

Corporate Governance in Russia: Is There Any Chance of Improvement?

Introduction: Feudal Wars for Russian Corporations

The majority of foreign investors and members of the general public usually shudder when they read articles by Western correspondents from Moscow about the fierce wars within and around Russian corporations. Various methods are employed in this campaign to redistribute ownership (“dilution” of blocks of shares through new issues, bankruptcy, reorganization of companies, manipulation of registers, creation of parallel boards of directors, and procedural points with regard to arranging shareholders’ meetings are employed very frequently). Things have even reached the point of the armed (!) takeover of enterprises: for example, directors, who have been removed from office prematurely for one reason or another, take over enterprises without authorization, relying frequently on the support of local authorities and members of the labor collective, and often utilizing specialized armed units.

Indeed, let’s take a look at just the most recent corporate conflicts in 1999–2000:

- the confrontation between “Sidanko” OAO [Open Joint-Stock Company] and “TNK” OAO;
- the forcible replacement of the manager of “Transneft” OAO;
- the attempt at deprivatization of the Lomonosov Porcelain Factory;
- the conflict surrounding violation of the rights of minority shareholders of subsidiary enterprises of YUKOS NK [Oil Company] OAO;
- clashes between owners and employees, who took over the Vyborg Pulp and Paper Production Complex;
- the armed takeover of the Kachkanar Mining and Concentrating Complex (with two separate sets of managers);
- two separate sets of managers at the Orsk-Khalilovo Metallurgical Complex;
- the conflict surrounding the conversion of “Surgutneftegaz” to a single stock;

- the attempted armed takeover of “Moskhimfarmpreparat”;

It is likely that the recent aggravation of the situation is tied in part to people’s desire to create for themselves a more favorable springboard for the next stage in the campaign to redistribute ownership. This process also took place previously, however—one needs only recall the “wars of the oligarchs” in 1997—and it is continuing to this day. The result of all this: the negative image of corporate governance “Russian-style” that has emerged in this environment.

Things are not as hopeless as they may seem, however. There is something positive and constructive to be found even in scandals: the public has a deeper awareness of the need for a fundamental improvement in the system of corporate governance in Russia, which will provide real protection for investors’ interests and rights. After all, investments go only where investors’ rights are observed!

Historical Background

Privatization in Russia: Birth of the Russian Model of Corporate Governance

It was the particularly Russian model of privatization (“the biggest sell-off of state property in the 20th century”) practiced in 1992–1994 that determined the basic characteristics of the structure of corporate ownership and governance in Russia, and it also outlined the major directions for their development: three-fifths of Russian open joint-stock companies in operation today appeared as a result of privatization, and they account for four-fifths of all industrial production. This in turn predetermined to a great extent the nature and specific characteristics of the development of the Russian corporate securities market.

The principal features of the Russian model of privatization can be summarized as follows:

- mass corporatization in the course of privatization (more than 30,000 open joint-stock companies were created in Russia; there are more of these companies in Russia than in the rest of the countries of Eastern and Central Europe and the CIS combined);
- major special advantages for insider employees and managers, and their widespread participation in privatization (at the very outset of the privatization process 50–60 percent of shares were transferred to insiders for vouchers (or sold for cash));
- mass sale (or free distribution) of shares in privatized enterprises for vouchers, which were issued to all citizens for a symbolic charge;
- the freely transferable nature of the vouchers and their free circulation on the market, which made it possible for processes involving the concentration of ownership to

begin considerably sooner than the actual sale of shares. (Approximately 25–30 percent of citizens sold the vouchers they received, and one-third of these vouchers that were sold went into the hands of foreigners);

- the sale of shares under certificate-based privatization both directly and through intermediaries—certificate investment funds. (Some 25 million citizens became shareholders in 450 such funds.) The certificate investment funds were the first collective investment institution in post-communist Russia;

- the open nature of joint-stock companies created in the course of privatization, which allowed the processes of redistribution of ownership through the free sale of shares to begin.

The specific initial structure of corporate ownership that appeared was the result of the implementation of this type of privatization model.

On average, in 1994 insiders accounted for 60–65 percent of shares held in privatized enterprises, outside shareholders accounted for 18–22 percent, and the state's ownership was as high as 17 percent.

In connection with the state's hold on large blocks of shares in so-called strategic enterprises, by virtue of the size of these enterprises (this situation is typical of other countries as well, such as Hungary, the Czech Republic, Poland, and others), the structure of corporate ownership and, accordingly, the subsequent trajectory of development of corporate governance, differed sharply at enterprises in the petroleum and gas industry, the electric power industry, and telecommunications, where the state's stake was usually around 38–51 percent, and the insiders' stake was 20–30 percent, compared to the majority of enterprises in light industry, the food industry, and the production of building materials, in which the state's stake was nonexistent or was in the 10–15 percent range, and insiders played a dominant role.

Continuing participation by the state in the capital of many Russian enterprises is one of the main reasons for the inefficiency of their economic operations and it is the source of a number of Russian political and new corporate scandals. Therefore, the privatization of these blocks is important not just in eliminating the budget deficit, but also in improving the efficiency of the Russian economy. Relevant privatization plans involving the quick sale of minority (up to 25 percent) blocks of state-held shares in thousands of privatized enterprises have been announced several times already by the Russian government, but they have not been carried out.

Generally speaking, the substantial dominance of insiders at the initial stage of post-privatization development is the most important feature of corporate ownership and governance in Russia.

This dominance by insiders and the inevitable problems and conflicts arising from this situation, which are related to the violation of shareholders' rights, are also characteristic of other post-communist countries. For example, it is occurring in Lithuania, Mongolia, Armenia, Georgia, Slovenia, Croatia, and Macedonia. As paradoxical as it may be, one can study the problems of corporate governance in Russia without having to travel to snowbound Moscow, but by spending time instead at the resorts of Slovenia, in the wonderful town of Bled, for example!

Mass certificate-based privatization in Russia resulted in a major dispersion of owners, as in other countries (in July 1994 there were 40 million small shareholders in Russia, both insiders and outsiders). Russia experienced the exact same thing as the Czech Republic, for example, when immediately after the mass privatization was completed, the process of concentrating ownership in the "struggle for control" began at these enterprises. As in many other countries in Eastern and Central Europe, the managers of the enterprises played and are continuing to play a major role in this process.

For a number of objective reasons, such as excessive advantages offered to insider employees, utilization of the institution of investment intermediaries—investment funds—did not undergo the same sort of vigorous development in Russia as it did in the Czech Republic, for example, where the funds hold 60 percent of the shares in Czech enterprises and they are the real owners of Czech industry. Investment funds in Russia hold approximately 10 percent of shares in Russian enterprises and they usually fall into the outsider shareholder minority. Accordingly, they could potentially play a positive role as champion of the rights of the minority.

At the same time, managers of Russian investment funds are infringing on the rights of small shareholders, which is also the case with managers of Czech funds; the problem of "dormant shareholders" of investment funds is even more pressing for Russia, and up until 1998 the regulation of these funds was too lax.

In the course of mass privatization in Russia and the majority of other countries with transition economies there were not any market quotations or reference points for the purchase of shares (as was the case with privatization in the 1980s in Western countries, such as Great Britain under Margaret Thatcher). Shares of enterprises being privatized appeared on the market for the first time in 1992–1994, and in the majority of cases their acquisition was a matter of random selection, as in a lottery. As a result, the structure of investment funds' assets also ended up being fairly "mixed." Now, as the market has undergone further development, quotations of many stocks have appeared and consequently, there is also an opportunity to obtain a market valuation of their assets, based on real quotations of enterprises' stocks, and on this basis to perform an "inventory of the funds' portfolios." As a result, the market for privatization funds' stocks that is "dormant" now is going to "wake up." This will create new stimuli and incentives for funds to act as shareholders of enterprises and as players in the stock market.

In an examination of the Russian model of corporate governance, one needs to focus in particular on the following points:

I. The structure of stock ownership and trends in the change of this structure.

II. The role of the Russian financial system as a mechanism for the transformation of savings into investments and prospects for its development.

III. The relationship among sources of financing for Russian corporations and prospects for change in this area.

IV. The history and trends in the development of the legal system.

V. Macroeconomic policy and its impact on corporations.

There are other factors that also have an influence on the Russian model of corporate governance, however, such as:

- current commercial practices and business ethics;
- the traditions and nature of state interference in economic life, and so on.

The structure of stock ownership that took shape after the completion of mass privatization and that is still in place at a number of enterprises is changing fairly rapidly. Specifically, from 1994 through the present the following changes have occurred:

- there has been a substantial reduction in the proportion of employee-shareholders (at the same time, employee-shareholders play a minor role in management—most of them delegate their votes to the administration);
- there has been an increase in the role of the administration (management);
- there has been an increase in the role of large outsider shareholders;
- there has been a decrease in the role of the state.

The “struggle for control” at Russian joint-stock companies now is not only not easing, but on the contrary, it is heating up, in particular in connection with the fact that a 50/50 balance of forces between insiders and outsiders has developed at many enterprises!

According to data from the Leontyev Center in St. Petersburg, by 1997 the struggle for control had already come to an end at more than 25–30 percent of Russian joint-stock companies, and as paradoxical as it may seem, in approximately two out of three cases this struggle ended with a victory by the outsiders! (According to other data sources, the number of such enterprises is even higher.) But at those enterprises where the bulk of ownership has

ended up in someone's hands, the "struggle for control" usually does not come to an end, and the primary distribution of ownership stage is quickly replaced by the secondary and tertiary redistribution stages. (As early as 1995 the first few "hostile takeover" attempts were made: the Red October Confectionery Factory in Moscow, and the Pulp and Paper Production Complex in Karelia, among others).

Methods employed by both sides in the "struggle for control" include:

loyees and small outside shareholders;

- putting together alliances with "friendly shareholders," for example, representatives of the state or certificate investment funds;

- obtaining shares in the course of privatization (directly, through one's own firms, and also at the expense of funds of the joint-stock company itself, which are used by managers); the latter method, incidentally, explains the sharp reduction in investments in Russian enterprises;

- restricting access to the register or manipulation of the register (used by managers).

The continuing "struggle for control" to a certain degree:

- results in numerous violations of shareholders' rights (especially on the part of managers);

- creates disincentives for the disclosure of information about enterprises (because managers have no interest in disseminating information about their joint-stock company, which they want to buy themselves and buy at a lower price);

- leads to the domination of the country's over-the-counter market, since it is not profitable for brokers to disclose prices and the volume of transactions to their clients;

- creates a situation in which enterprises do not have sufficient interest in new stock issues, out of fear of losing control of the enterprise (although there are, clearly, other obstacles to new stock issues, such as competition with monetary privatization and placement of government securities);

- is a factor hindering the effort to transfer the management of registers to independent registrars.

The phenomenon of growth in "one-way" temporary liquidity of enterprises' stocks also arises in the "struggle for control" (a phenomenon with which we are familiar from the Czech experience).

The absence in Russia of a fully realized, functioning system for the transformation of savings of individual citizens and legal entities into investments is key evidence of the transitional nature of the current Russian model of corporate governance. This system is still in the embryonic stage: neither banks nor various types of investment funds have been able to attract the public's savings. The bulk of savings are held in the form of cash (most often in U.S. dollars). The total amount of the public's savings is in excess of US\$30 billion. And the nature of this model depends on what is going to become the principal means for the transformation of domestic savings into investments—banks or nonbank structures (investment funds, mutual funds, and so on).

Furthermore, in connection with Russia's heavy dependence on foreign investments, the predominance in the future of one type of foreign investments or another (strategic or portfolio), with their different approaches to the securities market as a mechanism of external corporate control, will have a significant influence on the development of the Russian model of corporate governance.

In any case, however, the creation of a system for the transformation of savings into investments will require a major effort to restore the public's trust in investment intermediaries (banks and collective investments) after the widespread scandals involving pyramid schemes in 1994–1995 (more than 1,000 pyramid schemes were created during those years and some 30 million people fell victim to them) and people's losses at banks stemming from the crisis of August 1998.

Restoring the public trust is a complex and long-term task, which can be achieved only with a serious tightening of government control over the securities market and a targeted public information and promotional campaign.

At the present time, neither banks, investment funds, nor foreign investors of any kind are significant sources for financing the development of enterprises, i.e., the real sector, and accordingly, this also characterizes the formative stage of the Russian model of corporate governance which has not yet come to a close.

It is obvious that in the future, as the economic growth stage gets under way, this situation will change. Bringing the process of the formation of the Russian model of corporate governance to a more rapid close is tied in particular to:

1) a decline in the profitability and scale of government borrowing on the government securities market (which for a long period of time diverted monetary resources, particularly bank resources, from investments in the real sector);

2) development of the Russian legal base, particularly, for example, creation of the institution of securing credits provided to the real sector on the basis of: privatization of land and real property and development of a mortgage lending system, and also strengthening the legal position of creditors;

s were given the right to demand that a joint-stock company buy back shares held by them at a “fair” market price (determined by independent appraisers-auditors) in the event of reorganization, the conclusion of major transactions, or amendments to the joint-stock company’s charter with a subsequent change for the worse in the legal status of shareholders;

- for the first time a requirement was established that in the event of the acquisition of 30 percent or more of common stock, the buyer (buyers) in question must offer the shareholders of the joint-stock company an opportunity to sell their common stock at a price that is not below the weighted average price at which the joint-stock company’s stocks were acquired over the 6 months preceding the purchase.

At the same time, Russia is characterized by very weak enforcement of existing legislation on the protection of shareholders’ rights.

Concentration of ownership has become widespread in world practice through adaptation to failings in the enforcement of legislation (particularly in Napoleonic Code countries with their weak protection of investors’ rights); as “anti-director rights” are introduced more vigorously, the quality of accounting improves, and legislation is enforced, such concentration of ownership may decline. Considering the relatively weak adherence to the legislation in Russia, one may assume that the concentration of ownership in Russia will continue, or more precisely, the campaign for the redistribution of ownership will continue.

Corporate Governance: The Ideal Model and Russian Reality

The problem of corporate governance, which involves balancing the interests of various groups of stakeholders (shareholders, including large shareholders, minority shareholders, holders of preferred stock, a company's managers and its employees, government agencies), is a pressing one for most of the countries of the world.

International organizations have also focused their attention on the matter of developing corporate governance standards. For example, in May 1999 an OECD council approved the Principles of Corporate Governance, which are non-binding and are intended to serve as a sort of reference point for the creation of a legal basis for corporate governance at the government level, and also for a company's evaluation and development of its own practices. The document outlines principles pertaining to five areas: (1) the rights of shareholders; (2) equitable treatment of shareholders; (3) the role of stakeholders in management of a corporation; (4) disclosure and transparency; and (5) the responsibilities of the board of directors.

One-hundred percent compliance with these principles has not been achieved anywhere. But the most developed countries have come the closest to full compliance, particularly those that are part of the Anglo-American legal family (the United States, Hong Kong, Canada). Countries with the continental legal system are lagging somewhat behind, and especially those countries whose legal systems are based on the Napoleonic Code.

The most significant comparison for Russia is with the so-called emerging markets. But here we see that the myth about the uniqueness of the "horrors" of corporate governance in Russia, surprising as it may seem, is nothing more than a myth. Investors are encountering these same problems in Indonesia, Korea, Brazil, Mexico, Argentina, Turkey, the Czech Republic, and India (see Table 1).

Table 1

Overview of Major Risks of Corporate Governance in Russia

Risks	Probability of risk	Uniqueness (characteristic only of Russia)	Other markets with similar risks
Disclosure of information	++	Yes	--
Share dilution	+++	No	Korea
Asset stripping/ transfer pricing	+++	No	Indonesia, Malaysia, Korea, Mexico
Bankruptcy	+	No	India

Restriction on ownership of stocks and disposition of voting rights	+/-	No	Korea, Mexico, Thailand
Reorganization (mergers and takeovers)	++	No	Indonesia, Malaysia, Korea

Source: Brunswick Warburg

The second myth which it is time to dispel is the opinion held by some investors that Russia has no laws regulating the corporate governance sphere (see Attachment 1).

In connection with the above, it would be a good idea to take a more detailed look at the legal base of Russian corporate governance and compare it to the situation in other countries.

The G-7 countries (Canada, the United States, Great Britain, Italy, France, Germany, and Japan) and 15 of the largest emerging markets were chosen for this comparison:

- 4 countries from Latin America: Argentina, Brazil, Mexico, Chile;
- 2 countries from Europe: Greece, Portugal;
- 8 countries from Asia: South Korea, the Philippines, Indonesia, Malaysia, Taiwan, Thailand, India, Turkey;
- 1 country from Africa: South Africa.

The table below was compiled on the basis of research conducted by Rafael La Porte, Florencio Lopez de Silapes, A. Schleifer, and R. D. Vishnya, "Law and Finance" (see Table 2, as well as Appendix 2).

Table 2

(1) No.	(2) Shareholders' rights	(3) Positive (+) or negative (-) impact on investors' rights	(4) G-7 countries	(5) 15 largest emerging markets	(6) Russia
1.	One share – one vote	(+)	<u>No</u>	<u>in 4 of 15</u> - Malaysia - Greece - Chile - South Korea	Yes
2.	Voting by mail using ballots	(+)	<u>in 4 of 7</u> except: - Germany - Japan - Italy	<u>in 2 of 15</u> - Argentina - South Korea	Yes

(1)	(2)	(3)	(4)	(5)	(6)
3.	No blocking of stocks before a shareholders' meeting	(+)	<u>in 4 of 7</u> except: - France - Germany - Italy	<u>in 9 of 15</u> except: - Greece - Argentina - Mexico - Taiwan	Yes
4.	Cumulative voting	(+)	<u>in 1 of 7</u> - USA	<u>in 4 of 15</u> - Thailand - Argentina - Philippines - Taiwan	Yes
5.	Right of a minority of shareholders to overturn management decisions	(+)	<u>in 5 of 7</u> except: - Italy - France	<u>in 9 of 15</u> except: - South Korea - Indonesia - Turkey - Mexico - Greece - Portugal	No
6.	Right of a minority of shareholders to demand the buy-back of stocks at a fair price in the event of major transactions, reorganization, or a change in the charter of a joint-stock company	(+)	<u>in 5 of 7</u> except: - Italy - France	<u>in 9 of 15</u> except: - South Korea - Indonesia - Turkey - Mexico - Greece - Portugal	Yes
7.	Percentage of stocks needed to convene a special shareholders' meeting (%)	the fewer the better	1 – USA 3 – Japan 5 – Canada, Germany 10 – Great Britain, France 20 – Italy	1 – Chile 3 – Taiwan 5 – South Africa, Greece, Argentina, Brazil, Portugal, South Korea 10 – India, Malaysia, Indonesia, Turkey Philippines	10%

(1)	(2)	(3)	(4)	(5)	(6)
				20 – Thailand 33 – Mexico	
8.	Percentage of stocks needed to convene a special shareholders' meeting (%) [sic]	the fewer the better	1 – USA 3 – Japan 5 – Canada, Germany 10 – Great Britain, France 20 – Italy	1 – Chile 3 – Taiwan 5 – South Africa, Greece, Argentina, Brazil, Portugal, South Korea 10 – India, Malaysia, Indonesia, Turkey Philippines 20 – Thailand 33 – Mexico	10%
9.	Mandatory dividends	compensation mechanisms in continental law countries (+ for continental law countries)	No	<u>in 5 of 15</u> Chile – 30% Greece – 35% Brazil – 50% Philippines – 50% Portugal – 50%	No

The legislation in force in Russia, as one can see from the above, has already incorporated a number of important measures to protect shareholders' rights (for all practical purposes, the only thing missing is mandatory dividends and the right of a minority of shareholders to overturn management decisions).

Generally speaking, corporate governance in Russia is regulated by a whole body of laws—the Civil Code of the Russian Federation, the Federal Laws “On Joint-Stock Companies,” “On the Securities Market,” and “On Protection of the Rights and Legal Interests of Investors in the Securities Market,” as well as regulatory acts of the Federal Commission on the Securities Market and several other agencies.

In particular, the Law “On Joint-Stock Companies” (referred to hereinafter as the Law) contains basic norms of corporate law which define shareholders' rights, and the role, authorities, and liability of those who have been assigned responsibility for management of a joint-stock company's operations, and which also provide protection for shareholders' rights and interests. The law has been in force since 1996, and it has not been amended since that time. Practical experience in its enforcement has shown that although this Law, which is quite progressive from the standpoint of international experience, has done a great deal to normalize corporate relations, it still has some gaps, which urgently need to be filled in.

The shortcomings of the Law and the various interpretations of its standards have led to a situation in which certain violations fall entirely within legal bounds. Specifically, the situation is that provisions of the Law which would seem to guarantee a shareholder protection of his interests, in practice play the opposite role in the Russian environment as a result of their “skillful” application.

The main reason for Russia’s problems, however, is poor enforcement of the legislation. Russia is lagging seriously behind other transition economies in this regard, including a number of CIS countries.

The most typical violations of shareholders’ rights include: violation of a shareholder’s right to participate in a general shareholders’ meeting, dilution (watering) of capital, violation of shareholders’ rights in the course of reorganizations and consolidation of companies (especially in the process of converting to a single stock), violation of information disclosure requirements, asset stripping and transfer of assets to “friendly” companies, transfer pricing, conclusion of “sweetheart” deals in violation of the established procedure, and fraudulent bankruptcies with the subsequent buy-up of assets being sold.

Let’s take a closer look at some of these.

A. In Russia one of the basic principles of corporate governance—“one share – one vote”—is written into the legislation. A shareholder exercises his right to participate in a company’s management through participation in a general shareholders’ meeting—the highest governing body of a joint-stock company. But as it turns out, it is not always a simple matter for a shareholder to exercise this right.

According to the Law, the right to participate in a general shareholders’ meeting may be exercised by a shareholder both personally and through a representative. This provision gives shareholders broader opportunities to take part in a meeting. But the Law provides that a proxy must contain the representative’s passport data, and under the conditions of a struggle for control this becomes a powerful weapon. A party that does not want to allow an “opponent” to take part in a meeting may interpret passport data to mean any entry in a passport. The proxy of the shareholder’s representative is rejected on the basis of a mere formality, and the representative is not allowed to take part in the meeting.

The scheduling requirements for preparing for a general meeting are violated, and as a result a shareholder is not able to take part in a meeting because the notice that the meeting was going to be held or the voting ballot were received too late, or were not received at all, which also can happen, since someone simply “forgot” to send them.

Of course, if a decision by a general shareholders’ meeting is adopted in violation of the requirements of the legislation, or the company’s charter, it may be appealed by a shareholder through the courts. But there’s a catch here, too. A shareholder must take into consideration the fact that a court may leave a decision under appeal in force, if the given

shareholder's vote could not have affected the outcome of the voting, the violations that occurred were not serious, and the decision did not result in any losses for the given shareholder. Thus, a minority shareholder, whose vote usually does not affect the outcome of voting, often needs not only a good attorney, but also a lot of luck, in order to protect his interests in court if, for example, the requirement for providing advance notice of a meeting was violated.

B. Shareholders' rights are violated most often in the placement of securities. As a result of which, a new issue is already becoming synonymous with a violation of shareholders' rights.

An example of this can be seen in the well-known conflicts of recent years at a number of oil companies: "Yukos" (transfer of funds from subsidiaries, "dilution" of shares held by minority shareholders), "Sidanko" (an attempt to issue and place convertible bonds at a below-market price for placement with affiliated parties), "Sibneft" (transfer of assets to a holding company and discrimination against small shareholders of subsidiaries in the conversion to a single stock). It must be noted that the "share dilution" was not successful in a significant number of cases. In 1998 alone the Russian Federal Securities Commission refused state registration of stock issues in 2,600 cases, and some "oligarchs" even felt the impact (see Table 2).

Table 2

**Law Enforcement Activity by the Russian Federal Securities Commission
(1998–1999)**

January 1998	Refusal to register securities issue of "SIDANKO" OAO
May 1998	Russian Federal Securities Commission announced its disagreement with the Law limiting foreign ownership of stocks in United Energy Systems Republican Joint-Stock Co.
June 1998	Suspension of stock issue of "Krasnyy Kotelshchik" [Red Boilermaker] Thermal Boiler Plant OAO
September 1998	Refusal to register stock issue of "Sibneft" OAO
November 1998	Refusal to register stock issue of Vyksa Metallurgical Complex OAO
December 1998	Suspension of stock issue of "Dalmoreprodukt" [Far East Seafood Products] Holding Company
December 1998	Suspension of stock issue of NOSTA OAO
March 1999	Announcement of investigation of the special general shareholders' meetings of subsidiaries of "YUKOS" oil company: "Tomskneft" joint-stock co., "Samaraneftegaz" joint-stock co., "Yuganskneftegaz" joint-stock co.
December 1999	Refusal to perform state registration of stock issue of "Tomskneft" joint-stock co.

“Surgutneftegaz” OAO also taught its shareholders a lesson in corporate governance by proposing to them a scheme for conversion to a single stock, which, in the opinion of numerous experts, seriously violates the rights of shareholders who hold different categories of stock (holders of “Surgutneftegaz” Oil Company OAO common stock and holders of both common and preferred stock of “Surgutneftegaz” OAO).

It has already been mentioned a number of times that in spite of the crisis conditions in 1998–1999, there was no significant decline in stock-issuing activity by joint-stock companies. This can be explained by the fact that the mechanism involving the placement of securities is employed not as a means of attracting needed investments, but as an instrument in the struggle for control of a company through the “dilution” of shares held by undesirable shareholders (primarily small and mid-sized shareholders who hold a so-called “blocking” parcel of shares).

Boards of directors, taking advantage of the opportunity afforded to them by the Law to adopt decisions to increase authorized capital, placed shares especially often through closed subscription to affiliated persons at what were clearly below-market prices, frequently without even letting shareholders know.

The conditions of the placement were based on the “bottleneck” principle—the idea was to make it impossible or extremely difficult for shareholders to acquire stocks. For example, the placement of stocks of a large issuer occurred on just one day and a shareholder had to appear in person to conclude the transaction.

C. Violations of shareholders’ rights involving the reorganization of joint-stock companies also became widespread. The purpose of reorganization was to allow a “controlling” shareholder to convert a profitable business into new companies. The financial problems of the “old” company were inherited by its remaining shareholders. Or the other way around, certain shareholders were forced out and into new companies with an unfavorable financial status.

With a view to preventing such violations, the Russian Federal Securities Commission included a number of provisions in its regulatory acts aimed at protecting shareholders’ rights in the process of issuing securities. These provisions include a requirement that a decision to place stocks through a closed subscription may be adopted only by a general shareholders’ meeting of the given joint-stock company. This provision was subsequently written into the Federal Law “On Protection of the Rights and Legal Interests of Investors in the Securities Market.”

In accordance with the requirements of the Russian Federal Securities Commission, the time period within which shareholders may conclude contracts for the acquisition of said securities (with the exception of the placement of stocks and securities convertible into stocks among shareholders who are exercising their preferential right of acquisition) may not be less than one month.

A requirement was established calling for the mandatory participation by an independent appraiser to determine the price at which securities would be placed, in the event of their placement by an open joint-stock company with 1,000 or more shareholders, and also by an open joint-stock company whose securities issues are subject to state registration by the Russian Federal Securities Commission, through a closed subscription to persons who are not shareholders of the given joint-stock company, or not to all of the company's shareholders, or to all shareholders, but not in proportion to the number of shares held by them. Although it is no secret that the quality of the work performed by the so-called independent appraisers leaves much to be desired.

A clearly defined procedure has been established for the prior disclosure of information about an issue, which will enable shareholders to find out about the relevant decisions in the course of an issue in a timely manner and to appeal them before their rights are violated (including disclosure prior to the filing of documents for state registration of a securities issue (at least 30 days in advance)). Furthermore, the Standards establish priority for shareholders in the acquisition of stocks in the event of the placement of additional stocks, they clarify the rules for adopting decisions to effect large transactions and transactions with stakeholders involving the placement of stocks, as well as the rules for paying for stocks using nonmonetary forms of payment.

D. Russian boards of directors: whose interests do they represent?

Boards of directors are assigned an important role in the system of corporate governance, and it is assumed that a board of directors is supposed to provide for the management of a company in the interests of all of its shareholders, by looking for ways to achieve a possible balance. In the domestic practice of corporate governance, however, in the majority of cases the board of directors defends the interests of only the largest shareholder (the one with a controlling block of shares), as well as its own interests, which sometimes run counter to the interests of the company's shareholders. As already mentioned earlier, decisions by a board of directors to issue stocks have resulted in share dilution to the detriment of undesirable shareholders and to the benefit of large shareholders, new shareholders have appeared who are affiliated with members of the board of directors, and the block of shares acquired by them as a result of a closed stock issue has often turned out to be a controlling block.

In recent years, with the help of the boards of directors of various companies, there has been a redistribution of assets without consideration of the interests of small shareholders (the property of a joint-stock company is removed from the assets of that company and turned over to organizations that are friendly to the company's managers, or to a parent company). Unjustifiably high salaries and remuneration have been set for members of the board of directors and executive administrative bodies, while dividends and wages have not been paid. With the aid of transfer pricing and tolling schemes, shareholders' earnings often go into the pockets of managers and a "controlling" shareholder. It must be emphasized, however, that the resolution of these issues lies more in the realm of criminal law, and it has less to do with corporate law.

There is resistance to independent audits of the financial activity of a joint-stock company, which its unaffiliated shareholders are demanding.

At the same time, it should be mentioned that the collision of interests of shareholders and the board of directors is an objective phenomenon, and several measures to resolve this conflict have already been worked out in world practice.

These measures include, for example, the inclusion of so-called independent directors on the board, that is, people who have no business ties to the company, so that the objectivity and independence of their decisions will not be affected, and they can have a certain influence on the board's decisions. It is a good idea to create various ancillary committees within the board—an auditing committee, a committee to address remuneration for management, and one to deal with shareholder relations.

E. Managers and shareholders

The day-to-day management of a joint-stock company's operations is performed by the company's executive body, which has the right to decide any issues concerning the company's operations that do not fall under the exclusive authority of the general meeting and the board of directors. Thus, decisions of the company's executive body affect the company's operations directly and on a daily basis.

The question of which administrative body has the authority to form the executive body is of fundamental importance, since this determines the entity to which the executive body is accountable. The formation of a company's executive bodies and the early removal of their members from office in Russia is carried out by a decision of the general shareholders' meeting, unless the company's charter places the resolution of these issues under the authority of the company's board of directors.

Unfortunately, executive directors have made an immense contribution to the creation of the negative opinion of Russian corporate governance. Assets are stripped from joint-stock companies with the direct involvement of directors (and sometimes even at their initiative). When enterprises were privatized, no changes were made in the management staff, as a rule, but as a result of a change in ownership, new shareholders appeared who had no previous relationship with the given joint-stock company, and as a result, the "old" managers did everything they could to oppose participation by the new owners in the company's operations.

Over time some of these conflicts were resolved, but so sooner had the smoke cleared from past battles than new ones appeared: nonmarket transactions with a company's property, refusal to provide shareholders with required information, resistance to the hiring of new managers.

F. There is no let up in the struggle for information disclosure

For example, information about remuneration paid to members of management bodies of Russian joint-stock companies is a separate page in the story of domestic corporate governance. It is self-evident that shareholders have the right to know how much management of the company costs, and where and how their money is being spent. To this end, proceeding from world practice, the Russian Federal Securities Commission has established a requirement regarding disclosure of this information in securities issue prospectuses and quarterly reports of issuers. It is interesting that this requirement has turned out to be one of those most criticized by a majority of issuers and by some of the so-called professional participants in the securities market.

But still, there has been some clear progress in the information disclosure sphere. First of all, the Russian Federal Securities Commission, pursuant to the requirements of the Law “On the Securities Market,” has adopted a number of regulatory acts which identify in specific terms the nature of the information that is to be included in quarterly reports of issuers and information about important facts concerning their financial and economic operations, and which also establish the procedure for its disclosure. In addition, requirements have been established for the disclosure of information provided by issuers in the course of a securities issue.

In all fairness, it must be mentioned that the Russian legislation on information disclosure, which was drafted under difficult conditions, is far from ideal, but nevertheless it does allow the investor today to obtain basic information about a company’s management.

Second, with the publication of the Law “On Protection of the Rights and Legal Interests of Investors in the Securities Market,” the Russian Federal Securities Commission obtained the authority to impose penalties for violations in the area of information disclosure. This same law established a ban on public trading of securities of issuers who do not disclose information in the amount and following the procedure established by the legislation.

Thus, as a result of actions that have been undertaken, the year 1999 can be considered a turning point in the development of the information disclosure system. The number of quarterly reports of issuers available on the Russian Federal Securities Commission information disclosure server grew from 71 documents in January 1999 to more than 7,000 in January 2000, that is, it increased by a factor of more than 100.

Problems in Corporate Governance in Russia

To summarize the points discussed above, we will identify the main violations (corporate governance problems) that have a significant impact on the position of investors, and we will analyze existing mechanisms for protecting shareholders’ rights and possible ways to improve them.

Problem	Degree of protection	Method of protection	What needs to be done
Dilution of shareholders' stocks through stock issues	Insufficient	Law on Protection of the Rights and Legal Interests of Investors, Standards of Russian Federal Securities Commission	Amend the Law "On Joint-Stock Companies" by establishing new, clearly defined rules and conditions for the adoption of decisions to increase authorized capital. Introduce mandatory preferential rights for shareholders. Establish regulation of the procedure for issuing bonds convertible to stocks.
Violation of shareholders' rights in the process of reorganization of companies	Weak	Law "On Joint-Stock Companies"	Amend the Law "On Joint-Stock Companies" by introducing a requirement that the structure of ownership must be preserved in the event of a takeover, and a requirement that an independent appraiser be brought in. Improve information disclosure.
Violation of information disclosure requirements	Insufficient	Law "On Joint-Stock Companies," Law "On Protection of the Rights and Legal Interests of Investors"; Law "On the Securities Market," Russian Federal Securities Commission Standards	Improve legislation on information disclosure; introduce international accounting standards; impose criminal liability for failure to disclose information.
Asset stripping ("Asset sell-off")	Insufficient	Law "On Joint-Stock Companies," Criminal Code (Articles 165, 201, 204)	Reform of labor legislation (simplification of the procedure for dismissal of general directors); improve financial reporting forms; impose stricter requirements on the

Problem	Degree of protection	Method of protection	What needs to be done
			procedure for effecting major transactions and stakeholder transactions.
Transfer pricing	Insufficient	Law “On Joint-Stock Companies,” Criminal Code (Articles 165, 201, 204)	Improve tax legislation; improve financial reporting forms.

The main causes of the problems with corporate governance, and consequently, investor losses, can be summarized as follows.

1. The continuing struggle for “control” at many enterprises.
2. The unsatisfactory system of law enforcement in Russia (including the ineffectual operation of many courts).
3. The passivity of the Russian Federation government:
 - The State Commission for Protection of Investors’ Rights in the Financial and Stock Markets met just two times in 1997–1999!
 - In a number of cases state agencies initiated the violation of shareholders’ rights (the Russian State Property Ministry in the case of the Lomonosov Porcelain Factory).
4. Lack of unity and passivity among minority shareholders.
5. Gaps in the legislation, for example, the absence of mandatory preferential rights for shareholders or the institution of class-action suits.
6. Insufficiently thorough due diligence prior to the adoption of investment decisions, and in Russia in particular the following needs to be checked in advance:
 - the transparency and legality of financial schemes employed by managers; the existence of a “bad history” with respect to shareholders; the presence of ties to oligarchs and criminals;
 - the presence of legal “land mines,” such as the case involving “MGTS” OAO, in which the company had an unconditional obligation under the privatization legislation to increase its authorized capital and transfer a controlling block of shares to the party with the winning bid in an investment auction;

- the relationship between managers and local government authorities.

7. The specific motivating factors driving the behavior of Russian managers and large shareholders who are not working to increase capitalization or the company's profits, but are in a struggle to gain control over management of the joint-stock company or to drain off financial flows. For example, it was a desire to increase control that caused the appearance of the ADR "fashion"—an excellent mechanism for protecting investors' rights under American conditions, which unexpectedly turned into a "terrible weapon" for managers' absolute power through the abuse of voting rights of ADR holders under Russian conditions! (Although Russia is not unique in this—there were similar problems when ADRs were issued for Indian stocks.)

Are there any positive examples?

Late 1999 and early 2000 will go down in Russia's history not just as the end of the Yeltsin era and the time a new president was elected, but this period will also be known for a number of precedent-setting victories for shareholders in the campaign for their own rights:

- a compromise was reached between "SIDANKO" OAO/BP-AMOCO and "TNK" OAO regarding "Chernogorneft";

- foreign shareholders of the Lomonosov Porcelain Factory won a number of court battles with "nationalizers" from the Russian State Property Ministry;

org Pulp and Paper Production Complex was resolved;

- there were certain encouraging signs of progress in the crisis surrounding the YUKOS Oil Company OAO and its subsidiaries.

In addition, the newly elected State Duma has stepped up efforts to prepare a number of draft laws related to protecting shareholders' rights. For the first time in Russia's history a special parliamentary commission has been created to protect investors' rights, and it is headed by the well-known liberal Deputy I. Khakamada.

A number of the largest investors have begun to band together with a view to protecting their rights, specifically in the form of a sort of "trade union"—the Coordinating Center for Protection of the Rights and Legal Interests of Investors. (We would like to mention, incidentally, that this is not a unique phenomenon—there are investors' associations in 18 countries with some 1.2 million members.)

How can corporate governance in Russia be improved?

The corporate governance situation in Russia today requires a whole series of steps, some of which need to be taken by the State Duma and the Russian government, and some by investors themselves.

It is possible to provide protection for shareholders' rights against unscrupulous actions by managers both by imposing tougher penalties at the legislative level for actions that violate shareholders' rights, by improving the current legislation, and also by making improvements in the practical application of existing laws (which requires political will!).

In this connection, a number of regulatory acts need to be adopted that will fill in the existing gaps in the legislation. Some draft laws of this nature have already been submitted to the State Duma.

The main priorities in improving legislation on corporate governance in Russia are:

- The adoption of legal standards that provide for the unhindered dismissal (removal) of top managers, as well as the confiscation of assets belonging to top managers, in the event that they violate the rules of corporate governance.
- A ban on insider trading.
- An explicit definition of transactions with affiliated parties.
- Expansion of information disclosure requirements and liability for the content of information that is disclosed.
- Regulation of capital dilution (including through the introduction of mandatory preferential rights for shareholders).
- Restrictions on "cross shareholding."
- Introduction of direct liability on the part of officials, directors, and controlling shareholders for damages sustained by a joint-stock company itself or its shareholders (up to and including criminal prosecution).

It is most realistic to expect that the following will be adopted in 2000:

1. Amendments and additions to Federal Law No. 208-FZ of December 26, 1995 "On Joint-Stock Companies" (adopted by the State Duma in the first reading in 1999, and prepared for a second reading in 2000), which provide for, specifically:

- Additional protection for minority shareholders against capital dilution.

- Tighter control on the part of shareholders and boards of directors over company managers.
- Tighter regulation of large transactions and transactions with stakeholders.
- Stricter requirements regarding the mandatory participation of independent appraisers.

2. A law on affiliated parties (adopted by the State Duma in the first reading in 2000), which provides for:

- A broadening of the concept of an “affiliated party.”
- Greater authority for law enforcement agencies to stop transactions by affiliated parties.

Of course, effective protection of investors requires the adoption of a law on insider trading (which has been stuck on the desks of government officials for more than two years now), as well as amendments to the Criminal Procedural and Civil Procedural Codes (which provide specifically for more effective protection of purchasers of securities who are acting in good faith and introduction of the institution of class-action suits).

Improvements need to be made in the work of law enforcement agencies and the Russian Federal Securities Commission, which should include increased funding for them and upgrading the status of their employees; incentives also need to be provided for the enforcement of existing laws, specifically the Criminal Code, for criminal prosecution of transfer pricing and asset stripping.

Officials of government agencies who are guilty of taking an indifferent, careless approach to the problem of protecting investors’ rights need to be held accountable. No penalties have been imposed yet against any of the officials who were behind the deprivatization of the Lomonosov Porcelain Factory (?)(!)

Recommendations to Investors

The experience of investors in Russia shows that only energetic efforts to protect their own interests produce meaningful results. In this connection, a number of key points can be identified in investors’ activities which will help ensure success:

- a more thorough approach to due diligence than in other countries prior to the implementation of investment decisions (this was discussed in greater detail in previous sections);

- active efforts to protect their own rights (including the use of the mass media and appeals to government and court authorities, and more persistent efforts within the framework of the Foreign Investment Advisory Council);
- joining forces with other investors, including through the creation of associations (unions) of investors, since this helps to cut costs and enhances the effectiveness of measures being taken.

The use of corporate governance ratings could be of great assistance to investors, and a number of organizations in Russia are working on the development of such ratings. The key issue here is to devise an appropriate methodology that reflects the Russian reality.

Elaborating on this topic, let's take a closer look at specific options for actions by investors to protect their rights.

I. In the preparation of investment decisions to minimize potential risks it is necessary and sufficient:	II. Various approaches are possible to restore the rights of investors/shareholders that have already been violated, such as:
<ul style="list-style-type: none"> • to create a special structural division of the investor's firm in Russia with a sufficient number of highly-qualified specialists; 	<ul style="list-style-type: none"> • hiring a firm that specializes in protection of investors' rights (law firms, auditing firms, etc.)
<p style="text-align: center;">AND/OR</p> <ul style="list-style-type: none"> • to turn to consulting firms specializing in protection of investors' rights 	<ul style="list-style-type: none"> • turning to associations of investors (Coordinating Center for Protection of the Rights and Legal Interests of Investors)
<p style="text-align: center;">AND/OR</p> <ul style="list-style-type: none"> • to utilize corporate governance ratings 	<ul style="list-style-type: none"> • taking the necessary actions independently

There are various methods of protection available to investors depending on the nature of the violation, and they can tentatively be divided into two groups:

A. Mild methods of protection	B. Tough methods of protection
<p><u>1'. File a request with the violator-company to:</u></p> <ul style="list-style-type: none"> • convene a special general shareholders' meeting; • conduct an internal audit; • buy back stocks (in the event that such a right arises), etc. <p><u>1''. Submit a proposal to the violator-company:</u></p> <ul style="list-style-type: none"> • to hold negotiations. 	<p><u>1'. File a petition with a Russian court of law requesting, for example:</u></p> <ul style="list-style-type: none"> • that it overturn a decision by a general shareholders' meeting or the board of directors (that the shareholders' meeting be declared invalid); • compensation for losses; • the entry of a notation in the shareholders' register. <p><u>1''. File a petition with a foreign court.</u></p> <p>One of the steps taken to resolve the conflict in the fall of 1999 between "Sidanko" OAO</p>

<p><u>2. File a request (petition) with the Russian Federal Securities Commission:</u></p> <ul style="list-style-type: none"> • that an investigation of the violation be conducted; • that a fine be imposed on the issuer for violations (for not providing an investor with information, for example); • that it participate in a legal case in the capacity of co-claimant, witness, or expert. 	<p><u>2. File a petition with the Prosecutor General's Office:</u></p> <ul style="list-style-type: none"> • requesting the initiation of a criminal case (based on incidents of asset stripping or transfer pricing, for example).
<p><u>3. File a petition with the Russian Federation government.</u></p>	<p><u>3. File petitions with international financial organizations and governments requesting, for example, that they suspend lending programs benefiting the violator-company.</u></p>
<p>4*. File a petition with investors' associations (Coordinating Center for Protection of the Rights and Legal Interests of Investors).</p>	<p>4*. File a petition with investors' associations (Coordinating Center for Protection of the Rights and Legal Interests of Investors).</p>

*Depending on the situation, filing a petition with investors' associations (Coordinating Center for Protection of the Rights and Legal Interests of Investors) may be both a "mild" and "tough" method of protection.

Experience shows that in reality success is achieved only when all of the measures indicated are combined and the most important thing is that this also include close management (control) of the process of fighting for one's rights. A comprehensive (systematic) approach to resolving these issues is essential for the effective protection or restoration of investors' rights, which could include turning to consulting firms that specialize in the protection of investors' rights so that they can carry out all of the actions listed above.

As we conclude our discussion of the mechanisms for protecting investors' rights, let us turn to a brief analysis of the effectiveness of some of these mechanisms.

1. Up until now, the least effective approach has been to file a petition with the Prosecutor General's Office regarding asset stripping and transfer pricing. Possibly the reason for this is the far-reaching consequences of setting a precedent in initiating a case involving violations of this nature.

2. Court cases that have been brought to protect rights of shareholders that have been violated have had mixed success. One of the reasons is this: depending on whether the claimant is an individual or a legal entity, the very same case is heard either by a court of general jurisdiction or by an arbitration court. This provision complicates the procedural aspects of protecting violated rights, and it also creates a dual, contradictory legal practice. The fact that Russia has no institution of class-action suits also reduces the effectiveness of legal protection through the courts.

In a number of cases, as already mentioned, the problem lies in the passivity of shareholders with regard to important potential suits to defend shareholders' rights that have been violated. For example, suits to recover losses sustained by a joint-stock company for which its managers or another company controlling its operations are to blame are virtually nonexistent due to the difficulty associated with proving culpability in such suits.

In a number of cases in which a petition is filed with the courts to overturn decisions of general shareholders' meetings, a court may refuse to grant the petition on the grounds that the violations were inconsequential. This provision reduces significantly the level of legal protection afforded to minority shareholders, if only because in the majority of cases their votes do not influence the outcome of voting.

Shareholders are, however, able to achieve their aims under fairly challenging conditions (take the case of the Lomonosov Porcelain Factory, for example).

3. Petitions filed with international financial organizations and the government are effective (in the case of YUKOS Oil Company OAO investors appealed to the World Bank, and in the case of the conflict between "Sidanko" OAO and "TNK" OAO, they appealed to the U.S. government).

4. Methods of protecting shareholders' rights such as filing petitions with the Russian Federal Securities Commission are also fairly effective. The Russian Federal Securities Commission has been somewhat responsive to complaints that fall under its jurisdiction, such as monitoring securities issues, regulation of registrars' activities, and so on. In addition, starting in the second half of 1999 the commission stepped up its efforts with regard to imposing fines.

5. Appeals to companies are quite ineffective.

Thus, improving protection of investors' rights is not a walk in the park, but a difficult, gradual process that requires time, energy, money, and most important, persistence and perseverance.

Creation of Associations of Investors in Russia

There are a number of organizations in Russia today representing the interests of investors and shareholders. In the majority of cases, however, they are small in scale and "serve" private individuals exclusively. Such investors are characterized by relatively small-scale investments and are united, primarily, by their effort to find and recover money invested by them in pyramid schemes in 1993–1995.

A new phenomenon that appeared in 1998–1999 was the gradual unification of large investors, including institutional investors, which initially grew out of the NAUFOR Program to Protect Investors' Rights, and was followed in October 1999 by a prototype of the future

“trade union” (association) of shareholders (investors) within the framework of the Coordinating Center for Protection of the Rights and Legal Interests of Investors.

Today under the auspices of this Center a number of large foreign and domestic investors (there are more than 20 now, with a total volume of investments in Russia of US\$10 billion) have joined forces and resources in the campaign to defend their rights, converting the communists’ well-known slogan to fit their own purposes: “Investors of all

Main Goals of the Coordinating Center for Protection of the Rights and Legal Interests of Investors

- To prevent violations of the rights and legal interests of investors and to restore rights that have been violated.
- To increase the transparency of the market.
- To prepare proposals to improve legislation on protection of investors’ rights.
- To provide for the legal, organizational, technical, and other conditions that will allow market participants to join forces and coordinate their efforts to protect their rights and legal interests.

The Coordinating Center’s operations are organized within the framework of a number of working groups whose efforts are focused on addressing special problems of investors.

Coordinating Center working groups	Brief description of their objectives	Results achieved
Group to place representatives of the Coordinating Center on boards of directors (auditing commissions)	<ul style="list-style-type: none">• Nomination of candidates to serve on boards of directors (auditing commissions) of companies based on proposals from members of the Coordinating Center;• Drafting of proposals for amendments and additions to companies’ charters;• Introduction of principles of corporate governance, which members of the Coordinating Center believe should be developed in Russia;• Introduction of the institution	<ol style="list-style-type: none">1. Candidates for boards of directors of 32 enterprises have been registered.2. Suits are being prepared regarding unfounded denials.

Coordinating Center working groups	Brief description of their objectives	Results achieved
	of independent members of the board of directors.	
Group to prepare amendments to the charter of United Energy Systems and to analyze proposals for the development of a program to restructure the electric power industry	<ul style="list-style-type: none"> • Preparation of amendments and additions to the United Energy Systems charter that will provide protection for the rights of minority shareholders; • Participation in efforts to prepare a program for reorganization of the electric power industry. 	Amendments and additions to the United Energy Systems charter have been prepared, which are now being discussed with the company.
Dividend group	<ul style="list-style-type: none"> • Development and utilization of joint efforts to solve the problem of nonpayment of dividends. • Creation and maintenance of a data base to support monitoring of dividend practices of enterprises. 	<ul style="list-style-type: none"> • The main types of violations have been identified. An analysis has been performed and recommendations for action have been prepared for investors. • A survey of legal practice is being prepared. • Consultations have been held with government organizations regarding administrative pressure on issuers that are in violation.
Group to protect the rights of shareholders of subsidiaries of YUKOS Oil Company OAO	<ul style="list-style-type: none"> • Providing assistance to investors in restoring rights that have been violated. • Development of standard (model) methods and ways to restore rights that have been violated. • Creation of legal practice on issues concerning protection for investors' rights. 	<ul style="list-style-type: none"> • Six suits have been filed by NAUFOR and shareholders. • Trading in shares of YUKOS subsidiaries in the Russian Commodities and Raw Materials Exchange has been suspended.
Group to protect the rights of shareholders of "Surgutneftgaz" OAO subsidiaries	<ul style="list-style-type: none"> • Providing assistance to investors in restoring rights that have been violated. • Development of standard (model) methods and ways to restore violated rights. 	<ul style="list-style-type: none"> • A legal analysis of the violations has been performed. • A suit has been prepared to declare decisions of the special general

Coordinating Center working groups	Brief description of their objectives	Results achieved
	<ul style="list-style-type: none"> • Creation of legal practice on issues concerning protection for investors' rights. 	shareholders' meeting invalid.
Deprivatization group	Blocking attempts to violate investors' rights in the course of deprivatization.	<ul style="list-style-type: none"> • A public relations campaign against deprivatization has been conducted. • Negotiations have been held with the Russian Federal Property Fund and other government agencies. • An exchange of information has been set up with the Russian Federal Property Fund, and in particular information has been obtained about court decisions regarding deprivatization and enterprises at which the winning bidder has not fulfilled the investment conditions.

In Place of an Afterword

Everything that has been discussed above is of great importance and will be continue to be relevant for some time to come. But it is just as important to change the attitude toward the problem of corporate governance among joint-stock companies themselves, which will inevitably have to change since "positive" or "negative" corporate governance practices at a company will have a corresponding influence on its attractiveness to investors, which also means on its survival over the long run. Therefore, there is no alternative to improving corporate governance in Russia.

**Shareholders' Rights and Their Protection:
Basic Laws and Regulations Currently in Force**

Federal Law No. 208-FZ of December 26, 1995 "On Joint-Stock Companies"

Federal Law No. 39-FZ of April 22, 1996 "On the Securities Market"

Federal Law No. 46-FZ of March 5, 1999 "On Protection of the Rights and Legal Interests of Investors in the Securities Market"

Criminal Code of the Russian Federation (Articles 165, 201, 204)

Resolution No. 19 of the Russian Federal Securities Commission of September 17, 1996 "On Approval of Standards for the Issuing of Stocks when Establishing Joint-Stock Companies, Additional Stocks, Bonds, and Their Issue Prospectuses" (as amended by Russian Federal Securities Commission Resolution No. 47 of November 11, 1998)

Resolution No. 8 of the Russian Federal Securities Commission of February 12, 1997 "On Approval of Standards for the Issuing of Stocks and Bonds and Their Issue Prospectuses in the Reorganization of Commercial Organizations" (as amended by Russian Federal Securities Commission Resolution No. 48 of November 11, 1998)

Resolution No. 10 of the Russian Federal Securities Commission of May 14, 1996 "On the Procedure for Publication of Information about Acquisition by a Joint-Stock Company of More than 20 Percent of the Voting Shares of Another Joint-Stock Company"

Resolution No. 45 of the Russian Federal Securities Commission of December 31, 1997 "On Approval of the Regulation on the Procedure for Suspending the Issuing of Securities and Declaring a Securities Issue Null and Void or Invalid"

Resolution No. 8 of the Russian Federal Securities Commission of April 20, 1998 "On Approval of the Regulation on the Procedure for Holding a General Shareholders'

Resolution No. 9 of the Russian Federal Securities Commission of April 20, 1998 "On Approval of the Regulation on the Procedure for and Extent of Information Disclosure by Open Joint-Stock Companies in the Placement of Stocks and Securities Convertible into Stocks through Subscription"

Resolution No. 31 of the Russian Federal Securities Commission of August 11, 1998 "On Approval of the Regulation on Quarterly Reporting by an Issuer of Securities"

Resolution No. 32 of the Russian Federal Securities Commission of August 12, 1998 “On Approval of the Regulation on the Procedure for the Disclosure of Information about Significant Facts (Events and Actions) Affecting the Financial and Economic Activity of an Issuer of Securities”

Resolution No. 36 of the Russian Federal Securities Commission of September 8, 1998 “On Approval of the Regulation on the Procedure for Returning Money (Other Property) to Holders of Securities Obtained by the Issuer as Payment for Securities, the Issue of Which Was Declared Null and Void or Invalid”

Resolution No. 3 of the Russian Federal Securities Commission of June 7, 1999 “On Approval of the Regulation on the Procedure for the Hearing of Cases and Imposition of Fines for Violation of the Legislation of the Russian Federation on Protection of the Rights and Legal Interests of Investors in the Securities Market”

Resolution No. 7 of the Russian Federal Securities Commission of September 30, 1999 “On the Procedure for Maintaining a Record of Affiliated Parties and Furnishing Information about Affiliated Parties of Joint-Stock Companies”

Main Elements of Corporate Governance That Provide Protection for Shareholders' Rights
and Their Occurrence in Russian Legislation

Elements of Corporate Governance	Occurrence in the Federal Law "On Joint-Stock Companies"
One share – one vote	The general rule is that the "one share – one vote" principle applies. Preferred stock convertible into common stock is the exception. In this case on such share provides a number of votes that does not exceed the number of votes under common shares into which it may be converted. In addition, the legislation provides for the opportunity to create "people's enterprises." In this case, the "one shareholder – one vote" principle applies.
Opportunity to vote by proxy, or by mail	The right to participate in a general meeting may be exercised by a shareholder both personally and through a representative. At a company that has more than 1,000 shareholders with voting stock, when a meeting is held which shareholders may attend in person, they are also sent voting ballots, and a shareholder may participate in a meeting by sending the ballot to the company, and his personal appearance is not required.
Established minimum for a meeting quorum	A general shareholders' meeting is authorized to act (has a quorum) if at the time registration for participation in the general shareholders' meeting closes, shareholders (their representatives) have been registered who together hold more than one-half of the votes granted by voting stock placed by the company.
Qualified majority for the adoption of especially important decisions	A decision on matters such as amendments to the charter, reorganization, liquidation, the conclusion of large transactions by a company, and several others, are adopted by a general shareholders' meeting by a three-fourths majority vote of shareholders with voting stock who are participating in the general shareholders' meeting.
Limits on the number of votes held by a single shareholder	A company's charter may establish restrictions on the number of stocks belonging to a single shareholder, and their total face value, as well as the maximum number of votes granted to a single shareholder.

Elements of Corporate Governance	Occurrence in the Federal Law “On Joint-Stock Companies”
Creation of a board of directors	The creation of a board of directors (supervisory board) is mandatory at a company with more than 50 shareholders holding voting stock.
Election of members of the board of directors by cumulative voting	The election of members of the board of directors (supervisory board) of a company that has more than 1,000 shareholders with common stock is carried out by cumulative voting.
Early removal from office of members of the board of directors	By a decision of a general shareholders’ meeting, any member (all members) of the board of directors (supervisory board) may be removed from office before expiration of the respective term. In the event that members of a company’s board of directors (supervisory board) are elected by cumulative voting, however, a decision by a general shareholders’ meeting regarding removal from office may be adopted only with respect to all of the members of the company’s board of directors (supervisory board).
Participation by independent directors as members of the board of directors	The Law does not contain any requirements regarding the mandatory inclusion in the board of directors of so-called independent directors— persons who have no business ties to the company. The Law establishes that members of a company’s collective executive body may not represent a majority on the company’s board of directors. This limit is set too high, however, and does not protect shareholders from the concentration of power in the hands of a small number of people.
Restrictions on one person serving simultaneously as chairman of the board of directors and managing director	The Law prohibits the same person from serving as chairman of the board of directors and general director (one-man management).
Preferential right to buy stocks	Shareholders who hold voting stock in a company have preferential right to acquire these securities in a quantity proportional to the number of voting shares they hold in the company. This right must be specified in the charter, however, and it applies only when a company places voting stocks and securities convertible into voting stock through open subscription, and they must be paid for in cash. A general shareholders’ meeting may adopt a decision by a majority vote not to apply the preferential right (but for no more than one year).

Elements of Corporate Governance	Occurrence in the Federal Law “On Joint-Stock Companies”
Rules governing transactions with stakeholders	<p>The Law establishes the procedure for the conclusion of transactions in which affiliated parties have an interest.</p> <p>Practical experience has shown, however, that the current mechanisms for protecting shareholders from the unscrupulous use of a company’s property are ineffective and need to be changed.</p>
Takeover rules	<p>The Law establishes that a person who independently or in conjunction with affiliated parties has acquired 30 or more percent of common stock placed by a company is required to offer shareholders an opportunity to sell the common stock which they hold in the company at a price that is not below the weighted average price at which the joint-stock company’s stocks were acquired over the 6 months preceding the purchase.</p> <p>For a number of reasons, however, this requirement does not give investors an opportunity to recover their investments and to withdraw from the company in the event of a takeover of the company.</p>
Reliable methods for registration of ownership rights	<p>The Law establishes a requirement that a company manage and maintain a register of the company’s shareholders in accordance with legal acts of the Russian Federation.</p> <p>A company with more than 50 shareholders is required to turn over the management and maintenance of the company’s shareholder register to a specialized registrar.</p>
Information disclosure	<p>The Law contains a list of documents to which a joint-stock company is required to provide shareholder access. These documents include the company’s charter, financial reporting documents filed with the relevant agencies, minutes of the company’s general shareholders’ meetings and of meetings of the company’s board of directors (supervisory board), lists of affiliated parties, and the company’s audit reports.</p> <p>There is a requirement that every year a company must publish its annual report and certain other information in mass media to which all the shareholders of the given company have access.</p> <p>Furthermore, the Federal Law “On the Securities Market” establishes additional information disclosure requirements.</p>

Elements of Corporate Governance	Occurrence in the Federal Law “On Joint-Stock Companies”
Clear delineation of authorities among a company’s various administrative bodies (general shareholders’ meeting, board of directors, executive body)	<p>The provisions of the Law concerning the jurisdiction of a company’s administrative bodies do not establish a clear delineation of their various authorities.</p> <p>According to the Law, issues that fall under the exclusive jurisdiction of the general meeting may not be turned over to a company’s executive body, but at the same time, the charter (or a decision by a general shareholders’ meeting) may specify that some of the issues that are under the exclusive jurisdiction of the general meeting are to be turned over to the board of directors for consideration. For example, the formation of the company’s executive body, early removal of its members from office, determining the amount of remuneration to be paid to them, as well as an increase in the company’s authorized capital.</p> <p>In addition, issues that do not fall under the exclusive jurisdiction of the general meeting may be turned over to the company’s executive body or board of directors by the charter (a decision of the general meeting) without any restrictions.</p> <p>Practical experience in application of the Law has revealed a need to make amendments to the Law that identify more precisely the list of issues that are to be dealt with by one administrative body or another. For example, it needs to be specified that issues that fall under the authority of the general meeting cannot be turned over to other administrative bodies for consideration; and it must be specified in which cases and under what conditions the board of directors has the right to increase a company’s authorized capital.</p>
Auditing	According to the Law, a company is required to bring in an auditor who has no property interests tying him to the company or its shareholders to conduct an annual audit and provide confirmation of the annual financial statement.