SHAREHOLDER DISPUTES IN RUSSIA

GRATA INTERNATIONAL

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Shareholder disputes in Russia, as elsewhere in the world, are among the most sensitive and disruptive in their implications for business. A corporation based on agreement and trust between partners often lives and grows through the common efforts of its shareholders. In situations where disputes arise that cannot be resolved amicably, therefore, the overall business inevitably suffers and often suffers irreparably.

> When representing one of the parties to a corporate conflict, we lawyers at GRATA International always educate our clients about the variety of situations and practices that the conflicting parties create in an attempt to prevail over their vis a vi.

Since shareholder disputes are usually disputes between people who know each other and the business itself, the disputes escalates from two to three to several dozen separate contests, conducted simultaneously in different courts over the course of several years.

Such legal turbulence inevitably involves the company itself, which begins to be affected by the conflict through problems with the sustainability of economic relations or with obtaining external funding.

> However, despite the complexity of this category of cases, we at GRATA International believe that any person in need of qualified protection should receive it at a level that is appropriate for that particular person.

Representing our clients in various shareholder disputes, we use all the tools contained in Russian substantive and procedural law.

The starting point of any consultation is the question of the scope of rights held by the shareholder:

- What is the number of shares a shareholder has?
- What kind of resolutions a shareholder may block?
- May a shareholder withdraw from the company?
- Do the other shareholders have the right of pre-emption of the shares?
- Is the consent of the shareholders required for the alienation?
- Do the corporate documents have a pre-determined procedure for resolving such a situation?
- How votes are allocated at the general meeting?

Many other issues that make it possible to understand the power and perspective of a shareholder in a corporate conflict.

- First, it is important to pay attention to the legal form of the company, depending on it the approach to resolving corporate conflicts and actions in the corporate conflict will differ.
- It is equally important to study the corporate documents of the company, the shareholders agreement (SHA), if any, the articles of association and other documents to understand what additional rights are available and what can be done in a particular situation.
- By understanding your rights and liabilities, the competence of the company's executive bodies and the liabilities of the company and other shareholders, you can build a clear line of conduct and calculate the possible risks.
- Here are some of the most popular strategies in this article. See if you can find your case among them.

DISPUTES OVER SHAREHOLDERS RESOLUTIONS MADE BY SHAREHOLDERS.

Disputes arising from a shareholder's disagreement with a company resolution can be included in this capacious category. The range of violations we observe in companies is quite broad. Breach of the procedure for convening and holding the meeting, breach of a shareholder's right to review the materials drafted for the meeting and breach of the rights of a minority shareholder who voted against a resolution to approve a major transaction.

The strategy of representation in the mentioned disputes depends on such factual circumstances of the case as the size of the shareholder's stake, the merits of the issue put to a vote and the consequences for the company's business.

On the one hand, courts in the Russian Federation tend to delve into and assess how a dissenting shareholder's vote may have influenced the final corporate resolution and, on the other hand, take the corporate rights of shareholders to supreme governance in the company very seriously.

A notable example of the abuse of a general meeting is the use of a power of attorney for correspondence.

Receiving correspondence by power of attorney is an innocuous move for many business people but it carries a number of risks that they take in convenient ways to arrange their private lives.

A former shareholder of a company who had found out that he had ceased to be a shareholder of the company some time ago approached us. The investigation of the circumstances of the case revealed that without the client's knowledge several meetings had been held consecutively at short notice resulting in reorganisation of the company (with complete loss of corporate control of the client who did not take part in the meeting and conversion of his shares in ZAO into nil shares in LLC), establishment of a subsidiary company, transfer of all liquid assets to the subsidiary company and launch of liquidation procedure of the parent company.

Not everyone is aware that when legal action is properly taken, applicable law permits such unfavorable developments for the company owner. In particular, repeat meetings in public limited companies provide for a reduced quorum for the adoption of resolutions - sufficient to leave the owner without a significant portion of its assets. In this particular case, notification of meetings to the shareholder was done through a person acting under a power of attorney - through a courier who picked up the correspondence without informing the trustee. It took years of court hearings and a fierce adversarial process to regain corporate control for our client, return real estate to the company and contest the pledge of the property. The final stage was the expulsion of the wrongdoer from the company.

DISPUTES ARISING IN RELATION TO SHAREHOLDER ACCESS TO INFORMATION ON COMPANY OPERATIONS.

Disputes regarding shareholders' access to information on the company's operations are quite common. Russian corporate law obliges a company to provide shareholders with access to information on the company's business operations at their request. Not infrequently, it is only by gaining access to such information that shareholders can learn about transactions that are detrimental to the company. Accordingly, management and majority shareholders are motivated to withhold such information. As a rule, courts satisfy shareholders' requests for documents and information. However, depending on the legal form of the company, the approach may differ. Whereas in an LLC a shareholder is entitled to obtain any documents, in joint-stock companies the scope of documents requested depends on the shareholding in the company's authorized capital.

DISPUTES OVER TRANSACTIONS MADE BY THE COMPANY.

Frequently a director of a company acts in the interests of one of the shareholders or for the shareholder himself to be a director. Over time, this can lead to the company making a transaction that is not in the interests of the business. Issuing or obtaining a loan, disposing of a large asset, or purchasing raw materials from a company that is associated with the CEO. The applicable corporate law critically perceives such business activity. A shareholder who learns of such a transaction has the right to assert a claim to return the parties to their original position and to recover the damages caused to the company. In extreme situations, where the company has suffered substantial damage, the question of expulsion of the shareholder from the company may be raised. Depending on the circumstances of the case, the court may side with the aggrieved party and award the excluded shareholder compensation for the loss of shares.

DISPUTES ARISING BETWEEN THE CURRENT SHAREHOLDERS AND THE HEIRS OF COMPANY OWNERS.

Frequently a protracted litigation occurs after the death of a shareholder. The arrival of a new shareholder is perceived differently by the current shareholders and is governed differently by the articles of association of the companies. In some cases, the heir does not want to become a shareholder but wants fair compensation for his share. In other cases, on the contrary, the heir sees for himself the prospect and benefit of becoming a full shareholder. For effective advice in both situations, knowledge of the enforcement of certain provisions of the articles of association in this respect is essential. Some contain a blanket prohibition on third parties entering the share capital of companies; others contain a pre-emptive right for "old" shareholders to buy out the heir's share. If heirs are prohibited from becoming shareholders, the company shall pay the actual (market) value of the shares to the heirs. In the latter case, disputes may arise over the actual (market) value of such shares, and indeed over the value of the entire company.

AS AN EXAMPLE, A CASE CAN BE GIVEN TO ILLUSTRATE BOTH THE REJECTION BY SHAREHOLDERS OF AN HEIR AS A NEW SHAREHOLDER AND AN ATTEMPT TO WITHDRAW THE MAIN ASSETS FROM THE COMPANY.

For example, GRATA lawyers received a request from a minority shareholder who had inherited after the death of his spouse and became a shareholder with a 26% share in the share capital. According to our advice, the shareholder asked the company for information and documents about the company's operations. However, in response, management and the majority shareholders attempted to recover in court damages from the heir allegedly caused to the company by the deceased shareholder. Moreover, the majority shareholders took the company to court to exclude the new successor shareholder from the company. GRATA succeeded in obtaining the dismissal of these claims.

GRATA lawyers also succeeded in obtaining the proper documentation. After receiving the information and documents, we realised immediately what had happened: all of the main real estate was transferred to the subsidiary at book value, i.e. actually at a significantly undervalued amount.

Because of this major transaction, the company lost the entire production base required for its core business activities and the new minority shareholder was prevented from making any future managerial resolutions in respect of the transferred assets.

The cadastral value of the transferred assets was examined and a value was engaged to quickly arrive at a market value of the expropriated real estate. A claim to declare the transaction null and void was prepared and filed with the Arbitration Court.

Furthermore, in the course of the court proceedings, GRATA's lawyers received information that a general meeting of the shareholders was planned, the agenda of which included an item concerning the increase of the share capital of the subsidiary by including a new shareholder and diluting the share of the parent company to a non-controlling interest.

In this way, the management and majority shareholders not only withdrew all assets into the subsidiary but also attempted to sell the controlling interest of the subsidiary to a third party.

The case was heard by the courts of three instances, the minority shareholder's claims to invalidate the transaction were satisfied and the real estate was returned to the company.

CONCILIATION PRACTICE IN DISPUTE RESOLUTION.

Having spent thousands of hours in courtrooms, hundreds of hours at the negotiation table, GRATA International litigators know that in most cases, the best solution is not a court decision, but an agreement reached amicably. Our team includes professional negotiators with the necessary experience and special theoretical training. Their impartial participation in the negotiations, the absence of a toxic relationship with any of the parties, contribute to the trust and willingness of both parties to mediate.

In conclusion, we would like to give some advice.

1 Keep an eye on what the company's governing bodies and other shareholders are doing. In case a shareholder finds himself trapped in a company with no way out and no buyers for the shares could be found (which is generally not surprising, it is rather difficult to sell shares in conditions of corporate conflict, at least the price will be significantly lower than the market value), time is in any case in favor of the minority shareholder, one should wait for active actions and mistakes from the other party to the conflict. The legislator provides quite a number of tools, which enable protection of rights even in such situation. It is only necessary to use these tools correctly and in due time.

2 It is important to know everything there is to know and to get all the information on the company, on the resolutions taken and meetings held and to keep track of any changes.

3 It is also crucial to constantly check e-mail addresses, mailboxes and leave instructions in case any letters are delivered to the official postal addresses.

4 Keeping up to date with all the information and reacting quickly to the actions of the company's governing bodies will help ensure that corporate rights will be protected in a proper and timely manner.

5 In addition, shareholders agreement can save a significant amount of effort and money, and make corporate life or the outcome of a conflict as predictable as possible. Under Russian law, these are non-public contracts between shareholders which contain the rules of the corporate game and the liability for their violation. A well-drafted agreement is a scenario that not only resolves a problem, but also often prevents shareholders from behaving unlawfully. Imagine a situation where shareholders have granted each other share options in the event of a breach of contract, the commission or omission of a particular act, voting, etc. Such or similar corporate inoculations should, in our view, be given to the vast majority of companies in Russia.

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Tbilisi

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Astana
Almaty
Atyrau
Aktau, etc.

Kyrgyzstan
Bishkek

Moldova
Chisinau

Mongolia
Ulaanbaatar

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