

IN THE NAME OF THE RUSSIAN FEDERATION

CONSTITUTIONAL COURT
OF THE RUSSIAN FEDERATION

Judgment
of 10 April 2003 No. 5-II

in the case concerning the review of the constitutionality of the provisions of Section 1, Article 84 of the Federal Law "On Joint Stock Companies" in connection with a complaint of the Priargunskoye OJSC.

Moscow, 10 April 2003

The Constitutional Court of the Russian Federation composed of Presiding Judge V. G. Yaroslavtsev and Judges N. S. Bondar, G. A. Gadzhiev, L. O. Krasavchikova, Yu. D. Rudkin, A. Ya. Sliva, V. G. Strekozov, B. S. Ebzeev,

in the attendance of the attorney V. N. Burobin, representative of the Priargunskoye OJSC; Permanent Representative of the State Duma to the Constitutional Court of the Russian Federation V. V. Lazarev, Representative of the Council of the Federation N. M. Lavrova, PhD in Law,

pursuant to Section 4, Article 125 of the Constitution of the Russian Federation, Subsection 3, Section 1, Sections 3 and 4, Article 3, Subsection 3, Section 2, Article 22, Articles 36, 74, 86, 96, 97 and 99 of the Federal Constitutional Law "On the Constitutional Court of the Russian Federation",

in an open hearing, examined the constitutionality of Section 1, Article 84 of the Federal Law "On Joint Stock Companies".

The reason for the consideration of the case is a complaint of the Priargunskoye OJSC about violation of its constitutional rights and freedoms by Section 1, Article 84 of the Federal Law "On Joint Stock Companies" of 26 December 1995 (as amended on 24 May 1999) as applied by arbitration courts in the applicants' case.

Having heard the report of Judge-Rapporteur G. A. Gadzhiev, the expert opinion of G. Ye. Avilov, Deputy Chairman of the Board, Presidential Research Center for Private Law, interventions by Judge I. Sh. Faizutdinov of the Supreme Arbitration Court of the Russian Federation for the Supreme Arbitration Court of the Russian Federation; and having considered written submissions and other materials, the Constitutional Court of the Russian Federation

e s t a b l i s h e d :

1. Pursuant to Section 1, Article 84 of the Federal Law “On Joint Stock Companies” of 26 December 1995 (as amended on 24 May 1999), a conflict-of-interests transaction effected notwithstanding the requirements to a transaction under Article 83 of the Federal Law may be invalidated.

The above-mentioned norm was applied by the arbitration courts deciding the case of the Priargunskoye OJSC on invalidation of a purchase and sale agreement between the Varieganneftegaz OJSC and the Sidanko OJSC concerning 912,000 ordinary shares of the Varieganneftegaz OJSC and the application of invalidity consequences of a void transaction. The Sidanko OJSC, a party to the agreement, owned more than 20 percent of the voting shares and under Article 81 of the above-mentioned Federal Law had an interest in the transaction, and thus the plaintiff-shareholder of the Varieganneftegaz OJSC considered that the agreement was concluded notwithstanding the requirements of Article 83 of the Federal Law “On Joint Stock Companies”.

In its complaint to the Constitutional Court of the Russian Federation, the Priargunskoye OJSC argues that Section 1, Article 84 of the Federal Law “On Joint Stock Companies”, does not conform to Articles 19 (Sections 1 and 2), 46 (Section 1), 34, 35 and 55 (Section 3) of the Constitution of the Russian Federation.

2. Within the meaning of Section 1, Article 166 of the Civil Code of the Russian Federation, taken in conjunction with its Article 168, transactions which may be invalidated by the court (*inter alia* conflict-of-interests transaction under Section 1, Article 84 of the Federal Law “On Joint Stock Companies”) are considered voidable. The claim for invalidation of a voidable transaction pursuant to Section 2, Article 166 of the Civil Code of the Russian Federation may be filed by persons listed in the Code. Meanwhile, conflict-of-interests transactions are not regulated by the Civil Code of the Russian Federation, and the list of persons who may file claims for invalidation of such transactions is undetermined.

The Priargunskoye OJSC believes that the above-mentioned conflict of legal norms is one of the reasons why since January 2000 eight decisions on its lawsuit have been delivered by arbitration courts on different levels of jurisdiction, including the Presidium of the Supreme Arbitration Court of the Russian Federation. In the applicant’s opinion, its constitutional rights were violated, and primarily the right to judicial protection which is a general constitutional guarantee for such fundamental rights as the right to freely use abilities and property for entrepreneurial and other economic activities not prohibited by law and the right of private property, since the right to judicial protection implies guarantees of effective, i.e. within a reasonable time, restoration of a shareholder’s rights.

Pursuant to Articles 74, 96 and 97 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, the Constitutional Court of the Russian Federation, upon complains of individuals or associations of individuals, reviews the constitutionality of a law or of certain provisions of a law if they affect the constitutional rights and freedoms, and to the extent that they were applied in the applicant’s case, considering not only the literal meaning of the normative act under review, but also the meaning it acquires in the law-enforcement practice and considering its place within the hierarchy of legal acts, and decides only on the subject matter indicated in the complaint.

Accordingly, the subject matter for consideration by the Constitutional Court of the Russian Federation in the present case is the norm of Section 1, Article 84 of the Federal Law “On Joint Stock Companies” of 26 December 1995 (as amended on 24 May 1999) to the extent that it concerns the possibility to invalidate a conflict-of-interests transaction upon a lawsuit of a shareholder (including a minority shareholder) of the joint stock company that effected this transaction.

3. Pursuant to the constitutional principle of freedom of economic activity (Section 1, Article 8 of the Constitution of the Russian Federation) as one of the fundamentals of the constitutional order of the Russian Federation, individuals using their abilities and property for entrepreneurial and other economic activities not prohibited by law (Section 1, Article 34 of the Constitution of the Russian Federation) have the right to determine the scope of these activities and to carry it out individually or by participating in a commercial company, partnership or production cooperative, i.e. by founding a commercial enterprise as a form of collective entrepreneurial activity.

The right established in Article 34 (Section 1) of the Constitution of the Russian Federation is the basis of the constitutional status of commercial companies’ participants, in particular, shareholders of joint stock companies who are legal persons and individuals (including those who are not entrepreneurs) and who exercise their rights by holding shares certifying enforceable claims of shareholders to a joint stock company.

Pursuant to Article 35 (Section 2) of the Constitution of the Russian Federation everyone shall have the right to have possess, use and dispose of property both personally and jointly with other people. Within the meaning of this constitutional norm taken together with the norms of Articles 8 (Section 1) and 34 (Section 1) of the Constitution of the Russian Federation, the term “property” includes any possessions related to the exercise of the right of private and other forms of property, including proprietary rights. The exercise of proprietary rights relies on the general legal principles of inviolability of property and freedom of contract, which presume equality, autonomy of will and property autonomy of the participants in civil law relations,

impermissibility of arbitrary interference in private affairs (Section 2 of the reasoning, Judgment of the Constitutional Court of 6 June 2000 in the case concerning the review of the constitutionality of Subsection 3, Section 2, Article 77 of the Federal Law “On Insolvency (Bankruptcy)”).

Individuals and legal persons purchasing shares and thereby disposing of their property, acquire certain proprietary enforceable claims to a joint stock company, including *inter alia* participation in redistribution of profits and property (in case of liquidation). Proprietary enforceable claims are covered by the term “possessions”, and therefore these claims are secured by the constitutional guarantees, in particular protection by law of the shareholders’ rights, including the rights of minority shareholders as a weaker party in corporate relations, and judicial protection of violated rights (Sections 1 and 2, Article 35; Section 1, Article 46 of the Constitution of the Russian Federation). These guarantees are aimed at achieving public purposes of encouraging private investments in economy and ensuring stability of social relations in civil transactions.

4. Pursuant to the Constitution of the Russian Federation, state protection of the rights and freedoms of man and citizen shall be guaranteed (Section 1, Article 45). Thus, the Civil Code of the Russian Federation and the legislation on joint stock companies establish mechanisms of shareholders’ rights protection. Under Article 12 of the Civil Code of the Russian Federation, invalidation of a voidable transaction by the court and application of invalidity consequences of a void transaction is among the means of protecting a violated shareholders’ right.

The possibility of a conflict of interests between shareholders who hold significant amounts of shares, the management of joint stock companies and minority shareholders is inherent to joint stock companies. Chapter XI of the Federal Law “On Joint Stock Companies” (Articles 81–84), regulating conflict-of-interests transactions, provides for measures aimed at protecting the proprietary interests of shareholders (including minority shareholders) and a joint stock company as a whole in such transactions, particularly a possibility to invalidate these transactions in court (Section 1, Article 84).

A conflict-of-interests transaction may be invalidated if it was concluded notwithstanding Article 83 regulating the procedure for concluding these transactions. Thus, the decision to conclude such transaction shall be taken by the board of directors by a majority vote of directors not having an interest in this transaction (independent directors of joint stock companies with a number of voting shareholders exceeding one thousand persons); the board of directors shall decide on the matter only being satisfied that the price payable for the property alienated or services rendered is not below their market value.

At the same time, the scope of persons entitled to file a claim for invalidation of conflict-of-interests transactions is not expressly prescribed by the Federal Law “On Joint Stock Companies”. Therefore, Section 1, Article 84 of this Federal Law, should be interpreted in conjunction with Section 2, Article 166 of the Civil Code of the Russian Federation and with due regard to the fundamentals of the civil legislation securing the operation of the constitutional principles in the area of property and other relations, regulated by the civil legislation (Articles 8 and 17; Section 1, Article 34; Section 2, Article 35; Section 1, Article 45, and Article 46 of the Constitution of the Russian Federation). These fundamentals are inviolability of property, impermissibility of arbitrary interference in private affairs, guarantees for restoration of violated rights and their judicial protection.

Section 1, Article 84 of the Federal Law “On Joint Stock Companies”, is an integral part of the common system of constitutional and civil regulation, and thus, while revealing the legislator’s intent in creating this norm, one should consider that these constitutional principles have the highest degree of normative generalization, predetermine the content of the constitutional human rights and the citizen’s rights regulated by different branches of law, they are universal and have regulative effect on all areas of social relations (Judgment of the Constitutional Court of the Russian Federation of 27 January 1993 in the case concerning the review of the constitutionality of the law-enforcement practice on limiting the period of payment for involuntary absence at the workplace due to unlawful dismissal).

In order to ensure unified and coherent normative regulation, the uncertainty of understanding of Section 1, Article 84 of the Federal Law “On Joint Stock Companies”, may be eliminated through systematic interpretation considering the hierarchy of legal norms, which implies that interpretation of the lower level legal norms shall be exercised in accordance with the higher level norms. If it is impossible to use the analogy of statute (Section 1, Article 6 of the Civil Code of the Russian Federation), the rights and obligations of the parties shall be determined on the basis of the general principles and the spirit of civil legislation (analogy of law) and the requirements of good faith, reasonableness, and fairness (Section 2, Article 6 of the Civil Code of the Russian Federation).

Pursuant to the Civil Code of the Russian Federation, Section 1, Article 1 of the Federal Law “On Joint Stock Companies” establishes a procedure for incorporation and the legal status of joint stock companies, the rights and obligations of shareholders, ensures protection of the rights and interests of shareholders. Consequently, the norms of Articles 81–84 of the above-mentioned Federal Law are aimed at preventing conflicts between the interests of the company management, which is obliged under Section 3, Article 53 of the Civil Code of the Russian Federation to act on behalf of the legal person in good faith and in a reasonable manner, and the

interests of shareholders (including minority shareholders), who are not able to protect their lawful interests in conclusion of conflict-of-interests transactions. Introducing the norm of Section 1, Article 84 in the Federal Law “On Joint Stock Companies”, the legislator pursued the aim to establish a procedure for protecting minority shareholders. This procedure was designed to minimize the possible harm to their lawful interests without restricting the right to seek invalidation of the respective transaction in court.

Therefore, the norm of Section 1, Article 84 of the Federal Law “On Joint Stock Companies” taken in conjunction with Section 2, Article 166 of the Civil Code of the Russian Federation and giving due regard to the constitutional principles and fundamentals of civil legislation shall be interpreted as entitling shareholders (including minority shareholders) of a joint stock company which concluded a conflict-of-interests transaction, to seek invalidation of this transaction in court. This norm, in its constitutional interpretation, fosters implementation of the constitutional imperative that the exercise of the rights and freedoms of man and citizen shall not violate the rights and freedoms of others (Section 3, Article 17 of the Constitution of the Russian Federation). Consequently, the norm conforms to the Constitution of the Russian Federation.

5. Within the meaning of Articles 17 (Sections 1 and 3), 35, 46 (Section 1) and 55 (Section 3) of the Constitution of the Russian Federation, the period for lodging a request for application of invalidity consequences of a conflict-of-interests transaction for transactions concluded notwithstanding the requirements of Article 83 of the Federal Law “On Joint Stock Companies” may be restricted. Such period (statute of limitations) is aimed at securing stability of the constitutional regime of business activities under Article 8 (Section 1), 34 (Section 1) and 57 of the Constitution of the Russian Federation (Judgment of the Constitutional Court of the Russian Federation of 20 July 1999 in the case concerning the review of the constitutionality of the Federal Law “On Cultural Values Transferred to the USSR due to the Second World War and Present within the Territory of the Russian Federation”; Decision of 1 July 1999 on the constitutional complaint of V. V. Varaganov about violation of his constitutional rights by the Federal Law “On the Unified Tax on the Imputed Income” and the Law of the Belgorod Region “On the Unified Tax on the Imputed Income from Certain Activities”).

Consequently, it is not unlawful *per se* to consider conflict-of-interest transactions as avoidable transactions, and to establish for them one year statute of limitations. However, relying on the purpose and principles of the institution of statutes of limitations qualified by the above-mentioned provisions of the Constitution of the Russian Federation, the running of the statute of limitations shall commence from the moment the authorized person became aware or had a real

possibility to become aware of not only the fact of concluding a transaction, but also that there was a conflict of interests in it.

6. The recognition of the norm of Section 1, Article 84 of the Federal Law “On Joint Stock Companies”, interpreted in line with the constitutional principles and fundamentals of civil legislation as conforming to the Constitution of the Russian Federation shall not prevent the federal legislator from improving the mechanisms of protecting shareholders’ rights in order to guarantee the rights of minority shareholders, provided that there is no possibility to abuse these rights and that the stability of social relations in the civil transactions is not affected.

Concluding from the above and pursuant to Section 2, Article 43, Sections 1 and 2, Article 71, Articles 72, 75, 79 and 100 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, the Constitutional Court of the Russian Federation

h e l d :

1. To recognize the norm of Section 1, Article 84 of the Federal Law “On Joint Stock Companies” of 26 December 1995 (as amended on 24 May 1999) as conforming to the Constitution of the Russian Federation, as this norm, in line with the constitutional principles and fundamentals of the civil legislation, permits, upon a request of shareholders (including minority shareholders) of the joint stock company, which concluded a conflict-of-interests transaction, to invalidate such transaction in court if it was concluded notwithstanding the requirements of Article 83 of this Federal Law.

2. This Judgment shall be final and shall not be subject to any appeal, it shall come into force immediately upon pronouncement, shall be directly applicable and shall not be require confirmation by any other state body or official.

3. Pursuant to Article 78 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, this Judgment shall be published in the *Rossiyskaya Gazeta* and the Collection of Laws of the Russian Federation. The Judgment shall also be published in the Bulletin of the Constitutional Court of the Russian Federation.

Constitutional Court
of the Russian Federation

No. 5-II