Answers

1 The question asked candidates to explain the purpose and significance of the Constitution of the Russian Federation and to explain the different forms that legislation may take.

(a) First introduced in 1993, the Constitution forms the basis on which organs of government, sources of law and individual rights are built. It is the highest source of authority in the State, and as such all subordinate laws, including legal codes and legislative acts, must be fully consistent with its provisions.

The Constitution has nine chapters, the last of which provides mechanisms through which its own provisions may be amended.

Chapter 1 lays down the fundamentals of the constitutional system, and states in very general terms the rights of citizens, defines the territories that comprise the state and confirms the separation of powers. Specifically, Article 11 defines the main organs of government (the State Duma and the Federation Council), while Article 12 confirms the federal nature of the state, amplified in Chapter 3.

Chapter 2 lays down important personal rights of Russian citizens, including, *inter alia*, freedom of conscience, religion, speech and assembly. It also sets out fundamental rights, including the right to participate in entrepreneurial activities and the right to an education.

Chapters 4, 5 and 6 set down provisions in relation to the President, the Federal Assembly and the government respectively, while Chapter 7 lays down the structure of the courts, the role and duties of judges and the system through which they are appointed.

Chapter 8 states the rights of local governments to enact legislation, subject to the constraints set out elsewhere in the Constitution.

Although the provisions of the Constitution are inviolable, it acknowledges that international treaties entered into by the State have superior force of law.

(b) In common with other codified legal systems, the Russian Federation has a hierarchical structure of laws, through which each layer of legislation is subordinate to those above it.

As stated above, all laws enacted within the State are subordinate to the Constitution.

Federal constitutional laws deal with matters that are directly envisaged by the Constitution. They are enacted to deal with crucial areas of constitutional law, such as referenda and human rights. Such laws have a special status within the system, as the Constitution confirms that they are superior to other legislation. As such, federal laws may not contravene constitutional laws.

Federal laws are applicable across the Russian Federation. They are enacted through a formal process involving the State Duma, the Federation Council and the President. They include legal codes, which provide broad statements of principle relevant to certain areas of everyday life (Civil Code, Penal Code, Tax Code, etc) and more specific federal laws applicable to certain types of entity or activity, such as the Federal Law on Joint-Stock Companies.

Under the Constitution, law-making powers are delegated to subjects of the Russian Federation. These include the governments of the composite republics, autonomous regions and other authorities, municipalities and cities. Again, these may not contradict higher sources of law.

2 The question tested the candidates' knowledge of the nature of non-contractual obligations and the tests applied by the courts in assessing whether a non-contractual obligation has arisen.

(a) The law on non-contractual obligations is set down in Chapter 59 of the Civil Code.

Non-contractual obligations arise when one party causes injury to another by his or her actions or omissions. Such obligations are often generically referred to as 'torts' or civil wrongs.

Non-contractual obligations differ fundamentally from contractual obligations in that the injury caused may be inflicted upon a person or persons completely unknown to the perpetrator. These obligations include:

Negligence – failing in a duty of care to another.

Trespass – damaging the land or other property of another.

Slander – making oral false statements that cause damage to another.

Libel – uttering false statements that cause damage to another through written words, such as in a newspaper or on the internet.

Defamation – bringing about damage to the reputation of another.

(b) In assessing whether a civil obligation has arisen, there are four matters that must be considered by the court.

(i) There must be an undue action or deed by a person or legal entity. This may involve unlawful actions, or alternatively may be an omission to act in order to remove the possibility of causing damage. Therefore, it is possible to incur a non-contractual obligation by doing nothing, when a reasonable person would have seen fit to prevent the damage or injury being caused.

(ii) There must be a fault on the part of the perpetrator, though not necessarily an intention on his or her part to inflict the harm. Carelessness may in itself be a basis for a claim for a non-contractual obligation.

(iii) A claim will only be recognised if harm, injury or damage has been inflicted. This may take the form of financial or physical harm, which in many cases is relatively easy to assess. The court will normally assess such damage on the basis of *de facto* losses and missed profits (similar to damages in respect of contractual obligations). Significantly, ss.1099–1101 of the Civil Code recognise that damage may include moral damage, such as emotional distress and suffering. This is difficult and often impossible to assess in monetary terms. Nevertheless, the usual remedy decided by the court is monetary compensation.

(iv) The last test considered by the courts is whether there is a direct causal link between the undue actions or inactions of the perpetrator and the damage inflicted. A crucial consideration here is whether the damage is reasonably foreseeable. For example, a person who causes a road accident should foresee the loss inflicted on a driver of a car with which he or she collides, but will not foresee the losses that may be incurred by other motorists delayed by the accident on their way to work.

3 The question asked candidates to explain how a labour agreement is created, modified and terminated.

(a) Chapter 11 of the Labour Code states how a labour agreement may be concluded and lays down various obligations in respect of the contract.

A labour agreement may be concluded between an employer and any person of at least 16 years of age. Article 63 sets down various circumstances under which a labour agreement may be concluded with younger persons.

Articles 65 and 66 set out the documents that must be presented by the prospective employee, and the responsibility of the employer to provide a service record book.

Article 67 states that a labour agreement must be formed in writing, with two copies signed by both parties. However, the same article states that even if the agreement is not concluded in the designated form, the employee is deemed to have entered into such an agreement if he or she starts work. In such cases, it is the responsibility of the employer to produce a written contract within three days of the starting date.

(b) Chapter 12 of the Labour Code deals with matters relating to the modification of a labour agreement. As a general principle, modification can be performed with the consent of both parties.

Article 72 states that an employee can only be moved to a different permanent job or location with the consent of the employee. An employer must transfer an employee to a different job if this is brought about by medical necessity. Again, consent of the employee is required. However, the change is not considered to be a transition to another job if the job functions do not change, or if there is no substantive change in conditions of the labour agreement.

Article 73 permits an employer to modify the labour agreement if this is brought about by changes in the technological or organisational aspects of the job environment, provided the job function is not changed. If the employee does not agree to this, he or she must be offered an alternative job of a comparable nature. However, if such an alternative does not exist, the employer has the right to terminate the labour agreement. If the changes in the technological or organisational aspect of the environment may lead to mass dismissals, the employer has the right to introduce a shorter working day for up to six months.

Article 74 enables the employer to transfer an employee temporarily for up to one month in the event of catastrophe, the necessity to avoid the consequences of such a catastrophe, prevention of accidents, substitution for another employee or interruption of work activities.

(c) Chapter 13 of the Labour Code lays down provisions in relation to termination of a labour agreement.

Article 77 states that the general reasons for termination of a labour agreement are:

(i) agreement of all parties to the labour agreement;
(ii) expiration of the term of the labour agreement, except cases where the labour relationship is continuing and neither side requested its termination;
(iii) termination on the employee's initiative;
(iv) termination on the employer's initiative;
(v) transfer of the employee to a job for a different employer or transition to an elected job on the employee's request or with the employee's consent;
(vi) refusal of an employee to continue performing his or her job functions because of a change in ownership of the organisation's property, change of jurisdiction of an organisation or restructuring;
(vii) refusal of the employee to continue performing his or her job functions because of changes in significant conditions of a labour agreement;

(viii) refusal of the employee to transfer to a different job position because of his or her state of health following a medical examination;
(ix) refusal of the employee to transfer to a different job position due to the necessity to transfer to a different region;
(x) circumstances not depending on the will of either party;
(xi) violation of regulations under the labour agreement, specified in the Labour Code or in other federal laws, if this violation excludes a possibility of continuing the performance of the job.

4 The question asked candidates to explain the rights and obligations of the parties named in a power of attorney and to explain the rights and obligations of the parties to a contract of commission.

(a) A power of attorney is a method through which an individual or legal entity may confer powers on an individual to act on its behalf. It is a form of voluntary representation, and as such enables, but does not compel, the named individual to act under the provisions contained therein.

The law relating to power of attorney is set out in Articles 185 *et seq* of the Civil Code. Generally, the rights of the individual or entity conferring the power of attorney are the reciprocal obligations of the party to whom the power is given.

A power of attorney confers general or specific rights of one party to act on behalf of another for a period not exceeding three years (Article 186). The power may create general rights of agency, special rights to repeat actions of a like nature or a one-off right to carry out a specific transaction.

Under the power of attorney, the person to whom the powers are given has an absolute right to carry out actions defined in the document, though these powers may be withdrawn at any time. This person must act within the limits stipulated in the document, and any actions that exceed such limits become the personal responsibility of the attorney, unless the counterparty knew that such a violation had occurred.

The obligation of the party conferring the power of attorney is to stand by any decisions or acts made on its behalf.

The party originating the power of attorney has a right to terminate the contract at any time. Likewise, the attorney may stand down from his or her responsibilities.

On termination of the power of attorney, or after a period of three years, whichever is the sooner, the rights and obligations of both parties are terminated.

(b) Chapter 51 of the Civil Code sets out provisions in respect of contracts of commission.

A contract of commission is an agency agreement through which one party agrees, in return for a fee, to carry out one or more transactions on his or her own behalf for the benefit of a principal. The party carrying out activities on behalf of the principal becomes a party to the transactions entered into.

The commission agent must perform activities consistent with the contract and must act in a manner that is most favourable to the principal. For example, if the commission agent is buying goods, there may be a maximum price specified in the contract (and conversely a minimum price if selling goods).

In cases where the agent must sell goods for a minimum specified price, any shortfall is the responsibility of the agent unless it can be proven that accepting a lower price prevented greater losses. Conversely, if a surplus is generated, this is divided between the commission agent and the principal.

The commission agent bears responsibility for losses or damage to the principal brought about by his or her actions.

Once the authorised transactions have been completed, the commission agent must submit a report to the principal and transfer to the principal all monies received in respect of the contract.

The commission agent has the right to conclude contracts of sub-commission but retains primary responsibility for execution of responsibilities under the contract of commission.

The principal is obliged to pay the fee stipulated in the contract and to accept everything properly performed by the commission agent on his or her behalf.

Should there be any objections to matters contained in the report submitted on conclusion of the contract, these must be submitted within a period of 30 days, unless the contract specified a different period.

5 The question required an explanation of the concepts of separate legal personality and limited liability and the circumstances under which limited liability may be ignored and personal liability imposed.

(a) Separate legal personality refers to the status of certain legal entities, through which the entity itself is an 'artificial legal person'. As such, the entity's assets, liabilities and transactions are separated from those who own the entity (the shareholders) and those who manage it (the directors or executive body).

Separate legal personality arises from the date on which the entity is registered in the Unified State Register. From that point, accountability for all legal acts on its behalf lies with the entity and not with those who take decisions on its behalf. The entity can take legal action in its own name and can be liable for unlawful acts.

Article 48 of the Civil Code confirms the nature of separate legal personality. Article 48 (1) states: 'The legal entity shall be recognised an organisation, which has in its ownership, economic management or operative management the set-apart property and which is answerable by its obligations with this property, and may on its own behalf acquire and exercise the property and the personal non-property rights, to discharge duties and to come out as a plaintiff and as a defendant in the court. The legal entities shall have an independent balance or estimate.'

The remaining articles in Chapter 4 of the Civil Code go on to set out the essential features of organisations which have a separate legal personality. Federal laws that regulate specific types of legal entity support the principle. For example, Article 2(1) of the Federal Law on Joint-Stock Companies states: 'Shareholders shall not be liable for obligations of the company and shall bear the risk of losses associated with its activity only to the extent of the value of shares of stock owned by them.'

Limited liability is an extension of the concept of separate legal personality. It refers to the limited obligations that a shareholder may bear in respect of the legal entity's obligations. As a general rule, a shareholder only stands to lose the value of his or her share capital invested in the organisation. Therefore, no matter how large the financial obligations of the organisation, the shareholder cannot be held responsible for these.

Limited liability does not refer to the entity itself, which bears full liability for the obligations incurred on its behalf, and may even be vicariously liable for the acts of its employees and agents.

(b) Separate legal personality is a privilege that enables entrepreneurial activity to take place, but it may also be abused, resulting in loss or damage to others. For this reason, the law intervenes in order to make individuals personally accountable under certain circumstances.

Those who act ostensibly on behalf of an entity that has yet to be registered enter into any deals in their own name. Therefore, if a contract is created before a company is entered into the Unified State Register, the obligations under the contract fall to the signatory, and remain so even after the company comes into existence. It is possible for the company to accept such obligations through novation, or indirectly via a shareholders' agreement.

Under Article 53 of the Civil Code, the founders may hold those who act on behalf of the company accountable for losses or harm caused if they have not acted in the best interests of the company. The Article explicitly states that those who act on its behalf must act 'honestly and wisely'.

Additional obligations may be set down in the Charter of the company.

Article 3 of the Federal Law on Joint-Stock Companies states that if a company becomes insolvent, any shareholders or 'other persons' who have the right to give mandatory instructions on its behalf may be liable to the creditors for any action or failure to act in respect of the insolvency. This liability is subsidiary to the obligations of the company. The persons concerned are jointly and severally liable only if the resources of the company are insufficient to discharge the obligations.

Article 71 of the Federal Law on Joint-Stock Companies also states that directors must act in the best interests of the company and imposes personal liability for actions that are inconsistent with this. However, the obligation is not absolute, in that directors are not liable if they voted against acts that compromised the interests of the company, or did not participate in decisions relating to them.

Personal liabilities may also arise under penal law when the actions of individuals are illegal. This could arise, for example, if an employee acted on behalf of the company but in doing so assisted an individual to evade tax liabilities.

6 The question tested the candidates' knowledge of the purposes of capital, the process necessary to reduce capital and the legal protection afforded to creditors in the event of capital reduction.

(a) Capital fulfils several purposes. It finances operations, both at formation stage and on an ongoing basis. It may encourage investors to put funds into the business if the capital level is sufficiently robust, as well as reassuring existing shareholders and other stakeholders. Capital also provides a creditors' buffer in the event of unforeseen losses.

For these reasons, the law lays down prescriptive requirements in relation to the level of capital in a joint-stock company.

Article 99 of the Civil Code lays down general provisions in relation to authorised capital and cross-references the minimum capital requirements set down in Article 26 of the Federal Law on Joint-Stock Companies. Article 29 of the same law lays down the procedure necessary to reduce capital.

The conceptual basis for the law relating to capital maintenance is that an investor in a company should be entitled to peruse the financial statements of a company and be reasonably assured that the capital is of a permanent nature. This is not to say that reducing capital is always bad. A company may choose to do so in order to change its gearing ratio as part of its financial strategy, extinguish the interests of a shareholder by mutual consent, or simply to ensure that the financial statements are relatively representative of the company's true financial position. For these reasons, reductions in capital are permitted, but subject to compliance with statutory procedures.

(b) The procedure necessary to reduce the capital of a joint-stock company is set down in Article 29 of the Federal Law on Joint-Stock Companies.

Reduction of capital is mandatory in the event that a newly-formed company's capital is not paid up in full within the minimum statutory time limit. If after one year of operation the level of capital is less than the net asset value, the company is obliged to reduce the capital to the value that is paid up. If subsequently the company cannot maintain its capital at the level required by law, it must convert to an alternative legal form that permits the lower level of capital, or alternatively be liquidated.

A reduction in capital may not be contemplated if the company's capital is not paid up in full, or if declared dividends have not been remitted to shareholders, including any cumulative entitlements of preference shareholders. The company is responsible for ensuring that at the time of the proposed reduction, there are no symptoms of bankruptcy, and that the reduction will not compromise the solvency of the company.

A capital reduction may be implemented by reducing the nominal value of shares or reducing the number of shares by redemption, if permitted in the company's Charter. In both cases, it is necessary to secure the agreement of 75% of those voting at a general meeting of shareholders.

Once the general meeting of shareholders has sanctioned the reduction in capital, the company must make a public disclosure through the mass media and notify the authorities within 90 days of any amended constitutional documents. The creditors must be informed of the decision, who then have a right to recall their loans to the company.

(c) Article 30 of the Federal Law on Joint-Stock Companies sets down provisions for the protection of creditors in the event that a company adopts a decision to reduce its capital.

The decision to reduce capital must be notified to the state registration body within three working days, and two notices must be published monthly in a mass media organ that publishes data on state registration matters.

The notice must set out the company's name, its location, the details of the decrease and how effected and details of how creditors' claims may be submitted. Creditors are then entitled to submit claims for full payment of obligations due.

The company may oppose a claim of a creditor if it can prove that the decrease will not violate the creditor's rights, or if the collateral provided is sufficient to back the claim.

7 The question asked candidates to explain the meaning and scope of corporate governance and to describe the potential consequences of a joint-stock company failing to adhere to good practices in corporate governance.

(a) The simplest definition of corporate governance is 'the system through which an organisation is directed and controlled'. Implicit in this definition is that responsibility for compliance with best practices lies at the highest level of management, namely the board of directors and executives.

Corporate governance has to start with addressing the claims of principal stakeholders, such as shareholders (the owners of the business) and customers. However, most contemporary thought on corporate governance demands a broader-based approach to stakeholders, considering the needs of regulators, providers of finance, suppliers, the community in which the organisation operates and the physical environment.

Considering the needs of shareholders in the first instance, it is clear that shareholders should be treated fairly and equitably. To some extent, the law addresses this by laying down minimum requirements in respect of the provision of information, voting and other constitutional rights and protection of capital. In any system where there is a division of management and ownership, it is possible to bring about inequality and unfair treatment while remaining within the law.

Good corporate governance ensures that companies will have proper direction and management and will adopt policies that ensure transparency. In doing so, this narrows the 'information gap' between management and shareholders, which is vitally important given that investment decisions are nearly always based on subjective interpretation of historical information. It is only those who run the business who are intimately familiar with the future direction that it will take.

(b) The question required a discussion of any three potential consequences of failing to adhere to proper standards of corporate governance. Any of the following matters were relevant.

Management structure:
Proper standards of corporate governance demand that the company should be led by directors and executives with the appropriate level of knowledge, skills and experience, acting within a framework that ensures sufficient scrutiny of their decisions and actions. Without this, inappropriate decisions may be taken that threaten the future performance of the company.

Corporate social responsibility:
Lack of attention to corporate governance may result in the company focusing on maximising shareholder value to the exclusion of broader social responsibilities.

Impact on investment decisions:
Failure to adhere to proper standards of disclosure and transparency may result in potential and existing shareholders taking inappropriate decisions to acquire or divest shares in the company.

Investor confidence:
Poor governance standards dilute confidence in markets and may therefore result in lower levels of investment in the future.

Internal control and risk management:
Good corporate governance implies the need to have robust systems of control in place, as well as appropriate risk management strategies. Senior management should ensure proper scrutiny of decision taking and implementation strategies, without which serious failings may undermine performance, or even the future of the company. This is especially important in Russia, where even very large companies may have a high concentration of power in the hands of relatively few senior decision takers.

It is generally recognised that to create wealth and income it is necessary to take risks, but best practice in corporate governance dictates that the level of risk appetite of the shareholders is aligned with that of those who take decisions on their behalf.

Compliance:
Unless an effective corporate governance framework is established and implemented, there is a greater prospect that the company will fail to comply with the minimum requirements of the law.

Ethical behaviour:
It is possible to act legally but unethically. By focusing on corporate governance responsibilities, ethical behaviour is reinforced.

(Note: Candidates were required to describe only THREE potential consequences.)

8 The question tested the candidates' ability to apply their knowledge of securing obligations to a case study in which an entrepreneur was faced with demands in respect of his mortgage.

A mortgage is one of six means of securing obligations set out in Chapter 23 of the Civil Code. It is a secured borrowing arrangement through which the debtor may offer an asset in order to raise funds. In the event of default, the creditor is able to sell the collateral so that the debt is repaid. A mortgage is one form of pledge, the characteristics of which are defined in Article 334 of the Civil Code.

In the case study, Peter has received a letter in which the lender has adopted an aggressive stance due to his failure to meet the last two scheduled repayments. Generally, events of default are set out in the mortgage contract and failing to make repayments according to the schedule is the most common of these. Therefore, the assertion by the finance company that the mortgage is in default and all sums are now payable could be a condition of the agreement.

The finance company goes on to state that it is the owner of the real estate, and has the right to sell it immediately along with any belongings left in it.

When the mortgage contract was formed, Peter conferred rights in favour of the finance company, but he did not transfer ownership, as the creation of a mortgage does not involve a legal conveyance of land. Therefore, the finance company has significant rights over the land but does not own it.

Further, Articles 349 and 350 provide for specific procedures to be followed if the creditor wishes to realise the value of the security. For example, it cannot be sold without reference to the court. The finance company's belief that it can sell immediately is therefore fanciful.

The mortgage is secured on immovable property (land in this case), and the personal belongings contained within the house are unlikely to form part of the security, as they are bound to comprise movable objects. The creditor has no such rights over this property, unless Peter has explicitly granted such rights in a written contract.

Lastly, the finance company's letter states that it will sell the property to the first buyer who will offer a price that will cover the loan, and Peter will lose everything.

The finance company has to sell the property at a price determined by the court or by mutual agreement with Peter (Article 350(3)). It must sell by public auction to the highest bidder, and there is effectively a minimum price imposed. The next subsection states that only if the auction fails does the creditor have the right to acquire the property.

Peter will only lose everything if the property is eventually sold for a loss. As the loan-to-value ratio is about 25%, this would be extremely unlikely. There is a prospect that the property would eventually be sold for more than the value of the outstanding loan, in which case the creditor is obliged to hand back any surplus, net of disposal costs (Article 350(6)).

9 The question tested the candidates' understanding of the advantages and disadvantages of the commandite partnership and the limited liability company, in the context of a short scenario.

(a) The case study stated that two individuals were contemplating entering into business together, and that the mother of one of them would be prepared to help them financially, despite knowing nothing about the business they were going to set up.

The commandite partnership is a simple business form that is relatively uncommon in Russia. The essential characteristics of this type of business entity are set out in Articles 82–86 of the Civil Code. It enables unlimited partners, in this case Natasha and Nikita, to enter into business supported by a limited partner who must adopt a non-participative role. The implication in the case is that Natasha's mother would be the limited partner (or commandite).

There are various advantages of the commandite partnership in this situation.

The basic model of having unlimited partners supported by an investor is quite consistent with the needs of the entrepreneurs. Natasha's mother would not be able to participate in the business if she knows nothing about it, so her position as a prospective investor suggests that she would fulfil this role. Natasha and Nikita would be unlimited partners, participating fully in business activity.

The commandite partnership is quite a simple business form. The formalities involve the creation of a constituent document and registration, but there are few legal requirements in respect of division of management, share capital or administration. The three individuals could simply set down their desired roles in the constituent document. The Civil Code does set down minimum requirements in respect of the matters to be included in this document (Article 52), but these are not onerous.

This partnership form offers flexibility in relation to how the business develops or, if appropriate, is terminated or transformed. For example, new partners could join, and if this were to be the case either of the founding unlimited partners could leave.

As the commandite partnership does not have shareholders, there would be no need for general meetings to be held.

The main disadvantage of the commandite partnership is that Natasha and Nikita would be exposed to full liability in the event of business failure, shielded only by the investor's capital. The extent to which this would be a serious problem would depend on the extent of the investor's financial commitment to the business.

There are other practical disadvantages. As the constituent agreement cannot cover every future eventuality, there is a possibility that the partners could be 'deadlocked' in the event of disputes on management issues and business strategy. The partnership form does not provide for perpetual succession, so it is more difficult to pass the business on to others in the future.

(b) The alternative proposed business form is the limited liability company. The essential characteristics of this business entity are set out in Articles 87–94 of the Civil Code, as amended by Federal Law 312-FZ.

The limited liability company enables participants to take shares in the company, the size of which is determined by the founders' agreement. One major difference, therefore, between the limited partnership and the limited liability company is that the latter involves investment in shares, which in turn are transferable. The participants in the limited liability company have a specific financial claim against the entity, as well as formalised voting rights.

The major advantage of the limited liability company is that all registered participants have no greater financial liability than the value of their shares. By contrast, in the commandite partnership only Natasha's mother would enjoy this privilege.

The limited liability company must have a Charter, and its decision-taking body is the general meeting of participants. This greater degree of formality has some advantages in the event of disputes arising, as there will be clear mechanisms for resolving issues that arise between the shareholders.

It is possible for a limited liability company to admit new participants as the business expands, and this offers the opportunity to attract new capital more readily than through the partnership form. Conversely, however, the statutory right of withdrawal by participants was reformed by Federal Law 312-FZ, so if this eventuality was foreseen, explicit provisions would have to be included in the Charter, or revised subsequently through the general meeting.

There are various disadvantages of the limited liability company.

Forming a company requires a greater administrative burden, as the participants have to enter into a founders' agreement and create a Charter.

The company has minimum capital requirements, and the Federal Law on Limited Liability Companies imposes a greater administrative burden than that encountered by partnerships.

10 The purpose of this question was to test the candidates' understanding of the implications of significant transactions proposed by the board of directors of a joint-stock company, with particular reference to the legal provisions governing major transactions and interested party transactions.

The scenario states that the board of directors has agreed to acquire outlets currently owned by a competitor. This will involve a significant investment together with an increase in the gearing of the company.

As the value of the transaction exceeds 50% of the total assets of the company, it falls within the definition of a major transaction requiring the consent of the general meeting of shareholders. Such transactions are regulated by Chapter X of the Federal Law on Joint-Stock Companies. Therefore, the board of directors cannot proceed with the acquisition without consulting the general meeting of shareholders and securing a majority of at least 75% of voting shareholders (Article 79(3)).

Any major transaction concluded without recourse to due process can be declared void by the court, so the shareholders are protected to some extent by the provisions of Article 79. However, the last subsection of this article states that the court may not necessarily declare the transaction void if the counterparty did not know, and could not be expected to know, that the transaction was *ultra vires*. In such a case, the shareholders would still have strong grounds for legal action against the directors if it could be proven that they had not acted in the best interests of the company, or had done harm to the company.

The second issue in the scenario related to a change in supplier policy, and a proposed deal to switch to a single supplier in which shareholders believe directors have a financial interest.

If it can be established that the directors of –OAO- Clothes have financial interests in –OAO- Garb, the proposed transaction could fall within the definition of an interested party transaction as defined by Article 81 of the Federal Law on Joint-Stock Companies. This article states that those who hold 20% or more of the voting shares in the counterparty are regarded as interested parties. The directors may also be deemed to be interested parties if they hold managerial positions in –OAO- Garb.

Articles 82 and 83 lay down specific duties of disclosure in respect of interested party transactions. Those affected have a duty to disclose their interests, and the transaction is then subject to a vote by the board or, if the company has more than 1.000 shareholders, a vote by directors who are independent of the transaction.

Article 84 states that an interested party deal may be declared void by the court. However, as with major transactions, if the counterparty did not know, or could not be expected to know, that this was an interested party transaction, it could be enforceable. Again, were this to bring harm to the company, the directors could bear personal responsibility.

The case study scenario does not provide sufficient information to confirm that the transaction is an interested party transaction. However, even if it is not, the directors could still be liable under Article 71 of the Federal Law on Joint-Stock Companies due to a failure in pursuing the best interests of the company.

Fundamentals Level – Skills Module, Paper F4 (RUS)
Corporate and Business Law (Russia) **December 2013 Marking Scheme**

1	**(a)**	Purpose of Constitution	1 mark
		Citizens and territories	1 mark
		Structure of government	Up to 2 marks
		Courts	1 mark
		Legislative initiative of regions	1 mark
			(maximum 6 marks)
	(b)	Federal constitutional laws	1 mark
		Federal laws and codes	Up to 2 marks
		Delegated legislation	Up to 2 marks
			(maximum 4 marks)
			(Total 10 marks)
2	**(a)**	Definition of non-contractual obligation	1 mark
		Per example (up to two examples)	1 mark
			(3 marks)
	(b)	Wrongful action	1 marks
		Fault present or assumed	2 marks
		Actual loss, harm or damage	2 marks
		Causal link	2 marks
			(7 marks)
			(Total 10 marks)
3	**(a)**	Two copies in written form	1 mark
		Documentary requirements/process	1 mark
		Three-day rule	1 mark
			(3 marks)
	(b)	Mutual consent required to modify	1 mark
		Grounds for transfer	Up to 2 marks
			(3 marks)
	(c)	Per ground for termination	1 mark
			(4 marks)
			(Total 10 marks)
4	**(a)**	Per right/obligation of donor	1 mark, maximum 3 marks
		Per right/obligation of attorney	1 mark, maximum 3 marks
			(maximum 5 marks)
	(b)	Per right/obligation of principal	1 mark, maximum 3 marks
		Per right/obligation of agent	1 mark, maximum 3 marks
			(maximum 5 marks)
			(Total 10 marks)
5	**(a)**	Meaning and effect of separate legal personality	Up to 3 marks
		Meaning and effect of limited liability	Up to 3 marks
			(6 marks)
	(b)	Pre-incorporation contracts	1 mark
		Harm done to company (Civil Code)	1 mark
		Harm done relating to insolvency	1 mark
		Provisions of Federal Law on Joint-Stock Companies	1 mark
			(4 marks)
			(Total 10 marks)

6	**(a)**	Creditors' buffer	1 mark
		Investor confidence	1 mark
		Statutory requirements	1 mark
			(3 marks)
	(b)	Methods of reducing capital	1 mark
		Process, per substantive point	Up to 4 marks
			(5 marks)
	(c)	Notice requirements	1 mark
		Right to demand redemption	1 mark
			(2 marks)
			(Total 10 marks)
7	**(a)**	Definition of corporate governance	1 mark
		Scope of corporate governance	Up to 3 marks
			(4 marks)
	(b)	Per consequence of poor corporate governance	Up to 2 marks
			(6 marks)
			(Total 10 marks)
8		General understanding of mortgage contract	Up to 2 marks
		Recognition of event of default and consequence	1 mark
		Lender has no right of ownership	1 mark
		Lender has no right over personal belongings	1 mark
		Recognition that lender cannot sell immediately	1 mark
		Provisions of Civil Code relating to price	Up to 2 marks
		Requirement to sell by public auction	1 mark
		Surplus to be passed to borrower	1 mark
			(Total 10 marks)
9	**(a)**	Per advantage of commandite partnership	1 mark, maximum 3 marks
		Per disadvantage of commandite partnership	1 mark, maximum 3 marks
			(maximum 5 marks)
	(b)	Per advantage of limited liability company	1 mark, maximum 3 marks
		Per disadvantage of limited liability company	1 mark, maximum 3 marks
			(maximum 5 marks)
			(Total 10 marks)
10		Recognition of major transaction	1 mark
		Recognition of possibility of interested party transaction	1 mark
		Discussion of major transaction	Up to 2 marks
		Discussion of interested party transaction	Up to 2 marks
		Potential consequences and applications to case	Up to 4 marks
			(Total 10 marks)