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LEGAL ALERT




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Review of certain most important amendments introduced to the RF Civil Code regarding status and activities of legal entities

*We have prepared a review of certain most important amendments introduced to the RF Civil Code regarding status and activities of legal entities ("**Law No.99-FZ**")*.*

1. Types of legal entities and their legal authority

Law No.99-FZ introduces a new approach towards classification of legal entities. Thus, all legal entities are divided in corporate and unitary entities and certain corporate entities in public and non-public companies.

1.1. Corporate and unitary legal entities

Corporations are legal entities where their members form the supreme governing body (general meeting of members) and have participation rights:

- companies (joint stock companies and limited liability companies),
- partnerships,
- manufacturing and consumer cooperatives,
- social organizations and associations (unions), and others.

Unitary entities do not offer their founders any membership or participation rights:

- state and municipal unitary enterprises,
- foundations,
- institutions, autonomous non-commercial or religious organizations, and others.

1.2. Public and non-public companies

A **public company** is a joint stock company which shares and other securities converted into shares are publicly placed (via open subscription) or publicly circulated on terms and conditions established by laws on securities. A joint stock company, which charter and company name contain indication on the fact that this company is public, is considered a public company even though the above criteria are not satisfied.

A public company acquires a right to issue shares and other securities converted into shares via open subscription on the day of inclusion of the information on its company name (bearing an indication of the fact that the company is public) into the unified state register of legal entities.

* *Law No.99-FZ was signed by the RF President and officially published on May 5, 2014. The majority of amendments introduced by this Law come into force on September 1, 2014.*

Law No.99-FZ provides for certain restrictions and additional requirements to be met by public companies, such as:

- establishment of a collective management body with not less than 5 members;
- no restrictions on amounts of shares owned by a single shareholder, or on total nominal amount of such shares as well as on maximum amount of votes granted to a single shareholder;
- no restrictions (limitations) in the charter on sale of shares of a public company, e.g. by getting prior approval from other shareholders or public company itself;
- no pre-emptive rights (rights of first refusal) regarding shares except for cases established in the RF Civil Code;
- obligations on information disclosure and reporting as prescribed by the applicable law.

Limited liability companies and joint stock companies which do not satisfy the criteria of public companies are considered non-public companies.

Members of a non-public company may agree upon management rights being non-proportional to the interest owned in such a company. This arrangement should be reflected in the charter and (or) the corporate agreement, provided that information on existence of such corporate agreement is filed with the unified state register of legal entities.

1.3. Exclusion of subsidiary liability companies and change of regulation of closed joint stock companies

Upon coming of Law No.99-FZ into force, subsidiary liability companies will be regarded as limited liability companies, and closed joint stock companies – as joint stock companies, as provided in legislation applicable to limited liability companies and joint stock companies. Provisions of the Law on Joint Stock Companies regarding closed joint stock companies will apply to such companies until their charters are amended. Noteworthy, re-registration of subsidiary liability companies and closed joint stock companies in new forms of legal entities is not envisaged.

1.4. Changes in payment of the charter capital at the company establishment

Based on Law No.99-FZ, the company founders will be obliged to pay up 75% of the company's charter capital prior to the state registration of its establishment (current requirement – 50% of the charter capital). The remaining 25% of the charter capital shall be paid within the first year of the company's business activity.

2. Corporate documents

2.1. Charter – the only foundation document of a legal entity

This new rule will not affect partnerships which have foundation agreement as their foundation document. However, such foundation agreements will be subject to the provisions of applicable law on charters.

2.2. New rules on corporate agreement (shareholders agreement)

Based on Law No.99-FZ, all or some of members of a corporation may enter into a contract governing their corporate rights in respect of such a corporation (corporate agreement). Such a corporate agreement may govern:

- voting at the general meeting of members of a corporation in the manner specified in a corporate agreement;
- performance of other coordinated actions in the course of management of a corporation;
- provisions on sale and purchase of participatory interest (shares) for fixed price or upon occurrence of specified circumstances or abstention from sale of participatory interest (shares) until specified circumstances occur.

Legislation in force already envisages a possibility of conclusion of similar types of contracts: shareholders agreement (used in joint stock companies) and agreements of participants (for limited liability companies). However, Law No.99-FZ for the first time provides for the general framework of such type of contracts. Also, some matters introduced by Law No.99-FZ are more deliberately elaborated and progressive than those of legislation in force.

Thus, it is prescribed that a corporate agreement cannot:

- bind the parties thereto to vote as directed by management bodies of a corporation;
- define or change the structure and competence of management bodies of a corporation, except when the RF Civil Code or laws on companies allow such changes by amending of the charter.

Other provisions of Law No.99-FZ related to a corporate agreement:

- form of a corporate agreement – a single document signed by all the parties;
- a corporation must be notified on the fact of execution of a corporate agreement. Otherwise, members of a corporation not being parties to such an agreement will have a claim for damages against the parties thereto;
- parties to a corporate agreement cannot raise defense based on invalidity of a corporate agreement due to its incompliance with the provisions of the company's charter.

Law No.99-FZ introduces a rule stating that a breach of a corporate agreement executed by all the corporation members may lead to invalidation of decisions of management bodies of such a corporation upon claim of a party to a corporate agreement. However, invalidation of a company's decision does not necessarily lead to invalidation of transactions of a company with third parties executed pursuant to such a decision unless a third party knew or should have known about the restrictions imposed on its counterparty by a corporate agreement.

Unless otherwise provided by a corporate agreement, withdrawal of a member who is a party to a corporate agreement from a corporation shall not lead to termination of a corporate agreement.

Law No.99-FZ for the first time allows conclusion of contracts similar to corporate agreements

among company's members, creditors and other third parties. Pursuant to such contracts the members are bound to execute their corporate rights in a specified manner (or refrain from execution of rights altogether), including by means of voting as directed in such a contract; perform other actions; sale and purchase participatory interest (shares) for fixed price or upon occurrence of specified circumstances or abstention from sale of their participatory interest (shares) until specified circumstances occur. It is presumed that such contracts will be governed by norms regulating corporate agreements.

3. New rights of corporation's members and rules on management of a corporation

Law No.99-FZ grants a right to a commercial corporation's member, stripped of its right to participate in management of such a corporation against its will, to retrieve its participatory interest from the third parties to which it was transferred by offering just compensation (as determined by court), as well as a right to demand indemnification for losses incurred by such a member from the responsible parties.* However, a court may refuse to return participatory interest to such a member in case it may lead to an unjustified deprivation of participation rights of third parties or may cause material adverse effect of social or public nature. In this case a court shall determine an amount of just compensation payable to a corporation's member for the transferred participatory interest by the responsible parties.

Law No.99-FZ as well introduces unified rules on corporation management. A corporation's charter may provide for the authority of a sole executive body to be granted to several persons acting jointly or election of several sole executive bodies acting independently. Both an individual and a legal entity may act as a sole executive body of a corporation.

4. Introduction of liability of a chief executive officer (general director), members of a collective management body and persons controlling the activities of a legal entity

Law No.99-FZ specifies in detail the liabilities of the abovementioned persons towards management of a legal entity. Thus, pursuant to Law No.99-FZ a chief executive officer shall be liable for losses incurred by a legal entity under her management and shall reimburse the losses upon demand of such a legal entity or founders (participants) acting on its behalf. This liability attaches to a chief executive officer given that it is proved that she has acted in bad faith or beyond reasonable judgment, including when her actions (inaction) were inconsistent with the ordinary course of business or general business risk.

Similar provisions on liability are introduced for members of a collective management body who voted for a decision that caused losses to a legal entity as well as for a person having **actual** opportunity to direct activities of a legal entity. This person shall act in good faith and with due care in the company's best interests. Otherwise, it shall be liable for any losses incurred by such a company.

* *Please note that the procedure for protection of rights of shareholders that have lost their shares was previously established by Articles 149.3-149.5 of the RF Civil Code introduced by the Federal Law No.152-FZ dated July 2, 2013. For more information regarding this procedure, please see our client alert at: http://www.lecap.ru/upload/information_system_20/4/2/5/item_425/information_items_property_881.pdf*

Law No.99-FZ also introduces rules regarding agreements on elimination or limitation of liability of members of management bodies. In particular, agreements on elimination (or limitation) of liability for actions in bad faith (and in public companies – also for actions beyond reasonable judgment) shall be deemed void. However, such rules on the other hand provide for validity of such agreements to cover certain actions (inaction) of officers except for those committed in bad faith and (or) beyond reasonable judgment.

Noteworthy, any agreement on elimination (limitation) of liabilities of a person having actual opportunity to direct activities of a legal entity shall always be void.

5. Amendment of provisions on reorganization of a legal entity

5.1. Introduction of a combined reorganization and reorganization of two or more entities

Law No.99-FZ allows for reorganization of a legal entity combining different reorganization types. Current legislation provides such an option only to joint stock companies.

The new regulation will also introduce reorganizations with involvement of two or more entities, including those incorporated in different types (e.g., limited liability company and a joint stock company), provided that such legal entities are allowed to be transformed to such types.

5.2. Changes in regulation of creditors' rights of reorganized company

Law No.99-FZ sets rules on filing of creditors' claims to obligors – legal entities being reorganized – on acceleration of their obligations. These rules shall apply to all types of reorganizations. The above claims shall be filed within 30 days upon the date of publication of the second reorganization notice. The new regulation for the first time establishes that all the corresponding creditors' claims shall be filed in court.* Reorganization cannot be completed before the said claims are satisfied.

A creditor of a company being reorganized, whose rights were infringed or not considered at reorganization, is entitled to claim for damages (or use other available remedies) from the person that has actual opportunity to direct activities of the reorganized legal entities, as well as from members of their collective management bodies and authorized representatives. These persons and legal entities established as a result of reorganization, as well as the reorganized legal entity in case of spin-off, are jointly and severably liable to such a creditor.

Law No.99-FZ also provides for joint and several liability of newly established legal entities for the debts of a reorganized entity in case of inability to identify a successor for obligations of such an entity or in case of unfair distribution of assets among the newly established entities if it caused material violation of creditor's interests.

5.3. Annulment of decision on reorganization of a legal entity and declaration of such reorganization void

Annulment of decision on reorganization of a legal entity. Pursuant to Law No.99-FZ decision on reorganization of a legal entity can be annulled at the request of participants of the reorganized

* *This option was previously available with regard to reorganizations of open joint stock companies in the form of merger, consolidation or restructuring only.*

legal entity and other persons entitled by law. An eligible claimant shall file a respective claim to court within three months upon making of a record on the inception of reorganization in the unified state register of legal entities. If the claim is filed, the state registration of legal entities established in the course of reorganization is allowed only upon lapse of the above period. Legal entities established before the date when the court declares the reorganization void shall not be subject to liquidation, and the transactions concluded by such entities shall not be invalidated.

However, upon declaration of the decision on reorganization void, a participant of a reorganized company who has voted against a decision on reorganization or has not participated in voting, as well as the creditors of a reorganized legal entity shall be entitled to claim for damages caused by the reorganization. The claims for damages may be directed to persons supporting a decision on reorganization in bad faith and (or) to legal entities established as a result of such reorganization, all of which shall be jointly and severably liable.

Declaration of reorganization void. Reorganization of a corporation may be declared void by court upon a claim by a participant of a reorganized corporation who voted against the decision on reorganization or did not participate in voting, provided that:

- a decision on reorganization was not made by the participants of the reorganized corporation, or
- documents submitted for state registration of legal entities established as a result of reorganization contain deliberately misleading information on reorganization.

Declaration of reorganization void leads to the following:

- legal entities existing prior to the reorganization shall be re-established;
- newly established legal entities shall be liquidated with corresponding records to the unified state register of legal entities;
- all the transactions entered into by newly created companies with third parties relying in good faith on valid succession of such companies, shall be valid and binding for the re-established legal entities;
- transfer of rights and liabilities shall be declared void except for the transfer of rights and liabilities from obligors relying in good faith on valid succession on the side of a creditor;
- participants of a legal entity existed prior to the reorganization shall be recognized as holders of participatory interest in such a legal entity upon declaration of reorganization void in the same proportion as it was before the reorganization. In case the participants of such a legal entity have changed in the course of the reorganization or upon its completion, participatory interest in such a legal entity shall be restored pursuant to the rules described in Section 3 of this Legal Alert.