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Examination Report

# Through the Eyes of the Owners

A Comparative Analysis of the Russian and Swedish  
Legislations in regard to the Stockholder Protection

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## **A Word on the Layout**

This report was initially intended to consist of two fully independent parts, the first one describing the Swedish legislation and the second- its Russian counterpart. These two parts were then supposed to be followed up by a thorough comparative analysis.

The thought underlying such a layout was that anyone already familiarized with one of the two legislations in question, could avoid a closer study of the part that he/she was already familiar with and thus be able to escape unnecessary repetition (from the readers point of view). During the process of writing we discovered that such a categorical approach to the layout was fast becoming too unpractical because of the many tedious repetitions that were necessary in order to provide for uniform starting points for the coming discussion. We therefore chose to slightly soften up the strict categorisation, which led us to the final result which looks as following:

The report is now divided into four chapters. The first one contains information on the structure of this report as well as some thoughts we had prior to working on the comparative analysis; in the second one we process the Swedish regulations and the third one deals strictly with the Russian law. The fourth and concluding chapter is the analytic part of the report. While the basic structure is mainly featured the way we envisioned in the beginning, we preferred to make the Swedish and Russian chapters somewhat more reader friendly by not being as categorical in their separation. While it is still fully possible to read only one of the chapters on material regulations and get an apprehensive idea of the following analysis, the reader is strongly recommended to read the whole report as it goes. The reason is that the chapter on the Russian legislation might feel a bit unfinished without having glanced through the part about the Swedish legislation first.

# **Part One**

*The formal Introduction*

## **Introduction**

During the year of 2005 we were given a unique opportunity to study Russian law at the Kuban State University of Krasnodar, a city the size of Stockholm that is located in the southern part of the Russian Federation. At our arrival we were expecting to discover, by result of Russia's isolation from the rest of Europe for almost a century, the Russian legislation to be very far from its Swedish counterpart. We were certain that the Russian Law would be highly static and based on old communistic values but to our surprise we found that nothing could have been further from the truth.

Once there, we were marvelled by the unbelievably quick pace the Russian law is taking new shape, and how incredibly similar the main Russian legislation is to the Swedish one, a similarity that is anything else but unintentional since a vast majority of Russia's law professors, legislators and law practitioners take a great interest in Western and especially Northern European legislations. Something that has led to that a large number of legal acts adopted either bears a close resemblance or is tailored to cohere its Northern European counterpart.

## **Summary**

This report treats questions of litigious forms of protection that is provided to minority stockholders in Russian and Swedish companies by their respective Joint Stock legislations. Since the protection mechanisms target the minority stockholders in a greater extend we primarily approached the problem from their perspective.

We start off by providing the reader with a small introduction to the respective national legislations. In the chapter on the Russian legislation we also present a short historical overview and an introduction on the present day structure of the Russian legal system.

After this introduction we continue on to the legislations, aiming at reviewing the protection of stockholders on a more concrete level. First, we determine the actual field of application of the national laws respectively, which is followed by a brief explanation of the material legislation that is of interest to the stockholder, spending additional effort on a couple of the most central regulations.

In the main part of the report we present a more in-depth study of the actual litigious procedures available to the stockholders within the frames of the respective national legislations. We have chosen to limit ourselves to the following scope of procedures:

- Animadversion on Decisions Taken by the Company Bodies
- Liability of Damages
- The Possibility to Force Release/Expropriate Stock Owners
- The Company Liquidation
- Fusion and Fission
- Distribution of Profit

While not all of the aforementioned procedures are strictly litigious we regard it necessary to take into consideration all of the above mentioned aspects of the legislation in order to give a thorough picture of the existing stockholders protection.

In the analysis we try to answer three questions. The questions at issue are:

- **What kind of legal protection does the Russian and Swedish legislators empower their stockholders with in regard to protection of their stockholders rights?**
- **How do the regulations differ from each other and what strengths and weaknesses do the systems have when compared to each other?**
- **What are the reasons for the (if any) differences between the two legislations and can one of them be said to offer a better protection to stockholders?**

The first answer is in reality given in the informational section and fully complies with the above listed protection possibilities.

The short answer to the second and third answer is that the Swedish regulation really gives a much stronger overall protection to its minority stockholders but that it is far from unintentional since the Russian legislation concentrates on providing the company with a strong leadership and is really more interested in encouraging the creation of new companies than to ease a capital inflow into existing ones, something that the Swedish legislator is a lot more concerned about due to the far more developed Swedish market.

Finally we concur that if ones intention is acquiring a controlling post and intend to be actively involved in the company business, then a Russian joint stock company is a lot more beneficial than its Swedish counterpart. On the other hand we believe that if one is only interested in becoming a minor stockholder with little interest in the actual dealings of the company then the Swedish legislation provides a lot safer conditions.

## **Purpose**

The main purpose of this report is to try to provide the reader with a better understanding of the Russian law by making an up-and-down comparison to its Swedish counterpart. This report is further written with the thought of being of interest to a wider audience; therefore we have chosen to write it in English.

Since a detailed collation in every legal field is probably far beyond the scope of any report, and definitely beyond this one, we feel that we have to focus our efforts on a limited part of the legal field, a part that we are genuinely interested in and at the same time could be of interest to a western reader, namely the Corporate Law. To further narrow the field down we chose to offer a more thorough analysis of the legal possibilities and problems that stockholders are confronted with when functioning within the framework of the Russian law. The main purpose of this report is therefore the narrow field of the litigious protection of stockholders.

We find the abovementioned subject to be of great interest especially now that a lot of European companies are discovering investment of capital in Russian markets as one of the attractive wealth growth alternatives and there seem to be a lot of unclear issues on this matter. Another reason we chose to concentrate on the litigious aspects of legal actions lies in the Russian business culture; or rather lack of any business culture. Russian entrepreneurs (an

overwhelming majority of them) seldom follow any kind of business code by reason of ubiquitously poor legal culture in the Russian Federation. This combined with ignorance of the law, distrust for the existing and often unstable law norms, general unwillingness to search for compromise and few and poorly developed dispute settlement instruments tends to result in that Russians tend to resolve the majority of legal conflicts by applying to judicial authorities.

## **Scope**

First of all we would like to make the reader alerted of the fact that we are not in any way claiming to give the full truth of the legal matters at hand. In the beginning we wanted to base this report on up to date court cases and practical information in order to more fully cover the different aspects of the chosen issue, but unfortunately during the process of information gathering we discovered that this approach was far beyond our capability due to a couple of unfortunate reasons:

If one would just make a brief search (maybe not so brief) on Russian court cases and opinions of scholars, concerning the matter at hand one would be likely to find tons of contradicting verdicts and beliefs to the ones that we are going to present in this report. The reason for this is very simple, during our stay in Russia and under the course of the information gathering we were shown the bitter reality that legal theory and practice are two very different things when it comes to the Russian legislation. While there exists differentiations between the two in most countries the gigantic misconduct between “how it should be” and “how it actually is” in Russia cannot be explained by any “normal” occurrence.

The actual reasons for the existing abnormalities are not going to be discussed here but once again we want to notify the reader that what we are going to give in this report is a view of how the law should be interpreted, even though it is not always how it is used in practice, where consideration of personal and political interest of Judges and the Russian state far outweighs the legal rights and obligation of the participants.

This report is therefore solemnly based on the books of widely known and accepted Russian legal experts and reports and only to some extent on the most relevant cases of the respective High Courts. It should also be noted that the experts that we have chosen to use as reference (in the Russian part) are considered to be very Western oriented and their view, while being one of the most influential at the highest levels, is far from accepted by the majority of Russian legal practitioners.

## **Delimitation**

We have chosen to enclose our report to the area of legal protection of stockholders. More accurate would probably be to say that the focus of this report is the legal protection of stockholders rights that can be achieved by a stockholder in a court of law, with emphasise on the minority stockholders. While we fully understand that in most cases the preferable and most effective solution to solve the coming issues lies outside the legal field (especially when

it comes to Russia), no alternative methods will be discussed, partly due to our own interest and mostly due to priorities.

Furthermore, while we realize that there exist a lot of regulations in many legislative acts that affects joint stock companies and their owners, we have chosen to concentrate (due to limitation in time and space) our efforts solely on the main legal acts. The acts in question are the Swedish Joint Stock Law and its equivalent, the Russian Civil Code and Joint Stock Law. The reason for including the Russian Civil Code is that the Russian Joint Stock Law is basically an extension of the former law and should therefore not be reviewed without the relevant chapters of the Civil Code.

Finally we are going to include a lot more background information in regards to the Russian legislation than its Swedish counterpart. The reason for this is that while we hope that this report will be of interest to variety of different readers, we have no illusion that the majority of those will be a lot more acquainted with the Swedish law than the Russia.

## **Question at issue**

Our main question at issue is:

**What kind of legal protection does the Russian and Swedish legislators empower their stockholders with in regard to protection of their stockholders rights?**

The stated question we expect to be able to cover in the theoretical part and will probably not be dwelled upon in the analytic section of the report simply due to the fact that we expect the answer to unfold during the presenting of the material. As a natural extension of the given question and also our second one is:

**How do the regulations differ from each other and what strengths and weaknesses do the systems have when compared to each other?**

Part of this we believe will also need very little explanation, the strengths and weaknesses will likely appear during the essay and we don't think that a reader will have any problems spotting them, hence only the most interesting occurrences will be covered in the analysis. After covering and presenting the different systems we would like to try and answer:

**What are the reasons for the (if any) differences between the two legislations and can one of them be said to offer a better protection to stockholders?**

In a time of globalisation and cross border investments, we feel that it is of paramount importance to single out the dangers that a possible investor will face when becoming a stockholder in a foreign company. Because of this the last question is also the one that we will emphasize mostly upon in the coming report.

## **Hypothesis**

At the time of writing, we strongly suspect the Russian legislation to give a much weaker protection than its Swedish counterpart. While we would be pleasantly surprised if our assumptions will be proven wrong, we feel that in the light of the great economical, ideological and political turmoil that the Russian Federation has witnessed during the moulding of the regulations in question, this will hardly be the case. More so we believe that not only will the regulation give a weaker protection it will also be a lot more open to abuse due to a combination of sparse and contradicting precedent law, a relatively young legal system and the absence of explanations from the legislator.

After saying that we also believe to find the Russian system a lot more flexible and better equipped to handle the rapid changes of the modern market. We suspect that this will be the case simply due to the abovementioned factors that must have forced the Russian legislation to be very adoptable in order to survive the turbulent changes.

Lastly we do think that the Russian law will also show itself as the more dynamic one due to its major inspirational sources and absence of a traditional view, which has let the Russian legislator to adopt the most beneficial parts of different legal traditions (most notably from the Commonwealth and Germanic legal traditions).

## **Part Two**

*The Swedish Legislation*

## The Swedish Joint Stock Legislation

The Swedish company legislation has recently (in the year of 2005) undergone some major changes, mostly brought on by the harmonization process of legal acts in the European Union. In order to improve the capital flow within the Union and to encourage the creation of multi-national corporation the Union has emphasized the necessity to harmonize the individual company legislations. The Harmonization has so far been going slowly, the great national interests at stake is making countries unwilling to compromise, but nevertheless considerable progress has been achieved. Progress that has resulted in, among other things, several Company related directives and regulations.

As a result of the above-mentioned European integration, Sweden passed a new Joint Stock Law in the year of 2005. While the new Joint Stock Law has not radically changed the prior legislation, it has brought a lot of clarity to previously gray areas and simplified the layout and text so that the legislation will (hopefully) become more accessible to a broader audience.

While the material changes in the legislation are relatively few there can be, among other things, seen strong attempts at strengthening the protection of stockholders from misconduct by the executive organs and the broadening of regulation concerning company reorganizations. These changes are direct results of the integration process and also heavily influenced by last year's worldwide scandals within well-known companies.

### *A Short Historical Overview*

The first Swedish company with limited responsibility is considered to be "Stora Kopparbergs Bergslag" but the company and its structure is generally considered to be an anomaly (from a historical perspective) and the ancestors of the modern joint stock company are therefore considered to be the Trading Companies.<sup>1</sup>

The first recognition in Sweden of owner's freedom from personal responsibilities, for their commercial activities, came in 1731 with the appearance of the East Indian Company, later followed by similar grand scale trading companies. The premises of these trading companies were a personal Charter issued to the company by the government. These Charters were individually tailored and they all had their own personal legislations. The relinquish of personal responsibility was not lightly seen by the Crown nor the Parliament and although the benefits were found to far outweigh the deterrents it took well over a century before a uniformed regulation was deemed necessary.<sup>2</sup>

The incursion and changes brought about by the Industrialization (most notably the rapid growth of large-scale industries that required huge capital investments and involved high risk taking) finally brought the government to pass the first Swedish joint stock legislation in the year of 1848 (entered into force in 1849).<sup>3</sup>

In the beginning the joint stock regulation (as it was named) was also based on the premises that in order for the Company owners to be freed from personal responsibilities they had to

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<sup>1</sup> Broberg, p. 62-63

<sup>2</sup> Sandeberg, p. 16

<sup>3</sup> Broberg, p. 83

get confirmation from the King, although later the Courts, out of economical necessity, started to accept companies that had not gotten any confirmation, purely on the base of custom law. The requirement of concession was therefore later removed with the creation of Joint Stock Law of 1895, which instead based the creation of the joint stock company upon registration and the creation of the articles of association.

The liberal legislation of 1895 gave immense freedom to the founders/ owners of the joint stock companies (after all this was during a period of great economical evolution and prosperity), a freedom that quickly came to be greatly curtailed. The first change came in 1910, when a new Joint Stock Law was passed because of a general discontent from the government about how easy the law of 1895 was to abuse for a “dishonest” owner. The law was quickly to become obsolete and was hence replaced by Joint Stock Law of 1944 (passed in the year of 1948).

The law of 1944, which can be said to be a result of the Great Stock Market Collapse in the 30es (Triggered by the bankruptcy and following suicide of Ivar Kreuger, the Swedish match King), which had a major impact on the economy. The legislation in the new law was even more restricted and accentuation was made upon the protection of the creditors with the amendment of anti fraud regulations.<sup>4</sup>

During the 60es there was an upheaval in the unification movement of the Nordic countries. As a result of various agreements and harmonization attempts, the Swedish parliament passed a new Joint Stock Law in 1975. The new law was aimed at removing the unnecessary bureaucracy and unwieldiness of the law of 1944, as well as strengthening the power of the board of directors.<sup>5</sup>

### ***The Current Legislation***

The main law regulating the Swedish Joint Stock Market at present date is Joint Stock Law (SFS nr: 2005:551) and was, as been mentioned earlier, passed in summer of 2005 (2005-06-16).

Unlike a lot of other Nordic and European countries, that have chosen to split its legislation in this area on various specialized regulations, Sweden has chosen to keep most of its regulation concerning joint stock companies in one law. There are of course several other regulations of major importance to the Joints stock legislation, both in correlating normative acts (such as Taxation regulations) and separate legislations (such as the Law on Investment Fund), but Joint Stock Law is the foundation and without any doubt the center around which the other regulations are all revolving around. Not surprisingly the law is a result of a mammoth of a project, consisting of 32 chapters and close to 800 paragraphs, which took almost 15 years to complete.<sup>6</sup>

While a close examination of the current Law falls way out of the scope of this report we feel that a presentation of at least the basic principles and governing regulation should not be entirely misplaced.

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<sup>4</sup> Ibid. p. 115

<sup>5</sup> Sandström, p. 50-54

<sup>6</sup> JSL 1:1, Sandberg p. 9

## *The Principles of Joint Stock Law*

Since the emphasize of this report is focused on a very narrow field of the law, we are only going to give a brief summary of the main traits and general build of the legislation, before engrossing in the main field of the study. In order to achieve this without going into any details we have chosen to only present the basic principles and legislative intentions of the law:

1. The Swedish Joint Stock Law is only applicable on Swedish joint stock companies. This so called **incorporation principle**, means that only a company that has been registered in Sweden, following the forms given in Joint Stock Law, is considered to fall under the Swedish legislation no matter where the actual operation of the corporation is transmigrated.<sup>7</sup>

2. While the point of no return for the creation of the company is considered being the signing of the constituent document the company becomes a juridical person and gains the covet subject of law first after **the registration** at the Swedish Companies Registration Office.<sup>8</sup>

3. The legislator has further deemed that in order to achieve a favorable market environment it is of vital importance to **protect minority stockholders and creditors** of the company, especially since it can be argued that almost all disputes concerning Joints Stock Legislation are sprung from this area. Regulations regarding protection of said persons can therefore be found in wide areas of the law and it should be noted that while the rights of minority stockholders can be voided by consensus the rights of creditors can under no circumstances be reduced by any decision made by the joint stock company regardless of circumstances.<sup>9</sup>

4. **The existence of a stock capital and its cover** is thee greatest protection for creditors and other concerned parties. The creation, maintenance and changes of the stock capital are therefore clearly regulated in the legislation and are binding for the company until its liquidation.

The company will further not be granted registration without the verification of that the stock capital has been fully covered. Furthermore a company that has reduced its stock capital below 50% is required to amend the deficit or be forced into liquidation, while any member of the main organs that knowingly aids the continuing of the business risk personal responsibility.<sup>10</sup>

5. **A strong belief in the need of active stockholders**, recent corporate scandals and studies (both within Sweden and abroad) have shown that a joint stock company benefits greatly (in terms of productivity and efficiency) from a strong leadership and involvement from the stockholders. In order to “encourage” the stockholders to participate a number of regulations have been added so that the owners (at least the majority owners) are forced to participate. As a result the stockholders meeting is forbidden to transfer its rights as the main decisive body of the company. Further there are strong regulations concerning the conducting of the stockholders meeting and a general indivisibility of a stock (the owner of the stock can not give up the right to vote and only in rare circumstances can he/she surrender the right to compensation.<sup>11</sup>

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<sup>7</sup> Sandström p.31

<sup>8</sup> JSL, 2:4, Prop. 2004/05:85 p.519

<sup>9</sup> Sandström p.17-18

<sup>10</sup> Ibid. p.25-26

<sup>11</sup> Ibid. p. 21

6. The legislation imposes a great importance of a **stated field of operation and general purpose** for the joint stock company. A joint stock company will be denied registration without submitting this information, further a decision taken against the field and or purpose can be appealed in the court of law and any transactions taken by the governing bodies of the company may be invalid and considered voided. While the actual rules concerning this issue are vague and quite hard to enforce the preventive protection that they offer cannot be overstressed.<sup>12</sup>

7. Since the security in **limited responsibility and obligations** for the companies undertaking is one of the greatest causes of popularity and success of the joint stock company, the legislation strictly regulates this issue. As a couple of examples can be named; the unconditional right (apart from some specific situations) of exit from the company (as long as someone is willing to buy the stocks), no coercion to contribute extra funds, very limited responsibility for the companies actions (only responsible for severe culpa) and that the owner only stands the risk for losing the contributed capital.<sup>13</sup>

8. Due to the attractiveness of the joint stock company among disreputable persons, mostly because of the limited personal responsibility the legislators have seen it forced to, more than in other forms of commerce to **limit the rights of the stockholders**. The regulations that reduce the stockholders rights are plentiful but the most important are the general ban of the stockholders (unless part of the concerned body) to participate in the daily administration of the company and the strict regulations concerning the distribution of the company profit.<sup>14</sup>

9. As a natural extension of the limited rights and obligations can be seen the demand of a **clear distribution of rights between governing bodies**. The Swedish Joint Stock Law is based on a monistic principle. The companies' main administrative body is the stockholders meeting, while the board of directors is the highest executive body. The MD (according to Swedish law there don't need to be one) is appointed by the board of directors and is responsible for the current management. The task of drawing a sharp line between powers assigned to these bodies can sometimes be difficult since their competence do frequently duplicate each other on legal grounds; the law however strictly prohibits the bodies' mutual interference with each other's area of exclusive competence.<sup>15</sup>

10. **The rule of equal treatment of the stock**, is yet another important principle. Under no circumstances is it allowed to mistreat one stock on the behalf of another (without consent), furthermore as a general strive to lessen the possibilities for mistreatment the law only accepts a one to ten differentiations in the voting strength of the stocks.<sup>16</sup>

Finally a word should be said about demand of **Publicity**, from Joint Stock Companies. The legislation demands the company to submit a lot of information to the Swedish Companies Registration Office. Information like the consistence of the board of directors, the actual stock capital, purpose of the company and a lot of other, in many cases delicate information has to be reported so that it can become fully accessible to the broader public.

The main reason for the publicity is to ease for the market participants and thus increase the capital flow on the Joint stock market, but the publicity also has great value in juridical disputes since information that has been publicized are given a rule of presumption.

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<sup>12</sup> Ibid. p. 19-20, 198-199

<sup>13</sup> JSL 1:3, 25:19. Prop. 2004/05:85 p.511, Prop. 2000/01:150 p.101

<sup>14</sup> Sandström p. 19, 21

<sup>15</sup> Ibid. p. 23-25

<sup>16</sup> Ibid. p. 22

## The Protection of Stockholders

While all regulations could be classified in a number of different ways we feel that for our purposes a fitting one would be to divide the coming regulations into two intervening parts; namely into a material and a litigious one. The material part consists of all the relevant regulation in regard to what is allowed and or prohibited by the provided set of rules. It is the behavioral guide and it provides the involved parties with the relevant information of what they are allowed to do and what they are prohibited from doing.

The litigious part differs from the material in that it does not provide the involved parties with any form of self-standing right or obligation. The litigious part is fully dependant on the existing of the material regulations since the material part answers the question how to behave, where as the litigious provides the answer to the question of what to do when someone has failed to behave in the correct manner.

By the above given definition, the vast majority of articles in the JSL contains material regulations, while only a handful are of a litigious type. The majority of the material are also relevant (in one way or another) in regard to the protection of stockholders; but if we were to name a few of the more important once it would be; the various voting quotes, the calling of the stockholders meeting and the competence/obligations of the various bodies of the company.<sup>17</sup>

The amount of relevant regulations is to say the lest formidable and since the main focus of this report is the one that we call the litigious part of the stockholders rights; the material part is only going to be briefly covered as a staging ground for the litigious protection with a few notable exceptions, given below.

First we feel that there are two major regulations that have to be given special attention due to their specific role within the Swedish JSL. The regulations in question are the fair play clause and the grounds for disqualification. The major difference and reason for the special attention is that these two norms are cross spanning and thus has to be taken into consideration when dealing with almost any type of material breach.

Secondly some of the regulations that we have chosen to portrait as litigious legislation are in fact a lot more likely to be perceived as material norms but due their vital importance from a stockholders perspective and that they do contain at least some litigious regulations we have chosen to cover them in the main part of this report.

The report is due to the above given grounds hence divided into the following parts:

- Jurisdiction and the Arbitrary Procedure
- Specifics Concerning the Material Protection
- Animadversion on Decisions Taken by the Company Bodies
- Liability of Damages
- The Possibility to Force Release/Expropriate Stock Owners
- The Company Liquidation
- Fusion and Fission
- Distribution of Profit

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<sup>17</sup>For examples see JSL 7:40-45, 8:4, 8:29, 9:3

The first two headlines deals with various issues of importance (some of which has already been mentioned). Of the remaining six all, except fusion/fissions of companies (which are included due to the increased dangers that the procedures brings from a stockholder perspective) reviews the actual litigious protections that a stockholder can use.

## ***Jurisdiction and the Arbitrary Procedure***

Before even embarking upon any actual regulation concerning the protection of stockholders we'd like to briefly mention the issue of jurisdiction and the Swedish Joint Stock Laws compatibility with alternative procedures (or rather the Arbitrary procedure).

### **The Jurisdiction**

Regarding the jurisdiction, as been stated elsewhere, we don't feel that this is much of an issue concerning the Swedish regulation so this will be a brief explanation indeed. If the company falls under the JSL<sup>18</sup> (the above mentioned incorporation principle) then:

- The General Courts will always handle any corporate dispute in regard to the JSL.
- The bringing of action should be done according to all the normal Swedish procedures and thus initiate at the corporate seat

One thing that can cause a problem is when the matter revolves/springs from a joint stock companies changing of nationality. According to the incorporation principle the moving of the corporate seat does not affect the nature of the company and hence the legislation of the country that it is registered in should be used. Moving between two countries that both apply the incorporation principle causes therefore no (or relatively few) problems. Complication arises when one of the involved countries uses the "seating principle". According to this view, the nationality depends on where the company has its seat and/or conduct its business, changing of country therefore also means a change of legislation. If a company moves its seat from a country that uses the incorporation principle to one that enforces the "seating principle", in case of a dispute then both countries legislation will be applicable and if the immigration occurs the other way around then none of the countries laws will be usable.<sup>19</sup>

Unfortunately there are no simple solutions to this problem. The decisions about which legislation that should be used by the national court will be decided by existing agreements (if such are present), the actual legislation that is in question (highly unlikely that any national court would accept a situation where the choosing of a foreign company form/legislation was made in order to evade the stricter national legislation) and various other considerations.<sup>20</sup>

### **The Arbitrary Procedure**

The JSL strives to provide the market with a modern and workable regulation but in an environment that demands fast settlements of disputes the ordinary court processes (which takes a long time and are open to the public) is far from idealistic. Therefore the Swedish JSL

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<sup>18</sup> JSL 1:2, Prop. 2004/05:85 p.510, Sandström p.31

<sup>19</sup> Sandström p.31

<sup>20</sup> Ibid. p. 31

gives the company (or rather the stockholders and founders) a wide possibility to regulate a possible dispute by ways of an arbitrary court, in some cases going so far as enforcing it. As an example arbitrators mainly settle the force release of stockholders.<sup>21</sup> Furthermore if in the founding document there has been added an arbitrary clause then:<sup>22</sup>

1. All actions that are amenable to out of court settlement will be bound by the arbitrary clause.
2. All stockholders will be bound by an eventual arbitrary settlement, not only the ones involved in the dispute.

Of special interest should be noted that according to the JSL 7:60 a public company should as a general rule stand for the costs of the arbitrary procedure, somewhat lessening the costs that the procedure would normally result in for a minor stockholder.

### ***Specifics Concerning the Material Protection***

Most of the protection regulations offered by the law confers an equal amount of rights to all stockholders, although a lot of the regulations are of little value to the ones in command (the majority owners), they are of paramount importance to the minority stockholders since they have less possibility to influence and thus are more likely to suffer potential abuse.

Therefore it should be noted that the main rule in the Swedish legislation is that the mechanisms protecting the minority stockholders are not applicable when:<sup>23</sup>

- There is only one stockholder in the company.
- All concerned stockholders have given their consent.
- The action in question has been clearly stated in the article of association (the stockholders knew the danger of investing in the company).

Unless otherwise stated all actions and regulations has to be taken in consideration with the following regulations in mind.

### **The “Fair Play” Regulations**

The principle of equality and the general clause are generally referred to as the rules of “fair play”. While the JSL gives the possibility to lessen the principle of equality in the articles of association and in some cases rejects it all together, it is nevertheless a mighty instrument. The focus of equality within the JSL is on the stock and the result of this regulation is that JSL prohibits special treatment of stocks, which leads to that it is not allowed to handle stocks of the same value (and in lot of cases all stocks) differently.<sup>24</sup>

It is though important to remember that only stocks are protected by the principle of equality, it is therefore fully legal for the company to make a decision that treats all stocks equal but

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<sup>21</sup> JSL 22:5, Prop. 2004/05:85 p.815

<sup>22</sup> JSL 7:54

<sup>23</sup> JSL 4:1-5, Prop. 2004/05:85 p 542-43

<sup>24</sup> JSL 4:1, Sandström p. 196

that in reality discriminates individual stockholders. So while the principle provides a strong protection it leaves a lot of possibilities for individual abuse.<sup>25</sup>

In order to prevent mistreatment of the above-mentioned type the legislation has a second set of protection in the form of the two general clauses (one regulating the executive bodies and the other for the stockholders meeting).<sup>26</sup> The general clauses forbid the taking/enforcing of a decision that gives an undue benefit to any stockholder or other subject. The general clauses are in reality a balance between the minorities need for actual equal treatment versus the need for effective company decisions (the company might benefit from unequal treatment of stockholders). The court will have to ask itself the question of whether the actual decision can be justified from a commercial point of view, comparing the possible benefits to the committed violations before reaching any type of verdict.<sup>27</sup>

## **Grounds of Disqualification**

Another major rule set that in no small part can be attributed to the protection of minority stockholders is the regulations that concern challengeable persons. The JSL in a number of cases strictly prohibits different subjects to participate in the taking of decisions or possessing certain posts. For example a stockholder is forbidden to participate in a voting at the stockholders meeting, when the issue is about a deal between the stockholder (or someone close) and the company. An auditor is forbidden to own stocks in the monitored company, etc. While the actual cases are many and varied, they all have in common the fact that they all target situations where the integrity and objectivity of the person in question usually is difficult to uphold, mostly because of too great personal interests at stake.<sup>28</sup>

## ***Animadversion on Decisions Taken by the Company Bodies***

As already been mentioned the possibility to animadvert is one of the most central protection mechanism given by the JSL. Being purely litigious regulations they are fully dependent upon other binding regulations in order to be applicable.

## **The Stockholders Meeting**

The stockholders meeting is, as been noted, the highest administrative body of the company to which all other organs owe their loyalty. The actual regulations concerning the stockholders meeting are very detailed and can be found in the 7th chapter of the JSL.<sup>29</sup>

Because of the power wielded by the stockholders meeting the central right that a stockholder has is the right to participate, be heard and vote at the stockholders meeting. Therefore we believe that the first step when looking at the protection of stockholders must be to cover the possibilities to animadvert upon errors in regard to said meeting.

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<sup>25</sup> JSL 4:1-2, Prop. 2004/05:85 p 543, Prop. 1975:103 p 311

<sup>26</sup> JSL 7:47, 8:41, Sandström s.197

<sup>27</sup> JSL 7:47, NJA 2000 p.404, NJA 1977 p. 393

<sup>28</sup> JSL 7:46, 8:23, 8:34, SOU 2001:1

<sup>29</sup> Sandeberg p. 131

## **The Circle of Plaintiffs and the Responder**

The responder, in any case concerning the animadversion of a stockholders meeting, will always be the company therefore there is no reason to dwell on this matter.<sup>30</sup>

The question of the plaintiff is a bit more complicated. JSL 7:50 is the paragraph regulating the right for animadverting. The actual circles of people that can animadvert upon the stockholders meeting and thus be a plaintiff in a case are:<sup>31</sup>

1. Any stockholder, even one with a single (and often largely insignificant) stock.
2. The board of directors, as an entity or an individual member.
3. The Managing Director.
4. A person that wrongfully has been denied by the board of directors to be entered in the stockholders' register.

No other than the above named subjects have the right to appeal before the court (not even company creditors). When it comes to stockholders, the actual regulation is of most importance to minority stockholders since the one who controls the company, and hence elects the board of directors seldom has any reason to fear a misconduct of the rules regarding the stockholders meeting.

Because of the major influence of a majority stockholder(s) it is a rare occurrence that the Board of directors or the MD voluntarily initiates a court case against a decision made on the stockholders meeting. In order to force the said organs in to actions against severe misconduct of stockholders the legislator has enforced a number of situations where they must take action<sup>32</sup>. There is no actual paragraph regulating all type of actions the organs have to animadvert upon but due to the strict requirement of equal treatment, active actions, and loyalty (a loyalty firstly to the enforcements of the law and then primarily to the company and not its stockholders) they must take action when decision that damage the company or miss credits some of its stockholders are taken, or face the risk of suffering personal responsibility.<sup>33</sup>

The fourth type of complainant is by far the least common of them all and generally this type of problems only arise when the old owners and or board of directors uses their influence to stall a "hostile" takeover by not registering a new owner so that the balance of power stays the same during a stockholders meeting.

## **The Actual Decisions That Can Be Animadverted Upon**

The first and easily overlooked fact is that only actual decisions taken by the stockholders meeting can be animadverted upon. Informal agreement between stockholders and other decisions that are taken under such forms that they cannot substitute a stockholders meeting cannot be targeted by the mentioned procedure. Furthermore in order to animadvert upon a decision, the actual decision must have one of the following flaws:<sup>34</sup>

1. The decision has not been taken in the proper order (error in form)

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<sup>30</sup> JSL 7:50, Sandström p. 189

<sup>31</sup> JSL 7:50, SOU 2001:1, 1975:103 p. 414

<sup>32</sup> Sandström p. 188

<sup>33</sup> JSL 8:4, Sandström p. 208-18, Sandeberg p. 90

<sup>34</sup> JSL 7:50, SOU 2001:1

2. The decision is invalid according to Joint Stock Law or The law on Annual Reports
3. The decision goes against the content of the article of association

There are no other legal grounds to animadvert upon the stockholders meeting although if the said decision has transgressed against other binding laws (such as labor law or criminal law) or regulations the decision is considered to be void on the ground that none of the organs have any right to regulate the current issue. In such a case it is thus technically not a matter of an animadversion but the end result is the same.<sup>35</sup>

1. When it comes to decision that has error in form it should be noted that minor mistakes or incoherence's are not enough to give grounds for animadversion. The court will have to make an assessment of the actual level of mistreatment that the decision has resulted in, which means that minor errors (for example an insignificant miscalculation of the votes) that could not affect the outcome of the stockholders meeting generally will be allowed.

A special problem concerning the assessment causes the failures of notice of attend to a stockholders meeting of a (or more) stockholder(s). The regulation is not fully clear on this point since if a failure in calling a single minority stockholder, (to a meeting on which the decisions were passed with overwhelming majority) would result in an invalidation of the decision seems fairly impractical. Especially when the decision will be passed anyway and the only actual result would be extra cost for the company and stockholders. On the other hand the stockholders meeting is the most important (in most cases only) arena where a minority stockholder can make his/hers voice heard and it can always be argued that had the stockholder been heard the actual decision might have had another outcome, a fact that must be taken in consideration when dealing with failure to call the stockholder in question. While no certainty exists in this question the most likely and logical course of action would still involve an assessment of the situation by the court with much higher demands on the respondent to convince the court that the error had no effect on the outcome.<sup>36</sup>

2. If the decision goes against the regulations of Joint Stock Law or The law on Annual Reports the decision will be nullified in case transgression can be established.

The burden of proof that an actual transgression has occurred lies naturally on the plaintiff. When the transgression is against a formal article or regulation the task at hand, in most cases, is not overwhelmingly difficult, while if the dispute is about a JSL principle or norm the plaintiff will have a much harder time. The problem for the court (or rather the plaintiff) is that it is not authorized to judge the rightfulness of a decision made by the stockholders meeting, the court can only try to derive if the decision is a direct violation of the law. The great influence of the business judgment rule<sup>37</sup> results in that the court will most likely not intervene unless the plaintiff can prove that the given action has the effect of giving special treatment to some (or one) of the other stockholders (or an affiliated person) and even then only if that the special treatment is uncalled for.<sup>38</sup>

3. Most of what have been said about transgression of legal acts holds true of the matter concerning transgressions of the article of association. The difference is that proving that a transgression has taken place is even more complicated. Considering the necessity of great

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<sup>35</sup> Sandström, p. 188-89

<sup>36</sup> JSL 7:51, where the period of limitation for failing to call a stockholder to a stockholders meeting is a lot less strict than for, in the eyes of the legislator, a lesser transgression. Sandström p.188-89, Prop 2004/05:85 p. 613

<sup>37</sup> Sandström p. 190

<sup>38</sup> NJA 1977 p. 393

flexibility in the economical sector and the fact that all the information in the article of association is officially available, the increased problematic is that the article of association usually is a fairly vaguely composed document. The vague formulation and the wide scope of rights for the company to govern itself leaves great interpretational possibilities, possibilities that usually put the plaintiff at a severe disadvantage.

As an example, according to the JSL, the company must follow the above-mentioned field of operation and general purpose. While failure to do so can result in animadversions of decisions and liability for responsible persons it is widely known and accepted that a large company usually runs lots of other operations besides the stated ones and even if they do contain their main actions within the stated field of operation the company is still faced with daily decisions that does not involve their field of operation. Therefore a stockholder that tries to animadvert upon a decision based on that it falls beyond the field of operation will most likely be faced with an uphill struggle unless the misdemeanor is obvious.<sup>39</sup>

As a final word about the possibilities to animadvert upon the stockholders meeting it should be said that this is a possibility that, due to the need for elasticity and flexibility of the market economy and the societies demand for economical freedom and thus the right to manage its own affairs, is not taken lightly by the courts. As a rule of thumb it can be said that no court will pass a judgment against a company unless the plaintiff has proven that the company not only has violated his/ hers rights but that the transgression has been obvious and burdened with dire consequences.

### **The Results of the Animadversion**

If a stockholders meeting decision is found to violate the above-mentioned regulations the court will annul the wrongfully made decision.<sup>40</sup> The court has the right to change an annulled decision in to another one, but only if it is clear what the wording of the real decision should have been. Since its not in the power nor interest of the court to investigate in the commercial and/or financial dealings of a company the possibility to change a taken decision is only used if there can be no doubt of what the right decision would have resulted in (for example a miscount in votes regarding a yes or no decision, or any other instance where there are clearly defined propositions).<sup>41</sup>

The nullification of a decision is considered to be in effect from the moment of approval of the animadverted decision and as a main rule the ruling is considered to have a retroactive effect, back to the moment of the passing of the decision, unless the animadversion concerns the election of the board of directors. The animadversion concerning the appointment of the board of directors usually only affects the time from the ruling of the court (mainly due to the horrendous effects the invalidation of all actions taken by a board of directors may have on the company and its counterparts) unless the ground for animadversion is based on one of the voided grounds mentioned above, in which case the violation is considered so serious as to justify a retroactive nullification.<sup>42</sup>

While the main rule is that all actions based on the annulled decision are to be stopped and all activities that have sprung from it are to be reversed (the status of the company shall return to as closely as possible to the time prior to passing of the decision), this in fact often shows to

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<sup>39</sup> NJA 1987 p. 394

<sup>40</sup> 7:52 JSL

<sup>41</sup> NJA 1960 p. 705, Sandström p.192

<sup>42</sup> Sandström p. 192

be unfeasible. The reasons for actual irreversibility are too many (if at all possible) to compile, since it could be anything from the destruction of an irreplaceable object (due to uniqueness or cost) to an acquisition made in good faith, but for this report the actual reasons are of much lesser importance than the end result, which is the failure of the animadversion.

In fact, the delay, brought about by the courts handling of the case on damage, conveyed by a wrongful decision, may in many cases cause the very same damage to grow irreparable. Destruction of property or the regulations concerning good faith may obstruct the possibilities to reverse the transaction. Possibilities to hold responsible the liable persons may fail to stay maintained (either due to lack of means or have simply vanished). Most animadversions are therefore combined with a motion for sequestration (the legal seizure of property for security), thus insuring that no harm will be done.<sup>43</sup>

The sequestration can be combined with other security measures<sup>44</sup> but it should be noted that in order for the court to approve of any measures it is necessary for the plaintiff to show that:

1. That there is a probable causes for the existence of a claim that can be settled by the court
2. And that there exists a reasonable danger for that the respondent will come to in some way endanger the possibility of remediation.

The court should normally grant a sequestration only if the plaintiff provides an adequate security (for the damage that the procedure might cause the respondent) and only after that the respondent (or the representative) have gotten to voice his/hers opinion, although in some cases (most notably cases against various governmental bodies) these requirements can be voided by the court.<sup>45</sup>

## **The Period of Limitation**

Due to the need for commercial security and the great problems and cost of revoking a decision taken on a Stockholders meeting years ago, the JSL put severe limitations on the general Swedish period of limitation of 10 years. The main rule is that a Stockholders meeting becomes impossible to animadvert upon after a period of three months since the actual meeting, unless the animadverted decision is one of the following three (sc Voided grounds):<sup>46</sup>

1. The made decision could not been taken even with the unanimous approval of all the stockholders.
2. The decision could only been taken with the approval of all stockholders and such approval has not been given.
3. The notice to attend was done with essential errors or not done at all.

For the special cases in 1-3, the legislator has not given any time frame during which time the disputed decision can be animadverted upon. This could lead the reader to believe that no time limit exists, which is not entirely true, since the economical demands of market stability far surpass an individual right for protection. This leads to the probability that a court in such instance will be using the principles of passivity and contributory (if the stockholder has not

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<sup>43</sup> Processual Code 15:1-3, Sandström p. 193, Ekelöf p. 10-11

<sup>44</sup> For example under penalty of a fine, see Process Code 17:3

<sup>45</sup> Process Code 15:5-6, Ekelöf p. 12-13

<sup>46</sup> JSL 7:51, 2004/05:85 p. 613

acted within reasonable time and did not have an excusable reason for a delay, the chances for an animadversion will be slim) resulting in a balancing between the stockholders right of juridical protection (depending on the seriousness of offence) and the actual damage that the animadversion might result in.<sup>47</sup>

Considering the regulations given in 1-3, there are special regulations given for fusions and fissions of companies. In such instances the maximal timeframe of appeal is set to six months no matter what, mostly due to the humongous costs and inconveniences that revoking such enterprises results in.<sup>48</sup>

## **Specifics of Annulment of Decisions Taken by the Executive Organs**

A decision/action made by the board of directors or any other executive body of the company is also subject to animadversion by a disgruntled stockholder. The regulation has a similar build as the general regulation concerning legitimacy/ competence. The practical application resembles (both in form and result) the animadversion of a stockholders meeting. Due to the above mentioned grounds and the fact that the possibility to animadvert on said decision belongs to the majority of the stockholders we are only going to cover the basic build and the major specifics.

The starting point is the general competence of the executive body as defined in chapter 8 of the JSL. Any action taken by the executive bodies (mainly the board of directors) that goes against/ is outside the bodies' legitimacy is considered to be non-binding towards the company. The most important result of this is that serious violation from executive organs of the exclusive rights (decision of liquidations, amendments to the charter of association etc.) that befalls the competence of the stockholders meeting is to be considered voided.<sup>49</sup>

If the MD does the legitimacy violation or the question is about the overstepping of the bodies competence then the company is only considered to be free from any commitment if it can make it probable that the counterpart was (or should have realized that they were) in ill faith.<sup>50</sup>

Even if the counterpart is found not to be in good faith the company will still be bound to the action in question if the action has been carried out by either the MD or the board of directors and the action is only a violation of regulations concerning the stated field of operation or other regulations given in the articles of association or by other bodies of the company.<sup>51</sup>

Because of restraints enforced by the legislator the major applicability of the regulation is when the actual breach is against legal regulations. The most obvious has to be the restrictions defined by the general clause and the regulations concerning the disqualification grounds of the JSL.<sup>52</sup> The reason for the extra severity that the company faces, compared to other subjects of law, mainly depends on two factors. The first is the general belief (imbued in the JSL) that the stockholders should be responsible for their choice of executive personnel and the second is the major integration process within the EU.

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<sup>47</sup> Sandström p. 191

<sup>48</sup> JSL 7:51, 2004/05:85 p. 613

<sup>49</sup> JSL 8:42, Svensson p. 101, Sandström p. 235

<sup>50</sup> JSL 8:42

<sup>51</sup> JSL 8:42, Svensson p. 100, Sandström p. 230

<sup>52</sup> Svensson p. 101

## ***Liability of Damages***

Is the second litigious tool given to the wronged subject that enables them to ensure compensation in cases where:

1. An animadversion cannot be achieved due to earlier mentioned reasons.
2. The animadversion is not enough to achieve full compensation in the matter at hand.

## **The Plaintiff**

The main plaintiff according to the JSL 29:1 is the joint stock company. This obviously coincide with the fact that the company is not a sentinel being and thus all actions taken in the name of the company are executed and initiated by an actual person whose actions might harm the company. The second part of that paragraph increases the circle of plaintiffs to any person that has suffered damages that are covered by the law (more on this in a moment). While the circle of plaintiffs is an open one, we are going to concentrate on the four most common groups.

- The company (represented by the board of directors or the stockholders)
- Stockholders (or would be stockholders)
- Creditors (essentially anyone with a contractual claim)
- The bankruptcy trustee (as head of the bankruptcy capital)

The most preferable solution for all parties (from a legislative point of view) is if the company would be considered the plaintiff. If the company (as the prime subject of damages) is restored to its initial status then there will be no shifting in balance between the interested parties (mainly creditors and stockholders) contrary to the situation where all concerned parties would have to fail separate cases and vail for the possible compensation.

In light of the above reasoning it's not surprising that the JSL grants the greatest possibilities of claiming liability to the company and only secondary rights to all other parties. As an example of this can be shown the fact that under no circumstances can stockholder claim damages (although there are changes in progress<sup>53</sup>) against the company within the frame of the stockholders stock possession (mostly in order to strengthen creditors in case of bankruptcy and prevent capital outflow to the stockholders). This leads to an absolute impossibility of claiming liability for a stockholder and the company at the same time. Since the company has precedence when it comes to a damage claim the general rule is that if internal and external damages coincide (which is often the case, since a damage to the company often leads to decreased stock value) the internal one takes presidency.<sup>54</sup>

Generally the board of directors will be tasked (they are directly responsible for representing the company in a court of law) with such claims but in order for the company to be able to claim the damages it is necessary for the stockholders to make a formal decision on a stockholders meeting. If the case is about the responsibility of the board or MD then the actual decision that has to be taken is weather to give the named bodies freedom from liability (this is a mandatory issue that has to be accessed on the annual meeting).<sup>55</sup>

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<sup>53</sup> SOU 2005:18

<sup>54</sup> NJA 1935 p.270

<sup>55</sup> Sandberg p.253-54

Since the actual chance that a majority stockholder (who has appointed the board) will not grant freedom from responsibility and or / vote for a damage claim for an action that he's the benefactor of is minimal, the JSL grant a minority of stockholders with more than 10% of the stocks to despite the decision of the stockholders meeting to claim damages in the name of the company.<sup>56</sup> If the minority chooses to file a case, they will do so in their own name (and not in the companies) and stand for all the legal costs, although if the case is successful they have the right for compensation from the company, up to the amount that the company has benefited from the case.<sup>57</sup>

A stockholder can as a general rule only claim liability from direct damages towards the stockholder caused by the bodies and only in extreme circumstances (such as the minority owner having no possibility to force the company to act due to lacking the needed 10% of the stocks) have the right to damages caused by a direct damage to the company. A stockholder can therefore only claim liability (due to above mentioned reasons) for indirect actions spawned by the disregard of the general clausal or the principle of equality.<sup>58</sup>

While the creditors have the right to file a liability claim the bodies are only responsible towards the creditors for economical damages caused by inappropriate handling of regulations concerning the stock capital and its cover, hence it is not possible for a creditor to claim liability for general misdemeanor unless the company is left in such a position that leaves the company insolvent or close to the bring of bankruptcy.<sup>59</sup>

The Swedish Supreme Court has further, on a number of occasions, made it perfectly clear that not only is the responsibility to be limited to the existence and cover of the stock capital, but also that the actual evaluation should be base upon the auditoria account, which gives the bodies and stockholders grate benefits on behalf of the creditors.<sup>60</sup>

The last (but far from least important) of the main plaintiffs is the bankruptcy trustee as head of the bankruptcy estate. According to the JSL 29:14 the bankruptcy estate ascends the same rights as the other plaintiffs has according to JSL 29:1-3. While they do have the same right and responsibilities as other plaintiffs it should be noted that the Swedish regulations concerning bankruptcy greatly widens the trustees possibilities to receive compensation in a much more effective manner, resulting in the likeness of such cases being handled outside the boundaries of the JSL.

## **The Respondents and Their Liability**

When dealing with liability of the company bodies there is a need to divide the area of responsibility between the internal and external one. The internal responsibility concerns the bodies' responsibility towards the company, while the external applies to everyone else.

The internal liability according to the JSL is based on the premises that the bodies have an unconditional (unless binding legislative directives) duty of loyalty towards the company (the boards loyalty lies with the company and not its individual stockholders or other interested parties), therefore any action/ non-action that directly or indirectly damages the company is subjected to potential liability. The bodies are generally not responsible for misfortunate

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<sup>56</sup> NJA 2002 p. 446

<sup>57</sup> JSL 29:9, Prop. 1975:103 p. 546

<sup>58</sup> NJA 2002 p.404

<sup>59</sup> NJA 1979 p.157, NJA 1996 p.224

<sup>60</sup> NJA 1995 p.742

economical decisions, even so, they will be held responsible for actions of negligence; in breach of the JSL or other law (there is a presumption of negligence in that case), failure to follow the guidelines of the constituting document or falling short of fulfilling their duty.<sup>61</sup>

The traditional Swedish view of the external responsibility for damages is that only pure capital damages can form grounds for liability and if the damages are not caused in a contractual relationship then the act must be a criminal one. The JSL widens this responsibility to fully cover non-contractual relations (mainly to give a greater protection to involved parties) and the Swedish Supreme court has widen this further by allowing liability claims even when the damage is not a direct one, enabling for example a creditor to file a liability claim for endangering the companies possibilities to fulfill its obligations.<sup>62</sup>

Further in order for external responsibility to become a reality it is not enough with just negligence there has to be deviation from standard of the kind as given in JSL 29 1-3, there has to be a precise action that resulted in the damage.

It should be noted that the regulations in the JSL are only applicable with regard to the abuse of the company by its legal organs. The company is a juridical subject and as such has most of the rights and obligation of other subjects in the society, thus the majority of other regulations (in this case damages regulation) that affect the company can be found outside the JSL.<sup>63</sup>

Depending on what type of actions fore came the liability suit the respondent will therefore be one (or some) of the following:

1. The MD, the board of directors or the founders of the company
2. The minority accountant, auditor and special reviewer
3. Individual stockholders

Although all the named persons have different liability and grounds for responsibility the law divides them in the mentioned categories, based on the level of general responsibility each group has been assigned. It should also be noted that the members of the bodies are considered responsible for actions (and thus liable) upon their registration at the Companies Registration Office and remain so until their removal from the registry.

**1.** The MD, the board of directors or the founders of the company are all responsible for actions based upon intent or negligence. Of special importance it should be noted that not only actual actions can warrant liability but also the failure to act can and does substitute a liability claim. The responsibility of the named organs/persons is confined to their sphere of activities and they're given competences although as usual any sharp line, beyond those given in the actual legislation, is hard to draw due to the overlapping competences.<sup>64</sup>

**The Founders** are only responsible for inconsistencies during the creation of the company (i.e. faults concerning the constituent document) like failure to properly provide the stock capital.

**The board of directors** on the other hand is the main administrative body of the company and as such its responsibility is a lot wider. The responsibility is in many ways guided by the constituent document and therefore has to be diverted from the actual circumstances. When

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<sup>61</sup> Svensson p. 230

<sup>62</sup> Ibid p. 232, Liability Law 2:2

<sup>63</sup> JSL 29 1-3 Sandström p. 381- 383, SOU 2001:1

<sup>64</sup> JSL 29:1, 8:41. SOU 2001:1, Sandberg p. 252

it comes to the actual respondent the general rule is (due to that unless otherwise specified, all decisions are taken by a majority vote) that the members of the board answer for any damages in unison, but each member is only liable for the actual culpa. Thus an individual member that can prove that he/she had nothing to do (and could not have prevented) the caused damage will not have to face responsibility. The court will also take into consideration the competence of the member, his/hers active role in the taken decision and other palliative circumstances, resulting in the possibility to accommodate the claim of damages on the specific member. The individual members have the burden of proof in the above-mentioned matter.<sup>65</sup>

The boards' responsibility cannot be excluded by the fact that the actual decision was taken by the stockholders meeting, although a stockholder cannot (due to contributory) succeed with enforcing liability for an action that was made with the stockholders own consent. Finally it should also be noted that the board of directors are fully responsible for not only their own actions but also for any delegation of authority that they might have done, resulting in that they will be held accountable for any faults that falls under their exclusive competence.<sup>66</sup>

**The MD** responsibility is basically the same as the board of directors with the greatest difference lying in different areas of competence (and hence responsibility) and the increased risk of answering for failure to act. This of course coincides with the more active role that the MD occupies compared to the board of directors. Another difference is that the MD, during normal circumstances, only answers for his/hers own actions and not for any delegated ones.<sup>67</sup>

**2. A minority accountant, auditor and a special reviewer** all stock the same responsibility. They answer on the same ground as the main organs but with the limitation to their actual assignment, where the damage estimation is based on how much their failure to report the misdemeanor has actually cost the company. They are also responsible for damages done by any of their helpers.

Further they have a limited responsibility towards issues concerning money laundry (due to the complicated matter of such crimes) and if the auditor or special reviewer is part of a registered auditory company then the company and not the actual auditor will answer for the caused damages.<sup>68</sup>

**3. An individual stockholder** or group of stockholders answers only for liability caused upon intent or severe negligence. This greater protection springs partly from the principles of limited responsibilities but is also due to the fact that the stockholders have (normally) a much lesser influence and insight in the daily business of the company, compared to the above-mentioned persons.

A stockholder can only be responsible for an action that they have played an active part in, meaning that they will only ever face damages if they voted in a manner that contradicted the mentioned regulations or the Joint Stock Law. Due to the nature of this rule, it is primary useful as a protection from abuse caused by majority stockholders, since the minority stockholder can rarely muster enough influence to trigger this regulation.<sup>69</sup>

A special form of liability, although it is highly unlikely to occur, that deserves to be mentioned is the "lifting the corporate veil". Since the Swedish legislation does not define this

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<sup>65</sup> NJA 2004 p.3, NJA 1936 p. 78

<sup>66</sup> JSL 8:4, Prop 2000/01:150 p 82, 185. Prop 2004/05:85 p. 617

<sup>67</sup> JSL 8:4, 8:29 compared to 29:1

<sup>68</sup> Prop. 1997/98:99 p. 286-89

<sup>69</sup> JSL 29:3 p. Prop. 1997/98:99 p. 287

possibility nor even imply that it exists and there are extremely few cases on the subject we feel it is sufficient to say that under extreme circumstances the stockholders (or the person(s) that is deemed to be the actual principal(s)) may have to answer for any liability that the company has contracted. The actual situations where this might become a reality is where the form of the joint stock company is severely abused and the actions results in undue gains for the involved persons.<sup>70</sup>

### **The Extend of the Liability**

In an ideal world the result of the liability claim would be that the suffering party would be fully compensated for the caused damage. Unfortunately this is rarely the case since the majority of liability claims are of such magnitude and under such circumstances that the responsible person will not be able to offer full compensation. The reasons may be different but can range from anything to bankruptcy to the impossibility of valuing/ replacing the damage/ object.

In order to avoid such situations the majority of Swedish public (and some private) Joint Stock Companies have made a habit of insuring their executive bodies from malpractice with the company as the benefactor. This coupled with that in a lot of instances there is a legislative requirement of having such insurance, provides the company with a much higher chance of achieving retribution.

### **The Period of Limitation**

As always (when concerning the JSL) the period of limitation is limited comparing to general Swedish law. The law states that liability claims against the company MD or the board of directors has to be filed within a year from the presenting of the annual report on the stockholders meeting. While the mentioned period is the main rule, during specific circumstances the actual time limit is prolonged, mainly in case of wrongful actions from the governing bodies.<sup>71</sup> It should though be noted that unless the liability claim is based upon criminal actions the JSL provides a maximal timeframe for the possibility of liability.<sup>72</sup>

The periods are:

- Five years for MD and members of the board, counting from the ending of the accounting-year when the actual action was taken.
- A minority accountant, auditor and a special reviewer are no longer responsible when five years have passed since the ending of the accounting year that concerns the intended accountant-report.
- The founders' stops having any responsibility after five years from the creation (registration) of the company
- Individual stockholders only answers for two years from the actual decision and/or action.

As noted elsewhere the bankruptcy estate has the same rights and responsibilities as other plaintiffs but due to the nature of a bankruptcy the bankruptcy estate is only bound by the

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<sup>70</sup> Sandström p. 202-03, 392-93

<sup>71</sup> For actual reference of situations that grants prolonged the period of limitation se JSL 29:11

<sup>72</sup> JSL 29:10-3, SOU 2001:1

limitation given in JSL 29:11 (and thus not 29: 7-10) with the exception that it must file the claim no less than six months after that the bankruptcy trustee has been sworn in.<sup>73</sup>

### ***The Possibility to Force Release/Expropriate Stock Owners***

The possibility to force release/expropriate stockholders is the third litigious tool that under certain circumstance can be used as a way to protect a stockholders interest. Unlike the liability claim and possibility to animadvert the current regulation is something of a dual edged sword. It gives a hard-pressed stockholder a last resort way to exit but at the same time it also provides the majority stockholder with the power to get rid of unwanted interferences.

Due to the nature of the joint stock company and the strong belief in a free circulation of the stock, any regulations concerning expropriation or release of stockholders have to be handled delicately. On one hand the legislator wants to give a minority the possibility to force a disloyal majority owner to buy them out (the minority protection aspect) and on the other hand a majority owner is given the right to expropriate an obstinate minority (the strong stockholders aspect). The actual regulation can be found in JSL 22:1, 25:21-23 and 29:4, spilling out as following:

If a stockholder is in control of more than 90% of all the actual stocks, either by direct owning or indirectly through subsidiaries, that stockholder has an undisputable right to force an expropriation of the rest of the existing stocks. At the same time the minority stockholders can, in the abovementioned situation, force a realisation of their stocks.<sup>74</sup> Furthermore the given rights are individual, resulting in that the majority stockholder can direct the expropriation claims against some stockholders and let the others be.<sup>75</sup>

These rights and obligations are by its nature absolute. They can therefore not be encroached or widened by the articles of association or any other agreement.<sup>76</sup>

The next set of regulation concerns the situation when a majority stockholder severely abuses its power, giving the minority the right to file for liquidation of the company.<sup>77</sup> In order for the minority to be have any success of succeeding with such a claim the following six circumstances has to be present:

1. A majority stockholder must have (severely) abused its power.
2. The abuse must have been intentional, possibly studied but under no circumstance is it enough with culpa.
3. The action in question must have been in violation of either the JSL, the Law on Annual Reports or a direct violation of the articles of association.
4. The owners of at least 10% of the existing stocks must initiate the law case.
5. There has to be special (onerous) reasons present in order for the court to rule in favour of liquidation.

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<sup>73</sup> JSL 29:14, Prop 1997/98:99 p. 291

<sup>74</sup> In the old legislation there used to be an uncertainty whether the expropriation had to be aborted if the majority stockholder no longer had the necessary percentage for the expropriation due to the minority getting new stocks due to for example unused right of converting. The new JSL has amended this uncertainty by forbidding the use of options and convertibles during the procedure. Se JSL 26:2, Sandström p. 350.

<sup>75</sup> Prop 2004/05:85 p. 809-11

<sup>76</sup> Prop 2004/05:85 p. 809

<sup>77</sup> Prop 2000/01:150 p. 120

The extreme difficulty that faces anyone who would want to utilize this procedure coincides with the severity that liquidation could (and normally will) have towards employees, creditors and other interested parties. This is further emphasized by the fact that the company can request, when faced with the danger of liquidation, to be allowed to expropriate the minority stocks. A request that will generally be seen as more favourable than a liquidation, especially since the court is required to take special considerations toward the interest of the companies employees and creditors.<sup>78</sup>

The liquidation procedure should therefore be seen as a last resort, utilized only in extreme cases of negligence, oppression and border on criminal actions. This is also the reason why we choose to place this regulations under realisation options instead of the company liquidation, since the greatest (although still very rare) use of this regulations will result in the majority expropriating the minority's stocks.<sup>79</sup>

### ***Fusion and Fission***

The secession/merging of a company has little relevance from a litigious point of view when discussing the protection of minority stockholders. Still we have chosen to discuss it under a separate heading in the litigious part because of one important reason. The reason is that the procedures are some of the most dangerous and exposed situations from a minority owner's point of view (due to the vulnerable nature that this procedure creates) and if neglected makes a mockery of the security regulations discussed under the force release/expropriate heading.

Fusions and Fissions of Joint Stock Companies have traditionally, according to Swedish regulations, only been possible by the transferring of the tangible assets. Due to the harmonisation process within Europe, the new Swedish JSL has given birth to the possibilities to reorganize companies without having to resort to regulation outside of the JSL. The regulations that are based on a number of EC directives, concerning the merger had already been incorporated in the JSL of 1944 while the procedure of Succession is a novelty introduced with the JSL of 2005.<sup>80</sup>

### **The Merger**

Merger while not being technically a form of company liquidation shares a lot of similar traits and therefore is an issue of vital importance with regard to protection of stockholders. While it is fully possible to merge two companies within the frame of the JSL, simply by one companies acquisition of all of the other companies' stocks and then liquidation of the brought company, the merging procedures provides stock companies with a much more efficient and often less time consuming way.<sup>81</sup>

The merging procedure can only be applied on companies that fall under the JSL regulation and hence for example foreign stock companies cannot be merged on these grounds.<sup>82</sup> Due to the often long and complicated procedure that a merging involves, the legislation places as a

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<sup>78</sup> The only time when the court is forbidden to allow an expropriation of this kind is if the companies own capital would descend below half the stock capital, JSL 25:2.

<sup>79</sup> Sandström p. 202-204

<sup>80</sup> Ibid. p. 337, 346

<sup>81</sup> Svensson p. 186

<sup>82</sup> Although this might change due to coming harmonisations, Sandström p. 335-36

clear legal point of a successful merging in the registration. This results in that the dissolving of the other company, the possession of assets/ debts and all other happenings are considered to transpire at the moment of registration of the merging regardless of the actual time frame.<sup>83</sup>

The Swedish JSL acknowledges only two forms of merging, namely absorption and combination. In absorption one company will devour one or more of the other companies while in a combination the merging companies will all be extinguished into a newly formed company. In both cases one or more of the involved companies' sizes to exist as the JSL strictly prohibits partial absorptions.<sup>84</sup>

In order for a merger to take place the decision of merger shall be taken on the stockholders meetings at all the involved companies although the board of directors of the acquiring company can take the decision themselves, unless at least 5% of the stockholders demands otherwise. In order for the stockholders to be able to make such an important decision the board of directors has to present a Merger Plan to the stockholders at the stockholders meeting (the Merger Plan is regulated by the JSL and should include all relevant information such as an accountant report, account documents, statement from the board of directors etc).<sup>85</sup> The decision to merge has to be passed by a 2/3 majority of votes at the meeting.<sup>86</sup> If the company uses different stock types, the above-mentioned requirement has to be achieved within each of the different types.<sup>87</sup>

The much greater freedom given to the board of the acquiring company has to do with the lesser impact that the merger will have on the said company, especially as it could be argued that the actual effect on the stockholders in many instances will be marginal since the acquisition of a company doesn't necessary have to affect the company more than a regular business deal.<sup>88</sup>

After the approval the transferring company must give note to all its known creditors about the intended merger. The acquiring company does not have to notify its creditors if the accountants report states that the merger does not present any danger to the acquiring company's creditors.<sup>89</sup>

The final stage of the merger is the application for registration at the Swedish Companies Registration Office. The registration office will reject such application if one of the following reasons is at hand.<sup>90</sup>

1. The fusion plan has not been approved in the right order and or goes against other legal regulations or the constituent document.
2. The fusion violation anti-trust legislations.
3. In a combination the real value (according to the accountant report) of the merging companies is not enough to cover the stock capital.

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<sup>83</sup> Svensson p. 187

<sup>84</sup> JSL 23:1, Prop. 2004/05:85 p. 832

<sup>85</sup> JSL 23:7,

<sup>86</sup> JSL 23:15. Special consideration should be given the last paragraph of the article, where there is no need for any stockholders meeting if the merging is between private joint stock companies and all the owners have signed the merging agreement. Prop. 2004/05:85 p. 839

<sup>87</sup> JSL 23:17, Prop. 2004/05:85 p. 840

<sup>88</sup> Sandeberg p. 232

<sup>89</sup> JSL 23:19

<sup>90</sup> JSL 23:21, Prop. 2004/05:85 p. 842

If the Registration Office finds no ground to dismiss the request it will call the companies creditors. The acquiring companies creditors shall not be called if the accountants report, as above, states that the merger does not present any danger to the acquiring company's creditors or the creditors are given special security according to the law on Salary Guaranties.<sup>91</sup> If none of the called creditors objects to the merger the registration office gives the companies permission to initiate the merger and if anyone objects then the issue will be surrendered to the district court. The court will deny the registration unless the creditor has been given full payment or the company has provided the creditor with sufficient security. With the registration the dissolving company size to exist and the acquiring "inherits" all its debts and assets.<sup>92</sup>

While the main procedure gives the creditors considerable protection the legislation gives the ex stockholders surprisingly little. While the JSL does regulate the compensation (the merging pay) that has to be given by:<sup>93</sup>

1. Stating that the merging pay can only be given in money or newly emitted stocks in the new company.
2. Banning merging of companies that uses different account currency.
3. Enforcing equal calculation of compensation for all stocks of a given category.

It fully neglects the issue of how the evaluation of the stock shall be accomplished. Where the JSL clearly regulates the compensation when the matter concerns expropriation the merging procedure lacks all such regulations resulting in that the procedure is open for misuse from a disloyal majority stockholder. This lack of regulation is really surprising considered that a majority stockholder of 2/3 of the stocks can force a merging with a wholly owned company and in this way force a buyout of the other stockholders without having to abide the strict regulation that the more rigid expropriation regulation provides.<sup>94</sup> This inconsistent was brought up during the passing of the law and while the Cabinet has promised to address the matter, the present regulation can easily be abused.<sup>95</sup>

Lastly it should be noted that the mostly used procedure of merging is the merging of subsidiaries with its parent company. Since such mergers have no or at least minimal) stockholder conflicts and the creditor protection is the same as above-mentioned we do not feel the necessity of discussing the matter any further.

## **The Secessions**

According to the JSL secession can be done in one of two ways:<sup>96</sup>

1. Full Secession, where two or more companies will acquire all the former company's debts and assets. The giving up company seizes to exist without any liquidation at the end of the procedure.

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<sup>91</sup> JSL 23:22, Prop. 1993/94:196 p.191-92

<sup>92</sup> JSL 23:23-26, Sandeberg p. 232, Sandström, p. 344-45

<sup>93</sup> JSL 23:2, Sandström s. 339-42

<sup>94</sup> The majority requirement can in certain circumstances be even greater, one such instance is when the matter is about changing from a public to a private stock company where a majority of 90% is required, JSL 23:17, Sandström p. 341.

<sup>95</sup> Svensson p. 138

<sup>96</sup> JSL 24:1, Sandström p. 346

2. Partial Secession, where only some of the company's assets and debts are transferred and all companies will continue their existence.

The actual procedure of succession closely mimics the regulation concerning the merger and therefore we will only concentrate on the major differences. While small differentiations do exist, the most important ones concerns the stronger protection of the creditors and to some extends the minority stockholders. The stricter regulation is mostly due to the increased danger of company looting that the procedure can result in. The greater protection can among other things be seen in the following:

- While all the companies' answers for their own debts, all secession companies stocks a subsidiary responsibility for the debts of the transferring company, although maximally up to the real value that they gained by the secession.<sup>97</sup>
- The Swedish Registration Office has been given a much more active role than when the matter is regarding a merger. The legislation is more detailed and the Registration Office has a greater investigational duty.<sup>98</sup>
- The secession plan (the equivalent of a merger plan) is also stronger regulated to ensure the rightness of the secession.<sup>99</sup>

### **Special Issues Concerning the Animadversion of Mergers and Secessions**

The merger and Secession can be animadverted upon the same grounds as the animadversion of a stockholders meeting with the only difference that the stockholders meetings on which the decision to merge/success cannot be protested upon after the expiration of six months, no matter the nature of the violation.<sup>100</sup>

The effect of a successful animadversion is that the merger will be annulled and the dissolving company will be "resurrected" if needed. A merger of companies that goes against the JSL should be viewed as something completely different and thus the companies are considered to stop existing first when a formal decision of liquidation has been taken. It should also be noted that although the right to animadvert upon the decisions are diminished, the liability of damages of the Joint Stock Companies bodies is not. Any liability claims upon the organs by the company/stockholders or creditors are explicitly exempted from the new company's responsibilities, thus enabling liability claims even from a liquidated company.<sup>101</sup>

### ***The Company Liquidation***

The regulations concerning the company liquidations is of great interest from a minority protection point of view, since a lot of the above-mentioned misdemeanours will likely result or be followed by the company liquidation. Incidentally initiating a liquidation procedure is also one of the most powerful and up heaving rights that befall a stockholder as well as providing the final set of protective regulations.<sup>102</sup>

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<sup>97</sup> JSL 24:5, Prop. 2004/05:85 p. 852

<sup>98</sup> JSL 24:23, Prop. 2004/05:85 p. 865

<sup>99</sup> JSL 24:16, Prop. 2004/05:85 p. 861

<sup>100</sup> JSL 23:36, 24:30

<sup>101</sup> JSL 23:26, Sandström p. 345

<sup>102</sup> Within the frame of JSL that is. After the liquidation the Law on Bankruptcy and various criminal regulation is more likely to be of any real value.

According to the JSL a joint stock company's liquidation can be initiated by one of the following happenings:

1. A liquidation decision taken by the stockholders meeting.
2. Due to a court order.
3. A decision taken by the Swedish Companies Registration Office.

1. The majority of all company liquidations are voluntary. The actual reasons for liquidation is of no importance (since it is basically up to the free will of the owners) and it is sufficient to say that the general rule is that the decision should be taken with a single majority and that the stockholders meeting must actually have taken the decision in order for the procedure to be initiated.<sup>103</sup>

Somewhere between voluntarily liquidation and forced comes the regulations regarding the cover of the stock capital. If at any point the board of director has (or should have had) a reason to believe that the cover of the stock capital has fallen bellow half of its registered value, the board must establish and let the company accountant review a control balance cheat. In the control balance sheet the company is allowed to value its assets and debts/depreciations to their real value (which generally results in a showing of greater assets) in order to more correctly show the company's situation. If the control balance sheet confirms the boards suspicion than the board is obliged to call (as son as possible) for an extra stockholders meeting where the matter shall be brought to the stockholders attention.<sup>104</sup>

Failure to do so, or acting to slowly, results in that the members of the board of directors (or any one who knowingly acts on behalf of the company) are in unison held liable for all obligations that the company amasses during the period of passivity. Individual members can be excluded if they can show that no neglect has been taken place on their part.<sup>105</sup>

The actual point in time when the board must take action or risk suffering liability is hard to establish due to the huge difficulties that evaluation of any economical situations is in general, let alone in times of crisis. Therefore it can be argued that in order for the liability to take effect the board must have bluntly ignored or severely misinterpreted the situation.<sup>106</sup>

After the board of directors has called for the stockholders meeting the stockholders have to decide whether they want to liquidate the company (and cut their losses) or take actions in order to come to terms with the problem. In any case, as long as they don't vote for liquidation a second control stockholders meeting must be assembled within eight months, where a second control balance cheat must be presented. If at this point the company's cover of the stock capital has not been restored to or above the registered value the stockholders must vote for liquidation. If no such decision is taken the board of directors is obliged to file a liquidation case against the company, within two weeks of the taken decision, or face the same kind of responsibility as mentioned above. Any stockholder who takes part in a decision of continuation the operation knowing that the company must be liquidated faces the same responsibility as the board.<sup>107</sup>

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<sup>103</sup> JSL 25:1-2, Sandström p. 371

<sup>104</sup> JSL 25:13-15, Sandström p. 320-25

<sup>105</sup> JSL 25:18

<sup>106</sup> NJA 1988 p. 620

<sup>107</sup> JSL 25:18-19, Prop. 2000/01:150 p. 101-02

2. The first and most significant regulation regarding liquidation by force can be found in JSL 25:17. The court shall put a company in liquidation if one of the following situations has occurred:

1. No second control stockholders meeting has taken place within the maximum allowed time.
2. The second control balance sheet has not been reviewed by the auditor and / or does not show that the cover of the stock capital has been restored. The liquidation on these grounds is not to be enforced if during the hearing it can be established that the stock capital has been covered.<sup>108</sup>

The court has also the power to liquidate a company due to abuse from the majority stockholders. Since that has been handled elsewhere we are not going to repeat ourselves here.

3. The Swedish Companies Registration Office has been given a number of situations in which they can initiate the liquidation of a joint stock company. The actual situations are mostly concerned with the companies' failure to report vital information to the Swedish Companies Registration Office or the situation where the company has not amended the situation when the company owns its own stocks.<sup>109</sup>

The greatest practical result of the SCROs possibility to enforce a liquidation is that it simplifies the possibility to liquidate "dead" companies, since the legislation effectively leads to liquidation of a company that they have lost contact with within a year. This is clearly reflected in the statistic, which shows that 75% of all liquidations by the SCRO are done on the ground of neglected flowing of auditing procedures.<sup>110</sup>

### ***The Distribution of Profit***

Finally we'd like to take a look at the regulation concerning the monetary aspect of the legislation, which although it could be argued is a special type of animadversion is going to be reviewed as an individual procedure. The main reason for the special attention is that in the end the overwhelming majority of joint stock companies are created in order to amass profit and no matter how great the other protections given to minority stockholders are, if the legislation would be lacking in this aspect everything would be absolutely pointless.

### **Value Transferring**

A widely accepted and already mentioned fact is that the great success for limited companies as a business form is the owner's limited responsibility for the company's debts. The company and not its owners is responsible for its own economy and in order to ensure that the company will be able to fulfill its obligations to creditors and other interested parties the legislator has (among other things) enforced strict regulation regarding the stock holders possibility to withdraw assets from the company.<sup>111</sup>

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<sup>108</sup> Prop 2004/05:85 p.874

<sup>109</sup> JSL 25:11, SOU 2001:1

<sup>110</sup> Sandström s. 363

<sup>111</sup> Svensson s. 152

The law of 2005 has introduced the concept of value transfer, a term used for any transaction made by the company that has a beneficial element. The change from early legislation is a welcomed one, since it greatly simplifies the regulation and clears up the inconsistency of the Law of 1975.<sup>112</sup> The legislation splits the concept into four situations of which the first three are usual referred to as open distributions and the fourth deals with all forms of so-called disguised distributions. The main rule in JSL is that all forms of value transfer should be of the kind that falls under the open distribution category, but as long as the bound capital (per the latest yearly accounting) is fully covered the disguised distribution will be accepted by the court if the decision is taken by the unanimous decision of all the stockholders.<sup>113</sup>

In order to stop the stockholders from risking the company's health (and thus putting the creditors at a disadvantage) the legislation enforces a safety mechanism that has to be followed no matter which form of distribution is in question. The actual regulation is found in JSL 17:3 and is usually referred to as the "Value Barrier" which prohibits any value transfer if, immediately after the action the company lacks full cover of its bound capital. The actual evaluation has to be based upon the last available balance sheet, which is somewhat balanced by that it is possible to take into account possible coming changes.<sup>114</sup>

Even when the stock capital has been fully covered the value transfer can only be completed if it can be considered justifiable in light of the actual business risks taken by the company. The reason for this second obstacle is that the Value Barrier only shows the companies fictive value, while the so-called "Rule of Caution" requires the stockholders to also take into account the actual health of the company. It's therefore worth noting that the actual value transfer can never be increased by the second evaluation, effectively forcing the company to apply the lesser value of the two results.<sup>115</sup>

## The Open Distribution

All open distributions are in nature decisions taken by the stockholders meeting (with small exceptions), a decision that the stockholders are obliged to considerate at the annual meeting. According to the JSL the open distribution can be done in one of the following ways (due to this reports focus, case 2-3 will only be mentioned and nothing else:<sup>116</sup>

1. Profit distribution.
2. The company buying its own stocks.
3. The lessening of the stock capital and or the reserve funds in order to redistribute to the owners.
4. Gifts to common good means.

The profit distribution is probably one, if not the most important issue to a stockholder. Without an expectancy to make profit there would be few people indeed who would ever consider investing in a company and hence the need to regulate the issue is of paramount importance. The main rule is that a decision concerning the profit distribution can be taken by a simple majority but in order to avoid that a majority owner forces out the minority by stopping all distributions the legislation gives a minority that controls at least 10% of the

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<sup>112</sup> Sandström s. 285

<sup>113</sup> JSL 17:2, Prop. 2004/05:85 p. 749, Svensson s.153

<sup>114</sup> Prop. 2004/05:85 p. 749-50, NJA 1951 p. 6

<sup>115</sup> Prop. 2004/05:85 p. 751-52

<sup>116</sup> JSL 17:2, Prop. 2004/05:85 p. 749

stocks the possibility to force a partial profit distribution.<sup>117</sup> This forced distribution can never be higher than 5% of the companies bound capital, nor can it be lower than half of the current year profit that is left after the legislated deductions.<sup>118</sup>

A special form of open distribution is considered gifts to outsiders. As a general rule any gift goes against the principle of profit and is thus considered inappropriate, with the exception of gifts to the common good. JSL 17:5 gives the stockholders meeting (and the board of directors if the amount is considered insignificant in comparison to the company wealth) the right to decide about giving gifts to the common good if it can be considered reasonable compared to the purpose, the company's economy and other variables, a kind of "bonus patre familiar" reasoning.<sup>119</sup>

## **Disguised Distribution**

The term disguised distribution is not used in the JSL; instead the actual regulation is "other business occurrence that results in the lessening of the company's assets without being purely businesslike".

While there are innumerable transactions that can fall under this classification, they all stock the following common traits. The deal or transaction is between the company and a stockholder (or someone near) and the transaction has a benefic element.<sup>120</sup> In order to easier understand what classifies as a disguised distribution the actual process can be divided in the following way:

1. First it must be possible to show an actual diminishment of the company assets. This is an objective criterion and can be reasonably easily proven. Of special interest should be noted that this is not about the accounted value, the issue is the real (most likely market) value.
2. It must be further proven that the company was striving to make a (at least partially) benefic action. Simply bad judgment or a poor business decision is not enough; it must be shown that the actual action was not businesslike.<sup>121</sup>

The above mentioned division is not fully accepted (other views based on a pure objective criteria does exist) but we find it to be the most rational one, since we fail to see how it is possible to judge an issue of such complexity by any form of objective template.

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<sup>117</sup> JSL 18:11, Prop. 2004/05:85 p.767, Sandström p. 300

<sup>118</sup> JSL 18:11 SOU 2001:1

<sup>119</sup> Prop. 2004/05:85 p. 755, SOU 2001:1

<sup>120</sup> Sandström p. 290

<sup>121</sup> Sandström p. 294

**Part Three**  
*The Russian Legislation*

## **Introduction to the Russian Legal System**

Since the main “target group” for this report is the Western (more likely a Swedish) reader we find that providing the reader with a basic understanding of the Russian legal history and its current structure would not be irrelevant.

The information in this chapter is of ancillary significance to the main issues of this report, which allows a reader familiar with the Russian legal system and its development to ignore this chapter. On the other hand we believe that for the uninitiated the information below might be worth the time and effort.

### ***The History of the Current Russian Legislation***

During the late 19<sup>th</sup> - early 20<sup>th</sup> century the development of the Russian legal system was well harmonized with its European counterparts. Although it cannot be stated that the Russian laws were close to being equally as “advanced” and “progressive”, a great general legislative advancement could be observed due to the fact that many legislations and reforms were inspired and influenced by the continental European trends. All this was drastically changed in autumn of 1917 (the October revolution), when the Bolsheviks seized the power from the liberal Russian government (the Tsar had been usurped a couple of months before that) and later proclaimed the first Communist State or as it became known the Soviet Union.<sup>122</sup>

Not only did the foundation of the Soviet Union put an end to the somewhat faltering, incipient company legislation, it also radically changed the perception of the concept of law. The actual changes and their affect on the society and the legislation are too many to be studied here. The focus must, as we see it, be laid on the two most radical ones (from a legal point of view):

1. The weakening of the human rights.
2. The Endorsement of a Planned Economy.

### **The Weakening of the Human Rights**

The communistic regime was based upon the idea of absolute “goodness” and perfection of the state. After the October revolution the citizens were no longer in the necessity of being protected against abuse of power on the part of the government. The state, on the contrary, needed to be protected against the ignorance of its citizens; hence human rights and all other rights were given a low priority status. This was followed by tons of secret legislation acts, lodging of plenipotentiary powers in the hands of the communist party and its bodies and suppression of any kinds of critical opinions from being voiced.<sup>123</sup>

The main body of the state became the Party, which seized total control over all other state bodies of the Union. In order to make the system as efficient (or rather safe) as possible the decision was taken to fully subordinate the judicial system under the state control, a feat that was achieved by turning the public prosecutors office and the judicial authorities accountable

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<sup>122</sup> Gubin, p. 27

<sup>123</sup> *ibid*, p. 35

before the communistic party. It became impossible to carve a juridical career without first becoming an officer of the soviet army and a member of the party. Prosecutors were under direct supervision of the K.G.B., as they in effect became subjects to the secret service. The judges were, at least in theory, still supposed to be independent of the state; in reality they became fully dependent on the favour of the Communistic Party. The party passed a number of laws and amendments admitting prosecution of judges for making non communist-friendly decisions and the party also had the possibility to nullify any rulings made by the courts. In effect these changes made certain that any judge that ruled against the interest of the state, immediately became prosecuted for state treason and deported to prison camp or worse.<sup>124</sup>

To add further insult to the legal system a number of laws were passed that gave different bodies of the Russian government (such as the police, K.G.B. and the Ministry of Internal Affairs) a wide range of secret legislative capacities. The violation of these regulations that only the above mentioned bodies possessed knowledge of could and in practice often led to prosecution and conviction of citizens. Some of these acts went as far as to abolish the requirement for a fair trial and allowed the organs themselves to carry out the sentences at their own leisure.<sup>125</sup>

An absurd occurrence was that while the country's national judicial system was collapsing upon itself the Soviet Union came to the fore as one of the most progressive states in terms of international legislative development. The Soviet Union both initiated and was a major propulsive force behind the adoption of a number of the U.N. human rights acts. The irony was that since the official line of the regime was that the Soviet Union, knew no poverty, or injustice (both poverty and injustice could only exist in capitalistic countries) these treaties were either ignored or more often the Soviet Union excluded itself from the effects of the treaty.<sup>126</sup>

Parenthetically, it is to be marked that this double standard caused a major problem in terms of application of the national legislation. Since phenomena as for example prostitution could not exist in a communist country there existed no official laws against this type of "criminal" behaviour. So while the soviet citizens could be arrested and convicted for crimes that they did not even know existed the state was flaunting itself as a knight in shining armour against the capitalistic oppression on the international arena.

## **The Endorsement of a Planned Economy**

While absence of democracy and civil rights constituted the major problem for the average Soviet citizen, the international political image of the country in general, studied from the perspective of the international community, resembled any military dictatorship of that time. The endorsing of plan economy on the other hand was something that provided the political image of the Soviet Union with completely new features.

The Soviet citizens were proclaimed equal in all aspects, and since the state was to grant all their needs the decision was made to ban all private property and nationalize all possible assets. Further in an attempt to remove the "capitalistic oppression of money" they banned the use of any currency and it was decided, with the reference to the old Greek saying that no free man could be levied with taxes, to annul all such regulations. Since the wave of nationalization of property had swept all over the country without exceptions and there no

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<sup>124</sup> See, Yarkov, p.132

<sup>125</sup> Malinovskij, p. 39

<sup>126</sup> *ibid*, p. 45

longer existed any private property to speak of all currencies were banned from private use and the decision was made to replace the currency system with coupon/cheque systems. All manufacturing became strictly regulated by five-year plans, where the turnout was not based on the markets demand but on how much the government beforehand estimated necessary, competition was prohibited and all business was based on strict regulations.<sup>127</sup>

During the following years a number of different systems and modifications were employed, but the main notion always remained. A citizen would borrow his/hers belongings from the state for as long as they required them, where the extent of the citizens need would be estimated by the state itself. Many of the named changes were later either re-edified/reinstated or softened up but all in all (the private property ban, was somewhat loosened up by lifetime renting combined with succession rights, private retail trading was allowed under the N.E.P period and money was later reintroduced, although currency was strictly regulated and monitored by the government until the collapse of the Union) the Soviet Union fully endorsed Plan Economy.<sup>128</sup>

There are many more historically and socially significant events that could be restated to give a better understanding of the massive changes that the country was dragged through, but by just giving the above-mentioned examples it should be enough to make the reader understand how enormously the Soviet law had to differ to all other countries simply because of ideological necessity. As a result of taking a different ideological course of development, along with the distinctly differentiated fundamentals of the existing legislations and the harsh life conditions of the citizens, the Russian legal tradition as well as law education became very theoretically inclined. The legislation poorly corresponded to reality and Russian law professors started to emphasise the importance of law theory over practice to a much greater degree than what seemed common in Europe, a fact that hasn't really changed in present days.

### ***The Russian Legal System at a Glance***

Since the fall of the Soviet Union and the proclamation of the Russian state, the Russian legal system has gone through a radical and very drastic transition. For reasons mentioned earlier the current legal system can be said to have only existed for less than 15 years, a very short time from a legislative point of view. The painful re-evaluation of values that are to be protected by the legislation, and the revision of not only most legislative acts, but also an attempt to create a new, more complete and transparent judicial system combined with the fact that the state has undergone and is still going through great political and economical turmoil has resulted in that the legislative process have had a hard time keeping up with the necessary changes.

The first and maybe the main thing to remember when studying Russian law is therefore that it still is very young and far from fully developed. There are still great gaps in the legislation that the legislators just have not had the time to mend and there are also a myriad of bylaws, laws regulating inter-crossing issues and contradictive legislation on different levels remaining from earlier times. Although supreme courts, professors and politicians are trying their best to make things a bit clearer and more comprehensible, the reality of the Russian legal system is that for now it remains a web of uncertainty and full of gaps. The work on

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<sup>127</sup> Ibid, p. 244

<sup>128</sup> Bridenko, p. 243

disentangling this snarl of values is gaining ground but a lot of issues are still waiting for satisfying solutions.

## **Legal Acts of the Russian Federation**

The codification of the Russian legislation has a very complex structure. The main law of the federation is the Constitution of the Russian Federation, according to which all-federal constitutional laws; federal laws and subordinate acts must be in conformity with the word and spirit of the constitution. All other legal acts are strictly regulated and hierarchically ordered by the named document, where all legal acts of lower dignity must not contradict hierarchically superior laws/acts.<sup>129</sup>

The legal acts, presented in order of condescending legal force, are:

1. Constitution of the Russian Federation
2. Federal Constitutional Laws
3. Federal Laws
4. Presidential Decrees
5. Resolutions/acts of the Duma
6. Prescripts/provisions of the Government, of Federal Ministries (such as the F.S.B., internal affairs mm).
7. Constitutions of the Subjects of the Russian Federation.
8. Laws of the Subjects.
9. Prescripts/Provisions of the Subjects Governor.
10. Resolutions/Acts of Subjects Parliament.
11. Prescripts/Provisions of the Executive Authorities in Populated Areas
12. Resolutions of the City's Duma

This hierarchical classification of the legal acts is much more complicated than it might appear at the first blush. The classification is unemployable in areas where the subjects have autonomy and/or where the Russian Federation and the subjects have shared competence. In such cases the constitution still enjoys the status of the primary law whereas the legal force of many legal acts admitted by federal institutes, endowed with certain legislative capacity, recedes.<sup>130</sup>

The huge amount of regulations, laws and other normative acts are for the time being a major headache for the Russian law practitioners. The sheer volume of inter-crossing acts of legislation and regulations of differentiated legal dignity combined with the speedy crescendo they keep changing makes it almost impossible to navigate among them. Just to give a little insight into the problems that may arise we'd like to give an example:

- A real estate acquisition in Krasnodar is regulated by the following acts: The Constitution of the Russian Federation, the Land Code, The Civil Code, in addition to that a minimum of two normative acts of the president, a resolution of the Duma, provisions of the Taxation Ministry, two accessory laws of the subject of Krasnodar region and various regulations of the executive bodies of the city.

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<sup>129</sup> The Constitution, art. 76

<sup>130</sup> The Constitution, art. 71-72, 75, Malinovskij p. 8-9

Once one of the parties of a deal starts making claims or seeks lawsuit in court, a conflict situation arises where the knowledge of the abovementioned laws and legal acts becomes highly relevant. To start with, there are a great number of legal acts of different dignity that contradict each other. The issue wouldn't have to become a stumbling block, if the hierarchical order could be strictly upheld, thus allowing the superior laws to take precedence over the inferior ones. The problem lies with the fact that legal acts, ranged hierarchically equal often inter-contradict as well, or even worse happen to refer to regulations that haven't yet been implemented, for example:

Non-Russian citizens are not allowed to acquire real estate for the purpose of ownership in certain areas of Russia. The regulations naming the exact areas prohibited for land holding are carried in the Land Code, referring for more information to a specific normative presidential decree, a decree that simply does not exist.<sup>131</sup>

It should also be mentioned that, even if there existed a clear solution to the named legal problems, getting the courts to apply the appropriate legal acts could still represent a certain difficulty. The deficiency of a uniform judicial practice and inadequate monitoring of basic law application has made it possible for the courts to develop an internal competition, based on personal preferences. It is not a rare occurrence that judges of regional courts build up the judicial practice on the premises of promoting the influence and legal importance of their own regions, this of course, at the expense of the interest of the federation. It is not difficult to see that this type of unprofessional behaviour not only jeopardizes long-term goals of justice, it in a more short-term perspective undermines the trust for the superior federal laws. It should be noted though, that the Russian Federation is putting a lot of effort in attending the problem and lot of progress has been achieved already.

To add just a little extra complication the new constitution further proclaims that the law system of the Russian Federation is build upon the monistic legislative principle. It states that the:

“Universally-recognized norms of international law and international treaties and agreements of the Russian Federation shall be a component part of its legal system. If an international treaty or agreement of the Russian Federation fixes other rules than those envisaged by law, the rules of the international agreement shall be applied”<sup>132</sup>

Since the constitution allows both the subjects of the federation, populated areas and different governmental bodies to enter into international agreements, it means that all such treaties and agreements enjoy higher dignity than the nationally or regionally employable legislation these entities have the capacity to admit. This, in its turn, entails, that at every level of the law may contain numerous treaties and relevant norms that have higher internal priority than the national legislations.

As a final note: the presented law ranging is by no means universal or undisputedly accepted within the Russian juridical community. Presently, opinions of academicians have separated into three different flows. The viewpoint presented above is espoused/advocated by the Constitutional Court and is naturally perceived as the most influential one.<sup>133</sup>

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<sup>131</sup> Malinovskij, p. 76

<sup>132</sup> The Constitution art. 15

<sup>133</sup> Malinovskij, p.102

## Structure of the Judicial System of the Russian Federation

The Russian Constitution, which, as said before, is the primary legislative act of the federation, strictly regulates the judicial structure of the Russian Federation. The constitution states that the judicial system rests upon three different court systems responsible for the order of the Russian Federation. The court system comprises the following components: The Commercial Arbitrage Court and the Court of General Jurisdiction, both being civil jurisdiction courts and The Federal Constitutional Court. The Constitution also allows the subjects of the Russian Federation to establish their own Constitutional Courts.

Russian courts have no presidential rights. They are strictly bound to resolve all cases on the basis of the existing legislation and only the Constitutional Court has the right (except for certain circumstances) to question the legality of a passed law.

**The Constitutional Court** of the Russian Federation is located in Moscow and it consists of 19 judges. Unlike the other courts it does not only consist of professional judges but also of some of the most acclaimed Russian law professors.

Due to the absolute sovereignty of the constitution over all other acts of law in the Russian Federation, the Constitutional Court is considered to be the most prestigious of all courts. The Constitutional Courts main responsibility is to make sure that no law/decision by any authority or a verdict by any other court contradicts the constitution. If the court finds that any of the above mentioned decisions/acts, or any other for that matter, goes against the meaning and/or the spirit of the constitution they have the full authority to overrule the made decision and replace it by one of their own. The ground for the taken decisions can no longer be used and if it was a law or a part of one, then it is forfeited and can no longer be used from the time of the verdict.<sup>134</sup>

**The Court of General Jurisdiction and the Commercial Arbitrage Court** are the main judicial bodies of the federation. Both courts have a similar structure and abide by virtually the same process rules. Both institutes are divided in four instances: the first two are courts of the subjects (in all but the name these are also under strict federal control) while the highest two instances are federal ones.

The Court of General Jurisdiction deals with all civil cases, irrespective of whether they are of economical or criminal nature. The Commercial Arbitration Court on the other hand only treats cases of commercial nature, where legal persons and registered non-juridical persons, engaging in economic activity, participate as one of the parties.<sup>135</sup>

The distinction may look simple on paper, in reality many seasoned law practitioners experience difficulties deciding which of the courts to apply to in specific situations. Although the issue has been attended to and has become much clearer lately, there is still a lot of uncertainty, resulting in cases being shuffled back and forth and the same type of case being dealt with by different judicial instances.

**The Military Court** doesn't represent much interest for the subject of this essay, but as the name implies it treats all the cases involving the military. The Court is an integrated part of the Court of General Jurisdiction with the only exception being that it only comprising of only three instances instead of the regular four.<sup>136</sup>

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<sup>134</sup> The Constitution art. 125, <http://www.supcourt.ru/EN/supreme.htm>

<sup>135</sup> <http://www.supcourt.ru/EN/supreme.htm>

<sup>136</sup> <http://www.supcourt.ru/EN/supreme.htm>

At the time when this is being written there are several bills that are being considered by the Duma (the Russian parliament) the carrying of which might once again radically change the judicial system. The main changes proposed are the reformation of the present four-instance system in to a three-levelled one and establishment of yet another system of courts. These new Administrative courts are to deal with cases filed by and against the state and are quite similar to the administrative courts in use in some European Countries.<sup>137</sup>

All **subjects** of the Federation have the right to create their own constitution as long as it does not contradict the Constitution of the Russian Federation. The subjects that choose to implement their own constitution also have the right to set up their own constitutional courts, something that many subjects have abstained from, mostly because of the high cost of maintaining such a court. All these courts have the same structure and responsibilities as the Federal one, except they are not allowed to try any federal legislation and their rulings only cover the territory of the courts subject.

**The European Court**, while not a Russian institution, is considered as the second (after the Constitutional Court) most influential of all the courts; due to the direct effect of international treaties and the status that the Russian Constitution provides such treaties with (in theory any ruling made by the EC has the same effect on the Russian law as a ruling made by the Constitutional Court). The high status and the tendency of the Russian citizens to distrust their own authorities is a major contribution to the over-representation of Russian cases at the European court. According to the EC statistics the amount of Russia related complains stood for as much as 21 percent of the total cases that the court received during 2005. Even considering the population of the Federation the percentage is still un-proportionally high.<sup>138</sup>

## **The Russian Joint Stock Legislation**

The current Joint Stock Law was passed in 1995. At the time of its creation the legislator had vague interest in anything else but (both in regard to the JSL as well as most other various corporative regulations) to provide the government with a practical solution to carry out the massive privatization it had initiated. Initially the legislation was therefore focused on the top management and exceptionally ill equipped to handle the day-to-day problems facing the market participants.

During the coming years the increased private ownership combined with the need of attracting fresh investment capital, both foreign and domestic, as well as the rising problems in regard to asset stripping, transfer pricing, dilution and other self-dealings has forced the legislator to radically alter the legislation in a number of ways. The JSL has thus slowly started to shift its focus from the perspective of the company management towards the necessity of providing a functional protection for stockholders and creditors.<sup>139</sup>

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<sup>137</sup> <http://www.supcourt.ru/EN/supreme.htm>

<sup>138</sup> [http://www.echr.coe.int/NR/rdonlyres/4753F3E8-3AD0-42C5-B294-0F2A68507FC0/0/2005\\_SURVEY\\_COURT\\_.pdf](http://www.echr.coe.int/NR/rdonlyres/4753F3E8-3AD0-42C5-B294-0F2A68507FC0/0/2005_SURVEY_COURT_.pdf)

<sup>139</sup> <http://www.arbitr.ru/eng/hist.htm>

## *A Short Historical Overview*

The term "corporation" originates from the Latin word "corporatio" which can be translated as association, union or company. In all law systems "corporation" is regarded as an artificial law construction endowed with characteristic features distinguishing it from other forms of undertaking, thus given its certain historical peculiarities and traditions of law regulation.

The first stage of the development of a serious entrepreneurship, and the heyday of the Joint Stock Companies in Russia is commonly dated to the reign of Peter the Great (1689-1725). The two main factors, enabling the successful reformations of Peter the Great were the, prior to his reign, introduction of the first Trading Code (1653) and the abolishment of serfdom (1671). These two major events resulted in disbanding of most guilds (and their monopoly) and the creation of banking and credit institutions (although under strict governmental control).

So, with a relatively free market and strengthened finances at his disposal Peter the Great carried out a number of successful reforms and enterprises in order to try and bring the nation back on its feet, after it had been cast back in development by wars, civil upheavals, and severe negligence. One of his most successful endeavors was the imported concept of building own wharfs; or rather he brought the idea of how to finance the construction works from Holland. The wealthy nobility and merchants were suggested to invest in the enterprise in exchange for the profits the availability of a powerful fleet would entail. The idea was that the function of the investors would be different from that of an owner, the enterprises would bear the name of trading companies and these companies were founded by means of jointly invested capital. This was the first prototype of the present day joint stock companies and initially the idea was very successful. Unfortunately the tsars' death and the stifling attempts of the tsars' political opponents, frustrated by forced reforms, resulted in decline of activity and ultimately the end of the trading companies.<sup>140</sup>

Prior to the revolution of 1917, tsarist Russia had however once again caught up to its western neighbors in regard to the development of a private sector economy, and a variety of company forms, joint stock companies included. In fact, much of what motivated the Bolshevik uprising was a critique of the emerging capitalist economy and its attendant bourgeoisie. The revolutionaries initially flushed the "joint stock company concept" down the drain (together with pretty much all other private economy legislation) but due to the fact that the disastrous nationalization attempts put the Russian economy on the brink of collapse Lenin scaled back nationalization and allowed a partial revival of some components of a capitalist economy.<sup>141</sup>

Among other things he initiated New Economic Policy (N.E.P.), adopted in 1921, which lasted until the late 1920s. The N.E.P led to that legislations on both limited-liability "partnership" and joint-stock companies were adopted and enshrined in the year of 1922 and remained in force (although in various other forms) until the next Russian Civil Code was adopted in 1964.

In 1987 the Soviet Union introduced the first new company legislation governing joint stock and limited-liability companies since the N.E.P. Although these changes allowed for the creation of western-style companies in the form of joint ventures with foreign partners, the coming period (up to the end of 1991, when the U.S.S.R. formally disintegrated) was

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<sup>140</sup> Zhilinskij p. 53-54

<sup>141</sup> Janda p. 7-8

dominated by the creation of a number of so-called “leased enterprises”. The concept was that workers got to lease an enterprise from the state and were entitled to retain any profits. The leased enterprises came to be turned into the so-called “peoples enterprise”, which was a very peculiar form of joint stock company, regulated by three specially passed decrees named “On the Specifics of the Legal Status of Workers Joint Stock Companies” (passed in 1998).<sup>142</sup>

It was not until the rehabilitation of the property rights, by virtue of adopting the Constitution in December 1993, that the thought of joint stock companies as one of the driving forces of the market economy became highly topical. The Civil Code followed the Constitution in 1994, which granted the right to jointly invest capital and more importantly to derive profit on conditions of ownership without liability for the debts except for the value of own stocks. In accordance with the Civil Code the current Joint Stock Company Law was passed in 1995.

### ***The Current Legislation***

The current Joint Stock Law was passed in 1995 and during the short time of its existence the legislation has been amended in the year of 1996, 1998, 2001, 2003, 2005 and finally leading to its present wording, which was passed in July 2006.

The legislation, concerning Joint Stock Companies, cannot be said to have been successfully incorporated into one functioning legal framework. The regulations are, just on the contrary, scattered in the web of different laws, all of them in one way or another touching on the subject of joint stock companies. As a rough guidance the following laws can be mentioned as being fundamental in the area:

- The Civil Code
- Joint Stock Law
- The Law on Registration of Judicial Persons and Individual Undertakers
- The Law on Competition and Limitation of Monopolistic Activity on the Goods Markets
- The Law on the Protection of Investors Rights
- The Law on the Market of Securities
- The Law on Appraisal Activity
- The Law on Audit Activity
- The Law on Bankruptcy

The connection between the two major regulations (the Civil Code and the JSL) is that the Civil Code contains the general doctrine of juristic persons, which is considered to be the starting point of further regulation, while the Joint Stock Law governs in a more detailed manner the creation of the joint stock company, its operation and internal decision making.

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<sup>142</sup> Decree of the Supreme Court dated 13.1.2002 nr.49

## ***The Principles of Joint Stock Law***

For the sake of being consistent we will present a basic account of the guiding corporate principles. Unfortunately, the Russian legislator hasn't specifically codified the commonly acknowledged principles, with some minor exceptions. Most corporate principles are regarded as simply derivative from the principle of equality, something that in conjunction with the scanty wording of the law regulations has caused a lot of puzzle to the Russian legal practitioners.<sup>143</sup> With some degree of certainty it is possible to distinguish the following guiding principles:

1. The first principle that is derived from the Civil Code, (with a corresponding article specifically with regard to Joint Stock Companies, found in JSL art. 13) states that all commercial activity within the frame of a legal entity shall be subject to state registration. The registration shall be carried out in the Unified State Register of Legal Entities and the legal entity is considered to come into being at the moment of making notification in the register. Thus is the **principle of registration** given an explicit form in the legislation.<sup>144</sup>
2. The next important corporative aspect reflected in the legislation is the **principle of incorporation**. The Civil Code, duplicated by the JSL clearly states that any company registered in the Unified State Register is subject to the corporate regulation of the Russian Federation, irrespective of where the company's actual headquarter and/or place of operation might be.<sup>145</sup>
3. One of the most debated principles provided by the JSL is the principle of **equal treatment** of the stocks. While the principle is clearly stated, the extent of the poorly formulated regulation is at present widely debated in the doctrine. Viewing the regulation from the perspective of stockholder's protection the equal amount of rights of the holders of the same type of stock should not be underestimated, especially considering that other principles are regarded as derivative.<sup>146</sup>
4. The Civil Code of the Russian Federation further lays down the basic provisions on the existence of a **stock capital**. According to the JSL the stock capital is comprised of the face value of the company's stocks, acquired by the stockholders. At least half of the capital must be covered within 3 months after the registration. The Stock Capital is index regulated (based on a multiplication of the minimum amount for payment of labor, established by a federal law at the date of registration of the company) due to the Russian history with an unstable Ruble and the countries high inflation.<sup>147</sup> The whole of the stock capital is to be paid within a period of one year after the registration. In case a stockholder neglects to do so, the company is to withdraw and sell his stocks. Clearly the creditors protection is weakened at this point, since the stock capital doesn't have to be decreased during yet another year after withdrawal.
5. As a natural extension to the regulations of the stock capital the JSL also clearly regulates the **limited responsibility and obligations** of the joint stock company. The principle, regarding liability of the stockholders, is placed under the basic provisions of the JSL and stipulates that stockholders shall not be liable for obligations of the company and shall bear the risk of losses connected with its activity within the limits of the value of the stocks

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<sup>143</sup> Sukhanov p. 62

<sup>144</sup> CC art. 51

<sup>145</sup> Ibid art. 54, Sukhanov p. 168

<sup>146</sup> JSL art. 31 -32

<sup>147</sup> CC art. 99, 25

belonging to them, while at the same time stressing that the company itself bears the sole responsibility for its obligations with all of the property belonging to it.<sup>148</sup>

6. The Russian legislation employs a very strict **distribution of rights between the governing bodies**. While the law provides for possibilities to chose between authoritarian or divided structure of management (for instance, closed joint stock companies have the possibilities to transfer the competences of the board of directors onto the stockholders meeting) it also severely limits the stockholders meetings competence in general.<sup>149</sup>

6. The Russian legislator has tried to meet the requirements on incorporation of the commonly acknowledged corporate governance principle of **publicity**<sup>150</sup>. According to the legislator the publicity and transparency of the operations in Joint Stock Companies, plays a significant role in the development of credit institutions, a functioning stock market and the stimulation of the investment flows. Because of this the Russian law requires a company to submit a lot of formal information for public scurrility.<sup>151</sup>

Finally, it is worth noting the exceptionally **strong position** that the legislation puts in **the charter of association**, which regulates the legal relation of the company to its stockholders and third persons. The law lists all the information, which the charter must include. This list, though, is not complete. Other requirements, which are not contradictory to law, can be included. Joint Stock Law does not merely allow the stockholders to disregard from a number of the binding provisions of the law, by virtue of amendments to the charter, it also clearly states that in case of collision between the law and the charter of association the later shall hold true unless the law clearly stipulates otherwise. The registered charter binds the company and all the changes to it become binding towards third parties as soon as they have been registered.<sup>152</sup>

## The Protection of Stockholders

As a formal system of norms the Russian Joint Stock Law doesn't differ from that of any of its western counterparts. The present day law has clarified a lot of earlier unclear rules and filled out some loopholes. The Joint Stock Law contains quite a number of provisions, enabling stockholders to effectively protect their rights and safeguard their interests in a court of law. With the purpose of this report in view we've chosen to limit the scope of this chapter mainly to what we call the litigious part of the stockholders protection. The actual type of procedures/regulations that we are going to cover in this chapter is the following:

- Jurisdiction and the Arbitrary Procedure
- Specifics Concerning the Material Protection
- Animadversion on Decisions Taken by the Company Bodies
- Liability of Damages
- The Possibility to Force Release/Expropriate Stock Owners

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<sup>148</sup> JSL art. 2-3

<sup>149</sup> JSL art. 64, Malinovskij, p. 503

<sup>150</sup> The question was widely discussed at the Second Meeting of Corporate Governance Roundtable for Russia on Stockholders Rights and Equitable Treatment, on February 24-25, in Moscow. The meeting was co-sponsored by the OECD, World Bank Group and the Centre for International Private Enterprise (CIPE).

<sup>151</sup> Law on Registration of Legal Entities, art. 12, see art 87-93, JSL

<sup>152</sup> JSL art. 14, Janda, p. 65

- The Company Liquidation
- Fusion and Fission
- Distribution of Profit

A perceptive reader will quickly realise that the categorisation above is identical to the one presented in the chapter on the Swedish legislation. This is by no means unintentional, since the legislators have provided their stockholders with the same remedies of protection. We also find that a similar layout is much more beneficial in order to stay consistent.

Despite the similarity of the form, the actual contents of the subchapters above present considerable differences. There are a number of deviations and discrepancies between the national legislations, mostly because of different considerations to what traditionally is regarded as essential, something that will be dealt with in the analysis. We do, however, find it necessary at this point to draw the readers' attention to the fact that the Russian legislation lacks regulations concerning fair play and "proper" ground of disqualification. On the other hand the legislation contains regulations on two special procedures (regarding major transactions and transactions with affiliated persons) that should be studied closer. Therefore the heading "Specifics Concerning the Material Protection" only bears the same name, its contents however differ from its Swedish counterpart.

### ***Jurisdiction and the Arbitrary Procedure***

Both chapters on national jurisdiction are introduced with a discussion of Jurisdiction and the legislations compatibility with the Arbitrary Procedure. This is mostly because of the puzzle these two issues are causing to the Russian practitioner and hence some additional attention was paid to this part of the report.

#### **The Jurisdiction**

The question of jurisdiction and forum are generally not the most complicated ones. Unfortunately, the specifics of the Russian Civil Court system, results in that this question causes tremendous trouble for law practitioners. Therefore, we find it necessary to handle the question of which of the civil courts has the powers of jurisdiction over corporate cases, with particular attention.

Before both the Arbitrage and the Civil Process Laws of today were brought into use in the year of 2002, the main criteria for the distinction between the jurisdiction of the arbitrage courts and the courts of general jurisdiction in matters of commercial disputes was the subject composition of the dispute. If all the subjects were judicial persons the arbitrage courts could handle the case; if not, the task was a matter for the general courts.<sup>153</sup>

This came to be frequently misused by unscrupulous legal participants since by transferring one single stock onto a physical person one could hinder dispute resolution within the framework of an arbitrage process and thus stall the case for a very long time. According to the old legislation, once it became clear that either the plaintiff(s) or the respondent(s) was a physical person the Arbitrage Court was bound by law to reject the lawsuit and refer the case

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<sup>153</sup> Jarkov, p. 346

to the Court of General Jurisdiction. This inevitably made settling any economic dispute within the confines of the arbitration process almost impossible.<sup>154</sup>

The current Arbitration Process Law attended the problem by giving the Arbitration Court a field of exclusive competence. The exclusive jurisdiction of the Arbitration Court authorizes it to handle the following legal matters:<sup>155</sup>

1. Insolvency (Bankruptcy).
2. Disputes concerning the establishment, reorganization and liquidation of organizations.
3. Disputes concerning the registration of legal persons.
4. Disputes between the owners/ members of organizations and the organizations themselves, with the exception of labor law disputes.
5. The protection of business reputation.
6. Other proceedings concerning the economical sphere, where particular federal laws dictate the jurisdiction.

The clear wording of the article might easily misguide one, but unfortunately the employment of the regulation necessitates a proper look at a number of issues that greatly complicate the matter.

To begin with the new Arbitration Process Law dictates that disputes between stockholders on one side and the corporation on the other is not subjected to the jurisdiction of the Arbitration Courts. This is something that the Supreme Court<sup>156</sup> has rejected by stating that, when determining whether the Arbitration Court jurisdiction allows it to deal with a specific economical dispute, regard should be taken to the general notion of the law that states that the competence of the Arbitration Court covers commercial corporate disputes eventuating from entrepreneurial activity and thus comprise the questioned disputes.<sup>157</sup>

The Plenum clarified furthermore that disputes between stockholders and the corporation and disputes among the stockholders that are arising from the economic activity of the corporation belong to the jurisdiction exercised by the Arbitration Courts, given the disputes relate to exercising rights of the stockholders and fulfillment of the duties of the latter. Having said that, the power of jurisdiction of the Arbitration Courts doesn't extend to liability claims by the stockholders on behalf of the legal person that are sought against persons, who by the power of law or the charter of association are endowed to represent the legal person. This results from the fact that the Supreme Courts have ruled that the relations between the stockholders and the executives are not based on participation in the corporation.<sup>158</sup>

It is furthermore to be noted that the Arbitration Process Law relegates disputes eventuating from negation of state registration to the jurisdiction of the Arbitration Courts. This is also controversial (from the view of the Russian legal tradition) because of the fact that, strictly speaking, the complainant has not become a legal person yet and hence should not be a subject to the procedure in an Arbitration Court.<sup>159</sup>

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<sup>154</sup> *ibid.* p. 349

<sup>155</sup> APL art. 33

<sup>156</sup> Decree of the Supreme Court dated 12.9.2002 nr.9

<sup>157</sup> APL art. 27, Decree of the Supreme Court dated 12.9.2002 nr.9

<sup>158</sup> APL art. 33, Decree of the Supreme Court dated 12.9.2002

<sup>159</sup> APL art. 33, Jrkova p. 344

Following the principle that the exclusive jurisdiction of the Arbitrage Courts covers, according to the Arbitrage Process Law, all types of organizations/judicial persons, (irrespective of their goals as they are articulated in the charter of association) one could erroneously come to the conclusion that the article indeed does cover all legal persons. This is not the case because of widely contradictive legislation. The actual types of judicial persons that belong under the jurisdiction of the arbitration Court are derived from various federal laws, containing direct instructions about the appellation court. If no such references exist (or they contradict each other) one must, in order to avoid the effects of the contradicting regulation, use a comparison of the norms defining jurisdiction of each court system in accordance with Arbitrage Process Law and Civil Process Law respectively and in case of collision, the norms of the Civil Code shall have priority. Thus, for instance, an act of annulment of denial of state registration of a religious organization (irrespective of its judicial form) is consummated in the Court of General Jurisdiction.<sup>160</sup>

To sum up the said, in order to determine the court authorized to deal with a dispute, the following questions have to be answered in affirmative:

1. Is the dispute covered by the exclusive competence of either of the two courts?  
Alternatively: Are there any references in special federal laws as to which court is to handle the case?
2. Is the dispute of commercial nature?
3. Is the dispute related to the economic activity of the corporation?
4. Does the ground of the disputable relationship come from the fact of stockholding?
5. Does the matter of the dispute have a commercial nature?
6. Is the subject of the dispute a commercial organizations, or parts of such organizations?
7. Is the legal person (within or against which claims have been made) pursuing commercial goals?

If case an affirmative answer is given to the first question in either of the process laws or a special federal law, then the indicated court is to handle the dispute. In this case there are no requirements to turn to the “help”-questions 2-7 (Parenthetically, it is to be said that when both process laws give an affirmative answer, the Civil Process Law enjoys priority).

If the jurisdiction issue doesn't find its answers, the auxiliary questions 2-7 should be used. The concept here is easy: in order to be treated by the Commercial Arbitrage Court all the six questions are to be answered affirmatively. If one of the questions falls short the Court of General Jurisdiction handles the case.

Finally we would like to address the problems that arise with a company's changing of nationality. Since Russia and Sweden both employ the incorporation principle everything that was said about the Swedish approach holds equally true here, with one possible exception.

It is a well known fact that the Russian courts tend to be very prestige-bound and have low tolerance towards outside interference; therefore it is probably safe to assume that the Russian courts are much more likely to (in a situation of doubt) to rule that a company is subject of the Russian JSL than the other way around. While not based on any actual regulation the abovementioned peculiarity is well worth to keep in mind when dealing with the Russian judicial system.

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<sup>160</sup> Federal Law on freedom of conscience and religious associations art. 12

## **The Arbitrary Procedure**

The relation between the Russian courts and the arbitrary procedure is a very complex one. As earlier mentioned the Russian constitution<sup>161</sup> endows international agreements with greater power than all Russian laws and regulations. Due to the number of agreements that Russia has signed on this subject it could and should be argued in favor of the fact that arbitrary procedure is firmly established as a legal dispute settlement. The Process Code (both the Civil and the Arbitrage) also states that the parties are allowed to settle their differences within the framework of not only an arbitrary procedure but in types of meddling institutes.<sup>162</sup>

The matter is unfortunately greatly complicated by two major facts:

1. The national courts show great reluctance to accept any arbitrary involvement, revoking and dismissing arbitrary procedures on more or less personal whim.
2. At the present date, there is no clear definition of the matters that you are allowed to settle by the arbitrary procedure

The matter concerning the reluctance to accept arbitrary involvement springs from a number of different factors, the major being:<sup>163</sup>

- A general belief of incompetence/corruption among the arbitraries.
- The relative lack of information on the availability of the procedure among the judicial authorities.
- The unwillingness to give up power to an “improper” court.

While the “grounds” above are bound to disappear with time, the problem of the absence of clarification is a more troublesome one. Many individual judges choose to dismiss the rulings of any “off-court” settlement by referring to the uncertainty of the matter being possible to settle “off court”. At this point resolving of this problem is one of the burning issues of the Russian Process Law. While regulating the matter is still in process, the general belief remains that the arbitrary procedure (especially of Russian origin) is a far less acceptable solution than taking the matter to the Civil Courts.

### ***Specifics Concerning the Material Protection***

The Russian JSL has not accepted the notion of the “fair play” concept. Nor does it include any proper disqualification grounds. Admittedly, the principle of equality does exist, but due to the insecurity of its protective range and the lack of provisions reminding of that of the Swedish general clause, one can with a high degree of certainty state that the Russian legislation gives a lot of possibilities to discriminate individual stockholders.

In order to keep the worst kind of mistreatment at bay the legislation has empowered the stockholders with two types of special protections, namely the regulation concerning major transactions and transactions involving affiliated person.

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<sup>161</sup> The Constitution art. 15

<sup>162</sup> Jrkova, p. 173

<sup>163</sup> *ibid*, p. 196

## Major Transactions

The first of the special procedures is the regulation on major transactions. A major transaction is a decision taken by the executive body (or empowered member) that results in the acquirement or disposing of assets with a total value of 25-50 percent of the book value of the company's aggregate assets (as of the date of such a decision). In such case the decision can only be made by the unanimous decision of the board of directors. If no unanimous decision can be reached or the value of the assets is more than 50 percent then the decision must be subjected to the stockholders meeting's approval.<sup>164</sup>

This legislation has been strongly criticized by major Russian law professors because it empowers the board of directors with the power to do as they see fit with up to half of the company assets and at the same time defining a major transaction in such vague terms and so obscurely to its real meaning that in real life an involved party cannot be sure whether a specific transaction he/she is involved in can be deemed as a major one. Furthermore, the law makes no mention of the consequences of violating the procedure for conducting a major transaction, because of which the courts have chosen to automatically interpret major transactions conducted in violation of the established procedure as null and void.<sup>165</sup>

Recognizing the dangers inherent in this approach, the Supreme Court and the Supreme Arbitrage Court of the Russian Federation attempted to somewhat soften this provision by stating that such transactions can still be considered valid and creating corresponding rights and obligations for the company involved, if the court that is handling the actual case finds that the transaction in question was subsequently approved of in one of the above mentioned ways. Eventually, it so happened that the court have created a special category of invalid transactions, whose flaws can be made good by subsequent approval.<sup>166</sup>

Unfortunately, at the time of this writing the lower courts are still passing their rulings proceeding from the assumption that all major transactions are null and void. This has to a great extend to do with that the courts seldom have a clear perception of the technical criteria of major transactions, among other things they fail to compare the involved assets that represent more than 25 percent of the book value of the company's aggregated assets, instead the courts seem to compare the value of the transaction with the size of the Joint Stock Company's authorized capital, a procedure that is not in conformity with the Law.<sup>167</sup>

Another complication is that at the moment, most disputes involving major transactions, handled by the arbitrage courts feature transactions concluded by joint stock companies that were set up during the time of privatization. Such companies operate on the basis of the presidential decree on Model Charter of an Open joint stock company,<sup>168</sup> which sets stricter criteria for a major transaction.

In assessing the circumstances in which such transaction are concluded, the courts tend to proceed from the assumption that if a party enters into a transaction with a joint stock company set up in the process of privatization it must be aware of the requirements of the Model Charter and, therefore, must assume the detrimental effects of violating of the

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<sup>164</sup> JSL art. 79

<sup>165</sup> CC art. 168, Malinovskij p. 532

<sup>166</sup> JSL art. 78, Decree of the Supreme Arbitration Court dated 2.4.1997

<sup>167</sup> Decree of the Supreme Arbitration Court dated 23.2.1999

<sup>168</sup> Act of the President and Government of the Russian Federation 1992, N.1, P.3; N. 21 p.1731

established procedure for concluding such transactions. In some cases this approach appears too formal, because on surface the joint stock company created in the process of privatization is no different from a regular joint stock company. It is therefore hardly lawful to automatically place the burden of fining out the company's special status on the other contracting party. In the resolution of such disputes it would be advisable to assess evidence provided by the plaintiff depending primarily on whether or not the contracting party was familiarized with the joint stock company's charter and whether or not it was advised of the fact that the company operates on the basis of the Model Charter. In other words, assessment of the circumstances of such disputes should not be based on formal criteria alone.<sup>169</sup>

### **Transactions with an Affiliated Person**

A transaction is considered to be of an affiliated nature if the transaction involves a stockholder (that on his own or through subsidiaries have control over 20 or more percent of the voting stocks), member of the board, the supervisory board, the MD or other executive personnel and one of the following requisitions are reached:<sup>170</sup>

1. The other party (or one of them) of the deal (or is benefited by it) is one of the above-mentioned persons and or some one close.
2. The other party is a legal entity in which one of the above mentioned persons has an owning (or part) amounting to at least 20 percent of the total worth.
3. The affiliated person is a legal entity and the person in question is a member of one of the entities executive bodies.
4. Other situations freely dictated by the charter of association.

If a situation is found to be of an affiliated type then the transaction is subject to approval by the board of directors (supervisory board) with affiliated directors taking no part in the decision-making. As in the situation with Major transactions the approval must be made by the stockholders meeting in the following two cases:

1. If the value involved in the transaction exceeds 2 percent of the company's book valued assets.
2. If the transaction and/or several interrelated transactions represent the placement of a company's voting stock or other securities (that can be converted into voting stocks) that is in excess of two percent of the voting stocks previously issued.

Single majority is enough to takes the decision, but the affiliated stockholders are not allowed to vote. Essential to notice is the fact that the voting prohibition is voided when the transaction involves any type of fusion or fission of the company.

The laws provisions on interested party transactions are phrased in just as obscure language as major transactions provisions, which, of course, is hardly conducive to effective enforcement. Unlike the major transaction clause, however the Law specifies the consequences of failure to comply with the established procedure for concluding interested party transactions. Under Article 84 such a transaction may be deemed invalid, i.e., it is contestable. It does not specify however who has the right to file a complaint, something that must be a binding rule for contestable transactions. For this reason joint stock companies

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<sup>169</sup> Decree of the Supreme Arbitration Court dated 4.4.1996, Decree of the Supreme Arbitration Court dated 13.2.1996

<sup>170</sup> JSL art. 81

entangled in a dubious transaction mostly file the lawsuits themselves in order to get away of an unfavorable deal.

The most important criterion in decision-making on concluding an interested party transaction is assessment of a transactions impact on the joint stock company's assets. Courts are therefore when trying to determine the nature of the contested legal relations to apply the same criterion of how the company's assets will fare in the aftermath of a transaction.<sup>171</sup>

### ***Animadversion on Decisions Taken by the Company Bodies***

The Stockholder's meeting is the supreme governance/administrative body of the joint stock company.<sup>172</sup> Therefore the possibility to animadvert decisions taken by the body holding all the essential powers is by far the most important right conferred on a stockholder; therefore it is no more than fitting to start talking about animadversions from this perspective.

### **The Stockholders Meeting**

Being such an important part of the company the competence of the general meeting of stockholders is subject to surprisingly many limitations. While the JSL strictly regulates the competence of the stockholders meeting by signifying a list of issues authorizing the latter to make decisions on, it also states that the stockholders meeting is not entitled to step beyond the range of the relatively limited field of operation (unless it has transferred the role of the board of directors on itself). The stated issues are compromising the exclusive competence of the stockholders meeting; the power of decision on these issues can therefore not be delegated onto the MD or the board of directors, except for very specific cases that are strictly defined by the Law.

The full list of competences can easily be derived from the law, but it comprises issues like changes and amendments to the company's charter, reorganization and liquidation of the company.<sup>173</sup>

### **The Circle of Plaintiffs and the Respondent**

The legislation is very clear on who has the right/obligation to be involved in the animadversion. The respondent is always the company, represented by the board of directors and the only subject that is endowed with the right to animadvert upon the decision made by the stockholders meeting, and thus being the only plaintiff, is the actual stockholder or a nominal holder of the securities. The closed circle is due to the fact that the legislator regards decisions of the stockholders meeting as an exclusively internal administrative affair, thus third parties affected by the decision are reduced to other judicial remedies of protection.<sup>174</sup>

The plaintiff can thus only be either:

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<sup>171</sup> Decree of the Supreme Arbitration Court dated 2.7.1996

<sup>172</sup> JSL art. 47

<sup>173</sup> JSL art. 48, Malinovskij p. 207

<sup>174</sup> See, for instance, Civil Code art. Law on Bankruptcy

- A stockholder.
- Or a nominal holder of securities.

Defining a nominal holder of securities is relatively easy. The holder is a person who by virtue of a written agreement with an actual stockholder can certify that he/she has the right to manage the stocks on behalf of the owner. In order to be considered as such the stockholders register must contain a recording about the service agreement and the nominal holders persona.<sup>175</sup>

To determine who is regarded as the actual stockholder is on the other hand a bit more complicated, since due to inconsistencies in the legal framework and related corporative regulations, there may arise uncertainty. According to the federal law “On the Market of Securities” all the proprietary rights for any securities (like stocks) are transferred onto the buyer the very moment recording is made in the stockholders register.<sup>176</sup> Unfortunately there is no indication in the Joint Stock Law on the fact that the obligation to conduct a stockholders register is to chronologically coincide with the first stock inscription. According to the clarification from the Federal Committee of the central Bank of the Russian Federation, the distribution of stocks between the stockholders made before the registration is not forbidden<sup>177</sup>. This implies that, should the stocks be put in circulation before such register is created, the person who derived his/her right from the founder in close connection with the foundation cannot enjoy the rights of the stockholder or use protection remedies, until the register is created.

If, for any reason, the party presents before the court more than one stockholder`s register, the court is obliged to follow the factual circumstances concerning the actual distribution of stocks as well as the main provisions of both the Joint Stock Law and the federal Law on the Market of Securities. The court is bound to base its judgement on the fact that the person who had made payments to form the joint stock is the owner of the block of stocks in case he is in possession of the stocks. In those cases where the actual possession is doubtful, the possessor is considered to be the subject who made the payment to the company stock capital for the stock, which coincides with that stocks don`t grant voting rights until they have been fully paid for (an exception is made for the stocks that are acquired by the constitutors of the company at the moment of its constitution).

## **The Actual Decision That Can Be Annulled Upon**

A stockholder has according to the JSL the right to appeal to the court against a decision taken by the stockholders meeting, if the decision is a violation of:<sup>178</sup>

1. The requirements of the JSL.
2. Other laws or regulations of the Russian Federation.
3. The company`s charter of association.

In regards to the requirements of the law, the Supreme Court has clarified that the issues at hand are violations related to:<sup>179</sup>

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<sup>175</sup> Federal law on the market of securities, art. 8, Decree of FCCB RF, 16.12.1997 No 36

<sup>176</sup> Federal law on the market of securities art. 23

<sup>177</sup> Federal law on the market of securities art. 23, Decree of FCCB RF, 16.12.1997 No 19

<sup>178</sup> JSL art. 49, Malinovskij p. 402

<sup>179</sup> JSL article 52, 60, Decree of the Supreme Arbitration Court dated 18.11.2003

- Undue notification/non notification of the stockholder in regard to the date of conducting the stockholders meeting.
- Denial of access to the necessary information, related to the issues, included in the agenda.
- Undue granting of voting papers /ballots.

The court also implies that the above mentioned cases are far from the only existing ones and while it is for now uncertain what type of actions are supposed to fall in this category it is probably safe to assume that decisions of the stockholders meeting made beyond its competence definitely is a violation of this type.<sup>180</sup>

Actions/decisions that clash with Federal regulations are, of course, possible to animadvert upon. The only problem of note (obviously apart from actually being able to prove a transgression) is the remaining (and already mentioned) issues of cross legislation but these are few at the federal level and the legislator is making great progress at eliminating them, so the problem is an easily neglected one.

The most difficult task is to determine whether a violation of the company charter is at hand. The reason this task is so hard solved is two folded: on the one hand the company's founders tend to write vaguely formulated charters, including only mandatory, required by the law information. The founders frequently turn the whole process into a formal procedure; missing on opportunities to fill out loopholes of the Joint Stock Law, open for individual regulation. The problem is magnified by poorly organized control of the contents of charters of newly found entities, which have to meet the requirements of the law.

Even if a transgression is found to be at hand, it is not enough to prove that the decision is liable to animadversion; the stockholder must also be able to show:

1. That he/she didn't participate in the general meeting/or voted against the decision
2. That the decision violated his/hers rights and legitimate interests

Failing to do so will result in a dismissal from the court. When trying to derive if the aforementioned criteria have been fulfilled the court is also to take into consideration:<sup>181</sup>

1. The order of the making the decisions, settled by the JSL and the charter of association of the company. To note is the fact, that in case the charter of association is not fully congruent with the federal law the norms of the former are to be applied as far as they don't literally contradict the federal law.
2. The issue of how to define a quorum and that it is decided by the time the registration of its participants is completed, not by the time of voting on any specific issue.
3. In case the parts dispute about a decision made on the stockholders meeting at the same time as it becomes clear to the court the decision was taken with major infractions of the law, the court is obliged to declare it null and void, even if neither party has contested the validity of the decision.

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<sup>180</sup>JSL art. 48

<sup>181</sup>JSL art. 94, 49, Decree of the Supreme Arbitration Court and Supreme Court dated 2.4.1997, Decree of the Supreme Arbitration Court and Supreme Court dated 5.2.1998, Decree of the Supreme Arbitration Court dated September 8.9.1998

## The Results of animadversion

If a decision is found to be void, the court has at its disposal the following possibilities to decide the matter:

1. It can let the decision remain in power.

Even when a decision is found to be of a wronged type and the stockholder has fulfilled all requirements, the court is still in its full right to let the reviewed decision remain valid, if the vote of the stockholder couldn't have influenced the voting results and/or the violation is deemed inconsiderable. The same applies to a decision that didn't involve damage to the stockholder. To disallow the claim of nullification of the decision on the abovementioned grounds all the three conditions have to be defaulted in the aggregate.<sup>182</sup>

It is important to also bear in mind that a contested decision may be upheld by court only if it was passed with immaterial breaches of the Joint Stock Law, other laws and regulations, or the company's charter. Material breaches of the legislation render the decision fully or partially invalid regardless of whether or not any stockholders appealed against it or not. In the view of supreme judicial bodies, material breaches include, in particular, a decision that doesn't fall into the competence of the general meeting of stockholders, a decision made in the absence of the requisite forum and decisions made on items that wasn't on the agenda or on that was included in the agenda just before the meeting.<sup>183</sup>

2. The court can also revoke the decision and install a new one.

The possibility to change a wronged decision is mostly in order to amend simple mistakes (and thus spare the stockholders additional costs as for example having another stockholders meeting) but, in combination with the fact that the legislator has put the courts under an obligation to strictly derive the actual circumstances of the alleged transgression, may in some cases result in that quite complicated matters may be decided by the court.<sup>184</sup>

3. Nullify the taken decision

This should only be used if the court can't determine the actual decision that should have been taken (instead of the animadverted decision). The basic principle is that every action/transaction that has been made following the wronged decision should be considered as if it hadn't happened and everything should be restored to the time at the making of the decision.

The Russian legislation is a lot harsher when it comes to the reversing of actions, than its Swedish counterpart. Where the Swedish legislation gives third parties beneficial good faith possibilities the Russian does the opposite. Only if the correct body of the company takes a decision can a third party ever hope to achieve any protection and since it rarely is possible to animadvert a decision that has been made by the correct body, the chances are slim indeed. On the other hand the chances that you'll be able trace down the (if any) transferred funds are probably even slimmer. In the light of the Russian business climate it can't come as a surprise

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<sup>182</sup> Decree of the Supreme Arbitration Court dated 18.11.2003

<sup>183</sup> Decree of the Supreme Arbitration Court dated 2.2.1999

<sup>184</sup> JSL art. 48, a general meeting of stockholders is not entitled to consider such matter or make decisions on them. Therefore a decision of the general meeting of stockholders made outside its competence is legally invalid (null and void), something that is explicitly stated in the Decree of the Supreme Arbitration Court dated 2.4.1997

that most motions of animadversion are usually combined (or rather preceded) by a motion for sequestration.<sup>185</sup>

The Russian sequestration is a very favorable institution from the plaintiffs' perspective. He/she has to make the claim plausible and show that it is likely that the respondent will try to achieve steps to evade remediation but there is no requirement to put forward any type of security for the possible losses of the respondent and the decision is made by the court without notifying the respondent. So while the respondent will not get the chance to speak on his/hers behalf, the plaintiff does not need to guarantee the respondents security from losses (if the court finds the claim to be wrongful at a later time).<sup>186</sup>

### **The Period of limitation**

As in the Swedish counterpart there exists a general time limit applicable to all civil cases.<sup>187</sup> The existing one is set to three years but the legislator has deemed that to be inconvenient in a commercial environment and has thus limited the time of appeal to a strict six months limit. An application must be submitted to the relevant court within the cause of 6 months from the day when the stockholder found out or ought to have found out about the decision taken.<sup>188</sup>

In a number of exceptional cases (concerning grievous personal circumstances) when the court recognizes the plausibility of reasons for which the complainant missed to apply within a given term, the court may renew the application term.<sup>189</sup>

### **Specifics of annulment of decisions taken by the Executive Organs**

There are some specific situations under which the JSL grants the stockholders (who between them own at least 10 percent of the company's voting stocks) the right to animadvert upon the executive organs decisions, those are:<sup>190</sup>

- Decision taken by the supervisory board about not to include an issue to be voted upon at the stockholders meetings in regard to the agenda- or a candidate on the list of nominees for the board of directors or the auditing commission (auditor).
- Decision of the supervisory board not to convene an emergency meeting of stockholders.

Apart from those the JSL of the Russian Federation doesn't contain any separate regulations that provides a stockholder with a general possibility to contest a decisions made by the executive organs of the company, something that seems a bit odd, especially when taken into consideration the enormous power that the board is endowed with. Probably, the main reason for the absence of regulations is that at the time of creation of the Law the legislator considered such protection to be redundant since the power of vesting the board of directors with competence (except for the competences enumerated by the Joint Stock Law) lies with the stockholders meeting.

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<sup>185</sup> Malinovskij p. 436

<sup>186</sup> ibid p. 439

<sup>187</sup> CC art. 295-96

<sup>188</sup> CC art. 497, Zukhanov p. 604

<sup>189</sup> CC art. 205

<sup>190</sup> JSL art. 53-55

Never the less, the courts needed a definite answer (the situation was handled differently from judge to judge and was fast becoming unsustainable) of whether the opportunities of appealing against decisions of the supervisory board are limited to the aforementioned cases expressly provided for in the Law and whether or not decisions of the company's executive body, be they collegial or one-man bodies, may also be animadverted upon in some other way.

The answer to this question, delivered by the joint supreme judicial bodies, states that a decision of supervisory board or a collegial or one-man executive body of the joint stock company may be contested in court by filing a lawsuit demanding that this decision be deemed invalid. Should the decision run counter to the requirements of the Law or other laws and regulations and violates the rights and legally protected interests of a stockholder, the lawsuit may be brought irrespective of whether the Law provides for possibility of appeal or whether no such reference is made, as always it is the joint stock company that will be the defendant in such a case. The position taken by the Supreme Arbitrage Court conveys that the norms that regulate appeals against decisions taken by the board of directors are analogue to the norms used in cases of animadversions of decisions taken by the stockholders meetings.<sup>191</sup>

The Supreme Arbitrage Court stance results in that any decision incoherent with the norms of the Joint Stock Law made by the board of directors is to be regarded as a clear violation of the law. Such decisions are up for appeal in the same order as the decisions made by the stockholders meeting, thus the end result becomes that the guiding light when trying to find the decision that can be animadverted upon should be the provisions about the stockholders exclusive competence, since these issues cannot be handed over to the board of directors, except in limited situations.<sup>192</sup>

### ***Liability of Damages***

During a company's (often turbulent) existence there arises an uncountable amount of situations where the company, its creditors, other interested parties or stockholders sustain losses due to some ones actions/ non-actions. Of those innumerable situation only some few percents of cases will it ever be possible to succeed in getting any form of retribution.

### **The Plaintiff**

While it may be not the most usual way of beginning we have chosen to start by trying to derive who can be a plaintiff. The possible plaintiffs that have the right to file for damages in accordance with the JSL are:<sup>193</sup>

1. The company, usually represented by the board of directors or a group of stockholders.
2. Individual or groups of stockholders.
3. Stockholders of a subsidiary company

The circle of plaintiffs as can be seen is very narrow, the JSL refers all other suffering parties to seek retribution through other legislations. Overall it could be noted that the creditors of

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<sup>191</sup> Decree of the Supreme Arbitration Court dated 2.4.1997

<sup>192</sup> JSL art. 48, 65, Federal law from 07/08 2001 nr 120-FZ

<sup>193</sup> JSL art. 71

Russian Joint Stock Companies have little way to protect their interest before an eventual bankruptcy procedure, something that is strongly reflected by the high interest rates and strict security that Russian credit institutions demand from legal entities.

1. During normal circumstances the executive body represents the company as a plaintiff. Normally a liability case on behalf of the company is thus supposed to be initiated by the board of directors. With respect to the fact that management in major Russian corporations acquires increasingly large stakes, the board is unlikely to take the requisite steps to defend the company's interests (since the board is usually appointed among representatives of the majority stockholders) in cases of disloyalty.

Should the company's executive bodies or the principal (the company that can determine decisions of another company by virtue of holding predominant participation in its charter), be responsible for the damage that the joint stock company has incurred, it is therefore very important to give stockholders the right to representation in court proceedings. The stockholders will thus be the actual plaintiffs in cases where claims are made on the behalf of the company as well as on the behalf of the stockholders.

2. For this reason, the law stipulates that stockholders who own at least 1% of the common stocks have the right to sue for damages, if the damage was caused by a member of the supervisory board, a one-man executive body, a member of the collegiate executive body, or a manager (managing organization). In order for the damage claim to be satisfied the plaintiff is to prove:<sup>194</sup>

- The fact of implementation of the action/failure to act by the board of directors or by the collegial or individual body.
- Fact of the actual sustained damage.

3. Stockholders of a subsidiary company shall have the right to demand compensation by the principal company (or partnership) for losses caused the subsidiary company through the fault of the parent company. The Law doesn't say that in order to sue the principal for damages the subsidiary's stockholders must own a certain percentage of stocks. Hence, any stockholder of the subsidiary may lodge such a claim.

A company shall be deemed to be a subsidiary if another (principal) economic company (or partnership) by virtue of predominant participation in its charter/ capital or in accordance with a contract concluded between them, or otherwise has the possibility to determine decisions adopted by such a company. Seeking damage with the principal is one of the examples when persons outside the company can be held liable, which in common law countries is called "lifting the corporate veil". Of note is that, in accordance with Russian legal tradition, the main principle established both in the Civil Code and the Law on joint Stock Companies on the stockholder "immunity" for responsibility exceeding the value of the stocks, is extremely strong.<sup>195</sup>

In order not to unnecessary complicate the following part of the report we have chosen to, unless otherwise stated, handle subsidiary's responsibilities as a respondent as that of a subgroup of stockholders.

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<sup>194</sup> JSL art. 71, CC art. 53

<sup>195</sup> JSL art. 6

Unfortunately, the stance of the arbitrary courts on this category of cases is not yet clear, since while it is evident that there should be plenty of practical grounds for applying the liability regulations the stockholders make no haste to go to court, most likely due to the fact that such damages are difficult to prove, although the courts unwillingness to accept liability claims seem to start to change.

It is evident, however, that while establishing the fact of damages done to a joint stock company, the court cannot deal with the issue of compensation if no lawsuit to that effect has been filed, therefore it is inevitable that the plaintiff manages to prove that.<sup>196</sup>

- There is a causal correlation between the action and the alleged damage
- That the extend of guilt necessary to hold the body accountable is outside the acceptability of the JSL

## The Respondents and Their Liability

The general provision of the Civil Code in regard to liability doesn't require a willful action; an act of negligence is sufficient to entail responsibility, although naturally the more power to affect and the higher position within the company the greater responsibilities and thus liability is the subject prone to.

The application and definition of liability has caused a certain puzzle in the Russian court practice. While the general provision of the Civil Code is applicable at negligence, the wording of the provision in the JSL is aiming at intentional fault<sup>197</sup>. It was generally agreed that the interpretation of the liability in the JSL was unclear, which caused a fraction in opinion of scholars of its real meaning. It has, for instance, been stated that the fault should be interpreted to only concern situations where managers have violated their obligations as they are regulated in the law or the charter<sup>198</sup>. Since the last amendment the wording of this part has changed, by adding the words "unless other grounds of responsibility are established by other federal laws", thus in principle widening the sphere of responsibility. Unfortunately there are no clarifications on this issue for now and the matter is thus far from certain.

In accordance with the last revision of the JSL the respondent can be one (or some) of the following:

- Individual stockholders
- Company managers
- The members of the board of directors (or other high executive bodies, like the MD)
- The company auditors
- The bankruptcy administrator

Of further importance is the fact that all of the above (except the auditor) is held liable for the damages caused by virtue of violation of the mandatory procedural regulations of the JSL.<sup>199</sup>

**1. Stockholders.** The Joint Stock Law doesn't contain any general rule on the liability of stockholders and neither does the Civil Code, which only touches the liability of the representatives of the company. Provided the stockholder doesn't represent the company, acts

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<sup>196</sup> Decree of the Supreme Arbitration Court dated 1999

<sup>197</sup> JSL art. 71

<sup>198</sup> Ivanov, p. 203

<sup>199</sup> JSL art. 71, 84

on its behalf or fail to pay for his/hers stock commitment the majority of the possible responsibilities don't apply to the stockholder.<sup>200</sup>

Only in situations where the liability is clearly stated in the law or in cases concerning the lifting of the corporate veil (where a stockholder in a dominant position may be held personally liable for all the debts of the bankrupted company) may liability claims be directed at a stockholder.<sup>201</sup>

A novelty is that with regard to articles 83-84 (major transactions and forced reliefs/expropriation) the stockholder may be held responsible by the other stockholders if he, for instance, violates the compulsory formal procedures envisioned by the law, acquires stocks at prices different than determined by the law, or for placing other conditions or conditions diverging from those stipulated by the law. The new amendments do not however regulate how the liability is to be demanded. The JSL states if a contract on acquisition of securities, concluded on the basis of the offer doesn't correspond with the requirements of the Joint Stock Law, the ex owner of the stocks may claim liability of damage, unfortunately the articles fail to regulate the matter any closer than this, so apparently, the damage claims against a stockholder can be made on the basis of the Civil Law<sup>202</sup>.

The lifting of the corporate veil is rarely initiated due to the literal interpretation of the law (unless the issue regards the responsibility of a principal).<sup>203</sup> In the event of the insolvency of a subsidiary company by fault of the parent company, the courts almost always hold them subsidiary responsible for the debts<sup>204</sup>. The insolvency (or bankruptcy) of a subsidiary company shall be considered to have occurred through the fault of the principal company (or partnership) when the parent company (or partnership) used its influence knowing that as a consequence of its actions the insolvency (or bankruptcy) of the subsidiary company shall be ensured.

Flaws of the legislation in the area may however be slightly remedied by means of regulating the question in the company's charter, where as already been noted the stockholders have almost free reins.<sup>205</sup>

**2. The Company bodies.** The article 53, clause 3 of the Civil Code contains a general rule on liability for losses. It stipulates that the person, who by force of the law or of the legal entity's constituent documents comes out on its behalf, shall act in the interests of company it represents honestly and wisely. The person shall be obliged, upon the demand of the founders (the participants) of the legal entity, to recompense the losses he has inflicted upon the legal entity, unless otherwise stipulated by the law or by the agreement. According to this general rule the representative is liable at negligence.

The JSL contains provisions on liability of supervisory board, executive bodies or managers corresponding with that of the Civil Code. The members of the board of directors, one-man executive body of the company (the MD), and/or members of the collegial executive body of the company (the directorate), and likewise the management organization or manager must, when effectuating their rights and performing duties, operate in the interests of the company

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<sup>200</sup> Decree of the Supreme Arbitration Court dated 8.9.1998

<sup>201</sup> JSL art. 3

<sup>202</sup> CC art. 15, Zukhanov p. 239

<sup>203</sup> JSL art. 84

<sup>204</sup> JSL art. 3-6

<sup>205</sup> CC art. 98, 399, Zukhanov p. 406

and effectuate their rights and perform duties with respect to the company in good faith and with common reason.

According to the comments on the Civil Code good faith and common reason is defined so that the managers of a company have to take care of the business as if it were his/hers own and take the necessary precautions to ensure its prosperity. The law further stipulates that as determining grounds for the extent of the liability; the ordinary business practices and other relevant considerations must be taken into account. This is most commonly understood as a general responsibility to look after the benefit of the company and make sure that decisions are made carefully and with good business practice in mind.<sup>206</sup>

In order for the liability to kick in, the manager must be at fault for the damage and there must also be a causal connection between the activity/failure to act and the damage itself. In case several individuals are responsible for the losses the regulations on joint liability become applicable. The company may therefore claim liability from any one of them, who are jointly liable or from all of them. The individuals, members of the supervisory board or executive organs, who voted against the decision or didn't participate in voting, cannot be held liable if they can show that they in fact did not participate and did not have the duty to take action in order to avert the damage.<sup>207</sup>

**3. Appraiser/Auditor.** The Joint Stock Law does not regulate liability of appraisers as such. It only provides for the possibility to use services of an independent appraiser<sup>208</sup> in connection with deals with property where market value of assets is of importance for qualification of transaction or requires that an appraiser should be hired, like for instance in cases of buy out of stockholders.<sup>209</sup>

According to the Law on Appraisal Activity losses, suffered by the assigner, who had concluded an appraisal agreement, or property damages, suffered by the third parties as a result of utilization of final market or other value of the object of appraisal, determined in the account and signed by the appraiser, shall be fully compensated for by the appraiser. Action of the appraiser/failure to act in the process of the appraisal, causing damage, is due to be compensated at the expense of the property of the latter. The appraisal agreement signed with the judicial person as a party may contain provisions placing liability for damages caused by the appraiser on the judicial person, given the appraiser has concluded a labor contract with the judicial person.<sup>210</sup>

Appraisers can either be a member of self-regulative organization of appraisers or engage into appraisal business on the grounds of being licensed independent appraiser. In both cases professionally active appraisers run high risks of causing property damage in the course of their activity by mere miscalculation or misjudgment of market or other values of assets. The risks associated with appraising activity has caused the legislator to place demands that mandatory liability insurance be signed in connection with pursuing appraisal activity.

Appraisers liability is regulated in the Law on Appraisal Activity, articles 24.6-24.8. In case a member of self-regulative organization causes property damage the damage is to be fully compensated by the insurance. Damages that cannot fully be covered by the individual

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<sup>206</sup> Ibid, p 409

<sup>207</sup> JSL art. 71

<sup>208</sup> JSL art.77

<sup>209</sup> ibid, Malinovskij p. 176

<sup>210</sup> JSL art. 24

insurance are due to be compensated by making use of the organizations compensatory fund made up of the mandatory contributions of its members. If an insurance case occurs compensation demands may be placed on the organization in case the individual liability insurance doesn't fully cover the damage and the appraiser refuses to satisfy the demands of the assigner or the third party or the assigner or the third party haven't received any answer from the appraiser within a reasonable period of time. The compensation funds resources are exclusively intended for coverage of property damages and can only be utilized for compensation of damages caused by the organizations members or those being members at the time of damage occurrence.

As to auditors, their contractual liability is not either explicitly regulated in the Joint Stock Law. It can though be derived through articles concerning actions of supervisory or executive bodies. For instance, implicitly established in article 84 of the JSL, with references to article 83, dealing with the order of approval of "interested" transactions, where the relationship between the company's evaluated assets and acquired property may be based on the account report. In accordance with article 84, the "interested" person is liable for the damages caused by his/her actions. Since the article requires intentional fault, the "interested" person, who in good faith relied on the information in the account report for the purpose of transaction, should be able to shift the responsibility onto the auditor in case the "interest" was constituted by the inadequate values presented in the account report. The same applies for cases of major transactions in accordance with the article 78 and 79 of the Joint Stock Law, in case the major transactions at the same time turn out to be "interested" transactions.

The responsibility is also regulated in the Law on Audit Activity. Article 11 of the Law requires auditors to sign mandatory liability insurance. This is highly relevant in the context of this study since the Law establishes mandatory audit controls of open joint stock companies. Intentionally fraudulent auditors conclusion entails annulment of the auditors' license and in case auditor is an independent self-employed entrepreneur it also entails disqualification and liability in accordance with criminal law of the Russian Federation. The liability ground in this case is based on a conviction in a court of law.<sup>211</sup>

### **The Extend of the Liability**

The extent of damages in accordance with Article 71 of the JSL is not limited. The Law assumes, at least, theoretically the principle of full compensation regulated in the Civil Code which states that physical damage as well as losses (lost profits) is both subject to full compensation.<sup>212</sup> The problem (as always) is that there is rarely any one to claim the damages from due to the number of frauds, so called Phone companies (swindlers with nothing but a company name and a cell phone) and other illegal procedures that have been plaguing the Russian business-scene ever since the beginning of the privatization. As a response to this great problem one of the novelties of corporate relations in the Russian Federation is the popping up of mandatory licensees and malpractice insurance for various groups of corporate people (for example the company auditors and independent appraisers). Unfortunately it is still not common in Russian Joint Stock Companies to use voluntarily malpractice insurances with regard to the company's bodies i.e. members of the board of directors or the MD something that can be attributed partly to the low trust of Russian entrepreneurs towards insurance agencies and mostly with the highly unlikeness (for most medium to small companies) of finding an insurance company wiling to take such a risk.<sup>213</sup>

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<sup>211</sup> JSL art. 7, Malinovskij p. 59

<sup>212</sup> Sukhanov, p 643

<sup>213</sup> The Law on Audit Report art. 7, 13

## **The Period of Limitation**

As noted before the Civil Code provides general terms of the limitation of actions. The JSL however does establish different terms of limitation of actions in some cases but in cases of liability claims on the part of a company or stockholders the term of limitation is however the general one, i.e., 3 years.

The proceeding of the term of the limitation of actions shall start from the day, when the person has learned, or should have learned, about the violation of his right. Exceptions to this rule shall be established by the Civil Code and by the other laws<sup>214</sup>.

As in the case of animadversions, when the court in exceptional cases recognizes the cause of missing the term of limitation as valid on the ground of the circumstances (it being related to the plaintiff's personal characteristics, such as a grave illness, total disability, illiteracy, etc.), the citizen's violated right shall still be liable to protection. The reasons for him/her missing the period of limitation may be recognized as valid, if the personal circumstance has taken place within the last six months before the end of the time limit and can never be prolonged for more than six additional months.

## ***The Possibility to Force Release/Expropriate Stock Owners***

The Russian legislation provides almost no regulations where a minority stockholder has any legal possibilities to enforce a decision on the company (reasoning that the most important factor is a strong leadership), instead the legislator has given a stockholder very wide possibilities to force the company or the remaining stockholders to buy the minorities stocks, during situations where the legislator has envisioned a risk increase of continued ownership. While the normal way of withdrawing from a joint stock company is clearly to sell ones stocks to other stockholders or other interested people the Joint Stock Law envisions a couple of cases in which a stockholder may demand that the company repurchase all of his stocks or a part of them; the first type of situations are:<sup>215</sup>

- In the event of reorganization or the stockholders meetings' approval of a major transaction if the stockholder voted against either of the decisions or did not participate in the voting.
- In the event of the stockholders meetings approves of amendments to the charter of association that results in limitations of the rights of stockholders, if the stockholder voted against the decision or did not vote at all.

As can be noted this is typically situations where there might be an immediate danger for abuse and it should also be noted that it is irrelevant of how big the stock possession the actual stockholder has (can theoretically be the most influential) it is enough that the decision was passed with the required quorum.

The next type of situations is where the legislator provides the stockholders with an instrument to force release/expropriate other stockholders. These additions are one of the latest novelties of Russian corporate legislation, in fact amended on the 27 of July 2006 and

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<sup>214</sup> CC art. 200

<sup>215</sup> Decree of the Supreme Arbitration Court dated 2.4.1997 N 4/8

has been lobbied through by major Russian stockholders frustrated by the abuse of the right of putting veto on, for instance, reorganizations by minority stockholders. The main aspect affecting presidential approval is “the strong stockholders aspect”.

The threshold conferring an obligation of expropriation of minority stocks and other securities that can be turned into stocks is ownership of over 95% of stocks of the company (affiliated persons included). The minority that may come to suffer of compulsory expropriation of stocks is thus less than 5%. The obligation of the majority holder is corresponding to the reversed right of the minority holder to demand a forced release.<sup>216</sup>

The stockholder is to notify the minority stockholders of their right to demand forced release. Forced release/ expropriation of stocks can only be carried out in exchange for full payment in money. The notification is to contain the price of stocks; the actual compensation may not fall short of the medium sales value of the stocks, determined in accordance with the results of organized sales of such stocks on the market of securities. The medium sales value is the value registered 6 month prior to the date of sending a compulsory offer to the federal executive body, responsible for administration of the market of securities. If the securities circulate on two or more stock exchange markets, the sales value shall be determined as a medium value of the aggregated sales value of the stocks on all of the involved stock exchange markets.<sup>217</sup>

In case the stocks are not subject to circulation on stock exchange markets or have circulated less that 6 months, the value of the stocks to be acquired may not be lower than the market price, determined by an independent appraiser. This regulation is a lively debated one since there are few guiding lines of how to conduct an evaluation and there can be seen a strong trend that the appraisers are choosing the most beneficial evaluation, from their employers (usually the majority stockholders) point of view. This is somewhat eased by the appraisers liability responsibility and that the notification to the minority stockholders is to contain which of methods and grounds of value calculation that has been used but it still leaves a lot possibilities to misuse the procedure.

If, six months prior to sending a compulsory offer, the person who did so or its affiliated persons had engaged into acquisition of similar securities, the value of the stocks to be acquired by virtue of the compulsory offer shall not fall short of the maximum stock value accepted in the earlier engagement<sup>218</sup>.

Of interest are also the provisions touching upon the obligation of expropriation in cases of major acquisitions. The rule aims at protection of other stockholders interests not to be taken aback by the influence the major stockholder may come to practice with respect to decision making at the stockholders meeting. The regulation is a result of the last year’s centralization of Russian capital and the many scandals, the JSL states that a person who intends to acquire over 30 % of the voting stocks, must inform the existing stockholders of the company of his intentions to acquire the company’s stocks. The term “acquire over 30%” percent aims that the intention to acquire stocks extends its effect to all the cases of acquisition and is generally perceived to be treated as having a prolonged period of existence. The provision provides the other stockholders with the right to demand that their stocks be acquired as in the situations described above. The same is applied if the stockholder already has acquired the upheld quota with the difference that in such circumstances the stockholder must issue a formal proposal to buy the rest of the stockholders stock. The stockholders are entitled to keep their stocks

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<sup>216</sup> JSL art. 84

<sup>217</sup> Ibid

<sup>218</sup> JSL art. 84

should they find it appropriate for as long as the major stockholder hasn't come over the 95% threshold although the acquiring stockholder is only enforced to make the offer once.<sup>219</sup>

A few last words need to be said about the major stockholders right to expropriation. The Law doesn't contain any regulations aiming at protection of stockholders from the abusive or disloyal procedures on the part of the major stockholder. Apart from the possibilities mentioned above the law doesn't give stockholders any rights to claim redemption from other stockholders, which with regard to the procedure of forced release must be regarded as a major shortcoming in the context of protection of stockholders.

## ***Fusion and Fission***

Apart from the Civil Code and the JSL, that stipulates the central provisions/ regulations on mergers and successions, the matter is further regulated in; the Law on Competition and Limitation of the Monopolistic Activity, the Law on Registration of Legal Entities, the Law on Licensing of Certain Types of Activity and the Law on Appraisal Activity (as well as various other acts and decrees).

Because of the share amount of regulation on this matter (that is not taken into consideration in this report), the reader should keep in mind that the following is just a basic explanation of the valid legislation and not by any means a full breakdown of the procedures.

## **The Merger**

Unless otherwise stated by the charter of association, any decision with regards to reorganization shall be adopted by the stockholders meeting only upon the proposal of the board of directors. Submitting the question of reorganization as well as the question, concerning confirmation of the contract on mergers is a prerogative of the board of directors and can thus not be forced by the stockholders. The doctrine and a number of lawyers have expressed strong skepticism to the formulation of the regulation since it in practice robs the stockholders meeting of its exclusive competence to decide on matters of reorganization.<sup>220</sup>

The two forms of mergers acknowledged by the Russian legislation are the absorption and combination. The two procedures are defined in the following way:<sup>221</sup>

- The **combination** of a company shall be deemed to be the arising of a new company by means of the transfer to it of all the rights and duties of two or several companies with the resulting termination of the last.
- The **absorption** of a company shall be deemed to be the termination of one or several companies with the transfer of all their rights and duties to the other company.

As in the Swedish JSL the procedures are not intended to be partial. A Combination of legal entities entails that the rights and duties of every one of them is passed on to the newly emerged legal entity in conformity with the mandatory transfer sheet.<sup>222</sup> The procedure is

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<sup>219</sup> *ibid*, Malinovskij p. 209

<sup>220</sup> JSL art. 49

<sup>221</sup> Malinovskij, p. 322

<sup>222</sup> Civil Code, art. 58

considered started when stockholders, at the stockholders meeting, have voted for the initiation of the coming reorganization. Further the stockholders must agree on the contents of the merger contract, approve of the transfer sheet and vote on nomination of the members of the new board of directors. The transfer sheet shall also contain provisions on the legal succession by all obligations of the reorganized legal entities with respect to all its creditors and debtors, including all obligations disputed by the parties.<sup>223</sup>

In the case of absorption the main requisite is that the involved companies must conclude on a contract concerning the accession. The contract must regulate the procedure and conditions of the accession and also the procedure for converting the stocks of the acceding company to the stocks and/or other securities of the company to which the accession is being effectuated. The board of directors of the acceding company shall also submit for decision of the stockholders meeting the question on confirmation of the transfer sheet.

In order for the reorganizations to take place the stockholders meetings at all companies has to pass the decision on carrying out the reorganization with a majority of 2/3 of the votes represented at the meeting. In order for the decision to be valid no less than 50% of all the voting stocks must be present at the meeting.<sup>224</sup>

The stockholders are further to agree on how to determine the legal succession of rights and obligations as well as value of transferred assets, its composition and type. The merger contract may contain clauses establishing a specific order of concluding deals or/and prohibiting conclusion of transactions from the moment when the decision was made until the reorganization is completed.

The state registration of the newly established entity is prerequisite to acquisition of legal capacity<sup>225</sup>; and it is regulated in the Law on Registration of Legal Entities. A company shall be considered reorganized by merger from the moment of State registration of the juridical person, which arose anew. As to the reorganization by means of absorption, the reorganization is regarded completed the very moment the registration of the termination of the acceding company's activity has been made. The entry is done in the Unified State Register of Juridical Persons and is administered by the Federal Registration Agency.<sup>226</sup>

The registration is thus the key element in the reorganization procedure. In order for a registration to be granted the involved companies must present the Federal Registration Office with the following documents:

- The constituent documents.
- Verification that the decision on reorganization has been made by the appropriate body.
- Authentications of the approval of the merger contract and the approval of the transfer sheet.
- Documents verifying that the creditors have been informed (actually this is a sub group of the above mentioned authentication).

When the documents have been presented the registration office has the right to deny registration only in one of three cases:

1. They have not been presented with all the above-mentioned documents.

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<sup>223</sup> Malinovskij, p. 332

<sup>224</sup> JSL art. 16-17

<sup>225</sup> Zukhanov, p. 107

<sup>226</sup> The Law on Registration of Legal Entities, art. 14-18

2. Application for the registration was given to the wrong state body/ filial.
3. One/all of the companies, making up the newly formed entity that is applying for the registration are already subjected to forced liquidation in accordance with the legislation.

Provided none of the rejection grounds are at hand, the Federal Registration Office must register the merger. The Federal Registration Office is not authorized to try any material grounds for rejection of registration since according to the Russian legislation the material side can only be reviewed in a court of law<sup>227</sup> unless the reorganization of the legal entities shall be effected only upon the consent of the authorized state bodies (this is mainly due to anti monopolistic regulations).<sup>228</sup>

The prohibition imposed on the Federal Registration Office to review any material grounds is heavily criticized in the Russian doctrine. The reason is that in accordance with the Russian legislation you cannot initiate a case against a liquidated company (the best you can hope for is that the court will “lift the corporate veil”, something that is a very rare occurrence) nor can you resurrect the company once it has been liquidated. This in combination with how easy it is to be granted registration (and thus complete a liquidation of some of the involved companies) makes it surprisingly easy to cheat stockholders and creditors by way of reorganizations.<sup>229</sup>

In accordance with the Civil Code the founders of the legal entity or the body, which have adopted the decision on the legal entity's reorganization are obliged to notify the creditors of the reorganized legal entity. The creditor is entitled to claim that the obligation, by which the given legal entity is the debtor, be terminated or that the latter discharge it before the fixed date<sup>230</sup>. In accordance with the JSL, the notification of the creditors and communicating of the decision in press publications, provide for by the Federal Registration Office has to take place not later than 30 days from the date of the adoption of the final decision made by the last remaining contracting partner A creditor shall have the right to demand termination or the performance before time of obligations and compensation of losses by means of written notification within the following period:

- No later than 30 days from the date of the sending by the company to the creditor of notice concerning the reorganization.
- No later than 30 days from communicating the decision in press.

The state registration in situations of reorganizations as well as deregistration of companies is conducted only upon evidence of notification of the creditors, something that slightly remedies the lack of reviewing of the material grounds.<sup>231</sup>

## **The Secessions**

Both the Civil Code and the Joint Stock Law regulate the cases of secession employed by the Russian legislation. As with the merger there are only allowed two forms of secessions, namely The Division and The Branching Off.<sup>232</sup>

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<sup>227</sup> Decree of the Supreme Arbitration Court dated 23.2.1999

<sup>228</sup> CC art. 57

<sup>229</sup> APC art. 44, Jetcenka p. 99

<sup>230</sup> CC art. 60

<sup>231</sup> JSL art. 15

<sup>232</sup> JSL art. 18, Malinoviskij p. 508

1. The division of a company shall be deemed to be the termination of a company by the transfer of all of its rights and duties to the companies created anew.
2. The branching of a company shall be deemed to be the creation of one or several companies with the transfer to them of part of the rights and duties of the reorganized company without the termination of the last.

The differences that stand out in the case of secession when compared to merger, pertain to the questions discussed at the stockholders meeting as well as certain stockholders rights to take part in voting and forming the governing bodies in the newly established entities.

In case of a division the board of directors must submit the following information to the stockholders (at the stockholders meeting):<sup>233</sup>

- The question concerning the reorganization of the company in the form of division.
- The procedure and conditions of this reorganization.
- The procedure that should be used for converting the stocks of the reorganized company into the stocks and/or other securities of the companies being created.

The Division and branching off has the same principal procedure traits and most regulations are similar between the two forms of secession. The succession is carried out in conformity with the divisional/branching balance, containing information on distribution of rights and duties between the newly formed entities approved of by the stockholders meeting. Further it is stipulated that every stockholders stock shall provide proportionally the same amount of rights in the newly founded entity, as the stocks in the reorganized entity. This applies to all stockholders even the ones that didn't participate in the stockholders meeting or voted against the division<sup>234</sup>. Unlike many other situations, the legislation provides the holders of privileged stocks with the right to participate in voting on these questions. The stockholders of privileged stocks however don't have possibilities to influence the nomination of the board of directors of the newly established entity.<sup>235</sup>

Creditors cannot count on any more solid protection in case of secession than in cases of merger. The general rule on informing the creditors within 30 days after the decision was taken applies here as well. Creditors are given yet another 30 days to safeguard their interests by means of demanding payment fulfillment and eventually, damages, before the end of the by law stipulated time.<sup>236</sup>

## Special Issues Concerning the Animadversion of Mergers and Secessions

The main rule when dealing with Fusions and Fissions of a company is that in case the transfer sheet doesn't make it possible to determine the successor of the reorganized company or the debts left behind are not fully covered by assets (in accordance with the balance sheet) then the newly emerged legal entities shall bear the joint responsibility for the debts of the former companies. In all other cases the Russian legislation stipulates that all reorganized legal entities answer only for their own debts and thus as long as the remaining shell is left with enough assets to cover the debts in accordance to **the balance sheet** it is fully legal to plunder the company. From the minorities perspective this causes a major problem since the

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<sup>233</sup> ibid

<sup>234</sup> JSL art. 18-19

<sup>235</sup> JSL art. 48, Malinovskij p. 476

<sup>236</sup> JSL art. 15

distribution of new stock is also conducted in accordance to the balance sheet, something that may result in that the minority is left with worthless over valued assets while the majority disappears with every thing of value. The problem is greatly increased by the fact that the initiation of the procedures as well as the proposal of how to divide the property is done by the board of directors who tends to favor their own interest.

The stockholder, holding any amount of stocks at the moment of the creation of the merger contract may file a lawsuit demanding the merger to be deemed invalid like any other animadversion. The only specific is that the plaintiff must pay special attention so that no liquidation is carried out since that almost certainly leads to the dismissal of the case by the courts.<sup>237</sup>

### ***The Company Liquidation***

A proper starting point when discussing liquidation would be to orientate the reader about the interpretation of the word liquidation in the Russian doctrine and law norms. The doctrinal interpretation of the word is a final termination of the activity of the legal entity without transfer of rights and obligations in order of legal succession<sup>238</sup>.

The general norms on liquidation of any legal entity, joint stock companies included, are to be found in the Civil Code. It contains a list of grounds on which a legal entity can be liquidated in either voluntary or compulsory order. The voluntary ground include, for instance, inexpedience of the legal entity, impossibility to achieve the goals set up in the charter of the company or expiry of period for which the entity was established. A legal entity can also be liquidated in a compulsory order on grounds of operating without license (which is required in certain operation fields) and, for instance, on grounds of numerous and flagrant violations of legislation etc. The law also stipulates additional grounds of compulsory liquidation for some specific types of associational company forms; as an example the grounds of insolvency (the case when a company's net worth has fallen below authorized capital) is applicable only to joint stock companies.<sup>239</sup>

The order of liquidation is set in Article 64 of the Civil Code. Avoiding going into details, we'll just point out its 5 different phases:

1. Nomination of a liquidation commission that takes over the administration of the company.
2. Communication of the liquidation decision in press, encouraging creditors to make claims within 2 months period.
3. Evaluation of creditors debt and compiling of an interim liquidation balance; payment to the creditors in accordance with the balance (if in short of assets they are sold publicly).
4. Compiling a final liquidation balance and distribution of the remaining property between the participants or in accordance with the charter. Liquidation in a compulsory order is carried out in accordance with the Law on Bankruptcy, although the Civil Code still remaining the framework providing the basic provisions.

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<sup>237</sup> ibid

<sup>238</sup> U.K. Tolstoj

<sup>239</sup> CC art. 61-64

Unless the question is about a compulsory liquidation of a company, it is a decision exclusively decided upon by the stockholders meeting<sup>240</sup>. The requisite majority for taking a decision on liquidation is three thirds of the voting stocks. The stockholders meeting shall be empowered (have a quorum) if at the moment of the end of registration to participate at the meeting, stockholders (or their representatives) possessing in aggregate more than half of the votes of the placed voting stocks of the company are present<sup>241</sup>. The decision is exclusive in the sense that initiative to conduct the meeting, touching upon the question of liquidation can come from any stockholder and is compulsory for the board of directors to put forth irrespective of its own stance. Exclusivity of the right lies as well in its mandatory nature: the provision cannot be circumvented either by means of the law or conditions in the charter of association.

Along with the competence to decide whether liquidation is a required measure to undertake, stockholders present at the general meeting are endowed to cast vote on the nomination of the liquidation commission and approve/disapprove of the interim and final liquidation balance.

In order for the question on liquidation to be brought up at the yearly stockholders meeting, the stockholders holding a stock of no less that 2 percent of voting stocks are to notify the company in a period of 30 days upon completion of the financial year, unless a longer term is established by the charter. The question for the agenda of the general meeting of stockholders shall be submitted in writing specifying the reasons for the raising thereof, the names of the stockholder(s) submitting the question, and the quantity and category (or type) of stocks belonging to him.<sup>242</sup>

The board of directors of a company shall thereafter be obliged to consider the proposal received and to adopt a decision concerning the inclusion thereof on the agenda of the stockholders meeting or to refuse inclusion on the said agenda not later than 5 days later. The question submitted by a stockholder(s) shall be subject to inclusion on the agenda of the stockholders meeting, except for instances when:<sup>243</sup>

- 1) The stockholder(s) have not complied with the obligatory time limits.
- 2) The stockholder(s) are not the possessor of the quantity of voting stocks of the company.
- 3) The proposals do not correspond to the requirements of this Federal Law and other legal acts of the Russian Federation.

A reasoned decision of the board of directors concerning the refusal to include a question on the agenda shall be sent to the stockholder(s) who submitted the question or submitted the proposal not later than three days from the date of the adoption thereof. The decision concerning the refusal to include a question on the agenda of the stockholders meeting may be appealed in a court of law.

It is somewhat unclear whether the list of grounds above is exhaustive or not. Should the latter be the case, supervisory board is empowered to refuse to include the question of liquidation on the agenda and even though the possibilities to animadvert are still there, court proceedings may entail a significant delay thus aggravating insolvency situation.

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<sup>240</sup> JSL art. 48

<sup>241</sup> JSL art. 58

<sup>242</sup> JSL art. 53, Malinovskij p. 309

<sup>243</sup> *ibid.*

A stockholder can also demand that an extraordinary stockholders meeting be conducted in order to discuss a liquidation, under such circumstances the stockholders have to amass 10 percent of the voting stocks in order to be granted such a request. The extraordinary meeting is thereafter to be conducted within 40 days<sup>244</sup>. Just like in case with yearly meetings, the proposals may be turned down. The grounds for refusal are obscurely formulated and are as follows:

- The procedure for submission of the demand concerning the convocation of the meeting established by this Federal Law has not been complied with.
- The stockholder demanding the convocation of an extraordinary general meeting of stockholders is not the possessor of the quantity of voting stocks of the company provided for by JSL.
- None of the questions proposed for submission on the agenda of the extraordinary general meeting of stockholders is relegated to its competence.

Clause one of the lists, for instance, clearly provides possibilities for abuse, something that has caused some concern among legal practitioners.

It should also be noted that if there is a case against the company at the moment of liquidation, the liquidation is not allowed to be carried out (rather there will be no deregistration) simply because of the impossibility (at the present time) to continue or initiate a court procedure against a liquidated company.

A final comparison can be made between the Swedish Companies Registration Office and the Ministry of Taxations of the Russian Federation. Where the SCRO has the right to initiate a liquidation of a company that it has lost touch with, the Russian ministry of taxation can file a liquidation case if the company has failed to pay their taxes, the main intent of this procedure is that it allows the removal of “dead” company’s form the federal registers but unfortunately at present time the procedure is usually misused in order to pressure functioning companies in to prioritizing the payment of taxes above all other commitments.

### ***The Distribution of Profit***

The starting point of the JSL is that all sort of profit distribution shall be accommodated by the payment of monetary dividends and only if there is an amendment in the charter of association that says otherwise is it allowed to distribute profit in other ways (like in company property). The starting point is thus that the legislator expects the outflow of company assets to be done by monetary means and not in any other way.<sup>245</sup>

The payment is decided by the way of single majority on the stockholders meeting and can never be done if:

1. The intended amount exceeds the given recommendation of the board of directors.
2. The payment will risk putting the company in bankruptcy (or the company already has initiated the bankruptcy procedure).
3. The stockholders have not yet fully paid for the company stocks.

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<sup>244</sup> JSL art. 55

<sup>245</sup> JSL art. 42

4. There are still unsolved issues regarding forced exit (the involved stockholders have not yet been fully compensated).
5. If the payment will encroach on either the stock capital or the reserve funds.

The minority stockholder can under no circumstances force the company to pay dividends, unless the company charter states otherwise. Making a decision to pay dividends on common stock and preferred stock, if the amount of dividends is not specified in a company's charter, is a right not an obligation of the company, but once the decision to pay dividends has been made, a stockholder is entitled to this payment.

The right is also protected by court- in the event of delay in the payment of declared dividends; a stockholder has the right to go to court to demand that the amount due be paid by the company as well as the right to make sure that his stock is treated like every other stocks of the same type. This regulation poses a severe problem for minority stockholders since it makes it fully possible to "starve" the stockholders unless the charter directly forbids it.

The situation is even worse for owners of preferred stocks since the Supreme Arbitration Court has explained that if the general meeting has decided to pay no dividends or to pay less than the full amount of such dividends as specified in the charter of association, the dividends may not be claimed through a court proceeding, instead the stockholder receives the right to participate in future stockholder meeting as if he/she was in possession of voting stocks. This right starts from the meeting that follows the stockholders meeting that made a decision violating his/hers rights. While this might sound not too bad, in effect it results in that the stockholder (who by default is a minor one) will be in possession of minimal influence and at the same time have absolutely no possibility to force retribution.<sup>246</sup>

Moreover more often than not it is usually not a matter of simple refusal to pay dividends but the reason for the non-payment is that the joint stock company refuses to recognize the plaintiff as a stockholder and consequently his/hers right to any payments whatsoever. As the Presidium of the Supreme Arbitration Court pointed out in that regard, resolving the issue of dividends to be paid on purchased preferred stocks depends on the way the issue of validity or invalidity of contested sales contracts for the purchase of stocks is resolved<sup>247</sup>.

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<sup>246</sup> JSL art. 3, Decree of the Supreme Arbitration Court dated 2.4.1997

<sup>247</sup> Decree of the Supreme Arbitration Court dated 1.6.1999

## **Part Four**

*Concluding Thoughts*

## **Analysis**

Up to this chapter our pursuit has been to keep the descriptive parts on national regulations separate. The aim of this chapter is to review these regulations in the light of each other, to illustrate similarities and differences and consequences of the latter. In the course of this discussion we are going to allow the regulations intertwine in a certain extend, trying to point out the differences where appropriate.

To note is, therefore, that, unless otherwise stated, the discussed question is equally relevant (and regulated in a similar way) in both national legislations, whereas emphasis will be placed on the relevant differences.

### ***The Legislative Comparison***

We are going to start of the analysis by answering our first two questions at issue, them being:

**What kind of legal protection does the Russian and Swedish legislators empower their stockholders with in regard to protection of their stockholders rights?**

and

**How do the regulations differ from each other and what strengths and weaknesses do the systems have when compared to each other?**

As we have mentioned in the section “Question at issue” of this report the first question is thoroughly handled in the informational part of this report and therefore needs little extra attention and the second one is also somewhat self-explanatory and hence these two questions are only going to be given superficial attention to highlight some of the more interesting occurrences.

To keep it as simple and structured as possible we are therefore going to keep the same structure as prior and discuss one area of interest at the time, starting from the beginning.

### **Jurisdiction and the Arbitrary Procedure**

The Swedish and Russian legislations are both based on the incorporation principle, which leads to the same kind of problems and benefits for both legislations. Apart from the mutual problem of changing of nationality the only difficulty that can be found on this stage are both found in the Russian legislation.

The mentioned problems are the split competence between the two civil courts and the uncertainty of how to handle the arbitrary procedure. These issues have been handled in the Russian part and we therefore see no reason to repeat ourselves here, so we are just going to offer up some quick thoughts on the matters.

The seriousness of the split competence is very severe indeed. There is from our point of view (and from what we could gather our opinion is shared by the majority of Russian legal

professors) little logic in that exactly the same type of cases risks being handled by two different court systems. Already there have been instances where The High Courts have handled cases that are only differentiated by the fact that the respondent is registered as a different type of legal entity. While for now the rulings have been close to identical, there exists an anxiety for the day that their rulings will not coincide. Again the situation should probably not be exaggerated since the number of mutual decisions on questionable situations seems to indicate that the High Courts are fully aware and set on prevent this from becoming a reality.

The question of the arbitrary procedure, while presenting a big problem, is best left alone for now. The Russian legislator has promised to resolve the situation during the year of 2006-2007 and until then it is probably safe to recommend a foreign investor to stay clear of all Russian settlement institution, relying only on internationally acclaimed ones.

### **Specifics Concerning the Material Protection**

Under this heading we discuss (and to some extend compare) the following regulations:

- The Fair Play & Grounds of Disqualification (in the Swedish part)
- Major transactions & Transactions with an Affiliated Person (the Russian equivalent)

It is sufficient to say that already at this stage the differences in regard to the stockholders protections are becoming quite obvious. The Swedish regulations is far from perfect but still offer an all around protection and is really set on preventing most forms of abuse. Its Russian counterpart only regulates two basic situations and even then it leaves a lot of possibilities for abuse.

Since there really are few similarities in the way that the legislators have handled the matters in this part we will skip any further comparison.

### **Animadversion on Decisions Taken by the Company Bodies**

To begin with one could say, that Russian corporate culture is distinguished by the managerial approach, abandoned by most market economies, whereas the Swedish Law on Joint Stock Companies is generally founded on the market oriented approach, with agency theory as its base. The differences in protection level are to a great extend stemming from different perspectives on who is in whose` service. As a result the rules on corporate governance in Russia have been criticized as giving too much swinging rum to the management and too little protection to the stockholders, while the Swedish legislator (in our opinion) offers a more thought through solution.

A general conclusion can be drawn that while both national legislations allow individual stockholders to animadvert upon the stockholders meeting the Russian legislation greatly limits the possibilities to succeed with the animadversion compared to its Swedish counterpart. Further it quickly becomes evident that the Swedish JSL provides the company with a lot more safety valves in the form of numerous obligations for the board of directors to take action against misconduct. It is, in fact, in certain cases forced to animadvert upon taken decisions.

Having said that, it is worth pointing out that the Russian legislation actually provides with the better animadversion possibilities. The Russian legislation allows fewer situations where an animadversion can be carried out. It gives the plaintiff a lot better chances of succeeding with said animadversion mostly due to the greater possibilities of forcing the reversal of improper transactions and at the same time providing better sequestration regulations (and hence making it more likely to stop an improper action).

Speaking of the sequestration we would like to add that, while both the Russian and Swedish sequestration are similar in application and structure they have one important difference: the Russian one is far more favourable to the plaintiff and potentially damaging to the respondent than its Swedish counterpart. This is due to that the Russian law does not demand that the plaintiff puts forth any type of security and the willingness of Russian courts to grant sequestration on doubtful grounds.<sup>248</sup>

So, while the Swedish procedure might result in great liability costs for the plaintiff (or the refusal due to the inability to put forth adequate security), the Russian might lead to huge losses for the respondent caused by disloyal actions of a plaintiff. Yet, the existence of such procedure greatly increases the usefulness of the animadversion and, in our view, the gains far outweigh the possible losses if used with a certain amount of care.

## **Liability of Damages**

The general provisions are fairly similar. The main plaintiff is considered to be the company, while the respondent will be one of the company's bodies. According to both legislations the general rule for the company representatives is that negligence is sufficient to trigger their responsibility, while the owners are almost untouchable. The concept of "lifting of the corporate veil" is regarded mostly as doctrinal problem than something actually used by the courts.

There are, of course, differences, like the Swedish legislation offering a better explanation as to in what kind of situations that liability can be claimed and the Russian liability being stricter in its implementation (due to the laws perception of it as being a punishment), but on the whole we feel that there is only one special situation that really needs to be highlighted.

The situation is the Swedish laws places strict requirements on the board of directors to act on the behalf of the minority stockholders. This regulation that has absolutely no equivalence in the Russian law is, in our view, one of the most important differences between the different protective legislations. For now, it is a common known fact that Russian company managers are prone to disregard the most rudimental rights of minority stockholders, something that owes its existence to the relatively low risk of suffering any kind of negative consequences. By placing personal responsibility on the management, the Swedish legislation really minimizes the risk of most forms of misconduct that many Russian joint stock companies are currently struggling with.

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<sup>248</sup> During our stay in Krasnodar there were no less than two major scandals (involving multi million companies) where judges were accused of being a bit to "eager" in granting sequestrations that resulted in major losses for interested parties. Anyone more interested in the actual details is advised to look into the resent dealings of the telemarketing market, especially the company Megafon.

## **The Possibility to Force Release/Expropriate Stock Owners**

Both Swedish and Russian legislation provide the stockholders with the possibility to force release/ expropriate other stockholders. The main legislation is quite similar; both provide this possibility in situations where the overwhelming majority of all stocks are concentrated in one camp; the difference lies in slightly different requirements for the amount of stocks that must be acquired.

Having said that, it is evident that Russian legislation offers a lot more situations where the company or other stockholders are forced to force release individual stockholders. The reason for this is simple (and has already been mentioned), the Russian legislation offers few possibilities for a disgruntled owner to amend his/hers situation by leaving the company. Whereas the Swedish law goes as far as to (in extreme situations) give a minority the right to force liquidation of a company, the Russian stockholders can't even demand any kind of profit distribution. Therefore the greater possibilities to force an exit are not only fully justifiable but probably a necessity in order to enable any kind of minority ownership in a Russian joint stock company.

The only thing that we find really remarkable is the regulations concerning the situation where a stockholder acquires more than 30 percent of all company stocks. According to the Russian law, such a stockholder must offer (and thus be able to) buy all the remaining stocks in the company in question. First and foremost, this creates some odd situations; for example a stockholder will have to make a formal offer to become the sole owner but at the same time he may very well be forbidden by the monopolistic regulations from acquiring the majority of votes.

Secondly, regarding enormous values that multi national companies can be holding, an investor may not have access to the necessary funds to go through with such a major purchase something that may result in an economical disaster for the buyer. While it is for now a bit early to judge what kind of repercussions the named regulation will lead to the general feeling seems to be that the regulation is a bit too radical.

## **The Company Liquidation**

Where Swedish law stresses the free will of the owners, the Russian legislative counterpart is a lot more interested in the notion found on the continuing existence of the company. A prime example of this is the different voting requirements in regard to handling the question of the company liquidation. From the focus of this report the major implication of this difference is the much more restricted force liquidation regulations in the Russian legislation. The Russian law hardly gives any right to force liquidate the company against the stockholders will and in some cases even allows the board of directors to disregard a motion for liquidation from the stockholders. Further it is only possible to achieve force liquidation in Russia by a direct court ruling, where in Sweden the registration office can (in some cases) make the decision.

## **Fusion and Fission**

At a first glance both regulations concerning mergers and successions are fairly similar. They use exactly the same form of reorganizations, require the same type of formalia and enforce more or less the same form of requirements in regard to making the actual decision.

When taking a deeper plunge into the issue, one finds that Russian stockholders, generally, have a lot more to worry about in the event of reorganization. The possibility for abuse coupled with the lack of governmental control really puts a lot of responsibility on the individual stockholders to make sure that no disloyalty occurs. This is the kind of responsibility that Russian stockholders are ill equipped to handle, judging by the number of court cases on the matter.

Having analyzed that, it comes as a real surprise that for a change the Russian legislation provides a slightly better protection to the minority stockholders than the Swedish law in the event of a merger. The protection in question is, for the time being, possibility to circumvent the expropriation threshold (set at 90 percent) in the Swedish law by use of the merger procedure. While the same type of procedure is allowed under the Russian law, the difference lies in the fact that the compensation (according to Russian law) must be in stocks of the new company, while the Swedish allows for a monetary one as well. This results in that in reality the expropriation threshold of the Swedish law is set at a 2/3 majority and not at the intended 9/10.

### **Distribution of Profit**

From our point of view, one must, before investing in a Russian joint stock company, make sure that this issue is strictly regulated in the charter of association, since the Russian regulation must be a dream come true for a disloyal majority owner and vice versa. The possibility to (unless stated otherwise in the charter) starve minority stockholders (in reality it might be possible to starve individual types of stocks as well), the lack of clearly defined ways to transfer capital and the absence of any “fair play regulations” is absolutely mind-blowing.

On the other hand it must be admitted that the possibility for a minority to pay dividends, offered by the Swedish law may be a bit too generous from a wider point of view. The implication of such a regulation is that a company loses out on possibilities to harness capital for future investments, resulting in a possible slow draining of said company and less interest from owners in future investments.

### ***So which legislation offers the better form of protection?***

After giving a brief comparison of the main strength and weaknesses of the two legislations we find it appropriate to take a look at the most interesting (from our point of view) question, namely:

#### **What are the reasons for the (if any) differences between the two legislations and can one of them be said to offer a better protection to stockholders?**

In order to be able to adequately answer the defined question we think it's appropriate to look at the aforementioned protection rules from two different angles, one being strictly theoretical and the other more practically inclined.

## The Theoretical Approach

Initially, when we started writing this report, we thought that the Swedish legislation would be superior to its Russian counterpart in nearly every way, even disregarded all the anomalies created by the Russian legal situation and approach the problem from a strict theoretical point of view.

The reason we thought so was not due to us being bias (we are Swedish law students after all) but due to the following simple reasons:

1. The Swedish JSL is a monster of a project, that took more than 15 years to develop and consisting of almost 800 articles while its Russian counterpart was something of an emergency plan that has more akin to a patch-quilt than a law.
2. The Swedish (or more accurate the western) legal tradition (when dealing with free entrepreneurship) is far more developed than the Russian.
3. Overall the Russian free economy has only been operating for two decades and that is far to little time to fully test and adopt appropriate legislative countermeasures.

At least a dozen or more different reasons could be introduced, but we think that the readers should be able to get the picture with the brought examples.

Once we actually started to become engrossed in the specifics of the legislations, we, surprisingly enough, came to a different conclusion, not with regard to stockholders protection (we still believe that a Swedish stockholder and especially a minority one has a vastly superior position than its Russian counterpart) but with regard to what legislation we find most favorable since the two legislations have very different priorities (more on this later).

The Russian legislation can be concluded to give the stockholders a stronger position than their Swedish counterpart in the following matters:

- Greater possibilities to animadvert upon a taken decision. While the actual situations where an animadversion can take place is far sparser in accordance with the Russian law, the greater chances of succeeding, coupled with a far more beneficial sequestration procedural really makes the Russian a far better deal from a stockholders perspective than its Swedish counterpart.
- Better position in case of a hostile take-over or in a great shift in power balance. The unconditional possibility to force the acquirer of more than 30% of the stocks to buy your stocks as well is (maybe even a bit to) fantastic.
- A lot more freedom in regards to how the company should be run. The great freedom of what to put in the Charter of Association combined with the importance that the charters is given by the Russian legislator really allows the founders (and later the stockholders) of the company to suit the company to their liking.

The Swedish stockholder is in a better seat, compared to a Russian one, in the following circumstances:

- The increased responsibility upon the Swedish management in the form of risking responsibility for caused damages.
- Better insight and over watch possibilities. The Swedish legislation forces the joint stock company to both employ a "neutral" accountant and under specific conditions

appoints a minority one. This coupled with the above mentioned liability gives the stockholders a fairly good chance of being notified of any inconsistencies.

- Much better (even though sometimes still not fully satisfying) possibility to succeed with a liability claim.
- Greater insight from third parties (due to the registration and its publicly nature) that also enables for better controlling possibilities.
- Far better (even if less frequently used) protection against severe negligence, which epitomes in the possibility to liquidate the company.
- Rights to demand annual profit distributions that minimize the risk of any possibilities to starve individual stockholders.
- Greater chances when it comes to affect decisions. The Swedish law states more situations where a decision can only be made by the stockholders and also provides with higher voting requirements on specific decisions (hence greater influence for the minority) than the Russian one.

Weighting the different pros and cons that are given to the stockholders by their respective legislations it must be said without any doubt that the stronger protection is given by the Swedish legislator, especially when taking in consideration that the most prominent need for the protection is when the wronged party is a minority stockholder.

The increased protection of minority stockholders is of major importance and of course coincides with the simple fact that they have a lot less influence on the running of the company. It can even be argued that the majority owner should not be able to take advantage of the given regulations at all, since in the end the damage caused by a company's executive organs can all be blamed (to some extend) on the controlling party due to the fact that the majority stockholder is the one responsible for electing the representatives in the first place.

While we personally think that such a view to be a bit rash, we definitely feel that neither legislations takes enough consideration to the fact that the majority owner has a lot more responsibility in regards to disloyalty from the executive and/or monitoring bodies. We feel that it would be adequate to enable the minority owners to, in situation of severe misconduct from the company representatives, be able to claim liability from the people responsible for their appointment to a higher degree than at the present time, especially in situations where the misconduct is of such severity that it is bordering on situations akin to the "lifting of the corporate veil". While such regulation would really strengthen the vulnerable position of the minority stockholders it is probably something that is highly unlikely to ever happen simply due to the maintenance of the main benefit of a joint stock company (the great protection against loosing more capital than investing).

Getting back to what was previously said, the Russian legislation definitely provides the minority stockholders with fewer possibilities to protect themselves from abusive behavior caused by the various bodies of the company or/and the majority stockholders. This is somewhat redeemed with greater possibilities to leave the company in pressing or "dangerous" situations but it still leaves a lot less satisfying protection than could be expected from a modern joint stock legislation.

## The Practical Approach

So, from a theoretical point of view the Swedish law is superior to the Russian one in almost every case (when speaking of the protection of stockholders). Unfortunately, when taking into account other factors (such as time and evidence) one cannot help feeling that a lot of the given protections are very inadequate in providing the stockholders with the security that the legislator had intended and thus the situation becomes somewhat altered.

To clarify this statement we'd like to show the connection between the main protective regulations and a company's operational process. If grossly simplifying then any decision made by a company has to go through the following stages:

1. **The Stage of Preparations**, where the company gathers the relevant information in order to make a decision. According to the law, the individual stockholders are competent to put forward a proposal, in practice; other bodies of the company initiate the absolute majority of decisions. Those decisions are based on the information, gathered by other bodies of the company, as they are by far the most knowledgeable of the company situation. In Sweden the initiative can be taken by the administrative bodies and the MD, the same applies for the board of directors and one-man/one-man and collegial executive bodies in Russia.
2. **The Stage of Execution** is the one, where the authorized body formally/informally makes a given decision and then begins its implementation. The general lack of insight in the company's situation on the part of the individual stockholders usually turns the actual decision making mostly into formalia, since the actual decision frequently has the characteristics of being either:
  - A) Outside of the stockholders meetings competence (and hence is not presented for the latter). This is far more likely to happen according to the Russian regulations; but somewhat fluctuating and overlapping jurisdiction of the bodies in joint stock companies in accordance with the Swedish regulations makes the risks not totally unlikely.
  - B) Decided on the preoperational stage, since it is rarely that the MD or board of directors will present a major proposal without expectations of support from the majority stockholders and will certainly flavour the facts towards their preferred course of action.

After the actual (formal/informal) decision was made, it is usually initiated into action. Depending on the decision the time from the initiation to its completion can take anything from a few hours to several years depending on the intricacy of the endeavour.

3. **The Aftermath**. The stage when a decision has been carried out, all the transactions has at this stage been completed. Unless someone of the involved parties feels wronged then the process is considered to be finished.

So how does the various protective mechanisms function on the different stages of the decision-making and can it be said that they offer enough protection to the individual stockholders?

## The Stage of Preparations

Without taking too much of a risk it is probably safe to state that most cases of potential violations can and usually are, avoided by the simple fact that the involved parties are aware of the valid regulations and are unwilling to break them. It is perhaps also safe to assume that most violations that do occur are thus more a result from negligence and ignorance of a given regulation than anything else.

Starting from the above statements it is thus generally perceived that only a small amount of cases are violations in its true sense, being a result of intentional actions, since it can be assumed that trustees and owners generally want the best for their company. The essence lies therefore, inherent in the preventive side of any legislation, the discouragement to act wrongly, rather than the possibility of invoking any of the actual litigious protections provided by the law.

Therefore we believe that all the protective regulations are of most importance at the stage of preparation simply due to the preventive effect that they have on the involved parties. In order for the legislation to achieve any kind of preventive effect it has to be able to cover the following two aspects:

1. The actual regulation (the material part of the law) must be exhaustive enough to cover the possible misdemeanours that might arise; after all as long as certain behaviour will be legal there will be little that stops the participants from taking advantage of a possible legislative error. As already been noted a loyal (to the principles outlined in the JSLs) and knowledgeable body which follows the by law outlined requirements will avoid any misdemeanour and thus implementation of any of the other safety/punishment mechanisms. Most unwanted (from legislative point of view) actions are therefore avoided simply due to the fact that the persons involved in the decisional process restrains from going forward because of the known consequences that are enforced by the litigious threat.

Unfortunately, since the picture of an all knowing and fair collection of company bodies has proven, time and time again, to be less than accurate, it is not enough to create a functioning set of rules; you must also be able to enforce them. The key for success is, therefore, ensuring loyalty towards the company from its various bodies. As long as all company bodies share the common goal of doing what is best for the company there is little need for the use of any of the litigious regulations and there will seldom arise any risks for any misbehaviour.

2. There must therefore be a suitable incitement<sup>249</sup> for following the actual regulation. Hence the material regulations are not the only ones to be of interest at the stage of preparation. The litigious protection of stockholders comes into play on the preoperational stage simply due to the fact that if the material part is not adequately backed up by sanctions it doesn't matter how good protection it might provide in theory unless there is something that provides a possibility to enforce the use of the said regulation in practice it becomes useless.

Comparing the two legislations, the Swedish law has without much doubt, managed to achieve a much better overall enforcement of the mentioned requisites. For example, the Swedish law stresses the fact that it is highly inappropriate to risk any kind of conflicting interests between the involved parties and the company and therefore ensures a central role to

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<sup>249</sup> It really does not matter if the incitement is a punishment or a reward, the only thing of importance is that it is sufficient to ensure that the given regulations are being followed.

the various grounds of disqualification in the JSL, ensuring much less biased governing bodies.

The Swedish regulation further places great emphasis on the stockholders possibilities to monitor and control the activities of the management and it seems that a great effort was put down to facilitate the loyalty of the board of directors and the MD towards the company by for example the threat of extended personal liability.

The Russian legislator, on the other hand, has, unfortunately, chosen to only regulate the most urgent and critical matters. The Russian law provides few preventive mechanisms and those that it does offer are ill equipped to handle the actual transgressions, something that worsens the security of stockholders while at the same time offers more unneeded manoeuvring space for the company management. What's worse, by giving the management almost free hands and very little need to worry about possible repercussions, the Russian legislation almost encourages towards disloyal behaviours since there is little to fear while much to gain.

The Swedish set of rules gives the minority thus a better protection (due to its wider sphere of application) on this stage of the decisional process while the Russian law offers the stockholders a somewhat more flexible approach, something that greatly favours the major owners and allows for more individualized solutions.

A note should though be taken on the fact that worse protection regulations provided by the Russian law is by no means a coincidence. The imbalance is a direct result of the Russian legislator's main priority of providing the company with a stable and efficient management and only then secure the rights of the company's stockholders.

The Russian legislation is therefore content with preventing the worst kind of misconduct reasoning that the operative freedom of the company is more important than lesser misconduct. The problem with such an approach (as we see it) is that the Russian legislator fails to recognize that the company needs to be protected against the misconduct from the governing bodies as much as the various stockholders and since experience has shown that if the company bodies will be more or less unbiased, has no conflicting interests with the company and withhold from unnecessary favouring of various stockholders the risk of any form misconduct becomes minimal.

Because of this, the Swedish law is miles ahead of its Russian counterpart since the implementation of preventive regulations (like the Fair Play regulations and the Grounds of Disqualifications) are far more likely to be able to provide the stockholders with a loyal governing structure than the Russian equivalents could ever hope to achieve.

### **The Stage of Execution**

The problem of relying solely on preventive protection is that the majority of situations where they become inadequate (major and/or deliberate transgressions) are also usually the most harmful to the company.

Thus in cases where a court dispute becoming a reality the different litigious protections become the central means to ensure that the stockholders rights are being upheld especially since at this stage the wronging party has already disregarded (knowingly or unknowingly) the material regulations.

The litigious mechanisms are always based upon one of the various material regulations given in the JSL and/or other laws and legislations (or rather they are usually a form of animadversion). It is not a protection *pre se* but a *mean* that allows the realization of the various protections. Hence, while most of the regulations that are targeting protection of stockholders are designed to withhold executive personnel from doing things, these regulations targets the moment between the taking of the decision and its completion. While these regulations usually have a lot less value to the major stockholders (due to their dominate position and major influence over the board of directors) they give the minority a way to ensure that their rights will be respected. Simply the threat of for example a forced liquidation, however unlikely it might not be, will in most cases discourage the majority owners from abusing their power.

In order to make the threat more likely to discourage misconduct both the Russian and the Swedish legislations have been designed to be able to target executed decisions as well as decisions during the process of execution and has therefore the potential to affect a fairly long time span (especially according to the Russian law, simply due to the much fewer possibilities of a good faith acquisition). Even though the legislations provides with a lot of protective options that can be used at this stage (like the possibility to animadvert) we feel that in reality these possibilities are mostly blunt and inadequate instruments.

If one would take a look at the possibilities where the need to initiate the litigious protection is most likely to occur one will be able to list the following situations<sup>250</sup>:

1. Criminal actions initiated by the owners/management intended on severely damage the rights of either stockholders and or creditors/interested parties.
2. Disloyal and inappropriate behaviour from the management (the board and MD foremost but also auditors and other key personnel) results in the taking of a wrongful action against the stockholders.
3. Disloyal and inappropriate behaviour from the management (the board and MD foremost but also auditors and other key personnel) and or the majority stockholder(s) results in a violation of the minorities rights.
4. Disloyal and inappropriate behaviour from the management (the board and MD foremost but also auditors and other key personnel) and or the stockholders that results in a violation of the rights of creditors and other interested parties.
5. Inappropriate behaviour of the same type as the above mentioned (2-4) but with the difference that the violation of regulations occurred due to inaptness and lack of knowledge and not due to specific agenda.

The situation described under paragraph 1 is more interesting from a criminal law point of view, than from a civil one. The situations in questions can be a number of different things ranging from situations of shady enterprises where companies are being butchered (their assets disappear together with the responsible people), disloyal reorganizations and situation where company management uses false accounting and other illegal means to cover up the real status of the company to company management that feathers its own pockets.

Since we have chosen to limit our self within the frame of the exclusive joint stock legislation we are not going to dwell on this matter any more than necessary. Sufficient to say is that if

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<sup>250</sup> It should be noted that while both the Russian and the Swedish regulations only rarely explicitly states that the plaintiff has to suffered a damage from the taken action, there are few cases where a court would revoke a taken decision without solid evidence of an occurred loss. Also it is not enough that the behaviour in question is inappropriate and disloyal from a common view, it has to be in violation of the JSL and or other regulations.

judging by real life situation the corporative safety mechanisms is ill equipped to handle situations where the sole purpose of the endeavour is to cheat other interested parties. Especially when the nature of these types of endeavours is that by the time that the wronged parties become aware of what is going on the situation is such that the damage has become irreversible. The disappeared assets are almost always impossible to locate (in many cases they ceased to exist long before the revelation of the situation) and the losses suffered by the company is of such huge proportions that the befallen subjects rarely can hope to achieve any kind of redemption or compensation.

The difference between the situation above and the one described under paragraph 2 is that here the top management doesn't have the incitement to line their own pockets, they might very well have acted in the (perceived) interest of the company but they simply overstepped their boundaries for various reasons. If the wrongness is discovered at an early stage (not to likely unless it is really blunt) the actions maybe revoked, unless of course one of the numerous god faith situations have occurred. Not to mention the difficulties involved in reversing complex and time consuming operations (if at all possible) resulting in that an animadversion is highly unlikely to be of any real value after a successful execution.

Of not is that we feel that the Russian and Swedish regulations more or less equate each other at this stage, since, while the Russian legislator have given fewer possibilities to animadvert upon taken decisions the actual animadversion is by far much stronger instrument due to the much lesser possibilities to extinguish the rights to animadvert and acquire good faith.

Situation 3 is usually endeavoured when a stockholder acquires enough stocks (or a group of stockholders join forces) to achieve a majority of the votes. As soon as a party gets the dominant position odds are that the management starts to favour (due to the majorities influence on the representatives) the majority stockholder and the situation can easily spin out of control. A major stockholder is unlikely to damage the company and when he/she does the situation can usually be reversed due to low chances of good will acquisitions and or high probability of being able to get compensation.

While, at a first glance, the protective mechanisms seem to provide the minority with a strong instrument, in reality it is rarely the case simply due to the fact that the majority of the procedures are clearly based on a (sometimes silent) damage requisite. The difficulties involved in proving that a damage has occurred and that the acclaimed liability was due to the questionable decision leads to that only the most insolent misconduct will ever be possible to reverse and when such circumstances are at hand the odds are that we are far more likely to have a situation akin to the one described under paragraph 1.

The forth case is beyond the scope of this report but generally neither the Russian nor the Swedish legislation gives a third party any possibility to interfere with the company's decisional process (unless specifically agreed). Saying that it should be noted that while forbidding third parties to directly interfere it gives them an indirect right due to the enforced liability responsibility on the board and MD in case of negligence and failure to act (especially from a Swedish point of view).

The last situation, when the misconduct is a result of some kind of honest mistake, there usually is no need to act, since it could be assumed that the wrongful body will do everything in its power to set things straight and most of the situations where that won't be possible will be of such nature that any reversal will be impossible (due to good will acquisitions) and no liability can be claimed (due to non, or to little negligence).

Taking the above into consideration, we'd like to state that the use of the litigious protection at the stage of execution (where it is most needed) is most likely to be efficient in situations where it is least needed and a lot less likely to achieve its goals where it would be most useful. This is, probably, the result of that the legislator and actors on the market all seem to value the need of predictability (between business partners) a lot more than the individuals need for protection which if coupled with the nature of joint stock companies (relatively high turnover-ability) gives the end result in that they are ill equipped to handle inside frauds and questionable dealings of trustees.

Having said that, there is one litigious procedure that if used properly gives a lot more bite to the protections offered to the stockholders, namely the sequestration. If used properly the procedure results in the possibility to stop the execution of the animadverted decision and thus greatly increasing the possibilities to enable the aimed reversal. This possibility results in that if any wrongness is discovered at an early stage (almost all decisions taken by the stockholders meeting) can be stopped if the plaintiff acts fast enough.

Unfortunately, the procedure still does not, in our opinion, provide with satisfying protection, since it depends on rapid acting by the stockholders, which can be problematic to achieve in reality, especially if taken into consideration the rarity of the stockholders meetings and the stockholders dependence on the information given by the governing and monitoring bodies, the bodies that the regulation is most likely needed as a protection against.

The above-mentioned reasoning holds equally true in both the Russian and Swedish legislations but when compared to each other it is clear that the Swedish law gives far more possible litigious protections while the Russian on the other hand provides with the ones that are more likely to be of any real effect due to the more beneficial sequestration procedure, the greater forced exit possibilities and higher chances of a successful reversion in cases of animadversions.

Therefore as unlikely as it might seem we find that the Russian law actually provides with a more useful (and thus thought through) protection in cases of reversing/ preventing the execution of unlawful actions.

## **The Aftermath**

At this stage the by far most effective (from our point of view) and in many cases the only protection available is the liability claims that the persons responsible for taking a certain decision risk facing. If looking at the different ways that the legislators have chosen to regulate the matter of liability there can be seen two different types of thought:

- The traditional view (the Russian way), which sees damages as a punishment for the wrongdoer (neither Russian law, irrespective whether it is civil or criminal, nor the doctrine allows for any type of adjustment or “easing” regulations in cases of damages).
- The economical view (the Swedish way). This is a more pragmatic approach that concentrates on the on compensational side of the liability.

While there have been voiced concerns (in the Swedish doctrine) about the damaging effects of management insurances almost every open joint stock company enforces it on their management. Personally, we find the fear irrational and ridiculous, since the overall purpose of a liability is to ensure that the equilibrium is restored and to keep the wronged party from

taking any losses. Especially from a minority stockholders perspective there is little interest in punishing the management, since the actual stockholder has no or minimal influence. Their major concern is to cover their losses and whether the actual wrongdoers are covering them or an insurance company has usually little to no consequences. The major stockholders might be more interested in retribution since their trust has been compromised but then again they were the ones that agreed on the insurance in the first place so the reasoning doesn't make any sense.

Finally, since no insurance company will ever cover culpous actions there is little need for a parenting set of rules since the most obvious cases will still be handled through personal responsibility. While in such instances there it might be harsh to punish the stockholders it could (and from our point of view should) be argued that such gross miscalculations should be the problem of the stockholders (they were the ones that elected the wrongdoers in the first place).

Of special interest in regard to the liability claim is the Swedish regulation that forces the board and MD into action on numerous occasion or face the risk of paying for the damage. While the Russian legislation also contains long going liability responsibilities the beauty of the Swedish one is that it forces the company executives to be a lot more loyal to each and every stockholder instead of favouring the majority owner; which would be the case (the hand that feeds the mouth) if they did not risk economical sanctions. There is, of course, a downside to the strict set of rules enforced by the Swedish legislator in that the management of the company risks becoming more passive and is a lot more likely to take the safe approach in situations where the company might have benefited from unorthodox methods. The risk for this passivity should although not be exaggerated, especially due to the already mentioned tendency to ensure the people in the main bodies from this type of liabilities, something that considerably lessens the risk.

As in most other instances there can again be seen that the Russian legislator has been much less strict and a lot more open towards the parties, which while giving the stockholders less safety and a far worse protection in the final stage might benefit the company in the long run (although judging by the Swedish experience and the ongoing debate in Russia, about misuse of rights, it is much more likely to have the opposite effect).

The only exception to the more relax liability claim in the Russian legislation is the company managements responsibility for taxation deficits, a responsibility that closely mimics its Swedish counterpart in its build, mostly due to the fact that a lot of the Russian tax legislation is directly based on its Swedish counterpart.<sup>251</sup>

## **Rounding Up**

To round up we find that it safe to say that the Swedish JSL without any doubt provides a far better overall protection than its Russian counterpart. This statement holds equally true no matter how you chose to approach the protective regulations. As mentioned earlier, the difference in protection can be attributed, in some part, to the fact that our comparison is not

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<sup>251</sup> Although outside the scope of this report it can be mentioned that at present date the power that the Russian taxation authorities holds over Joint stock Companies and their management is almost frightening. If a company fails to pay its taxes (even by the slightest margin) there is a real chance that the management will suffer liability and risk criminal charges for causing the deficit while the company will face fines and risk liquidation.

utterly just. The Swedish JSL is a far more self-standing regulation than its Russian counterpart. The Russian JSL is just one part of a set of regulations, which while being dominant is far from as central as its Swedish counterpart. Such a simple answer is however not that satisfying simply because even if we would include the other Russian regulations, without touching any of the additional Swedish ones the Russian law would still be lacking in protective possibilities compared to the Swedish JSL.

Looking further we can see that another reason for the major legislative drawbacks that deprives Russian stockholders of a full-blooded protection is that the Russian corporate governance concept is still very young. It is also, unfortunately, subjected to the economic realities of the country, which is still making the very first steps towards a market economy. Since the corporate government concept has only recently become an issue of company legislation and is far from being rooted in the doctrine on legal entities the attitude towards corporate government notion is still influenced by the authoritarian management concept inherited from the communist era. Legislator or not, one is still influenced by the general business mentality and attitudes towards different models of corporate governance. Corporate governance in the developed market economies, which have the experience of using different corporate governance models, can therefore hardly be compared to corporate governance under conditions created in Russia.

Furthermore, the Russian model is based on the need of the creation and development of a joint stock market and the addition of new companies, while the Swedish legislation is based on the notion of existing companies with the need of strengthening the capital inflow.

The Russian joint stock market is also still relatively young and undeveloped, distinguished by rapid expansions and huge turmoil's, while the Swedish one is a lot more developed and saturated and while it does offer a weaker protection its primary interest is to provide the owners of the company with an efficient and relatively economical way of ruling a company. The protection mechanisms of the Russian legislation are thus spares and the possibilities to protect ones interest are pretty limited. The Swedish legislation is far more forgiving to the small owners but at the same time the myriad of regulations and security measures results in the slowing down of the corporate management process as well as upping the administrative costs of the company.

Combining the various reasons for the legislative differences one finds thus that the reason for them cannot be found in the volume of the actual legislations nor in the build of the articles but in the structure and purpose of the different laws. Where the Swedish legislation is build from the bottom to the top, concentrating on the rights and obligation of the stockholders, the Russian (heavily influenced by the Russian traditionally totalitarian way) views the stockholders as almost a necessary evil, placing far more power to the governing bodies of the company.

The Swedish system can thus be said to encourage split ownership. Something that in our opinion is a cursed blessing since on one hand the relatively strong protection for stockholders results in a greater will to invest in different portfolios (without the need to achieve a dominant position in order to secure ones investment) while on the other the split ownership directly contradicts the legislators intentions to increase the awareness and influence of the stock holders over the company (since the less chance to influence that the individual stockholders has the less likely are they to show any interest in the dealings of the management). The Russian legislation is on the contrary striving to provide the majority of the power to the administrative bodies, which coupled with relatively limited rights and protections for stockholders really encourage towards concentrated ownership.

The differences are by no means un-deliberate. As earlier stated the Russian legislation is primary concentrated towards the expansion of the market and creation of new companies. These companies rarely need the capital that major split-ownership ones wield and benefit a lot more from the concentrated power that is provided by the Russian legislation.

### ***Conclusion***

One of our main priorities when we started out was to try to determine which legislation gives the outmost protection in regard to the rights of company stockholders. While we found the answer to this question we also discovered that we initially made an error due to that we had not taken into consideration the fact that the two legislations had different priorities and guiding principles, something that inevitably transformed into the huge difference in the given protection.

So after taking everything into consideration, we feel that if one is interested in entering into a company as an active participant with a controlling post of stocks; then a Russian company, guided by Russian law is a lot more desirable than a Swedish one, but if one is only interested in owning a minor post and is mostly interested in a relatively safe income from the capital then you should defiantly think twice before getting involved with a Russian company and probably invest in a Swedish registered one.

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