Client Alert on New Rules on Related Party Transactions for all Azerbaijani Companies

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June 25, 2015

Previously, similar regulations existed only for issuers of investment securities (company shares and bonds) and banks. The new rules apply to any transaction or series of related transactions between a legal entity and a related party with respect to such legal entity.

In general, the term "related party" is defined quite broadly and includes the following:

1. The chairmen and members of the management and supervisory boards of a company
2. Heads of divisions, branches and departments of the company
3. Relatives of persons listed under items 1 and 2 above
4. Shareholders of the company (whether legal entities or individuals) holding (whether directly or indirectly) at least 10 percent of the shares in the company
5. Legal entities in which persons listed under items 1, 2 and 4 above (whether directly or indirectly) hold shares
6. Legal entities in which the company in question holds at least 20 percent of the shares
7. Persons (whether legal entities or individuals) holding (whether directly or indirectly) at least 20 percent of the shares in entities listed under items 4 and 6 above
8. Chairs of the management and supervisory boards of legal entities listed under items 4 and 6 above.

In the event that the value of a related party transaction is equal to or exceeds five percent of the relevant company's assets, such transaction may be entered into based on the opinion of an independent auditor engaged by the company and a resolution of the general meeting of its shareholders adopted by a simple majority. A shareholder of the company who is a related party in relation to the transaction in question may not cast a vote during the general meeting of shareholders. The scope of the opinion to be given by the independent auditor remains unclear.

If the value of the related party transaction is less than five percent of the company's assets, such transaction must be approved by either the general meeting of shareholders, the supervisory board or the management board of the company, in accordance with the charter of the company. For this purpose, a member of the supervisory board or the management board of the company or a shareholder of the company who is the related party in relation to the transaction in question may not cast a vote.

If the related party is the chair of a management board which consists of one person or the persons listed under items 3 and 5 above, such transaction must be approved by the supervisory board of the company, or by the general meeting of shareholders if no supervisory board is established.

The law also establishes liability for damages inflicted upon the company caused by the latter entering into a related party transaction in violation of relevant approval procedures. Such a transaction also can be invalidated by the company or any of its shareholders.

Finally, the law requires that the chair and members of the supervisory board of a company must disclose to the shareholders of the company in writing the fact that they are related parties in relation to a transaction with the

company, as well as the details of their interests in such transaction. A similar requirement applies to the chair and members of the management board of a company and any other related party, except that the latter must address the disclosure to the supervisory board (or to the general meeting of shareholders if no supervisory board is established).

Please note that the new rules do not include any materiality threshold for transactions and would therefore apply generally to all transactions, bearing in mind the company asset value provisions described above.

Other legislation is expected to be amended in order to bring it into compliance with the new Civil Code amendments.

Law stated as at 23 June 2015.

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