

RUSSIAN ECONOMY IN 2018
TRENDS AND OUTLOOKS
(ISSUE 40)

Gaidar Institute Publishers
Moscow / 2019

UDC 338.1(470+571)"2018"(063)
BBC 65.9(2Рос)я431

R95 **Russian Economy in 2018. Trends and Outlooks. (Issue 40)** / [V. Mau at al; ed. Editors – Alexei Kudrin, doctor of sciences (economics), Alexander Radygin, doctor of sciences (economics), doctor of sciences Sergey Sinelnikov-Murylev, doctor of sciences (economics)]; Moscow: Gaidar Institute Publishers 2019. – 616 pp. – ISBN 978-5-93255-556-9

The review “Russian Economy. Trends and Outlooks” has been published by the Gaidar Institute since 1991. This is the 40th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia's economic development, which allow to monitor all angles of ongoing events over a prolonged period: the socio-political issues and challenges; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

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ISBN 978-5-93255-556-9

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Limited liability companies (1998–2018): justice versus common law¹

6.5.1. Limited liability companies as principal business conduct in Russia

Legal framework of a limited liability company emerged in 1892 in Germany (Gesellschaft mit beschränkter Haftung, GmbH). It did not have any prototypes or models and was artificially created by German Ministry of Justice and approved as a law. Introduction of this legal framework owed largely to strengthening of shareholding legislation, which took place in 1884 as a follow up of a period when shareholding companies popped up using money collected from households in exchange of promise of high interest and accompanied by numerous fraud and abusive practices, taking advantage of liberalism of German shareholding legislation of that time².

Small and medium size entrepreneurs needed the opportunity to set up corporations with a low number of participants, relatively small assets and way of secession more complicated than in a shareholding company.

Such a corporation was liable for its debts and participants were exempted from corporation's debts, which made this legal framework attractive. Organizational design required by a limited liability company was adopted from a shareholding company and, therefore, they are frequently called "a younger sister of a shareholding company" in Germany or "small shareholding company".

Limited liability companies became the most popular form of entrepreneurship in Germany: at present, their number exceeded one million and they account for one third of all produced goods and services.

In addition to Germany, limited liability companies exist somehow in a number of civil law countries, i.e. in France (société à responsabilité limitée – SARL), Italy (società a responsabilità limitata – SRL), Belgium (private limited liability company), Luxemburg (limited liability company), Portugal (share society). Private company and closed corporation exist in British/American system. Moreover, private limited liability companies can be set up in the USA (LLC)³.

According to a different view, US private companies are not analogous to limited liability companies⁴. China with their limited liability companies provide another example of a country that adheres to common law models⁵.

This legal form is characterized by:

1. Predominance of dispositive norms;

¹ This section was written by Elena Apevalova, RANEPa.

² See here and below: Evgeny A. Sukhanov, *Comparative corporate right*, M. Statut, 2015, pp. 75-77.

³ See in detail: *Corporate right*. Edited by Irina S. Shitkina. V. Wolters Kluwer 2007, pp. 577 – 581.

⁴ Evgeny A. Sukhanov. *Issues of codification of corporate and ownership right*. – M. Statut, 2018, p. 21.

⁵ See in detail: *Corporate right. Topical issues of theory and practice*. Edited by V.A. Belov – M. Urait, 2015, p. 95

2. Qualities typical for a union of persons and a union of capitals¹;
3. A more facilitated process of establishment of these entities compared to shareholding companies;
4. Lower accounting requirements².

Legal regulation of limited liability companies is indeed more dispositive than of shareholding and especially public companies, however, dispositivity level of this regulation is still an argumentative issue³.

Current law on limited liability companies operating in Russia was adopted in February 1998⁴, that is twenty years ago. At present, there are over 3.5 million limited liability companies, i.e. $\frac{3}{4}$ of 4.5 million registered legal entities⁵. Most of limited liability companies are small and medium-sized businesses.

6.5.2. Legal regulation of limited liability companies in Russia, stages of development and specific models

Russia's transition to market economy demanded new legal regulation of civil turnover and entrepreneurial activity. In 1994, the first part of Civil Code was adopted and it stipulated main provisions on legal entities as well as rules on limited liability companies adopted from Germany as mentioned above.

As from this time, one may speak about stage I (**1994 – January 1998**) in the development of legislation on limited liability companies known for providing **platform for regulation of legal entities, including limited liability companies, as an organizational and legal form**. It was determined that a limited liability company is a company established by one or several persons with authorized capital divided into shares defined per size by constituent documents.

Participants are not liable for its obligations and bear risk of losses associated with the activities of the company according to value of their contributions (Article 87 of the Civil Code of the Russian Federation). It was stated that another economic entity consisting of one person will not be a sole participant of this company (Section 2, Art. 88 of the Civil Code of the Russian Federation). This restriction is related to a dangerous

¹ According to a different view, limited liability companies represent a union of capitals For details, see, for example, Evgeny A. Sukhanov, *Opere citato*, p.21

² See details: Corporate right. Edited by Irina S. Shitkina. M. Wolters Kluwer 2007, pp.577-581

³ See details: Corporate right. Topical issues of theory and practice. Edited by V.A. Belov – M. Urait, 2015, p. 128–129.

⁴ Federal law No.14 of February 8, 1998 “On limited liability companies”.

⁵ A number of scientific publications dedicated to the topic of legal regulation of limited liability companies: Stanislav D. Mogilevsky. Limited liability company. Legislation and practical implementation. M., 2010; Andrey A. Glushetsky. Public and private corporations. Specifics of shares turnover in the authorized capital of a limited liability company: legal and economic aspects. M. Statut, 2017; Andrey A. Glushetsky. Authorized capital: stereotypes and their overcoming. Economic analysis of corporate right standards; V.G.Borodkin “Civil-legal regulation of corporate agreement in Russian legislation: Monography-Justinform, 2017; A.G.Chreniavsky, D.A .Pashintsev, O.A. Ternovaya “International corporate right – Knorus M., 2019 and others.

situation when a group of legal entities may use the same person as sole participant controlling these legal entities and having no financial liability.

Firstly, it means to be responsible for obligations of a bankrupted legal entity caused by instructions of the founder and liability of the main company for obligations of the subsidiary.

According to Article 89 of the Civil Code of the Russian Federation, Agreement and Statutes present constituent documents. General meeting of shareholders will be the supreme governing body with its established competence (Article 91 of the Civil Code of the Russian Federation). Day-to-day management will be carried out by executive body, either collegial or individual. Executive body is accountable to general meeting of shareholders.

In addition, this law reflects on reorganization, liquidation of a company, transmission of a share in the authorized capital to another person and withdrawal of a participant from a company (Articles 92–94 of the Civil Code of the Russian Federation).

Moreover, Article 67 of the Civil Code secured the following rights and obligations of participants of the legal entity: to participate in management of activities, receive information about activities, participate in the distribution of profits; receive part of property remaining after settlements with creditors or its cost, etc. in case of liquidation. These duties include: investment and non-disclosure of confidential information about company's activities, etc., if they are provided for by its constituent documents.

According to Article 68, part 1 of the Civil Code of the Russian Federation, entities can be transformed into companies of a different type or production cooperatives by decision of the general meeting of participants.

Stage II: February 1998–2011, establishment of a system of standards on limited liability companies. In February 1998, Federal Law No.14 “On Limited Liability Companies” dated February 8, 1998 was adopted and consolidated the following standards:

- Subsidiaries and affiliates. A company shall be recognized as a subsidiary if another (principal) company has the ability to influence on decisions taken by this company due to its predominant equity holding or in accordance with the concluded agreement or otherwise. A company shall be recognized dependent if another (principal, participating) company has more than 20% of the authorized capital of the first company (Article 6 of the Federal Law "On Limited Liability Companies");
- withdraw regardless of consent of other participants;
- sell or otherwise award their share in the authorized capital of the company (Article 8, point 1 of the Federal Law "On Limited Liability Companies");
- introduce (terminate and restrict) additional rights for participants according to Statutes of this company (Article 8, point 2 of the Federal Law "On limited liability companies");
- contribute to the authorized capital of the company: monetary evaluation of in-kind contributions approved by unanimous decision of the general meeting;

- invite an independent assessor to evaluate contributions (Article 15 of the Federal Law "On Limited Liability Companies");
- sue for exclusion of a participant seriously violating his/her duties or rendering impossible or hampering company's activity due to his/her actions or inactions. Members possessing the least overall share of 10% of the authorized capital are entitled to have this right (Article 10 of the Federal Law "On Limited Liability Companies");
- increase authorized capital at the expense of the company's property, additional contributions of participants, deposits of third parties accepted by the company if not prohibited by Statutes (Article 17 of the Federal Law "On Limited Liability Companies");
- reduce authorized capital in a format of reducing nominal value of all participants' shares and/or repaying shares owned by the company (Article 20 of the Federal Law "On Limited Liability Companies");
- claim participant's share in the authorized capital. On creditors' demand for a share or part of a share, this request will be fulfilled only as a result of a court decision if there is no sufficient means to cover debts of other participant's property (Article 25 of the Federal Law "On Limited Liability Companies");
- contribute to company assets. Participants have the duty to contribute to company assets if stipulated by Statutes or by decision of a general meeting (Article 27 of the Federal Law "On Limited Liability Companies");
- allocate profits among participants. Company has the right to make a quarterly, semi-annual or annual decision on allocation of its net profit among participants (Article 28 of the Federal Law "On Limited Liability Companies");
- place bonds (Article 31 of the Federal Law "On Limited Liability Companies");
- regarding collegial executive body: It may be envisaged by Statutes, elected by general meeting (Article 41 of the Federal Law "On Limited Liability Companies");
- appeal decisions taken by governing bodies. Decision taken by general meeting violating law, legal acts of the Russian Federation, company's Statutes and rights of a participant who did not vote or voted against the contested decision, may be invalidated by the court (Article 43 of the Federal Law "On Limited Liability Companies".)
- liability of the Board of Directors, sole executive body and members of collegial executive body. All these bodies should act in good faith and reasonable in the company's interests when exercising their rights and duties. They are also liable for damages caused to company by their faulty actions and inactions, unless other grounds and amounts of liability are established by federal law (Article 44 of the Federal Law "On Limited Liability Companies");
- related-party transactions and major transactions (Articles 45, 46 of the Federal Law "On Limited Liability Companies"). Transactions proving interest of members of the Board of Directors, a sole or collegial executive body or of a member, who possesses

more than 20% of total number of votes together with affiliated persons, shall not be settled by company without consent of the general meeting.

A major transaction means a transaction or several interrelated transactions relevant to acquisition, alienation or possibility of alienation of a property by a company, directly or indirectly, with a value more than 25% of the property value unless the Statutes provides for a higher amount of a large transaction. Transactions settled in the ordinary course of business will not be considered major ones;

- auditing commission of the company. It will be elected by general meeting of participants for a period determined by Statutes (Article 47 of the Federal Law "On Limited Liability Companies");
- auditing procedures and public reporting (Article 48–49 of the Federal Law "On Limited Liability Companies");
- documents' storage (Article 50 of the Federal Law "On Limited Liability Companies");

The following principles were developed further:

- authorized capital and shares. (Article 14 of the Federal Law "On Limited Liability Companies");
- executive bodies: the highest body is the meeting of participants, the Board of Directors (supervisory board), the sole executive body (Article 32 of the Federal Law "On Limited Liability Companies");
- standards on general meeting of participants (Articles 33–39 of the Federal Law "On Limited Liability Companies");
- standards on reorganization and liquidation (Articles 51–58 of the Federal Law "On Limited Liability Companies").

As a result, a model of a limited liability company was established and characterized by:

1. Low authorized capital, i.e. Rb 10.000, slightly over 130 Euro;
2. Autonomy from their founder/founders with regard to activities and responsibility;
3. Separation of authorized capital into shares representing transferable complex of property and non-property rights, i.e. rights to take part in corporate organizations and in their management;
4. More complicated procedure of entry/withdrawal of founders compared to shareholding company;
5. Structure of executive bodies adopted from shareholding company.

Limited Liability Company is more attractive when participants are at the same time managers and there is no agency conflict or it is minimized. In this case, participants require much less of external additional management control compared to shareholding companies, i.e. external audit, registrar, state regulator. This will result in reduction of losses.

Innovations focused on exemption of strategic enterprises from legal terms were adopted in 2008–2011 (April 2008)¹; powers of the Board of Directors which can be attributed to their competence by Statutes, for example, definition of main activities, etc.) were significantly expanded, contract proving establishment of the company canceled as a constituent document, a list of issues requiring unanimous² decisions and two-thirds³ majority approved, procedure of shares transmission to other participants clarified, procedure for concluding a pledge share detailed; a new chapter “Maintaining a list of a company members” introduced, wording of interested-party transactions clarified, duty of affiliated persons to notify the company in writing about their own shares confirmed, procedure for concluding major transactions clarified as well as the list of exemptions; procedure for mergers, acquisitions, transformations of companies, etc. clarified (December 2008)⁴.

Furthermore, the right to demand transfer of a share in the court was confirmed in July-August 2009⁵ if the party to the transaction wrongfully evades its notarization (Article 21 point 11 of the Federal Law "On Limited Liability Companies"); Article concerning appeal of decisions of company's executive bodies confirmed provision stating that “the court has the right to uphold the decision being appealed if the committed violations are not material and decision did not entail losses to the company or this participant or other adverse consequences” (Article 43 point 3 of the Federal Law "On Limited Liability Companies").

Moreover, provisions were added on company's responsibility to provide information, in particular, that a company has the responsibility to provide access to participants to their judicial acts on dispute related to the establishment of the company, management and participation, changes of the grounds or the subject of previously filed claim, etc.

In February 2010, procedure determining payment of a part of the distributed profit of the company was clarified⁶ and the period of payment should not exceed 60 days from the date of the decision taken on distribution of profits among participants (Article 28 point 2 of the Federal Law "On Limited Liability Companies").

¹ Federal law No. 58 of April 29, 2008 “On amendments to certain legal acts of the Russian Federation and invalidity of certain provisions of legal acts of the Russian Federation as a result of approval of Federal law on international investment in business companies strategically important for defense and security of the state”.

² This decision on establishment of a company, approval of its Statutes, approval of its monetary evaluation of securities, other matters or property rights or different ones having monetary assessment of rights contributed by founders to pay shares in authorized capital.

³ Decisions on election of executive bodies, establishment of a revision commission or election of a controller and approval of an auditor have to be made by two thirds of votes.

⁴ Federal law No. 312 of December 30, 2008 “On amendments to Part one of the Civil law of the Russian Federation and certain legal acts of the Russian Federation”.

⁵ Federal law No. 205 of July 19, 2009 “On amendments to certain legal acts of the Russian Federation”

⁶ Federal law No. 409 of December 30, 2010 “On amendments to certain legal acts of the Russian Federation relevant to payment of dividends (distribution of profit).”

A participant who has not received his share of a distributed part of profits has the right to demand payment of the respective amount within three years. Statutes may suggest a longer period but not more than 5 years. Deadline set for the appeal will not be prolonged if missed. If a participant did not file such a demand due to violence or threat, it could be regarded as exception (Article 28 point 4 of the Federal Law "On Limited Liability Companies").

In July 2011, rules were clarified with regard to reduction of authorized capital of the company¹, in particular, company had the duty to report on this decision to a state organization maintaining registration of legal entities within 3 working days after the decision was taken and publish news in mass media twice a month. Requirements for publication of this news are stipulated in Article 20, points 3, 4 of the Federal Law "On Limited Liability Companies".

Then, the principles below were confirmed as follows:

- terms to claim early fulfillment of obligations for creditors, and/or when impossible, then, terminate it and pay damages 30 days from the date of publication of the last notice on reduction of authorized capital if creditor's claims arose before the notice was published;
- six month limitation of statutes from the date of the last publication on reduction of authorized capital;
- right of the court to refuse satisfaction of the above requirement, if the company proves that as a result of reduction of authorized capital rights of creditors were not violated and provided security was sufficient for proper implementation of duties (Article 20, point 6 of the Federal Law "On Limited Liability Company").

Furthermore, legislator settled the issues of funds and net assets of the company: the cost of such assets except for credit organizations is determined according to accounting data², for credit organizations it is the amount of own funds (assets)³. Company is obliged to provide access to information on the value of its net assets to any interested party. In addition, the company's annual report should contain information about the size of the company's net assets⁴.

¹ Federal law No. 228 of July 18, 2011 "On amendments to certain legal acts of the Russian Federation relevant to reviewing methods of protection of creditors' rights under reduction of authorized capital, change of requirements to business companies in case authorized capital does not correspond to cost of net assets".

² Executive order of the Ministry of finances of Russia No. 84n of August 28, 2014 (edited on February 21, 2018) "On adoption of procedure to define cost of net assets".

³ Instruction of the Bank of Russia No. 2332-Y of November 12, 2009 (edited on June 2, 2016) "On register, forms and procedure of formulation and presentation of accounting forms of credit organizations to Central Bank of the Russian Federation".

⁴ Annual report should include:

1) parameters characterizing dynamics of changes of the cost of net assets and authorized capital in the three last completed financial years, including accounting year or every completed financial year if the company exists less than three years;

In the event of reduction of net assets versus authorized capital, the company is obliged to decide on reduction of the authorized capital or on liquidation of the company not later than six months.

Stage III. 2012 until present. The reform of civil legislation introduced systemic changes and formulated fundamental legal standards in the sphere of legal entities' activities aimed at further development of corporate governance standards by changing requirements on reorganization and liquidation of enterprises, introduction of standards on corporate agreements, rights and obligations of companies. The most significant changes concerned the following topics:

a) *introduction of a concept of corporate relations* associated with participation in corporate organizations or their management;

b) *provision of corporate rights* as a compulsory condition for activity of a legal entity;

c) *introduction of a system based on legal forms of legal entities*¹.

Legal entities will be divided into corporate, i.e. those where founders (participants) have the right to participate/be a member and define their supreme body, and unitary entities where founders will not become participants and acquire membership.

Corporate legal entities include business partnerships and societies, agricultural (farmers) households, economic partnerships, production and consumer cooperatives, public organizations, associations (unions), real estate owners associations, Cossack communities entered into relevant register, and small indigenous communities.

According to few authors², revision of standards on legal entities was driven basically by the necessity to simplify and unify legal regulation, eliminate multiple current laws and their mutual contradictions and enhance the role of the Civil Code in regulating status of legal entities.

d) *facilitation of constituent documents of legal entities*. All legal entities except business ones must act only in compliance with Statutes approved by founders (participants) while for business companies this will be a constituent agreement of association. It is possible to use standard Statutes approved by relevant government body. Founders have the right to approve internal regulations governing corporate documents.

2) results of analysis of reasons and factors which led to lesser cost of net assets than of authorized capital according to opinion of a single executive body of the company, board of directors (if this board of directors established in the company);

3) list of measures assuring compliance of the cost of net assets with the size of authorized capital (Article 30 point 3 of the Federal law "On limited liability companies"

¹ In May 2014, Federal law No.99 of May 5, 2014 "On amendments to chapter four of Part one of the Civil code of the Russian Federation and invalidity of certain provisions of legal acts of the Russian Federation".

² Tatiana V. Soifer. Modern trends of development of civil legislation on non-commercial organizations. – //Rossiiskaya – yustitsiya, 2014, No.3, p.8. Codification of Russian private law 2015 (edited by Pavel Krashennikov).– Statut, 2015.

e) *members of collegial bodies of a legal entity take the responsibility to act in their interests, in good faith and reasonably*, i.e. the same way as a person authorized to act on behalf of a legal entity. Principle of good faith practically means that mentioned participants of civil turnover must respect rights and interests of the counterparty, avoid abusing their rights, misusing own rights, taking actions aimed at “circumventing” the law and deliberately creating conditions for non-fulfillment of obligations or unjust acquisition of rights. Civil law cannot prescribe and prohibit any possible violations of someone’s interest in practice, that is why it is important for courts to have the opportunity to recognize those or other persons dishonest and their actions to be abuse of the right.

Moreover, in our opinion, introduction of this principle brings this legal system closer to common law using the opportunity to take a decision based on general principles rather and specific norms.

f) *confirmation of responsibility of the person authorized to speak on their behalf as well as members of collegial bodies of legal entities* (with the exception of those who voted against the decision that caused losses or, acting in good faith, did not vote). The above-mentioned persons will be obliged to compensate damages caused to legal entity as a result of their fault at the request of legal entity and/or its founders (participants). Joint and several liability is envisaged if there are joint losses. Agreements to limit or eliminate such liability are void. In fact, a mechanism introduced to protect interests of the owner from abuses of management, which is a common practice in Russia. Practice of dealing with issues of recovery of losses from members of the board of directors has not yet developed;

g) *a significant change of reorganization standards of legal entities* – the possibility of a comprehensive reorganization of legal entities has been introduced, i.e. reorganization of a legal entity with a simultaneous combination of various forms of reorganization as well as reorganization involving more than two legal entities, including those belonging to different organizational and legal forms. It seems that these expanded abilities of reorganization will make it difficult to ascertain legal succession and contribute to the abuse by reorganized enterprises;

h) *introduction of the concept “non-operating legal entity”*, which is a legal entity that for 12 months did not submit reporting documents provided for by the legislation on taxes and fees and did not carry out transactions at least at one bank account. Such an entity will be considered to have actually terminated its activities and subject to exclusion from the unified state register of legal entities, which does not prevent members of its governing bodies, individuals determining its actions from taking responsibility. Introduction of these procedures is considered positive, and will contribute to “clear” the market from abandoned companies and one-day firms;

i) *introduction of general provisions on participants’ rights and duties*. It largely repeats the existing rules on rights and duties of legal entities. The new provisions are the following: to participate in corporate decisions required to continue corporation’s activity, if their participation is critical for making such a decision, as well as duty to

avoid taking actions to the detriment of the corporation interests. It is important to secure the following rights:

- demand remuneration of losses caused to the corporation acting on their behalf;
- challenge transactions settled by the corporation and demand application of consequences of invalidity of void transactions.

Law and constituent document of a corporation may include other rights and obligations for its participants.

Members of the corporation collegial executive body have rights to receive information about corporation's activities, get acquainted with accounting and other documentation, claim compensation for corporation's losses, challenge transactions settled by corporation and claim application of consequences of invalidity of null and void transaction;

j) *option to redistribute powers of participants disproportionately to their shares in the authorized capital is a new approach to regulation of activities of non-public business companies.* This option can be realized when included in the Statutes or in a corporate agreement subject to introduction of this information into the Unified State Register of Legal Entities.

Thus, a new mechanism capable to change the distribution of forces in corporate governance was presented to participants of limited liability companies. Having mutually agreed, participants have the possibility to implement other regulation different from law on regulation;

k) *general provisions on the authorized capital of the economic company were also developed.* Only cash means have to contribute to authorized capital. Monetary assessment of in-kind contributions to the authorized capital should be implemented by an independent appraiser. Participants of the economic company were forbidden to determine monetary value of in-kind contributions above the value determined by the appraiser;

l) *solidarity subsidiary liability of participants and independent appraiser* determined in case company's property is insufficient when paying shares by non-monetary funds in the amount equal to overestimated evaluation of property contributed to authorized capital within 5 years from registration of the company and/or making relevant changes to Statutes. Such responsibility does not apply to companies set up in the process of privatization through privatization of unitary enterprises.

In 2012–2018, more stringent requirements for a number of transactions, i.e. notarial form, were introduced to the Federal law “On Limited Liability Companies” and notary has the right to make sure that alienated shares have been fully paid. Substantial changes pertained to articles on interested party transactions and major transactions. Interested party transactions are no longer required.

A different procedure for approval of interested-party transactions or instruction on non- application of interest standards can be established by the company Statutes. Only those transactions that go beyond the ordinary course of business are considered major transactions. New rules on option plan were introduced.

In 2014, a concept of a standard Statutes of limited liability companies was introduced in Article 52 of the Civil Code of the Russian Federation. Today there are 36 of them¹. A real opportunity to choose a standard OOO Statutes will come into force only after June 25, 2019².

In 2016, Federal Notarial Chamber received an opportunity to maintain and store the list of participants included in the register of lists of participants of limited liability companies under unique information notarial system. The deadline for liquidation was reduced to one year. It was stipulated that the company's Statutes may provide for the need to obtain the consent of the board of directors or the general meeting to conduct certain transactions.

Existing law “On Limited Liability Companies” is twenty years old and the selected German model is characterized by the following principles:

- relatively low authorized capital, i.e. Rb 10.000, slightly more than 130 Euro;
- company act and take responsibility independently from their founder/founders;
- authorized capital is divided into shares representing a complex of property and non-property rights, i.e. rights to take part in corporate organizations and their management;
- more complicated procedure of entry/withdrawal of founders compared to shareholding company;
- structure of LLC executive bodies adopted from shareholding company.
- predominance of dispositive standards in the legal regulation of limited liability companies;
- existing model of limited liability companies possess features of a union of persons and capital;
- lower accounting requirements for limited liability companies.

6.5.3. On certain issues of regulation of the limited liability companies

First of all, let us focus on corporate agreements. The first corporate agreements appeared in Russia nearly in the 90-s when participants of Russian economic companies wanted to bring out corporate agreements from Russian regulation³.

¹ Presentation by Irina S. Shitkina at the Gaidar forum 2019 on January 17, 2019-
<http://gaidarforum.ru/about/mediamaterials/video17-yanvary-2019/>

² Standard OOO Statutes in 2018- <https://www.regberry.ru/registraciya-ooo/tipovoy-ustav-ooo-v-2017-godu>.

³ Corporate agreements were brought out from Russian regulation owing to such standard schemes as: 1) establishment of a holding structure with a conclusion of shareholders agreement on international right with regard to company switched under international jurisdiction; 2) application of international right directly to the agreement when establishment of a holding structure not possible. D.E. Lovyrev. Legal specifics of corporate agreements//Text of the presentation at the conference “ Practice of implementation of shareholders agreement and responsibility issues of executive bodies, shareholders and participants of shareholding companies and limited liability companies” URL: <http://www.mzs.ru/upload/iblock/434/434a72b108ab8584352722a2c0c37607.pdf>

In 2006, decisions taken on specific issues of ZAO “Russian Standard Insurance” and OAO “Megafon” stated that principles of shareholders’ agreements were recognized invalid as legislation lacked any detailed rule governing regulation of such agreements. However, courts did not investigate each individual principle of the agreement for its compliance with nature of corporate relations and obligations self-imposed by the parties¹.

Issues related to application of international law with regard to corporate agreements failed practical resolution for long enough. The reason was that corporate agreements “are at the junction of two areas of private law”, which are characterized by opposing approaches at the level of private international law. It is a fact that principle of autonomy of the parties dominates in the area of contractual duties with parties having the opportunity to choose the law applicable to the contract (Article 1210 of the Civil Code of the Russian Federation).

On the opposite, corporate right represents an area of practically inseparable and imperative supremacy of private law of a legal entity understood as its right according to its place of state registration (Article 1202, point 1 of the Civil Code of the Russian Federation)².

Later, in December 2008³ legislator adjusted separately agreements on rights of participants of an economic company and shareholding agreements in June 2009⁴. Adopted standards did not provide for a system and raised many questions among practitioners and theorists.

When Federal Law No.260 “On Amendments to Part Three of the Civil Code of the Russian Federation” of September 30, 2013 was adopted, it stated that parties to a corporate agreement including a foreign element have the right to subordinate its contract to an international law according Article 1214 of the Civil Code of the Russian Federation, however, obligatory taking into consideration imperative standards of a country where this legal entity was established and that is contracted.

Further development of standards on corporate agreements took place along with the reform of civil law, when, as of September 1, 2014⁵, general provisions on a corporate agreement were enshrined (Article 67.2 of the Civil Code). Thus, participants of the economic company or some of them are entitled to conclude an agreement among themselves on exercising their corporate (membership) rights (corporate agreement).

¹ See details: V.G. Borodkin. Civil/legal regulation of corporate agreement in the Russian legislation: Monography. D.I.Stepanov. New provisions of Civil code on legal entities//Law 2014. N7.C.-Justinform 2017, pp. 14-15

² See details: V.G. Borodkin. Civil/legal regulation of corporate agreement in the Russian legislation: Monography. – Jusinform 2017, p.19

³ Federal law No.312 of December 30, 2008 (edited on May 5, 2014) “On amendments to part one of the Civil code of the Russian Federation and certain legal acts of the Russian Federation”

⁴ Federal law No.115 of June 3, 2009 (edited on June 29, 2015) “On amendments to Federal law “On shareholding companies” and Article 30 of the Federal law “On the market of securities”.

⁵ Federal law No.99 of May 5, 2014 “On amendments to chapter four of Part one of the Civil code of the Russian Federation and invalidity of certain provisions of legal acts of the Russian Federation”.

Participants are obliged to implement these rights somehow according to the agreement or abstain from their implementation, i.e. to vote in a certain manner at the general meeting, fulfil other coordinated managerial acts, purchase or alienate shares in its authorized capital under specific circumstances or abstain from alienation of shares under specific circumstance.

A corporate agreement will not oblige its participants to vote in accordance with the instructions of executive bodies, determine structure of executive bodies and their competence. The terms of a corporate agreement that contradict the above rules are void.

Prior to adoption of changes to the Civil Code, the scope of powers of participants in the economic company was determined solely in proportion to their shares in the company's authorized capital. A corporate agreement may provide for a different amount of powers. A prerequisite is to include information on availability of such an agreement and on the scope of competence of the company's participants provided for in the unified state register of legal entities (Article 66, point 1, para 2 of the Civil Code of the Russian Federation). This can change influence and balance of power in corporate decisions, amount of dividends, etc.

Corporate agreement may include an obligation to vote at the general meeting of participants for provisions defining structure of executive bodies and their competence, to be included in the Statutes if, in accordance with the Civil Code and laws on business companies it is allowed to apply Statutes in order to change structure of executive bodies of the company and their competence.

Participants of business partnership having concluded a corporate agreement must notify the company about the fact of conclusion of a corporate agreement and its content does not have to be disclosed. When this obligation is not fulfilled, participants not being parties to the corporate agreement are entitled to claim compensation for their losses.

Unless otherwise provided by law, information on the content of a corporate agreement concluded by participants of a non-public company shall not be subject to disclosure and considered confidential.

Creditors and other third parties may also conclude an agreement with participants of economic company which obliges participants to exercise somehow their corporate rights in order to ensure legally protected interest of such third parties or refrain (refuse) from their implementation, i.e. vote in a specific manner at the general meeting, carry out other coordinated managerial actions, acquire or alienate shares of its authorized capital according to a special cost or refrain from alienation of shares prior to establishment of special circumstances. Rules on corporate agreement relevantly apply to this agreement.

Opposite from Russian law, corporate contract (agreement) is known for over a century for its developed international law enforcement, being part of common as well as continental law. At the same time, judicial and doctrinal recognition of such agreements did not happen at once. Corporate agreements were questioned for extended

period in law enforcement and science. However, at present, corporate agreements are recognized as an integral part of regulations governing relations between participants under international doctrine and judicial acts¹.

There are two principal positions with regard to the limits of the subject of a corporate agreement for participants of economic companies. The first one confirms unlimited subject of such an agreement relevant to management and activities of this company. This approach is typical for Great Britain and USA². Practice of corporate agreements in closed corporations is most developed in the USA with specified agreements between participants of corporation and agreements with members of the Board of Directors. The latter are traditionally focused on certain curtailment of freedom to take decisions by members of the Board of Directors.

In England, a corporate contract may contain corporate governance, financial, accounting issues, procedure for transmission of company's shares and others matters regulating relations of the parties with regard to specific circumstances which may include conditions for exercising rights to demand sales of company's shares due to insolvency of the other party, substantial violation of its contractual obligations as well as changes in the composition of shareholders or indirect owners of a party to a contract in the event of "change of control" situation. Such an extensive regulation is associated with a long tradition of common law system.

The second position means that the subject of a corporate contract is limited to issues related to procedures for exercising corporate rights by shareholders and this is typical for Western Europe and Russia. If Europe has experience in concluding corporate contracts, the, most often there is no relevant legislation. Where it exists, for example, in Italy, there are only two articles dedicated to a corporate contract, included in the legislation in 2003 and containing strictly imperative rules on such contracts.

Civil Law of Italy titles them accompanying corporate legal contracts with mainly historical background. These contracts should not contradict illegal imperative norms and their subject is very limited, i.e.: exercise of voting rights in a shareholding company or in its parent company; restrictions on transmission of shares or participation in such companies; mutual control over subsidiaries, however, period of their validity is limited to 5 years (Art. 2341-bis Civil Code). In public companies, such contracts have to be publicly announced at general meetings and their contents recorded in the minutes of the meeting and in the commercial register (Art. 231 -ter CC).

Corporate contracts were mostly expanded in Switzerland and after a series of doubts, nevertheless, it allowed an option to conclude mutual contracts relevant not only to

¹ V.G. Borodkin. Civil/legal regulation of corporate agreement in the Russian legislation: Monography.- Jusinform 2017, p.4

² Here and below: D.V. Dobrachev. Topical issues of judicial practice in corporate and entrepreneurial right.-M. Infotropic Media, 2018

coordinated voting but also to preliminary or preferential purchase of shares exclusively between participants of small (private, non- public) shareholding companies, impose certain additional obligations on shareholders (refraining from mutual competition, not disclosing certain information) or grant them additional rights (to receive information and even participate in decision making), treating them as contracts of shareholders' rights but firmly stating their obligation-legal nature, which, therefore, does not affect the relationship between a party to such contract and shareholding company as a whole.

Such a contract does not provide participants with additional corporate rights, it is not a constituent document or an annex to company's statutes. If regulation of the contract on the implementation of participants' rights in an economic society is an essential stage of development for Russian legislation, recognition of such contracts by courts is a long historical tradition in English law.

These norms are stipulated in the Russian civil law while in English law legal norms relevant to these contracts are primarily expressed under existing precedent law. According to several authors¹, extension of scope of a corporate contract may serve as a platform for abuse due to legal opportunity to output corporate governance beyond governing bodies of a business entity.

Significant mitigation of responsibility at all levels of corporate relations, including the responsibility of corporations and individuals determining their activities to creditors, i.e. other participants of civil circulation may lead to adoption of such norms. A company could become dependent not only on company's participants but also on third parties who take part in shaping the terms of a specific corporate agreement².

According to a different view, a corporate contract contains such a regulation of their relations, which corresponds to their goals of participation in corporate management. Last but not the least, parties received a real opportunity to protect their rights in case of violation of a corporate contract by one or several signatories³.

Limited liability companies face another significant issue, that is, the insecurity of creditors' rights. In order to ensure debtor's economic responsibility, creditors' interests have to be protected. In continental law, it happens at the expense of large authorized capital. In common law, authorized capital is minimal or does not exist and therefore protection of creditors' interests is carried out by means of a follow-up control (ex post).

Mandatory inspection of actual property status plays critical role in this system in order to prevent insolvency resulted from "redistribution of property". Directors should organize such an inspection using "solvency test." In order to increase protection of

¹ See details: Evgeny A. Sukhanov. Comparative corporate right.-M. Statut, 2015

² Decision of the Council on codification and improvement of civil legislation under the President of the Russian Federation of August 1, 2011, Protocol No.98. Civil Law Review Journal, 2011 No.5

³ See D.I. Stepanov. New provisions of the Civil code on legal entities//Law 2014. N7.C.37

creditors, common corporate law strengthen personal subsidiary liability of directors and tighten rules on bankruptcy.

What is the situation in Russia? On one hand, the European (German) model of solid capital is used as a basis. On the other hand, the size of the authorized capital is pure symbolic (in Germany, for comparison, it accounts for 25.000 Euro), i.e. it does not protect interests of the creditors. At the same time, there is no follow-up system of monitoring, typical for British/American legal system. This leads to both the insecurity of creditors' rights and conditions for emergence of fictitious companies.

It seems that legislator should gradually increase the size of the authorized capital. At the same time, members of limited liability companies should have an opportunity to switch to individual entrepreneurship.

What are the prospects? The model of legal regulation of limited liability companies was shaped and its characteristics discussed above in details. German model served as a basis. It took twenty years to develop the foundation and key provisions relevant to activities of limited liability companies.

Nowadays, a trend focused on a higher specificity of legislation relevant to limited liability companies, regulation of acute issues, frequently used gaps and resolution of existing contradictions dominates in legal practice. Definition of the most important principles to be followed shall be an alternative in legal practice, which is typical for common law with its traditionally strong "judicial" law. Although it is possible to point out the convergence of continental and common law as a tendency, such emphasis on "judicial" law is not yet possible.

Norms adopted under reform of the civil law (2012–2018) present to a certain extent a compromise between continental and common law systems in terms of regulation of business societies, in particular, size of the authorized capital and corporate contracts mentioned above. In this regard, it is extremely important to secure balanced interests of shareholders of limited liability companies and of other interested parties including creditors and the state.

As for development of corporate legislation, in relation to limited liability companies, the following trends are topical inter alia: compliance (harmonization) of federal laws on business companies with the Civil Code of the Russian Federation, dispositive regulation of priority right of shareholders of a limited liability company to the acquisition of shares sold to third parties, amendment of rules on foreclosure of shares in a limited liability company in terms of determining value of shares in order to ensure effective protection of interests of creditors pledgees and acquirers of shares by tenders, invention of a mechanism for simultaneous recording of transmission of shares in several business entities, reduction of excessive requirements to business companies in terms of disclosure (provision) of information.

¹ See: URL: <http://static.government.ru/media/files/ne0vGNJUK9SQj1GNNsX1X2d2CpCho9qS.pdf/>