Related Party Transactions:
International Experience and Russian Challenges
Anastasia Kossov and Dimitri Lovyrev
RELATED PARTY TRANSACTIONS
INTERNATIONAL EXPERIENCE AND RUSSIAN CHALLENGES

Anastasia Kossov and Dimitri Lovyrev

The purpose of this report is to present background information to participants of the OECD Russia Corporate Governance Roundtable organised for the 19th November 2014 in Moscow, Russian Federation. This report addresses the issue of related party transactions on an international scale and in Russia. It outlines the international context in which related party transactions are regulated across jurisdictions. The perspective of the OECD Principles on Corporate Governance is presented and the main elements dealing with related party transactions are described, including definitions of related parties, approvals and disclosure. The report presents the current Russian legislation and identifies key shortcomings illustrated by a number of abusive related party transactions cases. The history of the recent reform initiatives in Russia is also addressed in the report.

1 Anastasia Kossov is a Policy Analyst at the Corporate Affairs Division of the OECD and Dimitri Lovyrev is a partner of the law firm "Monastyrsky, Zyuba, Stepanov & Partners" (MZS). This report has been completed by the authors in a personal capacity and may not reflect the views of the OECD, the Moscow Exchange or the OECD Russia Corporate Governance Roundtable.
Related Party Transactions: International Experience and Russian Challenges

TABLE OF CONTENTS

INTRODUCTION .......................................................................................................................... 3

1. INTERNATIONAL EXPERIENCE .......................................................................................... 4
   1.1. The perspective of the OECD Principles on Corporate Governance.................................. 4
   1.2. Main elements in dealing with RPTs .................................................................................... 6
       1.2.1. Definitions .................................................................................................................. 6
       1.2.2. Approval procedures .................................................................................................. 8
       1.2.3 Disclosure .................................................................................................................... 14

2. RUSSIAN FRAMEWORK ........................................................................................................ 17
   2.1. Applicable legislation ........................................................................................................ 17
       2.1.1. Definitions .................................................................................................................. 18
       2.1.2. Approval Procedure ................................................................................................... 20
       2.1.3. Disclosure .................................................................................................................. 21
   2.2. Current legislative gaps and issues as illustrated by Court cases ........................................ 25
       2.2.1. Shortcomings of the existing definitions of “affiliate” and “group of persons” .............. 25
       2.2.2. Shortcomings in the definition of a “governance body” .............................................. 27
       2.2.3. Use of offshore companies with unknown beneficial owners ...................................... 29
       2.2.4. Interested-Party transactions by subsidiaries .............................................................. 30
       2.2.5. Issues of allocation of the burden of proof .................................................................. 31
   2.3. History of the Civil Code reform and current situation ....................................................... 33

ANNEX 1: ON DEFINITION OF AFFILIATES AND GROUPS OF PERSONS ................................. 36

ANNEX 2: INGOSSTRAKH OJSC CASE ....................................................................................... 37

REFERENCES ................................................................................................................................. 39

Tables

Table 1. Definitions...................................................................................................................... 7
Table 2. Board approval requirements in OECD member countries ............................................. 9
Table 3. Shareholder approvals of RPTs ...................................................................................... 13
Table 4. Disclosure of RPTs ........................................................................................................ 15
Table 5. Russia: Shareholder approval ....................................................................................... 20

Boxes

Box 1. IAS 24 definition of related parties .................................................................................. 6
Box 2. The cases of Parmalat and Cirio ..................................................................................... 8
Box 3. The case of Satyam ......................................................................................................... 10
Box 4. RPT approvals in Italy .................................................................................................... 11
Box 5. Reform of the role of auditors in reviewing RPTs in the USA ......................................... 12
Box 6. The case of the Dogan Group ....................................................................................... 14
Box 7. IAS 24 on the disclosure of RPTs .................................................................................. 16
Box 8. Russia: Shareholders agreement case ........................................................................... 26
Box 9. Russia: cases on the shortcomings of the governance body definition ............................ 28
Box 10. Russia: Cases involving subsidiaries .......................................................................... 30
Box 11. The cases of Kirovsky Zavod and Uralsky Plant .......................................................... 33

2 / 39
INTRODUCTION

1. The International Accounting Standards Board defines a related party transaction (RPT) as a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.\(^2\) The key for RPTs is not the so much the nature of the transaction but that of the relation between the parties. Related parties can generally include entities which exercise control or are under common control with the company, controlling shareholders, board members or management, as well as members of their families and close relations. For the corporate governance framework, transactions between these related persons pose an additional risk as their own interests may interfere in their decision-making, preventing them to make the best decisions in the interest of the company.

2. While the vast majority of RPTs are not detrimental, there is a global concern that in the absence of a relevant framework and effective enforcement RPTs can be easily abused by the company insiders, including management, board members and controlling shareholders. There are indeed significant risks that RPTs may not be conducted at arm’s length and present potential or actual conflicts of interest that can lead to expropriation of shareholders. For instance, this can manifest itself in situations where RPTs are used as a conduit to channel funds out of the company into another related entity, there is also a risk of lost business opportunities and other negative consequences.

3. In this respect, a number of high-profile cases causing several billions of dollars of damages to shareholders have demonstrated the serious risks of abuse presented by RPTs. Alone in the prominent Parmalat case, USD 620 million were misappropriated due to the failure of the corporate governance framework to properly deal with RPTs. In all known cases of abusive RPTs, shareholder value was significantly damaged and the companies’ reputations with domestic and foreign investors as well as with business partners were durably tainted or destroyed. Overall, these cases illustrated that RPTs are highly risky as they have the potential, if abused, to undermine overall investor confidence in the integrity of the financial markets. In the more recent Satyam case, adverse investor sentiment following RPTs problems brought the price of the company’s ADRs in NYSE down 55% from its close the only one day.

4. Indeed, minority shareholders’ willingness to invest is affected by two major concerns: not being expropriated of the investment and that their expected return being maximized. The risks of RPTs are thus ‘stealing’ and ‘shirking’ by the corporate controller (Pacces, 2008). When ownership is separated from control, agency problems can occur. While in the case of dispersed ownership the agency problems is between the management and the shareholders, in the case of concentrated ownership structures, the agency problem is rather between the controlling shareholder and the minority shareholders. The controller then has private benefits of control, which include all kinds of benefits accruing exclusively to the controller running the company, including private benefits of control which result in reduction of shareholder value. Hence, the key question is how stealing and shirking can be addressed in such a way as

\(^2\) RPTs can take a variety of forms such as the sale or purchase of goods, property or assets, provision or receipt of services or leases, transfer of intangible items, provision, receipt or guarantee of financial services, assumption of financial or operating obligations, purchase of equity or debt or even the establishment of joint ventures.
to render shareholders willing to invest and controllers willing to manage. However, it is also argued that minority shareholders may be willing to tolerate private benefits extraction if the contribution to the company’s value by the controlling shareholder compensates for that (Enriques, 2014).

5. Dealing with related party transactions has become an important issue on the global corporate governance agenda, both in OECD countries and also emerging markets. As illustrated by a recent OECD Peer Review on RPTs and Minority Shareholder Rights (OECD, 2012), RPTs constitute a particular area of concern in jurisdictions where ownership is concentrated and controlling shareholders as well as groups are predominant. Regional OECD programmes and reports from Asia (OECD, 2009), Latin America (OECD, 2012), India (OECD, 2014a) as well as the Middle East and North Africa (OECD, 2014c) all emphasize the challenges of RPTs.

6. OECD experience shows that corporate governance frameworks need to deal with the challenges presented by RPTs via a combination of three main elements: clear definitions, formal procedures and strong disclosure. Accordingly, the OECD Principles of Corporate Governance as well as recent international experiences highlight the importance of adequate rules and strong enforcement (OECD, 2012).

7. There is per se nothing wrong in entering into transactions with related parties and often such transactions are fully legitimate as they serve practical and commercial purposes which are in the interest of the company (or the company group), thus enhancing the company’s ability to maximise shareholder value. RPTs can be particularly beneficial in company groups where there are often developmental arguments that they substitute for under-developed markets and institutions. Banning RPTs is therefore not a solution and the key challenge is rather to ensure that RPTs are approved and conducted at arm’s length in a manner that potential conflicts of interest of those transactions are properly managed and disclosed as to ensure the protection of the interests of the company and all its shareholders.

8. The purpose of this paper is to outline the international context in which RPTs are regulated across jurisdictions (Section 1) and to focus on the Russian case in particular (Section 2). Section 1 first presents (1.1.) the perspective of the OECD Principles on Corporate Governance. It then (1.2.) focuses on the main elements dealing with RPTs, including definitions of related parties, approvals and disclosure. Section 2 focuses on the Russian challenges as it first (2.1.) presents the current legislation and (2.2.) identifies the key shortcomings illustrated by a number of abusive RPT cases. Finally, the Section (2.3.) outlines the history of the recent reform initiatives.

1. INTERNATIONAL EXPERIENCE

1.1. The perspective of the OECD Principles on Corporate Governance

9. To ensure that the company is being run with due regard to the interests of all its investors, the OECD Principles of Corporate Governance (hereinafter “Principles”) advocate that RPTs should be adequately addressed by the corporate governance framework. Indeed, most jurisdictions have put in place rules for:

- Clearly flagging these transactions. They include broad definitions of what is understood to be a related party.
Once the related party transactions have been identified, jurisdictions set procedures for managing and approving them in a manner that minimises their negative potential. This also implies disregarding some of these transactions when they are not material, can be regarded as recurrent or taking place at verifiable market terms or taking place with fully-owned subsidiaries. Great emphasis is placed in most jurisdictions on boards’ approval, with an emerging best practice of requiring that this is conducted by a committee of independent board members. In other jurisdictions shareholders are given a say in approving certain transactions, with interested shareholders excluded.

The advance of IFRS as a global standard (and therefore of IAS 24 for disclosing related party transactions) has introduced an important standard of uniformity and transparency in financial reporting of these transactions, but many jurisdictions have introduced additional requirements for ongoing disclosure of material transactions.

Acknowledging the underlying potential for conflicts of interest in RPTs, Principle III.A.2 provides that minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. Its Annotations explain that the potential for abuse is marked where the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk that they assume as owners through exploiting legal devices to separate ownership from control. Such abuse may be carried out in various ways, including the extraction of direct private benefits via high pay and bonuses for employed family members and associates, inappropriate related party transactions, systematic bias in business decisions and changes in the capital structure.

The Annotations to Principle III.A.2 further emphasize that in addition to disclosure, a key to protecting minority shareholders is a clearly articulated duty of loyalty by board members to the company and to all shareholders. Indeed, abuse of minority shareholders is most pronounced in those countries where the legal and regulatory framework is weak in this regard.

As per Principle III.C., members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation. As further outlined in the Principle’s Annotations, members of the board and key executives have an obligation to inform the board where they have a business, family or other special relationship outside of the company that could affect their judgement with respect to a particular transaction or matter affecting the company. Such special relationships include situations where executives and board members have a relationship with the company via their association with a shareholder who is in a position to exercise control. Where a material interest has been declared, it is good practice for that person not to be involved in any decision involving the transaction or matter.

With regard to disclosure, Principle V.A.5 provides that disclosure should include, but not be limited to, material information on (…) related party transactions, among other. Principle VI.D.6 highlights that the board should fulfil certain key functions, including (…) monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

Furthermore, the abovementioned Principles are fundamentally underpinned by more general duties of the board of directors. Thus, Principle VI.A provides that board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders. And, in line with Principle VI.B, it is key that where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly. Indeed, the duty of loyalty covered by Principle VI.A is of central importance since it underlines the abovementioned Principles, including Principle VI.D.6 that are fundamental for monitoring and managing RPTs.
1.2. Main elements in dealing with RPTs

15. In line with the abovementioned view of the OECD Principles, most jurisdictions have adopted clear rules and fine-tuned their regulatory frameworks to adequately address RPTs. The following Section will thus outline the approaches to the main elements in dealing with RPTs, namely: i) definitions; ii) board and/or shareholder approvals and iii) disclosure.

1.2.1. Definitions

16. The evident starting point for identifying and monitoring RPTs is the definition of entities or persons who can be considered as a related party. The OECD Methodology for the application of the OECD Principles of Corporate Governance (OECD, 2007) puts forward that the definition of a related party should be sufficiently broad to capture the kinds of transactions in the jurisdiction that present a real risk of potential abuse, that could not be easily avoided and that could be effectively enforced. The definition of a related party must thus take into account all parties who may exercise direct and indirect influence in a given transactional context.

17. The International Accounting Standard IAS24 provides a widely accepted definition of a related party for the purposes of financial reporting. The Standard then also establishes how transactions with such parties should be disclosed. The definition provided in IAS 24, as summarized in Box 1 has been adopted in numerous countries and is in substance similar to US GAAP.

<table>
<thead>
<tr>
<th>Box 1. IAS 24 definition of related parties</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 24 (§9) provides the following definition of a related party of a reporting entity:</td>
</tr>
<tr>
<td>(a) A person or a close member of that person's family is related to a reporting entity if that person:</td>
</tr>
<tr>
<td>(i) has control or joint control of the reporting entity; (ii) has significant influence over the reporting entity; or (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.</td>
</tr>
<tr>
<td>(b) An entity is related to a reporting entity if any of the following conditions applies:</td>
</tr>
<tr>
<td>(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).</td>
</tr>
<tr>
<td>(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).</td>
</tr>
<tr>
<td>(iii) Both entities are joint ventures of the same third party.</td>
</tr>
<tr>
<td>(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.</td>
</tr>
<tr>
<td>(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.</td>
</tr>
<tr>
<td>(vi) The entity is controlled or jointly controlled by a person identified in (a).</td>
</tr>
<tr>
<td>(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).</td>
</tr>
<tr>
<td>(viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.</td>
</tr>
</tbody>
</table>

Source: IAS 24
18. A sound and well-functioning definition of related parties helps provide adequate legal protection for all investors, whether large or small, domestic or foreign. Such a definition should prevent the exploitation of legal loopholes by those with greater legal resources. Roughly two-thirds of OECD countries locate their reference definition in a civil code, commercial code or company law. In substance, the respective definitions are equivalent to or very close to IAS 24.

Table 1. The sources of definition of related parties in OECD member countries

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Corporations Act 2001, Volume 1, Part 1.2, Division 1, Section 9</td>
</tr>
<tr>
<td>Austria</td>
<td>Commercial Code (UGB), § 237 Z 8b</td>
</tr>
<tr>
<td>Belgium</td>
<td>Company Code, Section XVIIIbis, article 91 / Royal Decree of 30/01/2001</td>
</tr>
<tr>
<td>Canada</td>
<td>Business Corporation Act, Part 1, No. 2</td>
</tr>
<tr>
<td>Chile</td>
<td>Securities Market Law, Title XV, article 100</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Law on Business Companies No. 90/2012, Part 9, articles 71-91</td>
</tr>
<tr>
<td>Denmark</td>
<td>Decree No. 1253 of 1 November 2013, Danish Financial Statements Act</td>
</tr>
<tr>
<td>Estonia</td>
<td>Securities Market Act, § s 168</td>
</tr>
<tr>
<td>Finland</td>
<td>Accountancy Decree 1339/1997 Chapter 2, section 7 b.</td>
</tr>
<tr>
<td>France</td>
<td>Commercial Code, Book II, Title II, Chapter V, Section 2, article L225-38</td>
</tr>
<tr>
<td>Germany</td>
<td>Stock Corporation Act (Aktengesetz) § 15</td>
</tr>
<tr>
<td>Greece</td>
<td>Capital Market Commission Encyclical No 45</td>
</tr>
<tr>
<td>Hungary</td>
<td>Civil Code, Section 685</td>
</tr>
<tr>
<td>Iceland</td>
<td>Public Limited Liability Companies Act No 2/1995, article 95</td>
</tr>
<tr>
<td>Ireland</td>
<td>Companies Act 1990, Section 26</td>
</tr>
<tr>
<td>Israel</td>
<td>Companies Law 5759-1999, Part 1 Definitions</td>
</tr>
<tr>
<td>Italy</td>
<td>Civil Code, article 2391-bis / CONSO Regulation 17221/2010, Annex No. 1</td>
</tr>
<tr>
<td>Japan</td>
<td>Ordinance on Company Accounting (Enforcement of the Company Act), article 112(4)</td>
</tr>
<tr>
<td>Korea</td>
<td>Commercial Act 398, article 542-8 section (2)</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>Companies Law, articles 49bis(3), 309, 344</td>
</tr>
<tr>
<td>Mexico</td>
<td>Securities Market Law, article 2, section XIX</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Civil Code, Book 2, article 381</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Companies Act, Part 1, No.2(3)</td>
</tr>
<tr>
<td>Norway</td>
<td>Public Limited Liability Companies Act, § 1–5 / Securities Trading Act, Section 2–5</td>
</tr>
<tr>
<td>Poland</td>
<td>Code of Commercial Companies, Dz.U.2013.1030, article 4, section 1</td>
</tr>
<tr>
<td>Portugal</td>
<td>Law on Trading in Financial Instruments, Dz.U.2010.211.1384, article 160</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Companies Code - articles 66.- A/3 and 508.-F/3</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Commercial Code, Section 59a</td>
</tr>
<tr>
<td>Spain</td>
<td>Companies Act, Chapter 1, articles 527-534</td>
</tr>
<tr>
<td>Spain</td>
<td>Ministerial Order 3050/2004, article 2</td>
</tr>
<tr>
<td>Sweden</td>
<td>Companies Act, Chapter 16, Section 2</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Civil Code, Book V Code des Obligations / BBl 2004 4223, 23 Juin 2004</td>
</tr>
<tr>
<td>Turkey</td>
<td>CMB Communicue II-17.1 (Capital Market Law, article 17 regulation), article 3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Companies Act, Sections 252-256</td>
</tr>
<tr>
<td>United States</td>
<td>Securities Exchange Act of 1934, Rule 13e-3</td>
</tr>
<tr>
<td></td>
<td>SEC Regulation S-K, Item 404</td>
</tr>
</tbody>
</table>

Source: OECD analysis.

19. As reflected in the Table 1, eight OECD Members include the definition of related parties in their most basic laws, usually the Civil Code or the Commercial Code. Another eighteen OECD Members address related parties in pieces of legislation dealing with the corporate governance framework, such as the Securities Market Law or the Companies Act, that are applicable to all entities conducting business in the capital market, regardless of their specific legal form (i.e. whether they are stock companies, partnerships or entrepreneurs).

20. Finally, a third group of eight OECD Members have the definition of related parties built into the laws regulating specific legal forms of organising a business, such as the Limited Liability Company Act or the Public Corporations Law. In some of these jurisdictions, these rules are complemented by listing
regulations or disclosure requirements, making it necessary to ensure that all these rules are well coordinated and encompass all relevant parties and cases to prevent loopholes. Some of these jurisdictions, however, follow a common law system and it is therefore their judicial system, via case law and precedents, which ensures the appropriate scope of the definition and prevents those loopholes.

1.2.2. Approval procedures

21. Boards play the primary role in the approval of RPTs although there can be differences in board structures and processes. Within the decision making process of the board, independent directors, the audit committee, and internal or external auditors/experts can all contribute to monitoring and restricting abusive related party transactions.

22. Where board approval processes and controls fail, as for instance in the cases of Cirio and Parlamat (see Box 2), abusive RPTs can go ahead unhindered. For instance, the Cirio bonds were used to repay banks, leaving investors to take the loss of Cirio because the board failed to prevent that assets are diverted to other companies via RPTs. The fraud at Parmalat involved the use of a highly complex corporate group with key assets located overseas and therefore not covered by the new main auditor (an audit rotation was in force) who had to rely on another auditor for confirmation of cash balances that later proved false. The board and its audit committee lacked independence and failed to detect the abuses where Parlamat was used repeatedly to shift funds to the other companies of the controlling shareholder and his family.

---

**Box 2. The cases of Parmalat and Cirio**

The Parmalat case has been described by the US SEC as "one of the largest and most brazen corporate financial frauds in history". While the case is one of pure corporate fraud it involved elements that together required a policy response with regard to the handling of RPTs (Ferrarini and Giudici, 2005). The fraud at Parmalat involved the use of a highly complex corporate group with key assets located overseas and therefore not covered by the new main auditor (an audit rotation was in force) who had to rely on another auditor for confirmation of cash balances that later proved false.

The board of statutory auditors failed to detect the fraud while the board and its audit committee lacked independence. In 2001, Parmalat declared that four of its thirteen directors were independent but did not name them. It gave names in 2002 when it became clear that they all had had close relations with Parmalat owner Mr. Tanzi. One of the earliest known abuses of corporate property occurred in 1989 when Parmalat was used to cover the debts of Mr. Tanzi in other business areas such as a television station. Thereafter the company's funds were used to support, inter alia, an ailing tourism company owned by the family. In addition, discounts from a packaging company amounting to some USD 15 million per year were diverted from the company to the family's accounts. Unlike other recent cases of fraud, Parmalat appears to be a straightforward case of an owner/manager fraud on a vast scale. According to the press of the time, the CEO confessed having misappropriated over $620 million to cover losses in other family-owned companies. The failure of the gate keepers, the board, the auditors and the audit committee, all formed the background for wide-ranging legal changes in Italy's regulation of RPTs.

In the Cirio case, which occurred before Parmalat, a major conflict of interest evidenced a failure of board and internal oversight. Cirio was failing and had large debts to a number of banks. Assets from the listed company were diverted to side businesses via related party transactions and other tunnelling mechanisms. Cirio arranged for the company to issue new bonds that were bought by their wealth management subsidiaries and soon transferred to retail investors. The proceeds from the bond were then used to repay the banks, leaving the investors to take the loss. Later, retail investors were in some cases compensated by the relevant financial intermediary, pursuant to Court sentences finding a breach of duties when providing investment services to the public.

*Source:* adapted from Ferrarini and Giudici, 2005.
In line with the OECD Principles, board directors and key executives should inform the board in advance if they have a material interest in any transaction or matter directly affecting the corporation and conclude the transaction with the approval of the board through an effective monitoring system. Furthermore, in some cases, it may be relevant for companies to prohibit directors from engaging in such transactions (OECD, 2009).

A recent OECD Peer Review (OECD, 2012) has shown that Belgium, India, Israel and Italy all place the first responsibility for approving RPTs on the audit committee or another specialised committee of the board comprising a majority of independent directors, which appears to become a general trend around the world. In Belgium and Italy there is also a statutory right to be able to use independent experts to help with valuation issues.

### Table 2. Board approvals of RPTs

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Board approval for non-routine RPTs</th>
<th>Abstention of related board members</th>
<th>Opinion from</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Independent directors / Audit committee</td>
<td>Outside specialist</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>Required</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>Austria</td>
<td>Required</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>Required</td>
<td>- Required</td>
<td>Required</td>
</tr>
<tr>
<td>Canada</td>
<td>Required</td>
<td>-</td>
<td>Required</td>
</tr>
<tr>
<td>Chile</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Recommended</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Estonia</td>
<td>Required</td>
<td>-</td>
<td>Recommended</td>
</tr>
<tr>
<td>France</td>
<td>Required</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>Germany</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Greece</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Hungary</td>
<td>Required</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>India</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Israel</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Italy</td>
<td>Required</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>Japan</td>
<td>Required</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>Korea</td>
<td>Required</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Mexico</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Norway</td>
<td>Required</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>Poland</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Portugal</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Slovenia</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Spain</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sweden</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Turkey</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>United States</td>
<td>Required</td>
<td>-</td>
<td>Recommended</td>
</tr>
</tbody>
</table>

Source: OECD Corporate Governance Factbook 2014.

The most common basis for the board responsibilities are their fiduciary duties. On top of the general responsibilities of the board, nearly half of the jurisdictions reviewed (see Table 2) require explicit board approval of non-routine RPTs. It is worth highlighting that the definition of the duty of loyalty of directors may be fairly delicate in the context company groups. Problems can emerge if the duty of loyalty is defined, as it is normally the case, with regard to the company and its shareholders, i.e. not to other companies of the group. Belgium, Italy and France (OECD, 2012) addressed this issue through law as well as through jurisprudence, recognising the interest of the group and concluding that directors’ duties must also take into account the likely benefits from a group membership.
It is market practice for group companies to among other things assist each other. However, this may result, at least in the immediate term, in a potential detrimental consequence for their own shareholders. Normally, the duty of loyalty is defined with respect to the company and its shareholders and not to other companies of the group, which can create problems. The issue raised in OECD reviews of Belgium, India, Israel and Italy (OECD, 2012) is how to combine the duty of loyalty with the reality that company policy is being determined elsewhere. Moreover, there an empirical question arises as to whether an independent director is likely to stand up against a policy determined on a group level by the very shareholders who have probably elected them.

In this context, a jurisprudence doctrine, the Rozenblum doctrine admits a group defence for directors regarding loyalty if there is: a group characterised by capital links between the companies; there is a strong, effective business integration among the companies of the group; and financial support for one company to another must have an economic quid pro quo and may not break the balance of mutual commitments between the concerned companies; the support from the company must not exceed its possibilities or in other words it should not create a risk of bankruptcy for the company (see Conac et al., 2007, p. 519). As the Rozenblum doctrine widens the duty of loyalty of directors to cover the interests of the group as a whole, this arguably opens the way for potentially abusive group RPTs and thus effectively weakens minority protection.

Box 3. The case of Satyam

Satyam Computer Services Limited proposed to acquire stakes in Maytas Infrastructure Limited and Maytas Properties Limited both of which were controlled by the controlling shareholder (i.e. promoter) of Satyam: Ramalinga Raju. Satyam Computers informed the Exchanges on December 16, 2008 that their Board of Directors at its meeting that day had approved proposals to acquire a 100 per cent stake in Maytas Properties Limited and a 51 per cent stake in Maytas Infrastructure Limited. In the announcement it was mentioned that the total outflow of the acquisition was expected to be USD 1.3 billion for Maytas Properties and USD 0.3 billion for 51 per cent stake in Maytas Infrastructure Limited. The Ramalinga Raju group held around 8.60 per cent of equity in Satyam Computers and 36.64 per cent of the equity capital of Maytas Infrastructure Limited, whereas Maytas Properties limited was an unlisted company belonging to the Ramalinga Raju group. Several media reports questioned the action of the Board of Satyam Computers regarding the rationale for diversification of an information technology company into the real estate sector and the rationale for paying a huge consideration for acquiring stakes in the entities owned by the group of the controlling shareholder. Further, the media reports questioned the role and the duties of the independent directors since the deal was approved unanimously by the Board of Satyam Computers. Due to adverse investor sentiment, the price of the ADRs of Satyam Computers listed in NYSE fell 55 per cent from its close the previous day.

Subsequently, Satyam Computers made an announcement on 17 December 2008, stating that it was not going ahead with its proposed acquisition of Maytas Properties and Maytas Infrastructure, in light of the feedback received from the investor community. An independent director resigned on 25 December 2008, stating that she had voiced reservations about the transaction during the board meeting, but had failed to cast a dissenting vote to ensure that her views were put on the record. It transpired that the compensation package of one of the independent directors was more than seven times that of the other independent directors and well above the market rate. It turned out that he was undertaking consulting work for the company, something that should have barred him from being an independent director.

Following the Satyam scandal, independent directors around India recognised their potential liability. As a result it is reported that at least 620 resigned in the year following the scandal (Khanna and Mathew, 2010). Another aspect of the case is that it showed that the independent directors remained focused only on fair valuation and on obeying SEBI and Company Law regulations. The business case does not appear to have been considered. Moreover, the independent directors did not actually commission the valuation. The Chair claimed that this had been undertaken by a reputable audit company, a claim strenuously denied by the big audit partnerships.

Source: adapted from OECD 2012.
29. Directors’ liability and culture are important aspects in the context of board approvals. Following the Satyam scandal (Box 3), independent directors in India recognised the risks entailed by their potential liability. As a result it is reported that at least 620 resigned in the year following the scandal. In recent years, the role of independent directors became increasingly important in approving RPTs around the world. On this matter, an empirical study (Dahya, Dimitrov and McConnell, 2007) with a sample of 782 publicly traded companies from 22 countries with a dominant shareholder found that a higher proportion of independent directors is associated with a lower likelihood of related party transactions.

30. However, this growing reliance on independent directors also raises questions about whether they are competent and genuinely independent, and if so, for how long they can be considered as fully independent. Therefore, it appears that some shareholder involvement (see next sub-section) might be emerging as good practice and not only in jurisdictions characterised by concentrated ownership.

31. A particularly interesting example is the Italian approach (see Box 4) where two paths are provided depending on a transaction’s materiality. It is worth noting that the Italian context is overall marked by a rather concentrated ownership structure and the use of company groups. A general procedure applies to any RPT other than small transactions, with further procedures that apply to those transactions considered material. Directors, shareholders and auditors are all involved in the approval process.

**Box 4. RPT approvals in Italy**

In Italy, one of two procedures has to be followed to approve RPTs, depending on the transaction’s materiality. A general procedure applies to any RPT other than small transactions, while further requirements are to be followed when a RPT is material (special procedure).

The general procedure for transactions below the materiality threshold requires that a committee of unrelated directors comprising a majority of independent ones gives its advice on the company's interest in entering into the transaction and on its substantial fairness. The opinion of the committee is not binding for the body responsible to approve the RPT – whether it is the CEO or the board of directors. However, if this opinion is negative, the transaction must be disclosed in the quarterly report. The involvement of independent directors is stronger when the RPT is material. A committee of unrelated independent directors must be involved in the negotiations early on: they have to receive adequate information from the executives and may give them their views. The committee has a veto power over a given transaction. Material RPTs must be approved by the whole board upon the favorable advice of the committee of independent directors.

Companies may still enter into a given transaction despite the negative advice of independent directors, provided that a general meeting is convened where a majority of unrelated shareholders approve it. In other words, companies may enter into a RPT on which independent directors have given a negative opinion and a majority of unrelated shareholders have voted against, so long as the unrelated shareholders represented at the meeting hold together less than 10 percent of the shares (or less than the lower percentage as identified by companies charter).

Under both procedures, the committee in charge of giving its advice may obtain the advice of independent experts (such as an investment bank or a law firm) of its own choice at the company's expense. For non-material RPTs the internal code shall set an annual budget for such external advice.


32. A well-defined pattern can be observed in the jurisdictions which have adopted the “German model” (Germany, Brazil, the Czech Republic, Portugal and Slovenia). In these countries the board of the controlled entity must prepare a report on relations with the controlling entities including the negative impact of any influence by the controlling entities. Conversely, in India, the Companies Act provides that the terms of reference of the Audit Committee include the approval of transactions with related parties.
Audit Committee is required to have the power to obtain professional advice from external sources and have full access to information contained in the records of the company.

32. Auditors can also play a critical role. In certain jurisdictions including Canada, France and Hong Kong, China (OECD, 2013) executives must report all RPTs to the internal auditors and the auditors are then responsible for assessing the proposed transaction and reporting on them ex-ante to the board. Likewise, the US (see Box 5) currently appears to be a forerunner with regard to the role of auditors in reviewing RPTs ex-ante and ex-post, which may trigger further global debate on the roles and responsibilities of auditors in RPTs approval procedures.

Box 5. Reform of the role of auditors in reviewing RPTs in the USA

In June 2014, the US Public Company Accounting Oversight Board adopted new and amended audit standards that expand audit procedures for related party transactions, significant unusual transactions, and a company’s financial relationships and transactions with its executive officers. The new standard for related parties, Auditing Standard No. 18, requires the auditor to perform specific procedures to obtain an understanding of the nature of the relationships and of the terms and business purposes (or the lack thereof) of related party transactions identified by management.

Also, the auditors have to carry out additional procedures to evaluate whether the company has properly identified all of its related parties and transactions with such parties. The new standards go beyond their previous version by requiring the auditor to perform procedures to obtain the understanding of the company’s transactions with its executive officers, although the auditors are not expected to make assessment as to whether compensation arrangements are reasonable.

The new Audit Standard 18 requires auditors to communicate to the audit committee their evaluation of the company’s identification of, accounting for, and disclosure of its relationships and transactions with related parties. The management also has to confirm in writing that it has made available to auditors names of all related parties and confirm that they are no agreements other than those declared in the management representation letter.


33. Finally, in order for non-controlling shareholders to check whether the board effectively monitors and approves related party transactions, it could be considered good practice that the company develops and discloses a policy/guide to monitor related party transactions. Regardless of the approach chosen by a given jurisdiction, it gains in clarity when formal processes are in place, especially if emphasis is given to approvals by independent directors. Certain jurisdictions, for example India and Italy encourage companies to issue policy statements as to the processes and policies to be followed when approving RPTs (OECD, 2012).

34. In certain cases, a shareholder approval may be a direct resort to underpin the system of checks and balances. In the vast majority of OECD countries, direct shareholder approvals are rather seldom in RPTs. Such procedures are broadly regarded as an alternative or a complement to board approvals, but are generally only applied to large transactions or transactions which are proposed not on market terms.

35. There are two main approaches to shareholder approvals of RPTs. The first and most common type is the so-called “(majority of the) minority approval”, where disinterested shareholders are given a say in approving certain transactions, while the interested shareholders (mostly this is the controlling shareholders) are excluded from voting.

36. The second type exists in certain jurisdictions, for example Israel, and consists in the controlling shareholder having a fiduciary duty to other shareholders and the company. Hence, an abusive RPT would contradict the interests of non-controlling shareholders and consequently represent a breach of duty and
this could arguably help prevent abusive RPTs from happening by deterring the respective shareholders. To be sure, this presupposes an efficient enforcement system. In that case, a potential claimant would not need to prove criminal or fraudulent intent but only show that the respective shareholder occupied a fiduciary relationship and that he breached his duty to benefit personally.

37. Almost half of all OECD jurisdictions provide for shareholder approval as an additional control over the potential abuse of related party transactions. Accordingly, in three OECD countries, namely Italy, Chile and Turkey shareholder approval is only necessary if a transaction is disapproved by the independent directors or the relevant committee of independent directors. In the UK, ex ante shareholder approval is required in the case the non-routine related party transactions by premium listing companies.

### Table 3. Shareholder approvals of RPTs

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Shareholders’ approval for individual RPT</th>
<th>Requirement for shareholders voting</th>
<th>Opinion from</th>
<th>Outside specialists</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shareholders’ approval for individual RPT</td>
<td>Requirement</td>
<td>RPTs for shareholders’ approval</td>
<td>Auditors</td>
</tr>
<tr>
<td>Australia</td>
<td>Yes</td>
<td>Not on arm’s length terms</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Austria</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Brazil</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Canada</td>
<td>Yes</td>
<td>Not on market terms; &gt;25% of market cap.</td>
<td>-</td>
<td>Required</td>
</tr>
<tr>
<td>Chile</td>
<td>Yes</td>
<td>If disapproved by the directors</td>
<td>-</td>
<td>Required</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Estonia</td>
<td>Yes</td>
<td>Not on market terms; &gt;30% of market cap.</td>
<td>Required</td>
<td>-</td>
</tr>
<tr>
<td>France</td>
<td>Yes</td>
<td>Not on market terms</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Germany</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Greece</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Hungary</td>
<td>Yes</td>
<td>Material RPTs</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>India</td>
<td>Yes</td>
<td>Either of the following: Not on market terms; Material; Not on regular business activity</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Israel</td>
<td>Yes</td>
<td>Disapproved by the committee of independent directors</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Italy</td>
<td>Yes</td>
<td>Disapproved by the committee of independent directors</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Japan</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Korea</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Mexico</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Netherlands</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Yes</td>
<td>&gt;10% of market cap</td>
<td>-</td>
<td>Required</td>
</tr>
<tr>
<td>Norway</td>
<td>Yes</td>
<td>&gt;5% of share capital (&gt;10% for private limited liability companies)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Poland</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Portugal</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Slovenia</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Spain</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sweden</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Switzerland</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Turkey</td>
<td>Yes</td>
<td>Disapproved by the independent directors</td>
<td>-</td>
<td>Required</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Yes</td>
<td>Non-routine transactions</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>United States</td>
<td>No</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: OECD Corporate Governance Factbook 2014.

38. While minority approvals are common, in certain jurisdictions this process can also involve regulators or stock exchanges. For instance, in Australia and New Zealand, the regulator or stock exchange
must be given an opportunity to comment on or approve the proposed resolution of the majority of the minority. In New Zealand, issuers can avoid the requirement to obtain the approval of the ordinary resolution providing that the stock exchange is satisfied that the personal interest of a related party is immaterial or plainly unlikely to have influenced the promotion of the proposal to enter into the transaction or its terms and conditions (OECD, 2014).

39. Interestingly, in the Middle East and North Africa shareholder approval remains the most prevalent approval method of RPTs (OECD, 2014c). For instance, in Tunisia, the board and the internal audit function are required to submit special reports to the AGM which decides whether any given RPT should be approved. In Kuwait, Morocco and Lebanon, RPTs are subject to shareholders’ approval and must also be reviewed by the audit committee or equivalent

1.2.3 Disclosure

40. Disclosure of RPTs is a key mechanism to inform all market participants about the company’s transactions with related parties and can thus provide an opportunity to challenge the approval if it was performed improperly or if an RPT was not treated as such. Disclosure therefore completes the RPT regulation framework, playing a central role in facilitating proper monitoring by shareholders and stakeholders.

41. While the OECD Principles emphasize that disclosure should include, but not be limited to material information on related party transactions, the Methodology for the application of the OECD Principles further outlines that transactions should be disclosed to the market either individually or on a grouped basis, including whether they have been executed on normal or market terms.

42. The selected approaches to disclosure of RPTs may differ in terms of whether the transactions should be disclosed individually vs. cumulatively; and in terms of whether they should be disclosed immediately vs. periodically (e.g. on a quarterly or annual basis). Such differences depend on the size of the transaction, its materiality, its terms and with whom it was concluded.

Box 6. The case of the Dogan Group

In the face of weak enforcement by the authorities and courts, the Dogan Group reportedly engaged in related party transactions for the purpose of tax avoidance and wealth shifting (Ararat and Orbay, 2006). Coupled with weak board oversight, Dogan shareholders suffered losses through the purchase of overpriced paper and publishing supplies by Dogan Gazetecilik from offshore companies owned by the Dogan family. Gatekeepers, namely external auditors also failed to ensure the accuracy of disclosure of the related party transactions.

In October 2008, the CMB announced that it was recommending court action against Aydin Dogan and three executives of Hurriyet Gazetecilik and Dogan Gazetecilik for having caused losses to the shareholders through these related party transactions.

In September 2009, an indictment was filed by the CMB to the Public Prosecutor’s Office against these four executives for intentionally causing losses by purchasing paper and publishing supplies from offshore companies in the 1999-2007 periods. This action followed the Finance Ministry’s fine of TL 3.76 billion (USD 2.53 billion) on Dogan Yayin Holding for evading tax regarding its accounts for the time period 2005-2007.

Source: OECD 2013

43. In line with the OECD Principles, transactions involving the major shareholders (or their close family, relations etc.), either directly or indirectly, are potentially the most difficult type of transactions. Cases of missing or inaccurate disclosure, such as the prominent Dogan Group case (Box 6) which
occurred in Turkey in 2008, substantially underline this aspect. In some jurisdictions, shareholders above a
limit as low as 5 per cent shareholding are obliged to report transactions. Given the inherent opaqueness of
many transactions, the obligation may need to be placed on the beneficiary to inform the board about the
transaction, which in turn should make a disclosure to the market. This should not absolve the firm from
maintaining its own monitoring, which is an important task for the board. A few countries (Table 4) adopted their own local standards which are equivalent to IAS 24.

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Periodical disclosure</th>
<th>Immediate disclosure for specific RPTs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Financial statement</td>
<td>Additional disclosure</td>
</tr>
<tr>
<td>Australia</td>
<td>Local standard</td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>IAS 24</td>
<td>Required (intra-group)*</td>
</tr>
<tr>
<td>Brazil</td>
<td>IAS 24</td>
<td>Required (intra-group)*</td>
</tr>
<tr>
<td>Canada</td>
<td>IAS 24</td>
<td>Required for SHs approval</td>
</tr>
<tr>
<td>Chile</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>IAS 24</td>
<td>Required (intra-group)*</td>
</tr>
<tr>
<td>Denmark</td>
<td>IAS 24</td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Finland</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>France</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Germany</td>
<td>IAS 24</td>
<td>Required (intra-group)*</td>
</tr>
<tr>
<td>Greece</td>
<td>IAS 24</td>
<td></td>
</tr>
<tr>
<td>Hungary</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Iceland</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>India</td>
<td>Local standard</td>
<td>Required</td>
</tr>
<tr>
<td>Indonesia</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Ireland</td>
<td>IAS 24</td>
<td></td>
</tr>
<tr>
<td>Israel</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Italy</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Japan</td>
<td>Local standard</td>
<td>Required</td>
</tr>
<tr>
<td>Korea</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Mexico</td>
<td>Local standard</td>
<td>Required</td>
</tr>
<tr>
<td>Netherlands</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Local standard</td>
<td>Required</td>
</tr>
<tr>
<td>Norway</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Poland</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Portugal</td>
<td>IAS 24</td>
<td>Required (intra-group)*</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Slovenia</td>
<td>IAS 24</td>
<td>Required (intra-group)*</td>
</tr>
<tr>
<td>Spain</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>Sweden</td>
<td>IAS 24</td>
<td>-</td>
</tr>
<tr>
<td>Switzerland</td>
<td>IAS 24 or US GAAP, Swiss GAAP FER or Local Standard</td>
<td>Required</td>
</tr>
<tr>
<td>Turkey</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>IAS 24</td>
<td>Required</td>
</tr>
<tr>
<td>United States</td>
<td>US GAAP</td>
<td>Required</td>
</tr>
</tbody>
</table>

Source: OECD Corporate Governance Factbook.

44. The ongoing review of the OECD Principles\(^3\), which aims to ensure their continuing high quality, relevance and usefulness taking into account recent developments in the corporate sector and capital markets, is also addressing RPTs. The revised OECD Principles consider that to make disclosure more informative, a distinction could be made between RPTs according to their materiality and conditions,

demanding ongoing disclosure of material transactions. Recurrent transactions on “market terms” are often disclosed only in periodic reports while material transactions are subject to ongoing disclosure requirements. To be effective, materiality thresholds need to be based on both quantitative and qualitative criteria, and may need to be underpinned by continued reporting of transactions below the threshold to the regulator.

45. With regard to disclosure, almost all OECD countries have adopted the IAS 24 standard on related party transactions. Its disclosure provisions are outlined in Box 7. Accordingly, all listed companies have to disclose any transactions with directors, senior executives and controlling shareholders on an annual basis in accordance with IAS24. In the European Union, for example via the Company Law Directives (EU,2014) member states must require even smaller and unlisted companies to disclose any material RPTs which might have been concluded on non-market terms.

46. An OECD Peer Review (OECD, 2012) found that the introduction of IFRS has been a major step forward with respect to enhancing financial reporting and transparency in the disclosure of RPTs. Yet, the same review also concluded that alone it is not sufficient. It is hence vital that in all jurisdictions quarterly/annual disclosure be accompanied by requirements for ongoing disclosure of material transactions. Also, continuous monitoring by the regulator appears to be helpful for more effective disclosure.

---

**Box 7. IAS 24 on the disclosure of RPTs**

In accordance with § 18 of IAS 24:

If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. (...). At a minimum, disclosures shall include:

(a) the amount of the transactions; (b) the amount of outstanding balances, including commitments, conditions and guarantees (...); (c) provisions for doubtful debts related to the amount of outstanding balances; and (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

As per § 19, the disclosures required by paragraph 18 shall be made separately for each of the following categories:

(a) the parent; (b) entities with joint control of, or significant influence over, the entity; (c) subsidiaries; (d) associates; (e) joint ventures in which the entity is a joint venturer; (f) key management personnel of the entity or its parent; and (g) other related parties.

Pursuant to § 21 of the Standard the following examples of transactions with related parties require disclosure:

(a) purchases or sales of goods (finished or unfinished); (b) purchases or sales of property and other assets; (c) rendering or receiving of services; (d) leases; (e) transfers of research and development; (f) transfers under licence agreements; (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind); (h) provision of guarantees or collateral; (i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts1 (recognised and unrecognised); and (j) settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

In line with §23, disclosures should indicate that related party transactions are made on terms equivalent to those that prevail in arm’s length transactions.

*Source: IAS 24*
47. Some countries, including the UK require immediate disclosure of any significant RPT as soon as their conditions become clear (OECD, 2014b). Italy has adopted a proportionate approach as to disclosure, differentiating between material and immaterial transactions. While immediate disclosure is required for material transactions which exceed the materiality thresholds (5% or 2.5% for pyramid structures). Moreover, in the jurisdictions which have adopted the “German model”, a controlling company must take responsibility for their actions to the detriment of another group company by paying compensation as required. Disclosure is key in this regard. The negative impact of any influence by the parent company must be first disclosed, then audited and finally compensated. For instance, in accordance with the German Stock Corporation Act (§ 117 VII and § 311, Aktiengesetz) the compensation must be determined in the same financial year. The management board of the controlled company is thus required to prepare a report on relations with other group companies, describing all intra-group transactions of the company and discussing compensation to be received. Such a “dependence report” (Abhängigkeitsbericht) must be audited by the statutory auditor and the approved by the supervisory board, which reports to the shareholder meeting.

48. Finally, there may be some exemptions from disclosure requirements in the context of State-Owned Enterprises, which are predominant in certain Asian economies as well as in Russia. In accordance with IAS 24 (paragraph 25) a reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and outstanding balances, including commitments, with: a) a government that has control or joint control of, or significant influence over, the reporting entity; and b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity. As governments can have control over many entities and transactions among them can be extensive and important, this is an important measure to avoid too burdensome volumes of disclosure.

49. Nevertheless, this exemption does not mean an exemption from the other key elements of dealing with RPTs, namely i) flagging them as RPTs and ii) going through the appropriate approvals. Therefore, paragraph 26 of IAS 24 provides that if a reporting entity applies the exemption in paragraph 25, it shall disclose: a) the name of the government and the nature of its relationship with the reporting entity, as well as the nature and amount of each individually significant transaction and for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

2. RUSSIAN FRAMEWORK

50. In Russia, RPTs indisputably remain a key corporate governance challenge. This Section therefore highlights the applicable law with regard to definitions, approvals and disclosure of RPTs and illustrates remaining loopholes with concrete cases. Moreover, it also presents the recent history of the Civil Code reform. The term interested-party transactions will be employed in the remainder of the text as an equivalent of related party transactions (RPTs) as interested-party transactions is substantially closer to the Russian terminology employed.

2.1. Applicable legislation

51. In Russia, a special legal regime directly applies to interested-party transactions for companies with different forms of incorporation, including i) joint stock companies (Chapter XI of Federal Law No. 208-FZ dated 26 December 1995 and titled “On Joint Stock Companies”); ii) limited liability companies
Related Party Transactions: International Experience and Russian Challenges


52. The purpose of relevant regulations is to prevent the companies from entering into transactions on unfavourable terms with persons which can directly or indirectly (i.e. through third parties) influence the decision making process of the company. The below review of the problems relating to interested-party transactions in Russian law will focus on joint stock companies as such companies are involved in most of the relevant court cases.

2.1.1. Definitions

53. Although the notion of interested-party transactions has been existing in Russian law for long time, there has been no codification of the relevant terminology, and legal definitions employed by rules on interested-party transactions are still somewhat equivocal and inconveniently spread over several bodies of law with complex interrelations, which often makes a proper application of interested-party transactions’ rules difficult for both practitioners and judges. Some of the more pressing issues in this area are discussed in more detail in 3.2.1 and 3.2.2 below.

54. Article 81.1 of Federal Law No. 208-FZ dated 26 December 1995 and titled “On Joint Stock Companies” (the “JSC Law”) defines an interested party as a member of a collective governance body of a company, a shareholder holding jointly with its affiliates at least 20% of the voting shares in a company or a person entitled to issue binding instructions to a company, provided that they or any of their spouses, parents, children, siblings, half-brothers or sisters, stepparents or stepchildren and/or any of their affiliates:

- are a party, beneficiary, intermediary or representative in the transaction in question;
- own separately or in the aggregate at least 20% of the shares (interests) in a party, beneficiary, intermediary or representative in the transaction in question;
- hold offices in the governance bodies of a legal entity (or its parent company), who is a party, beneficiary, intermediary or representative in the transaction in question; or
- otherwise as may be provided for by the charter of a company.

55. The concept of “affiliation”, which is applicable to define interested parties as mentioned above, is regulated by RSFSR Law No. 948-1 dated 22 March 1991 and titled “On Competition and Restriction of Monopoly Activities on Commodity Markets” (the “RSFSR Competition Law”). All provisions of the RSFSR Competition Law except for those concerning affiliates were cancelled almost 10 years ago and are therefore inapplicable. However, the existing competition law does not employ the notion of an “affiliate.”

56. The RSFSR Competition Law defines affiliates as individuals or legal entities able to influence the activities of legal entities and/or individuals engaged in business activities. The list of such persons is exhaustive (see Annex 1). The affiliation-related provisions refer to another notion in antitrust law – “a group of persons.” Article 9.1 of Federal Law No. 135-FZ dated 26 July 2006 and titled “On Protection of

---

4 Furthermore, as provided for by paragraph 13 of Russian Federation Supreme Commercial Court Plenary Resolution No. 28 dated 16 May 2014 and titled “On Some Matters of Challenging Major Transactions and Interested-Party Transactions”, (the “RF SCC Plenary Resolution on Interested-Party Transactions”), the legal regime of interested-party transactions applies to any other businesses and non-for-profit entities, unless otherwise provided by law or essentially follows from the business relations of such entities.
Related Party Transactions: International Experience and Russian Challenges

Competition” (the “Federal Competition Law”) defines a “group of persons” as several individuals and/or legal entities that meet one or more of the strict criteria (see Annex 1).

57. A “beneficiary” is a person who is not a party to a transaction but can be released from such person’s obligations to a company or any third party or acquires any rights under such transaction (in particular, a beneficiary under insurance or property management agreements or bank guarantees or a third party in favour of whom an agreement was entered into or otherwise benefits, whether by getting the status of a participant in a stock option plan of that company or otherwise, or is the debtor under an obligation secured by a surety ship or pledge provided by that company.

58. One unique feature of the Russian law is that it provides for two different concepts: an uninterested director and an independent director. In general, a transaction shall be approved by uninterested directors (see the criteria for an “interested party” above). An additional requirement was introduced for companies with more than 1,000 voting shareholders. A director approving a transaction shall not only be uninterested but also independent. The JSC Law lists the following criteria for an independent director:

- the director and his/her relatives shall hold neither the office of a general director or a member of the board of the company nor any offices in the governance bodies of its management company; and
- the director shall not have been an affiliate of the company during one year preceding the approval of the transaction (save only being a member of the board of the company).

59. Therefore, an “independent director” is understood to mean a person who is not materially related to the company himself, and neither whose relatives are so related. Accordingly, the criteria of “independence” of a director as stipulated by the JSC Law do not cover all possible relations. A more progressive and flexible definition of an “independent director” is set out in the recently adopted Corporate Governance Code. It says that a director cannot be regarded as independent if he/she is related to the company or to any of its majority shareholders, major business partners or competitors (article 2.4.1). The Code, however, only reflects the “best practice” standards of corporate governance and serves as non-binding guidelines.

60. Companies whose securities are listed on the Moscow Stock Exchange have to comply with special criteria of independence for certain members of their boards. In particular, the following relations shall be considered: the ability to exercise direct or indirect control, whether individually or together with any other persons with whom they may have a contract to that effect; joint residence and housekeeping by several individuals; employment relations with the company or any of its material shareholders, major business partners or competitors; or receipt of any remuneration or economic profit, including actual income, etc.

61. However, as is the case with the Corporate Governance Code, the above criteria of the Moscow Stock Exchange cannot be applied when approving interested-party transactions or during court proceedings. They only serve as guidelines for a legislator drafting amendments to the JSC Law. Thus, the significance of approval of an interested-party transaction by the board is often devaluated as members of the board are deemed to be independent by the applicable law but not qualified as such by the best practices of corporate governance.

^ See the RF SCC Plenary Resolution on Interested-Party Transactions, paragraph 9.


^ Listing Rules of FB MMVB CJSC as approved by its Board of Directors on 31 July 2014 (Minutes No. 4).
2.1.2. Approval Procedure

62. Approval procedures are, for the most part, the least complex matters when it comes to implementation of interested-party transactions regulations. Both the procedures and potential exposure associated with failure to comply with them are solidly codified in the laws devoted to particular types of legal entities and the Civil Code of the Russian Federation (the “RF CC”), and judicial practice has not come up with any practice that would significantly deviate from the letter of such laws. There are, however, some practical difficulties (as discussed below) associated with recovery of damages from interested parties in case the procedure is breached for their benefit.

63. Under the applicable law, entering into an interested-party transaction by a company involves two crucial steps, such as the determination of the price of such transaction and the approval thereof by its governance bodies. Under article 83.7 and article 77 of the JSC Law, the price or pricing conditions (e.g. the top and bottom limits)\(^8\) of the properties or services to be disposed of or acquired by a company in an interested-party transaction shall be determined by the board of directors of that company based on their fair market value.

64. The choice of the proper body of a company that is authorised to approve an interested-party transaction mostly depends on the book value of the subject matter of such transaction (as provided for by article 82 of the JSC Law).

65. The board of directors of a company shall only approve an interested-party transaction if its subject matter consists of the properties having a total book value amounting to less than 2% of the company’s assets. The approval procedure will also depend on the number of shareholders in the company. In the event that the company has not more than 1,000 shareholders, the decision shall be adopted by a majority vote of the uninterested directors (see the criteria for “interested party” above). The number of uninterested directors shall not be less than the board quorum specified by the company’s charter, otherwise the transaction shall be approved by the shareholders in their general meeting.

66. In the event that the company has more than 1,000 shareholders, the decision shall be adopted by a majority vote of (i) those independent directors who (ii) are not interested in the transaction. Thus, in addition to the requirement of no interest in a transaction, a requirement for a director to be independent is also introduced. Yet, this issue relates back to the poor definition of an independent director in the JSC Law discussed in the previous sub-section. One independent uninterested director on the board is enough to approve an interested-party transaction.

67. The decision to approve an interested-party transaction shall be made at a general meeting of shareholders by a majority vote of all uninterested shareholders in the following cases:

<table>
<thead>
<tr>
<th>Table 5. Russia: Shareholder approval</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The price of the subject matter</strong></td>
</tr>
<tr>
<td><strong>of the transaction is more than 2%</strong></td>
</tr>
<tr>
<td><strong>of the company’s assets</strong></td>
</tr>
<tr>
<td>In all cases.</td>
</tr>
<tr>
<td><strong>The price of the subject matter</strong></td>
</tr>
<tr>
<td><strong>of the transaction is less than 2%</strong></td>
</tr>
<tr>
<td><strong>of the company’s assets</strong></td>
</tr>
<tr>
<td>In all cases.</td>
</tr>
</tbody>
</table>

Not more than 1000 shareholders

More than 1000 shareholders

**Source:** Authors’ analysis.

\(^8\) See paragraph 7 of the RF SCC Plenary Resolution on Interested-Party Transactions.
Failure to follow the applicable approval procedure for an interested-party transaction will entail the following consequences:

First, an interested-party transaction made in violation of law may be invalidated upon an action brought by the company or any of its shareholders with further return by the parties of all the assets previously transferred by them to each other in kind or in cash (as provided for by article 84.1 of the JSC Law).

Further, according to article 181.2 of the RF CC, the limitation period for invalidation of a transaction shall begin on the date when the claimant learned or shall have learned about some circumstances that constitute a ground for invalidation of that transaction. Paragraph 5 of the RF Constitutional Court Plenary Resolution on Interested-Party Transactions presumes that a shareholder shall become aware of the transaction made in violation of the applicable procedure on or before the date of the annual general shareholders meeting held to review the results of the year during which the disputable transaction had been made. However, the above presumption only applies if the materials distributed at the meeting could lead the shareholder to the understanding that such transaction had been made (e.g. if the key assets on the balance sheet differ from those for the previous year).

The Russian Federation Constitutional Court has earlier resolved that the limitation period for invalidation of a transaction shall commence as soon as a shareholder becomes or may become aware of the fact that such transaction was made and also that there was a conflict of interest, including any information concerning the relevant interested party.9

Second, in the event that a transaction was made in violation of the applicable procedure, those persons interested in such transaction shall reimburse the company, upon request thereof or any of its shareholders, for any damage caused by that transaction (as provided for by article 84.2 of the JSC Law). If several persons are held liable, their liability shall be joint and several. It is worth mentioning that this liability only applies to those persons who are deemed interested in the transaction. Those members of the board who voted to approve the transaction, even if they were not interested therein, may be held liable for any damage caused by the transaction under article 71 of the JSC Law for their failure to perform their duty to act reasonably and in good faith for the benefit of the company.

It is very difficult to hold a shareholder who voted to approve a transaction liable if such shareholder is not an interested party. Such claim may only be filed against a legal entity that is considered a “parent company” under article 6.2 of the JSC Law: “a company shall be deemed a subsidiary if another (parent) company (or partnership), by virtue of predominant participation in its charter capital [predominant participation generally denotes the holding of a controlling (exceeding 50%) stake of voting shares], or in accordance with a contract entered into between them, or otherwise has the power to determine decisions adopted by such company.” The claimant shall also prove that the parent company was aware of the disadvantages of the approved transaction (i.e. it had an express intention to act maliciously). The period of limitation for damage claims is three years.

2.1.3. Disclosure

In order to make sure that the affected parties are aware of anticipated interested-party transactions, a great deal of disclosure requirements on various levels and through various sources applies to companies and their affiliates. While mostly serving their purpose, they are sometimes neglected by the parties acting in bad faith in case it fits their needs to avoid approval procedures, due to penalty being strictly monetary and even then comparatively limited.

9 Russian Federation Constitutional Court Resolution No. 5-P dated 10 April 2003.
The requirements to disclose information on any interested-party transaction apply to both the company and the interested parties. Accordingly, article 82 of the JSC Law obligates those persons who may be considered to have a potential interest in a transaction (i.e. the members of the governance bodies of the company and those shareholders holding together with their affiliates at least 20% of the voting stock of such company) to notify the company of any shares held in any other entities, any offices held in their governance bodies or any ongoing or potential transactions in which they may be deemed interested. Such notice shall be given to the board of directors, internal audit committee and the auditor of the company. There is no need to publicly disclose the information contained in such notice or to furnish it to any supervisory authorities.

Failure by the above persons to provide the relevant information may be a reason for holding them liable to the company for any damage caused by the interested-party transaction. Furthermore, any person who fails to disclose information may be subjected to an administrative penalty under article 15.19 of the Russian Federation Code of Administrative Offences. The applicable law requires preliminary approval of any interested-party transaction, and any existing conflict of interest shall therefore be revealed prior to such transaction.

The scope of disclosure largely depends on whether the company is public or private under the securities market laws. The disclosure shall be made by publishing a message and/or relevant document on the company’s official website or in a news feed of an authorised media agency. Any person may request a copy of the relevant document with further coverage of any relevant costs.

Public joint stock companies with publicly placed or floating shares are required to disclose any interested-party transactions they have made (“ex-post disclosure”):

- in their corporate event notices (within two days after the event occurs);
- in their quarterly reports (within 45 days of the end of the relevant quarter);
- in their prospectuses (within two days after the company receives a notice of registration of its prospectus by the Central Bank of the Russian Federation);
- in their annual reports (within two days after the minutes of the general shareholders meeting adopting the report are executed); and
- in a report on or notice of the results of any securities placement, including any interested-party transactions made in the course of such securities placement (within two days after the company receives a notice of registration of the relevant documents by the Central Bank of the Russian Federation).

Private joint stock companies are required to disclose their interested party transactions in their annual and securities placement reports. The list of interested-party transactions and the scope of the information to be disclosed depends on the type of a disclosure document. An annual report shall disclose all of the interested-party transactions made during the accounting year, stating the interested parties, material terms and approving governance body for each such transaction.

---


80. A corporate event notice given by a company with a total asset book value not exceeding RUR 100,000,000,000 shall disclose any interested-party transaction having a value of at least RUR 500,000,000,000 or amounting to at least 2% of its book asset value. A corporate event notice by a company with a total asset book value exceeding RUR 100,000,000,000 shall disclose any interested-party transaction having a value amounting to at least 1% of its book asset value. No transaction with a value lower than those stated above is required to be disclosed. Such notice shall contain all the details of the transaction, including its value, terms and conditions, parties, beneficiaries and approval.

81. The approval by the company’s board of directors of any interested-party transaction shall also be disclosed in a corporate event notice. Since any interested-party transaction is subject to prior approval, the relevant corporate event shall be disclosed by the company prior to the transaction (“ex ante disclosure”). However, for the purposes of securing the commercial interests of the parties, it is permitted to disclose such information after the transaction is made (“ex post disclosure”).

82. A quarterly report and a prospectus shall disclose summary information concerning the number and monetary values of the interested-party transactions made during the accounting quarter and the preceding five years, respectively. The two aforementioned documents shall include the details of interested-party transactions or series of such transactions (including the parties, subject matter, other material terms and conditions, the interested party and any reason(s) for such party’s interest, etc.) in any of the following cases:

- if the value of the transaction amounts to at least five per cent of the book asset value of the company; or
- if the transaction was subject to approval but not approved by the authorised governance body of the company.

83. In addition to disclosure of their interested-party transactions, any joint stock company is required to quarterly publish (in the form of a separate list) any information concerning its affiliates and report any changes in the list of its affiliates. Such changes shall be publicly reported within two business days after they are made. All of the persons belonging to the same group to which the company belongs shall be listed as its affiliates.

84. The company shall prepare the list of its affiliates by itself. Within 10 days of the date of purchase of the shares, the affiliates of the company shall notify it in writing of the number and types of the shares they have purchased. Any company that is required to disclose its affiliates shall do so by publishing the relevant information in the Internet.

85. For the purposes of listing its affiliates, any company can also use the information provided to it by the members of its governing bodies and shareholders under the aforementioned article 82 of the JSC Law. Furthermore, the securities market laws impose additional disclosure requirements for shareholders of public companies. For example, a shareholder holding more than 5% of the voting stock of a public company shall notify it of the existence of a person controlling such shareholder. The disclosure requirement is also applicable to any person who has acquired or lost the right to dispose of, directly or indirectly, individually or together with any other persons, 5%, 10%, 15%, etc. of the voting shares in the company.

---


86. In terms of sanctions, any affiliate of a company who culpably fails to inform or timely inform the company shall reimburse the company for any damage caused by such failure (as provided for by article 93 of the JSC Law). Such person may also be held administratively liable in the form of a penalty under article 15.19 of the Code of Administrative Offences.

87. The company itself may incur an administrative fine of up to RUR 1,000,000 if it fails to disclose its affiliates or if the published list of its affiliates contains any incorrect data. In such case, when determining the degree of guilt of a company, courts and supervisory authorities are expected to observe the following principle set out in article 93 of the JSC Law: any list of affiliates shall contain the information that is known or shall be known to the company. If a shareholder is unwilling to disclose that he or she is affiliated with the company and does not provide the company with the relevant information, the company may not be held liable for its failure to put such shareholder on the list of its affiliates. Given the fact that the amount of the penalty that may be imposed on a failing shareholder is insignificant for large businesses, they often prefer to pay such penalty rather than disclosing their affiliation.

88. In addition to the requirement to disclose affiliates as imposed by the applicable corporate and securities market laws, the accounting laws also require that the so-called “related-party transactions” be disclosed in an explanatory note to be attached to annual accounts. The notion of “related parties” has some specific features. The term “related parties” means those parties that can influence the business of the entity preparing its accounts (the “Entity”) or whose business may be influenced by such Entity, including:

- the Entity and a person who are affiliated with each other;
- the Entity and a person who are engaged in any common business (a business that is jointly controlled by two or more parties); and
- the Entity and a non-state pension fund organised for the benefit of the employees of, or any party related with, the Entity.

89. However, even if the Entity has any related parties, it is only required to disclose information concerning those parties if:

- the Entity is controlled or significantly influenced by any person;
- the Entity controls or significantly influences a legal entity; or
- the Entity and a legal entity are controlled or significantly influenced (directly or via any third parties) by the same person or group of persons.

90. Unlike the securities and antimonopoly laws, the terms used in the accounting laws (such as “control” and “significant influence”) are quite flexible and open-ended. For example, significant influence, including indirect influence, may be recognised to take place by virtue of participation in the charter capital of a company, the provisions of its foundation documents, any agreement it has entered into, participation in its supervisory board or other circumstances. Despite the evident advantages of such

---

14 RUR 1,000 to RUR 2,000 for individuals, RUR 10,000 to RUR 20,000 for officers, and RUR 300,000 to RUR 500,000 for legal entities.

15 Russian Finance Ministry Order No. 48n dated 29 April 2008 and titled “On the Approval of the Accounting Regulations concerning Information on Related Parties” (PBU 11/2008)”

16 Paragraph 5 of clause 3 of IAS 28 “Investments in Associates and Joint Ventures” as approved by Russian Finance Ministry Order No 106n dated 18 June 2012.
criteria for the relation of parties over the criteria for the interest or affiliation, the former are inapplicable to corporate relations.

2.2. Current legislative gaps and issues as illustrated by Court cases

91. The existing gaps in the Russian law governing interested-party transactions are crucial. Despite the fact that legislation on interested-party transactions is designed to prevent persons from having significant influence on the business of a company from managing the company in their own interests and contrary to those of all or any of its shareholders, it is the interested-party transactions that have been used by Russian businesses as the primary means for stripping assets for years. It is noteworthy, though, that due to the extremely high share capital concentration in Russia most abuses are committed by majority shareholders through managers fully controlled by them contrary to the interests of minority shareholders rather than by company managers acting for their own benefit.

92. There are five major issues that hamper the full-fledged development of the institution of interested-party transactions in Russia. These issues will be further outlined and illustrated by relevant court cases below (Sections 2.2.1. – 2.2.5)

93. First, the criteria for recognising a person “interested in a transaction” are very formal. Second, the use of the term “governance body” in the definition of an “interested party” appears to be incorrect since it is apparently insufficient to embrace all possible cases of conflict of interest. Third, offshore companies whose beneficial owners are unknown are frequently used to make and approve interested-party transactions. Fourth, there is no corporate control over interested-party transactions made by subsidiary companies.

94. Fifth, the burden of proof is distributed unfairly between the parties to the dispute. In particular, courts tend to lay the burden of proving that a transaction is not beneficial to the company on the shareholder whose abilities to get evidence are very limited (for instance, a shareholder may not request any documents concerning the activities of the subsidiary companies, which makes it more complicated to evaluate the shares in those subsidiary companies if such shares are disposed of, nor may they request any primary accounting documents; furthermore, it is far from being settled that shareholders are entitled to have access to the contracts entered into by the company). Such burden rests with the shareholder even where the company fails to substantiate the value of an interested-party transaction. Such a burden of proof often entails significant extra costs, e.g. to engage an appraiser to make an evaluation (for more details, see section 2.2.5 below).

2.2.1. Shortcomings of the existing definitions of “affiliate” and “group of persons”

95. In order to determine those persons interested in a transaction, the legislation uses the term “affiliate”, which has been adopted from the antimonopoly laws (according to its interpretation in court cases) and provides for an exhaustive list of relations that give rise to persons being recognised as affiliates. The meaning of the term “affiliate” has remained unchanged since 1990s. It reflects neither all of the possible relations that can exist between persons nor all of the possible conflicts of interest. Nor, unlike the similar provisions of the German and French laws, does it contain a provision allowing to take into account the actual relations and links beyond the express legislative presumptions.

96. The shortcomings of the current regulation makes it possible for persons acting in bad faith to make sure that persons controlled by them (shareholders and/or directors) approve interested-party
transactions or even to avoid such approval due to the fact that such transactions fall outside the formal requirements for an interested-party transaction.17

97. According to the legislative logic, the exhaustive list of interested parties shall be extended by inclusion of their affiliates and those persons belonging to the same group of persons, i.e. through a combination of corporate and antimonopoly law concepts. However, neither of these two concepts fulfils its role. This is because both concepts were created to operate in antimonopoly law and are not tailored for corporate relations. Furthermore, both concepts use formal and very inflexible definitions (“what is not in the law does not exist”). The presence or lack of links and relations between persons is determined solely on the basis of the same exhaustive and formal list of criteria that is used to determine whether there is an interest in a transaction (shareholding, position in a “governance body”, etc.). Accordingly, rather than extending the scope of interested parties, the use of the affiliation and group of persons criteria constitutes a guideline for structuring relations in holding companies so as to ensure that none of those criteria is met.

98. In particular, the existing definitions of an “affiliate” and a “group of persons” do not embrace the following common situations:

- A shareholders agreement providing for voting to approve one or more transactions in which a party to the shareholders agreement is interested, but not specifying that one shareholder is giving the so-called “binding instructions” to the other.18 Such a situation was the matter of dispute in the cases outlined in Box 8.

Box 8. Russia: Shareholders agreement case

In Cases No. A41-12348/09 and A41-25483/09 a company had entered into disposal agreements in respect of some real properties in favour of two of its members, each holding a 40% interest and not being affiliated with the other. While those agreements constituted interested-party transactions, they were approved at a general meeting since the first member voted to approve the agreements with the second member and the latter voted to approve the same with the former. While it was evident that the two members voted in concert to the prejudice of the third member holding a 20% interest in the company, there were no grounds for regarding the two members as affiliates.

As a result, the Presidium of the Russian Federation Supreme Commercial Court had to find the two agreements to be inter-related to be able to invalidate them. In the opinion of the Russian Federation Supreme Commercial Court, a party interested in one of inter-related transactions shall be deemed to be a party interested in all of such inter-related transactions. Therefore, both members, each holding a 40% interest in the company, were interested in the company’s transaction with another member. However, it is not always possible to recognise two transactions as inter-related (i.e., if there is a significant time between the transactions or the shareholders agreement only concerns the voting to approve only a transaction with one of the shareholders).

(1) While the matter of dispute was an interested-party transaction made by a limited liability company, given the fact that those transactions are regulated similarly as for joint stock companies, such situation may well have taken place in a joint stock company.

Source: Authors’ analysis.

17 As was pointed out in the report presented to the Council of the Federation, “civil legislation has followed a different path, paying no attention to the purpose of the regulation… the definition of “affiliates” as initially introduced by antimonopoly laws for other purposes was taken as a basis… As a result, both the provisions governing interested-party transactions and those governing mandatory offer have lost their initial purpose to eliminate actual conflicts of interest and become a formal requirement.” (“Defining “Affiliates” in Russian and Foreign Law in Light of the Proposed Amendments to the Russian Civil Code”, Debevoise and Plimpton LLP, 4 June 2013, page 6).

18 An agreement for giving binding instructions is a type of agreement that gives rise to the parent-subsidiary relations between companies (see article 105.2 of the RF CC as amended before 01.09.2014 and article 6.3 of the JSC Law).
• Shares are held by persons having de-facto marriage relations.

99. The West Siberian Circuit Federal Commercial Court Overview of the Court Cases Concerning Disputes on Invalidation of Major Transactions and Interested-Party Transactions (as approved by West Siberian Circuit Federal Commercial Court Presidium Resolution No. 6 dated 10 June 2011) expressly states that de-facto marriage relations where the marriage has not been officially registered do not give rise to an interest in a transaction;

• Other cases where business partners act in concert.

100. According to article 9.1.1 of the Federal Competition Law, for a group of persons and a company to form a new group of persons, those persons belonging to that group of persons shall have the ability to dispose of over 50% of the votes in that company. However, those business partners jointly holding a majority block of shares in the company may have no ties of relationship at all and may not formally form a group of persons, although their joint operations and joint influence on the company’s business may be apparent (e.g., they may hold an equal percentage of shares in each of the group companies, vote similarly on all matters on the agenda, etc.). Although joint control over a business is a rather common practice, we regret to say that the existing Russian corporate laws, unlike the corporate acts effective in many Western countries, do not recognise actions in concert and affiliation arising from such actions;

• Control by the employees elected to the board of directors of the company but not being part of any of the governance bodies (such as the board of directors and the management board) of the parent company and, therefore, not regarded as affiliates of the parent company according to the existing definition of an “affiliate”; and

• Other control over the shareholders or members of governance bodies (e.g., an employee of a shareholder has a power of attorney authorising him to vote on behalf of an offshore company whose beneficial owner is unknown), friendly relationships, etc.

101. An illustrative example is the judgment handed down on a corporate dispute involving Ingosstrakh OJSC, one of the Russia’s largest insurers (see Annex 2).

102. The Supreme Commercial Court has attempted to solve the problem with the list of “affiliates” being exhaustive in a radical way and to determine that any persons having influence on each other shall be deemed affiliated for the purposes of corporate law (see Ruling No. VAS-15749/10 dated 24 January 2011 and paragraph 9(2) of the draft Russian Federation Supreme Commercial Court Plenary Resolution titled “On Some Matters Related to Contesting of Major Transactions and Interested-Party Transactions”). Such approach is corroborated by article 4 of the RSFSR Competition Law which provides a general definition of “affiliates” (as “individuals and legal entities capable of having influence on the business of legal entities and/or individuals”) followed by some examples of affiliation. However, the revolutionary interpretation was not eventually supported by the Supreme Commercial Court in either case. The attempts to reform the law on affiliates are further discussed in (2.3) below.

2.2.2. **Shortcomings in the definition of a “governance body”**

103. The list of interested parties in respect of a transaction is limited to, along with the shareholders of the company, the members of its governance bodies. However, the very concept of “governance bodies” fixed in Russian law is construed narrowly and therefore often fails to encompass individuals who, while employed by, or acting for the company, may have significant practical impact on its operations.

104. In accordance with the JSC Law, the governance bodies of a company include only its sole executive body (general director), board of directors (supervisory board) and joint executive body
(administrative or management board). None of the company’s other officers or entities, irrespective of their role in the company, are treated as governance bodies. A similar regulation applies to limited liability companies and other forms of legal entity which paves the way to a serious abuse.

105. While Russian companies often have no joint executive body (such as an administrative or management board), they may have a deputy general director, vice president, department heads, etc., whose powers and authorities are similar to those of the members of the management board and who can adopt important managerial decisions. Nevertheless, any transaction entered into by and between the company and such officer not formally belonging to any “governance body” will not be regarded as an interested-party transaction, nor will it be subject to any approval.

106. Another, even more important aspect of this problem is that it is impossible to regard as interested parties those members of the governance bodies of a company who or whose affiliates are employees but not members of the governance bodies of the other party to the transaction as illustrated by the cases in Box 9.

---

**Box 9. Russia: cases on the shortcomings of the governance body definition**

Case No. A31-2233/2005-18 was related to a claim for invalidation of certain sale and purchase contracts entered into by and between two companies in respect of certain real properties. The claimant insisted that the contracts were subject to the legislative provisions governing interested-party transactions since they were executed by the respondent’s director simultaneously holding the office of engineering director with the counterparty to the transaction. In its Judgment handed down on 30 May 2006, the Volga-Vyatka Circuit Federal Commercial Court found this position to be groundless:

> “The court rightly found that Mr G.P. Buchatsky is not an interested party in respect of said contracts since his office of engineering director at Kostromatrubinvest SCJSC does not belong to the governance bodies of the company and, therefore, there was no need to follow the approval procedure for interested-party transactions.”

Another example is Case No. A58-470/08, which was heard by the Presidium of the Russian Federation Supreme Commercial Court. The board of directors of Yakutgazprom approved a transaction to purchase additional shares in an oil company called Yakol, in which some of the board members were interested. Four members of the board participated in the voting, including Mr I.I. Pakhomov, who, according to the claimant, was interested in the transaction since his brother headed the commercial department at Yakol. Although both the appeal and cassation courts agreed with the claimant's position, the Presidium of the Russian Federation Supreme Commercial Court repealed their judgments and referred the case for retrial, saying that:

> “By recognising Mr I.I. Pakhomov as a party interested in said transaction on the basis that his brother holds the office of commercial department head at Yakol, the court of wrongly interpreted the fifth paragraph of article 81.1 of the JSC Law. <…> According to article 103 of the Russian Civil Code and articles 47, 64, 69 and 70 of the JSC Law, the governance bodies of a joint stock company include the general shareholders meeting, board of directors (supervisory board), sole executive body (director or general director) and joint executive body (administrative or management board). The commercial department of Yakol is not its governance body.”

A similar conclusion was made by the court in a corporate dispute involving one of the subsidiary companies of Obiedinyonniye Konditery OJSC:

> “The court of appeal agrees with the trial court’s conclusion that article 81 of the JSC Law and articles 91 and 103 of the Russian Civil Code, classifying the general meeting, board of directors and sole and joint executive bodies of a company as its governance bodies, may not be interpreted extensively. The deputy sole executive body, vice president or any other office vested with managerial functions are not mentioned in the above provisions as offices with governance bodies of the company. (This conclusion is supported by the existing case law, including Russian Federation Supreme Commercial Resolution No. 11005/09 dated 12 January 2010).”

*Source: Authors’ analysis*
107. Given that such an approach to interpretation of the term “governance body” is taken by the court and contrary to the purpose and meaning of the relevant provisions of the JSC Law, it is utterly widespread in practice that the management of major holding companies delegate their mid-level employees to the boards of directors of their subsidiary companies and, given that such employees are not members of the governance bodies of the parent company (such as the management board, administrative board or board of directors) or another company belonging to the same group of persons, those employees may participate as uninterested directors in the approval of any transactions that are not beneficial to the subsidiary companies.

108. At present, attempts are made to eliminate this obvious gap in the law that allows abuses involving the company’s employees. For example, the Russian Federation Ministry of Economic Development has prepared a set of amendments to the JSC Law and the Federal Law on Limited Liability Companies, expanding the list of interested parties by including other employees vested with managerial or administrative powers and authorities. As of now, it is unclear whether those amendments will be finally adopted or not.

2.2.3. Use of offshore companies with unknown beneficial owners

109. Offshore companies which are not allegedly connected with the company’s shareholders, directors and management and whose beneficiaries are not disclosed are often used to evade the application of the provisions of the JSC Law governing interested-party transactions, particularly when such offshore companies i) act as a party to the transaction; or ii) acquire a shareholding interest which allows them to approve interested-party transactions with the majority shareholder to the prejudice of the minority shareholders.

110. For example, in Case No. A50-6200/2012 following a claim filed by the minority shareholders of Kamkabel OJSC seeking to invalidate certain pledge agreements with Uraltekhnokabel LLC, the claimants were unsuccessful in proving that Singroves Holding Limited, a Cypriot company holding a 20% interest in Kamkabel OJSC, was related to another Cypriot company, Darnex Limited, holding the 100% interest in Uraltekhnokabel LLC and controlled by Cypriot trustee WCN-Worldwide Corporate Nominees Limited.

111. As a general rule, it is impossible to find out who is the beneficial owner of an offshore company. The fact that an offshore company repeatedly votes in favour of the decisions beneficial to the majority shareholder is not regarded by the courts as the proof of affiliation. In one of its latest resolutions, the Presidium of the Russian Federation Supreme Commercial Court attempted to solve the problem of abuse of corporate relations by offshore companies:

“Given the legal position developed by the Presidium of the Russian Federal Supreme Commercial Court in its Resolution No. 14828/12 dated 26 March 2013, in a situation where the Russian law protecting third parties shall be applied to an offshore company the burden of proving the facts protecting that offshore company as an independent entity in its relations with third parties shall be borne by that offshore company itself. It shall do so, first of all, by disclosing the persons standing behind it, i.e. its beneficial owners.” (Russian Federation Supreme Commercial Court Presidium Resolution No. 8095/12 dated 10 June 2014)

112. We expect the united Supreme Court to uphold this progressive approach. In particular, the continuity of court approaches will be ensured by the legislative provision concerning merger of two Supreme Courts that the clarifications by the Plenum of the Russian Federation Supreme Commercial
Court of approaches to application of laws and regulations will remain in effect until replaced by the relevant decisions made by the Plenum of the Russian Federation Supreme Court.  

113. Similarly, article 170 of the Russian Commercial Procedure Code states that a judgment may refer to resolutions of the Presidium of the Russian Federation Supreme Commercial Court that remain in effect. Therefore, though the position on the disclosure of the beneficial owner was formulated by the Presidium of the Russian Federation Supreme Commercial Court, it will hopefully be applied by courts in similar disputes.

2.2.4. Interested-Party transactions by subsidiaries

114. The rules of the JSC Law only apply to those transactions made by a company itself and are inapplicable to those transactions made by any of its subsidiaries that appear to be beyond corporate control (unless the charter of the parent company requires its board of directors to consider approving such transactions).

115. In practice, this has led to numerous abuses where subsidiaries disposed of their assets at an understated value or purchased overpriced assets. The existing court cases (see Box 10) have been consistent in not entitling the shareholders of a parent company to challenge transactions made by its subsidiary companies.

---

**Box 10. Russia: Cases involving subsidiaries**

For example, in its Rulings No. VAS-2571/12 dated 26 July 2013 and No. VAS-1969/12 dated 28 August 2012, the Russian Federation Supreme Commercial Court supported the finding by the subordinate courts that a shareholder of Kirovsky Zavod OJSC has no right to file a claim seeking to invalidate the transactions made by the company’s subsidiaries:

"While dismissing the claim for invalidation of the transactions and application of the consequences of such invalidation, the courts based their findings on the fact that the claimant had no interest in filing the claim since the claimant was neither a party to the contested agreements nor a shareholder or member of any of the business companies who were parties to those agreements to which Kirovsky Zavod OJSC was not a party, too. It follows from the judicial acts that the claimant provided no evidence showing that the contested transactions prejudiced any of its rights or obligations."

The Resolution passed by the Presidium of the Russian Federation Supreme Commercial Court in the Kirovsky Zavod case was really revolutionary in this respect. In this case, according to the claimants, the managers of Kirovsky Zavod caused its subsidiary, Putilovsky Zavod, to purchase overpriced assets from companies under their control.

When considering the claim made by the shareholders of Kirovsky Zavod against its managers for compensation of damages, the Presidium of the Russian Federation Supreme Commercial Court held for the first time that:

- any reduction of the asset value of a subsidiary will reduce that of its parent (i.e. will inflict damage to the parent) – an effect that will be contrary to the investment interests of the shareholders of the parent; and
- the shareholders may file a claim pursuant to article 71.5 of the JSC Law against the general director of the company to whom the general director of the subsidiary reports and who shall not avoid his/her duties to supervise the performance by the general director of the subsidiary of his/her managerial powers and authorities.

1. A similar position is set out in RF Supreme Commercial Court Ruling No. VAS-1969/12 dated 28 August 2012.
2. RF Supreme Commercial Court Presidium Resolution No. 12505/11 dated 6 March 2012.

*Source: Authors’ analysis.*

---

116. The only remedy currently available to shareholders is a damages derivative suit. However, it is not entirely clear whether the legal position of the Russian Federation Supreme Commercial Court in the Kirovsky Zavod case (Box 11) shall apply to transactions made by sub-subsidiaries or those companies where the parent has a significant but non-controlling interest. Furthermore, it is not always efficient to hold the general director of a company liable, especially where it comes to multibillion transactions or where the general director’s liability is not insured.

117. The lack of control over transactions made by subsidiaries has resulted in the appearance of schemes where the assets of a company are first assigned to a subsidiary and then disposed of in favour of an interested party without any corporate control. At the first stage, the parent’s board of directors passes a resolution pursuant to article 65.1.17.1 of the JSC Law to establish a fully owned subsidiary and to contribute some of the parent’s assets in payment for the shares in such subsidiary. Since the criteria for an interested-party transaction are not usually met at this stage, no special procedure protecting the rights of minority shareholders is applicable. The only exception are instances where the value of the assets so assigned represents more than 25% of the company’s book asset value, i.e. where there is a major transaction that is subject to corporate approval. The Plenum of the Russian Federation Supreme Commercial Court pointed out in this regard as follows:

“Considering the adverse effects of a major transaction between a parent and its subsidiary in an action brought by shareholders/members of the parent seeking to invalidate such transaction, it should be taken into account that disposal of assets in favour of the subsidiary, including where the shares/participatory interests in the subsidiary are fully owned by the parent, may evidence an infringement of the rights or legal interests of minority shareholders/members of the parent if such disposal deprives them of the possibility to make managerial decisions in respect of such assets or to obtain benefit from using such assets in their interests.”

118. At the second stage, the parent causes the assets to be sold to an affiliate of the majority shareholder of the parent company on required terms through its representatives in the governance bodies of the subsidiary. Despite the fact that the criteria for an interested-party transaction are met at the second stage, the transaction does not formally constitute a “company transaction” within the meaning of article 81.1 of the JSC Law and it would be very difficult for minority shareholders to challenge it as an interested-party transaction.

119. Minority shareholders could argue that the assignment of the assets to the subsidiary and their further disposal are inter-related transactions or constitute sham transactions. However, we are unaware as of now of any court cases where minority shareholders succeeded in challenging transactions made in accordance with that scheme. Furthermore, the argument that the transactions are inter-related or sham can be easily discouraged if, for example, there is a significant period of time between the two transactions.

2.2.5. Issues of allocation of the burden of proof

120. The difficulties of proving the existence of an interest in a transaction where an offshore scheme is used were discussed in section 2.2.3 above. Moreover, it is also difficult for minority shareholders to prove that the interested-party transaction has caused damages to the company or its shareholders, and article 84.1 of the JSC Law expressly states that a failure to prove so shall constitute an independent and sufficient ground for dismissal of the claim.

---

20 Paragraph 3 of the RF SCC Plenary Resolution on Interested-Party Transactions.
121. Previously, in similar cases, the courts relied on the highly ambiguous provisions of paragraph 3 of Russian Federation Supreme Commercial Court Plenary Resolution No. 40 dated 20 June 2007 and titled “On Certain Matters of Application of the Law Governing Interested-Party Transactions” (now repealed). On the one hand, it stated that the burden to produce evidence of adverse effects of a contested transaction shall rest with the respondent. On the other hand, it required the claimant to show how exactly the transaction had infringed his rights. Given that both matters in the end come down to proving that the transaction was detrimental, such approach appears to be very contradictory. When applying article 65 of the Commercial Procedure Code (stating that the burden to prove any adverse effects shall rest with the party referring to such effects), the courts rarely obliged the respondent to prove that the transaction had no adverse effects, while the failure by the claimant to prove that his rights were infringed served as one of the most frequent grounds for dismissal of the claim.21

122. As a result, the ambiguity of this approach was eliminated not in the favour of shareholders. According to paragraph 3 of the Russian Federation Supreme Commercial Court Plenary Resolution on Interested-Party Transactions (repealing the interpretation of 2007):

“\textit{A person who filed a claim for invalidation of a transaction as made in violation of the approval procedure for major or interested-party transactions has to prove... that the transaction infringes the rights and legal interests of the company or its members/shareholders, i.e. that it has or may have a detrimental or adverse effect for the company or its member/shareholder who filed the claim.}”

123. If the burden of proving that a transaction is detrimental to the company is laid on the shareholder in all cases, such burden becomes utterly onerous for the claimant:

- Article 83.7 of the JSC Law does not require involvement of an appraiser in order to determine the price of a transaction. It only requires the board of director of a company to determine the price of an interested-party transaction in accordance with article 77 (i.e. based on the fair market value of the assets involved). However, the JSC Law does not obligate the board of directors to substantiate its decision. As a result, any price determined by the board of directors is deemed to be the fair market price, though it is often unclear how it was determined, which makes it difficult to check it. Nor is the board of directors obligated to clarify the price calculation upon request of a shareholder; and

- A minority shareholder has no access to those subsidiary documents that are necessary to check the value of the shares/participatory interests in subsidiaries to be disposed of or primary accounting documents of the company. Furthermore, it is not settled whether minority shareholders are authorised to have access to the company’s agreements.

124. If the company neither clarifies the transaction price nor produces any documents, the minority shareholders are forced to apply to the court where, in turn, they bear the burden of proving that the transaction is detrimental, i.e. the minority shareholders have to bear significant expenses associated with evaluation in addition to legal costs. Hence, it would be fairer to oblige the company to show that a transaction is not detrimental by either producing an appraiser’s report or, where the fair market value of the assets was determined by the board of directors without involvement of an appraiser, by clarifying the transaction price calculation in detail.

---

125. An essentially different approach to proving that a transaction is detrimental for the company applies where a shareholder files a claim for compensation of damages as per article 71.5 of the JSC Law. That approach was developed by the Russian Federation Supreme Commercial Court Presidium in the aforementioned Kirovsky Zavod case in respect of those transactions where a conflict of interest did exist but was not duly resolved (Box 11).

**Box 11. The cases of Kirovsky Zavod and Uralsky Plant**

The managers of Kirovsky Zavod concealed from the shareholders their control over those companies that sold the overpriced assets to Kirovsky Zavod’s subsidiary. According to the Russian Federation Supreme Commercial Court, the key factor for allocation of the burden of proof is whether the applicable approval procedure was followed in respect of the transaction and whether the conflict of interest was resolved. Where a transaction was made without proper approval, the person who acted in conflict of interest is not presumed to have acted in good faith and has to prove that the transaction was beneficial to the company. Furthermore, according to the Supreme Commercial Court, a failure to produce evidence disproving the claimant's arguments shall mean confession of such arguments by the respondent (pursuant to article 70.3.1 of the Commercial Procedure Code):

“Therefore, the disputed transactions involved a potential conflict of interest, i.e. raised serious doubts as to Mr G.P. Semenenko being guided solely by the interests of the parent and subsidiary… Such circumstances exclude the application of the presumption that the respondent acted in good faith and relay the burden of proof on him: it is Mr Semenenko who acted in conflict of interest and had to prove that the assets were purchased by Putilovsky Zavod, who is fully owned by Kirovsky Zavod, in the interests of these companies rather than for the personal benefit of Mr Semenenko or his mother.”

The criterion for allocation of the burden of proof as proposed by the Russian Federation Supreme Commercial Court has been frequently used by commercial courts in disputes over claims for damages. We suppose that this approach can be extended to disputes over claims to invalidate transactions, which the Presidium of the Russian Federation Supreme Commercial Court once attempted to do in the Uralsky Instrument-Making Plant case where the claimant sought to invalidate a sales contract between the company and a stepdaughter of its general director:

“The respondents (parties to the interested-party transaction) failed to produce any evidence showing that the price of the disputed contract corresponded to the fair market value of the assets. Nor did they produce any evidence showing that the transaction entailed no adverse consequences for the plant.”

Source: Authors’ analysis.

2.3. **History of the Civil Code reform and current situation**

126. Just as the entire spectrum of Russian civil law, the concept of interested-party transactions has been undergoing a reform for some time now. While the slow-paced process was hurdled by resistance and controversies as discussed above, there is still some ongoing progress, and some further developments are on the legislator’s agenda.

127. The issues of affiliation and interest in the Russian law were the crucial items on the agenda during the RF CC reform. The reform is believed to commence with Russian Federation Presidential Order No. 1108 dated 18 July 2008, which declared the key goals and objectives of the reform, including: i) making the Russian civil law more responsive to the development of market relations; ii) reflecting the latest trends in court practices in the RF CC; and iii) bringing the RF CC in line with the rules of regulation of the relevant relations as set by the European Union and using the recent positive experience of several European countries.

---

128. Later on, the specially formed RF Presidential Council for Codification and Development of Civil Legislation (the “Codification Council”) drafted a development concept for various institutions of civil law (such as corporate law, property law, law of obligation, etc.). For example, the Development Concept for Corporate Law reflected the following issues that are of crucial importance for this review:

i) reforming the concept of a parent company and a subsidiary by introducing rules concerning persons influencing the will of a company;

ii) reforming interested-party transactions primarily by depriving bad faith businessmen of a chance to use this institution for avoiding previously assumed liabilities; and

iii) simultaneously strengthening the liability of members of the governance body of a legal entity, whether in conflict-of-interest situations or otherwise.

129. As is clearly seen from the scope of the aforementioned reforms, no significant adjustment of the criteria for a conflict of interest and affiliation was initially on the agenda. For example, the suggestion to introduce into the RF CC the notion of a “person influencing the will of a company” mostly concerned the so-called “corporate unveiling.” As regards interested-party transactions, the legislators focused more on enhancing and protecting fair counterparties than on protecting minority shareholders.

130. However, the published bill drafted on the basis of the Development Concept for Corporate Law entailed heavy criticism by private investors concerned about the fact that the important problem with affiliation and interest remained unresolved by the bill.

131. As a result, the bill was extensively amended to contain detailed provisions concerning affiliates by the date it was approved in the first reading by the State Duma. Those amendments were designed to achieve the following goals:

- substitute the outdated notions of competition law in the context of corporate relations with the proposed concepts of affiliation and control;
- set a uniform notion of affiliation covering both vertical (subordination) and horizontal relations between persons;
- set a disputable presumption of affiliation between close relatives;
- take into account both direct and indirect participation in the charter capital of a legal entity;
- allow courts to recognise as affiliates those persons having a practical possibility to influence a legal entity by taking concerted actions;
- ensure that the notion of “controlling person” covers any individual or legal entity irrespective of the degree of control;
- introduce a special notion of “persons under common control;”
- provide an open-ended list of grounds for recognition of control, including actual/informal control; and
- provide for possible indirect control (through third parties) and split control (together with other persons).

132. Many businesses, especially large holding companies, were very sceptical about the proposed amendments. As regards the general provisions on affiliates, it was argued that the definition should not be

---


placed in the Civil Code; a default definition would interfere with other sectored and specific definitions. The Russian Union of Industrialists and Entrepreneurs (the “RSPP”) has argued in favour of several separate definitions for different domains and included in specific laws. In their opinion, this approach would achieve an equivalent outcome while avoiding negative effects on business including instability of transactions, greenmail, and an excessive burden on companies due to an unduly broad definition of affiliation and the formalistic approach to interpreting legislation in Russia.

133. According to the opponents, the complex application of regulations on affiliation of individuals and legal entities as well as controlled and controlling persons could result in the artificial construction of almost endless relations. The latter concern predictably perplexed the amendment drafters since the draft introduced a possibility to contest affiliation of an individual and his relatives which was not currently allowed and the list of relatives considered affiliated with a person was limited compared to the current law.

134. As regards the possibility to consider persons acting in concert as affiliates, it was noted that the draft amendments unreasonably broadened opportunities for judicial discretion, were ambiguous, and could lead to absurd situations where any shareholders voting similarly on the same agenda item would be considered affiliated.

135. However, the operation of the existing specific definition of related parties in the tax area demonstrates that the concerns regarding inability of the judicial system to make such determinations on affiliation are unfounded. Indeed, judicial determinations on affiliation have been working correctly in Russia within the tax sphere for years now and there is no reason why this would not have been the case in the corporate domain. Indeed, possibility for such determinations would have had a strong deterring effect over prospective misconduct and abuse.

136. As in the case of tax law, under the proposed general definition of affiliation, the courts would have been asked to use their knowledge and wisdom to interpret the rules, in order to prevent loopholes being created or exploited by bad faith argumentation breaching the spirit of the law, a risk that has materialised many times in the recent Russian corporate history.

137. After a discussion, those articles were removed from the bill with only article 53.1 kept in the RF CC. While that article does not address interested-party transactions directly, it can well prevent further abuses from occurring in this area. Article 53.1 imposes an obligation to act reasonably and in good faith for the benefit of the company not only on its management but also on any person who can influence its actions, whether by giving binding instructions to its governance bodies or otherwise. This obviously refers to most of the indirect control cases discussed above in this review. Unfortunately, such person is considered neither affiliated with the company nor belonging to the same group – the reform left these institutions unchanged. However, according to article 53.1 of the RF CC, such person shall reimburse the company, upon the claim of such company or any of its shareholders, for any damage caused by such persons’ bad faith actions, including by any transactions to which such person is an interested party (pursuant to article 65.2.1 of the RF CC).

138. There is also understanding that, when interpreted altogether, article 53.3 and article 65.3 of the RF CC allow to bind shareholders with the relevant obligation and responsibility as the existing law provides that a general meeting of shareholders is the supreme body of any corporation and article 53.3 expressly says it is applicable to the members of joint bodies of any legal entities. Given the flexibility of the aforementioned rules, their further influence on interested-party transactions and on corporate governance in general will depend on the approach of the new Russian Federation Supreme Court.
### ANNEX 1: ON DEFINITION OF AFFILIATES AND GROUPS OF PERSONS

<table>
<thead>
<tr>
<th>“Affiliates of an individual”:</th>
<th>“Affiliates of a legal entity”:</th>
</tr>
</thead>
<tbody>
<tr>
<td>persons belonging to the same group of persons to which that individual belongs; and a legal entity in which that individual has the right to control more than 20% of the votes.</td>
<td>members of the governance bodies of the that legal entity; persons belonging to the same group of persons to which that legal entity belongs; persons having the right to control more than 20% of the votes in that legal entity; a legal entity in which that legal entity has the right to control more than 20% of the votes; and members of the governance bodies of the participants of a financial and industrial group to which that legal entity belongs.</td>
</tr>
</tbody>
</table>

Article 9.1 of the Federal Competition Law defines a “group of persons” as several individuals and/or legal entities that meet one or more of the following criteria:

- a company and a person who, by virtue of such person’s participation in that company or an agreement with any other persons, holds more than 50% of the votes in that company;
- a company and a person performing the function of a sole executive body of that company;
- a company and a person entitled, by operation of such company’s charter or an agreement, to give binding instructions to that company;
- companies in which the same persons form more than 50% of the members of their governance bodies or in which the same person exercises the function of a sole executive body;\(^{25}\)
- a company and a person upon whose request a sole executive body or more than 50% of the members of any governance body of that company was/were elected;
- an individual or any of his spouse, parents (including stepparents), children (including stepchildren), siblings and half brothers and sisters;
- persons belonging to the same group to which a person belongs as well as other persons belonging to the same group to which any of such persons belongs; or
- a company and persons belonging to the same group, if they hold, by virtue of their joint participation in that company or the authorities granted to them by any other persons, more than 50% of the votes in that company.

ANNEX 2: INGOSSTRAKH OJSC CASE

There was a long-lasting corporate conflict between the companies controlled by Oleg Deripaska (Bekar-Service LLC, Granit LLC and Soft-Karat LLC, each beneficially held by one of three Cypriot offshores), who actually controlled the company’s business and jointly held a controlling shareholding interest, on the one hand, and the Czech investment group PPF (Vega LLC, New Capital LLC and Investment Initiative LLC) having a minority shareholding interest, on the other hand. For a few years PPF was making unsuccessful attempts to prove that Bekar-Service, Granit and Soft-Karat are controlled by Mr Deripaska so as to ensure that they are recognised interested parties when it comes to voting to approve the transactions made by Ingosstrakh with other companies owned by him. One striking example of another unsuccessful attempt is the Judgment handed down by the Ninth Commercial Appeal Court on 6 May 2013 in Case No. A40-95467/11-138-772. In this case, the claimants submitted a huge body of evidence, which, according to them, proved that Ingosstrakh is part of Mr Deripaska’s group, including: the voting in concert by Bekar-Service, Granit, Soft-Karat and Mr Deripaska at general meetings; the interview of Mr M.Y. Volkov, head of the financial services sector at Basic Element (Mr Deripaska’s holding company), commenting on the events related to Ingosstrakh on behalf of Basic Element as Ingosstrakh’s majority shareholder; the news release announcing the purchase by Basic Element of a 17% shareholding interest in Strabag SE, stating that Basic Element’s entities manage the assets of and hold significant interests in dozens of companies many of which play a key role in the relevant market segments both in Russia and in other countries, including Ingosstrakh; and Ingosstrakh is mentioned in the “Financial Services” section on the official web site of Basel Group [managing Mr Deripaska’s assets].

Nevertheless, the Court applied the law in an utterly formal way to reject the evidence provided by the claimants showing that the shareholders who approved of the transaction were interested parties:

“Circumstantial evidence does not prove that Bekar-Service LLC, Granit LLC, Soft-Karat LLC and Mr O.V. Deripaska are affiliated with one another or with Ingosstrakh OJSC. Since Ingosstrakh OJSC is mentioned on www.basel.ru in the “Financial Services” section, the claimants conclude that Basic Element acknowledges its affiliation with the respondent. However, pursuant to article 4 of the Law on Competition and Restriction of Monopoly Activity on Commodity Markets and article 9 of the Federal Competition Law, the concept of affiliation presupposes clear criteria. Such criteria, as well as any indication of affiliation, are absent on the aforesaid web site. Based on this information, a conclusion can be made that Basic Element is in partnership terms with Ingosstrakh. The provisions of article 4 of the Law on Competition and Restriction of Monopoly Activity on Commodity Markets and article 9 of the Federal Competition Law shall not be construed extensively based on any surmise. The news release announcing the purchase by Basic Element of a 17% shareholding interest in Strabag SE states that Basic Element’s entities manage the assets and hold significant interests in dozens of companies many of which play a key role in the relevant market segments both in Russia and in other countries, including Rusal, GAZ Group, Glavstroi Corporation and Ingosstrakh. This argument by the respondent was not disproved by any written evidence. The notion of “significant interest” does not correlate with that of “affiliation.” The claimants rely on the interview of Mr A.V. Grigoriev, General Director, with Vedomosti. However, it does not follow from the answers given by Mr Grigoriev that he acknowledges or confirms that Ingosstrakh has a majority shareholder. His interview with Kommersant of 1 June 2009 is not a quote but rather contains the reporter’s comments. The claimants argue that Mr M.Y.
Volkov, head of the financial services sector at Basic Element, commented on the events related to the respondent on behalf of Basic Element as Ingosstrakh’s majority shareholder. However, the interview states that Mr Volkov is a deputy chairman of the board of directors of Ingosstrakh. In order to prove that Mr Deripaska and Basic Element are affiliated with each other, the claimants rely on media publications and the information available on the Internet. However, that information concerns the period of time after the disputed general shareholders meeting took place. The fact that both Mr Deripaska and Basic Element jointly own EN+ Group does not mean they form a group of persons. The claimants’ argument that Granit attempted to hold Ms D.A. Vetrova, a member of Ingosstrakh’s board of directors, administratively liable without any attempt to charge the company itself does not prove Granit and Ingosstrakh are affiliated with each other, too. The claimants’ argument that the governance bodies of Ingosstrakh include employees of the companies belonging to Basic Element is not supported by any written evidence. The voting in concert by Bekar-Service, Granit, Soft-Karat and Mr Deripaska at the general meeting does not prove they are affiliated with each other since the law does not state that a concerted position taken by shareholders on the voting on particular items on the agenda indicates affiliation. Thus, there is no circumstantial or direct evidence that Bekar-Service, Granit, Soft-Karat and Mr Deripaska belong to the same group of persons and, therefore, could not vote on item 10 of the agenda of the disputed shareholders meeting. The misinterpretation by the claimants of the mentioned circumstances in order to deprive the majority of the shareholders of their voting rights does not constitute evidence of affiliation or grouping of persons pursuant to article 4 of the Law on Competition and Restriction of Monopoly Activity on Commodity Markets or article 9 of the Federal Competition Law.”

Source: Authors’ analysis.
REFERENCES


Conac, P.H. et al. (2007), Constraining Dominant Shareholders’ Self-Dealing: The Legal Framework in France, Germany and Italy, ECFR, No. 4., available at: http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1453&context=faculty_scholarship


