

**Expert opinion of the INSTITUTE OF STATE AND LAW OF THE RUSSIAN ACADEMY OF SCIENCES on the lawsuit by Rosneft and Bashneft claiming damages of RUB 170 billion.**

**Information on the experts who prepared the opinion:**

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**Questions considered:**

1. Is it possible for a company to incur losses as a result of the cancellation of its own shares, which were received during a restructuring, and does the cancellation of its own shares received by Bashneft upon its merger with Bashneft-Invest mean the lack of equivalent consideration for shares of Sistema-Invest and the right of claim for loans held by Bashneft before the restructuring?

2. Does a joint stock company that buys back its own shares from shareholders and, beforehand, prior to the commencement of the buyback procedure, decides to cancel them, incur losses in the amount of the costs for the buyback of the cancelled shares resulting from the inability to sell them to other investors in the manner provided for in Article 76(6) of the Federal Law on Joint Stock Companies?

An analysis of Russian legislation and its practical application provides answers to these questions as follows.

## **Answer to Question No 1**

If there are conditions in the merger agreement for the cancellation of shares, **losses may not be incurred by the company** that was merged. A number of factors testify to this conclusion.

In the legal sense, damages in civil law doctrine and law are understood as a measure of responsibility applied to a debtor in connection with the failure or improper performance of an obligation before a creditor, as a result of which the latter incurs losses (Article 393 of the Civil Code of the Russian Federation).

It follows from this that, as a general rule, an unlawful action on the part of the entity responsible for the losses is a prerequisite for satisfying a claim for damages.

By virtue of Article 17(4)(3) of the Federal Law on Joint Stock Companies, shares of a company being merged are subject to cancellation if this is stipulated by the merger agreement. And since the analysed case relates to such a situation, there are no **indications of wrongful actions during the restructuring**.

At the same time, the company's cancellation of its own shares received during restructuring is not legally applicable to cases that allow the right to compensation for damages to be satisfied (if, in this case, it is possible to speak about the occurrence of damages) as a result of lawful actions (Article 1064(3) of the Civil Code of the Russian Federation).

In such circumstances, the submission of **claims for compensation of losses** caused by the cancellation of shares on terms agreed upon in the merger agreement **does not comply with the law and is inadmissible**.

Moreover, such claims lead to nothing more than the **unjust enrichment of the plaintiff**, in whose favour the claims have been made, due to the following factors.

A joint stock company is, by its legal nature, the issuer, and it has, on its own behalf, obligations to its owners to implement the rights conferred upon its securities, and it is intended to attract capital through the issuance of shares

(Determination No 372-O-O of the Constitutional Court of the Russian Federation of 10 February 2009).

**A reduction in the authorised capital** of a joint stock company **by the cancellation of a portion of shares** by a decision of the general meeting of shareholders in no way **undermines the legal nature of the joint stock company** as an issuer of securities. A joint stock company has the right at any time by a decision of its authorised management bodies to attract funds from new investors by issuing additional shares.

From the available materials, it follows that this right was employed by Bashneft, represented by its Board of Directors, which decided to issue additional ordinary shares in place of those cancelled during the restructuring. Subsequently, however, the additional issue was stopped by the new controlling owner of Bashneft, the Russian Federation.

Nevertheless, Bashneft still retains the possibility to issue new shares in place of those cancelled during the restructuring. The cancellation of shares is not the same as a loss of shares. Consequently, the notion of any losses is out of the question.

**In the case of satisfying the plaintiff's claim** for compensation for 'losses' associated with the cancellation of shares under the terms of the merger agreement, Bashneft will receive cash compensation for the cancelled shares and will, at the same time, retain the right to issue new shares in place of those redeemed, and it will have the ability to sell them to third parties during the issue. Thus, **Bashneft will have the ability to receive a double unjustified benefit for the same shares.**

Therefore, the cancellation of its own shares received by Bashneft upon its merger with Bashneft-Invest does not at all signify the absence of consideration upon the restructuring.

## **Answer to Question No 2**

A joint stock company that buys back its own shares from shareholders and, beforehand, prior to the commencement of the buyback procedure, decides to cancel them, does not incur losses in the amount of the costs for the repurchase of the cancelled shares.

On the basis of Article 76(6) of the Federal Law on Joint Stock Companies, shares repurchased by a company are at its disposal. These shares do not provide voting rights, are not taken into account when counting votes, and no dividends are accrued on them. They must be sold at a price not lower than their market value no later than one year after the transfer of the right of ownership to the repurchased shares to the company; otherwise, the general meeting of shareholders must take a decision to reduce the company's registered capital through the cancellation of said shares.

In this regard, Article 29 of the Federal Law on Joint Stock Companies and Article 101 of the RF Civil Code allow the issuer to take a decision on the cancellation of shares at any time before the expiry of the one-year period provided for in Article 76 of the Federal Law on Joint Stock Companies in the event that such an option is provided for in the issuer's charter.

On the basis of available materials, during the restructuring of Bashneft on the basis of, and in accordance with, the procedure provided for in Article 75 of the Federal Law on Joint Stock Companies, shares were repurchased pursuant to the requests of shareholders who voted at the general meeting against the decision to restructure or who did not participate in the voting. In accordance with Article 29(1) of the Federal Law on Joint Stock Companies, the general meeting of shareholders of Bashneft, through the votes of Sistema, Sistema-Invest and a number of minority shareholders, decided in advance (simultaneously with the decision to restructure) to reduce the company's registered capital.

Thus, the cancellation of shares repurchased at the request of minority shareholders is not an illegal act. At the same time, the cancellation of shares repurchased by the issuer is not a case prescribed by law that would permit claims

for compensation for damages caused by lawful actions (Article 1064(3) of the RF Civil Code).

As set out in the answer to question No 1, the cancellation of shares is not the same as the loss of shares. The issuer, by virtue of its legal nature, has the opportunity at any time to issue new shares in exchange for those cancelled. Shares repurchased at the request of shareholders based on the provisions of Article 75 of the Federal Law on Joint Stock Companies are no exception.

Taking into account the compensatory nature of legal relations for the purchase and sale of shares, the company buys back shares from minority shareholders at a price no lower than their market value.

**The qualification of costs incurred by Bashneft to buy back shares from minority shareholders as a loss is unjustified** and would lead to the unjust enrichment of Bashneft, as detailed in the answer to the first question.

The concept of losses proposed by Bashneft would lead, in practice, to a situation where the cost of repurchasing shares would always be qualified as a loss incurred by the issuer unless the repurchased shares are sold to third parties. This includes when repurchased shares are, for one reason or another, cancelled after the expiration of the one-year period provided for in Article 76(6) of the Federal Law on Joint Stock Companies.

Such a concept is not justified. An action originally provided for by law and carried out in accordance with the procedure prescribed by law cannot violate the rights of a company and, as a consequence, be recognised as a loss.

**Therefore, based on the above, one must arrive at the following conclusions:**

**1. In case of the merger of one joint stock company with another and the existence in the merger agreement of conditions for the cancellation, at the time of the merger, of shares of the absorbing company belonging to the**

**absorbed company cannot entail a loss for the merged company. Given the comparability of cost parameters of a 49.9% stake in Sistema-Invest and Bashneft's right of claims to loans prior to the restructuring, and a 16.8% stake of its own shares acquired by Bashneft resulting from the restructuring, the absence of consideration from Bashneft during the restructuring, regardless of the cancellation of the 16.8% stake, is not possible.**

**2. A joint-stock company that buys back shares from its shareholders and, beforehand, prior to the commencement of the buyback procedure, decides to cancel them, does not incur a loss in the amount of the cost of repurchasing the cancelled shares as a result of its inability to sell them to other investors in the manner provided for in Article 76(6) of the Federal Law on Joint Stock Companies.**

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