



New rules for interested party transactions

Like we have pointed out, on January 1, 2017, the law¹ that introduces new rules for major transactions becomes effective. It will also introduce new rules for interested party transactions.

As is known, transactions that assume a personal interest of any manager of the company or its owner holding a large share in the company's capital, are under special control, since such persons might get any personal benefit as a result of such transaction. Such transactions are called interested party transactions. For example, any transaction may be considered an interested party transaction if both companies which are parties to it have the same director.

Controlling person

The new rules will most significantly affect transactions in which there is an interest of one of the owners of the company. Previously, apart from the management, any person owning at least 20% of the company's capital could be considered an interested person. Now, for the purpose of controlling interested party transactions, the terms "shareholder" and "member" are replaced with a newly introduced concept of a "controlling person". A controlling person is someone who has the right to:

- ✓ Control, whether directly or indirectly (including, e.g. under a shareholder agreement), more than 50% of votes at the General Meeting of the company, or
- ✓ Appoint a director, or
- ✓ Appoint more than a half of a collegial body (e.g., the Board).

As before, in order to be regarded as a person interested in any transaction it is not enough to be a manager or hold a share in the capital.

Additional criteria

To consider any person an interested one such person or his/her spouse, parents, children, siblings, adoptive parents, adopted children, controlled companies have to meet at least one of the following criteria:

- ✓ To be a party to the transaction;
- ✓ To control the company which is a party to the transaction, or

- ✓ To hold positions in the company's governing bodies.

To be regarded as having an interest, such person or company may not only be a party, but also a beneficiary, an agent or a representative in such transaction.

The thing that makes the above list different from the previous one is that the former one lacks affiliated persons, which greatly narrows the range of situations when the interest arises.

Simplified procedure

The general rule is that interested party transactions require no consent, it is only necessary to notify the members of the Board of Directors, collegial executive body, and in some cases shareholders or members. After such notification, they will have the right to request that a General Meeting or a meeting of the Board of Directors be held in order to provide consent to such transaction. In case such consent is not obtained, but transaction is entered into, members of the Board of Directors, shareholders or members (if they have at least 1 % of the company's capital) will be entitled to receive information about the transaction that confirms that the interests of the company have not been violated, and, among other things, that the transaction has taken place on arm's length terms.

Litigation prospects

Similar to major transactions, the conditions for challenging interested party transactions due to the violation of associated corporate procedures have been changed – such right will be provided to the company itself, members of the Board of Directors, and persons who own at least 1% of the company's capital, but at the same time, the legislator, as with major transactions, has excluded the opportunity to defend arguing that the plaintiff could not affect the outcome of voting. The plaintiff must prove the following:

- ✓ That the company's interests were violated, moreover, if the consent to the transaction was not given, and the information about the transaction (as mentioned above) was not provided, it shall be considered a violation;
- ✓ That the counterparty knew or must have known about the interest in the transaction and/or the lack of consent to it.

Same as before, the law provides for exceptions, according to which certain transactions fall outside the scope of general rules, for example, if a transaction is committed in the ordinary course of business (for more detailed description of this term, see our article about major transactions).

In general, when making final decisions on any transactions, we recommend that you analyze the company's Charter, as well as its internal documents that may contain any special conditions.

October 31, 2016

¹ Federal Law No 343-FZ "On Amendments to the Federal Law "On Joint Stock Companies" and Federal Law "On Limited Liability Companies" dated July 3, 2016 with regard to controlling major and interested party transactions".