CORPORATE AGREEMENT: SHAREHOLDERS' AGREEMENTS UNDER RUSSIAN LAW

1 Shareholders' Agreement: Foreign Law and Russian Practice

Shareholders' agreement is a tool for the contractual regulation of relations between shareholders/participants of companies that is widely used in jurisdictions of the Anglo-Saxon legal system (in particular, the UK and the US), but also recognized and regulated by the laws of countries that have continental legal systems (including Russia, Germany and Italy).

The core value of this tool is that it allows for:

- redistributing the rights of shareholders in the domain of corporate governance, regardless of the number of votes that a particular shareholder is granted under the law based on the number of shares owned by said shareholder;
- increasing the liquidity of shares of non-public companies by granting to shareholders additional rights to dispose of their shares under certain circumstances and by establishing corresponding obligations of other shareholders for the acquisition of such shares;
- providing for the undertakings of shareholders related to the promotion of business development, competitiveness and the economic security of a company that cannot be established by the articles of association and internal documents of the company;
- stipulating mechanisms for settling disputes among shareholders out of court or through arbitration.

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The concept of a shareholders' agreement (as applicable to joint stock companies) and an agreement on the exercise of participants' rights (with respect to limited liability companies) was first enshrined in Russian law in mid-2009:

a. Article 8 of the Federal Law dated 8 February 1998 No. 14-FZ,"On Limited Liability Companies" (hereinafter – the "LLC Law") was supplemented with a provision on the right of a company's founders (participants) to enter into an agreement on the exercise of participants' rights[1];
b. the Federal Law dated 36 December 1995 No. 208-FZ,"On Joint Stock Companies" (hereinafter – the "JSC Law") was supplemented by Article 32.1[2], which provides for the right of shareholders to enter into a shareholders' agreement pertaining to exercising of the rights granted by shares.

Since the entry into force of amendments to the JSC and LLC laws, which introduced the concept of a shareholders' agreement and an agreement on the exercise of participants' rights (hereinafter – a "participants' agreement"), the respective agreements governed by Russian law have been actively employed by companies alongside state participation (in particular, ROSNANO OJSC, companies belonging to the VTB group), investing in innovative and/or fast-growing businesses as minority shareholders/participants.

At present, however, the courts' practice in Russia regarding disputes arising from shareholders' agreements and participants' agreements has not yet been established[3] despite the efforts of certain attorney to create such practice artificially.This refers, first of all, to the decision of the Arbitration Court of Moscow dated 24 November 2010 on rendering invalid the participants' agreement of Verniy Znak LLC, which was further upheld by other judicial instances, including the Highest Arbitration Court of the Russian Federation (hereinafter - the 'HAC'). The following provisions of the agreement were deemed invalid as contradicting to the imperative rules of the Civil Code and LLC Law:

a. <u>In terms of company management</u>:
   - an obligation of the parties to unanimously vote on all issues on the agenda of the general meeting;
   - a special procedure for convocation (including a shortened notice period) of the general meeting of participants;
   - the right of one participant to take decisions at the general meeting regardless of the will of another participant;
b. <u>In terms of the rights and obligations of participants</u>:
   - the exclusive right of one participant to nominate the executive body and deprivation of another participant of the right to vote against such a nomination;
   - disproportionate distribution of the company's profits among the participants (e.g., 90% and 10%);
   - restriction of the right of a participant to exit the company;
   - restriction of the right of a participant to dispose of their share in the charter capital;

[1]Clause 3 was introduced by the Federal Law dated 30 December 2008 No. 312-FZ.
[2] Introduced by the Federal Law dated 3 June 2009 No. 115-FZ.
[3]According to Article 13.2 of the Federal Constitutional Law dated 28 April 1995 No. 1-FZ, "On Arbitration Courts in the Russian Federation", the Plenum of the Highest Arbitration Court of the Russian Federation took decisions within its jurisdiction that were obligatory for arbitration courts in the Russian Federation. Following the abolition of the HAC RF and transfer of its powers to the Supreme Court of the Russian Federation (SC RF), according to the Federal Constitutional Law dated 4 June 2014 No. 8-FKZ (effected into force on 6 August 2014), clarifications issued by the HAC RF Plenum regarding the application of laws and other regulations by arbitration courts shall remain valid until issuing of the respective decisions by the SC RF Plenum. To date, no decisions of the HAC Plenum or SC Plenum have been issued with clarifications in connection with shareholder or participant agreements.

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c. In terms of the consequences of a breach of the agreement and liability of the parties:
   - the invalidation of a transaction entered into by a participant in a breach of the agreement upon demand of another participant;
   - deprivation of the right to vote at extraordinary general meetings, the right to a share in the charter capital or to distribution of the company's profits;
   - transfer of the share of one participant to another participant for a breach of the agreement;

d. In terms of the 'deadlocks' settlement:
   the obligation of a participant to transfer his share to another participant at a price no more than 50% of the company's net profit for a financial year in the event of the impossibility of taking a decision at the general meeting on the agenda due to voting against such a decision by one of the participants.

The abovementioned provisions were as well clearly inconsistent with the fundamental principle of Russian civil law - the equality of parties. Additionally, as it was noted by the parties to this case in a public announcement, the case was initiated solely for the purpose of establishing the position of Russian arbitration courts with respect to the relevant terms of the participants' agreement, whereby no evidence had been provided for proving that either party to the agreement had actually intended to perform their undertakings with another party.[4]

In relation to shareholders' agreements, a similar negative precedent is the Decision of the Federal Arbitration Court of Volga District dated 7 September 2010, regarding the shareholders' agreement of Agro JSC, the terms and conditions of which were rendered invalid by the court in the first instance, since they were aimed at "alteration of the procedures and methods of corporate governance of the company", while some also contradicted the principle of the balance of interests of the parties, in particular:

a. In terms of company management:
   - the appropriation of the general shareholders' meeting competencies by one shareholder;
   - the right of the company's owner to appoint/dismiss at its sole discretion directors, their deputies and chief accountants;
   - the right of one shareholder to determine a list of transactions that require prior written approval by all the shareholders, including the transactions of subsidiaries and affiliates of the company;
   - the right of one shareholder to establish a new temporary managing body for the company endowed with the right to appoint by its decision a temporary sole executive body of the company;
   - alteration of the procedure for convening the general meeting of shareholders of the company and alteration of its quorum to a 2/3 majority vote;

b. In terms of the rights and obligations of shareholders:
   a waiver of one of the shareholders of the right to participate in the distribution of profits, dividends, bonuses and other payments in favour of another shareholder.

2 Corporate Agreement: Novelties in the Regulation of Shareholders'/Participants' Agreements

The Federal Law dated 5 May 2014 No. 99-FZ, which became effective on 1 September 2014, introduced Article 67.2, as well as a number of other provisions in the Civil Code of the Russian Federation (the "Civil Code") that establish the concept, object, scope and consequences of breaching a corporate agreement (including economic partnerships and companies).

[4] As mentioned in the HAC Ruling dated 12 September 2011 No. VAS-10364/11 upon the refusal to refer the case for consideration to the HAC Presidium.

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As the next stage of Russian civil law reform, the Federal Law No. 42-FZ dated 8 March 2015 (hereinafter - the 'Law No. 42-FZ') substantially changed the first part of the Civil Code with an effect from 1 June 2015. Such changes for the first time at the level of law introduced institutions and mechanisms analogous to those existing in the Anglo-Saxon legal system, which allow to regulate relations between the parties of corporate agreements more flexibly and comprehensively, in particular, the option for contract and option agreement.

Besides, the Federal Law, dated 29 June 2015, No. 210-FZ amended the JSC Law, LLC Law, and the Federal Law, dated 8 August 2001, No. 129-FZ 'On the State Registration of Legal Entities and Individual Businessmen'', including in terms of the disclosure of information on a corporate agreement.

2.1 Subject Matter of a Corporate Agreement. Correlation between the Articles of Association and a Corporate Agreement

Corporate agreement is defined by Article 67.2. of the Civil Code as an agreement under which the participants of the company undertake to exercise their corporate rights in a certain manner or withhold (refuse) from exercising such rights, in particular:

- to vote in a certain way at the general meeting of participants;
- to perform in an agreed manner other activities related to the management of the company;
- to acquire or dispose of shares at a pre-determined price and/or upon occurrence of a certain event; or
- to abstain from the disposing of shares until the occurrence of a certain event.

A corporate agreement, however, may not:

(a) bind the participants to vote in accordance with the instructions of the company's management bodies and (b) determine the structure of the company's bodies and their competence –the respective terms and conditions will be deemed null and void.

At the same time, participants/shareholders of non-public companies (including LLCs and JSCs, whose shares and securities convertible into shares are not placed by public subscription) enjoy considerable freedom in terms of the contractual regulation of their relations.

Firstly, a corporate agreement of a non-public company may provide for the obligations of the parties thereto to vote at the general meeting of participants that provisions altering the structure of the company's bodies and their competence be included in the company's charter (articles of association) to the extent that changes in the structure of the company's bodies and their competence are permitted under the Civil Code, the LLC or JSC Laws, respectively.[5]

Furthermore, if a corporate agreement is entered into by and between all the participants/shareholders of a non-public company, such an agreement can include provisions apart from those that must be included mandatorily in the charter under the laws.[6]

The provisions that must be included in the charter of a company are, in particular:

- the composition and authority of the management bodies of the company and the procedure for the adoption of resolutions by them (including issues regarding decisions that should be taken unanimously or by a qualified majority)[7]; this means that a corporate agreement cannot provide for a new management body and/or vest management bodies with additional powers compared to the powers vested under the charter;

[5] Article 67.2 clause3 of the Civil Code.
[6] Article 66.3 clause 4 of the Civil Code.
[7] Article 89.3 of the Civil Code.

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- the terms for conducting an ordinary general meeting of an LLC's participants, where results of the annual performance of the company are approved[8]/the terms for conducting of the annual general meeting of shareholders[9];
- the term of authority of the chief executive officer of an LLC;[10]
- the term of authority and number of members of the collective executive body of an LLC;[11]
- the procedure for election and quorum to hold a meeting of the board of directors (supervisory board) of a JSC;[12]
- the procedure for exercising a pre-emptive right to purchase a participatory interest that a participant intends to sell to a third party and a period for the exercising of such a right by other participants;[13]
- the number and nominal value of shares acquired by the shareholders (outstanding shares) and the rights granted by such shares; the number, nominal value and categories (types) of shares that the company may place in addition to the outstanding shares, and the rights granted by such shares;[14]
- the amount of a dividend and (or) amount paid in liquidation of the company (liquidation value) on the preferred shares of each type.[15]

Accordingly, a corporate agreement may not regulate the issues specified above but may supplement the charter on the issues provided for by dispositive rules of law.

A corporate agreement of a non-public company may establish, inter alia:

- the procedures for convening, preparing and holding general meetings by participants of an LLC[16](provided that they do not deprive the participants of the right to participate in the general meeting of the company and to receive information thereon);
- the procedural requirements for the formation and for holding meetings by the collective management body or collective executive body of either an LLC or JSC;
- a maximum amount of the participatory interest of a participant in the LLC's charter capital[17];
- restrictions regarding the number, nominal value of shares or maximum number of shares owned by a shareholder of a non-public JSC.[18]
- the procedure for exercising the pre-emptive right to purchase shares or convertible securities placed by the company, which is different from the procedure established by the JSC Law;[19]
- a number of votes of voting shareholders required to make a decision by the general meeting of the shareholders (which, however, cannot be less than a number of votes established by the JSC Law for making the respective decisions)[20].

In non-public companies (LLCs and JSCs) shareholders may stipulate in the charter and a corporate agreement the scope of the rights of the participants not in proportion to the amounts of their interests in the charter capital. Information concerning such an agreement and the scope of rights provided thereby should be entered into the Unified State Register of

[8] Article 34 of the LLC .
[9] Article 47.1 of the JSC law.
[10] Article 40 of the LLC.
[11] Article 41 of the LLC.
[12] Article 66.2 of the JSC law.
[13] Article 93.2 of the Civil Code.
[14] Article 27 clause 1 of the JSC law.
15 Article 27 clause 2 of the JSC law.
16 In a JSC, the preparing and holding procedure for the general meeting of shareholders, including the list of issues to be resolved by the governing bodies through a qualified majority or on a unanimous basis, shall be specified under Article 11.3 of the JSC law.
17 Article 66.3 clause 3 of the Civil Code (since under Article 14.3 of the LLC law, such a restriction may (rather than mandatorily must) be provided for by the articles).
[18] Article 99 clause 5 of the Civil Code.
[19] Article 21.5 of the JSC Law.
[20] Article 49.5.1 of the JSC Law.

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Legal Entities (the USRLE).[21]The rights that may distributed disproportionally include not only the right to vote at general meetings, but also the pre-emptive right to purchase shares/interest sold by other shareholders of the company at the price offered to a third party[22], as well as the distribution of profits between the participants.[23]

In the case of conflict between the provisions of a corporate agreement and the charter, the parties to the agreement may not invoke the invalidity thereof on this ground.[24] Apparently, the parties cannot challenge provisions of the corporate agreement due to their non-compliance with the charter, where the respective provisions of the charter are based on the dispositive rules of the law. At the same time, provisions of the corporate agreement should not conflict with the provisions of the charter based on the imperative rules of the law, otherwise the agreement may be rendered invalid.[25]

2.2 Parties

Parties to a corporate agreement may be all or some of the shareholders/participants of the company.[26]

Currently, it is not expressly provided whether several parallel corporate agreements may exist and whether the same shareholder may be a party to several corporate agreements entered into by different groups of shareholders. At the same time, the Civil Code, JSC Law and LLC Law do not provide for explicit restrictions in this respect.

It appears that the answer to the first question should be positive, since the coalescence of shareholders, especially minority ones, formalized by corporate agreements in order to protect and promote their interests (in particular, to veto inadvertent decisions on certain important issues by voting in an agreed manner)meets the intent and purposes of this type of agreement. On the other hand, a corporate agreement between only some of the shareholders is binding for them only as it is provided for by Article 67.2, clause 5 of the Civil Code.

As to the second question, participation of the shareholders in several corporate agreements within the same company makes sense, depending on undertakings provided for by each of the corporate agreements and whether performance by a shareholder of its undertakings under one corporate agreement will be in a breach of its undertakings under the other corporate agreement.

Another important novelty is that a "quasi-corporate" agreement may be entered into between shareholders and creditors of the company and other third parties. Like a corporate agreement, such an agreement may provide for obligations of the shareholders to exercise their corporate rights in a certain way or to abstain from doing so, but in favour of the respective third parties (such as ultimate beneficiaries or holding companies). Such an agreement is generally subject to the requirements of a corporate agreement.[27]It should be noted, however, that such third parties acquiring under a corporate agreement the effective rights to determine the actions of the company incur fiduciary duties and may be held liable for damages sustained by the company.[28]

[21] Article 66.1 of the Civil Code.
[22] Article 7 clause 3 of the JSC law, Article 21 clause 4 of the LLC law.
[23]Article 28 clause 2 of the LLC law.
[24] Article 67.2 clause 7 of the Civil Code.
[25] For instance, the Decision of the Ninth Arbitration Court of Appeal dated 11 February No. 09АП-640/2014-GK on case No. A40-97313/2013 invalidated the participants' agreement, which provided a quorum for taking decisions by the general meeting on a certain issue that differed from that of the quorum established by the LLC law and articles of the company.
[26]Article 67.2. clause 1 of the Civil Code.
[27] Article 67.2 clause 9 of the Civil Code.
[28]Article 53.1 clause 3 of the Civil Code.

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Agreement on the establishment of a company between the founders of the company is also governed by the rules applicable to a corporate agreement, unless otherwise provided for by the law or arises from the essence of the relations between the parties to such an agreement.

The Civil Code is silent on whether the company itself can be a party to a corporate agreement (which is a common case in shareholders' agreements governed by English law). It is obviously impossible when a corporate agreement is at the same time an agreement concerning the establishment of the company, since the company does not exist by the date of the agreement. However, the performance of certain undertakings by shareholders may be difficult without the assistance or cooperation of the company represented by its chief executive officer (or directors, if several persons are appointed as such, pursuant to Article 65.3, clause 3 of the Civil Code).

If a company participant disposes of its share or otherwise loses their status as a participant, the status of a corporate agreement party is likewise terminated. At the same time, in the event of termination of the title to the shares of a party to a corporate agreement such agreement remains in force for other parties (unless otherwise is provided for by the corporate agreement itself).[29]

2.3 Form of a Corporate Agreement and Disclosure Requirements

A corporate agreement must be made in writing as a single document to be signed by the parties. Therefore, it is not possible to execute such an agreement by the exchange of documents by mail, telegraph, teletype, telephone, electronic or other means of communication.

In addition, if a corporate agreement of an LLC includes undertakings of the parties related to the sale or acquisition of shares, such agreement shall be deemed *an agreement providing for the obligations to execute upon occurrence of certain events or subject to the performance by another party of its obligations a transaction aimed at the disposal of shares* under Article 21, clause 11 of the LLC Law. There is no requirement for certification of such an agreement by a public notary; however a transaction for the disposal of the shares (i.e., a sale and purchase agreement) to be entered into by the parties in performance of their obligations under the agreement in question should be notarized and shall be invalid in the absence of such notarization.

The parties to a corporate agreement of either a non-public or a public company are obliged to notify the company upon entering into such an agreement within 15 days from the date of execution thereof. If as the result of a failure to perform this obligation by the parties third parties sustain damages (e.g., if a sale and purchase transaction entered into by a shareholder in breach of restrictions established by a corporate agreement is subsequently rendered invalid upon a claim of the other shareholders), the former shall be obliged to compensate for such damages.

In the event of acquisition under the shareholders agreement of the right to determine the procedure for voting at the general meeting of shareholders on the shares of a public company, the person who acquired such a right shall be required to notify the public company thereof, if as a result the person independently or jointly with its affiliated person or persons, directly or indirectly, became entitled to more than 5, 10, 15, 20, 25, 30, 50 or 75 percent of votes on the outstanding common shares of the public company.[30]

The information on a corporate agreement shall be entered into the USRLE in the following cases:

- the corporate agreement defines the scope of powers of the company's members disproportionate to the size of their interests in the charter capital of the company (information on the scope of competences of the company's members (number of votes on interests of the members disproportionate to the amount of such interests));

[29] Article 67.2 clause 8 of the Civil Code.
[30] Article 32.1.5

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- the corporate agreement provides for restrictions and conditions of the interests (shares) disposal.[31]

2.4 Undertakings in Connection with Sale and Purchase of Shares

Undertakings to acquire or dispose of shares at a pre-determined price or upon occurrence of certain events (call option and put option, respectively), as well as abstaining from disposal of shares until the occurrence of certain events (lockup conditions arrangements in shareholders' agreement under English law) are effective tools for the prevention or resolution of corporate disputes in the event that any of the parties to a corporate agreement are not content about decisions being promoted by a another party.

Before entry into force of the amendments to the Civil Code effective from 1 June 2015 that introduced such contractual mechanisms as option for entering into a contract and an option agreement, there was uncertainty both in courts' practice and legal doctrine regarding enforceability of the undertakings of a party to a corporate agreement to sell its shares to or purchase the shares from the other party, respectively, under conditions precedent that are fully dependent on the will of a party(i.e. filing a demand for sale/purchase): as long as Article 157 of the Civil Code provides that a condition precedent to which the parties subordinate entering into force their rights and obligations under a transaction should be an event that may happen or may not (i.e. there is uncertainty regarding its occurrence).

A call option and a put option are often used in shareholders agreements under English law (or in the form of separate agreements) as mechanisms for settlement of 'deadlock situations' - when due to lack of agreement between the shareholders/participants, the general meeting or the board of directors cannot take a decision on any material issues.

From 1 June 2015, the parties to a corporate agreement have the opportunity to structure their commitments under the corporate agreement for the acquisition or sale of shares/interests through:

- inclusion into the agreement of the **option for contract** - an agreement, under which one party by an irrevocable offer grants to the other party for a fee or other valuable consideration (unless otherwise stipulated in the agreement) the right to enter into one or more agreements on the terms and conditions provided by the option, and the other party may enter into the agreement by acceptance of the offer in the procedure, terms and conditions provided by the option[32]; or
- entering into a separate **option agreement**, which can be gratuitous or its conclusion can be subject to other obligation or other legally protected interest arising from the relations between the parties, and which directly establishes the right of one party (an ″authorised party″) to demand the other party subject to the conditions provided for by the agreement and within the established term to take actions specified by the option agreement (to pay cash or transfer the shares or interests, respectively)[33].

Thus, the principal difference between the above contractual mechanisms is that:

- in case of the option for contract, a transaction for sale-and-purchase of shares is deemed executed from the moment of acceptance of the offer by the acceptor;
- in case of the option agreement, the relevant transaction is, in fact, executed under the condition precedent of filing a demand by the authorised party.

Thereat, the Civil Code explicitly provides that the option for contract:

[31] Article 5 of the Federal Law, dated 8 August 2001, No. 129-FZ 'On the State Registration of Legal Entities and Individual Businessmen'.
[32] Article 429.2 of the Civil Code
[33] Article 429.3 of the Civil Code

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- must provide for the conditions that allow to define the subject and other material terms of the agreement to be entered into;
- shall be executed in the form established for the agreement to be entered into.

With respect to an LLC, this is a notarisation form. [34]The LLC Law provides for the procedure to enter into a transaction aimed at disposal of an interest or part thereof in the charter capital of the LLC in the exercise of the option for contract: the transaction may be executed by a separate notarisation of the irrevocable offer (including through the notarisation of an agreement on the option for contract), and further notarisation of the acceptance. An irrevocable offer is deemed accepted from the moment of notarisation of the acceptance.

An irrevocable offer can be subject to aconditionresolutive or condition precedent, including the ones at the will of a party[35]: for instance, the offerer may make the acceptance contingent on the provision by the acceptor of an independent guarantee to secure its obligations, on obtaining the prior consent of the antimonopoly authority and/or acceptor's management bodies to the transaction.

In this case, the company's participant, to which the offer is addressed, shall provide the notary with evidence supporting the non-occurrence or occurrence of the respective condition.

The notary, who certifies the acceptance of an irrevocable offer, shall within two business days send a notice to the offerer on the acceptance and, unless a longer period is provided for by the agreement (option for contract), submit an application with the state registering authority for registering amendments in the EGRUL.

The main feature of the option agreement is its automatic termination, if an authorised party does not file a demand within the specified period.

Furthermore, the changes in the Civil Code that entered into force on 1 June 2015 allow to structure more complex conditions in corporate agreements: the right to demand the sale of shares/interests to a third party (drag-along right.), and the right to join the sale of shares/interests to a third party (tag-along right), which are often included into shareholders agreements that are governed by laws of common law jurisdictions.

Such conditions can be provided, in particular, on the basis of Article 327.1 of the Civil Code, pursuant to which the performance of obligations, as well as exercising, amendment and termination of certain rights under the contractual obligation, may be contingent the certain actions or omission by one party or any other reasons provided by the agreement, including those that are fully dependent on the will of a party.

However, the enforceability of the relevant structuring mechanisms still requires testing in the course of litigation.

2.5 Consequences of a Breach of a Corporate Agreement. Liability

A party to a corporate agreement is entitled to file a claim with a court to render invalid a decision taken by a company's management body as the result of a breach of the agreement (e.g., of the obligation to vote in a certain way on the general meeting of shareholders) by the other party.[36] However, for this right to be enforced, it is necessary that at the time of taking the respective decision all shareholders of the company were the parties to the corporate agreement.[37]

At the same time, rendering the decision invalid does not result in the invalidity of the transactions of the company with third parties entered into based on such a decision.

[34] Article 21.11 of the LLC Law.
[35] Article 429.2.1 of the Civil Code
[36] Article 32.1 clause 4 of the JSC law provides that violation of a shareholder agreement cannot be grounds for invalidation of the decisions taken by the company's bodies and is therefore not applicable.
[37] Article 67.2 clause 6 of the Civil Code.

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In practice, it means that claims need to be filed in each particular case in order to contest such transactions.

In the event a party to a corporate agreement enters into transactions in a breach thereof (in particular, transactions involving the sale of shares to third parties), such transactions may be rendered invalid by a court upon a claim of another party to the corporate agreement, provided that the claimant proves that the other party to the transaction knew or should have known about the restrictions established by the corporate agreement. As noted above, starting from 1 June 2015 the information about restrictions and conditions of the interests/shares disposal under a corporate agreement shall be entered in the USRLE. However, this disclosure requirement does not have retroactive force, that is, with respect to corporate agreements entered into force before, which in practice may lead to a difficulty of proving the knowledge of the restrictions under such an agreement by the other party to the transaction.

The Civil Code does not provide for any specific forms of liability for a breach of a corporate agreement; therefore, the general rules regarding liability for failure to perform obligations shall apply as follows:

- recovery of damages caused by the failure or improper performance of obligations, including actual damage and loss of profits[38] (unless the agreement provides for limitations on the amount and/or types of damages);
- award of a penalty[39] (subject to the possibility of decreasing the penalty amount specified by the agreement by a court if it is clearly disproportionate to the impact of the breach);[40]
- payment of interest on the amount due that has not been paid on time.[41]

To recover damages, a claimant is required to prove the following facts in aggregate: (a) a breach of obligations by the other party to the agreement (the wrongful act); (b) the occurrence and amount of damages caused by the breach;(c) the cause and effect connection between the breach and damages. Proving all of these elements may be impracticable in the event of a breach of the obligations under a corporate agreement that does not provide for monetary consideration, in particular, an obligation to vote in a certain way.[42]

A corporate agreement of a JSC may also provide for the obligation of a party at fault to pay compensation –a fixed amount or an amount to be determined according to the procedure specified in the agreement.[43]This form of liability may be deemed *sui generis,* different from a penalty in that it may not be reduced by a court based on Article 333 of the Civil Code.[44]

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[38] Article 393 clause 15 of the Civil Code.

[39] Article 394 of the Civil Code.

[40]Article 333 clause 1 of the Civil Code; according to the clarifications of the HAC Plenum (paragraph 2 of the Resolution dated 22 December 2011 No. 81, ″On Some Issues of the Application of Article 333 of the Civil Code of the Russian Federation″), the reduction of the penalty by the court to less than double the refinancing rate of the Bank of Russia, as effective in the period of the violation, shall be permitted in exceptional cases, provided that the awarded amount cannot be less than the amount that would have been accrued on the amount of debt based on a single refinancing rate of the Bank of Russia and the reduction of the penalty to less than a single refinancing rate of the Bank of Russia shall only be permitted in extraordinary cases, when the creditor's losses (loan, credit, commercial facility) are compensated for by other mechanisms pursuant to the monetary obligation.

[41] Article 395 of the Civil Code.

[42]At the same time, pursuant to the resolution of the HAC Presidium dated 6 September 2011 No. 2929/11 on case No. А56-44387/2006, a court cannot completely dismiss the claim for compensation for damages based only on the fact that the amount of damages cannot be determined within a reasonable degree of certainty: in this case, the amount of damages shall be determined by the court, taking into account all the circumstances of the case and based on the principle of justice and proportionality.

[43] Article 32.1 clause7 of the JSC law.

[44]I. Kornev, V. Arutyunyan, 'Shareholders' Agreement: Conclusion, Content and Execution', 'Corporate Lawyer'. 2010. No. 1; I.S. Shitkina 'Shareholders' Agreements (Agreements for Exercise of Participants' Rights) as a Source of Regulation of Corporate Relations', 'Economy and Law'. 2011. No. 2. The author also takes the view that monetary compensation is an independent form of liability similar to the compensation provided for by Article 1252 clause 3 of the Civil Code, which provides for the right that the holder may demand from a violator instead of compensation for damages subject to the proof of violation of the exclusive rights.

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A corporate agreement may provide as well that in case of a failure to perform an obligation, payment of a penalty and compensation of damages do not relieve a breaching party from specific performance.[45] However, with respect to an obligation of a shareholder to vote in a certain manner at a general meeting, the laws in force do not explicitly provide for specific performance of such an obligation upon a court's decision and there are currently no positive court precedents in this regard.[46]

At the same time, the case law in connection with the recovery of penalties for a breach of the corporate agreement is currently being established. In particular, the courts recognise valid and enforceable the conditions stipulating that:

a. in case of the voting on issues specified in the agreement without the express written consent of the shareholder, or not in accordance with such a consent, the shareholder is obliged to pay another shareholder a penalty in the amount of 50% of the value of real estate owned by the company, company's net assets at the time of execution of the agreement and to compensate the damages caused;[47]
b. in case of a failure by one party to perform at least one of the obligations in accordance with the agreement (in particular, to vote jointly 'FOR' on the issue of the agenda of the general meeting of the company's participants on the company's reorganisation), provided that the obligation is not performed for two months or more, the other party shall have the right to demand from the other two parties or one of them deemed a guilty party to pay a penalty in the amount of 5 (five) million roubles.[48]

2.6 Applicable Law

In the event at least one of the shareholders of a Russian company is a foreign person, the company's shareholders may choose foreign law as applicable law for the corporate agreement.

Notwithstanding the choice of applicable law, certain matters will be subject to the imperative rules of Russian law, in particular:

- incorporation, reorganization and liquidation of the company, including legal succession matters;
- the company's legal capacity;
- procedure for the acquisition by the company of rights and undertaking of obligations;
- liability of founders (shareholders) of the company for their obligations;
- internal relations, including relations between the company and shareholders thereof.[49]

Neither the laws in force nor courts' precedents provide for a definition of "internal relations" within a business entity. "The Concept for Development of the Civil Legislation of the Russian Federation"[50] classifies as "internal" the relations between business entities, persons being members of the executive bodies and shareholders, in particular, procedure for the making of decisions by general meetings and other collective bodies, and the terms of exit or exclusion of shareholders from the company.

[45] Article 396 clause 2 of the Civil Code.
[46] Publicly available decisions in which courts refused to satisfy claims to oblige a shareholder or members of the board of directors to vote in a certain manner were taken prior to the entry into force of the provisions on shareholders' agreements and agreements on the exercise of the rights of participants (e.g., the decision of the Federal Arbitration Court of Moscow District dated 16 April 2003 under case No. KG-A40/1855-03 and the decision of the Federal Arbitration Court of Volga District dated 20 February 2007 under case No. A55-3338/06).
[47] Resolution of the Moscow district Arbitration Court, dated 29 January 2015 No. F05-16088/2014 on the case No. A40-47005/14).
[48] Resolution of the West-Siberian district Arbitration Court, dated 2 June 2016 No. F04-2554/2016 on the case No. A45-12277/2015).
[49] Article 1202 clause 2 and Article 1214 clause 1 of the Civil Code.
[50] Approved by the Decision of the President's Council for Codification and Improvement of the Civil Legislation dated 7 October 2009.

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In all other respects, the law chosen by parties to a corporate agreement may regulate the rights and obligations of the parties, as well as issues related to interpretation of the agreement, the performance and termination thereof, as well as to determine the consequences of failure or improper performance of the agreement and its invalidity.[51]

In the absence of agreement between the parties on the applicable law, the corporate agreement and articles of association will be subject to Russian law.[52]

2.7 Settlement of Disputes

Pursuant to Article 225.1 of the Arbitration Procedural Code of the Russian Federation (hereinafter, the 'Arbitration Code'), an arbitration (state commercial) court at the location of a Russian legal entity considers corporate disputes (disputes related to the incorporation of a legal entity, governance or participation in the legal entity), including those related to:

- title to shares, establishment of encumbrances thereon and the exercising of rights granted by the shares (except for disputes arising from the activities of depositaries in connection with the accounting of rights to the shares and other securities and disputes arising regarding the distribution of inherited property or common property of spouses);
- appointment or election, termination or suspension of powers and liabilities of members of the management bodies and supervisory bodies of the legal entity;
- contesting decisions of the management bodies of a legal entity.

Based on the above provisions, the arbitration (state commercial) courts with respect to case No. A40-35844/11-69-311 upon the claim of Mr. Maksimov to NLMK OJSC[53]came to the conclusion that, since the disputable agreement regulated the issues of corporate governance and the issuing of additional shares, those issues were corporate issues referred to by Article 225.1.2 of the Arbitration Code to the special jurisdiction of arbitration courts, and therefore could not be submitted for consideration to an arbitral tribunal″ due to the nature and specific character of relationships that give rise to such disputes". The Federal Arbitration Court of the Moscow District, in its resolution dated 26 September 2011, also noted the non-arbitrable nature of public law in the dispute regarding the transfer of the title to shares as a result of the performance of all conditions of the agreement on corporate governance.

However, the abovementioned position may not be an ultimate position on the part of Russian courts on the issue of the arbitrability of disputes under corporate agreements and dissenting opinions on this issue have been expressed in legal doctrine as well.

Furthermore, according to the Federal Law dated 29 December 2015 No. 382-FZ 'On Arbitration in the Russian Federation' that becomes effective on 1 September 2016, disputes related to the establishment of a legal entity in the Russian Federation, management thereof or participation therein may be referred to the arbitral tribunal (i.e., are arbitrable) when the following conditions are simultaneously met:

- a legal entity, all members of the legal entity, as well as other persons, who are claimants or defendants in such disputes, entered into the arbitration agreement on the transfer of such dispute to an arbitral tribunal;
- a dispute is submitted to arbitration administered by a permanent arbitral institution;
- an arbitration institution approved, deposited and placed on its web site the rules of proceedings on corporate disputes;

[51] Article 1215 of the Civil Code.
[52] Article 1214 clause 2 of the Civil Code.
[53] The decision of Moscow Arbitration Court dated 28 June 2011 under case No. A40-35844/11-69-311 satisfied the claim for cancellation of the ICAC decision; the judicial act was affirmed by the Resolution of the FAC of the Moscow District dated 26 September 2011. The HAC ruling dated 30 January 2012 No. VAS-15384/11 refused to refer the case to the Presidium of the HAC; the ruling of the Constitutional Court dated 17 July 2012 No. 1488-O refused the claim.

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- the place of arbitration is the territory of the Russian Federation.

Under the Arbitration Law, the following categories of disputes cannot be referred to an arbitral tribunal:

- disputes on the general meeting of participants of the legal entity;
- disputes related to challenging regulatory legal acts, decisions and actions (omission) of state bodies, local bodies, other bodies and organizations that are vested with certain state or other public authority by federal law, and officials;
- disputes related to economic entities which are essential for national defence and state security;
- disputes related to the acquisition and redemption by a company of shares, disputes related to the invalidation of interested party transactions;
- disputes on the expulsion of participants of a legal entity.

Thus, after enactment of the Arbitration Law, almost all disputes arising from the most common conditions of corporate agreements, including disputes in connection with a breach of a shareholder/member obligation to vote at the general meeting in a certain way, as well as obligations related to the disposal/acquisition of shares/interests, can be considered by arbitral tribunals provided they meet the requirements established by the Arbitration Law and subject to the relevant arbitration agreement.

***

Russian civil law currently in force grants to shareholders/participants of companies greater freedom in regulating their relations within the framework of corporate agreements.

At the same time, when drafting the terms and conditions of a corporate agreement governed by Russian law, it should be taken into account that such an agreement:

a. cannot be a document that is 'parallel' to the articles of association of the company or regulates matters that may only be regulated by law and the articles of association;
b. should not contain conditions that establish the powers of the company's bodies or the procedure for their election, which differs from the procedure specified by the imperative rules of law;
c. may not provide for the rights and obligations of third parties that are not parties thereto.

Furthermore, there is to date no complete certainty regarding the possibility of enforcement by Russian courts of certain provisions usually included in a shareholders' agreement, in particular, the obligations related to the sale and purchase of shares or obligations to vote in a certain manner. This uncertainty should be eliminated in the course of the formation of judicial and arbitration practice shortly.

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Best Regards,

GRATA International Law Firm (Moscow)

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What we do:

- advising on choice of the optimal form of incorporation for doing business in Russia;
- legal support with establishment of legal entities (including joint ventures), branches and representative offices of foreign legal entities;

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- due diligence of Russian legal entities;
- complex support of transactions for sale and purchase of shares/interests in Russian legal entities, including transaction structuring, drafting sale-and-purchase agreements, corporate contracts (shareholders' agreements) and other transaction documents, obtaining prior approvals of the antitrust authority;
- development of internal documents regulating the activities of management bodies of legal entities.

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