**ON BEHALF OF THE REPUBLIC OF AZERBAIJAN**

**DECISION**

##### OF THE PLENUM OF THE CONSTITUTIONAL COURT

##### OF THE REPUBLIC OF AZERBAIJAN

*On interpretation of the Articles 107.2.1 and 107.5.1 of the Civil Code of the Republic of Azerbaijan*

# 16 December 2011 Baku city

The Plenum of the Constitutional Court of the Republic of Azerbaijan composed of Farhad Abdullayev (Chairman), Sona Salmanova, Fikret Babayev, Sudaba Hasanova, Rovshan Ismaylov (Reporter Judge), Jeyhun Garajayev, Rafael Gvaladze, Isa Najafov and Kamran Shafiyev;

attended by the Court Clerk Ismail Ismaylov,

the legal representative of the subject interested in special constitutional proceedings: Inshallah Guliyev, Judge of the Court of Appeal of Sheki city, Vasif Amiraslanov, senior advisor of Department of Economic Legislation of Administration of the Milli Majlis of the Republic of Azerbaijan;

specialists: Bagir Asadov, Judge of the Supreme Court of the Republic of Azerbaijan, Kamran Babayev, Head of Legal Department of the State Securities Committee of the Republic of Azerbaijan, Ekram Hasanov, Deputy Chairman of Board of the Open Joint Stock Company Bank VTB (Azerbaijan);

the expert: Sarvar Suleymanli, Deputy Dean of the Faculty of Law of Baku State University, Associate Professor of Civil Law Department, Doctor of Philosophy in Law;

based on the Article 130.6 of the Constitution of the Republic of Azerbaijan has examined in open court session via procedure of special constitutional proceedings the constitutional case oninterpretation of Articles 107.2.1 and 107.5.1 of the Civil Code of the Republic ofAzerbaijan based on inquiry of Court of Appeal of Sheki city;

having heard the report of Judge Rovshan Ismaylov, the reports of the legal representatives of the subjects interested in special constitutional proceedings and conclusions of expert and specialists, the Plenum of Constitutional Court of the Republic of Azerbaijan

**DETERMINED AS FOLLOWS:**

 The Court of Appeal of Sheki city having applied to the Constitutional Court of the Republic of Azerbaijan (hereinafter referred to as the Constitutional Court) asks to give interpretation of Articles 107.2.1 and 107.5.1 of the Civil Code of the Republic of Azerbaijan (hereinafter referred to as the Civil Code) from the point of view of Articles 13 and 29 of the Constitution of the Republic of Azerbaijan (hereinafter referred to as the Constitution) and Article 1 of Protocol N1 of the European Convention “On Protection of Human Rights and Fundamental Freedoms” (hereinafter referred to as Convention).

In the inquiry it is specified that at consideration of the civil cases by Court of Appeal of Sheki city on the claim of Nizami Aslanbekov and others concerning invalidation of the actions which are carried out in connection with change of an organizational and legal form of Mingechaur Temir-Tikinti Open joint stock company (hereinafter referred to as the JSC Mingechaur Temir-Tikinti), and also, concerning the requirement of the claimant Sakhavat Namazov about invalidation of the protocol No. 3 of extraordinary general meeting of this joint-stock company held of October 22, 2009arise a need for interpretation of a number of articles of the Civil Code.

At the extraordinary general meeting of JSC Mingechaur Temir-Tikinti held on October 22, 2009 on which 25 shareholders of society from 188 participated (79,47% owning the right of vote) decision on transformation of JSC Mingechaur Temir-Tikinti into limited liability company by reorganization was made on acceptance of shareholders of joint-stock company in limited liability company as shareholders according to the shares, and on withdrawal from a turnover of shares of JSC Mingechaur Temir-Tikinti.

According to the applicant, articles 107-2.1 and 107-5.1 of the Civil Code contradict the constitutional norms regulating the property right. Thus, it isn't allowed to decide destiny of the actions belonging to shareholders without expression of will of each shareholder in connection with transformation of open joint stock company to limited liability company.

According to the applicant, Articles 107-2.1 and 107-5.1 of the Civil Code contradict to the constitutional norms regulating the property right. Thus, it is not allowed to decide destiny of shares belonging to shareholders without expression of will of each shareholder in connection with reorganization of open joint stock company to limited liability company.

In the inquiry it is also noted that in connection with these questions, lack of the mechanism of protection of the property rights of the shareholders who did not participate in voting at joint-stock company and were opponents of the made decision does not exclude abuse of the rights in the course of enforcement, and also existence of disagreements in opinions between shareholders in practice, including emergence of unreasonable and illegal restrictions connected with the rights and freedoms. Unambiguous application of noted norms of the Civil Code by courts is possible only after their interpretation by means of the constitutional justice.

In connection with the inquiry the Plenum of the Constitutional Court considers necessary to note the following.

On the basis of the Article 130.6 of the Constitution the courts may apply to the Constitutional Court of the Republic of Azerbaijan on interpretation of the Constitution and the laws of the Republic of Azerbaijan as regards the matters concerning the implementation of human rights and freedoms.

The question which is brought up in the inquiry of Court of Appeal of Sheki city is directly connected with implementation of the property right fixed in the Article 29 of the Constitution. According to this article everyone has the right to own property. Neither kind of property has priority. Ownership right including right for private owners is protected by law. Everyone might possess movable and real property. Right of ownership envisages the right of owner to possess, use and dispose of the property himself/herself or jointly with others. Nobody can be deprived of his/her property without decision of law court. Total confiscation of the property is not permitted. Alienation of the property for state or public needs is permitted only after preliminary fair reimbursement of its cost.

The content of this right should be understood, in view of provisions of Article 13 of the Constitution. The property as important institute of civil society is one of the main factors making a basis of development of economy. Therefore, the property, is declared inviolable under Article 13 of the Constitution and is protected by the state. The property right, acting as the basis of freedom of each individual of society, is an important condition for development of personality and free business.

The state has to abstain from illegal intervention in effective implementation of the property right and prevent such actions. Systemically analyzing Article 29.1 and Article 71.1 of the Constitution it is possible to come to a conclusion that for providing the property right to the state both negative and positive obligations are assigned. Positive obligations cover implementation of some measures, including definition of the legal regime providing effective realization of the property right. On the basis of the Article 94.1.13 of the Constitution these obligations are assigned on Milli Mejlis of the Republic of Azerbaijan (hereinafter referred to as the Milli Mejlis).

Along with it, despite the importance of noted right, it is not obligatory and can be limited. It is necessary to take into consideration that besides that the property bears important function in implementation of special interests of the individual, it has also important social function in socially directed state on the basis of contents of Article 15 of the Constitution. On the other hand, in the Constitution and in the Constitutional Law of the Republic of Azerbaijan “On regulation of implementation of the rights and freedoms of the individual in the Republic of Azerbaijan” the limits of the general and special restrictions of the property right are set. Milli Mejlis, at realization of the powers by definition of the contents of the property right, has to consider these limits and proportionality of functions of property.

The property right found the reflection also in Article 1 of the Protocol No. 1 of the Convention.

On a legal position of the European Court of Human Rights (hereinafter referred to as the European Court) the concept of “possessions” in the first part of Article 1 of Protocol No. 1 has an autonomous meaning which is not limited to ownership of physical goods and is independent from the formal classification in domestic law: the issue that needs to be examined is whether the circumstances of the case, considered as a whole, may be regarded as having conferred on the applicant title to a substantive interest protected by that provision. Accordingly, as well as physical goods, certain rights and interests constituting assets may also be regarded as “property rights”, and thus as “possessions” for the purposes of this provision. The concept of “possessions” is not limited to “existing possessions” but may also cover assets, including claims, in respect of which the applicant can argue that he has at least a reasonable and “legitimate expectation” of obtaining effective enjoyment of a property right (the decision of Grand Chamber of the European Court of November 30, 2004 on case of Öneryildiz v. Turkey, §124).

By the opinion of the European Court a company share is a complex thing. It certifies that the holder possesses a share in the company together with the corresponding rights. This is not only an indirect claim on company assets but also other rights, especially voting rights and the right to influence the company (decision of the European Court on case of Shesti Mai Engineering OOD and others v. Bulgaria of September 20, 2011, §77and decision on case of Sovtransavto holding v. Ukraine of July 25, 2002, §92).

According to Article 1077.1 of the Civil Code a share is a security, certifying a membership in a joint stock society as well as certifying the right of an owner (shareholder) to receive a part of income of a joint stock society in form of dividend, the right to participate in the management of activities of a joint stock society and the right to one part of the property of a joint stock society left after its liquidation.

As it became clear, the shareholder, being the member of society, has certain rights in case management. These rights are concretized in Article 106-1 of the Civil Code.

Along with it, it is necessary to take into consideration that the rights of shareholders connected with management of joint-stock company are carried out on the basis of the principle of the majority.

Joint-stock company, in essence, being the cofounder commercial organization and formed directly on investments, surely has to be governed by such principle as well.

The principle of the majority found the reflection in the civil legislation in the form “one voting share is one vote” (Article 107-3.5 of the Civil Code). On the basis of this principle, the majority – is defined not by the number of shareholders, but volume of the participating share in authorized capital. In other words, in joint-stock company, the rights are determined not by the person but by the made investments.

Otherwise, recognition for each new shareholder of the right of veto, irrespective of number of the shares which are in its property actually means application of the principle of unanimity in management of joint-stock company. It, in turn, can paralyze management of such legal entity. It does not answer the purpose and duties as support of business activity and creation of conditions for development of free market economy, provided in Article 15.2 of the Constitution and in Article 1 of the Civil Code, defining creation of conditions for development of economy on the basis of the market relations.

On the other hand, if, for the purpose of protection of the rights of minority, the principle of unanimity in management of joint-stock companies is recognized and for each shareholder will be granted the right of veto in view of the fact that the shareholders representing the majority won't be able to predetermine legal destiny of the shares, it can become a cause of infringement of their rights in even bigger volume. Thus, at collision of those who represents smaller part of the capital in joint-stock company and does not want change of a legal and organizational form of joint-stock company of a form and those who represents the most part of the capital in joint-stock company and the preference of will of those who represents the majority of the capital wants change of a legal and organizational form of joint-stock company, it is considered more fair and expedient from the point of view of the equilibrium principle.

Main objective of each commercial organization is profit earning. For achievement of this purpose, they make different decisions, including the decisions connected with reorganization of the organization. In such cases, authorized bodies of the state have no right to check expediency of such decisions from the economic point of view. Nevertheless, the state as the guarantor of property rights of all participants of joint-stock company, establishing the corresponding procedural rules, performs a duty to control their observance and by means of effective protective mechanisms has to protect persons which rights was violated.

According to it the Milli Mejlis at implementation of the discretionary (exclusive) powers on the basis of part I of point 13 of Article 94 of the Constitution, for the purpose of protection of the rights of all shareholders, in view of conditions of authority of general meeting of joint-stock company, sets various limits of the majority demanded for decision-making depending on the importance of the made decision in joint-stock company. Thus, according to Article 107-2.1 of the Civil Code general meeting is valid if holders of 60 % voting shares participate in shareholders’ general meeting. At the same time according to contents of Article 107-5.1 of the specified Code the decision of general shareholder meeting is made by a simple majority vote, participating at general shareholder meeting, taking into account the situation “one voting share is one vote”. Decisions concerning reestablishment, liquidation of company, amendments and addendums to the charter are accepted by 2/3-majority vote of shareholders having voting right in the general meeting.

Definition of such limits completely corresponds to practice of corporate management of foreign countries. Also in the countries entering into continental legal system (Romano-German) (German Law of Share Partnership, Article 179; Civil Code of Switzerland, Article 647, 703; Civil Code of Italy, Article 2368), and in Anglo-Saxon legal systems (Law on the Companies of England, Article 378; Law on Corporations of the State of Delaware the USA, Article 216) authority on making decision on legal destiny of joint-stock company is conferred to the shareholders owning the prevailing share in authorized capital.

Nonparticipation of shareholders in decision-making in connection with change of the charter of society or with reorganization of society or vote by shareholders against these decisions, in itself does not violate their property right.

The legal regime governing the corporate relations is not applied to shareholders irrespective of their will and because these relations are based on multilateral agreements, participation in them is optional. Each shareholder foreknows or has to know that one of features of a legal regime of joint-stock company is possibility of change of the charter of society or reorganization of society can be carried out from the shareholders owning the prevailing share in authorized capital. According to it when the person joins joint-stock company, it is considered the accepted introduction of such changes in the order provided by the law. At the same time it is necessary to take into account that one share grants to the owner the right to participate in management of society, but not to define destiny of joint-stock company.

Besides, the shareholder possesses a share of the co-owner and in the reorganized limited liability company is proportional to the balance cost of the share which is available in authorized capital of former joint-stock company. On the other hand the share and the right of a share in limited liability company has the same contents: both, being the undivided right in authorized capital of economic society, grant to the owner the identical rights (profit earning, the right of participation in management) in society. Only the making decision on assignment of a share of minority or reduction of its cost, and other cases of this kind can promote violation of the property rights of the corresponding shareholders.

Thus, when at general meeting of joint-stock company the decision on reorganization of this society to Limited Liability Company is made according to requirements of Articles 106-1.3, 107-2.1 and 107-5.1 of the Civil Code, the property rights of the shareholders who are not participating at this meeting or voting against the decision on reorganization are not broken.

However, in the civil legislation there are no rules of exact regulation of division of shares of shareholders who not interested to participate in the reorganized society.

In this regard the Plenum of the Constitutional Court notes the following:

Reorganization of joint-stock company, being multi-stage process, includes liquidation of former legal entity and creation of the new legal entity on its property base. Because this process is very difficult and can influence the rights of different subjects, it has to be precisely settled in the legislation.

Before transformation of joint - stock company to Limited Liability Company, the decision on reorganization is made at general shareholder meeting, on the basis of contents of Article 107-5.1 of the Civil Code. The actions which are carried out at the subsequent stages and the made decisions, are related to the reorganized society. Thus, according to contents of Article 87.2 of the Civil Code Company can be established via foundation of new entity in accordance with the Code hereof and re-organization (merger, joining, division and transfer). According to Article 87.3 of the Civil Code establishment of the Company covers implementation of the foundation meeting and making of agreement (in cases stipulated under Article 45.2 of the Code) or decision on establishment of the company (if company is founded by one person, payment of the charter capital and preparation of the charter. At the same time according to Article 87.6 of the Civil Code in the foundation meeting of the Company, decisions on foundation of the company, approval of the Charter, approval of value of the non-monetary assets paid into the Charter Capital when establishing the company, organization of management authorities accepted by the founders unanimously and decisions on other issues- with the majority of votes.

 As evident, irrespective of a form of the organization, all participants have to approve the charter of the founded limited liability company. However, as well as it was specified in the inquiry, shareholders of former joint-stock company have the right not to participate in the reorganized limited liability company as the participant (founder) and nobody can force them to it. Where there is such compulsion the right of free enterprise affirmed in Article 59 of the Constitution and the principle of freedom of contracts following from this right is violated. Thus, the content of the right of free enterprise consists from that everyone has the right to make the free and independent decision on use of the opportunities, ability and property individually and together with others within the organizational and legal forms provided by the legislation.

 At the same time, there is no the clear reflection in the legislation to what legal consequences will lead the not adoption of the charter of limited liability company by those who does not want to become the participant (founder) of new society with limited responsibility, founded by reorganization.

In this regard, Plenum of the Constitutional Court considers that the liquidating share has to be given out to those shareholders who does not interested to participate in the reorganized legal entity created by transformation, and the charter has to be approved by the persons wishing to be participants of again created society with limited responsibility.

Contents of Article 1077.1 of the Civil Code also confirms it. Thus, the share along with the other rights, confirms the right of shareholders for the rest of the property that remained after liquidation of society. At the same time, as it was already noted, transformation of joint-stock company, being multi-stage process, includes also liquidation of former legal entity. At rendering at general meeting of the decision on transformation, shareholders at the same time also pass the decision on liquidation of joint-stock company. After it the shareholder, who will not interested to participate in the reorganized legal entity, can demand delivery of the liquidating share.

However, the absence in the legislation of the clear regulating rules of all stages of transformation of joint-stock company into limited liability company, can negatively influence the rights of both all shareholders and creditors of joint-stock company, including the interests of state (for example, in tax questions).

In the decision of Plenum of the Constitutional Court of September 26, 2007 according to complaint of R.Agalarov it is specified that  the legislation can not fully embrace the changes and general diversity of civil relations in society. Even if the legislators attempt to adopt the legal norms that embrace all the cases and regulate permanently developing legal relations, sometimes it is objectively impossible …As a result, certain cases to be regulated are left aside from the legal regulation due to the absence of a relevant norm.

Taking the above-stated into consideration, Plenum of the Constitutional Court comes to conclusion that the establishment in the legislation of the clear rules regulating the all stages of transformation of joint-stock company into limited liability company has to be recommended to Milli Mejlis.

Such regulation is expedient also from the point of view of Article 88.1 of the Civil Code. On the basis of this article number of participants of limited liability company should not exceed the limit specified by the legislation.

However, in the legislation this number is not determined. On the basis of point 1 of the resolution No. 224 of the Cabinet of Ministers of the Republic of Azerbaijan “On the solution of some issues following from adoption of the Civil Code of the Republic of Azerbaijan” the limit number of participants of closed joint stock company has to consist of 50 natural or legal entities.

Nevertheless, as the limited liability company and closed joint stock company carry out identical economic functions (consolidation of the small and average capital), the number of participants of limited liability company should not exceed number of participants of closed joint stock company.

Along with above-stated, Plenum of the Constitutional Court in connection with the inquiry considers necessary the examination of some provisions of the Civil Code.

Thus, on the basis of Article 58.2 of the Civil Code the creditor of a reorganized legal entity is entitled to demand require termination or early performance of obligations where the reorganized legal entity is a debtor and to recover losses.

On this norm the impression can be made that creditors anyway have these rights at reorganization of the legal entity.

In this regard, Plenum of the Constitutional Court notes that if the fact of pure reorganization in itself does not constitute a menace for these requirements of creditors, unconditional existence of such right does not correspond to the principles of balance and proportionality, and also interests of the state in the field of business activity. Only when, the guarantee of payment of requirements of creditors of the reorganized organization is exposed to real threat (for example if authorized capital of the new founded organization is much less than authorized capital of the former organization), creditors can have a right to make the demands provided in Article 58.2 of the Civil Code.

On the basis of the above, Plenum of the Constitutional Court comes to conclusion:

- the decision adopted at general meeting of joint-stock company, on transformation of joint-stock company into limited liability company with observance of requirements of Articles 106-1.3, 107-2.1 and 107-5.1 of the Civil Code, does not violate the property right of shareholders who did not participate at this meeting or voted against the decision on transformation.

- the establishment in the legislation of the clear rules regulating the all stages of transformation of joint-stock company into limited liability company has to be recommended to Milli Mejlis.

- before entering of the corresponding additions and changes into the civil legislation courts have to take into account that the requirement concerning deliveries of a liquidating share of shareholders who not interested to participate in the reorganized limited liability company, has to be satisfied after making decision of general meeting on transformation.

According to the above stated, Plenum of the Constitutional Court comes to the following conclusions:

The provision of Article 1203.1 of the Civil Code "the circumstances which are the reason of deprivation of a right of succession" covering the circumstances specified in Articles 1137 and 1138 of this Code means not only the last will of the testator but also the circumstances directed against the testator.

Being guided by Article 130.6 of the Constitution of the Republic of Azerbaijan and Articles 60, 62, 63, 65-67 and 69 of the Law of the Republic of Azerbaijan “On Constitutional Court”, Plenum of the Constitutional Court of the Republic of Azerbaijan

**DECIDED:**

1. The decision adopted at general meeting of joint-stock company, on transformation of joint-stock company into limited liability company with observance of requirements of the Articles 106-1.3, 107-2.1 and 107-5.1 of the Civil Code, does not violate the property right of shareholders who did not participate at this meeting or voted against the decision on transformation.

2. Taking into consideration the legal position reflected in the given Decision to recommend to Milli Mejlis to establish in the legislation of the clear rules regulating the all stages of transformation of joint-stock company into Limited Liability Company.

3. Before entering of the corresponding additions and changes into the civil legislation courts have to take into account that the requirement concerning deliveries of a liquidating share of shareholders who not interested to participate in the reorganized limited liability company, has to be satisfied after making decision of general meeting on transformation.

4. The decision shall come into force from the date of its publication.

5. The decision shall be published in “Azerbaijan”, “Respublika”, “Xalq Qazeti” and “Bakinskiy Rabochiy” newspapers, and “Bulletin of the Constitutional Court of the Republic of Azerbaijan”.

6. The decision is final and can not be cancelled, changed or officially interpreted by any body or official.