

Ways to Get Out of a Corporate Conflict (Deadlock)

Newsletter

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In practice, shareholders in a limited liability company (LLC) often face situations where they are unable to reach a mutual agreement on company management. As a result, the risk is high of getting into the so-called deadlock, where a deep divergence in the views on further business development between the owners can block the operations of the company.

What are the ways to get out of a prolonged conflict in a limited liability company and what risks should one anticipate? See the “Mosgo & Partners” newsletter below.

Measure	Description	Risks
<p>1 A shareholder’s withdrawal from the LLC</p>	<ul style="list-style-type: none"> ▶ The shareholder’s right to withdraw from the LLC shall be provided in the company’s charter. ▶ Application for withdrawal requires notarization. ▶ Participation in the company is terminated from the date of receipt of the application for withdrawal by the company. ▶ Actual value of the withdrawing shareholder’s share is determined in accordance with the company’s accounting reports for the last reporting period preceding the date of submission of the application for withdrawal (Art. 23(6.1) of the Federal Law “On LLCs”). ▶ Court practice: Actual share value is determined in accordance with the company’s accounting reports as of the last calendar day of the month preceding the month of submission of the application for withdrawal. 	<ul style="list-style-type: none"> ▶ Accounting reports produced to determine the actual share value may be flawed. ▶ Another shareholder may deliberately lead the company to bankruptcy. The company is not entitled to distribute the actual share value or a part thereof in the charter capital to the shareholder, or distribute property in kind for the same value, if as of the time of such a distribution of funds or property it meets the criteria for bankruptcy or if the company will meet such criteria as a result of such a distribution.

	<ul style="list-style-type: none"> ▶ In case of court action, the actual share value can be confirmed in a report by an independent appraiser. 	
2 Sale of the share to a third party	<ul style="list-style-type: none"> ▶ Other shareholders' right of first refusal should be taken into account. 	<ul style="list-style-type: none"> ▶ It is difficult to find a third party ready to get involved in the business. ▶ The sale may be restricted by the company's charter.
3 Demand to purchase the share in case of approval of a major transaction or a share capital increase	<ul style="list-style-type: none"> ▶ If the company's general shareholders' meeting approves a major transaction or a share capital increase, the company must purchase the share if demanded by the shareholder who voted against such a resolution or did not participate in the voting. ▶ The shareholder's demand shall be notarized. ▶ The deadline for the shareholder's demand is 45 days from the day when he/she has become aware or should have become aware of the resolution adopted. 	<ul style="list-style-type: none"> ▶ Risks are the same as in case of withdrawal from the LLC (see para. 1). ▶ The effects are identical to withdrawal from the LLC; however it is possible in any case (even if the charter does not provide for the right to withdraw from the company).
4 Expulsion of the other shareholder from the LLC	<ul style="list-style-type: none"> ▶ Expulsion is only possible through judicial procedure. ▶ A material violation by the shareholder being expelled is required. Examples: <ul style="list-style-type: none"> ▶ Persistent avoidance of participation in the company's general shareholders' meeting without good reason, which makes the company unable to make important business decisions on the issues on the agenda of the general shareholders' meeting; 	<ul style="list-style-type: none"> ▶ This instrument is undesirable where shareholders have equal shares. It is more fit for cases of conflicts between a majority shareholder and a minority shareholder who can veto resolutions and thus block them.

	<ul style="list-style-type: none"> ▶ A shareholder acting contrary to the interests of the company, including while performing the functions of the sole executive body (for example, causing significant damage to the company's property, concluding a transaction detrimental to the company's interests, economically unfounded dismissal of all employees, competing with the company, voting for the approval of a knowingly unprofitable transaction). 	
<p>5 Forced liquidation</p>	<ul style="list-style-type: none"> ▶ Possible only through judicial procedure. ▶ Position of the Russian Supreme Court: the claim shall be satisfied in case of a longstanding corporate conflict involving substantial abuses by all shareholders of a commercial partnership or company. ▶ Liquidation of the legal entity as a way to solve the corporate conflict is only possible when all other measures (expulsion of a shareholder, voluntary withdrawal from the company, election of new general director, etc.) have been exhausted or are impossible. 	<ul style="list-style-type: none"> ▶ Russian courts are extremely reluctant to satisfy claims on forced liquidation (according to the practice of the Moscow District Commercial Court). ▶ The procedure is time-consuming and costly. ▶ There is a risk of reduction of the "liquidation share", i.e. the amount that the shareholder could receive as compensation for the actual share value if he/she had chosen another way to solve the corporate conflict.



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