

Russian Law Changes.

New Russian law on shareholders' agreements for joint stock companies. What does this mean for joint ventures in Russia?

On 9 June 2009 certain amendments to the Russian joint stock company ("JSC") law came into effect. These changes mean that, for the first time, shareholders in a JSC are expressly permitted to enter into a shareholders' agreement (an "SHA"). This narrows the gap between standard commercial practice and the Russian regulatory framework. It is of course customary practice to regulate the relationship of shareholders in a joint venture through an SHA. However, there were previously doubts about the enforceability of an SHA between direct shareholders in a JSC. Whilst not removing all of these doubts, it is at least helpful that Russian law does now at least acknowledge the existence of SHAs.

The position is clearest in relation to SHAs where all the parties are Russian. Such an SHA must be governed by Russian law in order to be enforceable, and must follow the rules set out in the new law.

If an SHA has one or more non-Russian parties, the position is less clear. The new law provides no guidance, but some members of the judiciary have commented in public that SHAs with non-Russian parties must be governed by Russian law to be enforceable. Our view is that such an SHA should be enforceable in Russia even if it is not governed by Russian law.

However, aside from the basic question of enforceability, a number of problems remain with SHAs in Russia. If you use an English-law governed SHA, then in practice it may be necessary to involve Russian courts to enforce a foreign court judgment or arbitral award. Some customary provisions often included in SHAs (e.g. put and call options) may not be enforceable in Russia.

We look in detail at the provisions of the new law below. However, for an international party entering into a joint venture in relation to a Russian business, the use of an offshore JV holding company together with an SHA governed by English law remains, in our view, the approach that provides the greatest protection and certainty.

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Contents of an SHA pursuant to the new law

Under English law there are, broadly speaking, very few restrictions on the contents of an SHA or as to what the parties to it may agree. To date, Russian law has provided no guidance on permissible provisions for a JSC SHA, since SHAs themselves have not been expressly permitted for JSCs. The new law sets out two broad categories of rights to be regulated by a Russian law SHA: (i) the way in which a shareholder can exercise his rights as a shareholder of the company (e.g. voting as a shareholder) and (ii) the way in which a shareholder can exercise his ownership rights of his shares (e.g. disposing of his shares).

Voting Rights

The new law allows, on the face of it, substantial flexibility in relation to what can be governed by an SHA. A non-exhaustive list of the rights that can be covered includes:

- voting at the general meeting of shareholders (including a requirement to vote in a certain way or an obligation to agree on how to vote with other parties to the SHA); and
- governance of the JSC, including reorganisation or liquidation.

One express restriction is that where a manager who is also a shareholder in a JSC (a common scenario for Russian companies post-privatisation) enters into an SHA in relation to his shareholding in that JSC, he may only direct the other shareholder as to how to vote their shares (e.g. in support of the appointment of a director nominated by him) in his capacity as a shareholder and not in his capacity as a manager. The voting instruction therefore needs to be drafted and reviewed carefully to avoid the risk of the other shareholder not complying with the voting instruction on the basis of a technical formality.

Ownership Rights

The new law appears to give parties freedom to impose standard SHA restrictions on one another as regards the pricing and disposal of shares. There is no express permission or prohibition in the new law regarding put and call options but wider restrictions in Russian law mean that doubts remain as to their enforceability in Russia. It is too early to confirm whether put and call option agreements of the type customary in an English law SHA would be recognised by a Russian court, but the wording of the new law may be an additional argument that such put and call agreements should be enforceable.

Execution of an SHA and Parties

When signing an SHA governing a direct holding in a JSC (or where at least one party to the SHA is a Russian domiciled company), the parties must comply with Russian law execution formalities requiring that such an SHA be executed as a single document. This means that parties should not sign in counterparts or sign separate signature pages. An exchange of signed pages by pdf is therefore not possible.

The new law does not expressly limit the parties to the SHA to only the shareholders. Therefore it should be possible to make the company itself a party to the SHA. This is desirable in theory as it should provide further protection as regards any obligations imposed in the SHA on the JV company itself. However, there is a risk, given analogous restrictions on limited liability companies, that the Russian courts will argue that shareholders are permitted to be parties to the SHA and not the company itself.

Scope of an SHA's effect on shares

The new law requires that an SHA must be entered into "in respect of all the shares owned by a party to the SHA". In other words, voting arrangements provided by the SHA must apply to all the JSC's shares that are owned by each party to the SHA. It is therefore advisable, in order to avoid any ambiguity as regards future acquisitions of shares in the same JSC, for the SHA to state that it also applies to any new shares (e.g. acquired in a future rights issue or from third parties) held by the parties.

Breach of an SHA and Remedies

The following remedies are available under Russian law:

Damages - these are always subject to proving loss, which can involve protracted court processes in Russia.

Specific Performance - this is technically available but in practice difficult to obtain from a Russian court.

Penalty, the amount of which is specified in the SHA (in Russian, неустойка) - a contractually agreed fine which may be subject to review by the Russian courts.

Penalty specified in the SHA pursuant to the new law (in Russian, компенсация) - under the new law, any penalty amount of this new type specified in an SHA is unlikely to be subject to further review by the Russian courts. Although the penalty may still need to be enforced through the courts,

this new type of penalty seems to provide additional assurance and increase the chances of recovery.

Invalidating a corporate action - unless certain provisions of an SHA are mirrored in a JSC's charter, it will not be possible for a shareholder to bring a claim to invalidate a corporate decision adopted in violation of the terms of an SHA.

Under English law, typically the provisions of an SHA are expressed as taking precedence over those of the company's articles of association in the event of a conflict between the two. In a Russian context, it is advisable (subject to commercial and confidentiality concerns) to replicate the terms of an SHA as far as is possible in the JSC's charter in order to allow for the widest range of remedies.

An agreement with a third party that is in violation of the terms of an SHA may only be invalidated under Russian law if the third party was aware that the relevant agreement constituted a breach of an SHA. It is not yet clear whether registrars or depositories will register encumbrances over a JSC's shares that result from an agreement which breaches the terms of an SHA, since the existing regulations of the Russian Securities Regulator do not cover SHAs.

Notification duty

The new law requires any person who, as a result of signing an SHA, acquires a "right to determine voting" above certain ownership thresholds¹ in a JSC that has a registered prospectus (the equivalent of a "public company" in the UK) to notify the JSC and the Russian Securities Regulator².

If the necessary notifications are not made, there is a risk that any votes at a shareholder meeting made pursuant to specific voting arrangements in an SHA will be invalidated by a court. This may lead to corporate decisions being challenged as invalid on the grounds that they were passed only due to votes that should not have been counted or at a meeting that in fact was not technically quorate.

Dealing with deadlock

An important provision in any SHA is to set out the manner in which deadlocked disputes between shareholders are to be resolved. For the most part, flexibility exists under Russian law on this point, with two important exceptions:

¹ These thresholds are 5 / 10 / 15 / 20 / 25 / 30 / 50 and 75 per cent in relation to ordinary shares.

² Or the Central Bank of Russia if the JSC is a bank.

Exercise of Options

A common deadlock resolution mechanism in English-law governed SHAs is for one party to buy the other out (often at a premium/discount in the event of a default). This technically constitutes a share option. However, as referred to above, doubt exists under Russian law as to the enforceability of options over shares in Russian companies. The new law neither expressly permits nor prohibits options and therefore does not remove the risk that a Russian court might decide they are unenforceable.

Appointment of CEO

Russian law does not permit a company to operate without a CEO. If a deadlock arises over the appointment of the CEO, the new law states that the shareholders must be notified and the chairman of the Board shall act as a temporary CEO. For companies which have a registered prospectus, it is also necessary to disclose information about the failure to appoint the CEO. Following this, the Board must call a shareholders' meeting and appoint a temporary CEO.

Other issues

Information Rights

It is common for an SHA governed by English law to include provisions relating to procurement of information related to the company. Such provisions are easy to enforce when a majority of shareholders of the company and/or the company itself is party to an SHA. In Russia, if the law is interpreted to prohibit a JSC from becoming a party to an SHA, enforcement of information rights may become cumbersome.

Financing of a JV

Another issue to be considered is the financing obligations of parties to an SHA. If financing is to be provided in the form of shareholder loans, parties need to note that the definition of a loan agreement differs under Russian and English law, namely, under Russian law a loan agreement does not come into existence until the disbursement of funds to a borrower.

Before such disbursement, it is not possible to force a lender to make the loan. Consequently, a provision of an SHA governed by Russian law setting out a general obligation on the shareholders to provide shareholder loans may not be enforceable in Russia.

Further information

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