
Aspects of Transactions by Business Entities in Civil Legislation

L.B. Sitdikova¹, S.J. Starodumova², M.A. Volkova³

Abstract:

The article reviews novelties of the civil legislation related to transactions making by business entities. It analyzes attributes of joint stock companies as the most common form of corporate entities, and it identifies problems of shareholders' agreements application.

The article reviews a corporate agreement as a special type of a transaction, and it analyzes its content and consequences for the society in case of a failure to fulfill this agreement.

The authors make conclusion about special aspects of transaction making by a legal entity, which require special procedure of approval and suggestions on civil legislation improvement.

Keywords: *Corporate entities, shareholders' agreements, corporate agreement, extraordinary transactions, interested party transactions, major transactions.*

JEL Classification: *K10, K19.*

¹Russian State Social University (RSSU), lbsitdikova@mail.ru

²Russian State Social University (RSSU), clear06@mail.ru

³Russian State Social University (RSSU), mvolkova2013@bk.ru

1. Introduction

Another stage of civil legislation reforming in the years 2012-2015 was related to civil law subjects – legal entities. Not only the very notion but also the structure of constitutional documents, the reorganization procedure and management bodies' liability, have been changed, as well as the legal entities classification has been modified through introduction of corporate entities. Corporate agreement requires special attention since it has dual legal nature and represents a special transaction. Since January 1, 2017, changes were introduced in transactions made by corporate entities in relation to simplification of the procedure of major transactions and interested party transactions approval; another quite serious change was related to a firmly established concept of extraordinary transactions execution by business entities. From the point of view of business running by business activity subjects, analysis of these transactions' execution is the most interesting.

Since 2014, corporate relations have been included in the subject matter of civil law regardless of ambivalence of their legal nature. Therefore, it is interesting to analyze not only the general issues of legal entities formation and termination of their activity but also their business activity as such. The problems of transactions execution by corporate entities have been raised in fundamental works by Grishchenko (2014). Pushkarev (2008) has performed an analysis of the procedure of major transactions and interested party transactions approval by management bodies of business entities and these problems have drawn attention of other authors. Certain issues of corporate entities classification are analyzed in the works of Andreev (2016), Gutnikov (2014), Lenkovskaya and Shilovskaya (2017), Lenkovskaya and Mamaev (2016), Mazo (2015), Pavlyuk (2015), Starodumova (2016), Urasova *et al.* (2017).

Peculiarities of certain types of transactions execution by corporate entities are described in the articles by Berezkin (2013), Zolotareva, Kireeva (2014), Kapul (2016), Kononov (2010), Makarova (2017), Rostovskiy (2014), Shitkina (2017), Beglova *et al.* (2017). In detail the quality of transactions' execution by legal entities has been reviewed in the works of Ershova (2016), Starodumova *et al.* (2016), Volkova and Starodumova (2017), Kitova *et al.* (2017).

2. Method

Performing the research, the authors followed generally accepted scientific and specific legal method of obtaining knowledge: historically legal, formally legal, comparatively legal, sociological, etc. The authors mainly applied a systemically structural method, which allowed identifying legal nature of corporate transactions. Combination of historically legal and comparatively legal methods allowed identifying peculiarities of historical conditions influence the development of corporate law institution in general and transactions' execution by corporate entities in particular.

Formally legal method allowed analyzing legal norms regulating transactions made by corporate entities and the procedure of their execution. Systemically structural method provided the authors the opportunity to review the peculiarities of extraordinary transactions' execution.

3. Results

The authors identified that the legislators use the terms "corporate entities" and "corporations" in an identical way, and yet state-owned and municipal unitary enterprises created in the form of corporations are not corporate entities. The authors suppose that a shareholders' agreement should not go beyond the scope of legislative instructions and provisions of a business entity's charter. If there are any discrepancies between the agreement and the charter, the charter should prevail. Therefore, shareholders' agreements may not be recognized as the sources of corporation law, but they should be viewed as a tool regulating relations between the members of an entity.

The authors determined that referencing the price of property to be alienated to its net asset value in the books of a business entity is not a good idea; hence, the authors suggest using market value, presuming that it corresponds to the net asset value, unless proved otherwise. The authors revealed that in order to align provisions of the federal laws "On Joint-Stock Companies" and "On Limited Liability Companies" and article 173.1 of the Civil Code of the Russian Federation the notion of "transaction approval" is replaced with the notions of "consent to execute a transaction" and "further approval of a transaction".

The authors found that since the Laws on business entities contain no reference to the periods, within which from the moment of notification of entity's intention to make an interested party transaction certain person might demand that a shareholders' meeting or the board meeting is called, such transactions are executed prior to their approval. It is advisable to set forth a reasonable period for a meeting convening and prohibit by law execution of such transactions without their prior approval.

In order to improve the legislation on transactions execution by corporate entities, the authors come to conclusion on the necessity to include notifications of extraordinary transactions execution in the Unified Federal Register of Legally Relevant Information about the Facts of Legal Entities Activity.

4. Discussion

The Civil Code of the Russian Federation has been expanded with Art. 65.1, which divided all legal entities into corporations and unitary legal entities; at the same time, the content of this article implies that the notions of "corporate entities" and "corporations" are identical. Therefore, we face an ambivalent situation with the

names of several state-owned and municipal unitary enterprises that are created in the form of corporations but are not corporate entities.

Business entities with chartered capital divided into founders' shares certifying the members' liability rights in relation to the entity hold a special position among the commercial corporate entities. A novelty in the field of legal entities classification is division of business entities into public and non-public entities (which are fundamentally different in their ability to place shares and securities of a legal entity through public offering). Non-public corporations are limited liability companies and joint-stock companies, which do not comply with the attributes of a public corporation. The legislator gave no additional explanations in relation thereto and only used rather vague phrases.

Complexity of interaction between the members of a joint-stock company is determined by a peculiarity of corporate cooperation, which is developed in a joint-stock company. For instance, in Pavlyuk's opinion, a method of internal organization commonly found in joint-stock companies is a peculiar type of relations, which is characterized by corporate nature (Pavlyuk, 2015). Interests of three groups of subjects are often identified in a joint-stock company: shareholders; management bodies; and personnel of the company.

Gutnikov (2014) notes such attributes of joint-stock companies as existence of shares certifying liability rights of company members in relation to the company; the right of free alienation of shares without consent of a joint-stock company; shareholders limited liability within the scope of value of shares that they hold, and other characteristics determining legal status (Gutnikov, 2014). Mazo (2015) adds two more important characteristics of a joint-stock company: 1) a joint-stock company is the largest corporation allowing involving not only significant financial resources but also many members; 2) joint-stock companies may be created by various means in accordance with the established registration procedure.

Grishchenko (2014) identifies pooling of capital but not persons, which is certified by the number and value of shares, as a significant attribute of joint-stock companies. Participation interests of joint-stock company members may differ, although the nominal value of all shares is the same. Some other significant attributes of joint-stock companies may be identified: commercial name of a joint-stock company should contain a description showing that the entity is a joint-stock company; shareholders liability is only limited to those amounts that are invested in the shares.

It is important for the joint-stock companies that the Federal Law dated Dec-26, 1995 № 208-FZ "On Joint-Stock Companies" is expanded with Art. 32.1 dedicated to the shareholders agreements. Kononov (2010) points out to the fact that shareholders' agreements were executed before the introduction of Art. 32.1 of the above law in the legislation, but in case of a dispute related to the issues of

corporate legislation, the courts ignored the provisions of executed shareholders' agreements and only applied the above norms. In effect, in the court one could only protect the interests resulting from the shareholders' agreement. In V. Kononov's opinion, shareholders' agreements on the voting procedure (e.g. on shareholders votes aggregation when creating a sole executive body) could be recognized as relatively legal.

During the period when the Russian legislation norms did not regulate the shareholders' agreements issues, foreign laws applied. A vivid example of such option realization was a litigation involving Megafon cell operator. In its ruling, the court placed emphasis on the fact that in accordance with cl. 2 art. 1202 of the Civil Code of the Russian Federation the court recognized as illegal use of foreign laws for regulation of corporate legal relations arising out of a membership in a Russian entity, since it contradicts the incorporation principle when determining a legal entity's personal law (Ruling of the Federal Arbitration Court of West-Siberian District dated March 31, 2006 № F04-2109/2005(14105-A75-11) on case № A75-3725-G/04-860/2005).

Otherwise, the shareholders had to create a complex corporate structure including an additional management body (e.g., a parent company in foreign jurisdiction) applying foreign laws. It should be noted that international practice has long been knowing and using the widely known concept of shareholders' agreements (SHA). In its classical meaning defined by Rostovskiy, shareholders' agreement is a contract between the shareholders and the company, and its purpose is to organize corporation management, allocate profit to the shareholders, settle disputes and resolve deadlocks (Rostovskiy, 2014).

In accordance with the current legal precedents (Decision of the Arbitrazh Court of Moscow dated November 24, 2010 in a case № A40-140918/09-132-894) an agreement should elaborate and make specific company members' rights; hence, it has to comply with the charter provisions. It should be noted that the participation agreements are more loyal in their optionality level than the shareholders' agreements. We suppose that shareholders' agreement should not go beyond the scope of legislative instructions and provisions of a company charter. If there is a discrepancy between an agreement and a charter, there is no doubt that the court will give preference to a charter, since cl. 2 art.11 of the Federal Law "On Joint-Stock Companies" and cl. 2 art. 12 of the Federal Law dated Feb-08, 1998 № 14-FZ "On Limited Liability Companies" clearly determine that the charter requirements must be fulfilled by all bodies of an entity and all of its members. Special attention should be paid to such transaction expanding the limits of corporate relations regulation as a corporate agreement (art. 67.2 of the Civil Code of the Russian Federation).

This norm expanded the scope of members, since the creditors and persons intending to be future entity members may become parties to a corporate

agreement. Entities' members may ensure corporate agreement execution as early as at the stage of business entity incorporation, i.e. prior to the moment of state registration of a legal entity. At the same time, a corporate agreement has certain legal force, since the decisions of an entity management bodies may be deemed invalid if they contradict its content.

Interpretation of a corporate agreement provided by a legislator in art. 67.2 of the Civil Code of the Russian Federation combines the provisions of the existing shareholders' agreements and participation agreements of limited liability companies' members. At the same time Berezkin (2013) suggests that the notion of a corporate agreement also includes agreements executed between the founders at the time of a corporation creation and agreements on transfer of a company management bodies' authorities.

According to Zolotareva and Kireeva (2014) execution of a corporate agreement concurrently with execution of the charter and other necessary constituent documents allows maintaining confidentiality, setting forth obligations for all members and using (if necessary) a simplified procedure of amendments and addenda introduction. However, there are certain drawbacks in optional opportunity to disclose information related to the content of a corporate agreement, since corporate agreements are not subject to state registration it is impossible to check if they comply with the effective legislation. When entering a corporate agreement, members are obliged to notify the entity of this legal fact without disclosing its exact content, which is mentioned in cl. 4 art. 67.2 of the Civil Code of the Russian Federation. If an incorporation agreement belongs to the type of corporate agreements, it means that an entity must be notified of its creation before it is created.

During their business operations, corporate entities execute two groups of extraordinary transactions subject to prior approval under certain conditions: major transaction and interested party transactions. An extraordinary transaction is a transaction, which somehow goes beyond the limits of common business activities of an entity, and therefore the parties to corporate relations require additional guarantees securing their rights and legal interests. Such transactions include major transactions, interested party transactions, and transactions, which special execution procedure is described in entity's charter.

Currently, a major transaction is a transaction (interrelated transactions) for purchase, alienation or potential alienation by an entity, directly or indirectly, of property, the cost of which is equal to 25% of net book value of its assets as identified based on the data from its accounting reports as of the last reportable date. Moreover, major transactions include transactions not resulting in property alienation from a corporation ownership, transactions related to property handover for temporary ownership and/or use, or transactions for granting of the right to use intellectual property or means of personalization under the license terms, if such

assets' value exceeds 25% of net book value of the legal entity's assets. According to Kapul (2016) referencing the price of property to be alienated to its net asset value in the books of a business entity is not a good idea; hence, he presents arguments for using market value, presuming that it corresponds to the net asset value, unless proved otherwise. The authors support the above opinion.

Interested party transactions represent a separate category of transactions due to existence of a special mechanism for protection of rights of parties to a civil transaction generally and members of business entities. In Pushkarev's opinion, the key criterion for transaction recognition as an interested party transaction is certain attitude towards it from the persons that may be deemed interested therein (Pushkarev, 2008). However, currently, an interested party transaction does not require prior consent to its execution.

To execute an interested party transaction, members of the board of directors, a collective executive body of the company, or uninterested members of a company – shareholders – must be notified of execution of an interested party transaction. Prior to execution of an interested party transaction, a sole executive body, a member of a collective executive body, a member of the board of directors or shareholder(s) holding at least 1% of the entity's voting shares (par. 2 cl. 1 art. 83 of the Federal Law "On Joint-Stock Companies"), and for a limited liability company – member(s), whose total share amounts to at least 1% of the chartered capital of the entity (par. 2 cl. 4 art. 45 of the Federal Law "On Limited Liability Companies") accordingly, may demand a consent to execution of an interested party transaction.

In Shitkina's opinion, it is dangerous for practical implementation that the Laws on business entities do not identify the exact periods, within which from the moment of notification of entity's intention to make an interested party transaction the specified persons may demand that a shareholders' meeting or the board meeting is called. Such ambiguity may result in such transaction execution prior to its approval. (Shitkina, 2017).

In addition, Makarova (2017) notes that a notice of an interested party transaction execution is not subject to inclusion in the Unified Federal Register of Legally Relevant Information about the Facts of Legal Entities Activity (cl. 7 art. 7.1. of the Federal Law "On State Registration of Legal Entities and Individual Entrepreneurs"), and it does not belong to the information, the inclusion of which in the register is required by the laws on business entities. We suppose that this fact also creates certain risks for a legal entity's partners since such transactions may be deemed invalid based on cl. 2 art. 174 of the Civil Code of the Russian Federation, if a transaction is executed to the detriment of an entity and it is proved that the other party to the transaction knew or must be taken to have known that a transaction is an interested party transaction and/or that there was no consent to its execution.

We should also note other novelties introduced since January 1, 2017. For instance, a notion of an “affiliate” in relation to the transactions is replaced with a “controlling person”, i.e. a person entitled to control, directly or indirectly, more than 50% of votes in the highest management body of the controlled organization or the right to appoint a sole executive body and/or more than 50% of members of a collective management body of the controlled organization. The Russian Federation, its subject and a municipal structure are not recognized as the controlling persons.

Another elaboration in the legislation is related to the definition of “transaction approval”: currently, it is replaced with “consent to execute a transaction” and “further approval of a transaction”, probably for the purpose of alignment of regulations of the federal laws “On Joint-Stock Companies”, “On Limited Liability Companies” and art. 173.1 of the Civil Code of the Russian Federation.

Mandatory prior approval of an interested party transaction is replaced with the entity’s obligations to inform about its intention to execute such transaction (cl. 1.1. art. 81 of the Federal Law “On Joint-Stock Companies”, par. 1 cl. 3 art. 45 of the Federal Law “On Limited Liability Companies”). Concurrently, to execute a major transaction it is still mandatory to have a prior approval from the authorized body. When presenting a major transaction to the shareholders general meeting, its execution must be approved, and it should contain an evaluation of such transaction’s consequences for the entity and its advisability through inclusion of information of such transaction into materials for the meeting (par. 2 cl. 2 art. 78 of the Federal Law “On Joint-Stock Companies”).

Andreev (2016) notes that later approval of a transaction is allowed when members of an entity holding the total of more than a half of votes may express later consent or approval of the executed transaction, although the transaction approval procedure established by the law had been violated now of its execution. The procedure of decision making on granting consent to an interested party transaction execution differs depending on whether an entity is public or not, and it is also determined by organizational and legal form of a business entity.

To conclude, let us determine a procedure of decision making on granting consent to an interested party transaction execution, which is common for all entities. Prior to transaction execution, an entity should check whether it is necessary to have consent to (approval of) its execution; identify parties interested in the transaction (if any); at least 15 days prior to the execution date notify members (shareholders) and other persons of the transaction; and finally make a decision on granting consent to (approval of) transaction execution, if such is demanded by members (shareholders) and other persons. If an entity fails to comply with the rules of granting consent to (approval of) an interested party transaction, it may be deemed invalid (art. 84 of the Federal Law “On Joint-Stock Companies”, cl. 6 art. 45 of the Federal Law “On Limited Liability Companies”).

The authors should also draw attention to the new provision of the Federal Law “On Joint-Stock Companies” related to the non-public entities’ right to exclude necessity to approve interested party transactions, or to set forth a provision on non-applicability of the provisions related to such transactions approval to such entity, if this decision is required by the non-public entity’s charter. Provisions requiring interested party transactions approval may be excluded from the charter of an existing entity based on the decision of shareholders general meeting made by all shareholders unanimously (cl. 8 art. 83 of the Federal Law “On Joint-Stock Companies”).

Hence, the amendments made during the last year in relation to corporate entities’ transactions approval are aimed at simplification of entities business activity, on the one hand, but on the other hand such optionality may result in infringement of rights and interests of entity members (shareholders) that are not interested in a transaction, as well as those of the entity partners.

5. Conclusion

Hence, the performed analysis of amendments made to the legislation on legal entities allows acknowledging a general tendency to simplify transactions execution. At the same time, the recognized optionality of shareholders’ agreements and corporate agreements execution contributes to potential infringement of rights of both minority members and partners of an entity that are not aware of existence of certain rules established in legal entities in relation to entity’s business affairs conduct.

References:

- Andreev V.K. 2016. Application of general provisions on obligations from the Civil Code of the Russian Federation to corporate relations (corporate obligations). *Civil law*, 4, 3-6.
- Beglova, E.I., Nasyrova, S.I. and Yangirov, A.V. 2017. Factors of Economic Behavior of Population in Regional Labor Market. *European Research Studies Journal*, 20(4B), 167-182.
- Berezkin I.V. 2013. Comparative characteristics of corporate agreement in Russian and foreign laws. *Law and politics: modern challenges: collection of articles by professors, post-graduates, and students of law department*. Khabarovsk: RITS Khabarovsk State University of Economics and Law (in Russian).
- Ershova I.V. 2016. Self-regulation of business and professional activities (SRO). *Contemporary problems of Russian law*, 7 (68), 203-206.
- Grishchenko O.I. 2014. State participation in joint-stock companies: legal problems. Author’s abstract of thesis research for candidate of legal sciences degree. Moscow.
- Gutnikov O.V. 2014. Legal Liability in corporate relations. *Civil Law Bulletin*, 6, 51-117.
- Kapul Y.A. 2016. Changes in legislation related to major transactions and interested party transactions: novelties, controversial issues, and problem. *Law and economics*, 10, 27-36.

- Kitova, O.V., Savinova, V.M., Dyakonova, L.P., Bruskin, S.N., Beshmelnitskiy, A. A., Danko, T.P. and Sekerin, V.D. 2017. Information-Analytical System for Forecasting Indicators of the Social and Economic Sphere of the Russian Federation. *European Research Studies Journal*, 20(4A), 275-283.
- Kononov V. 2010. Problems of subject matter and content of a business entity members' agreement under the Russian laws. *Corporate lawyer*, 10, 22-70.
- Lenkovskaya, R.R., Shilovskaya A.L. 2017. Legal nature and correlations between internal and corporate relations in a legal entity. *Gaps in the Russian legislation*, 5, 70-74.
- Lenkovskaya, R.R., Mamaev I.Y. 2016. Peculiarities of formation and authorities of management bodies in the limited liability companies. *Gaps in the Russian legislation*, 8, 103-106.
- Makarova O.A. 2017. Procedure for obtaining of consent to interested party transactions execution in business entities. *Russian laws: experience, analysis, practice*, 3, 63-69.
- Mazo M.A. 2015. Legal mechanics or competing interest's regulation in a joint-stock company. *Russian legal journal*, 2(101), 127-136.
- Pavlyuk A.V. 2015. To the issue of a joint-stock company notion in the Russian law. *Administrative and municipal law*, 1, 8-18.
- Pushkarev I.P. 2008. Procedure of major transactions and interested party transactions approval by management bodies of business entities. Thesis research for candidate of legal sciences degree. Chelyabinsk.
- Rostovskiy A. 2014. Methods of deadlock resolution within the scope of shareholders' agreement. *Corporate lawyers*, 10.
- Shitkina I.S. 2017. Interested party transactions. *Economics and Life, Lawyer*, 9, 14-15.
- Starodumova S.J. 2016. Commercial corporate legal entities. *Liberal, social-economic and social sciences (electronic journal)*, 11, 142-145.
- Starodumova, S.J., Shilovskaya, A.L., Volkova, M.A. and Efimova O.V. 2016. Role of Self-Regulating Organisations in the System of Quality Assurance in Works and Services. *Man in India*, 96(10), 4155-4164.
- Urasova, A.A., Kuznetsov, P.A., Plotnikov, A.V. 2017. Economic and Mathematical Model of Business Struggle with a Vertically Integrated Company in the Market. *European Research Studies Journal*, 20(4A), 77-101.
- Volkova, M.A. and Starodumova S.J. 2017. The notion and types of self-regulated organizations in construction industry. *Liberal, social-economic and social science (electronic journal)*, 5, 41-46.
- Zolotareva, A. and Kireeva A. 2014. *Corporate agreement: second edition. Business and law*, 10, 69-80.