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Are the minority shareholders able to rely on the norms of the Commercial Law governing timely convocation and procedure of a shareholder meeting?

Why should shareholder cooperate in capital companies?

Establishment of a stable and successfully operating company requires a good business idea, people able to implement such idea in practice and financial investments for covering the expenses. A person having good ideas not always has adequate financial resources or abilities to implement those ideas in practice, while people having extensive financial potential sometimes lack good business ideas. Therefore, frequently several people unite their efforts in establishing a company, and sometimes they are rather diverse in their characters and life perception.

Is it essential for the minority shareholders to be aware of the actual available protection in case of potential disagreement?

Many entrepreneurs being shareholders of capital companies (a joint stock company or a limited liability company) have faced a situation when the opinions of several shareholders of one capital company on the development strategy of the company radically differ or are mutually incompatible, and it becomes difficult to agree on and adopt common decisions. Occasionally such disagreements develop into a real fight among the shareholders of the capital company regarding adoption of decisions favourable to them or just the opposite – a fight for non-adoption of some decision, and unfair and illegal methods are used in such fights. In order to protect their rights and interests, it is essential for the shareholders of capital companies to know the procedure for convocation of a shareholder meeting and adoption of decisions prescribed in the law and the articles of association, as well as the potential consequences in case of failure to observe the procedure set in the law and the articles of association. In cases when the law does not provide for adequate protection it would be advisable for the minority shareholders to bargain regarding inclusion of better protection in the articles of association.

When is it requested to declare the shareholder meeting decisions invalid?

The law prescribes that in case a decision or the procedure of adoption thereof contradicts to the law or the articles of association, or material breach has been committed in convocation of the meeting or adoption of the decision, then, on the basis of a request of a shareholder, management board, supervisory board or individual member of the management or supervisory boards, the court may declare the shareholder decision invalid. On the one hand, the possibility to attain declaring the shareholder decision invalid through court provides protection to the shareholder, whose rights have been infringed by such decision, against the arbitrariness and illegal activities of other shareholders. However, on the other hand, that regulation of the law is frequently used by indecent minority shareholders causing obstacles to convocation of a shareholder meeting and adoption of a decision, thus trying to prevent or delay adoption of a decision unfavourable to them.

Should the breach of the shareholder meeting and progress thereof be considered essential, if there is no conclusive evidence that the decision would be different, if no breach were committed?

That problem has been studied and considered also by courts when adjudicating the cases on declaring the shareholder decision invalid. Not every breach of the procedure for convocation of shareholder meetings and adoption of decisions may be considered adequate basis for the court to declare the shareholder decision invalid. In case of a breach of the procedure for convocation of a shareholder meeting and adoption of a decision the court has the option either to declare the shareholder decision invalid or not to do so; however, the decision of the court may not be

arbitrary, and the court has to assess the case circumstances and the consequences the contested decision has caused, and the court should clearly justify its decision, why it has chosen either to declare or not to declare the shareholder meeting decision invalid. The court practice states that errors of procedural nature and their influence on the legitimacy of the final decision should be assessed prudently, and the breach of convocation of a shareholder meeting may serve as basis for declaring a shareholder meeting decision invalid, only if such breach has been material. One of the main criteria for assessment whether a breach should be considered material is whether there is basis for considering that the decision would have been different in case the procedure for convocation of the meeting were complied with. For example, in case the procedure for convocation of the meeting has been breached, but the shareholder, who requests declaring the shareholder decision invalid, attended the announced shareholder meeting, or had known of the convocation of the meeting, but voluntarily chose not to participate therein, the breach should not be admitted to form a material and adequate basis for declaring the shareholder decision invalid.

Situation A. No information on all the issues on the agenda

The court has not considered that there was a material breach of the convocation and progress of a shareholder meeting for declaring the shareholder meeting decision invalid in case, when a minority shareholder and a management board member had been informed of the convocation of the shareholder meeting, but had not been informed of all the issues on the agenda. The minority shareholder performing the duties of the management board member had himself given a timely notice of the venue, timing and agenda of the meeting stating specific issues and additionally discussion of different issues as one of the issues on the agenda. 100% of the share capital was represented at the meeting of the company. It was only during the progress of the meeting when it was adjusted that the issue to be additionally discussed was the change of the management board member. The minority shareholder, who had not been timely informed of such issue to be discussed during the shareholder meeting and who had not had an opportunity to prepare and make his proposals, considered that a material breach in the adoption of the decision was committed. However, the court considered it to be adequate that the minority shareholder had been invited to provide his proposals at the same meeting, as well as that the minority shareholder had been invited to a recurrent meeting, the agenda whereof contained the assessment of the management board and an invitation to propose an applicant for the position of the management board member.

Situation B. Not informed of the shareholder meeting or informed, but chose not to participate

Similarly, the court did not recognize such a material breach in convocation and progress of a shareholder meeting as to declare the shareholder meeting decision invalid in the situation, when a minority shareholder stated that he had not been informed of the shareholder meeting at all, while the other two shareholders, who jointly represented more than ½ of the share capital and one of whom was also a management board members, witnessed that they had informed the minority shareholder of the shareholder meeting by phone. It was not clear from the testimonies of other shareholders, how timely and detailed the information on the venue, timing and agenda had been. However, it was stated that previously the meetings had usually been convoked in such manner, and usually 100% of the share capital had been represented therein. Although the management board had not adopted a decision on the convocation of the shareholder meeting, the invitation to the shareholder meeting had not been sent to the shareholders according to the procedure and by the deadline prescribed in the procedure set in the Commercial Law, and as the result thereof the minority shareholder had not participated in the shareholder meeting, the court considered that the breach was not material, since the number of votes belonging to the other two shareholders was enough for the adoption of the shareholder meeting decision. Moreover, during the court hearing the other shareholders recurrently confirmed that, provided

that no breach in the procedure for convocation of the shareholder meeting were present, as well as in case the meeting were held during the court session, those shareholders would not change their decision and would vote in the same manner. Therefore the court considered that, in the event the minority shareholder were notified of the shareholder meeting according to the set procedure and he had participated in that meeting, as well as had voted against the adoption of the aforementioned decision, that decision would still be adopted, since the Commercial Law did not prescribe and the shareholders had not agreed in the articles of association that adoption of such decision would require a qualified majority of votes. Consequently, the court concluded that the rights of the minority shareholder had not been infringed, since the decision had been adopted by a majority of votes that could not be affected by the minority shareholder.

It is essential that in the particular case, the actual procedure of convocation and progress of the meeting, which would disclose the deficiencies, was intentionally omitted from the minutes of the shareholder meeting to be submitted for registration of the changes to the Commercial Register, since otherwise the Enterprise Register would not perform the necessary registration considering the fact that 100% of the share capital was not represented at the meeting.

Can the minority shareholder trust that he will be timely informed of the convocation and progress of the shareholder meeting?

Considering the fact that the courts are very critically assessing whether the committed breach of the procedure for convocation of the shareholder meeting is material, and the cases when the court declares the shareholder decision invalid due to the breach committed in the procedure for convocation of the shareholder meeting, the possibilities of indecent minority shareholders to unjustifiably delay the adoption of shareholder decisions have decreased, and another problem has become more topical. Being aware of the current court practice, there is an increasing tendency that the shareholders of capital companies jointly holding the majority of votes required for adoption of decisions flatly ignore the procedure for convocation of the shareholder meeting set by the law and the articles of associations, by arbitrarily ignoring the set deadlines for convocation of the meeting and the procedure for notifying thereof. Consequently, the minority shareholder, who has previously had full or partial influence in the management board, may lose such influence at any moment without the possibility to renew it, by suddenly being simply informed of the fact. In such cases the shareholder, not having enough votes to influence the adopted decision, has limited ability to attain declaration of the adopted shareholder decision invalid through court, since it will be difficult to refute the argument of the other party that even in the case the procedure for convocation of the meeting were observed, that would not have influenced the adopted decision. Such a criterion should be considered by everyone who is assessing his/her options for contesting the shareholder decision due to the breach of the procedure for convocation of the shareholder meeting, thus paying much attention to substantiating in a reasoned manner the fact that the committed breach has materially infringed the shareholder's rights and could have influences the final decision.

What are the possible solutions?

In order for the shareholder of a capital company to avoid a situation, where he is no more able to influence the decisions adopted by the shareholders and feels powerless against the arbitrariness of other shareholders, it would be worth to timely take care of an efficient mechanism for protection of his legal interests. It may be prescribed in the shareholder agreement and the articles of association of the company that a larger quorum and a larger number of shareholder votes, or consent of all the shareholders is required for adoption of certain essential shareholder decisions. One of the instruments in such cases could be also the shareholder agreement, where different conflict solution mechanisms (e.g., purchase/buy-out, liquidation etc.) would be included in addition to the procedure for convocation of shareholder meetings and adoption of decisions, and determination of the responsibility of shareholders for the breach of those provisions and

consequences of other violations. If the agreement is made and the rules of the game have been initially clearly defined, such activities may essentially decrease the potential differences and disagreements among the shareholders of a capital company.