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1. Legislation Regulating the Rights of Shareholders

1. There are the following fundamentals laws in this area: part one of the Civil Code of the Russian Federation (RF), the Federal Law on Joint-Stock Companies, dated December 26, 1995, and the Federal Law on the Securities Market, dated 22 April, 1996. The Civil Code of the RF contains the most general rules concerning joint-stock companies, the Law on Joint-Stock Companies regulates everything relating to the creation and operation of joint-stock companies, corporate governance and supervision over companies’ operations, shareholders’ rights and mechanisms of exercising them. The Law on the Securities Market contains important rules on the issuance of securities and the circulation of issued securities, which apply first and foremost to joint-stock companies, including the rules of the protection of shareholder rights.

2. Application of the aforementioned laws poses questions about relations between their provisions. Some of them will be considered later. At this point it is essential to highlight a matter of principle – one of the shares that joint-stock companies may issue. The Law on Joint-Stock Companies calls for the issuance of only named shares, whereas the Law on the Securities Market, which was passed later, provides for the

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1 The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries.


opportunity of issuing both named and bearer shares. Specialists think that it is the Law on Joint-Stock Companies that takes precedence in this situation, interpreting these provisions so that the Law on the Securities Market mentions possible types of shares, whereas the Law on Joint-Stock Companies limits shares issued by companies set up in the territory of the Russian Federation to just named shares.

3. Four years have already elapsed since the Law on Joint-Stock Companies came into force, but it has been amended only twice – the deadline for bringing the founding documents of joint-stock companies in line with the Law provision was extended in 1996, and the 1999 amendment stated that the specifics of reorganising natural monopolies in which over 25 percent of shares are kept in federal ownership shall be determined by a corresponding federal law. These amendments have made no fundamental changes to the legal status of joint-stock companies and they have confirmed that the Law remains fairly stable, considering Russian conditions. This is attributable primarily to the fact that the need for this law was very urgent in the mid-1990s and that on the whole it has had a benign impact on joint-stock companies. This does not mean that the law does not require serious changes at all, since many of its provisions are far from perfect. There have been repeated proposals for amendments to be made to the Law since the very first days of its application, and currently the State Duma is considering a number of drafts. The most far-reaching of them is the draft sponsored by the Russian Government, which was passed in first reading in 1999.5

4. Specifics of the legal status of the shareholders of the so-called “people’s enterprises,” which are fairly peculiar joint-stock companies, are not considered in this report, first, for formal reasons, since these joint-stock companies are not widespread – by the time the Federal Law on the Specifics of the Legal Status of Workers’ Joint-Stock Companies (of People’s Enterprises)6 was passed in July, 1998, there were only a few dozens of those who wished to form such companies, and there is no indication that these numbers are going to grow; second, since the law itself calls for solutions so uncharacteristic of joint-stock companies that the question of scope and protection of the rights of such companies’ shareholders7 moves largely into the realm of social problems the law attempts to resolve to the detriment of the legal framework.

5. The Law on the Securities Market has not undergone any significant changes throughout the time of its application either – in all, only two amendments have been made to it, in 1998 and 1999 - of which the first one, made on November 26, 1998, is particularly important for the purpose of this report; it calls for the state registration of such regulations of the Federal Commission for the Securities Market (hereinafter, FCSM) that create rules of law8 and that were formerly exempt from such a registration. The FCSM itself attributes this change to the fact that “by the end of 1998 there was no longer a need for an accelerated creation of a regulatory legal framework for the securities market”9. In our view, this rationale is not enough to justify its previous exemption from registration, since the registration of departmental regulations with the Justice Ministry is designed to check them out for compliance with the law, and the need to create a legal framework at an accelerated pace cannot take precedence over the requirement of making it non-contradictory and in conformity with the law.

6. Further to the aforementioned laws various agencies, first of all the FCSM, have passed departmental regulations. While the Law on Joint-Stock Companies envisioned a limited number of regulations to be

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5 Not only does this draft bring certain provisions of this law into line with other federal laws, but it also contains a number of provisions that are aimed at strengthening the protection of the rights of shareholders, and the state in the first place. The limited framework of this report does not make it possible to consider changes proposed in the amendment.


7 In particular, the Law introduces the “one shareholder, one vote” principle instead of “one share, one vote” with respect to the most important management issues and at the same time limits the rights of worker-shareholders to own and sell their shares, and requires the outgoing worker to sell his or her shares to the joint-stock company at a repurchase price that is to be determined by the company, etc.


adopted it its wake as its provisions contain sufficient rules both substantive and procedural, the application of the Law on the Securities Market required that several dozens of legal acts be adopted. The most important of them from the viewpoint of shareholders’ rights are the FCSM rules regulating the activities of register holders and depositories, who confirm the ownership rights of shareholders and other players in the securities market, and also an entire range of regulations relating to the issuance of securities and the protection of shareholders’ right to information.

7. The list of key regulations and areas of lawmaker in this areas would have been incomplete had we not mentioned the Federal Law on the Protection of Rights and Legitimate Interests of Investors in the Securities Market, which was passed on March 5, 1999 (hereinafter, the Law on the Protection of Investors’ Rights). This Law pursues a number of objectives at the same time; in particular, it seeks to protect investors, including shareholders, by raising the quality and accuracy of information made available to them and improving the system of its dissemination. The Law for the first time calls for administrative liability for violating the rights of investors and shareholders in the form of fairly high fines and also certain civil-law remedies to protect shareholders’ rights and forms of damage payments to individual investors (physical persons). The Law also attempts to create a rule designed to protect shareholders from “equity dilution,” in particular, it prohibits closed subscriptions to shares and convertible securities at the decision of the board of directors.

8. Therefore, in the four years of application of the Law on Joint-Stock Companies a wide-ranging legislative framework has been created in Russia, of which the rules concerning shareholders’ rights and protection thereof form an important element. As for basic, fundamental rights of shareholders, the Law itself phrases them in a very concise and straightforward fashion. For instance, the holders of common shares may participate in a general meeting of shareholders and vote on all matters that fall within its competence, they are entitled to dividends - and in the event of liquidation, to a share in the company’s assets (Article 31, Clause 2). All the other rights that are recognised and protected by the current Russian legislation are but derivatives from these ones. In addition, the crucial principle of equality of shareholders’ rights – “any common share of a company confers the same rights on the shareholder who owns it” – was incorporated in the Law (Article 31, Clause 1, of the Law).

2. Protection of the Rights and Legitimate Interests of Shareholders in the Practice of Arbitrage Courts of the Russian Federation

9. When we speak about the use of judicial remedies to protect the rights and legitimate interests of shareholders, it clearly applies first and foremost to minority shareholders. Shareholders with a majority stake can fairly efficiently protect their rights by “pushing through” decisions at a general meeting or act through persons they elect to management bodies. At the same time, any shareholder, including the one who has a controlling block of shares, can bring a lawsuit demanding that certain transactions be deemed invalid in order to stop actions of company managers that cause damage to him.

10. Regrettably, judicial statistics do not single out this category of cases so we cannot establish just how many out of more than 740,000 cases considered by the arbitrage courts in 1997-1998 dealt with the protection of shareholders’ rights. One thing is evident, however – the practice of judicial arbitrage related to shareholders’ rights is just beginning to take shape, for which reason it does not provide enough material to draw conclusions from concerning the judicial interpretation of certain complex or controversial provisions of the company law. A lot of contentious issues have not yet reached maturity to form a court case or have not yet passed all stages of court proceedings.

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10 Among the most important ones the Statute on the Procedure for Holding a General Meeting of Shareholders by Absentee Voting, which was approved by the FCSM’s Resolution N. 4, dated April 20, 1998, and the Statute on the Keeping of a Register of Named Securities Holders, which was passed further to both laws’ requirements.


11. If judicial remedies for the protection of shareholders’ rights and legitimate interests are to be effective in real-life situations it is essential that shareholders themselves take a pro-active stance and demonstrate their desire to defend their rights and interests in court, drawing on the possibilities the law gives them. So far there have been few signs of this kind of activism on the part of ordinary shareholders.

12. It is worthwhile to mention the fact that a considerable number of shareholders are physical persons (individuals), many of whom have become shareholders unexpectedly for themselves in the process of privatisation. Protection of the rights of individuals who have no status of legal entity (entrepreneur) is vested in primary-jurisdiction courts, not arbitrage courts. Primary-jurisdiction courts extremely rarely hear such cases, however, except for cases of financial pyramids.

13. The problem of “dual jurisdiction” itself deserves special attention. The jurisdictions of the primary-jurisdiction and arbitrage courts are delineated in such a way that a case may be heard by either of the aforementioned courts depending on just who the parties to it are. This situation gives rise to what can be described as dual adjudication and in some cases creates practical problems when the courts refuse to grant protection of certain rights. For example, not only primary jurisdiction, but also courts of cassation often deem lawsuits brought by legal entities-cum-shareholders as falling outside of the arbitrage court’s jurisdiction on the grounds that a court ruling would also have an impact on the rights and legally protected interests of other shareholders, individuals 13.


15. The Law on Joint-Stock Companies contains a whole range of provisions that can be invoked by shareholders to protect their rights and interests in court. On the basis of these provisions the following key judicial remedies are available to shareholders, and particularly minority shareholders:

1) to appeal against decisions of a general meeting of shareholders or other management bodies of a joint-stock company;
2) to file a lawsuit to oblige the company to repurchase shares if the shareholder has the right to mandatory redemption under the law;
3) to claim compensation to be paid to the company for damage incurred through the actions of its managers or any other economic entity or company that controls its operation;
4) to file lawsuits demanding invalidation of major transactions entered into in violation of established procedures;
5) to file lawsuits demanding invalidation of transactions involving an interest on the part of persons who may influence the way the company is run;
6) to file lawsuits to oblige a company to pay dividends;

13 As was done, for instance, in the ruling of the Federal Arbitrage Court of the Moscow District, dated November 2, 1998, on the lawsuit brought by “Inter-Komes” Medical Insurance Limited Joint Stock Company against “EAGLE” Closed Joint-Stock Air Company (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1999, N. 6) or the ruling of a primary jurisdiction arbitrage court on November 19, 1998, on the lawsuit brought by the Russkiy Khrom (Russian Chrome) Closed Joint-Stock Company against the “Mosvormet” Limited Joint-Stock Company, deeming invalid the latter’s decision to issue securities, which was upheld by the ruling of an appellate court (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1999, N. 11). In both cases the situation was rectified by resolutions of the Presidium of the Supreme Arbitrage Court, but it is impossible to determine how many cases simply did not make it to the Supreme Arbitrage Court.


7) to file lawsuits in connection with infringements on shareholder’s right to information if access to it envisioned in legislation.

16. These remedies for the protection of shareholders entail the filing of a lawsuit against the company or in defence of the company. In addition, the shareholders have the right to sue the company’s register holder, if he violates the rights of shareholders and thus commits a breach of legislation in the exercise of his functions.

17. In fact, the aforementioned judicial remedies have been used to a varying degree. Lawsuits mentioned in paragraphs two and three are virtually non-existent. Since we have been unable to find in published materials on judicial practice one single lawsuit relating to the non-disclosure of information to shareholders, the right to information will be considered as part of the regulatory framework.

Appeals against decisions of a general meeting of shareholders or other executive bodies of a joint-stock company

18. The right to participate in a general meeting of shareholders is one of the fundamental rights of a shareholder through which he can protect his property interests relating to his share in a joint-stock company. The Law on Joint-Stock Companies contains sufficiently detailed provisions on the procedure for calling and conducting general meetings, a breach of which gives grounds for decisions of such general meeting to be invalidated by court. Under Article 49, Clause 8, of the Law the shareholder has the right to appeal in court against a decision passed by a general meeting of shareholders if it runs counter to the requirements of the Law, other laws and regulations of the Russian Federation, or the company’s charter, if he did not participate in the general meeting or voted against this decision and if such a decision violated his rights and legitimate interests. It follows from this provision that a decision of a general meeting may be deemed invalid, first, on formal grounds relating to a breach in the procedure for calling and conducting a meeting (for instance, when the shareholders were not notified of the meeting as Article 52 of the Law requires, when the list of shareholders entitled to participate in the meeting was not properly compiled, when the meeting adopted its decisions in the absence of the requisite quorum, etc.) and, second, in the event that the general meeting of shareholders makes a decision on matters that fall outside its competence, as defined by the Law on Joint-Stock Companies.

19. It is essential to point out that the Law displays obvious inconsistency in dealing with appeals against decisions of a general meeting. While proclaiming the aforementioned general rule, it largely undermines it by stipulating that “the court, taking into account all the circumstances, has the right to uphold the decision being contested if the vote cast by this shareholder could not affect the results of the voting, if the breaches were not material and if the decision did not cause damage to the shareholder in question.” This provision significantly reduces the level of legal protection for minority shareholders simply because in the majority of cases their votes do not affect the final results of the voting. This is what turns many imperative provisions of the Law defining the procedure for calling and conducting a general meeting into merely optional ones.

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16 This does not mean to say that senior executive officers of joint-stock companies do not take actions that cause losses for their companies. For instance, when considering the lawsuit brought by the “Inter-Komes” Medical Insurance Limited Joint Stock Company against the “EAGLE” Closed Joint-Stock Air Company, the arbitration court established that “actions of newly elected managers of the closed joint-stock company have caused damages both to the company and its shareholders” (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1999, N. 6), but no lawsuit was filed to claim damages.

17 Failure to give the shareholder access to information or materials that are to be made available to shareholders in preparation for a general meeting of shareholders may give grounds for deeming a decision of the general meeting to be invalid and will be considered as part of that issue.

18 Under Article 48, Clause 3, of the Law, a general meeting of shareholders is not entitled to consider such matters or make decisions on them. Therefore, a decision of the general meeting made outside of its competence is legally invalid (null and void), something that is expressly stated in Clause 9 of Resolution N. 4/8.
20. It is important to bear in mind that a contested decision of a general meeting may be upheld by court only if its was passed with immaterial breaches of the Law on Joint-Stock Companies, other laws and regulations, or the company’s charter. Material breaches of legislation, as stated in Clause 9 of Resolution N. 4/8, render the decision invalid (fully or partially) regardless of whether or not any of shareholders appealed against it. In the view of supreme judicial bodies, material breaches include, in particular, a decision that does not fall within the competence of the general meeting of shareholders, a decision made in the absence of the requisite quorum, a decision made on an item that was not on the agenda or on an item that was included in the agenda just before the meeting.

21. One widespread violation relating to the conduct of general meetings of shareholders is failure to notify a shareholder of a general meeting, which tends to be called to make decisions that infringe on the interests of the unnotified investor.

22. There have been lawsuits in the arbitrage courts demanding that decisions of general meetings be deemed invalid because due process of convening these meetings was not observed. This violation should also be considered material. For instance, in the lawsuit brought by “Inter-Komes” Medical Insurance Limited Joint Stock Company against “EAGLE” Air Company Closed Joint-Stock Company, demanding that decisions of extraordinary meetings of shareholders be deemed invalid, the court ruled that the meetings under consideration were conducted in a manner that violated virtually all the articles of the Law regulating the conduct of such meetings (Articles 49, 51, 52, 55, and 58) – apart from the lack of a quorum, consideration of items not on the agenda, and failure to notify shareholders of the meetings’ agenda and dates, the meetings were called by shareholders without requesting the board of directors in advance that such a meeting be convened, that is, in the absence of legitimate rights to call a meeting.

23. The arbitrage courts also encounter the issue of how to define a quorum when a general meeting of the joint-stock company’s shareholders is held. The Presidium of the Supreme Arbitrage Court of the Russian Federation clearly stated in Resolution N. 5167/98, dated September 8, 1998, that the quorum of a general meeting is determined by the time the registration of its participants is completed, not by the time of voting on any specific issue. This explanation of the court is fully in line with the letter and spirit of Article 58 of the Law on Joint-Stock Companies.

24. Apart from clauses on appeals against decisions of the general meeting of shareholders, the Law on Joint-Stock Companies also contains provisions under which decisions of the company’s board of directors (supervisory board) may be deemed invalid as well. Under Article 53, Clause 5, if the board of directors (supervisory board) decides not to include an item in the general meeting’s agenda - or a candidate on the list of nominees for the board of directors (supervisory board) or the auditing commission (auditor) to be voted upon, this decision may be appealed against in court. Furthermore, under Article 55, Clause 5, of the Law, shareholders who own between them at least 10 percent of the company’s voting shares may appeal in the court against a decision of the board of directors (supervisory board) not to convene an emergency meeting of shareholders.

25. Given that, the question has arisen in judicial practice of whether the opportunities of appealing against decisions of the board of directors (supervisory board) are limited to the aforementioned cases expressly provided for in the law and whether or not decisions of the company’s executive bodies, be they collegial or one-man bodies, may also be contested in court. The most detailed answer to this question can
Currently be found in Clause 10 of Resolution N. 4/8. In our view, the supreme judicial bodies took an absolutely correct stance on the issue as they stated that a decision of the board of directors (supervisory board) or a collegial or one-man executive body of the joint-stock company may be contested in court by filing a lawsuit demanding that such a decision be deemed invalid whether the Law provides for the possibility of appeal or whether no such reference is made, should this decision run counter to the requirements of the Law or other laws and regulations and violate the rights and legally protected interests of a shareholder. It is the joint-stock company that will be the defendant in such a case.

**Lawsuits to oblige a joint-stock company to repurchase its shares**

26. One important guarantee of the protection of minority shareholder rights is the remedy they have under the law to put their shares back to the company for fair compensation. Clearly, the normal way of withdrawing from a joint-stock company is to sell one’s shares to other shareholders or in the open market. There can be cases, however, where a shareholder has no recourse to this option, yet to remain in a joint-stock company is no longer unprofitable for him for reasons beyond his control.

27. The Law on Joint-Stock Companies envisions two cases in which a shareholder may demand that the company repurchase all his voting shares or a part of them:

1) in the event of reorganisation or the general meeting’s approval of a major transaction if the shareholder voted against decisions on reorganisation or a major transaction or did not participate in the voting;
2) in the event of the general meeting’s approval of amendments to the company charter that limit the rights of shareholders, if he voted against that decision or did not vote.

28. As was stated above, arbitrage courts have not yet had enough practice of hearing this category of cases. Yet the supreme judicial bodies have made clear their attitude to this question in general in Resolution N. 4/8. Clause 15 of the Resolution states that should a joint-stock company refuse or try to avoid redeeming its shares in cases provided for in Articles 75 and 76 of the Law in due process and within specified dates, the shareholder has the right to go to court to demand redemption of such shares. In considering such disputes the courts should be aware of the fact that the list of grounds that entitle the shareholder to the redemption of his shares by the company under Article 75 of the law is exhaustive. The owners of common stock - and owners of preferred stock if under Article 32 (Clauses 3-5) and Article 49 (Clause 1) the latter have the right to participate in a general meeting and to cast a vote — may file lawsuits to oblige the company to repurchase their shares in cases provided for in the aforementioned Article of the Law.

**Demanding that damages be paid to the company for damage it has incurred through actions of its executive officers or another economic entity or company that controls its operation**

29. Should its executive officers or another economic entity or company that controls its operation be responsible for damage a joint-stock company has incurred, it is very important to give shareholders the right to representation in court proceedings, since in such cases those on whom this right is conferred by law are unlikely to take the requisite steps to defend the company’s interests. For this reason, Article 71 of the Law on Joint-Stock Companies, drawing on provisions of Article 53 of the Civil Code of the Russian Federation, stipulates that shareholders who own at least 1 percent of common stock have the right to sue for damages if the damage was caused by a member of the board of directors (supervisory board) of a joint-stock company on setting the price of assets (including the price of shares) made under Article 77 of the Law on Joint-Stock Companies may be appealed against in court, if such a decision was made in violation of the requirements of the Law (Clause 12 of Newsletter N. 33 of the Presidium of the Supreme Arbitrage Court, dated April 21, 1998, “Review of the Practice of Settling Disputes over Transactions Involving the Placement and Circulation of Shares”, see Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1998, N. 6).
board), a one-man executive body, a member of the collegiate executive body, or a manager (managing organisation).

30. By the same token, shareholders of a subsidiary have the right to demand compensation for damage incurred by the subsidiary if the damage was caused by its parent economic entity or company. At the same time the Law does not say that in order to sue the parent company for damages the subsidiary’s shareholders must own a certain percentage of shares. Hence, any shareholder of the subsidiary may lodge such a claim.

31. Unfortunately, the stance of arbitrage courts on this category of cases is not yet clear, though it is evident that there should be plenty of practical grounds for applying Article 71 of the Law. The shareholders make no haste to go to court, however, possibly because such damages are difficult to prove, although there have already been court cases in which such damages were exposed. For instance, in the lawsuit brought by “Inter-Komes” Medical Insurance Limited Joint Stock Company against the “EAGLE” Closed Joint-Stock Air Company, demanding that decisions of emergency meetings of shareholders be deemed invalid, the court ruled that “the actions of newly elected managers of the “EAGLE” Closed Joint-Stock Air Company have caused damage to both the company and its shareholders”[23]. It is evident, however, that while establishing the fact of damages done to a joint-stock company, the courts cannot deal with the issue of compensation if no lawsuit to that effect has been filed.

Lawsuits Seeking Invalidation of Major Transactions

32. A special procedure for conducting so-called “major transactions” in the Law on Joint-Stock Companies is a novelty in the Russian legislation, an arguable one at that, because it can jeopardise the stability of a civil law framework, of which joint-stock companies are a major part. Under Article 79 of the Law a joint-stock company may enter into a major transaction only by a unanimous decision of the board of directors (supervisory board) if the assets to be purchased or sold under the terms of the transaction are valued between 25 percent and 50 percent of the book value of the company’s aggregate assets as of the date of such a decision or - subject to a general shareholder meeting’s approval - if the transaction value is higher or if the board of directors (supervisory board) failed to approve such a transaction unanimously.

33. Article 78 of the Law defines a major transaction in such vague terms and is so obscure in regard to its meaning that in real life a bona-fide creditor cannot be absolutely sure whether a specific transaction he is involved in can be deemed as major. Furthermore, the Law makes no mention of the consequences of violating the procedure for conducting a major transaction, for which reason the courts have chosen to automatically interpret major transactions conducted in violation of the established procedure as null and void under Article 168 of the Civil Code. Recognising the dangers inherent in this approach, the Supreme Court and the Supreme Arbitrage Court of the Russian Federation attempted to somewhat soften this provision in Clause 14 of Resolution N. 4/8. In our view, they were not quite successful in so doing, though. Recognising that a major transaction concluded in violation of the established procedure is null and void they noted that such a transaction can be deemed by court as valid and creating corresponding rights and obligations for the company involved if a court hearing this case finds that this transaction was subsequently approved by the board of directors (supervisory board) or a general shareholder meeting respectively. Eventually, it so happened that the courts have created a special category of invalid transactions whose flaws can be made good by subsequent approval. Attempts by certain scholars to attribute this situation to a complex legal composition, in which the second element (approval of a transaction by a joint-stock company’s body) emerges with a time lag after the transaction was concluded, do not appear to be based on sufficiently valid grounds.

34. Currently, courts still pass their rulings proceeding from the assumption that such transactions are null and void. At the same time, often they have no clear perception of the technical criteria for a major transaction as set out in the Law. A transaction is regarded as major if it involves assets that represent more than 25% of the book value of the company’s aggregate assets. The courts, however, sometimes compare the value of transaction with the size of the joint-stock company’s authorised capital, which is not in conformity with the Law.

35. At the moment, most disputes involving major transactions that are being heard by arbitrage courts feature transactions concluded by joint-stock companies set up during privatisation. Such companies operated on the basis of the Model Charter of an Open Joint-Stock Company, approved by Presidential Edict N. 721 of July 1, 1992, in which Article 6 sets stricter criteria for a major transaction. In assessing the circumstances in which such transactions are concluded, the courts tend to proceed from the assumption that if a party enters into a transaction with a joint-stock company set up in the process of privatisation, it must be aware of the requirements of the Model Charter and, therefore, must assume the detrimental effects of violating the established procedure for concluding such transactions. In some cases this approach appears too formal, because on surface a joint-stock company created in the process of privatisation is often no different from a regular joint-stock company. It is hardly lawful to automatically place the burden of finding out the company’s special status on the other contracting party. In the resolution of such disputes it would be advisable to assess evidence provided by the plaintiff depending primarily on whether or not the contracting party was familiarised with the joint-stock company’s charter and whether or not it was advised of the fact that the company operates on the basis of the Model Charter. In other words, assessment of the circumstances of such disputes should not be based on formal criteria alone.

**Lawsuits seeking invalidation of transactions in which persons who affect the company’s management have an interest**

36. The Law on Joint-Stock Companies calls for a special procedure for transactions in which persons who affect corporate decisionmaking have an interest. The list of such persons is given in Article 81 of the Law.

37. A transaction in which any of the persons mentioned in the Law have an interest is subject to approval by the board of directors (supervisory board), with “interested” directors taking no part in decisionmaking. Approval of a general shareholder meeting is required in two cases: (1) if the amount of transaction costs and the value of assets involved in the transaction is more than 2 percent of a company’s assets; and (2) if the transaction and/or several interrelated transactions represent the placement of a company’s voting stock or other securities that can be converted into voting shares that is in excess of 2 percent of the voting stock previously issued.

38. The Law’s provisions on interested party transactions are phrased in just as obscure a language as major transaction provisions, which, of course, is hardly conducive to effective enforcement. Unlike the

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24 As was the case in the rulings of the court of primary jurisdiction, the appellate court, and the court of cassation on the lawsuit of the “Rosinka One” Closed Joint-Stock Company against the “Russkaya Berezka” Limited Joint-Stock Company, seeking that certain paragraphs of an additional agreement to the contract between them be deemed invalid (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1999, N. 6).
major transaction clause, however, the Law specifies the consequences of failure to comply with the established procedure for concluding interested party transactions. Under Article 84, such a transaction may be deemed invalid, i.e., it is contestable. It does not specify, however, who has the right to file a lawsuit, something that must be a binding rule for contestable transactions. For this reason lawsuits are mostly filed by joint-stock companies entangled in a dubious transaction themselves, not by individual shareholders. Clearly, it can only be possible when a one-man executive body of the plaintiff is not an interested party.

39. The most important criterion in decisionmaking on concluding an interested party transaction is assessment of the transaction’s impact on the joint-stock company’s assets. The same criterion of how a company’s assets will fare in the aftermath of a transaction is also applied by courts to determine the nature of contested legal relations.

**Lawsuits to demand dividends from a joint-stock company**

40. Making a decision to pay dividends on common stock and preferred stock, if the amount of dividends is not specified in a company’s charter, is a right, not an obligation, of the company, but once the decision to pay dividends has been made, a shareholder is entitled to this payment. This right is also protected by court – in the event of delay in the payment of declared dividends a shareholder has the right to go to court to demand that the amount due be paid by the company.

41. Resolution N. 4/8 explained that if a general meeting on the basis of Article 42, Clause 3, of the Law on Joint-Stock Companies has decided to pay no dividends or to pay less than the full amount of such dividends on the preferred stock specified in the charter, the dividends may not be claimed through a court proceeding (Clause 13). With respect to the owners of the preferred stock for which the amount of dividends is specified in the charter, the Law provides them with another remedy – should a decision to pay no dividends or to pay less than the full amount be made, the shareholder receives the right to participate in a general shareholder meeting with a vote, starting from the meeting that follows the annual general meeting of shareholders that made a decision violating his rights (Article 3, Clause 4, of the Law).

42. In real life shareholders seldom go to court with demands that dividends be paid. Moreover, more often than not it is not a matter of a company’s simply refusing to pay dividends. For instance, in the case of claiming dividends on the preferred stock of Transneft by the Benevent Limited Company the defendant brought a counter lawsuit seeking invalidation of the sales contracts under which Benevent had bought Transneft shares, i.e., the reason for the non-payment of dividends was the joint-stock company’s refusal to recognise the plaintiff as its shareholder and, consequently, its right to any payments whatsoever.

43. As the Presidium of the Supreme Arbitrage Court pointed out in that regard, resolving the issue of dividends to be paid on purchased preferred shares depends on the way the issue of validity or invalidity of contested sales contracts for the purchase of shares is resolved.

**Liability of a Holder of the Shareholder Register and Judicial Protection of the Rights of Shareholders Violated by the Register Holder**

44. Under Article 44 of the Law on Joint-Stock Companies the register of shareholders contains information on each registered person (shareholder or nominal holder of securities), number and categories (types) of shares entered in the name of an interested person. The register may be held by

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28 See, for instance, Resolution N. 757/96 of the Presidium of the Supreme Arbitrage Court of the Russian Federation, dated July 2, 1996, on the case of the “Sistema” Limited Joint-Stock Company, in which it was determined that the chairman of the “Sistema” Company’s board of directors clearly acted on behalf of another company by stripping the joint-stock company of its assets and selling them at or just above cost (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1996, N. 10).

either a joint-stock company itself or by a specialised registrar. At a time when an overwhelming majority of shares are issued in paperless form, the register takes on a special importance, since under Article 28 of the Law on the Securities Market an entry in the personal account with the register holder turns out to be the only certificate of shareholder rights (except for the case of accounting for the rights to securities at a depository, where an entry in a DEPO account is recognised as such a certificate). Under Article 29 of this Law the transfer of ownership rights to issued securities must be accompanied by notification of the register holder.

45. Given that, Article 45 of the Law on Joint-Stock Companies stipulates that refusal to make an entry in the register of shareholders can be contested in court. In addition, Clause 4 of Resolution N. 4/8 explained that an owner of shares also has the right to request that the entry be made to the register of shareholders if it has not been made within a period of time provided for in the Law and the registrar has not sent a notice to the shareholder, specifying the reasons for such a refusal. Should the reasons be deemed faulty and the registrar be found avoiding making this entry, the court at the shareholder’s request will oblige the registrar to perform the requisite registration, effective from the date it should have been done under the Law.

46. In the current Regulation on the Maintenance of Registers of Owners of Named Securities, the provision on the registrar’s liability is phrased in the most general terms, by reference to the Russian legislation. The Regulation states that this liability ensues in the event of failure to perform or improper performance of responsibilities in regard to the holding and keeping of a register, including failure to ensure confidentiality of the information contained in the register and provision of inaccurate or incomplete data. At the same time, the Regulation points out that failure on the part of interested parties to provide information on changes in the data to be included in the registered person’s file and submission of incomplete or inaccurate information relieves the register holder of any liability for damage caused thereby. By the way, this rule indirectly confirms that in the absence of circumstances relieving him from liability the registrar may be obliged to pay compensation for the losses he has caused.

47. The registrar’s material liability is a matter of great practical importance, since in certain cases he turns out to be the only person who can realistically compensate a shareholder for damage. For instance, in one case, which passed all the stages of court proceedings and reached the Presidium of the Supreme Arbitrage Court, it was recognised that the registrar is obliged to compensate shareholders for the value of the shares that he wrote off in violation of the law from the account of the plaintiff/seller under a shares purchase contract subsequently invalidated and that were no longer on the purchaser’s account by the time the court passed a ruling deeming this contract invalid. It is worth pointing out, however, that this decision was based on the requirements of the former Regulation N. 840-r of the State Property

30 There have been frequent cases in judicial practice where a court had to investigate whether or not the legally established procedure for transferring ownership rights to shares has been complied with. For instance, in the lawsuit of “Bolshoy Gostiny Dvor” Limited Joint-Stock Company against “Yenisey” Closed Joint-Stock Company the Presidium of the Supreme Arbitrage Court of the Russian Federation ruled that the court of primary jurisdiction erroneously proceeded from the assumption that the plaintiff obtained the ownership right to shares at the moment the sales contract for the shares was signed (See Resolution N. 2566/99 of the Presidium of the Supreme Arbitrage Court of the Russian Federation, dated September 21, 1999, Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1999, N. 12).

31 There have been no infrequent cases in recent judicial practice where a contested refusal to make an entry in the register had valid reasons behind it. This can happen when the sales contract for shares is invalid, for instance, when the seller himself is not a legitimate owner of the shares. For instance, in the lawsuit of “Riondo” Trade House Closed Joint-Stock Company against “Ochakovo” Food Warehouse Open Joint-Stock Company - which maintained its register on its own – requesting that the plaintiff be registered in the register of shareholders, courts did not check out the register for the seller’s personal account there. The Presidium of the Supreme Arbitrage Court of the Russian Federation stated in its Resolution N. 6712/97, dated November 30, 1997, that in this situation the issue of registering the plaintiff in the register of shareholders cannot be resolved, since it depends completely on the way the issue of validity or invalidity of the sales contract for shares, which requires further investigation, will be resolved. (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 2000, N. 2).


Committee (GKI) of the Russian Federation “On the Register of Shareholders of a Joint-Stock Company, issued on April 18, 1994, which is no longer in force. Under Clause 5 of that Regulation, the holder of a register of shareholders shall carry out activities related to the holding and keeping of a register in accordance with the requirements of the current Russian legislation and shall be obliged to compensate for damage caused should these requirements be violated or errors be made during registration.

48. Courts have repeatedly encountered lawsuits demanding that an entry in the register of shareholders by which shares are written off from the plaintiff’s account and recorded in the account of another person be deemed invalid, in particular, where such entries were made without the share owner’s consent. In one of such cases a court of primary jurisdiction and a court of cassation dismissed a case demanding that an adjustment to registration be deemed invalid, claiming that such an entry may not be recognised as a transaction, it is not an act of a government authority, and that the Law on Joint-Stock Companies does not provide for such a legal remedy to defend one’s civil rights. The Presidium of the Supreme Arbitrage Court, however, deemed such conclusions groundless, since “under Article 29 of the Law on the Securities Market an entry in the register of shareholders certifies one’s ownership right to a corresponding number of shares. Making changes to this entry without the shareholder’s knowledge and request is a violation of his ownership right.” For this reason, the court stated, the lawsuit demanding that such changes in the register be deemed invalid and that the original entry be restored is in fact a suit seeking to enforce a right that has been infringed upon.34

49. Apart from being liable to shareholders, the registrar also assumes administrative responsibility to the state, being liable for unlawfully refusing or avoiding making the requisite entries in the register, entering inaccurate data, unduly delaying the issuance of excerpts from the register, and for failure to comply or inadequate compliance with other legitimate requests of a securities holder or his nominee. This type of liability was first introduced in the Law on the Protection of Investors’ Rights and it entails fines that can be imposed on officials, legal entities, and individual entrepreneurs.35

3. The Shareholder’s Right to Information

50. This right can be broken down into two components. The first component is a shareholder’s right to have the requisite information on the business affairs of a joint-stock company in which he owns shares, to familiarise himself with its founding or other documents, to get timely and complete information he may need to get ready for participation in a general shareholder meeting. The second component is the shareholder’s right to get information about share issues undertaken by the company. In the latter case, the shareholder, like any other investor, enjoys the right to information that is required to make decisions on the advisability of extra investments in the company, but apart from that he is also entitled to timely information on the main stages of issuance so as to be able to have recourse to remedies provided for in the legislation should his rights be violated in the process.

A shareholder’s right to information on the company’s business affairs

51. A joint-stock company is obliged to give shareholders access to documents that are listed right in the Law on Joint-Stock Companies. First of all, these are the company’s charter and the decision on creating the company, internal documents regulating the operational organisation of the company and its bodies, the annual financial report, minutes of general meetings of the company’s shareholders, the prospectus of

35 Although the imposition of a fine cannot be regarded as a means of shareholder protection in a specific case where a violation has already been committed, the very threat of being fined will act as a deterrent on the registrar and his officials. Unfortunately, we have no information yet on how often or how efficiently this remedy has been applied.
share issues. What is important is that this list is not exhaustive, and it can be expanded by the company’s charter, internal documents, decisions of general shareholder meetings, board of directors, or other executive bodies of the company.

52. Apart from providing this information directly to shareholders, any open joint-stock company is obliged to publish its annual financial reports and other information provided for in the law on an annual basis. Such publications are designed, first of all, to give shareholders access to this information, since Article 92, Clause 1, of the Law calls for the publication of this information in “the mass media accessible to any shareholder of this company.”

53. Among documents a joint-stock company is obliged to make available at a shareholder’s request - and also to publish – the Law includes lists of affiliated persons, specifying the quantity and categories (types) of shares they own. Up to the present time, however, few joint-stock companies have actually kept the register of their affiliated persons. Currently, the FCSM’s Regulation N. 7, dated September 30, 1999, “On the Procedure for Accounting for Affiliated Persons and Disclosing Information on the Affiliated Persons of Joint-Stock Companies” provides for a standardised procedure for disclosing this information to shareholders – at a written request of a shareholder within 10 days from the date such a request was presented.

54. In order to efficiently participate in the company’s process of decisionmaking a shareholder needs to know who the other shareholders are and how many shares they own. Different laws set different requirements a shareholder must meet to be able to get information about other shareholders. The Law on Joint-Stock Companies proceeds from the assumption that a shareholder will need such a disclosure only for general meetings. Article 51 of the Law stipulates that a list of shareholders who have the right to participate in a general meeting can be made available at the request of persons who account for at least 10 percent of votes at the general meeting of shareholders. On the one hand, this provision enables shareholders who own enough shares to influence the process of decisionmaking at a general meeting to get information on other shareholders who are also entitled to participate; on the other, it is a deterrent against abusing this type of information, since information on the allocation of shares between shareholders has a commercial value of its own in the eyes of competitors.

55. The Law on the Securities Market proceeds from a different assumption – a shareholder and even a nominal holder of securities can at any moment of time obtain from the registrar information on any owner of securities registered with this registrar, including the quantity, category, and book value of the securities he owns. There is just one threshold – the shareholder or his nominee must own more than 1 percent of the voting stock. This means that shareholders will find it much easier to get access to information on other shareholders’. This “more liberal” approach from the viewpoint of exercising shareholders’ rights could have been justified by the fact that the Law on Joint-Stock Companies sets a quantitative threshold for certain actions of shareholders. For instance, in order to propose items to be included in the agenda of a general meeting and to nominate candidates for the board of directors one must own at least 2 percent of voting shares (Article 53, Clause 1 of the Law), and in order to call an emergency meeting of shareholders or an emergency audit of the company’s finances and business operations, 10 percent (Article 33, Clause 2 and Article 85, Clause 3 of the Law). In such situations

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36 In addition, Article 52, Clause 4 of the Law contains the list of documents a shareholder must be provided with in preparation for a general meeting of shareholders, which includes, along with the aforementioned documents, information on candidates nominated for the board of directors, draft changes to the company’s charter, etc.

37 At the same time, Article 92, Clause 2 of the Law and Articles 23 and 30 of the Law on the Securities Market oblige a company that has publicly offered securities at least once to publish quarterly reports for general information and also to disclose information on significant developments.

38 Article 8, Clause 3, of the Law on the Securities Market; the same rule is contained in Clause 7.9.1 of the Regulation on the Keeping of Registers of the Owners of Named Securities.

39 A nominal holder of shares can exercise this right on behalf of a shareholder who may own just one share, if he is simultaneously a nominee for other shareholders of the same company and if the shares he nominally holds for all of them exceed 1 percent of the company’s voting stock.
having access to the register may help a shareholder who owns less than one percent of voting shares to find an ally and thus exercise a right conferred on him under the Law. Yet this explanation does not make clear, however, why this issue was not resolved in the Law on Joint-Stock Companies and why it should be regulated by the Law on the Securities Market, which should not have any bearing on corporate governance issues. Admittedly, so diverging approaches to one and the same issue demonstrate the lack of a system in this area of legislation.

A shareholder’s right to information in the event of the issuance of shares or other convertible securities by a joint-stock company

56. The current legislation sets the strictest disclosure requirements for information that a joint-stock company is obliged to disclose to the widest-possible audience in the event of issuing securities. In this case information disclosure is a means to protect the interests of investors by enabling them to make informed investment decisions. Further to the rules provided for in the Law on the Securities Market and the Law on the Protection of Investors’ Rights, the FCSM has over the past several years passed a number of documents regulating the procedure for and the scope of information disclosure by open joint-stock companies that issue securities by subscription and also defining the contents and structure of a quarterly report of a securities issuer.40

57. It is important for shareholders to be informed about a share issue from its very first stages. For this reason Article 52, Clause 4, of the Law on Joint-Stock Companies states that even at the stage of preparations for a general meeting of shareholders whose agenda includes the item on the issuance of shares or convertible securities shareholders, along with other materials, must receive the minutes of a meeting of the board of directors containing the decision on the market value of such securities and specifying a quorum and the results of the voting.

58. At subsequent stages the company is obliged to publish the following reports in the Supplement to the Newsletter of the FCSM: (1) on the decision concerning the placement of securities, specifying whether or not the shareholders’ pre-emptive rights will apply; (2) on the official registration of the issue; (3) on completion of the placement of securities. Shareholders will thus have the opportunity to familiarise themselves with this information.41 Reports on the decision concerning the placement of securities and issue registration give an idea about the types, quantity, dates, and other conditions (except for the price, which is stated in the prospectus of the issue) of the securities issue.42 A prospectus gives information on the company itself and its financial status.

59. There is yet another disclosure requirement worth paying attention to. In the event of issuing securities by open subscription (public offering) the issuer is obliged to publish information on registration of the report of securities placement results, specifying where the text of the report itself can be obtained. Should the official registration of an issue entail the registration of its issue prospectus, the issuer is also obliged to publish information contained in the report on placement results. This rule, which has been in existence for several years now, took on a real importance for shareholders after Article 5 of the Law on the Protection of Investors’ Rights barred the owners of securities from entering into transactions with these securities till they have been fully paid for and till the report on placement results has been officially registered. Proper compliance with the requirement to publish information on

40 Yet more proof of the fact that the need for additional regulation in this area is still strong was furnished by the FCSM, which passed on November 29, 1999, Regulation N. 10 on Certain Matters of Information Disclosure in the Securities Market,” which was registered by the Ministry of Justice on February 4, 2000.
41 In the event of closed subscription with less than 1000 shareholders, it is permitted to send such reports to all shareholders instead of publication. If a closed subscription is undertaken by a joint-stock company with 1000 or more shareholders, decisions concerning the placement of securities must be published, whereas other reports could be sent out to shareholders.
42 If the shareholders’ preemptive right to purchase shares and other convertible securities is exercised, under Article 41 of the Law on Joint-Stock Companies each shareholder must be notified of the possibility of exercising his preemptive right at least 30 days before the date of the securities issue; among other things, the notice must contain information on the price of the issue.
registration of the report will enable a shareholder to receive timely information as to the moment of time from which the shares may be lawfully traded.

60. So, the system of disclosure requirements in the process of issuance is designed in such a way that any shareholder will have the opportunity to obtain sufficient information on the subject. If he believes that the issuance is going to or may result in an infringement on his rights, he can lodge a complaint with the FCSM or file a lawsuit.

61. What penalties does a violation of an investor’s right to information entail? They were first set out in the Law on the Protection of Investors’ Rights and, therefore, have been enforced for less than one year. Under Article 5 of the Law, the issuer’s officials who signed the prospectus for a securities issue, and also appraisers and auditors who confirmed the information contained therein are liable for damage done to investors through provision of inaccurate or misleading information. They are held jointly and severally liable for that together with the issuer. It is common knowledge that such a damage poses a serious problem because it needs to be appraised, something that will not always be easy to do in such situations. We are yet unaware of the practice of arbitrage courts with respect to this category of cases. Presumably, it will develop in the near future, given the fact that this class of lawsuits envisions a reduced statute of limitations – one year from the time a violation was uncovered, but within three years from the day the issuance of securities began (Article 5, Clause 5 of the Law).

62. It would have seemed that investors will be more eager to seize the opportunity given to them by Article 6, Clause 7 of the Law to go to court to demand that a contract for the purchase of securities signed with an issuer or a professional participant of the market be invalidated under Article 450, Clause 2, Paragraph 2 of the Civil Code of the RF, if the requisite information was not disclosed to the investor or if it was disclosed improperly.

63. The Law on the Protection of Investors’ Rights calls for a fairly broad administrative liability in the form of fines – under Article 12 of the Law such fines can be imposed on officials and on legal entities for various violations of information disclosure rules. The results of its application in the first year after the Law came into force will be summed up in the near future and, hopefully, will be included in the next annual report of the FCSM.

4. The Rights of Shareholders in the Process of Placing the Issues of Shares and Convertible Securities

64. A joint-stock company can increase its authorised capital by increasing the book value of its shares issued or by issuing new shares. For that to be done a general meeting of shareholders or the board of directors must make a decision in accordance with the company’s charter to issue new securities. If such a decision is made in violation of shareholder rights provided for in the legislation, a lawsuit can be filed demanding that this decision be invalidated, as was done by “Russkiy Khrom” (Russian Chrome) Closed Joint-Stock Company, which filed a lawsuit with the Arbitrage Court of Moscow against “Mosvormet” Open Joint-Stock Company.43

65. The Law on the Protection of Investors’ Rights introduced a significant novelty in the procedure for making decisions on the issuance of shares and convertible securities. Article 5, Clause 4, of the Law strips the board of directors of the right to decide on the placement of such securities by closed subscription and, as an exemption from Article 49, Clause 4, of the Law on Joint-Stock Companies, requires a super-majority of two-thirds of the votes for such a decision to be made. The rationale behind this rule is that boards of directors tend to abuse their power to decide on closed subscriptions in every

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43 See Resolution N. 1206/99 of the Presidium of the Supreme Arbitrage Court of the Russian Federation, dated August 3, 1999, (Newsletter of the Supreme Arbitrage Court of the Russian Federation, 1999, N. 11). With respect to appeals against such decisions, the rules of appealing against decisions of a general meeting of shareholders and other executive bodies of a joint-stock company, which were considered above in this report, also apply in this case.
conceivable way, and shareholders often do not even know that such a decision was made by the board of directors and that new securities were issued. This mechanism has been used in the majority of recorded attempts at “equity dilution.” In our view, this is a more profound problem, one that is rooted in the very structure of declared capital that is envisioned in the Law on Joint-Stock Companies and in the fact that the board of directors is allowed to make such decisions at all. In no way attempting to question the correctness of this threshold, we cannot but point to its legal inconsistency. If a corresponding system is set out in the Law on Joint-Stock Companies, it should be adjusted by making amendments to that Law.

66. It is a general rule that following the issuance of new shares the stakes of shareholders may change disproportionately. However, under Article 40 of the Law on Joint-Stock Companies in the event of open subscription where shares are paid for in cash the charter of a joint-stock company may provide for a pre-emptive right to be given to the owners of voting shares so that they could purchase shares or convertible securities on a proportional basis. Such provisions are a frequent feature of company charters. Yet even if such a provision in the charter exists a general meeting of shareholders can make case-by-case decisions to waive the pre-emptive right clause for a period of up to one year inclusive (Article 40, Clause 2, of the Law).

67. If the charter of a joint-stock company does not contain a pre-emptive right clause or if a general meeting of shareholders passes a decision that the pre-emptive right will not apply, a shareholder will have the same rights to purchase additionally issued securities as any ordinary investor. Earlier in this report we have already considered the subject of a shareholder’s right to information disclosure in connection with a securities issue.

68. The procedure of issuance is regulated in detail by provisions of the Law on the Securities Market and follow-up regulations of the FCSM. The Law on the Protection of Investors’ Rights, too, sets additional limits related to securities issues. Securities issues require a number of registration procedures—registration of the issue of securities, registration of the prospectus for a securities issue (if this is required under Article 19 of the Law on the Securities Market), and registration of the securities issue report.

69. Issue registration may be denied on grounds listed in Article 21 of the Law on the Securities Market. Statistics show that there is a high number of cases in which issue registration is denied—for instance, in 1998 the FCSM’s regional offices alone denied registration to 2,612 issues of securities (an overwhelming majority of which were share issues), registering a total of 19,775 share issues. For the FCSM’s central office the ratio was 5:73. Therefore, the percentage of “faulty” share issued undertaken by joint-stock companies is very high: nearly 12 percent of the overall number of issues submitted for registration failed to pass the procedure.

70. According to FCSM data, the most frequently cited reason for denying registration is that the requisite information is missing from the prospectus for a securities issue or it is inaccurate. A case in point is refusal to register a share issue of Siberian Oil Company in August 1998. Conditions of payment for shares in the prospectus were at odds with the conditions set in the initial decision concerning the share issue. Furthermore, the prospectus contained provisions that could mislead investors.

44 Abuses committed by boards of directors do not limit themselves to that. There have been cases where a board of directors made a decision to allocate shares issued on the basis of revaluation of the issuer’s fixed assets among shareholders, but not on a proportional basis. For instance, the FCSM refused to register the report on the results of a common stock issue by “Nosta” Open Joint-Stock Company, which was placed in this fashion among shareholders. – See the Annual Report of the FCSM for 1998, p 52.


71. Refusal to register an issue or the prospectus for a securities issue can be contested in court. Such appeals are infrequent, however, despite the fact that a majority of court proceedings involving the FCSM as a defendant concerns just its refusal to register securities issues\textsuperscript{47}.

72. Upon completion of the placement of securities the company is also obliged to submit for registration its internally approved report. If any violations of legal requirements in the process of issuance or inaccurate information in the documents on the basis of which the securities issue was registered are uncovered by that time, registration can be denied. Non-registration of the report is one of the reasons for invalidating an issue. With a total of 18,748 reports on the results of share issuance registered in 1998, FCSM regional offices denied registration to 1,102 reports, which means that about 6 percent of registered share issues were subsequently invalidated\textsuperscript{48}. Issues are also deemed invalid if securities thus placed were less than the share specified in the initial decision on issuance; if at least one security was not placed; if the issuer failed to provide a report on the issue within specified dates; and for some other reasons.

73. A securities issue in which violations were uncovered after the report was registered can be deemed null and void by court. There have been few such issues – in 1998 there were only 58\textsuperscript{49}. From the point of view of an investor who pays for the securities, however, the consequences will be essentially the same.

74. Should an issue be deemed invalid or null and void, the issuer will be obliged to compensate the never-would-be owners of these securities in cash or return to them assets received toward payment for the securities. The rules of compensation should be aimed first and foremost to protect the rights of such never-would-be owners. Under the Law on the Securities Market, the FCSM issued a regulation on the procedure for such compensation\textsuperscript{50}. It does not go far enough, however, to protect such never-would-be owners’ rights. First, under Clause 4.1 of that Regulation, the entire amount of investment is to be repaid in cash regardless of whether it was paid in cash or in kind. Money paid in hard currency is to be repaid in rubles. Second, while under Clause 4.2 of the Regulation, the amount invested shall be compensated in full, it will be repaid not at once, but after completion of a whole range of actions for which the Regulation reserves up to 5 months. These rules run counter to provisions of the Civil Code of the RF concerning immaterial enrichment. An owner of securities does have the right to compensation in the amount paid, but only on the date when the issue was deemed invalid or null and void, from which date interest must accrue on this amount under Article 395 of the Civil Code for the use of borrowed funds. So far as property is concerned, it must be returned in kind in accordance with Article 1104 of the Civil Code. The authors of the Regulation were evidently aware of this inconsistency with the law, since they added Clause 6.3, which states that if the owner of securities is dissatisfied with the amount of compensation he has the right to contest it in court.

\textsuperscript{47} For instance, in 1998 there was a total of 52 court proceedings involving FCSM regional offices as defendants - see Annual Report of the FCSM for 1998, p 85.
\textsuperscript{49} Annual Report of the FCSM for 1998, p 82.
\textsuperscript{50} Approved by FCSM Resolution N. 36 on September 8, 1998.