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# Implementation of Preemptive Rights in Corporate Relations

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## ABSTRACT

This article lays emphasis on: the legal nature of the preemptive rights, the classical concept in corporate law, the possibility of its occurrence in the sale or assignment of a share (or shares) to the third parties, the implementation of preemptive rights in corporate relations, protection of impaired preemption, the occurrence of preemptive purchase rights in the hereditary succession.

**Keywords:** *preemptive rights to purchase, shares, stocks, corporate relations, deed of gift, the hereditary succession*

## 1. INTRODUCTION

Preemptive rights secured a conglomerate of features to protect the personal rights and interests of members of the corporation. Due to the above method of protection, the authorized person on the basis of his rights has the possibility in certain cases: claim to increase his influence to the corporation through the acquisition of alienated share in additional and limited liability companies, as well as the purchase of shares in the closed joint-stock company, on the ground of violation of preemptive right to purchase and other options require the invalidation of the transaction in which the law allows to resort to such a method of protection.

The classic understanding of preemptive rights in the corporate law of the converted property law in corporate, having a special feature:

- a. The subject of legal act is privileged right of the requirement of one corporate member to another, that wishes to leave, a transfer of the relevant shares (or shares).
- b. Consequently, a person will have the right to purchase a share of participation in the corporation, which gives all possible corporate rights.

Legal nature of the preemptive rights remains unclear. Preemption, IA Pokrovsky attributed to the subspecies of property rights to another thing, the essence of which was to establish a legal relationship between a thing and a person.<sup>1</sup> Different position in the modern legal literature is presented by the authors KI Sklovsky and Smirnova. By understanding these authors the right of preemption is the right securing the privilege of a certain group of people for the purchase of a property, is characterized as a contractual right<sup>2</sup>. It is necessary to

agree with EA Sukhanov rightly pointing out that the right of preemption, in the classic sense, refers to a group of human acquisition of things, being restricted real right<sup>3</sup>.

The content of preemption is an important and controversial issue. Since the preemptive right to buy has a special, exceptional character, as indicated by EA Sukhanov, that this right is beyond the scope of the principle of equality of subjects of civil relations. This results in a rule one above the other entity<sup>4</sup>. It should be noted that this method of protection of corporate law is expressed in the fact that since the beginning of the preemptive rights, there are legal entities, one of which shall have the possibility to require the contractor a certain behavior. This implies that the preemptive right is a subjective civil right<sup>5</sup>.

The purpose of the establishment of the preemptive rights in corporate relations (shares or shares in the Company) is expressed in the provision of protection from the risks that can be associated with the appearance of new members. At the preemptive right to purchase shares (or shares of JSC) does not change the composition of the participants. Otherwise, the emergence of new parties could adversely affect the affairs of the corporation, due to their lack of competence

<sup>3</sup> EA Sukhanov Limited property rights in civil law // PE-Lawyer, № 3, 2003.

<sup>4</sup> Civil law. 4 volumes, Volume 1: General Part, Br. Ed. - EA Sukhanov. - 3rd ed., Revised and enlarged. - Moscow: Wolters Kluwer, 2010, pp. 135.

<sup>5</sup> Corporate Law: Current Problems of the theory and practice / under total. Ed. VA Belov. - Moscow: Publishing Yurayt, 2009, (the author of the essay, MV Subbotin). S. 578. However, some scholars consider the individual elements of the process of preemptive rights as a "sekundarnyh powers", which are expressed in the possibility of its unilateral action of a civil rights and obligations. See Sklovsky KI Smirnova Institute of preemption in the Russian and international law. // Economy and Law, № 10, 2003.

<sup>1</sup> Pokrovsky I. The main problems of civil rights. M.: "the Statute", 2009. S. 206-207.

<sup>2</sup> Sklovsky KI Smirnova Institute of pre-emption in the Russian and international law. // Economy and Law, № 10, 2003.

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and ability to do business properly<sup>6</sup>. In addition, this method makes it possible to provide other protection aim: to protect the participants from the risks in the event of a possible dilution of the share in the authorized capital of the company owned by each of them<sup>7</sup>.

The legislator has a special way of protecting the broken preemption – transfer of rights and obligations under the transaction. This method is enshrined in the provisions of paragraph 3 of Art. 7 of the Federal Law "On Joint Stock Companies"<sup>8</sup>, and paragraph 4 of Art. 21 of the Federal Law "On Limited Liability Companies"<sup>9</sup>. In the scientific literature, it is believed that until the fulfillment of contractual obligations of the parties, it is allowed to transfer the rights and obligations under the transaction. Commitments are terminated after such a performance, and no formal transfer of rights and obligations under the transaction cannot be<sup>10</sup>. However, case law recognizes the possibility of transfer of rights and obligations after the preliminary invalidation<sup>11</sup>.

In the case of sale of shares of one member of society - another participant, preemption does not arise. The charter may provide for the approval of this type of transaction with other members of the corporation. Consequently, the occurrence of preemption is only possible in the case of sale of shares to a third party. The participants of the society are able to use preemptive right to purchase shares "at the offer price to a third party." This situation can lead to abuse of the right of the party,

<sup>6</sup> See: Novoselov LA Preemptive right to acquire shares in the closed joint-stock company. / "Full Consultant".

<sup>7</sup> Corporate Law: Current Problems of the theory and practice / under total. Ed. VA Belov. - Moscow: Publishing Yurayt, 2009, (the author of the essay, MV Subbotin). S. 599.

<sup>8</sup> The Federal Law of 26 December 1995 № 208-FZ "On Joint Stock Companies". / "Full Consultant."

<sup>9</sup> The Federal Law of 08.02.1998 № 14-FZ "On Limited Liability Companies". / "Full Consultant."

<sup>10</sup> Novoselov LA Preemptive right to acquire shares in the closed joint-stock company. / "Full Consultant." This position is supported in the case law. See: Resolution of the Federal TSBs from July 5, 2007 number A28-8716/2006-440/9 / "Full Consultant", in which the Court expressly stated that the "agreement made in violation of the right of preemption does not entail the invalidity such a transaction".

<sup>11</sup> See: Resolution of the Presidium of the Russian Federation of 10 June 2008 number 5539/08. / "Full Consultant." However, in this case, the plaintiff was not notified of the sale of shares, and therefore, could not take advantage of the preferential right of purchase. In this case, the defendant was abusive acquirer.

decided to dispose of its stake. To prevent this, the charter may provide for and secure additional rules that will govern the price for the possible sale of shares. According to this rule should not be permitted infringement of the rights of society members wishing to sell their share. In accordance with paragraph 4 of Art. 21 of the Federal Law № 14-FZ, dated February 8, 1998 "On Limited Liability Companies", the implementation of community-emptive right to purchase shares or parts thereof at a predetermined price statute permitted only on condition that the purchase price of the company shares or parts thereof not less than the Prices for members of society. If several shareholders wish to buy a share, then each of them extends preferential right with the proportional size of shares held by them. The charter may provide for different rules.

Particular attention is paid to the emergence of the preemptive rights. Under federal law, a person who intends to sell its share (or shares) should send this offer to society. The offer shall include all material terms of the proposed sale, otherwise it may be considered that preemptive rights have been violated. Significant attention is paid to the possible acceptance deadline, after which, the person alienating his share (or shares) will have the opportunity to sell it to a third party<sup>12</sup>.

It should be noted the impossibility of preemptive rights concessions, otherwise this legal structure would lose its meaning.

In the scientific literature examines the question of the possibility of preemptive rights, as in the sale or assignment of a share (or shares) to third parties, but also in cases of alienation as a gift or barter<sup>13</sup>. Given the above, in which the legislator says the sale of shares, it can be concluded that in some cases the preemptive right does not arise. But, nevertheless, this feature can lead to abuse of the rights of participants who decided to dispose the share, and that this is not allowed, the statute can

<sup>12</sup> In limited liability companies such period is 30 days (unless a longer period is established in the statute). See par. 2 Part 5, Art. 21 of the Federal Law "On Limited Liability Companies", in the closed joint-stock companies - within 2 months (unless a shorter period is established in the statute, but can not be less than 10 days). See par. 6 § 3. Art. 7 of the Federal Law "On Joint Stock Companies".

<sup>13</sup> Civil law: the textbook. Part I / ed. AP Sergeev, JK Tolstoy. Moscow, 1999. S. 450; Novoselov LA Preemptive right to acquire shares in the closed joint-stock company. / "Full Consultant"; Civil law: the textbook: in 3 vols 1. 6th ed. / Min. Ed. AP Sergeev, JK Tolstoy. Moscow, 2004. S. 177-178; tradable shares in the charter capital of a limited liability company. Objects of civil law: a collection of articles. - Min. Ed. MA Rozhkov, Moscow, Statute 2007 / "Full Consultant."

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provide and secure a ban on the grant (or the other, except for the sale of) the transfer of a share (or shares).

Charter of Closed Joint-Stock Company cannot extended the effect of preemptive rights to any assignment of shares for reasons other than sale, contracts: Shareholder of Closed Joint-Stock Company filed a lawsuit on the transfer of the rights and obligations of the purchaser of the shares of this company on a barter agreement entered into by another shareholder with a third party, pointing out that the Charter Company provides preemptive right to acquire the shares alienated shareholders to third parties not only in the sales contract, but compensated by other contracts, including the contract of barter.

According to the plaintiff, the possibility of establishing in to the charter of a Company additional rights as shareholders preemptive right to purchase the shares at their disposal for other onerous contract follows from the sixth paragraph of paragraph 3 of Article 11 of the Companies Act, under which the articles of association shall contain information on the rights of shareholders - the owners of the shares of each category (type) of the thirteenth paragraph of paragraph 3 of Article 11 of the same Act, according to which the charter may also contain other provisions not contrary to the Law on Joint Stock Companies and other federal laws. As the plaintiff believed, enshrined in the charter of this regulation with the legal nature of the Company as a corporate entity in which the membership of the shareholders has a significant meaning for them, due to which the charter may contain provisions that establish additional mechanisms to ensure control over the preservation of the existing shareholders of the participants .

The court of first instance dismissed the claim on the following grounds.

According to paragraph 3 of Article 7 of the Companies Act Company's shareholders have a preferential right to purchase the shares sold by other shareholders of the Company<sup>14</sup>. This rule implies that the Companies Act does not provide for preemptive rights to acquire shares of the Company are not alienated by the contract of sale, and other instruments. In addition, the establishment of the preemptive right to purchase the shares at their disposal for other reasons than the sales contract constitutes a restriction of the rights of a shareholder on the free disposal of shares, so the possibility of establishing this limitation, the company's charter must be specifically authorized by law. Because the same paragraph 3 of Article 7 of the Companies Act, which regulates the grounds and procedure of preemptive rights to acquire shares, this possibility does not allow the relevant provisions of the Articles of Association, notes

<sup>14</sup> The Federal Law of 26 December 1995 № 208-FZ "On Joint Stock Companies". / "Full Consultant."

the existence of the right of the shareholders in any gratuitous transfer of shares (including barter agreement ) shall not apply as contrary to this norm.

The courts of appeal and cassation court left the decision of first instance<sup>15</sup>.

If these contracts of donation and purchase and sale of shares are sham and cover a single contract of sale and purchase of shares, the shareholder has the right to require the Company to transfer the rights and obligations of the purchaser under a single contract of sale, which really had in mind: Shareholder Company filed a claim a transfer of the rights and obligations of the purchaser under a single contract of sale of the shares of this company, which in reality meant the defendants entered into a sham contracts of donation and purchase and sale of shares of CJSC.

The defendants objected to the claim, on the grounds that they had entered into two separate contract. However, when making the first contract with the other shareholders of JSC was out preemptive right in connection with the gratuitous alienation of shares. Upon the sale of shares by the second contract this right also has not acted, because at the time of its conclusion was the shareholder of the buyer.

As follows from the case, between the Company and shareholder of a person who had no stake in the company, was imprisoned and executed the deed of gift of shares of five. Subsequently (after two weeks from the date of registration in the register of shareholders of the donee JSC) the same person entered into a contract of sale of three hundred shares of the company, which was also performed by them.

Assessing the circumstances described, the trial court granted the petition on the following grounds.

Contracts executed by the defendants of gift and purchase and sale of shares of sham is because, as established by the court, they were made to cover up the contract of sale three hundred and five shares of this company and to deprive others of shareholders of the opportunity to use its preemptive right to purchase shares disposed. About feigned disputed contracts and will focus on the defendants' gratuitous alienation of shares indicate a short period of time between the conclusion of the two agreements, a small amount of donated shares compared to the number of shares sold, the lack of kinship between the defendants or other relationship, which could be due to the nature of the first grant agreement .

According to paragraph 2 of Article 170 of the Civil Code sham transaction, that is, a transaction which

<sup>15</sup> See: Information Letter of the Presidium of the Russian Federation of 25 June 2009 number 131. / "Full Consultant."

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committed for the purpose of concealing another transaction is invalid, and the transaction which the parties actually had in mind, given the nature of valid transaction, apply rules there under. In this regard, the plaintiff has the right to require to transfer him the rights and obligations of the buyer in respect of three hundred and five shares to a single contract of purchase and sale of shares of which the defendants did have in mind.

In another case on the same grounds as the court qualified the following for a short period of contract: The contract of donation public company shares of the seven natural person, the contract of donation that an individual received six of the shares of the Company with limited liability and a contract of sale hundred shares Company concluded between these public company (seller) and a limited liability company (the buyer). However, neither the individual nor the limited liability company didn't have the shares before signing the giving agreement.

In this case, the requirement to transfer the rights and obligations of the buyer in respect of the six hundred shares of the conditions specified in the contract of sale was filed by shareholder of a joint stock company and limited liability company. Having established the impossibility of the case without the participation of the defendants of all parties within the chain of transactions, attracted with the consent of the complainant to participate in the case and the individual.

To meet the stated requirement, the court proceeded from the following.

An individual who received the gift of the shares of the public company, after a short period of time, almost all of their donated to the limited liability company. These circumstances, in the absence of motives for the transactions giving evidence of their orientation to cover the donation of shares between these business entities in circumvention of the prohibition of donation between commercial organizations established by subparagraph 4 of paragraph 1 of Article 575 of the Civil Code. In the present case, the commission between companies of transactions of shares of six gift and purchase a hundred shares of this company was actually sent to cover the contract of sale of the shares of between these business entities and depriving other shareholders of the Company from exercising their preemptive right of purchase.

In a similar case, the court qualified as a sham contracts of donation and purchase and sale of shares for similar reasons, stating further that the defendants will focus on gratuitous alienation of shares is confirmed by the fact that prior to their imprisonment seller sent the plaintiff a notice of intent to sell shares in amount equal to the total amount donated and subsequently sold their

shares, but on the plaintiff's application to use them to their preemptive rights of the defendant did not respond<sup>16</sup>.

Not just is the case with the forms of reorganization. For example, the separation, consolidation, merger and separation (if raised a question of giving the right of inheritance evolved a legal entity). In such cases there is a liquidation of legal entities. If at the time of opening the inheritance entity existed, but in the future (within 6 months from the date of opening of the inheritance, or at a later date, if the entity was substitutional bequest) lost its status because of elimination, we can draw some analogy with the heirs of the deceased, not had time to accept the inheritance, from which the right to accept the inheritance passes to their legal heirs in the order of hereditary transmission. Immediately, we note that this is just a guess, based on the presumption of equality of civil rights in their hereditary legal status.

For example, under Part 5 of Article. 5 of the Federal Law № 129-FZ, dated August 8, 2001 "On State Registration of Legal Entities and Individual Entrepreneurs": Unless otherwise provided by this Federal Law, a legal person, within three working days of the change of the legal form is required to notify the registering authority in the place of its respective location<sup>17</sup>.

From the date of submission of the documents, the state registration will be done within five working days. After the submission of the relevant documents, but before entry of the state registration opens inheritance. In this regard, from the previous entity, hereditary capacity goes to his successor as a whole.

Certain specifics of the order of entitlement to accept the inheritance by legal persons. In accordance with Art. 53 of the Civil Code, the legal entity shall acquire civil rights and assume civil obligations through their authorities, acting in accordance with the law, other legal acts and statutory documents. Procedure for the appointment or election of a legal entity shall be determined by law and the constituent documents. In the cases provided by law legal person may acquire civil rights and assume civil obligations through its participants. A person who, under the law or the constituent documents of the legal entity acting on its behalf, shall act in the interest of the legal entity in good faith and reasonably. It shall at the request of the founders (participants) of the legal entity, unless otherwise provided by law or by contract, to compensate losses

<sup>16</sup> See: Information Letter of the Presidium of the Russian Federation of 25 June 2009 number 131. / "Full Consultant."

<sup>17</sup> Part 5, Art. 5 of the Federal Law number 129 dated 08 August 2001 "On State Registration of Legal Entities and Individual Entrepreneurs" / "Full Consultant."

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caused them to a legal entity<sup>18</sup>. It can be concluded on the basis of the provisions of a number of articles of the Russian civil law, that legal person may have governing authorities - the supreme governing authority (the general meeting, the board of directors, etc.) and other structural units - executive authorities (the director, the board), counting and auditing committees.

In accordance with paragraph 6 of Article. 37 and Art. 40 of the Federal Law № 14-FZ, dated February 8, 1998 "On Limited Liability Companies": the status of the governing authorities of the legal entity is confirmed by an extract from the minutes of the general meeting of members of a limited liability company on the election of the sole executive authority of the company (CEO, president, etc.), or the order of appointment of the head of state or municipal unitary enterprise<sup>19</sup>. The main task of the executive authority of the legal entity is to organize the implementation of decisions of the governing authorities. Consequently, the decision to accept the estate (or refusal thereof) must be taken supreme governing authority of the legal entity (the resolution shall be in writing), and direct implementation of actions to take charge of the inheritance to the actuator, which are specialists in legal profile.

In the event of decline of the organization of the inheritance, the order of the powers of the procedure is similar to the powers of the adoption of property of the deceased.

In the context of discussions about the right to accept the inheritance by legal persons, it is appropriate to dwell on issues that relate to the preemptive rights of the heir to the hereditary succession, which seem to us a very interesting and controversial. According to the first paragraph of Art. 1178 of the Civil Code heir, who on the day of opening of the inheritance is registered as a sole trader or a commercial organization that is the successor of a will, the division of inheritance has a preferential right to receive in respect of their inheritance share is part of the legacy businesses in compliance with the rules of Article 1170 this Code<sup>20</sup>. In this case, the logic of the legislator is understandable, it aims to avoid splitting a single property of the complex, which is an enterprise. This takes into account the provisions of Art. 1170 of the Civil Code of the compensation received by the disparity of the property as inheritance share: inadequacy of the estate, on the preemptive right to the heir who declares

under section 1168 or 1169 of the Code, with the hereditary share of the heir to the heir of this transfer is eliminated the other heirs other assets from the inheritance or the provision of other compensation, including the payment of the corresponding amount of money. If an agreement between all the heirs otherwise stated, the implementation of any of these preemptive rights may, after giving appropriate compensation to other heirs<sup>21</sup>.

In our standard provides a distinctive feature of the preemptive rights of legal entities and individual entrepreneurs. It consists in the fact that the company is recognized as a subject of rights of property complex used for business purposes (Section 1, Art. 132 of the Civil Code)<sup>22</sup>.

In the scientific literature, with special inheritance of the property (the company), which has the property of indivisibility, in preference to that of the heirs, which has the greatest skills in the use of such property<sup>23</sup>.

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<sup>18</sup> Art. 53 of the Civil Code of the Russian Federation of November 30, 1994 N 51-FZ - Part 1 / "Full Consultant."

<sup>19</sup> paragraph 6 of Article. 37 and Art. 40 of the Federal Law number 14 dated 8 February 1998 "On Limited Liability Company" / "Full Consultant."

<sup>20</sup> Art. 1178 of the Civil Code of the Russian Federation of November 26, 2001 N 146-FZ-Part 2 / "Full Consultant."

<sup>21</sup> Art. 1170 of the Civil Code of the Russian Federation of November 26, 2001 N 146-FZ-Part 2 / "Full Consultant."

<sup>22</sup> 1 Article. 132 of the Civil Code of the Russian Federation of November 30, 1994 N 51-FZ - Part 1 / "Full Consultant."

<sup>23</sup> Blinkov OE, Nicholsky S. Preemptive rights in the succession law in Russia and abroad: Monograph. Moscow, 2006. S. 99

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