

IN THE NAME OF THE RUSSIAN FEDERATION

CONSTITUTIONAL COURT
OF THE RUSSIAN FEDERATION

Judgment

of 24 February 2004 No. 3-II

in the case concerning the review of the constitutionality of the provisions of Articles 74 and 77 of the Federal Law “On Joint Stock Companies”, regulating the procedure of consolidation of issued shares of joint stock company and redemption of fractional shares in connection with complaints of individuals, the company CADET Establishment, and upon a request of the Oktyabrsky District Court of Penza.

Moscow, 24 February 2004

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

in the attendance of P. A. Moiseyev, judge of the Oktyabrsky District Court of Penza; attorney Ye. M. Khayretdinov, representative of CADET Establishment, V. O. Paliy and L. G. Paliy; M. P. Arushanov and his representative, attorney I. P. Andrianov; Y. V. Baskakova, N. S. Baburina, V. P. Blazhevich, V. P. Vasin, T. G. Grinko, N. A. Zelyanin, V. A. Kashina; B. A. Kekhman, representative of A. I. Kekhman; N. Ye. Kopylova, V. F. Lavrenko, V. A. Lobanova, K. N. Mamyka, A. S. Mokhovaya, V. O. Paliy, G. V. Potseluyev, A. V. Sokolova, N. N. Chernyshova, who submitted their constitutional complaints to the Constitutional Court of the Russian Federation; Representative of the State Duma V. S. Pleskachevsky, Chairman of the Committee on Property of the State Duma; Plenipotentiary Representative of the Council of the Federation to the Constitutional Court of the Russian Federation Yu. A. Sharandin,

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, 99, 101, 102 and 104 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”,

in an open hearing, examined the constitutionality of the provisions of Articles 74 and 77 of the Federal Law “On Joint Stock Companies”.

The reason for the consideration of the case is a request of the Oktyabrsky District Court of Penza, complaints of the shareholders M. P. Arushanov, N. S. Baburina, V. P. Blazhevich,

V. V. Borovskikh, F. I. Vavilin, V. P. Vasin, T. G. Grinko, N. A. Zelyanin and V. F. Lavryenko, V. A. Iliushin, A. I. Kekhman, K. N. Mamyka, L. G. Paliy and V. O. Paliy, G. V. Potseluyev, A. V. Fateyev, A. A. Tsyba, G. N. Razetskaya and D. D. Chervyakov, Ye. G. Cherkashenina, a collective complaint of V. A. Kuslina, A. Y. Leonova, N. I. Lisenko, Y. A. Obukhova and L. D. Pecherskaya, a collective complaint of Ye. V. Baskakova, T. V. Grekova, G. I. Zvyagina, V. A. Kashina, N. Ye. Kopylova, V. A. Lobanova, A. S. Mokhova, O. A. Skvortsova, A. V. Sokolova and N. N. Chernyshova, a collective complaint of G. A. Gareyeva, A. R. Fazlutdinov, A. R. Fazlutdinov and S. M. Tselykh, and a complaint of CADET Establishment (Liechtenstein). The ground for the consideration of the case is the discovered uncertainty of whether the provisions regulating the procedure of consolidation of issued shares and determination of their market value, challenged by the applicants, are in conformity with the Constitution of the Russian Federation.

Insofar as all the complaints concern essentially the same subject matter and pursuant to Article 48 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, the Constitutional Court of the Russian Federation is permitted to consider these applications together.

Having heard the report of Judge-Rapporteur G. A. Gadzhiev, statements by the parties and their representatives, the expert opinion of V. F. Popondopulo, PhD in Law, opinions of G. Ye. Avrilov, PhD in Law, P. D. Barenboym, PhD in Law, D. I. Dedov, interventions by M. Yu. Barshchevsky, Plenipotentiary Representative of the Government of the Russian Federation to the Constitutional Court of the Russian Federation; Judge I. Sh. Fayzutdinov of the Supreme Arbitration Court of the Russian Federation for the Supreme Arbitration Court of the Russian Federation, A. S. Simonyan for the Federal Securities Market Commission, O. Yu. Litovka for the Ministry of Economic Development and Trade; 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. Individuals who are shareholders in Penzkhim mash OJSC brought lawsuits to the Oktiabrsky District Court of Penza aimed at invalidating decisions made by the general meeting of shareholders regarding consolidation of the company’s shares and compulsory redemption of the plaintiffs’ shares by the company. Having come to the conclusion that the provisions of Subsection 19, Section 1, Article 48, and Paragraph 2, Section 1, Article 74 of the Federal Law “On Joint Stock Companies” of 26 December 1995 (as amended on 24 May 1999) to be applied in the plaintiffs’ cases are not in conformity with the Constitution of the Russian Federation, its Articles 19 (Section 1), 34 (Section 1), 35 (Sections 1 and 3) and 55 (Section 3), the court filed a

request to the Constitutional Court of the Russian Federation concerning the review of the constitutionality of the mentioned provisions and provisions of Section 3, Article 25, and Section 7, Article 49 of the Federal Law as amended on 7 August 2001.

Pursuant to the challenged provision of Subsection 19, Section 1, Article 48 of the Federal Law “On Joint Stock Companies”, the general meeting of shareholders may decide on matters concerning the purchase of issued shares out of capital by the company and redemption of issued shares by the company when such powers are provided for by the Federal Law. The mentioned normative provision does not directly affect the individuals’ rights set out in Articles 19 (Section 1), 34 (Section 1), 35 (Sections 1, 2 and 3) and 55 (Section 3) of the Constitution of the Russian Federation, and therefore to this extent the request is not admissible. Section 3, Article 25, and Section 7, Article 49, of the mentioned Federal Law as amended on 7 August 2001 cannot be the subject matter of the present case either since these norms were not applied and were not applicable in the case of Penzkhimmash OJSC. Therefore, pursuant to Article 68 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation” to the extent concerning the review of the constitutionality of the mentioned provisions, the proceedings on the request of Oktiabrsky District Court are to be discontinued.

According to Paragraph 2, Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, if any fractional shares are created as a result of consolidation of shares these shares shall be redeemed by the company at market value determined under Article 77 of this Federal Law. The constitutionality of this provision is also challenged in the complaints of a number of individuals-shareholders and the company CADET Establishment. In the complainants’ opinion, the mentioned provision establishes compulsory, without the shareholders’ consent, redemption of fractional shares by a company at market value determined by the board of directors and thereby violates their constitutional rights established in Article 35 (Sections 1, 2 and 3) of the Constitution of the Russian Federation. Ye. G. Cherkashenin also argues that this provision deprives him of his right to judicial protection and therefore is not in conformity with Article 46 (Section 1) of the Constitution of the Russian Federation.

M. P. Arushanov, V. V. Bobrovskikh and T. G. Grinko in their complains, along with Paragraph 2, Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, challenge the constitutionality of the provisions of Article 77. In the complainants’ opinion, these provisions establish an administrative procedure to determine the fractional shares market value, i.e. a procedure which does not require an independent appraiser to be involved or to coordinate the proposed value with the shareholders whose shares are to be redeemed, and thereby allow the company to redeem shares at value which differs considerably from the market value, depriving the shareholders of their possessions.

Furthermore, A. I. Kekhman challenges the constitutionality of Section 3, Article 42 of the Federal Law “On Joint Stock Companies” to the extent that it provides for the power of a general meeting of shareholders to decide not to pay dividends on issued shares of some classes (types) or not to pay dividends in full on privileged shares, for which the amount of dividends is established in the articles of association. Pursuant to this norm, Samaraneftgaz OJSC, by a decision of a general meeting, refused to pay dividends on privileged shares for the year 2000 on the grounds that it was necessary to pursue production development and that the capital investments funding was a higher priority. The Leninsky District Court of Samara, with reference to the same norm, dismissed the lawsuit of A. I. Kekhman aimed at invalidating the mentioned decision, recovery of payable dividends and compensation for psychological distress. Consequently, in order to resolve the question presented by the applicant, it is necessary to review not the constitutionality of Section 3, Article 42 of the Federal Law “On Joint Stock Companies”, but the legality and validity of the decision delivered by the court of general jurisdiction, *inter alia* to the extent concerning the review of propriety of ascertaining and examining the facts of the case, which is not within the jurisdiction of the Constitutional Court of the Russian Federation (Section 4, Article 3 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”). Therefore, to this extent the proceedings on the complaint are to be discontinued pursuant to Article 68 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”.

2. According to Section 2, Article 43 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, if a challenged normative act had been repealed or had lost its legal force by the moment the proceedings in the Constitutional Court of the Russian Federation commenced, or was repealed or lost its legal force in the course of these proceedings, the proceedings may be discontinued, except for cases where particular rights and freedoms were violated by this normative act while in force.

The Federal Law “On Amendments to the Federal Law ‘On Joint Stock Companies’” of 7 August 2001, which came into force on 1 January 2002, repealed the norm of Paragraph 2, Section 1, Article 74 of the Federal Law “On Joint Stock Companies” (as amended on 24 May 1999); the other provisions of Section 1, Article 74, and Article 77 were amended. However, since the implementation of the challenged provisions, as is confirmed by the submitted materials, resulted in substantial legal consequences which in the complainants’ opinion violated their constitutional rights the proceedings, pursuant to Section 2, Article 43 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation” may not be discontinued.

Thus, the subject matter of the present case is the following provisions of the Federal Law “On Joint Stock Companies” (as in force before 1 January 2002): (a) Paragraph 2, Section 1, Article 74, pursuant to which if any fractional shares are created as a result of consolidation of shares these shares shall be redeemed by the company at market value determined under Article 77 of this Federal Law, and certain interrelated provisions of Article 77 providing for a procedure for determining the market value of a fractional share, namely the provision of Section 1 pursuant to which the “market value” of a share is defined as a price at which a seller fully informed about the value of the shares and not obliged to sell them would agree to sell them, and a purchaser fully informed about the value of the shares and not obliged to purchase them would agree to purchase them; (b) the provision of Paragraph 1, Section 2, stating that the market value of shares shall be determined by the board of directors (supervisory board) of a company; (c) Paragraph 1, Section 3, pursuant to which an independent appraiser may be involved in determining the market value of shares; (d) Paragraph 5, Section 3, pursuant to which if the possessions to be appraised comprise ordinary shares, the price at which a purchaser fully informed about the total value of all ordinary shares of the company agrees to purchase them, and any other factors which a person appraising the shares considers to be significant may be also taken into consideration in determining the market value of the shares.

3. Article 8 (Section 1) of the Constitution of the Russian Federation proclaims freedom of economic activity as one of the fundamentals of the constitutional order. The principle of economic freedom is the foundation of the rights which are constitutionally protected and are part of the core content of the constitutional right to freely use one’s abilities and property for entrepreneurial and other economic activities not prohibited by law. While implementing the mentioned right established in Article 34 (Section 1) of the Constitution of the Russian Federation, individuals are entitled to determine the sphere of these activities and to perform them individually or jointly with other persons by means of membership in a commercial company, a partnership, or a production cooperative, i.e. by formation of a commercial enterprise as a form of collective entrepreneurial activity; to choose, by themselves, an economic strategy of business development; to use their possessions giving due regard to the guarantees for the right of property (Article 35, Section 3) and fair competition (Article 8, Section 1; Article 34, Section 2) established by the Constitution of the Russian Federation.

Entrepreneurial activities are exercised by persons registered in due procedure, independently, at their own risk, and with an aim of systematically gaining profit through the sale of goods, performance of work or provision of services. Activities of shareholders are not entrepreneurial, but is “other economic activity not prohibited by law”. However, it entails

certain economic risks as well, since the joint stock company itself exercises entrepreneurial activity.

The right to freely use abilities and property for entrepreneurial and other economic activities not prohibited by law is the foundation of the constitutional status of associates in commercial companies, in particular shareholders of joint stock companies (legal persons and individuals), including those who are not entrepreneurs and who exercise their rights by holding shares certifying the rights *in personam*, which the owner of a share has in respect of the joint stock company. The term “possessions” also includes enforceable claims, and therefore these claims are protected by the constitutional guarantees of legal protection of shareholders’ rights, including the rights of minority (i.e. small) shareholders as a weaker party in corporate relations, and guarantees of 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 such public goals as attracting private investments into economy and ensuring stability of public relations in civil transactions (Judgment of the Constitutional Court of the Russian Federation of 10 April 2003 in the case concerning the review of the constitutionality of Section 1, Article 84 of the Federal Law “On Joint Stock Companies”).

According to Subsection “g”, Article 71 of the Constitution of the Russian Federation, the competence of the Russian Federation includes determining the legal foundations of the single market. And thus the integrity of economic space, free movement of goods, services and financial resources, support of competition, freedom of economic activity (Section 1, Article 8 of the Constitution of the Russian Federation) are secured. The constitutional criterion for striking a balance between the freedom of economic activity and the state’s duty to establish legal foundations of the single market is the constitutional principles proclaiming the Russian Federation as a rule of law state with socially oriented market economy.

Entrepreneurial activity in the form of joint stock company affects the interests of a wide range of persons (shareholders, investors) and public interests. While regulating formation of joint stock companies and their legal status, the rights and duties of shareholders, protection of the shareholders’ rights and interests, the state acts within the limits determined by the Constitution of the Russian Federation. It shall not deprive joint stock companies or other commercial enterprises of their rights, which are part of the core content of the constitutional right to freely use abilities and property for entrepreneurial activity.

Since a conflict of interests may occur in the course of the entrepreneurial activity of a joint stock company (between creditors and shareholders, shareholders and management, majority and minority shareholders) one of the main tasks of the legislation is to provide for a balance of lawful interests. The legislator must give due regard to the fact that the Constitution of

the Russian Federation establishes the principle according to which the exercise of the rights and freedoms of man and citizen may not violate the rights and freedoms of others (Section 3, Article 17) and that the Constitution guarantees judicial protection of rights and freedoms (Article 46, Section 1). The right to judicial protection implies specific guarantees securing its full exercise and providing for effective restoration of rights through administration of justice which meets the requirements of fairness and legal certainty.

4. A joint stock company is a commercial enterprise with a shared capital divided into a certain number of shares; the right of property in a joint stock company has specific nature as issues of possession, use and disposal of property are resolved jointly by the shareholders. The main issues related to the dynamics of proprietary relations within a joint stock company are within the competence of a general meeting of the shareholders (Sections 5, 6, 11, 16–19, Article 48 of the Federal Law “On Joint Stock Companies”); the general meeting using democratic procedures ensures harmonization of interests of shareholders who have large numbers of shares and the interests of minority shareholders.

By a board of directors (supervisory board) decision, the issue of consolidation of shares is submitted to the general meeting of the shareholders for decision (Section 5, Article 65 of the Federal Law “On Joint Stock Companies”). After the decision on consolidation of the issued shares is adopted by the general meeting, the issuance of shares and the emission prospectus are submitted for the state registration, which in part consists of control over public sale of securities (Article 20 of the Federal Law “On the Securities Market”). The registration body, in its turn, may, on reasonable grounds, deny state registration of an issue of securities and may conduct an inquiry into the authenticity of information in the submitted documents. After the issue of shares and the emission prospectus are registered, the conversion of shares takes place according to the conversion rate prescribed by the general meeting.

The legislator regulating corporate relations relies on the constitutional principle of freedom of economic activity pursuant to which a general meeting of shareholders has the right to make its own strategic economic decisions. At the same time, the legislator takes into account that there are different types of joint stock companies, some of which were formed during the period of mass privatization of state and municipal property. While creating legal norms that apply to each type of joint stock companies, the legislator considers it necessary to standardize diverging situations. For example, the norm of Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, which does not establish criteria for setting a conversion rate for consolidation of shares, is intended to be implemented by joint stock companies of different types.

The applicants' (individuals shareholders') main argument substantiating unconstitutionality of Paragraph 2, Section 1, Article 74 of the Federal Law "On Joint Stock Companies", is that fractional shares created by consolidation and redeemed by the company are not objects of civil rights and consequently this norm does not conform to Article 143 of the Civil Code of the Russian Federation, which recognizes securities (*inter alia* shares) as objects of civil rights. However, it is not within the jurisdiction of the Constitutional Court of the Russian Federation, as established by Article 125 of the Constitution of the Russian Federation and the Federal Constitutional Law "On the Constitutional Court of the Russian Federation", to decide on the nature of relations concerning redemption of fractional shares and whether the challenged norm conforms to the Civil Code of the Russian Federation.

Thus, the norm of Paragraph 2, Section 1, Article 74 of the Federal Law "On Joint Stock Companies", stating that fractional shares created by consolidation of shares following a decision by a general meeting of the shareholders through conversion of two or more shares into one new share of the same class (type) shall be redeemed by the company at market value conforms to the Constitution of the Russian Federation.

5. Pursuant to Section 2, Article 74 of the Federal Constitutional Law "On the Constitutional Court of the Russian Federation", the Constitutional Court of the Russian Federation considers not only the literal meaning of the act under review but also the meaning it acquires from its place within the hierarchy of legal acts and in the law-enforcement practice.

5.1. The shareholders' complaints in the present case demonstrate that the existing law-enforcement practice of Paragraph 2, Section 1, Article 74, and Sections 1, 2 and 3, Article 77 of the Federal Law "On Joint Stock Companies", is controversial. Some applicants were minority shareholders in subsidiaries of large joint-stock companies structured as holding companies. In these holding companies, the consolidation of shares was primarily aimed at creating vertically integrated companies and transition of subsidiaries to a "unified share" program and therefore achieving a common benefit for the joint stock company, namely creating a unified profit center, enhanced control over subsidiaries, increase in the cost of the mother company shares, enhance investment valuation ratings, and ultimately gaining competitive advantages both on domestic and international markets.

The management bodies of certain joint stock companies guided by the imperatives of the Federal Law "On Joint Stock Companies", in their by-laws established their own legal procedures for consolidation of shares. For example, during consolidation of the shares of Samaraneftgaz OJSC (in which V. A. Ilyushkin was a shareholder), even before the matter was submitted to the general meeting, the board of directors informed the shareholders about the planned consolidation, suggested that the shareholders in the company subsidiaries should

exchange their shares for shares in the mother company under barter contracts, and invited an independent appraiser to determine the market value of the shares. After the independent appraiser submitted his report, the board of directors, by its own decision, increased the market value of shares as compared to the value in the report. In addition, minority shareholders who, for any reasons, did not have sufficient time to exchange their shares, were provided with an opportunity to purchase the mother company shares with money payable due to redemption of the fractional shares, in the amount equal to the amount of shares they could have acquired under a barter contract. Such opportunity was also provided to the applicants D. D. Chervyakov, G. N. Razetskaya, V. O. Paliy and L. G. Paliy during shares consolidation of Samotlorneftegaz OJSC and Nizhnevartovskoye Neftgazodobyvayushcheye Predpriyatiye OJSC (100 percent of shares in both companies are owned by Tyumenskaya Neftyanaya Kompaniya OJSC).

Therefore, Section 1, Article 74, and Article 77 of the Federal Law “On Joint Stock Companies”. within the meaning attributed in the law-enforcement practice mentioned above, conform to the Constitution of the Russian Federation. These provisions are constitutional because consolidation of shares takes place on their basis within due legal procedures and with due regard to the common benefit of the joint stock company and the rights and lawful interests of minority shareholders, provided that all the other measures reasonably taken by the mother company, including exchange of subsidiary shares into mother company shares, did not secure the outcome pursued.

5.2. However, on certain occasions the provisions of Articles 74 and 77 of the Federal Law “On Joint Stock Companies”, were interpreted in a manner violating the rights of shareholders possessing fractional shares.

Ye. V. Baskakova, G. I. Zviagina, V. A. Kashina, N. Ye. Kopylova, V. A. Lobanova, A. S. Mokhova, A. V. Sokolova and N. N. Chernyshova, who were shareholders in the Torgovy Dom “Kuntsevo” CJSC, challenge the constitutionality of Paragraph 2, Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, because consolidation of the company shares took only 20 days; the market value of the fractional shares was determined by the board of directors without an independent appraiser; 426 shareholders became owners of fractional shares, and as a result only one person remained to be a shareholder in the company.

The Constitution of the Russian Federation does not preclude restrictions on the right to private property (Section 3, Article 55) or to deprive of it (Section 3 Article 35). However, the possibility of property redistribution is counterbalanced by the constitutional principle of inviolability of private property. In a number of judgments, the Constitutional Court of the Russian Federation has reached the conclusion that this principle is deduced from the complex of constitutional provisions, and its normative content includes constitutional guarantees of free use

of possessions for private owners, stability of proprietary relations, impermissibility of arbitrary taking of property or disproportionate restrictions on the right of property.

The board of directors' decision on shares consolidation results in redistribution of property among the shareholders. Respect for stability of proprietary relations and preservation of a balance between redistribution and stability during consolidation of shares may be ensured by due legal procedures, judicial review, and equal compensation. These mechanisms permit to reduce the negative social costs incurred by redistribution of shareholders' property.

As follows from the Constitution of the Russian Federation, when property is taken from the owner (irrespective of the grounds for taking) effective judicial review shall be exercised as a guarantee of inviolability of property. According to Article 35 (Section 3) of the Constitution of the Russian Federation, no one may be deprived of property otherwise than by a court decision. The term "deprived" means that the right of property is terminated in a coercive manner and implies the existence of a property dispute, and therefore *ex ante* or *ex post* judicial review is necessary. The second sentence of Section 3, Article 35 of the Constitution of the Russian Federation, stipulates that as a general rule property may be taken only after prior and equal compensation.

The provision of Article 35 (Section 1) of the Constitution of the Russian Federation, stipulating that the right to private property shall be protected by law, implies the legislator's constitutional duty to ensure inviolability of private property, *inter alia* by establishing due legal procedures for adopting general meeting decisions.

Due to the specificity of entrepreneurial activity exercised by joint stock companies, the shareholders may be deprived of their property in the interests of the joint stock company as a whole if it contributes to the company's common benefit. However, it must be taken into account that it is majority shareholders who primarily benefit from consolidation of shares while minority shareholders generally suffer from negative consequences of consolidation. The existence of diverging interests of different groups of shareholders during consolidation of shares, results in ever growing significance of due legal procedures for making decisions on economic matters and effective (not formalistic) judicial review as guarantees of the minority shareholders' rights.

The Judgment of the European Court of Human Rights in *Sovtransavto Holding v. Ukraine* (25 July 2002) states that pursuant to Article 1 of the Convention for the Protection of Human Rights and Fundamental Freedoms, the High Contracting Parties shall secure to everyone within their jurisdiction the rights and freedoms defined in Section I of the Convention. This duty to guarantee the effective protection of rights may result in certain positive obligations of the State. In respect of the right of property, guaranteed by Article 1 of Protocol No. 1 to the Convention, these positive obligations may require specific measures to be taken in order to protect the right of

property. In particular, an obligation is thereby imposed on the State to comply with a judicial procedure, which shall put the judicial guarantees into practice and at the same time shall allow national courts to resolve disputes between private persons in an effective and fair manner.

The provisions of the Federal Law “On Joint Stock Companies” under consideration are a part of a system of constitutional and civil law regulations, and thus in review of their constitutionality it should be considered that the elements of uncertainty in Paragraph 2, Section 1 of Article 74, may be overcome by systemic interpretation, provided that the constitutional principles and constitutionally significant civil law principles prevail in the interpretation of legal norms concerning joint stock companies. In this context, the role of judicial review of the consolidation procedure objectively increases. The special responsibility of courts is predetermined by the fact that the legislator established legal procedures for decisions on consolidation of shares in general terms and did not provide detailed regulation.

Judicial review is aimed at protecting shareholders’ rights and freedoms, not at examining the economic appropriateness of decisions taken by the board of directors and general meeting of the shareholders, because the management bodies of a company have broad discretion in business decisions. Consequently, courts exercising control over them upon the complaints of shareholders and owners of fractional shares shall not examine the economic appropriateness of the proposed consolidation model since due to the risk-taking nature of entrepreneurial activity there are objective limits to the courts’ ability to argue errors in economic judgments.

At the present time, consolidation of shares with the use of conversion rates which create fractional shares subject to redemption against the owners’ will takes place in the absence of a fully developed securities market and lack of independent directors on the board of directors. Under these conditions, a decision of general meeting of shareholders to consolidate shares is a considerable interference in the domain of economic interests of minority shareholders similar to deprivation of owners of their property.

Thus, under the constitutional principles of a rule of law state and inviolability of private property (Section 1, Article 1; Section 3, Article 35; Sections 1 and 3, Article 55 of the Constitution of the Russian Federation), decisions on consolidation of shares shall be taken within due legal procedure which implies gradual progress within reasonable time limits aimed at protecting the minority shareholders’ rights (as a weaker party in corporate relations) secured by effective judicial review.

5.3. Ye. G. Cherkashenin, a shareholder in Omsky Neftepererabatyvayushchiy Zavod OJSC, believes that Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, pursuant to which fractional shares created by conversion shall be redeemed by the company, deprives him of the right to judicial protection as it deprives him of the status of a shareholder,

which is a standing requirement for appeals against decisions of a general meeting under Section 8, Article 49 of the mentioned Federal Law.

After shares are consolidated and the issue of shares with a new nominal value is registered, a shareholder who owns nothing but fractional shares ceases to be the owner of at least one share and formally ceases to be a shareholder. However, it does not mean that he is deprived of the possibility to enjoy, within the statutes of limitation prescribed by law, judicial protection of his proprietary rights as the owner of fractional shares. Any other interpretation of Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, taken together with Section 8 of its Article 49 would not be in conformity with Article 46 (Section 1) of the Constitution of the Russian Federation.

5.4. Fair compensation for redeemed fractional shares may be secured only when the decision on consolidation of shares is taken by a general meeting in a due legal procedure prescribed by law. Since this decision affects the lawful interests of a large number of shareholders, before they take a decision on consolidation of shares the joint stock company management bodies shall ensure that the minority shareholders are duly informed about it. For that purpose the shareholders shall be informed about the board of directors’ decision to put the issue of consolidation of shares on the agenda of a general meeting and to notify of the market value of the shares and the conversion rate.

As follows from Article 29 (Section 4) of the Constitution of the Russian Federation, providing for the right to receive information, shareholders have the right to be duly informed of decisions concerning considerable changes in the joint stock company, e.g. changes to the articles of association. According to Paragraph 1, Section 1, Article 74 of the Federal Law “On Joint Stock Companies”, when two or more shares are converted into one new share of the same class in the course of consolidation the respective amendments concerning the nominal value of the shares and the number of authorized shares shall be introduced in the articles of association. Since consolidation creating fractional shares transfers control over the company to only certain shareholders, the rules and procedures regulating the respective relations shall be clearly formulated and made public so that shareholders could understand their rights and be aware of the remedies at their disposal.

Even before the issue of consolidation is put on the agenda of a general meeting of the shareholders, the board of directors may take measures to determine the market value of the shares so that respective information could be made available to the shareholders. The board of directors’ decision to submit the matter of consolidation to a general meeting may be appealed in court.

5.5. The principle of equality before the law and the court proclaimed by Article 19 of the Constitution of the Russian Federation, in corporate relations implies equal treatment by the state of all shareholders in regulating these relations.

Fractional shares created by consolidation shall be redeemed by the company at the market value determined under Article 77 of the Federal Law “On Joint Stock Companies”. Its norms presume the existence of a well-developed securities market where the securities of a large number of issuers are evaluated. However, such securities market still does not exist in Russia, which complicates determination of an actual value of fractional shares and requires additional measures securing compliance with the constitutional imperative of “equal compensation”.

The norms of the Federal Law “On Joint Stock Companies” regulating redemption of shares also must comply with the constitutional principle of equality before the law and the court.

Section 1, Article 74 of the mentioned Federal Law, states that fractional shares created due to consolidation shall be redeemed on the initiative of the joint stock company. At the same time, Article 75 of the Federal Law provides for a procedure applied where shares are redeemed by the company on the shareholders’ initiative. The principle of equality implies equal possibilities to be provided to shareholders both when redemption is initiated by the company and when it is initiated by the shareholders themselves. Thus, the provisions of Article 75 are applicable to redemption of fractional shares upon the initiative of the company.

According to Section 1, Article 75 of the Federal Law “On Joint Stock Companies”, shareholders who are owners of voting shares are entitled to request the company to redeem their shares in full or in part, provided they voted against the respective decision of a general meeting of the shareholders or did not participate in the voting. Section 2 of this Article establishes that if agenda of a general meeting of the shareholders contains issues which may lead to decisions entitling the shareholders’ right to request redemption of their shares, a list of these shareholders shall be prepared. Since consolidation of shares is followed by respective amendments to the articles of associations, the same list of shareholders has to be prepared in these cases as well.

While determining the market value of fractional shares to be redeemed it is permissible to use criteria provided either in Paragraph 5, Section 3, Article 77 of the Federal Law “On Joint Stock Companies”, or in Section 3 of its Article 75. The provisions of the Federal Laws “On Valuation in the Russian Federation” and “On Protection of the Rights and Lawful Interests of Investors on the Securities Market” shall be taken into consideration as they prescribe that shareholders shall be fully informed about the market value of shares, and provide for liability of persons signing the securities emission prospectus and of the independent appraiser for damages

incurred by the issuer to the shareholders due to unauthentic and (or) deceitful information in the prospectus.

However, formal non-compliance with due legal procedures revealed by the constitutional interpretation of the challenged provisions of the Federal Law “On Joint Stock Companies”, provided that they did not significantly affect the determination of the objective market value of the shares which were redeemed, is not a ground for reconsideration of the respective decisions.

6. Therefore, the interrelated provisions of Paragraph 2, Section 1, Article 74, and Sections 1, 2 and 3, Article 77 of the Federal Law “On Joint Stock Companies”, implying that the rights and lawful interests of owners of fractional shares shall be taken into account by means of due legal procedures and effective judicial review of decisions made by the board of directors (supervisory board) and general meeting of the shareholders shall be applied in their constitutional meaning revealed by the Constitutional Court of the Russian Federation in the present Judgment.

Concluding from the above and pursuant to Sections 1 and 2, Article 71, Articles 72, 75, 79, 100 and 104 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 interrelated provisions of Paragraph 2, Section 1, Article 74, and Article 77 of the Federal Law “On Joint Stock Companies” (as amended on 24 May 1999), pursuant to which if any fractional shares are created as a result of consolidation of shares, these shares shall be redeemed by the company at market value, as conforming to the Constitution of the Russian Federation as these provisions in their constitutional interpretation imply that the rights and lawful interests of the owners of fractional shares are taken into account by means of due legal procedures and effective judicial review of the decisions of the board of directors (supervisory board) and a general meeting of the shareholders.

The constitutional meaning of the mentioned provisions revealed in the present Judgment shall be generally binding and shall preclude any other interpretation in the law-enforcement practice.

2. The court judgments delivered in the cases of the individuals-shareholders on the basis of the provisions of Paragraph 2, Section 1, Article 74, and Article 77 interpreted in a manner diverging from the constitutional meaning revealed in the present Judgment are to be reconsidered by courts according to the established procedure if there are no other obstacles to it.

3. 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 require confirmation by any other state body or official.

4. Pursuant to Article 78 of the Federal Constitutional Law “On the Constitutional Court of the Russian Federation”, this Judgment shall be published in *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.

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