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PROTECTION OF PARTICIPANTS' AND CREDITORS' RIGHTS IN THE REORGANIZING COMPANIES

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Abstract:
This contribution shows us quite an emphasis recently on protection of participants' and creditors' rights during the reorganization. The aspiration to the most optimal economic and legal business management structure make modern companies to resort to the reorganization proceedings. So, reorganization is one of the methods of creating widespread holding structure in the modern economy that allows to protect safely against hostile take-overs and has other advantages. However the author demonstrates in practice how the reorganization institute is not always used in good faith and frequently makes a significant material damage both to company's creditors and its minority participants. This article describes effective ways of creating the regulation and control mechanism that helps to reduce risk of reorganization with infringement of rights and interests of creditors and participants.

Key words:
Reorganization proceedings, Special legal regulation, Legal personality of company, Property complex, Succession, Predecessor, Successor, Rights of participant, Minority shareholder, Conversion, Rights of creditor.

Cases are widely known, when company division was conducted with that unique purpose to concentrate all debts of the reorganizing companie in one of the new companies who then became the bankrupt therefore requests of creditors were repaid. Other company which has created by the division, got clear of debts and started to prosper. Such example visually shows requirement for special legal regulation for the purpose fastenings of warranties of the creditors' and participants' rights in the companies under reorganization.

1. LEGAL CONCEPT OF REORGANIZATION

From the legal point of view, company reorganization represents a procedure which makes changes to a legal personality of the company. The main events by which the legal destiny of a legal personality of the company is noted, are its occurrence (i.e. company creation), transformation (change of the organisation-legal form) and the termination. Therefore reorganization is directed on creation, termination and transformation of the companies. Forms which reorganization can pass are rather diverse: merge, division, joining, allocation, transformation. However a consolidating sign of all forms of reorganization is the availability of assignment which results in passing all the rights and responsibilities of the reorganizing company to the other company. The availability of assignment distinguishes a company reorganization from methods of its creation and termination, such as primary establishing (creation) and liquidation (including bankruptcy).

For descriptive reasons we will give an example and compare consequences which appear after liquidation and reorganisation (for example attract, division). Liquidation should be considered as absolute winding-up: the legal subject terminates the existence, its debts are liquidated (they either come back, or are reset in bankruptcy procedure), and the remained

property is distributed between participants of the company according to liquidating balance[1]. There is another situation during the reorganization: the company ceases to exist as a legal subject, but its property complex is saving and continues to function as the economic subject of market relations. The company's rights and responsibilities do not cease, but pass in assignment order to other legal persons.

The availability of assignment causes sharing in procedure of reorganization not less than two subjects: predecessor and assignee. Assignment relations between them are regulated by the special act: transfer act (at merge, joining and transformation) or dividing balance (at division and allocation). Those acts allow to establish assignees of the reorganizing company under each obligation where it is a participant. Positions of these certificates are obligatory for creditors (debtors) of the predecessor which become creditors (debtors) of the assignee after termination of the reorganization. So, as the result of assignment is party change in the obligation which occurs in the form of transition of the rights or conversion of debt. However if transition of the rights does not require the consent of the other party of legal relation (i.e. debtor) the conversion of debt, under the general rule, is supposed to be only with the consent of the creditor[2]. The person of the debtor is not indifferent for the creditor: at conclusion of the transaction it considers at least a property status and business reputation of the debtor. During the period of changing the debtor, the creditor risks to deal with the insolvent person. Despite the general rule, the norm of Article 391 of Civil Code of the Russian Federation does not extend on reorganisation procedure that means there is an universal character of assignment during the reorganization. To restore fair balance of interests, the legislator establishes a number of the legal guarantees which capable to ensure a safeguarding interests of creditors and participants of the company within the limits of procedure of the company-debtor reorganization.

2. PROTECTION OF THE PARTICIPANTS' RIGHTS OF THE COMPANY

Participants of the company (shareholders, participants of a restricted liability society) are in debt relationships with it. So, according to the Article 67 of Civil Code of the Russian Federations, in particular, the participants have the rights on a part of profit and the rights on a part of property of the company in case of its liquidation. This rights have property character, and prospects of their realization directly depend on a company economic situation.

Therefore shareholders (participants) are allocated also with the right to share in management of the company, in essence – the right of non-property character which allows them to supervise acceptance and realisation of the decisions advancing destiny of the company. The decision about reorganization concerns their too.

Procedure of reorganization of the companies is regulated by the Article 57 Civil Code of the Russian Federations, and mainly – special laws: Federal Law On joint-stock companies (Articles 15-20) and Federal Law On limited societies (Articles 51-56). The basic warranty of the participants's rights of the company consists that decision-making on realisation of reorganization is within the exclusive competence of general meeting of participants of the

[1] Civil Code of the Russian Federation, Article 63

[2] Civil Code of the Russian Federation, Article 391

company[3]. In case when some companies participate in reorganization (at merge and joining, etc.), general meetings of participants of each of the companies should give the consent to reorganization.

In limited societies the decision on reorganization is accepted by unanimously all participants of the company[4] and removes a protection problem of its participants interests in procedure of reorganization. In joint-stock companies such unanimity is almost impossible, in this connection great value rules about an order of realisation of general meeting of shareholders and acceptances on it acquire decisions about reorganization (procedural warranties).

According to the Article 49 of Federal Law On joint-stock companies, the decision on reorganization is accepted by general meeting:

- First, only under the offer of directors' board (if there is nothing else in the company's charter);

- Secondly, the competent majority in three quarters of voices of shareholders – holders of the voting shares participating in general meeting of shareholders.

This approach, at which the counting of votes is carried out concerning present on a shareholder's meeting, opens ample opportunities for abusings: for realisation of meeting and decision-making about reorganization there is sufficient a sharing of half of all shareholders – holders of voting shares (quorum in 50 % + 1 voice)[5]. During the realisation of repeated meeting the quorum and at all constitutes 30 % of voices[6]. To protect interests of minor-shareholders, the law establishes requests to an informing order of shareholders about realisation of general meeting[7]. The message about the realisation of the meeting, which contains a questions about company reorganization, should be made not less than 30 days prior to its realisation. In the same period, i.e. 30 days prior to realisation of the meeting, access (on the location of an executive office of the company) to all materials and documents which become a consideration and assertion subject the future meeting should be ensured to the shareholders.

During the reorganization on the shareholders meeting there are variety of questions which depends on a concrete kind of reorganization. So, besides the question about the reorganization the shareholders are suggested to approve the whole package of documents: dividing balance or the transfer act, the agreement for joining or for merge, the charter of company created as a result of merge.

One of the main and the most painful questions is about order of converting company-predecessor's shares to the company-assignee's shares. Conditions of converting at merge and

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[3] Federal Law On joint-stock companies, Article 48; Federal Law On limited societies, Article 32

[4] Federal Law On limited societies, Article 37

[5] Federal Law On joint-stock companies, Article 58

[6] Federal Law On joint-stock companies, Article 58, paragraph 3

[7] Federal Law On joint-stock companies, Article 52

joining (including the exchange rate) are fixed in the corresponding contract which should be approved by shareholders. Conditions of converting in other cases are advanced in the decision of general meeting about the order and conditions of reorganization. Special rules fix that during the reorganization in the form of division and allocation each shareholder, who was voting against reorganization or not participating in voting, should receive shares of both companies which have resulted division (both companies which have remained after allocation), and it is proportional to number of shares of the reorganized company. Visible defect of the current legislation in regulation of these relations is shareholders sometimes inconveniently independently to evaluate economic validity of the shares converting rate, offered to them. Realisation in such cases of an appraisal by a company account is no always means provided by its charter. Therefore it is expedient, that realisation of such examination became compulsory condition, without which observance the resolution of the general meeting about reorganization would be nullified. States of European union have a positive experience of similar regulation[8].

According to part 7 Article 49 of Federal Law On joint-stock companies, the shareholder have the right to require judicially a recognition of the decision of general meeting of shareholders void at availability in aggregate following conditions: 1) the decision is accepted with infringement of Federal Law On joint-stock companies or the company charter (the delayed notice or unnotice shareholders about forthcoming meeting; the possibility unaccordance to familiarise with the necessary information, decision-making by smaller quantity of voices, than it is required the law, infringements at a counting of votes); 2) the claimant (shareholder) did not participate in the given meeting or voted against the made decision; 3) the indicated decision infringes his rights and legitimate interests. The resolution of the general shareholders meeting can be appealed within six months since the moment when the shareholder has learnt or should learn about the accepted decision. However use of the given remedy not always leads to desirable result: the court with allowance for all circumstances has the right to keep this decision in force if sharing of the shareholder in voting could not affect on its outcome, the admitted infringements are insignificant and shareholder has not suffered any losses. The evidential burden of proof of the indicated circumstances lies on the respondent – joint-stock company.

At last, the important warranty of the participants' rights of the reorganizing company, voted against decisions of reorganization or did not participate in voting about reorganization, is their right to require the repayment of their shares, by the company, at the market price which should be advanced the independent appraiser disregarding its change in result of decision-making about reorganization[9]. This right, however, in concrete circumstances can have the limited character. According to the Article 76, the sum of the means directed by company on the repayment of own shares, cannot exceed 10 % from cost of a net wealth of company at the decision-making date, which have formed the basis for requests about redemption of shares. Otherwise, shares will be redeemed at shareholders not in full, but only proportionally declared requests.

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[8] Council Directive 78/855/EEU about merge of joint-stock companies, Article 10; Council Directive 82/891/EEU about division of joint-stock companies, Article 8

[9] Federal Law On joint-stock companies, Article 75

3. PROTECTION OF THE CREDITORS' RIGHTS

Along with the protection of the participants' rights in the reorganizing company there is also protection of the rights and interests of its creditors as one of the main directions of legal regulation of the companies' reorganization . It is impossible to use the Article 391 of Civil Code of the Russian Federation (conversion of debt only with the consent of the creditor) application, to change of the person on the party of the debtor, forces the legislator to search more flexible methods of creditors' rights and interests protection. It is possible to state conditionally all warranties of the creditors' rights through their division into some groups of legal regulations.

Firstly, the Article 60 of Civil Code of the Russian Federation establishes that reorganizing company is obliged to notify the creditors about the accepted decision in writing. Special laws about the companies[10] establish a specific period for the advice: 30 days since the day when the decision about reorganization was accepted. Besides that, the message about the accepted decision should be published in the printing edition named «Bulletin of the state registration» (the Order of the Ministry of Taxes and Tax Collection of the Russian Federation from September, 29th, 2004 № САЭ-3-09/508). According to paragraph 6 of Article 15 Federal Law On joint-stock companies and paragraph 5 of Article 51 Federal Law On limited societies, the state registration of the companies, which have resulted reorganisation, and also entering record into the register about discontinuantion of activities of the reorganised companies are carried out in the presence of notification to the creditors' proofs.

Obvious defect of the current legislation's norms about the notification to the creditors is absence of the fixed list of data which the company is obliged to grant the creditors. The matter is that for acceptance of the decision concerning possibility of continuation of economic relations with reorganising company, it is important to creditor to know not only the fact of decision-making on reorganisation. For it data on can have essential significance what companies participate in reorganisation (for example, in merge), what their economic situation, what conditions and a reorganisation order. Hence, it is expedient to ensure access of creditors to the documentation concerning reorganisation (the agreement for merge or joining, the transfer certificate and dividing balance, the decision of a shareholder's meeting on an order and reorganisation conditions), and it is possible – to the accounting documentation.

Secondly, creditors of the reorganizing company have the right to require in writing prior execution or the termination of corresponding obligations of company and repairing a loss[11] during 30 days from the date of a direction the advice to them about accepted decision (or from the date of the corresponding information publication). This norm is deviation from the general principle according to which unilateral failure of discharge of an obligation or unilateral change of conditions of the obligation are not supposed[12].

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[10] Federal Law On joint-stock companies, Article 15; Federal Law On limited societies, Article 51

[11] Civil Code of the Russian Federation, Article 60; Federal Law On joint-stock companies, Article 15; Federal Law On limited societies, Article 51

[12] Civil Code of the Russian Federation, Article 310

Thirdly, independent norms are devoted a situation when there are difficulties with definition of the valid assignee of the reorganised company. As already it was marked above, assignment relations are regulated by special certificates: the transfer certificate (if there is one assignee) or dividing balance (if there is several assignees). Under the general rule, the transfer certificate and dividing balance should contain positions about assignment under all obligations of thereorganising company, concerning all its creditors and debtors, including obligations which are challenged by the parties[13].

Incompleteness (uncertainty) of the transfer certificate or dividing balance is the infringement caused by negligence of the reorganizing company management, that is why it should not affect the rights in any way and interests of the creditor. Naturally, difficulties arise, in a situation of plurality of assignees: frequently happens it is impossible to advance, who from assignees bears responsibility under the concrete obligation of the reorganised company. In that case all assignees are jointly and severally liable before creditors of the predecessor[14].

Fourthly. In practice often there are situations when it is clearly visible in the dividing balance who the assignee is, but partition of property of the reorganized company is spent unfairly: to one all assets, and to another – debts which economically weak company cannot reset are transferred almost. The current legislation directly does not provide methods of a legal protection from similar abusings. In the legal doctrine discussion about possibility of a recognition of dividing balance void under the claim of the creditor was led. Now this problem has found the decision by duly and quite well-founded interference of Plenum of the Supreme Arbitration Court of the Russian Federation[15]. In the paragraph 22 of the indicated Order it is explained that assignees of the reorganized company should (as in case of uncertainty of dividing balance) to bear a joint liability before creditors of the reorganised company if from dividing balance it is visible that at its assertion the principle of fair distribution of assets and obligations between assignees has been infringed. In an explanation sending to part 1 Article 6 of Civil Code of the Russian Federation (civic right application by analogy) and part 3 Article 60 of Civil Code of the Russian Federation has made, i.e. the legal analogy is applied. In addition to it, it is possible to refer to Article 10 of Civil Code of the Russian Federation which forbids misuse of right and requires from participants of civil matters - reasonable and diligent actions.

Fifthly, the current legislation does not exclude possibility of claim submission about a recognition of a void company reorganization in that case when infringement of an order of its realisation fixed in norms of Civil Code of the Russian Federation both special acts had admitted. The rights and interests of creditors are restrained by such gross violations of the legislation norms, as the non-notification about the accepted reorganisation decision or the advice with infringement of the provided terms more often. As an occasion to reorganization actions for nullity the joint Order of Plenum of the Supreme court of judicature of the Russian Federation and Plenum of the Supreme Arbitration Court of the Russian Federation on some questions connected with enactment of a first part of the Russian Federation Civil Code from

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[13] Civil Code of the Russian Federation, Article 59

[14] Civil Code of the Russian Federation, Article 59

[15] Order on some questions of application of the Federal Law On joint-stock companies from November, 18th, 2003 № 19

February, 28th, 1995 № 2/1 has served. Paragraph 6 of the indicated Order, indicated that reorganization of the company can be carried out only according to Articles 57-65 of Civil Code of the Russian Federation, otherwise the decision on reorganization, and also the certificate on registration of the company created as a result of reorganization of other company, admit void.

The subsequent judiciary practice has introduced corrective amendments in the given explanation. So, in most cases courts refuse satisfaction of creditors' claims about a recognition void decisions of the reorganization, accepted by a shareholder's meeting: the right of appeal of these decisions admits only for shareholders (for example, Order FAC of the Moscow district from December, 2nd, 2001 № КГ-А40/7275-03). Therefore creditors need to require only a recognition void certificates of registering body which register liquidation of the company-predecessor and-or register company-assignee creation. The given request has the basis of Article 13 of Civil Code of the Russian Federation: illegal a state structure, not corresponding to the law both infringing the civil rights and interests of the legal person protected by the law, can be nullified by court. Judiciary practice under the given claims is ambiguous also at times has inconsistent character.

So, frequently courts indicate that for satisfaction of the claim about a recognition of reorganization void it is necessary for claimant to prove that his rights to reception of discharge of an obligation are infringed because of reorganization (for example that the insolvent person became its creditor). For this purpose, in particular, it is necessary to bring up a question on justice of dividing balance (if it is a question about division or allocation). Thus, in this part crossing of the given protection frame with what has been considered above (paragraph 4) is obvious. Thus the claim about the discharge of an obligation, presented to joint debtors (at injustice of dividing balance), looks more preferable, rather than the separate production directed on a recognition of results of reorganization by the void.

4. CONCLUSION

In conclusion it is necessary to notice that active regulation of the way of the companies' reorganization has sometimes too liberal character. In many foreign states the control over reorganization process is stricter. Actual approach is represented as justified by following reasons. Accumulation of the preventive, legislative, control and organizational measures directed on the prevention of infringements and abusings during reorganization, allows to avoid the numerous litigations initiated by restrained participants and creditors of the company for the purpose of a recognition void results of reorganization.

It is quite obvious that the recognition of the conducted reorganization void should be only an extreme measure in case of ineradicable of the admitted infringements. It means that the similar measure negatively affects stability of a trade turnover, attracts infringement of rights and interests of the company's creditors which have resulted reorganization. For this reason claims about recognition of reorganization void can't execute function of an effective remedy of protection of the creditors' and participants' rights in the company. Creation of such regulation mechanism and the control at which the risk of realisation of reorganization with infringement of creditors' and participants' rights and interests considerably decreases is in the present state of affairs more rational. Experience of foreign countries offers variety of useful measures, some of which were considered above: for example, introduction of obligatory expert appraisal of economic validity of the offered rate of converting of shares, and also justice of dividing balance; Maintenance to creditors of access to the information on

a financial position reorganising the companies; investment of creditors with the right to require pledging of collateral of discharge of the obligation by the debtor; the notarial certification of legitimacy of a shareholder's meeting and its protocols; accurate regulation of control functions of registering bodies. Some of the indicated measures quite can appear useful in the Russian reality.

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