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ROLE OF RECOVERY OF LOSSES FROM MANAGERS OR CONTROLLING PERSONS AT ENTERPRISES

U. E. Monastyrsky (a)*
*Corresponding author

(a) Moscow State Institute of International Relations (MGIMO University), 119454, Vernadsky Avenue, 76, Moscow, Russia, monastyrsky@mzs.ru

Abstract

The corporate law reform has predetermined the need for a detailed study of managers' liability. It is liability, not only for the deliberate appropriation of the company property, but also for careless business operations, which resulted in negative economic indicators of the legal entity. Losses in corporate relations arise from violations and obstacles to actions that have a positive effect on the organizational position in the market, the value of its shares or its capitalization. In this case, the causers of damage to the organization may be people entrusted with its current financial and economic management, as well as subjects that have the ability to determine the company's behavior, with whom the owner of the share does not have a direct real or binding relationship. The author tries to find answers to the question of implementation by company representatives of their right to claim compensation for loss-making activities that also occur when performing actions that do not meet the usual conditions of the civil turnover or ordinary business risk. It is concluded that it is unacceptable to hold managers accountable for displaying bad faith or unreasonableness in the absence of their guilt. Guilt is a prerequisite for corporate liability of managers. In general, it should be noted that the civil law reform of the corporate sphere was unsuccessful in terms of the applied tools for recovery of losses. The legislation needs to be amended to specify that the managers' liability in organizations occurs only if there is their guilt.

Keywords: Joint-stock companies, losses, damages, guilt, bad faith, unreasonableness.

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1. Introduction

Ownership of shares in a corporate organization is a special category of property rights that are highly individual. For example, the amount of participation may be different: up to half of the authorized capital or exceed it, give control or be small, not providing leverage to influence the business activities of a legal entity. The rights of the participant are limited by the ability to elect individuals to the corporate management bodies and, depending on the decisions of the organization itself, receive a dividend. Participants are also entitled to the remainder of the property after the company's liquidation. However, the two last-mentioned commercial benefits may be meaningless and have no attractive demand. In relation to public joint-stock companies, the payment of dividends does not significantly exceed the amount of deposit interest. In this case, the sale and turnover of shares is always carried out at a price higher than the nominal value. As for the remaining assets from liquidation, according to the priority of a number of creditors, the transfer of any significant assets of the organization to its participants in the bankruptcy case is very unlikely, and in the real law enforcement practice it fluctuates around 3 % (Zanina & Raisky, 2017). Thus, the property interest expressed in the ownership of stocks or shares in the authorized capital depends not on the profitability of the corporation, but on the control provided by the participation amount.

Therefore, it is fair to call the discussed rights "managerial" (Gabov, Gutnikov, & Sinitsyn, 2015). Losses in corporate relations arise from violations and obstacles that have a positive effect on the organizational position in the market, the value of its shares or its capitalization. In this case, the causers of damages may be individuals entrusted with the current financial and economic management of the organization, as well as subjects that have the ability to determine its behavior, with whom the share owner does not have a direct real or binding relationship. Therefore, the main means of the legal protection for participants may be the compensation for incurred losses.

2. Problem Statement

The liability of managers is strict, since it comes as a result of actions that are "unfair" or "unreasonable" and do not correspond to "normal conditions of civil turnover or normal business risk" (Potapov, 2015). This formula increases the emphasis on the liability for the loss-making activities of a corporation, because the wording of the Civil Code of the Russian Federation, at first glance, says about sanctions, regardless of the guilt for decisions that ignore dangers in the commercial turnover. However, sometimes they are necessary for business companies. In addition, the civil law provisions on obligations apply to this case of liability, and the existence of an alleged fiduciary relationship between the manager and the company requires him to exercise the highest degree of care and discretion.

Such a liability structure, primarily for non-performance of operational functions, cannot work in the Russian legal system, since the guilt is a central criterion for imposing adverse consequences for damage that occurs in other business entities, in this case, managed companies (Novak, 2017). According to article 307.1 of the Civil Code of the Russian Federation, the general provisions on obligations apply to claims arising from corporate relations. This is one else recognition of the fact that the obligation has a special legal relationship, different from simple obligations, since subsection 1 of section III of the Civil Code of the Russian Federation is applied by reference, because the corporate sphere is not mandatory. This

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establishes that all aspects of the claim for compensation should be based on the principle of guilt, as it is customary in the mandatory regulation of ordinary civil relations, and not commercial relations, which are guided by the division of risks for profit.

Practice knows exceptions when losses are collected from entrepreneurs-managers who present themselves as experts in the market for a fee that is many times higher than the cost of performing directors functions who is elected according to the usual procedure. At the same time, it is emphasized that the liability of managers should be for decisions that are simply "unreasonable" or "unfair" (Bao, Diabat, & Zheng, 2019; Vygovskaya, 2015), i.e. unprofessional or dishonest. You need to understand why this formula has migrated to the legislation from the OECD Code of Corporate Ethics (OECD, 2004; Gutnikov, 2014a) aimed at implementing well-established legislative mechanisms in the countries-recipients of foreign investments. The result of these efforts is, in particular, the paragraph 2.1 of article 53.1 of the Civil Code of the Russian Federation, which also refers to sanctions without any guilt.

The expansion of grounds for the liability itself puts managers in an extreme risk area. Any transaction that for individual reasons would deviate from market conditions, for example, the sale of large volumes of goods at a discount, could entail a repressive obligation of the director of a large enterprise to pay hundreds of millions rubles in favor of the company headed by him in the case of a claim by even a small (at least 1% of the share) shareholder (who, by the way, may be the controlling person of a competitor) (paragraph 5 of article 71, Federal Law of December 26, 1995 N 208-FZ (as amended on November 4, 2019) "On Joint-Stock Companies"). A literal interpretation of the above paragraphs in their mutual relationship allows us to conclude that liability in the form of losses occurs only if there is guilt, and such types of liability as a fine, penalty, reduction of remuneration amounts, fees take place in cases of bad faith or unreasonableness (paragraph 2.1 of article 53.1 of the Civil Code of the Russian Federation).

3. Research Questions

The main research questions of this study are:

- To study the managers' liability institution applied into the legal field;
- To consider the issue on implementation by participants of the right assigned to them to demand compensation for loss-making activities and the issue of limits of managers' liability;
- To analyze risks related to loss-making activities of a corporation.

4. Purpose of the Study

A key element of the corporate law reform (Lomakin, 2014) was the formation of the institute of managers' liability not only for the deliberate appropriation of the property of an organization, which was quite common in our country in the 1990s, but also for the careless conduct of business, which resulted in negative economic indicators of a legal entity. Participants have the right to claim damages that are collected in favor of the organization by filing claims by them. The purpose of the study is to analyze the impact of expanding the grounds of managers' liability for loss-making activities of the corporation on the economic activity of enterprises and the associated risks.

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5. Research Methods

The main methods of this study are the descriptive method, methods of observation, interpretation, comparison and generalization. In addition, theoretical methods of analysis, synthesis, induction, deduction, and classification were used. The methodological research basis is also a systematic approach to the study of modern practice of civil law implementation on the issues of liability of corporation managers for damages occurred because of the misconduct, bad faith or unreasonableness. The use of these methods allowed e author to ensure the validity of the study results, justify theoretical and practical conclusions, and developed proposals.

6. Findings

Over time, the courts will find a preferred formula of prerequisites for liability, and we can assume that its most frequent expression will be an intent aimed at robbing the society and the own enrichment, or gross negligence, because imposing sanctions on managers only for slight indiscretion will make this profession uninteresting, which was clearly not the main goal when adopting the norm.

The above consideration can also be justified by interpreting the rules. Two paragraphs of section 1 of article 53.1 of the Civil Code of the Russian Federation define two completely different conditions of liability: the first – guilt, and the second (alternative one) – bad faith or unreasonableness. The watershed between them is the burden of proof: for the subject – liability and for the plaintiff – bad faith or unreasonableness. Thus, the victim must prove dishonesty and unreasonableness (section 5 of article 10 of the Civil Code of the Russian Federation). We believe that it is not possible to judge managers only in the own broad sense, that is, to judge them in the specific semantic expression of these terms, for dishonesty or only for unreasonableness. For example, the irrationality has the following manifestations: making decisions by the head without considering the known information, failing of normal business practices to obtain information necessary for decision making, not conducting of the usual approval procedures within the company (with the legal department, accounting office, etc.).

In addition, unreasonableness can be understood as inaccurate calculations, lack of foresight, lack of mental activity during operations, asset management, etc. The head cannot be responsible for such manifestations and shortcomings with all his property, and in case of the selfish interest of individuals, revenge or a PR company, he cannot avoid a lot of such claims, motivated not by the protection of the property status of the company, but by other considerations. However, if we conduct a coordinated joint interpretation of these paragraphs, the guilt is a necessary condition for the corporate liability of managers. Losses caused only by unreasonableness cannot be imposed. This criterion is the main one when calculating the damage caused to the organization by unweighted and ill-considered operations. The same role is played by dishonesty, when its more specific manifestation is hidden commercial knowledge of a subject or (in some cases) dishonesty. This concept seems to be broader than the concept of guilt.

According to Gabov, Gutnikov and Sinitsyn (2015) the unreasonableness of the director's actions as an element of illegal behavior must differ from all types of guilt as a subjective basis of liability. In 2013, the Supreme Arbitration Court of the Russian Federation stated that the executive bodies of organizations have a right to act in line with a normal business risk. Such an establishment of liability limits is nothing

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more than a statement of the impossibility of being responsible for a case, for an unforeseen development of events. We would say that there is something missing here, because achieving strategic goals sometimes directly requires going beyond the usual risk. Nevertheless, the explanation makes important adjustments to the concept of fiduciary relations modeled in common law countries and the special role of directors who are entrusted with the "property" of shareholders for its increment, preservation and profitable commercial exploitation (Stern, 1981).

In the UK and the USA, senior managers are managers with greater operational powers, balanced by responsibilities of both property and criminal types. Therefore, as a condition of working in such a position, a talented manager puts a special contractual regulation of sanctions against him, sometimes very detailed, according to the specifics of the industry where he should act.

After the amendments made in 2014 to the Civil Code of the Russian Federation, another concept of internal corporate relations was formed, where representative bodies are not managers in the literal legal meaning of this word, but performers. We can even consider them as employees of a special class, since they are subject to the provisions of the Labor Code of the Russian Federation. A corporation is managed by a board of directors, a board of senior members, a supervisory board, and so on. Executive and management bodies base their interaction on the imperative structure provided in the law (Art. 65.3 of the Civil Code of the Russian Federation, etc.). For this reason, an agreement to limit the liability of board members and managers is void and prohibited, as well as the case with controlling persons in general.

However, calling the relationship between the director and the shareholders fiduciary is incorrect and does not reflect their essence. Participants in many cases, for example, if they have a significant share, have opposite aspirations to the society, which differ from the interests of each of the members of the collegial or executive body. Suffice it to say, that the shareholder is always interested in the largest valid dividend payments, which means that opportunities for investment and program financing are narrowed. Participants in corporate relationships in general seem to be in favor of increasing the capitalization of the company, for a high market value of participation shares. However, even here it is not difficult to find some differences.

Members of management and executive bodies are interested in high remuneration and preferential lending, to some extent ignoring macroeconomic risks, although they may be forced to pay losses as a subsidiary liability. The shareholder, an ordinary participant, opposes the first and the last. He is usually for the stability, safety and growth of the value of his securities. It would be possible to call “fiduciary” duties of the head, members of governing bodies for the company itself. However, there are not always full-fledged civil relations between the head and the company itself, as well as with each member of the director board. These relations are primarily labor ones by the head, and at the same time, there is no doubt that the participants have corporate rights that are the basis for collecting losses (Mogilevsky, 2001).

The requirements of participants, or members of a supervisory board, or a director board, expressing the collective will of the depositors, are declared in favor of the company. We believe that the liability of controlling entities should come by the damage, but not loss of profit, i.e. for losses caused by damages to the company property, and not for lost profits, negligence, resulting in non-receipt of income, especially because of a single operation. Otherwise, the institute of losses could become a tool for permanent blackmail of the organization's managers, who could have used, but missed, a particular market chance.

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Rational legal logic on the issue of limits of managers' liability is reflected in article 277 of the Labor Code of the Russian Federation dated December 30, 2001 N197-FZ (as amended on December 16, 2019): the head is responsible for the loss of property in full (direct actual damage). This category does not include non-received income, which can always be pointed out, but this will not have a fair basis for recovery, since the function of the head is to maintain the stable operation of the organization, and not to chase ghostly chances.

The specificity lies in the fact that the unprofitable action "de jure" is committed by the creditor himself, i.e. the organization. At the same time, it receives subsequent compensation from subjects who formed its legal will (for example, the director board), expressed in actions or omissions in relation to the property of the corporate structure. Such unprofitable behavior should include not only transactions, but also actual operations, the results of production or other costly activities. If the structure of the violation of the subjective right of the organization itself must include an intent or only gross negligence, but not light negligence, then the condition of liability should also be a more direct and explicit causal relationship (Hecht, Newman, & Tafkov, 2019; Pleshanova, 2017), since it is the guilt that creates it in the first place.

Legal provisions describing the terms of liability of the parent company in the form of losses incurred by the subsidiary (paragraph 2, section 2 of Article 67.3 of the Civil Code of the Russian Federation), establish the absence of the need for guilt (Shitkina, 2015; Spirin, 2014). We assume that if the state of bankruptcy of a subsidiary involves the recovery only because of the culpa of a controlling subject, then a one-time episode of losses that occurs almost always intentionally, less often – because of gross negligence, should be associated with it. Otherwise, the basic principle of the civil law on the independent legal personality of participants in the turnover is undermined. This rule forms the institution of "blind surety", which paralyzes the activity "at the own risk". In section 3, article 67.3 of the Civil Code of the Russian Federation, there is an unjustified reference from chapter 59 of the Civil Code "Obligations because of the infliction of harm" to article 1064 of the same document that describes general grounds of compensation. This legislative solution cannot be considered as optimal one.

As a result of damage, losses are collected alternatively, and in the first place is the execution by replacement of things or elimination of defects in them (article 1082 of the Civil Code of the Russian Federation). Along with this, the verdict occurs for culpable behavior as a basic rule.

Thus, corporate responsibilities may consist of compensation for damages to the company on claims of various persons, its participants, and directors. However, the relevant rights are also implemented through a contract, in this case its signatories can be directly obligated to the damages recovery. The corporate agreement mediates strategic investments in the company. First of all, it is for this purpose. The classic scheme of a corporate agreement is exchange operations based on the model of "capital investment instead of future management decisions that support it", which, in the end, if the investment is successful, leads to an increase in the value of shares. The investing party is interested in obtaining control of varying degrees, i.e., in many cases, in increasing the amount of participation. At the same time, management actions can be performed at several levels by members of the management board, the director board, and the head. In the scientific literature, it is noted that there is a lack of practice here and caution when requesting large sums of money (Kozodoi, Lessmann, Papakonstantinou, Gatsoulis, & Baesensc, 2019).

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The remedy for violation of such duties should be the award of damages for claims against the parties to the contract under discussion. At the same time, the wording gives us its structure, largely repeating the agreement on joint activities, i.e. serving a common goal. Capital investments regulated by the corporate agreement are made available to the company, but not to shareholders or managers who adopt supporting resolutions collectively (the director board, etc.).

The main subject of the described agreement in the Russian Federation is voting in a certain way, the presence of an individual structure of bodies, the transfer of shares under certain conditions, but this is clearly not enough for this world-famous tool to work effectively (Monastyrsky, 2017). It does not follow from the provisions of the corporate agreement that someone will be responsible to a major shareholder for disrupting the investment. The description of a corporate agreement in the Civil Code of the Russian Federation suggests how to respond to its non-performance, obviously, like it is recorded – by recognizing decisions of authorities and transactions involving third parties as invalid. But the main thing is to award damages for non-voting in a certain way. In section 4 of article 67.2 of the Civil Code of the Russian Federation, they are referred to only in connection with non-informing the company itself "about the fact of concluding a corporate contract" (and such a right belongs to the person who didn't participate in it).

The possibility of imposing sanctions for non-voting, apparently, should be deduced from articles 15 and 393 of the Civil Code, the application of which will be determined the question of why the lack of voting led to a violation of the subjective right of the plaintiff. This perspective becomes even more nebulous if the decision in the organization was made in secret. Here, once again, we deal with the abnormality of the construction for losses compensation in case of non-fulfillment, but only with one's own promise, and not for the inability to ensure the implementation of a decision taken not only personally, which is really demanded by time and economic expectations.

At the moment, we are not aware of the recovery of lost profits because of the violation of the agreement to vote in a certain way. However, this is the main purpose of this legal instrument, which supports investments guaranteeing the growth in the value of shares.

7. Conclusion

Award of damages is the main legal remedy for violation of corporate or managerial rights, the restoration of which has its own special algorithm or is impossible in natural terms. The nature of the relationship here consists in unity with the corresponding responsibilities, just as the parent ones – the right and duty of education. Corporate rights of managers, heads, members of the supervisory board and the director board have a mediated property background, and above all they are inalienable. However, their effective implementation affects the synthetic capitalization (market value) of companies (Sidorenko, Bartsits, & Khisamova, 2019).

The presence of corporate powers by members of the governing bodies is expressed in their so-called right to sue the company's managers. For the latter, their corporate rights consist in the ability to act on behalf of the company, to claim compensation for losses caused by members of the collegial body and participants, when this is permitted by law.

Holders of original corporate rights may also, by law, claim damages in the following two cases. First, in case of loss of participation as a result of illegal actions (section 3 of article 65.2 of the Civil Code

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of the Russian Federation). Losses are collected from the guilty subjects, whoever they are – shareholders, registrars, issuers.

Secondly, when the corporate procedure was implemented, which was recognized as illegal and aimed at diluting the participation of the plaintiff (paragraph 4 of article 60.1 of the Civil Code), the legislative innovation will allow attracting its authors to damage compensation – members of the collegial body, as well as legal entities and all subjects that contribute to decision-making. It is obvious that the listed defendants were not necessarily the beneficiaries of such a restructuring, and the liability here, according to a number of legal experts (Gutnikov, 2014b; Tsepov, 2016), is unique, since it, on the one hand, occurs only because of bad faith (in case of dishonest concealment of facts and estimates). On the other hand, members of the collegial body (although this is not always noted) must be held liable necessarily by virtue of guilt. This conclusion follows from the fact that the пeneral grounds of liability remain universally applicable (article 393 of the Civil Code, according to the instructions of article 307.1 and chapter 4 of the Civil Code).

For example, participants are authorized to claim damages when there is a price difference in a voluntary or mandatory offer to purchase shares, as well as after a forced foreclosure based on an unfair market valuation. When calculating losses, article 15 of the Civil Code of the Russian Federation “On restorative compensation” should play a dominant role.

When determining the mechanism for generating losses in the corporate area, it is not superfluous to understand how chapter 25 of the Civil Code of the Russian Federation should act. The main point here is the guilt of the creditor that does not act to reduce losses (article 404 of the Civil Code). At first glance, it is impossible to understand how the company itself should behave in order to prevent or reduce its own losses, since it acts as a creditor. Obviously, the applicant should do it, but sometimes there are not any opportunities for this. Neither the shareholder, or participant, or member of the director board can unilaterally set the course of actions and behavior of the lender – the organization itself. Another issue is the failure to comply with a complex corporate agreement that ultimately regulates the investment process. The plaintiff and the beneficiary here is the participant of the agreement, but the question is: not always the aggrieved party can demonstrate, what are its losses, and to prove a causal relationship, for example if there was not a vote in accordance with the agreement, the credit was not attracted, a management decision was not accepted. Here it is rational to refer to such a type of loss as future expenses.

It seems that the civil law reform of the corporate sphere was unsuccessful in terms of the applied tools for the recovery of losses. The legislation needs to be amended, for example, in terms of disclosing the essence of a corporate agreement, making changes to the fact that the company itself can be a party to it and a subsequent claimant on the basis of the well-known principle of the continental legal system that the responsibility of the heads of organizations occurs only if there is their guilt.

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