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Legal Alert
from Dispute Resolution Team

Court practice regarding the expulsion of shareholders

Not long ago, the Supreme Court of the Russian Federation (SC RF) issued 2 rulings on the expulsion of a shareholder from a corporate entity which are contrary to the prevailing trends in recent court practice: rulings of the SC RF dated 28 August 2023 No. 305-ES22-28611 in case No. A40-260466 /2021 and dated 10 October 2023 No. 310-ES23-6418 in case No. A08-11902/2021.

With these new rulings, the SC RF clearly (and not for the first time) outlined its desire to adjust judicial approaches to resolving disputes of this category.

Below, we will briefly outline under what circumstances the law allows for the expulsion of a shareholder from a corporation, how the relevant rules are applied by the courts and what signals the SC RF is sending to the courts of lower instances with the abovementioned rulings.

When can a member lose their status?

Clause 1, Art. 67 of the Civil Code of the Russian Federation contains a general rule according to which a shareholder of a corporate legal entity (partnership or company, except for PJSC) has the right to demand the expulsion of another shareholder followed by payment in the amount of the value of their share (shares) in one of the following cases:

- the shareholder caused significant harm to the corporation
- the shareholder is otherwise significantly impeding the activities of the corporation and the achievement of the goals for which it was created, including by grossly violating its duties

A similar provision is contained, for example, in Art. 10 of the Law on Limited Liability Companies: a shareholder can be expelled from the company if he or she "grossly violates their duties or through their actions (inaction) makes the company's activities impossible or significantly more complicated".

What actions may be considered a gross violation of a shareholder's duties? An approximate list is given in clause 35 of the Resolution of the Plenum of the SC RF dated 23 June 2015 No. 25 (hereinafter referred to as the "**Resolution**"):

- systematic avoidance of participation in general meetings of shareholders without good reason
- causing significant damage to company property
- making a transaction to the detriment of the interests of a company
- economically unjustified dismissal of all employees
- carrying out competing activities
- voting for approval of an obviously unprofitable transaction

By and large, the relevant clarifications of the SC RF reflect the earlier clarifications of the Supreme Commercial (Arbitrazh) Court of the Russian Federation given in Information Letter of the Presidium of the Supreme Commercial (Arbitrazh) Court of the Russian Federation dated 24 May 2012 No. 151 "Review of the practice of consideration by arbitration courts of disputes related to the expulsion of a shareholder from a limited liability company."

What approach has been developed by court practice?

The courts resolve disputes regarding the expulsion of a shareholder from a corporation with extreme caution. Many claims remain unsatisfied.

This is because courts have formed several positions that radically limit the possibility of expulsion of a shareholder from the corporation.

(i)

Thus, courts are often guided by the idea that the expulsion of a shareholder is possible only when their behavior has created such serious obstacles to the activities of the corporation that they cannot be overcome in any other way [1].

This approach has sometimes resulted in the failure to seek expulsion in situations where the defendants clearly acted in bad faith. For example, according to the circumstances of one of the cases, a member of the company, who was also its director, withdrew all assets from the company in favor of another person controlled by him and was therefore subsequently brought to criminal liability. However, the court found that the expulsion of such a shareholder is not necessary to restore the rights of the company citing the fact that the expulsion "can only be applied in exceptional cases when it is proven that a shareholder has grossly violated their duties or their behavior makes the activities of the company impossible or rather complicated" (Decision of the Moscow Region Commercial (Arbitrazh) Court dated 23 May 2019 in case No. A41-89398/18)[2].

(ii)

Courts often impose extremely strict requirements for proving that a corporation's activities were made more difficult to carry out due to the defendant's actions. A simple indication of the defendant's activity that is obviously harmful to the legal entity or his manifestation of disloyalty is not enough; it is necessary to provide specific evidence of harm[3].

As a result of this approach, there are situations in which the court even refuses to expel a shareholder proven to be leading a competing company (Resolution of the North-Western District Commercial (Arbitrazh) Court dated 04/09/2018 in case No. A44-3683/2017):

"The plaintiffs have not proven that the company suffered losses or any obstacles in carrying out its activities in connection with the defendant's performance of the functions of the sole executive body of a company engaged in similar activities, and the mere fact that a shareholder in one company performed the duties of a director of another legal entity is not a sufficient basis for applying to a shareholder such an exceptional measure as expulsion".

[1] See, for example: Resolution of the Volga District Commercial (Arbitrazh) Court dated 19 April 2019 in case No. A06-10191/2017; Resolution of the Moscow District Commercial (Arbitrazh) Court dated 26 April 2017 in case No. A41-35236/2016; Resolution of the West Siberian District Commercial (Arbitrazh) Court dated 4 May 2016 in case No. A75-7327/2015; Resolution of the North-Western District Commercial (Arbitrazh) Court dated 25 July 2017 in case No. A56-81415/2015.

[2] However, it is worth noting that this decision was overturned by the Resolution of the Tenth Commercial (Arbitrazh) Court of Appeal dated 18 September 2019 in case No. A41-89398/2018 (upheld by the Resolution of the Moscow District Commercial (Arbitrazh) Court dated 24 December 2019 in case No. A41-89398/2018).

[3] See, for example: Resolution of the North-Western District Commercial (Arbitrazh) Court dated 13 June 2013 in case No. A05-12722/2012; Resolution of the North-Western District Commercial (Arbitrazh) Court dated 11 February 2013 in case No. A21-5562/2012; Resolution of the Central District Commercial (Arbitrazh) Court dated 13 June 2018 in case No. A84-3139/2017

(iii) In addition, the position that the expulsion of a shareholder cannot be a method to resolve a corporate conflict between shareholders is often found in the court's reasoning. The courts indicate that the expulsion of a shareholder is permissible only in the interests of the corporation, and not in the interests of one or another specific shareholder or group of shareholders, and refuse to pick a side in such conflicts.[4]

For example, in the Resolution of the Central District Commercial (Arbitrazh) Court dated 4 December 2018 in case No. A09-7751/2017, it is noted:

"There is a corporate conflict in the company which cannot be overcome with the help of the state, in particular, with the help of a court, which, by adopting binding acts on the claims of company shareholders, are not able to compensate for the lack of consistency in the actions of shareholders, which in some cases can block effective management and, consequently, the activities of the company."

It is worth noting that this approach is based on the provisions of clause 35 of the Resolution, according to which a claim for expulsion cannot be satisfied in the case when such a claim is made by a person in respect of whom there are grounds for expulsion. In other words, in a situation where a shareholder, violating the interests of a corporation and thereby provoking a conflict, tries to attack other shareholders in order to maintain control of the corporation, such a claim cannot really be satisfied. However, in court practice, the application of this logic has been expanded to any situation involving corporate conflict.

What ideas are espoused by the SC RF?

For several years now, the SC RF has been consistently advocating for a more sophisticated application of the rules on the expulsion of corporate shareholders.

Consequently, the SC RF has included several positions in the Review of court practice on certain issues of the application of legislation on commercial companies dated 25 December 2019 (hereinafter referred to as the "**Review**") that conflict with the trends in the practice of courts of lower instances.

For example, clause 7 of the Review directly states that neither the presence of a corporate conflict, nor the equal distribution of shares between its parties, are grounds for refusing a claim to expel a shareholder.

Also, clause 9 of the Review states that the possibility of expulsion a shareholder does not depend on whether the consequences of their actions (inaction) can be eliminated without the expulsion.

It would not be fair to say that these positions were not noticed by the judges of the lower courts at all. Sometimes, references to them can be found in court practice. For example, in the Resolution of the Moscow District Commercial (Arbitrazh) Court dated 16 June 2023 in case No. A40-207701/2022, the defendant's arguments about the inadmissibility of filing a claim for expulsion in the context of a corporate conflict were rejected by the court with reference to the explanations of the Supreme Court of the Russian Federation.

However, most disputes about the expulsion of a shareholder are resolved not based on the positions of the SC RF but based on the abovementioned approaches spontaneously formed in the court practice, which preclude the satisfaction of claims for expulsion in most situations.

[4] See, for example: Resolution of the Volga District Commercial (Arbitrazh) Court dated 28 January 2019 in case No. A12-17390/2018; Resolution of the Far Eastern District Commercial (Arbitrazh) Court dated 21 July 2014 in case No. A51-22498/2013; Resolution of the Moscow District Commercial (Arbitrazh) Court dated 24 June 2013 in case No. A40-113458/12–48–1058; Resolution of the North-Western District Commercial (Arbitrazh) Court dated 13 May 2013 in case No. A52-3207/2012.

What ideas are expressed by the SC RF in the two new rulings?

It can be assumed that the reason why the SC RF has already considered two disputes regarding the expulsion of a shareholder this year is its disillusionment with the current situation. Over the past several years, such disputes have not reached the highest court instance.

In its rulings, the SC RF did not say anything fundamentally new but emphasized and developed the positions it had formed previously:

- a corporate conflict is not an obstacle but a reason for the expulsion of a shareholder if such a conflict is provoked by this shareholder
- when assessing the existence of grounds for the expulsion a shareholder, violations that were committed by the shareholder in the exercise of the powers of the sole executive body should be taken into account
- consequences in the form of expulsion of a shareholder may also occur if the harm was caused by the actions of the head of the corporation controlled by such shareholder; in this case, the plaintiff does not even have to convincingly prove the conspiracy between the shareholder and the manager; it is enough to prove that the manager takes the side of said shareholder in a corporate conflict
- the “extreme” nature of a measure such as expulsion is associated with the situation of the impossibility of further cooperation between the shareholders of the corporation and not with the inability to eliminate the consequences of the defendant’s behavior without expulsion
- restoration of the violated rights of the corporation (for example, through the adoption of a judgement, which results in the return of the previously sold assets) itself also cannot be a basis for refusing to expel a shareholder, since a gross violation of their obligation not to cause harm to the corporation makes it unacceptable for the other shareholders to continue conducting business as usual

In this regard, it is quite possible to expect that the latest efforts of the SC RF may attract the attention of other courts to the explanations it developed several years ago and that the bias in favor of defendants in disputes about the expulsion of shareholders from corporations will gradually begin to level out.

As litigators, we want to emphasize that in legal disputes, including ones on the expulsion of shareholders, much depends not only on the legal positions of the SC RF and court practice but also on the specific circumstances of the case and the careful preparation of evidence. To paraphrase a classic idiom, all unhappy corporations are unhappy in their own way.

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