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DIFFICULTIES IN USING CORPORATE AGREEMENTS UNDER RUSSIAN LAW

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A corporate agreement provides for certain assurances and predictability for participants in investment projects structured through the development of existing business companies. In the absence of corporate agreements, the participants (shareholders) are driven by the same incentives as independent members of parliament: the relationships among both the former and the latter beyond the scope of their activities in the respective bodies appear to be outside the legal domain and are based on their mental sympathies and preferences and on their personal sovereignty, that should not be given absolute priority in the field of business where coinciding property interests should be followed by availability of their effectuation in a legally binding way.

Russian law had provided no specific regulation for this type of contracts for a long time, therefore business entities engaged foreign counsel and relied upon English law as the law most developed for such purposes. As a result, one of the most important segments of the legal services market, court practice and jurisprudence stagnated due to the lack of practical material for review. However, even after the adoption of appropriate amendments to the Russian laws, corporate agreements under Russian law are still almost nonexistent. The inactivity of entrepreneurs is, as we see it, explained due to three reasons that we would like to discuss in the order of increase of their role and significance.

Three key obstacles

1. We note that legislation contains inadequate language regarding this type of transactions which expressly declares that their purpose is a concerted exercise of shareholder rights. One can deduce from this that the provisions of a contract should be devoted to providing information and describing the way in which the shareholders, participants or counterparties are to exercise their discretion. We, law practitioners, believe this proposition to be highly inept. Given that shareholder rights (including the ones arising "out of paper" (out of the shares)) can have their own value in modern economic reality, corporate agreements make it possible to control them by assuming either obligations to do or omit certain acts (most commonly, to cast votes) or a promise to transfer a share (or to accept assignment thereof) for a specified price and at a

specified time. It is a limitation on discretion through the assumption of property obligations in exercising corporate rights that constitutes the subject-matter of such agreements, their purpose being not only to receive monetary consideration but to implement an investment project. Russian legislation is silent about it, and, unless we resort to legal speculation, corporate agreements under our law turn out to be contracts without a distinct *cause*.

2. Another factor restraining the wide use of corporate agreements by participants in business companies is certain conservative commenting on the limits of their application and legal effect according to which they must not violate any mandatory rules of law or distort the corporative structure of the company. While being absolutely right and fair, such comments produce lack of firmness among that part of our legal community which could actively promote the use of corporate agreements under Russian law.

3. In comparison to the aforesaid, the primary difficulty in the use of corporate agreements is the position of our judicial system which does not grant relief to creditors under any obligations arising from corporate agreements and does not provide protection for complex legal structures, despite that such structures facilitate the turnover of huge financial and physical resources. The courts actively and even with somewhat suspicious ardour invalidate contracts, refuse to accept proof of damages etc.. In addition, the notion of lost profit causes the overburdened judges to feel professional fear and confusion, and we attribute this not even to the corruption factor but just to their laziness and reluctance to understand important details.

Recommendations

This standstill situation where the business community does not use Russian law because no reasonable judicial practice has been developed and dispute-resolving bodies cannot express their attitude due to the lack of an appropriate number of such cases or lawsuits, can only be overcome by the Russian doctrine of law and by such representatives of it as judges, arbitrators of the Moscow Commercial Arbitration Court or arbitrators of the Arbitral Tribunal of the Chamber of Commerce and Industry who have the highest weight and are recognised as distinguished authorities among the Russian executors of law (in our opinion, it could be done best of all by means of individual or joint publications or interviews). Events, conferences or discussions featuring such persons and devoted to an in-depth review of the problems described herein would be of use.

The general goal of such efforts should be to make representatives of large businesses in the RF confident that:

1. Companies themselves may typically be parties to corporate agreements as the key recipients of investments or, if you wish, creditors in relation to their investors, either shareholders or third parties. Applicable law uses the term “shareholders’ agreements”. Its literal construction appears to prevent any persons other than members of the relevant business companies from being parties to such agreements. However, practice is already such that, first, business entities assume obligations to their members by signing such agreements in a considerable number of cases; and, second, future participants receive binding guarantees of assistance in their investments from their counterparties.

2. Lawsuits involving related claims to transfer a certain shareholding and to accept a certain money amount (or *vice versa*) should be accepted and heard on the merits without regard to Article 157 of the Civil Code concerning conditional transactions as a result of occurrence of certain circumstances, although depending upon the will of the relevant parties, or even due to

their own willful acts. The court will rely upon a broad interpretation of Article 314 of the Civil Code concerning the maturity date of obligations (which is inappropriately referred to in the Civil Code as the "obligation performance deadline").

3. The court will order compensation (Article 32.1(7) of Law No. 115-FZ) not as a kind of a penalty but as a payment similar to "liquidated damages", subject to reduction solely under Article 10 of the Civil Code (abuse of law) but not under Article 333 of the Civil Code requiring that damages should be commensurate to security.

4. The duty of any shareholder (participant) to vote in a specified manner at a meeting, which is ascertainable with respect to quantity, dates and content as at the date of the contract (but which does not necessarily involve a general promise to vote as instructed), should be performed as a kind of property consideration whose value results from expectations in the process of investment.

5. Special covenants in corporate agreements will be governed by Articles 313(1) and 430 of the Civil Code regarding the imposition of performance upon a third party or in favour of a third party (for example, if it is promised to procure a loan for the company on certain specified terms etc.).

6. For any failure to perform reciprocal tag-along obligations, such as a failure to accept a third party offer or the disposal of a shareholding other than jointly with, or with the approval of, a counterparty, the court will order the willfully defaulting party to pay the actual amount of lost profit.

7. Irrespective of any choice of foreign law, an agreement among the participants in a Russian business company will be governed by Russian law, either because the corporate agreement establishes the legal framework for "internal relations" within a legal entity (Article 1202(2)(7) of the Civil Code), or by virtue of the imperative rules being applicable in international private law (Article 1192 of the Civil Code). The anticipated benefits of the foregoing appear to be a wider and more frequent use of our national law as the law governing corporate agreements and the development of legal, business and judicial practice and doctrine in this area.