INFORMATION LETTER

RESOLUTION OF THE PLENUM OF THE HIGHER ARBITRAZH COURT ON MAJOR AND RELATED PARTY TRANSACTIONS

On 16 May 2014 the Plenum of the Higher Arbitrazh Court adopted the resolution "*On Certain Issues Related to Challenging Major and Related Party Transactions"* ("**Resolution 28**"). Resolution 28 contains a number of new legal views, the most important of which are described below.

Correlation between the approval of the transaction and the consent of the corporate body of the legal entity

A new Article 173.1 has been recently introduced to the Civil Code of the Russian Federation which regulates the consent of the corporate body of the legal entity to a transaction and the consequences of the absence thereof.

In its clarifications the plenum of the Higher Arbitrazh Court mentions the special character of regulations governing consent provided by corporate laws with respect to the rules of the new Article 173.1 (consent of the corporate body of the legal entity) and Article 182.3 of the Civil Code of the Russian Federation (a representative is prohibited from entering into transactions in which it is involved). In other words, these articles of the Civil Code of the Russian Federation do not apply to challenging major and related party transactions.

Transactions that do not fall within the rules governing major and/or related party transactions and concluded without the requisite consent (approval) of the corporate body of the legal entity may be challenged by virtue of the Articles 173.1 and 182 of the Civil Code of the Russian Federation.

Challenging transactions made in prejudice of the company's interests

A new Article 174.2 was introduced to the Civil Code of the Russian Federation providing grounds for challenging transactions entered into by a legal entity as a transaction concluded in prejudice of the interests of the legal entity, provided that (i) the other party of the transaction was or should have been aware of manifest damage to the company, or (ii) there were circumstances evidencing collusion or other joint actions of the representative or the corporate body of such a company and the other party in prejudice of the lawful interests of the represented person or the company.

The Higher Arbitrazh Court of the Russian Federation clarified that the mere fact that a transaction was approved as a major or related party transaction does not eliminate the ground of invalidity provided by Article 174.2 of the Civil Code and does not prevent such transaction from being recognised as invalid.

In addition, the court clarified the criteria of manifest damage to the company in the context of the new Article 174 of the Civil Code of the Russian Federation. The foregoing is indicated by entering into a transaction on knowingly and notably disadvantageous conditions, for instance, if the consideration received by the company under the transaction is twice or more lower than the value of the consideration provided by the company to the counterparty. At the same time the other party should be aware of manifest damage if it was evident to any ordinary contractor at the time the transaction was entered into.

Challenging intragroup transactions

Resolution 28 contains significant information regarding transactions made by a parent company with its subsidiaries.

A person who has filed a claim seeking the invalidation of a transaction on the ground that it was made in breach of the prescribed approval procedure must prove, *inter alia*, the breach of rights or protected interest of the company or its participants (shareholders) by such a transaction.

When assessing the adverse consequences of a major transaction made by the parent company with a subsidiary under a claim seeking the invalidation of such transaction, one should take into account that the alienation of property in favour of the subsidiary may result in a breach of the rights and lawful interests of minority shareholders (participants) of the parent company if it aims to deprive them of the possibility to make management decisions with respect to such property and obtain benefit from using such property in their interest in the future.

This clarification was aimed at preventing the siphoning off of assets through establishing subsidiaries and the subsequent sale or alienation of property to subsidiaries at a cut price. Moreover, this clarification should be taken into account when intragroup transactions and restructuring are carried out.

Good faith criteria

One ground for dismissing a claim seeking the invalidation of a major or related party transaction is when a party who entered into the transaction is deemed to have acted in good faith, ie when such party did not and should not have known that the transaction was carried out in breach of statutory requirements.

Resolution 28 clarifies some cases when a party should be deemed to have acted in good faith. In general, these clarifications are consolidated by the idea that parties involved in civil transactions must be diligent and circumspect to the conclusion of transactions by their counterparties.

Firstly, one should take into account to what extent a reasonably diligent person involved in civil transactions could notice signs of a major transaction or the failure to have it approved as such. Specifically, a party should have known that the transaction was a major transaction and required approval if it was evident due to the nature of the transaction, for instance if flagship assets of a company (real estate, valuable equipment, etc) were being disposed of. In other casas a person should be deemed to have acted in good faith.

Secondly, in the context of related party transactions a court should proceed on the basis that the party knew or should have known that a transaction is a related party transaction, if the counterparty or its representative (or their spouse or relatives) were acting as a related party.

If the court determines that the relation was not obvious for an ordinary person, the respondent in the case is deemed to have acted in good faith. At the same time the claimant may furnish evidence showing that, in the circumstances of the specific case, a party to the transaction should have known about an implicit affiliation. For example, when a suretyship or pledge agreement is entered into with a company in order to secure the performance of obligations of the spouse of the company's general director, where the general director and the spouse have the same surname.

Resolution 28 also contains an important clarification regarding representations and warranties of a party to an agreement with respect to the observance of requisite corporate procedures. These representations and warranties as such are not enough to have the party recognised as a good faith contractor.

Calculation of the statute of limitation for challenging transactions

The Higher Arbitrazh Court has clarified that the statute of limitation for invaliding a major or related party transaction made in breach of the procedure established for its approval shall run from the moment the claimant became or should have become aware that such transaction required approval in accordance with procedure provided by law or the company's charter.

A party to a transaction should discover that a transaction was made in breach of the approval procedure by the date of the annual general meeting of the participants (shareholders) following the results of the year in which the transaction was made.

However, the materials provided to the participants at the meeting should be enough to actually conclude that such a transaction took place (for example, if the balance sheet showed the composition of assets changed in comparison to the previous year).

Criteria for classifying a transaction as a transaction made in the ordinary course of business

Resolution 28 defines the "ordinary course of business" in the context of major transactions. Such business consists of any operations customary for the day-to-day activities of the company or other business entities engaged in similar activities, having comparable assets and turnover, irrespective of whether such transactions have been made by such company before.

At the same time the Higher Arbitrazh Court tends to avoid setting formal criteria for classifying transactions as transactions made in the ordinary course of business. According to the Higher Arbitrazh Court, the mere fact of entering into a transaction as part of the activities specified in the charter or the Unified State Register of Legal Entities as the principle activities of the company or the mere fact of holding a license to carry out such activities do not serve as grounds for automatically classifying such transactions as transactions made in the ordinary course of business.

Qualification of employment contracts as major or related party transactions

The Higher Arbitrazh Court has stated that a contract concluded by an employee or specific provisions thereof can be qualified as a major and/or related party transaction. These views follow court practice.[1]

In particular, the possibility of qualifying an employment contract as a major transaction can be evidenced by the provisions thereof governing payments (made as a lump sum or several times) in case of dismissal and/or other circumstances, or if the salary amounts to over 25 percent of the book value of the company's assets.

The plenum of the Higher Arbitrazh Court has specifically noted that if an employment contract is concluded for an indefinite term, the reference period for assessing the transaction as a major transaction shall be one year.

While deciding whether the conclusion of an employment contract infringes on the interests of a legal entity, one should take into account whether the terms and conditions thereof are similar to ordinary terms and conditions of employment contracts usually concluded with employees of a similar qualification and with the relevant level of proficiency for the employee's duties.

Details on the approval of major and related party transactions

Resolution 28 contains a number of provisions on the rules regulating the adoption of resolutions to approve major and related party transactions and to amend agreements which have already been concluded.

Subsequent amendments to the terms and conditions of an approved transaction constitute an individual transaction subject to new approval if it entails the amendment of the

[1] Ruling of the Higher Arbitrazh Court No. 17255/09 dated 27 April 2010, Ruling of the Higher Arbitrazh Court No. BAC-14757/12 dated 15 November 2012, Ruling of the Higher Arbitrazh Court No. BAC-11017/12 dated 5 September 2012

principle terms and conditions of a previously agreed transaction, for example, changing the transaction value, increasing the suretyship validity period or concluding an agreement on levying execution on a pledged item out of court. It is not required to approve a transaction which amends the terms and conditions of a previously agreed transaction if such amendment is apparently beneficial for the company (decreasing the amount of a penalty for a debtor, decreasing in the rent for a lessee, etc).

Clarifications specify individual provisions for resolutions on the approval of transactions. For example, an approval may contain:

- a general description of the principle terms and conditions of the transaction being approved, for example, the cap of the property purchase price, the lower threshold of the sale price, and the approval of the conclusion of a number of similar transactions;
- alternative options for the principle terms and conditions of the transaction and an indication stating that approval is given only with respect to concluding several transactions simultaneously, for example, the extension of a loan subject to the simultaneous conclusion of a pledge or suretyship agreement;
- the term of such an approval. If this term is not set out in the resolution, the approval shall be deemed effective for a year after its adoption, unless another term follows from the nature and conditions of the approved transaction.

A right of a new participant (shareholder) to challenge transactions concluded before becoming a participant (shareholder)

It has been clarified that a participant (shareholder) challenging a company's transaction acts in the interests of the company. Therefore, that fact that the claimant was not a participant (shareholder) of the company at the time the transaction was made shall not serve as grounds for dismissing the claim.

At the same time the statute of limitations on the requirements of such participants (shareholders) commences on the date when the predecessor in title of such participant (shareholder) of the company became or should have become aware of the transaction being concluded in breach of the company's approval.

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