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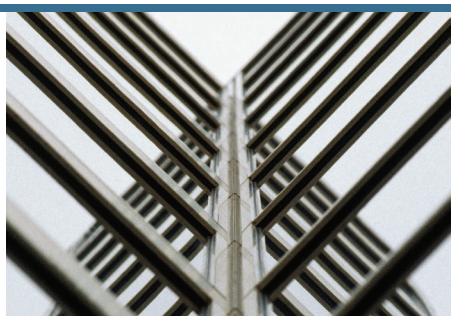

Liability of a company's officers

On 30 July 2013 the Plenary Session of the Supreme Commercial Court of the Russian Federation adopted Resolution No. 62 "On Certain Matters of Indemnification of Damages by Members of a Company's Governing Bodies."

In this Resolution of the Plenary Session, the Supreme Commercial Court (the "SCC", the "Court") summarized a number of positions regarding indemnification of damages by a company's managers taken in earlier commercial court decisions, and set out a number of rules that had not previously been established by the SCC. This alert analyses the main provisions of the Resolution where the Court (i) extended the range of persons to whom the provisions on directors' liability apply and persons entitled to claim damages on behalf of the company; (ii) set out rules for the sharing of the burden of proof of the occurrence or nonoccurrence of the circumstances that entail a director's liability; and (iii) listed the main circumstances where a director is liable for damages or is released from liability.

Liable persons and persons entitled to claim damages. In its Resolution, the Court pointed out that, aside from the persons listed in the law, the following persons are liable for damages caused to the company by their unreasonable and (or) bad-faith actions: (i) individuals who *used to be* the members of the company's governing bodies; (ii) a management company or a manager; (iii) a liquidator (members of the liquidation committee); and (iv) an external manager or receiver – altogether referred to as directors, – *Clauses 1, 12 of the Resolution*.

The company and (or) its participants (including those persons that were not the company's participants by the date when the damages were caused to the company – new participants[1]) are entitled to claim damages caused to the company by a director[2]. Approval by the company's joint executive body or the general meeting of participants does not rule out a director's liability for the bad-faith and (or) unreasonable decision that caused damages to the company, – *Clauses 7, 10 of the Resolution*.

1 However, on the issue of contesting transactions, SCC Presidium resolutions No. 9736/03 dated 2 December 2003 and No. 9688/05 dated 6 December 2005 clarify that a person that was not the company's participant by the date of the transaction may not challenge it because such transaction could not have breached a participant's interest then.

2 The limitation period for such claim is three years and it starts as of the day when a new participant's predecessor learned or should have learned about the director's misconduct. When the predecessor is the company itself, or when the company requests indemnification, the limitation period starts as of the day when the company could really learn about the director's misconduct (e.g., by the new general director), or when the controlling participant learned or should have learned about the director's misconduct, – *Clause 10 of the Resolution*.

All disputes from claims for indemnification of damages by the directors are corporate, not labor disputes, and are under the jurisdiction of commercial courts, – *Clause 9 of the Resolution*.

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Burden of proof[3]**.** As a general rule, a claimant bears the burden of proof of the company's damages and the cause and effect relationship of such damages and the director's bad-faith and (or) unreasonable conduct. However, bad faith and unreasonableness of the director are *presumed* and the director bears the burden of proof of the opposite if he/she (*Clauses 1, 2, 3, 5, 6 of the Resolution*):

- refused to submit evidence to refute the claimant's arguments or his/her explanations were obviously incomplete;
- made a decision that caused damages to the company without considering the relevant information;
- failed to take steps to obtain sufficient and necessary information prior to making the decision though such steps are commonly taken by businesses in similar circumstances;
- although normally required or followed by the company in similar transactions or decisions, failed to follow the internal procedures prior to executing the transaction (e.g., approval with the legal department, accounts department, HR, etc.);
- acted in the situation of a conflict between personal and the company's interests;
- concealed from or provided to the participants inadequate information about the transaction;
- although required by the law or the company's charter, failed to approve the contract with the company's governing bodies prior to its execution;
- after his/her authority had ceased, deviated from handing over to the company documents related to the circumstances that entailed the unfavorable outcome for the company; and
- knowingly acted against the company's interests (e.g., concluded a contract knowing that the terms of the contract were unprofitable for the company or that the counterparty was unable to perform its obligation).

Events of liability. The law requires the director to act in the company's interests reasonably and in good faith. The Court clarified that good faith and reasonableness mean that the director takes necessary and sufficient steps to secure the objectives of the company's business, including *due performance by the company of its public law obligations, – Clause 4 of the Resolution*.

The objective of the company's commercial activities is to make a profit (Clause 1 Article 50 of the Civil Code). In this connection, in order to identify the **company's interests,** it is necessary to take into account, in particular, (i) the provisions of the company's charter and other documents that establish the priorities of the company's business and (ii) business plans. Also, according to the Resolution, in case of a conflict between the company's and a participant's (several participants') interests, the director must act in the company's interests, – *Clause 2 of the Resolution*.

The Court pointed out that a transaction contradicts the company's interests, i.e., is unprofitable[4], if its price and (or) other terms are significantly worse for the company than the terms common for similar transactions in similar circumstances (e.g., the performance of the company's counterparty is twice or more than twice cheaper than the company's performance in favor of its counterparty). Unprofitability of the transaction is determined as of the date of its conclusion. If such unprofitability was revealed afterwards, the director must pay damages only if it was proved that he/she had known from the outset that such transaction would not be performed at all or would be performed improperly, – *Clause 2 of the Resolution*.

The Resolution indicates a few factors that must be taken into account when determining whether a director was supposed to know about a circumstance that caused damages to the company, i.e., whether the action in question was within the scope of the director's responsibility (including selecting the company's representatives, contract parties, employees and exercising control over their actions (omission)). Such factors include, among others: (i) usual business practice; (ii) the magnitude of the company's business; (iii) the nature of the action in question; and (iv) whether a director's action in question was aimed at avoiding liability by involving third parties, – *Clause 5 of the Resolution*.

Release from liability. According to the Resolution, a director is not liable for damages caused to the company, if:

- indemnification has been obtained by another remedy (e.g., the consequences of invalidity of a transaction have been applied, the property has been vindicated, the compensation has been obtained from the person who directly caused harm to the company), – *Clause 8 of the Resolution*;

3 The Resolution summarizes certain clarifications set out, in particular, in SCC Presidium resolutions No. 12505/11 dated 6 March 2012 (*the Kirovsky Plant Case*); No. 15201/10 dated 12 April 2011 (*the Medical Center "Similia" Case*); No. 12771/10 dated 8 February 2011 (*the Bank "ROST" Case*).

4 For more information, refer to SCC Presidium resolutions No. 76/12 dated 5 June 2012 (*the Ciment Français Case*); No. 15756/07 dated 20 May 2008 (*the Sanitarium "Peredelkino" Case*); No. 1795/11 dated 13 September 2011 (*the Baltiysky Plant Case*).

- the director's actions (omission) that resulted in damages were within the scope of a reasonable commercial risk[5], – *Clause 1 of the Resolution*;
- the members of the joint executive body voted against the harmful decision or, *acting in good faith*[6], did not participate in the vote, – *Clause 7 of the Resolution*; and
- the unprofitable transaction (i) was part of a series of related transactions that altogether should have become profitable for the company or (ii) was concluded to prevent greater harm to the company's interests, – *Clause 2 of the Resolution.*

The Resolution is mandatory for lower commercial courts when considering similar matters.

5 SCC Presidium Resolution No. 871/07 dated 22 May 2007.

6 The Plenum has not clarified when failure to participate in the vote may be considered a good-faith omission. Draft Federal Law No. 394587-5 "On Amending Certain Legislative Acts of the Russian Federation with Regard to the Liability of Members of Companies' Governing Bodies" (adopted by the State Duma in the first reading on 5 October 2010) proposes, in particular, to introduce an obligation of the members of the joint executive body to inform it about their inability to participate in the meeting and to explain their reasons (supplement the LLC Law with Article 42[2] and the JSC Law with Article 70[1]).