

### **CORPORATE LAW UPDATE**

New amendments to the Civil Code of the Republic of Azerbaijan are introduced by Law No 635-VQD, dated 25 April 2017, effective 21 May 2017. The amendments principally govern corporate matters of commercial legal entities.

In accordance with amended Sub-Sections 67.6 and 68.3, neither a subsidiary nor a dependent company may acquire shares of the main (parent) company (typically, a company is a subsidiary of another if it is >50 per cent belongs to the latter and dependent if such percentage is >20). The changes can be regarded aiming to eliminate practical issues with determining subsidiary and dependent statuses where ownership is “circular”. The changes may also restrict an ability of shareholders to “inflate” the equity capital (the contributions of which are otherwise tax-free) of a group parent company.

Another important, from practical point of view, amendment is with respect to the agenda of meetings of shareholders of limited liabilities companies (LLCs) and joint stock companies (JSCs). A meeting agenda can now be revised during the meeting by a majority of votes of shareholders specified in an LLC’s/JSC’s charter. The amendment enables shareholders to decide on pressing issues without awaiting the next meeting.

Under the amendment to Sub-Section 91.3.5, shareholders have an exclusive right to not only appoint but also terminate the board of directors (supervisory council) and audit committee (auditor); this amendment is more a clarification than a substantive amendment.

The newly introduced Sub-Section 91-4 prescribes establishment of the audit committee at LLCs with the total number of shareholders exceeding 50 persons or if the LLC has social importance. “Socially important entities” are defined with reference to Sub-Section 2.1.9 of the Law on Accounting, *i.e.*, credit institutions, insurers, investment funds and their managers, non-public (private) social funds, persons licenced at the securities market, entities with securities listed at stock exchanges, and commercial entities with any two of these criteria, annual revenue, average number of employees during a reporting year, and the balance sheet total amount, exceeding thresholds established by the Cabinet of Ministers.

Under Sub-Section 88.1 of the Civil Code, the maximum number of shareholders of an LLC cannot exceed the limit “established by law”, which, so far, has not been done. Resolution No 224, dated 23 December 2000, of the Cabinet of Ministers provides for the maximum number of shareholders in closed JSCs at 50 and the 16 December 2011 decision of the Constitutional Court of the Republic of Azerbaijan suggests that the number of shareholders in LLCs cannot exceed the number of shareholders at closed JSCs. It remains to be seen if the provision in the newly introduced Sub-Section 91-4 for LLCs with the total number of shareholders exceeding 50 would practically be interpreted as allowing such number to exceed 50.

91-4.6 within the newly introduced Sub-Section 91-4 indicates that the audit committee of an LLC is subordinate to the LLC’s board of directors (supervisory council). Apparently, in relation to the LLCs, where no board is established, this provision would be inoperative.

The newly introduced Sub-Section 107.12 prescribes that JSCs of social importance or with the total number of shareholders exceeding 50 shall establish the audit committee. As in LLCs, a JSC audit committee internally audits the JSC and is subordinate to the board of directors.

Following the introduction of 107.12, JSCs with the number of shareholders exceeding 50 must have an inspection commission (inspector) appointed (pursuant to Sub-Section 107-11 of the Civil Code) by the

general meeting and the audit committee formed by the board of directors (as stated above, the committee is also a must for “socially important” JSCs). The difference between the commission and committee is that the former is formed to control financial and economic activity of the JSC while the latter develops and implements policy and strategy of internal audit and forms an auditor’s control.

The newly introduced Sub-Sections 91-1.4 through 91-1.6 provide for rules of establishment of an LLC board of directors, convening the board meetings, voting at the board, including resolution of tie-votes, and requirements for documenting board meetings (which are useful and sensible additions to the rules applicable in the absence of legislatively-prescribed provisions).

The amendments also touch upon the obligation of a JSC to publish its annual report and accounting balance sheet together with the following information: (i) financial reports; (ii) list of transactions with related parties; (iii) funds attracted; (iv) information of managing bodies and officers, primary and secondary places of their employment; (v) management structure; (vi) development policy; (vii) rate of return of equity capital and dividend policy; (viii) payments to members of managing bodies; (ix) investment volume and sources; (x) turnover and rate of return of JSC’s securities; and (xi) public projects.

The introduced Sub-Sections 106-1.3.8-1 through 106-1.3.8-4 provide the following rights to the holders of ordinary shares of a JSC: (i) to call for accountability of members of executive bodies and board of directors (supervisory council) for negligence and damages wilfully inflicted upon the JSC; (ii) participate in the process of sale of shares of the JSC; (iii) appeal to court and other competent bodies for compensation of damage and related costs of the JSC out of a concluded transaction; and (iv) review schedules to transactions (with related parties and especially important transactions) to be made.

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