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Background Paper on
THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

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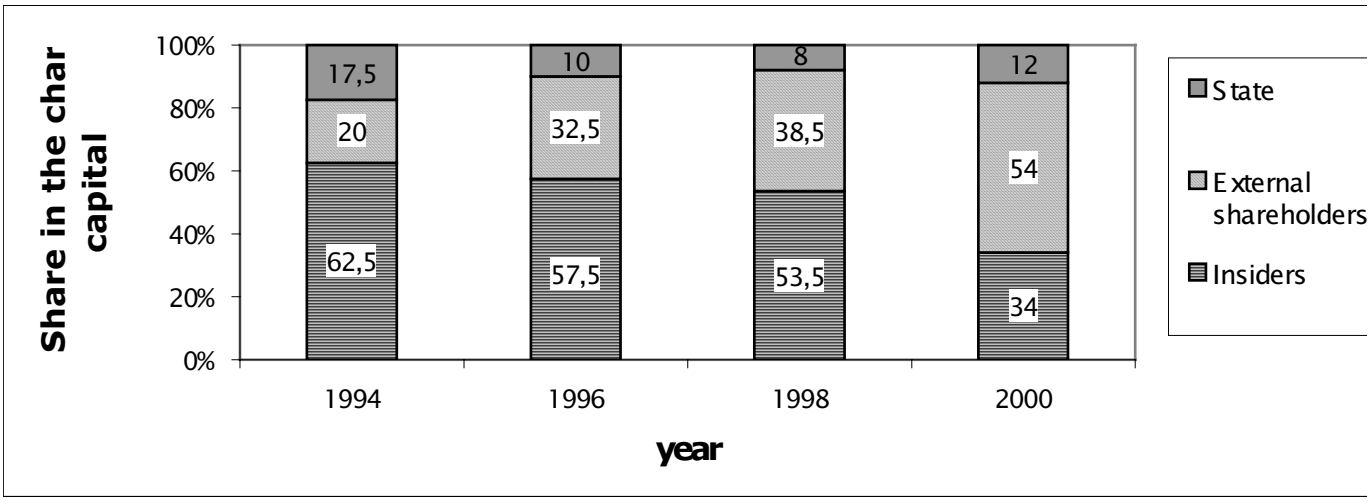
1. Participants in Corporate Governance and their Role in Development of Enterprises [1]

Today it is no longer sufficient to regard the problems of corporate governance exclusively from the point of view of protection of shareholders' rights, although this problem remains the most urgent one for the Russian enterprises and the economy in general. Creditors, suppliers and consumers, workers of enterprises, and the state authorities are actively involved in the process of corporate governance (Diagram 1).

Diagram 1. Changes in the Structure of Property of Russian Medium and Large Joint-Stock Companies, 1994-2000, as % of the Charter Capital

(based on surveys conducted by IET and other organizations).



Speaking about the role of the corporate governance participants in development of enterprises, it is necessary to take into consideration that both the strategic orientation of

[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. This paper is subject to further revision.

investors (targeted on development), and speculative orientation, ensuring the mobility of capital and, hence, extending the possibilities of corporate financing, are important for the Russian enterprises. So far, small investors have not played an active role in protecting their interests, often failing to use their legally established rights. They do not participate in the company management. Most large investors are not interested in attracting investment via joint-stock capital for fear of losing control over business. In the future this situation should change. Such changes are already beginning to transpire in some joint-stock companies.

The activity of institutional investors, for instance, pension funds, requires a possibility of investment in a sufficiently large number of different stocks involving small risk and moderate income rates (portfolio diversification). Presently, the Russian stock market does not offer such opportunities. Therefore it is only possible to talk about the role of institutional investors in a mid-term perspective.

The Boards of Directors of the Russian companies are rather passive and consist mainly of insiders. According to surveys[2], the Board of Directors usually represents four groups: the controlling private owner, the management and employees, representatives of the state authorities, and small shareholders – outsiders. A tendency towards promotion of independent directors, maintaining the interests of minority shareholders, has shaped out of late. However, this practice is still rare. In the Russian conditions, where there is frequently a conflict between various groups of shareholders, the protection of a narrow group of minority shareholders may lead to negative consequences for the economic activity of the joint-stock company. In the future, the notion of "independent director" is supposed to signify, above all, activity on a professional basis, with observance of certain rules and the business ethics.

As for the executive authorities, their role is still quite significant. The returns of the surveys of industrial enterprises[3] show that all decisions, including strategic ones, at the majority of enterprises are adopted by the General Director. This is largely connected with the prevalence of the insider structure of property of many Russian enterprises (Supplement 1), where the management is the main proprietor (shareholder). Besides, the majority of Russian companies do not have a formal procedure of appraisal of the General Director's performance. As a rule, the only criterion is the way he protects the interests of insiders.

Creditors play a special role in the process of corporate governance. The accessibility of bankruptcy procedures leads to strong creditors' influence on the processes of property redistribution, including at the expenses of intentional bankruptcies, which is already beginning to result in the elevation of the enterprises' discipline of payments. On the whole, the institution of bankruptcy is one of the strongest mechanisms of corporate control in Russia, the more so because of the weak role of the stock market in this matter. In the future this institution should acquire a greater role in financial recovery of enterprises.

The state, remaining a large proprietor, most frequently has a neutral or even negative influence on the work of enterprises due to the imperfection of the institutional arrangement of the state system. Nevertheless, there have been examples where the state functioned as an active

[2] Corporate Governance in Russia. Troika Dialog Research, November 2000.
[3] Problems of Property and Management in Processes of Restructuring of Industrial Enterprises in Russia. Analytical Report. Bureau of Economic Analysis. Moscow, 2000.

shareholder defending its own interests and adopting decisions directed at real development and restructuring of enterprises. In the future it is expected that it is precisely the state as a major proprietor that can promote the development of corporate culture in the Russian companies.

The balance of interests achieved between the participants in corporate governance does not always result in development of enterprises and effective management. The legislative norms, the infrastructure, and legal practice fail to attain their goal, among other things, due to the lack of a **comprehensive approach to state regulation in the sphere of corporate governance.** The lack of accord in various spheres (for example, in the sphere of legislation on joint-stock companies and the sphere of labour relations, in the sphere of legislation on joint-stock companies and in the field of bankruptcy, in the sphere of legislation on joint-stock companies and the legislation on privatization) leads to a situation where investors' expenses on protection of property rights exceed the cost of "uncivilized" methods of making money.

2. Rights of Executive Bodies of Economic Companies.

2.1. Rights and Duties of a One-Man Executive Body.

We have already mentioned that the executive bodies of the Russian companies adopt the majority of decisions, including strategic ones. In this connection, the issue of their rights and responsibilities, as well as the mechanisms of control over their activity on the part of the Board of Directors and shareholders, is of paramount importance. The rights and duties of a one-man executive body of a joint-stock company emerge on the borderline between the civil and labour legislation. The issue of certain gaps in these areas of the law, as well as the collisions between the labour and civilian legislation is still open, which causes a number of practical problems.[4]

The Federal Law "On Joint-Stock Companies" restricts the authority of the company chief executive in the field of carrying out major transactions and transactions with respect to which there is an interest. From the point of view of restricting the authority of the executive body and protecting shareholders' rights, these norms are frequently ineffective for the following reasons:

- The legislation classifies as "major transaction" a transaction the volume of which exceeds 25% of the balance value of the company assets. At the same time, the balance cost of assets at the moment of concluding the deal may be considerably different from its market value.

- In the event of carrying out a major transaction within the frames of "routine economic activity," the decision may be adopted without shareholders' consent (under the Federal Law "On Joint-Stock Companies"). In the absence of criteria of classifying a transaction as routine economic activity, the majority of important deals can in fact be concluded by the one-man executive body.

- Legal practice shows that a mortgage agreement may not be regarded as a transaction, which equips the one-man executive body with broad opportunities of property alienation.

[4] Yu.A.Meteleva. Legal Position of Shareholder in a Joint-Stock Company. Moscow, STATUT, 1999.

There is a possibility of compensating these shortcomings by the agreement (stipulating the rights and duties of the executive body, and containing clauses on his early dismissal from office, remuneration, etc.). However, although the Law on Joint-Stock Companies offers the possibility of settling this issue by the Board of Directors (by introducing this clause to the joint-stock company charter as "other issues," not constituting the shareholders' competence), the shareholders have only mediated control over the activity of the one-man executive body – via the Board of Directors. And considering that the Board of Directors is also subordinate to the executive body, this control is hardly effective. A more serious legal gap emerges when there is no Board of Directors, in that case the shareholders would not be able to control the contents of the contract concluded with the one-man executive body, as the introduction of clauses on the contract into the charter would contradict the Federal Law "On Joint-Stock Companies," which does not allow the general shareholders' meeting to solve issues not referred to its competence by the law.

Proposal: It is necessary to work out and approve the criteria of classifying deals as major transactions and transactions with interest, and to specify the notion of "routine economic activity."

The lack of clarity of rights and duties of a one-man executive body is also connected with contradictions between the labour and civil legislation. The issue of referring the contract with a one-man executive body to the labour or civil legislation still has no unequivocal solution (some researchers note that although literal interpretation of a number of laws speaks of its civil nature, legal practice shows otherwise[5]). Although the Law on Joint-Stock Companies stipulates that "the labour legislation regulates the relations between the company and the one-man executive body in the part, not contradicting the present Law," the labour legislation does not exclude the heads of joint-stock companies from the sphere of its validity, which signifies overt collision between the labour legislation and the legislation on joint-stock companies. In practice, the authority and responsibilities of a one-man executive body differ significantly, depending on whether the contract is interpreted under the labour or the civil law (Table 1).

Table 1.

Labour Code	Civil Code
Rights	
If the company chief executive is admitted to exercise his functions, the agreement shall be considered concluded; the absence of a written agreement does not mean that the agreement is invalid and practically deprives the shareholders of the possibility to contest the legitimacy of actions of the chief executive (article 18 of the RF Labour Code).	The commencement of exercising the duties by a one-man executive body does not signify the conclusion of an agreement, and the legitimacy of actions of the chief executive can be contested (articles 161, 432 of the RF Civil Code).

[5] B.R.Karabelnikov. Labour Relations in Joint-Stock Companies. Moscow, STATUT, 2001.

The chief executive who commenced to exercise his functions has a right to demand the conclusion of a perpetual labour contract.	The agreement can be both terminable and interminable.
The agreement can be cancelled on the grounds indicated in article 32 of the Labour Code (on demand of the worker in the event of his illness or disability, preventing him from discharging his functions on agreement (contract), violation of the labour legislation, the collective or labour agreement (contract) by the administration) and for other valid reasons.	The agreement can be cancelled on the grounds indicated in article 450 of the RF Civil Code (in case of considerable violation of the agreement by one party and in other cases envisioned by the Civil Code, other laws or agreements).
The dismissal of the chief executive is complicated, particularly in the absence of a written form of agreement (as the grounds for dismissal indicated in the Labour Code are aimed at protecting the interests of the employee, i.e. the shareholders would either have to wait for the expiration of the agreement or the perpetration of faulty actions by the chief executive).	The dismissal shall be carried out in accordance with provisions of the agreement. It may be terminated at any moment ahead of time on decision of the general meeting of shareholders or the Board of Directors, if the company charter envisages such possibility (item 4, article 69 of the Federal Law "On Joint-Stock Companies").
Duties	
The chief executive has the right to issue an order to delegate his powers to his deputy.	The Federal Law "On Joint-Stock Companies" does not give the chief executive the right to fully delegate his powers to his deputy, as the formation of a one-man executive body constitutes the competence of shareholders.
The norm stipulated by article 69 of the Federal Law "On Joint-Stock Companies" is invalid, as it deteriorates a worker's position (article 5 of the Labour Code), in other words, in the event of recognition of the supremacy of the labour legislation over the Federal Law "On Joint-Stock Companies," the chief executive shall be granted the right to combine jobs.	It is prohibited to occupy positions in the managerial bodies of other organizations (article 69 of the Federal Law "On Joint-Stock Companies").
It is impossible to charge the lost material profit, and cases of full material responsibility are restricted by the norms of the Labour Code (articles 119, 121).	Is responsible before the company in the volume envisaging both the compensation of real damage and lost profit (article 71 of the Federal Law "On Joint-Stock Companies," article 15 of the RF Civil Code).

Does not bear full material responsibility for the disclosure of commercial secret (articles 15, 119, 121 of the Labour Code).	Must compensate the damage inflicted by disclosure of commercial secret.

Proposal: It is necessary to introduce amendments to the legislation in order to specify the legal status of a one-man executive body.

During bankruptcy procedures, the authority and rights of the debtor's chief executive may be restricted.[6] The appointment of an acting manager seriously restricts the authority of the debtor's management bodies, including the chief executive, to dispose of property. The following transactions may be carried out only upon consent of the acting manager: deals with real estate; with the debtor's property, the balance value of which exceeds 10% of the balance cost of assets; deals connected with obtaining and issuing loans, issuance of warranties and guarantees, concession of chose in action, debt transfer. This restriction is quite justified if the acting manager maintains the interests of the majority of creditors, rather than a narrow group, that can be connected with deliberate bankruptcy. At the same time, the procedure of appointing an acting manager does not always result in such approach. The matter is that the court adopts a decision to initiate a case on bankruptcy without the participation of the debtor, and the candidate to acting manager is proposed by the claimant creditor. This gives room to abuse for the purposes of frustrating the enterprise's activity in the interests of the counteragent.

Proposal. It is expedient to envisage that the issue of initiating the bankruptcy case and appointing an acting manager should be considered with the debtor's participation (adversary proceeding).

If the satisfaction of demands of one creditor leads to the impossibility of fulfilling the debtor's obligations to the other creditors in full volume, the debtor's chief executive or individual entrepreneur must appeal to court with an application to recognize the debtor bankrupt. Subsidiary property liability of the debtor's chief executive is envisioned for non-fulfillment of this obligation. Besides, the debtor's chief executive can be disqualified – dispossessed of the right to occupy a leading position. This mechanism of protecting creditors' rights is practically never used in practice. This is connected with the ambiguousness of the norm itself. It is unclear what criteria should be used as the basis for analyzing the impossibility of fulfilling demands.

[6] V.V.Stepanov. Inconsistency (Bankruptcy) in Russia, France, England, Germany. Moscow, STATUT, 1999.

2.2. Rights and Duties of a Collegial Executive Body.

The legal status of the one-man executive body is largely identical to the legal status of the collegial executive body, which, in accordance with the Federal Law "On Joint-Stock Companies," should run the current activity of the joint-stock company.

Just like in the case with a one-man executive body, the contradiction between the labour legislation and the legislation on joint-stock companies leads to uncertainty of rights of members of a collegial executive body.

The Federal Law "On Joint-Stock Companies" allows early termination of the contract with a member of the collegial executive body. If the correlation between the labour and civil legislation is interpreted in favour of the former (and this is what usually happens in practice), it is necessary to admit that according to the Labour Code, a member of the collegial executive body would have to be dismissed as a rank and file company employee, as the Labour Code makes no exceptions in this issue for members of the collegial executive body (under article 33 of the Labour Code).

The following clause of the Federal Law "On Joint-Stock Companies" – combining posts in a joint-stock company and in the management bodies of other organizations – is admitted only upon consent of the Board of Directors. On the one hand, the general logic of the Labour Code also envisions that an employee may have only one "main" job, but on the other hand, the Labour Code does not contain a mechanism of recognizing the contract contradicting the law null and void. Consequently, there are in fact no obstacles for concluding another similar contract with another company.

According to the Federal Law "On Joint-Stock Companies," members of a collegial executive body "shall be responsible to the company for losses inflicted to the company, if other grounds and size of responsibility are not established by the federal laws."

According to the Federal Law "On Joint-Stock Companies," members of a collegial executive body "shall be accountable to the company for the losses inflicted on the company, if the federal laws do not envision other grounds and measure of responsibility."

The duties and responsibilities of a member of the collegial executive body are also a question of correlation of the norms of the labour and civilian legislation. The Federal Law "O Joint-Stock Companies" contains a clause that members of the collegial executive body "shall be accountable to the company for the losses inflicted on the company, if the federal laws do not envision other grounds and measure of responsibility." However, the Labour Code limits the cases of full material responsibility. Moreover, it is impossible to impose civil-legal measures to an employee on the basis of article 5 of the Labour Code. This is confirmed by legal practice: over the past five years not a single court decision has been adopted to charge the sum of the damage inflicted on a company from the leader of the joint-stock company. Such legal practice shows the dubiousness of inclusion in the agreement with a member of the collegial executive body such clauses as responsibility for disclosure of confidential information, the ban on taking up a job at a competing firm, etc. Moreover, the shareholders cannot fire one of the members of the collegial body, as the

formulation of the Federal Law "O Joint-Stock Companies" suggests that the shareholders' meeting is empowered to terminate the authority only of the entire collegial body, rather than just one of its members. The solution of this issue has also been left up to various interpretations and the legal practice.

During bankruptcy, the legislation sets a special order of managing the debtor's affairs, depending on the applied procedure. According to the Law on Inconsistency, the company's executive bodies shall exercise their functions with restrictions and may be suspended from the company management, and in case of employment of the procedures of external management and bankruptcy proceedings, the aforementioned bodies are dismissed from the leadership of the organization.

3. Creditors as Participants in Corporate Governance.

An organization's creditors play a special role in the process of corporate governance. It is expedient to regard the creditors as participants in corporate governance from the point of view of evaluating their rights at different stages of the company's activity. Certain classification of creditors' rights with respect to their participation in corporate governance is also useful.

The main right of the creditors is the right to demand timely and complete fulfillment of obligations accepted by or imposed upon a debtor. At the same time, corporate governance considers creditors from the point of view of existence of the following rights:

- the right to receive information on decisions of the managerial bodies (partial disclosure of the corporate data);
- the right to demand early fulfillment of obligations by the debtor (influencing the organization's economic activity);
- the right to participate in the management of the debtor and the debtor's property.

It should be noted that the creditors, as participants in corporate governance, on the one hand, represent the debtor's counteragents, and on the other hand, act as participants of the corporate control mechanism, using the rights granted to them by the legislation on reorganization, liquidation and bankruptcy. Therefore creditors' participation in corporate governance should be regarded from the viewpoint of their rights during:

- reduction of the size of the debtor's charter capital;
- reorganization of the debtor;
- liquidation of the debtor;
- inconsistency (bankruptcy) of the debtor;

The participation of the creditors in corporate governance during reorganization and liquidation of the organization (company) is identical, considering that creditors' rights during reorganization and liquidation are close in contents, as well as the "interconnection"[7] of these procedures.

[7] During reorganization in almost all forms, except secession, one of the reorganized organizations is terminated, therefore reorganization and liquidation are institutionally interconnected.

3.1. Creditors' Participation during the Reduction of the Size of the Debtor's Charter Capital.

The Federal Law "O Joint-Stock Companies" stipulates that the creditors must necessarily be notified of the fact of reduction of the charter capital. Therefore, the creditors execute their right to receive information on decisions of the debtor's management bodies, capable of entailing non-fulfillment or unduly fulfillment of obligations by the debtor.

In accordance with article 30 of the Federal Law "On Joint-Stock Companies," creditors shall acquire the right to demand the termination or early fulfillment of obligations by the debtor and compensation of the related losses. The aforementioned clauses of the Law "On Joint-Stock Companies" are aimed at protection of creditors' rights, but they seem to be redundant, as today the charter capital of a company has lost its former role of a guarantor of fulfillment of the debtor's obligations.[8]

It is also noteworthy that the legislation stipulates that under certain circumstances, the decision to reduce the size of the charter capital is obligatory (see example).

Example: *Article 99 of the Civil Code stipulates that if upon the expiration of the second and each subsequent year the cost of the company's net assets is less than the charter capital, the company must announce and register the reduction of its charter fund in the duly established order. Proceeding from the aforementioned article, it is necessary to admit the following situation: founders set up a company for implementation of a project with a period of repayment exceeding two years. The company charter fund has been formed and is used to implement the aforementioned project. At the same time, considering that the company would spend part of its charter fund on the implementation of the project, the size of the company assets would be lesser than the amount of the charter capital. In this case, after the company announces the reduction of the charter capital, the creditors would acquire the right to demand early fulfillment of obligations, which may push the company into bankruptcy.*

Proposal: Proceeding from the above, it is expedient to stipulate that the creditors shall acquire the right to demand early fulfillment of the debtor's obligations only in case the reduction of the charter capital may entail non-fulfillment of the debtor's obligations or inflict damage on the creditors.

Conclusion: it is necessary to restrict the rights of the organization's creditors during the reduction of its charter capital.

[8] The company charter capital is not isolated from the property, and money or other assets constituting parts of the charter capital are utilized by the company.

3.2. Creditors' Participation in Corporate Governance during Reorganization and Liquidation of the Indebted Organization.

3.2.1. Creditors' Participation in Corporate Governance during Reorganization of the Indebted Organization.

The debtor's creditors shall be notified of the reorganization of the debtor. Thus the creditors shall exercise their right to receive information on decisions adopted by the debtor's management bodies, capable of entailing non-fulfillment or unduly fulfillment of the debtor's obligations. The implementation of this right is the main way of protecting creditors' interests. At the same time, the concept of protecting creditors' interests, fixed by the RF Civil Code, does not attain any practical goals due to the imperfection of the notification rules and also due to frequent cases of violation of such rules. It should be noted that the legislators do not specify which information should be granted to the creditors, besides their notification of the very fact of reorganization, as well as the sanctions for failure to notify the creditors by the reorganized company.

Example: *The "A" company has appealed to the arbitration tribunal with an application to recognize the decision of the shareholders' meeting of the "B" joint-stock company invalid, as the "A" company was not notified of the reorganization of the "B" company, and the goods consigned to the "B" company were, as a result of reorganization, handed over to the seceded "C" company. The respondent did not accept the claim, motivating his refusal with the following arguments:*

1. *The decision on reorganization was adopted in full compliance with the legislation, the shareholders' meeting has also approved the "B" company's separating balance.*
2. *The legislation stipulates that creditors shall be notified after the adoption of the decision, and the law does not connect this notification with the invalidity of the decision on reorganization.*
3. *The agreement between the companies "A" and "B" envisioned that the ownership right should be transferred only after drawing up a commodity acceptance act, which has neither been drawn up nor signed at the moment of adopting the decision.*

The arbitration tribunal accepted the reasoning of the respondent and dismissed the claim.

Proposal: Creditors must have an opportunity to find out about the upcoming reorganization much sooner than they do now, probably at the same time with the participants (founders), i.e. before the adoption of the decision to this effect. Moreover, it seems necessary to stipulate that the information on reorganization of a legal person should be entered in the register of legal persons, and requirements to the volume of information granted to the creditors should be extended.

The Russian Federation Civil Code and the Federal Law "On Joint-Stock Companies" envisages the rights of creditors of a legal person, which is in the process of reorganization, to demand early fulfillment or termination of obligations.

Russian experience shows that legal persons, incapable of meeting their obligations before the creditors, are frequently deliberately set up in the course of reorganization. Moreover, reorganization is often undertaken for the purpose of shirking certain debts. The strictness of provisions of the RF Civil Code is connected precisely with this sort of practice.[9]

Nevertheless, the protection of creditors' rights by the RF Civil Code seems to be excessive. It should be noted that the creditors of a reorganized legal person are entitled to demand early fulfillment or termination of responsibilities before them irrespective of whether this reorganization infringes their interests or not. Reorganization does not always entail a decrease of the probability of fulfilling obligations before the creditors. Very often, reorganization, especially in the form of merger or affiliation, is aimed at raising the efficiency of the organization and meets the interests of its creditors.

Apparently, in a number of cases termination or early fulfillment of obligations may pose an interest to the creditors regardless of the growing probability of duly fulfillment of these responsibilities. Early termination of obligations may turn out to be impossible for the reorganized person itself, or involve unreasonable expenses, pushing the company into bankruptcy. This may inflict even greater damage on the creditors.

Absolute protection of creditors' rights is impossible, they take risks together with their debtor, and reorganization is only one of the situations when their interests could be infringed. As far as creditors of a commercial organization are concerned, the very entrepreneurial activity is dangerous for them, because it involves risk. Protection of creditors' interests should depend on whether the reorganization affects such interests.

Proposal: to introduce amendments to the Civil Code, envisaging restrictions of the creditors' right to demand early cancellation or termination of obligations, stipulating that the creditors are entitled to advance such demands only if the creditors' demands will not be fulfilled as a result of the reorganization.

According to the RF Civil Code, if the separating balance does not offer an opportunity to nominate the successor of the reorganized legal person, the newly emergent legal persons shall bear joint responsibility for the obligations of the reorganized legal person before its creditors. This norm is quite reasonable and fully guarantees the rights of the creditor and the debtor, but legal practice raises a number of important questions, specifically, concerning legal succession, which should be resolved by a special act.

Example: *A state unitary enterprise has filed a claim with the arbitration tribunal against a joint-stock company, seeking to charge from this company some illegally appropriated property. The arbitration tribunal accepted the claim for consideration.*

The claimant justified its demands with the fact that it is the legal successor of another state unitary enterprise, which in its turn handed the disputed property over to the respondent. The claimant presented to the tribunal the abstracts from its charter and the separating balance to confirm its right of a legal successor to the transformed unitary enterprise.

[9] Reorganization and Liquidation of Legal Persons according to the Legislation of Russia and West European Countries. YURIST, State University – Higher School of Economics. Moscow, 2000.

The respondent dismissed the claim for the following considerations:

1. Documents presented by the claimant should not be regarded as valid and sufficient proof of the claimant's ownership of the disputed property. The respondent drew the attention of the tribunal to the following circumstances. The claimant is a legal successor of the reorganized state unitary enterprise, but the documents presented to the tribunal do not specify the method of reorganization applied for the creation of the new enterprise.

2. Without the establishment of the method of reorganization, it is impossible to determine, which rights the claimant has inherited from the reorganized enterprise.

3. As the claimant presented to the tribunal a separating balance, the respondent assumed that the reorganization took place in the form of division or in the form of secession, since these are the cases a separating balance is drawn up.

4. The respondent noted that in violation of article 59 of the RF Civil Code, the presented separating balance does not contain a list of obligations, the rights to which have been inherited by the claimant, and the monetary sums indicated in it have a generalized nature. No concrete data are presented on individual creditors and debtors, in connection with which this document does not suggests any conclusion either of the existence or the lack of the respondent's indebtedness to the claimant.

However, the arbitration tribunal dismissed the respondent's reasoning and satisfied the claim in full volume. The respondent disagreed with this decision and contested it at superior legal instances. Having reconsidered the decision, the cassation instance of the arbitration tribunal deemed the respondent's arguments convincing and cancelled all judicial acts on the case, handing the case for reconsideration by the court at first instance.

An opposite situation is also possible, where the credit indebtedness would be transferred in a "lump," without the indication of a concrete creditor, or the supplements to the separating balance would contain unreliable data.

Proposal: It would be expedient to set additional requirements to the separating balance and the reorganization decision, specifically the nomination of the successor to the rights and responsibilities on each particular obligation. Besides that, it is necessary to introduce sanctions for non-fulfillment of these requirements.

3.2.2. Creditors' Participation in Corporate Governance during the Liquidation of the Indebted Organization.

The RF Civil Code contains a requirement to notify all creditors of the liquidation of the debtor and the publication of a liquidation notice. There is also a requirement according to which the proprietors of a legal person or a body, which has adopted the reorganization decision, should immediately forward a written notice about it to the body exercising state registration of legal persons.

The implementation of the aforementioned provisions of the Civil Code is a follow-up of the concept of information openness of data, capable of entailing non-fulfillment or unduly fulfillment of the debtor's obligations. At the same time, the legislation does not specify, which

mass medium should publish the announcement of the organization's liquidation. Therefore frequently "anonymous" creditors are not notified of the debtor's liquidation. This problem can be solved by appointing a particular mass medium to publish the information on liquidation, and by stipulating that the publication should be carried more than once. It is necessary to mention that the legislation does not contain an exhaustive list of data subject to disclosure in connection with the liquidation of the debtor.

It also seems necessary to stipulate that if the creditors cannot be revealed personally (anonymous creditors), such creditors shall be notified by publishing information on the liquidation.

The RF Civil Code envisages the minimal period granted to creditors for forwarding claims (2 months). It is also stipulated that the creditors' demands presented after the period established for forwarding claims, shall be satisfied at the expense of property of the liquidated legal person, remaining after settling creditors' claims filed in due time. The above provision prompts the conclusion that the creditors, who have not presented their demands at all, shall not claim their satisfaction. This is considered to be a violation of creditors' interests.

Proposal: to envision the possibility of reserving funds for creditors who have not presented their claims. Besides, it is possible to grant creditors a possibility of restricted participation in the liquidation procedure.

According to the RF Civil Code, in case the cost of property is insufficient, a legal person, which is a commercial organization or a consumer cooperative or fund, can be liquidated only by a court order by employment of the bankruptcy procedure. The norm seems to be necessary, as one of the purposes of the legislation on inconsistency (bankruptcy) is even distribution of funds gained by the sale of the debtor's property. At the same time, it seems expedient to institute obligatory investigation of legitimacy of actions of the debtor's chief executive, preceding the liquidation, as in accordance with the Federal Law "On Inconsistency (Bankruptcy)," if the case of liquidation has been initiated by the liquidation commission, the bankruptcy procedure shall be simplified (without superintendence of the debtor). The debtor's management often resorts to such procedure of initiating cases of inconsistency (bankruptcy) for "covering up" the illegitimate actions, specifically, evading taxes or shirking responsibilities before creditors.

Proposal: If simplified bankruptcy procedures are applied to the debtor, it is necessary to envision obligatory investigation of actions of the debtor's chief executive in case they might contain indications of intentional or fictitious bankruptcy.

The Civil Code stipulates that in case of insufficiency of property of the indebted legal person, which is an official enterprise or institution, the creditors shall have a right to file a claim to the owner of property of such legal person. The norm goes slightly beyond the corporate legislation in its traditional Russian interpretation,[10] but at the same time a number of surveys refer institutions and unitary enterprises to the Russian analogues of public corporations, thus justifying the application of corporate law to them. Creditors are not supposed to carry legal expenses on satisfaction of their rights and demands. It is possible to assign the duties of

[10] T.V.Kashanina. Corporate Law. M-1999.

demanding funds for satisfying creditors' claims to legal persons – official enterprises or organizations – on the liquidation commission.

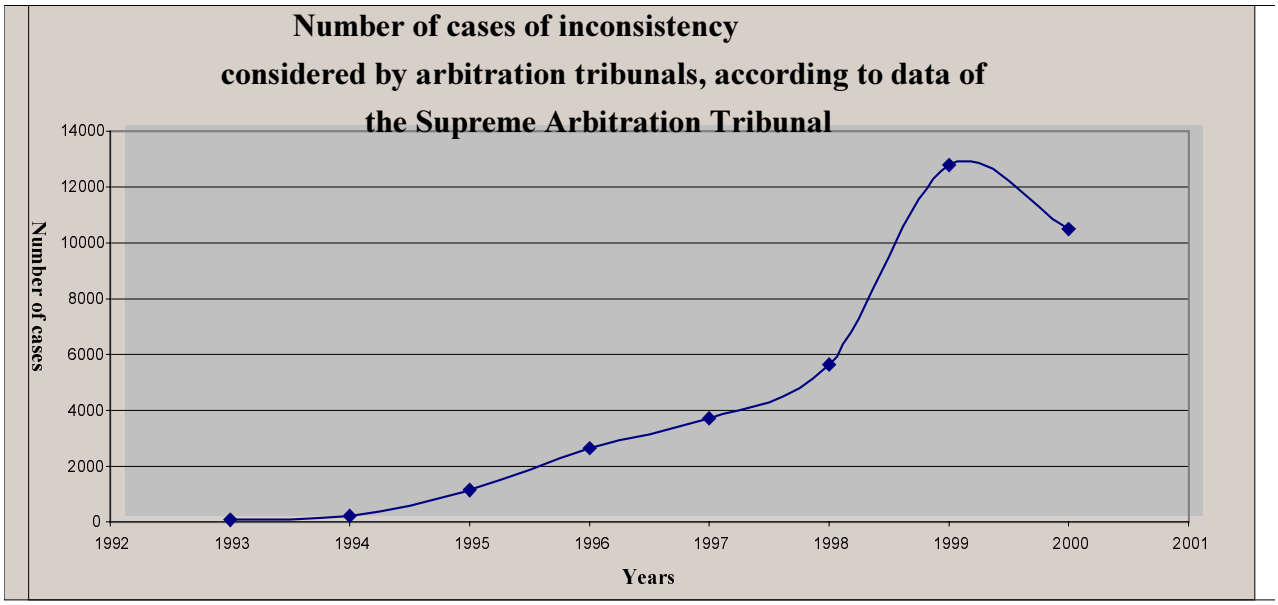
General Proposal to Section 2

The analysis of the aforementioned proposals prompts the idea of the necessity to prepare a special normative act or acts, regulating the order of liquidation and reorganization.

3.3. Creditors as Participants in Corporate Governance during Procedures Envisioned by the Legislation on Inconsistency (Bankruptcy)

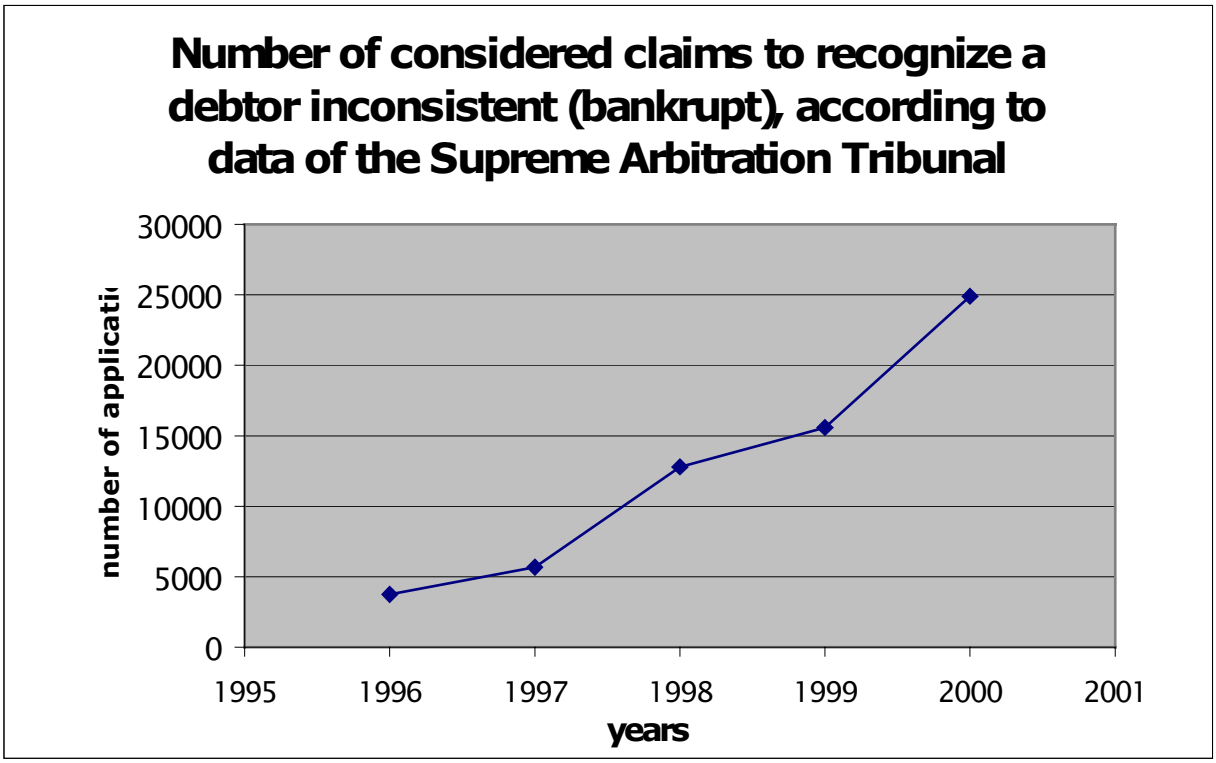
The legislation on bankruptcy has a considerably long history, according to the Russian standards. The acting Federal Law "On Inconsistency (Bankruptcy)" was adopted by the Russian Federation State Duma on December 10, 1997, approved by the Federation Council on December 24, 1997, and signed by the Russian President on January 8, 1998. Its predecessor, the Russian Federation Law "On Inconsistency (Bankruptcy) of Enterprises," was adopted in 1992 and entered into force in 1993. It is noteworthy that with the adoption of the new law regulating inconsistency (bankruptcy), the number of cases of inconsistency (bankruptcy) has increased.

Diagram #1



It is also necessary to mention that despite the decrease of the number of considered cases of inconsistency (bankruptcy), the number of claims to recognize debtors bankrupt has been constantly growing in the course of the past five years (see diagram #2).

Diagram #2



One of the factors of such growth is the change of the inconsistency criterion. The RF Law "On Inconsistency (Bankruptcy) of Enterprises" used the criterion of insolvency (exceeding of the cost of the debtor's property over the total sum of all debtor's obligations), while the Federal Law "On Inconsistency (Bankruptcy)" applies the criterion of inability to pay (the debtor's inability to timely fulfill the obligations to the creditors). The concept of the acting Federal Law "On Inconsistency (Bankruptcy)" is supposed to protect creditors' interests in a greater measure, and, allegedly, the law is "pro-creditor."

At the same time, it is expedient to slightly adjust the target of the Law. It is possible to introduce certain legal procedures, in the course of which the debtor's founders (participants) would be offered an opportunity to recuperate the debtor's business under creditors' control.

Inconsistency (bankruptcy) is one of the crucial legislative institutions, providing creditors' "economic" control over the debtor's activity. Practice shows that it is precisely the threat of bankruptcy that plays the decisive role in the debtor's adoption of a decision to fulfill obligations. Moreover, the institution of bankruptcy is called upon to protect the interests not only of each individual creditor, but of all creditors of the indebted organization. Proceeding from this premise, the Law stipulates that creditors shall not be empowered to exercise their rights independently.

It is precisely the legislation on bankruptcy that enables creditors to participate in the debtor's management, specifically, during external management and bankruptcy proceedings.

The Russian civil legislation offers the creditors the right to choose the way of protecting their rights: the creditor is empowered to file a conventional court appeal or to initiate a case of inconsistency (bankruptcy) against the debtor. However, creditors often abuse their right to file claims to recognize debtors inconsistent, resorting to the filing of such claims to compel the debtor to cancel the debt in the earliest possible time. The grounds for filing an application to recognize a debtor inconsistent (bankrupt) is a three-months delay in fulfillment of the monetary obligation by the debtor in the amount exceeding 500 minimal salaries. The practice of employment of the Federal Law "On Inconsistency (Bankruptcy)" has also demonstrated that the creditors often abuse their right to file a claim to recognize the debtor bankrupt, because the bankruptcy procedure offers a possibility to appropriate the management of the debtor. With this end in view, the creditors often file claims under false pretexts.

Proceeding from the above, it seems expedient to envision compulsory court consideration of justification of creditors' demands, which in fact takes place presently in accordance with the Decree of the Constitutional Court #4 of 12.03.2001. However, the consideration of the case of lack of justification in accordance with the above decree can "blockade" and in some cases "bring to naught" the consideration of the case of inconsistency (bankruptcy).

In order to meet creditors' demands, the court is empowered to adopt measures envisaged by the Arbitration-Procedural Code of the RF on application of a person participating in the case. Besides, the court can prohibit the chief executives of the debtor to carry out certain transactions without consent of the arbitration manager and adopt measures to ensure the integrity of the debtor's property. Therefore, the creditors can start influencing the activity of the debtor's managerial bodies from the moment of initiating the case of inconsistency (bankruptcy). At the same time, the aforementioned legal norms are almost never used in practice.

However, after the Constitutional Court issued Decree #4 of 12.04.2001, suggesting that arbitration tribunals should consider the justification of creditors' demands at a separate session, the courts can be expected to apply norms ensuring the integrity of the debtor's property more actively (banning a number of transactions in order to guarantee the fulfillment of creditor's demands).

Starting from the moment of initiating the case of bankruptcy by the arbitration tribunal, the creditors acquire the right to present their claims to the debtor. The procedure of establishing creditors' demands differs depending on the procedure applied to the debtor. The creditors' demands should be entered in the register of creditors' claims. Creditors receive a vote at the creditors' meeting in proportion to the size of their demands.

This group of legal norms, equipping creditors with a right to file their claims to the debtor during the bankruptcy procedure, brings to fruition the concept of consolidating creditors' efforts and inadmissibility of independent maintenance of the creditors' rights. At the same time, the interpretation of this concept by the Federal Law "On Inconsistency (Bankruptcy)" seems excessively strict. We do not consider it particularly expedient to establish creditors' demands, consider disputes on inflicted losses, compensation of damage, compensation of the harm inflicted within the frames of the legal proceedings in a case of inconsistency.

And as the Law does not envision direct possibility of contesting such determinations, the Constitutional Court (Decree #4 of 12.03.2001) has recognized illegal the clause of the Law,

prohibiting the contesting of the determination of the arbitration tribunal on establishment of the size of creditors' demands. Besides that, decisions to enter or strike creditors' demands from the register are assigned to the arbitration manager, while the order of establishing such demands is not sufficiently formalized. Consequently, we deem it necessary to ensure greater formalization of the order of establishing creditors' claims, and to restrict the abuse of powers both by the arbitration manager and by the creditors.

It is necessary to stipulate that the establishment of creditors' demands in a bankruptcy case should be the basis of determining the number of the creditor's votes at the creditors' meeting. The creditor shall have a right to apply to the arbitration tribunal in a general order to establish the size of the debtor's indebtedness. The determination on establishment of the amount of the creditors' demands should be applied exclusively for the purposes of a creditor's participation in the creditors' meetings, and should not become a prelude of consideration of the case of establishment of the debtor's indebtedness to the creditor by the Arbitration Tribunal.

As a follow-up of the creditors' rights to information on the debtor in the course of the inconsistency (bankruptcy) procedure, the creditors have a right to demand information on the pace of the inconsistency (bankruptcy) procedure, on the debtor's financial state, on the activity of the arbitration manager. On the whole, the group of these norms meets the concept of protection of creditors' rights. But at the same time, the rights to disclosure of information on the debtor should be extended, especially at the stages of external management and bankruptcy proceedings.

Many of the aforementioned creditors' rights become more concrete or acquire specifics in the course of different procedures envisaged by the legislation on inconsistency (bankruptcy).

3.3.1. Creditors' Participation in the Superintendence Procedures.

It is necessary to take into consideration that the superintendence procedure is not obligatory, as a simplified bankruptcy procedure is applied against the absent and liquidated debtors – without superintendence of the debtor. For example, in 2000, the superintendence procedure was used with 7,959 organizations out of the total of 19,041 cases accepted for consideration. It is noteworthy that the simplified bankruptcy procedure is often applied for the purposes of evading taxes or dodging the cancellation of credit indebtedness. Therefore it is necessary to envision the investigation of possible indications of intentional or fictitious bankruptcy during the simplified bankruptcy procedures.

During the superintendence procedures, creditors enjoy the right to file their claims to the debtor. The acting manager is authorized to reveal the debtor's creditors and notify them of the possibility to file claims to the debtor. The practice of the Law has shown that the acting manager is incapable of revealing all creditors, particularly creditors on unregistered obligations (bills, securities payable to bearer, etc.). Therefore, the norms establishing the order of notification of creditors seem logical and necessary, but at the same time not void of shortcomings. It is possible to stipulate in the Law the notification of creditors by publication of information to this effect in mass media.

Besides, the procedure of establishing creditors' demands at the stage of superintendence largely depends on the debtor who is the only one who can accept or reject creditors' demands.

Example: *The arbitration tribunal has initiated the case of inconsistency (bankruptcy) against the "A" joint-stock company, introduced superintendence and appointed an acting manager. The general director accepted the demands of creditor "B" to compensate the sum exceeding 70% of the total credit indebtedness revealed by the acting manager. The acting manager applied to the arbitration tribunal with objections against the creditor's claims, accepted by the general director. However, the arbitration tribunal dismissed the objections of the acting manager in connection with the fact that article 63 of the Federal Law "On Inconsistency (Bankruptcy)" does not grant an acting manager the right to file objections to creditors' demands. After receiving a determination on refusal from consideration of the complaint, the arbitration manager appealed to the arbitration tribunal with an application to declare the transaction, entailing the debtor's credit indebtedness to creditor "B," invalid. However, the arbitration tribunal refused to accept this application, as it has not recognized the arbitration manager as an interested person in the above transaction.*

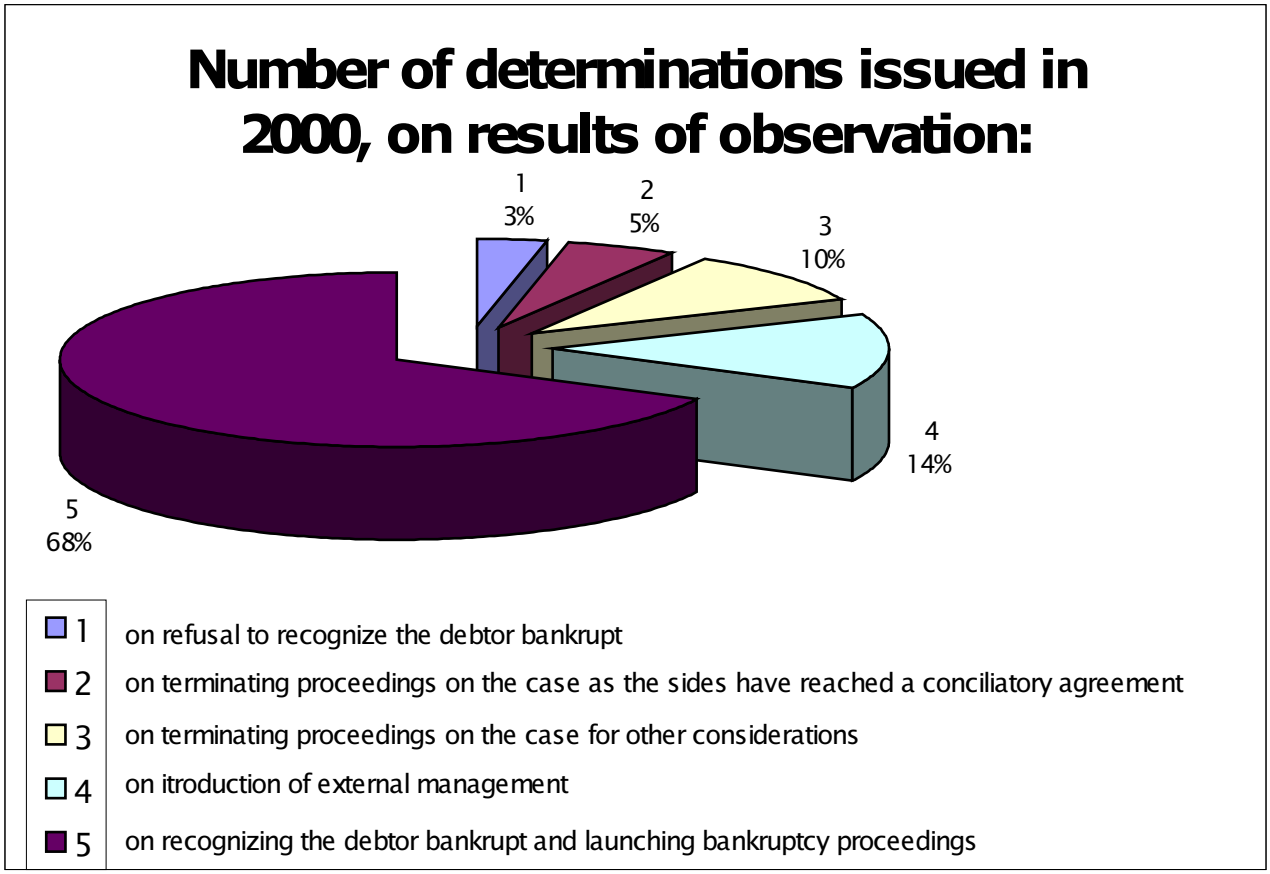
Proposal: to legislatively stipulate the right of an acting manager to file objections to the arbitration tribunal concerning creditors' claims.

During the superintendence procedure, the creditors have a right to receive information on the debtor's financial condition. The acting manager presents information on the debtor's financial condition to the arbitration tribunal. Creditors, as parties to the case of inconsistency (bankruptcy) are empowered to familiarize themselves with the presented data. At the same time, the role of information on financial condition of the debtor, presented by the manager, is often insignificant. Moreover, the Law does not specify the contents of this information and the deadlines for its presentation.

Proposal: To specify which particular data should be presented by the acting manager to the creditors, the contents of these data and deadlines for their presentation.

During the superintendence procedure, creditors shall have a right to participate in the first meeting deciding the debtor's future. Bankruptcy creditors shall participate in the vote at the first meeting of creditors in proportion to the amount of claims.

The norms establishing the order of holding the first meeting of creditors, the order of taking decisions by the first meeting of creditors, as well as the implementation of these decisions, offer the opportunities for the creditors to determine whether they ought to try to restore the debtor's solvency, applying the procedure of external management, or whether it is necessary to recognize the debtor bankrupt and launch bankruptcy proceedings. It is necessary to point to special importance of decisions adopted by the first meeting of creditors, actually deciding the future destiny of the indebted organization. However, when creditors adopt such decision, it is necessary to consider that they are not interested in amelioration of the debtor's business, therefore in the majority of cases creditors prefer appealing to court with a claim to recognize the debtor inconsistent (bankrupt) and launch bankruptcy proceedings. In most cases, creditors take a decision to recognize the debtor inconsistent (bankrupt) (see diagram #3).



Proposal: The norms are necessary, but we consider it advisable to add some norms ensuring the protection of minority creditors, as well as the participation of the debtor's members (founders) in the inconsistency (bankruptcy) procedure. It is possible to legislatively institute a procedure different from external management, in the course of which the participants (founders) of the debtor would be granted a right to ameliorate the debtor's business on their own.

3.3.2. Creditors' Participation in External Management Procedure.

It is necessary to mention the low efficiency of the external management procedure. For example, in 2000 the external management procedure was terminated in connection with the restoration of solvency with respect to 50 organizations or conclusion of a conciliatory agreement with respect to 296 organizations (a total of 397 cases). At the same time, 907 organizations (70% of the overall number of procedures completed in 2000) were recognized inconsistent (bankrupt) upon the results of external management.

During external management, the creditors shall have a right to file their claims to the debtor. The mechanism of filing claims and their establishment differs from the mechanism envisaged for superintendence, but it does not infringe creditors' rights to file claims and ensures efficient protection of those rights.

During external management, the creditors shall have a right to participate in the debtors' management. The creditors shall be granted the right to approve the plan of

external management, coordinate major transactions of the debtor and deals in which there is an interest.

In fact, the procedure of external management signifies partial substitution of the debtor's managerial bodies with the creditors' meeting and the creditors' committee. The debtor's managerial bodies are suspended from decision-making with respect to the debtor's property, as well as the amelioration of the debtor's business. The realization of this concept of external management often results in uncontrolled withdrawal of the indebted organization's assets. It is becoming common practice for all liquid property to be sold during external management, rendering the organization unviable.

Proposal: We consider it possible to admit the debtor's managerial bodies to participation in the debtor's amelioration or, as it has been mentioned above, to legislatively introduce an alternative procedure to external management, in the course of which the debtor's participants (founders) would have an opportunity to ameliorate the debtor's business.

3.3.3. Creditors' Participation in Bankruptcy Proceedings

Creditors' rights shall be extended in comparison with external management; at the same time the creditors acquire the right to demand from the bankruptcy manager the satisfaction of their clams in the order and priority established by the Law.

Undoubtedly, the granting of such rights to the creditors is caused by the very essence of the procedure. At the same time, we regard it possible to extend these rights and institute a more strict control over the activity of the bankruptcy manager by the creditors.

During bankruptcy proceedings, the creditors shall have a right to participate in the management of the debtor's property (disposal of the bankrupt estate). The sale of the debtor's property is controlled by the creditors and the court. The norms regulating the order of disposal of the debtor's property, control over the sale of the debtor's property by the bankruptcy manager are on the whole aimed at the protection of creditor's rights. At the same time, it is necessary to make the sale of the debtor's property more public. Practice shows that the managers try to create a situation where the most liquid property of the indebted organization is sold to organizations connected with the manager.

3.3.4. Creditors' Participation in Conciliatory Agreement

Creditors are entitled to conclude a conciliatory agreement with the debtor, the text of which shall envisage the order, terms, and volumes of cancellation of creditors' demands. At the same time, the conciliatory agreement in an inconsistency (bankruptcy) case does not fully comply with the general legal norms on conciliatory agreement.

In our opinion, the order of concluding a conciliatory agreement in the bankruptcy case does not fully comply with the RF Constitution, as well as the main requirements of the adjective law, as a conciliatory agreement is concluded by the debtor with the "meeting of creditors," i.e. the creditors approve it at their meeting. Besides, the creditors voting against the conclusion of a conciliatory agreement must join it. Such order of concluding a conciliatory agreement contradicts the principles of civil law.

In practice, the fulfillment of these provisions of the law results in the infringement of the rights of minority creditors or creditors who voted against the conciliatory agreement. For instance, it has become common practice for the conciliatory agreement to envision a respite in payment of the credit indebtedness for a period up to 20-50 years, which inflicts serious damage on small creditors.

Proposal: To stipulate that a conciliatory agreement should be concluded individually with every creditor, and the terms of it may be different. The creditors, who have concluded a conciliatory agreement, or the debtor, must fully satisfy the demands of the creditors who refused to conclude a conciliatory agreement.

It is also possible to introduce certain compulsory requirements to the conciliatory agreement if the earlier recommendations are not accepted.

Recommendation to Section 3.

We consider it necessary to adopt amendments to the Federal Law "On Inconsistency (Bankruptcy)."

4. The state as a participant in corporate governance.

4.1. Rights of the State as a Proprietor (Shareholder).

The rights of the state as a shareholder include the following principal components:

The right to participate in management of the enterprise;

The right to receive information on the enterprise's activity and condition;

The right to receive part of the profit from the enterprise's activity;

The right to sell the enterprise (its shares) and gain a fair compensation.

The rights of the state on the shares of enterprises in its property are regulated both by corporate and privatization law. As a result, on the one hand, the rights of the state (as well as the rights of any other shareholder) depend on the number of voting shares in its property, and on the other hand, on the status of this parcel of shares (constituting state property or fixed in the federal property), the size of the parcel of shares fixed in state property, the employment of the special "golden share" right, the rights of the state in the period after the sale of stock at a commercial tender before the rights to the shares are handed over to the tender winner.

At present, the property of the Russian Federation alone (not including the property of the Russian Federation members and municipalities) includes the parcels of shares of 3524 joint-stock companies, and approximately 3200 representatives of the state are members of the managerial bodies of joint-stock companies.

The above joint-stock companies are divided, depending on the Russian Federation share in their charter capitals in the following way:

100% of the charter capital – 61 joint-stock companies;

over 50% of the charter capital – 506 joint-stock companies;

from 25% to 50% of the charter capital – 1211 joint-stock companies;

less than 25% of the charter capital – 1746 joint-stock companies.

According to the corporate law, the state (as well as other shareholders) enjoys the corresponding rights depending on the size of parcels of shares in its property. There is no special need to enumerate the full list of rights of the state as an ordinary shareholder.

Rights of the state under the law on privatization.

The state enjoys a number of specific rights as a shareholder in the following circumstances:

1. **Over 98% of shares are fixed in state property;**
2. **Over 25% of shares are fixed in state property;**
3. **The special "golden share" right is exercised with respect to the joint-stock company;**
4. **With respect to joint-stock companies whose shares have been privatized at a commercial tender under the moment the rights on these shares pass over to the tender winner.**

We regard as a serious drawback of the existing legal regulation the vagueness of the grounds for fixing shares in state property or the employment of the special right. The Law on Privatization does not make distinctions between the grounds for fixing shares or employing the special right, which are defined as follows: ensuring national defense and state security, protection of morality, health, rights and legal interests of the RF citizens. Ensuring state security can be interpreted in a broad sense – in accordance with the Concept of RF National Security, approved by the Edict of the RF President #24 of January 10, 2000, which makes it possible to apply this reason to a very broad range of enterprises with state participation. Tables 2 and 3 show the standing of enterprises whose shares are fixed in the federal property, according to industrial sectors.

Table 2.

Standing of Joint-Stock Companies whose Shares, Fixed in the Federal Property, Are Not Subject to Early Sale, in Basic Sectors of the Economy

	Number of enterprises whose shares are fixed in the federal property.
Industry[11]	512
Transport and communications	92
Construction	73
Trade	46
TOTAL	**723**

Table 3.

Average Sizes of State Parcels of Shares of Enterprises in Different Sectors of the Industry, Fixed in the Federal Property

Industrial sector	**Average size (%)**
Nuclear industry	48,2
Mechanical engineering	30,9
Aviation industry	28,4
Production of ammunition and special chemicals	30,7
Industry of armaments	32,4
Industry of communication means	35,8
Radio industry	37,3
Production of space rocket equipment	35,9
Ship-building	29,9

[11] Not including branch construction organizations.

Industrial sector	Average size (%)
Electronic industry	38,1
Chemical and petrochemical industry	31,8
Medical and microbiological industry	27,1
Light and cosmetics industry	
Forestry	25,5
Metallurgy	25,4
Liquor industry	47,4
Production of baked products	33,7
Oil industry	42,7
Gas industry	25,3
Electric power engineering	28,1
Coal industry	38,0
Fuel industry	26,3
Gold and diamond industry	37,0
For all sectors	**34,1**

1. Rights of the State with Over 98% of Shares of a Public Joint-Stock Company Fixed in State Property

In June 1999, significant additions and amendments were introduced to the Law on Privatization, determining the specifics of the state's rights on the management of parcels of shares fixed in state property, exceeding 98%. The purpose of these amendments was to boost the efficiency and simplify the management procedures, without infringing the rights of other shareholders in any way from the viewpoint of the Law on Joint-Stock Companies.

If 100% of the shares are fixed in state property, the functions of the general meeting of shareholders shall be carried out by the state property management body, while the procedures of preparing and holding a general shareholders' meeting, envisaged by the Law on Joint-Stock Companies, shall not be applied.

As the shareholders owning jointly not less than 2% of the company's voting stocks enjoy the right to introduce proposals to include additional items on the agenda of the general meeting, the general shareholders' meeting shall convene, deliberate and adopt decisions in accordance with the Law on Joint-Stock Companies only as of the moment of alienation of not less than 2% of shares of the company, whose 100% shares used to be fixed as state property.

The formation of executive bodies of a joint-stock company and early termination of their authority shall be carried out by the state property management body, if the charter of this company does not refer these issues to the competence of the board of directors (supervisory board). The state property management body shall appoint members of the board of directors for a period of one year, and be empowered to terminate their (every one of them) authority beforetime.

2. Rights of the State with Over 25% of Shares of a Public Joint-Stock Company Fixed in State Property

The fixing of more than 25% of shares of a joint-stock company in state property grants the state the following additional rights.

Firstly, in accordance with item 3, article 6 of the Law on Privatization, a one-man executive body of a public joint-stock company, over 25% of shares of which are fixed in state property, is not authorized to carry out transactions on alienation of stocks included in the company's charter capital, and transactions entailing their possible alienation or transfer in management on proxy without written consent of the state property management body in charge of formation of this company's charter capital. This right of the state remains in force until the expiration of the privatization period or until the moment when the number of shares in state property will amount to not more than 25% of their overall number.

Matter for discussion

This additional right of the state seems fair for the joint-stock companies whose charter capital has been initially formed fully from state property. However, some joint-stock companies were created on the basis of share holding – with participation of private investors. Moreover, private investors could make contributions to the charter capital when the company was already functioning. Therefore, granting broader rights to the state as a shareholder compared to the rights of private shareholders is questionable and may be regarded as unjustified restriction of authority of the one-man executive body of a joint-stock company.

Secondly, in accordance with item 4, article 28 of the Law on Joint-Stock Companies, the increase of a joint-stock company's charter capital by issuing additional shares the parcel of shares, fixed in state property, representing over 25% of votes at the general shareholders' meeting, may be carried out only with preserving the share of the state

during the fixation period.[12]

Matter for discussion

This norm has emerged as a result of broad spread of the practice of "dilution" of parcels of shares belonging to the state. At the same time, the risk of "dilution" of shares exists not only for the state, but for private investors as well. Therefore this norm is aimed, most probably, at preventing dishonest behavior of state representatives, who have a right to influence the company's decisions to issue additional stock. Specifically, the state enjoys a priority right to purchase additionally issued shares on a par with the other shareholders. The problem consists in the fact that the order of participation of the state in the payment for additional emission is presently undefined, which may result in an insoluble situation where the decision on additional emission would be impossible to fulfill because of the state's non-payment for its share.

It is necessary to make special mention that only the blocks of shares fixed in state property are protected against "dilution" from the point of view of legal regulation, whereas the parcels of shares exceeding 25% of the charter capital, merely owned by the state, do not enjoy this sort of legal protection.

3. Rights of the State in Case of Existence of the "Golden Share"

The Law on Privatization defines the "golden share" as a special right to participation of the Russian Federation, its members and municipal entities in the management of joint-stock companies. The special right (the "golden share") does not remain valid for three years as does the "golden stock" – the security, but until the state adopts a decision to terminate its validity.

If the special right is exercised with respect to a joint-stock company, it is prohibited to fix the shares of this company in state property at the same time. According to item 1, article 5 of the Law on Privatization, the "golden share" provides the state with the following rights:

- **to appoint representatives of the state on the board of directors (supervisory board) and the auditing commission of a public joint-stock company**[13]**;**
- **to introduce proposals to the agenda of the annual general meeting of shareholders;**
- **to demand the convocation of an extraordinary general meeting of shareholders;**
- **access to all documents of a public joint-stock company.**

[12] After the adoption of the new Law on Privatization in July 1997, the notion of "fixation period" has lost its meaning, as the shares are no longer fixed for a certain period of time, but until the adoption of a decision on their release.

[13] Only state employees may be appointed representatives of the state on the "golden share."

The special right also enables the state to impose a veto on decisions of the general meeting of shareholders on certain issues. Let us compare the authority of this veto with the authority of the guaranteed blocking of decisions in accordance with the Law on Joint-Stock Companies.

The special right empowers to veto decisions on the following issues:	**The Law on Joint-Stock Companies empowers a shareholder with 25% of votes to block decisions on the following issues:**
Introducing amendments and additions to the charter of the joint-stock company or approving the charter in a new edition	**Introducing amendments and additions to the charter of the joint-stock company or approving the charter in a new edition**
Reorganization of the joint-stock company	**Reorganization of the joint-stock company**
Liquidation of the joint-stock company, appointment of a liquidation commission and approval of the liquidation balance sheet	**Liquidation of the joint-stock company, appointment of a liquidation commission and approval of the liquidation balance sheet**
	Establishing the maximum size of declared shares
Changing the charter capital of the joint-stock company[14]	
Concluding major deals[15]	**Carrying out major deals connected with the purchase and alienation of property by the joint-stock company**
Concluding deals with interest	

Matter for discussion

The "force" of the special right is identical, and in some cases (changing the charter capital, concluding major deals and deals with interest) even surmounts the powers of the blocking parcel of stocks. The introduction of the special right at a moment when over 25% of voting shares are in state property does not constitute any significant violation of shareholders' rights. However, the special right may be exercised even if only one share of a joint-stock company is in state property (which may equal mere fractions of percent of the overall number of shares), which would undoubtedly result in a violation of the interests of the other shareholders.

[14] The Law on Joint-Stock Companies does not require a compulsory qualified majority of votes to pass decisions on issues of increase or reduction of the charter capital.

[15] Therefore, the special right enables to veto decisions connected not only with conclusion of large deals with property, but also deals connected, in particular, with the placement of equities or privileged shares converted into equities, exceeding 25% of equities previously placed by the joint-stock company.

There is an obvious inconsistency in the regulation of rights of the state on stocks in its property: specific rights with blocks of shares over 98% or over 25% emerge only in case those shares have a "fixed" status, whereas no such status is required to employ the special right.

There is a very high risk that the employment of the special right may become a basis for state arbitrariness with respect to "deeply" privatized enterprises and lead to the violation of rights of the other shareholders.

4. Rights of the State with Respect to a Joint-Stock Company whose Shares have been Privatized at a Commercial Tender until the Moment the Rights to these Shares Pass Over to the Tender Winner

The sale of state property by means of a commercial tender does not mean that the functions of state property management end simultaneously with this sale. The Law on Privatization stipulates that the right of property on the assets privatized through a commercial tender shall pass over to the tender winner after the latter fulfills investment and (or) social conditions (item 2, article 21). If the object of privatization is the stock of a joint-stock company, item 3, article 21 of the Law on Privatization stipulates that before the property rights on these stocks pass over to the tender winner:

- **the joint-stock company cannot take a decision to change the charter capital, to emit additional stocks and other securities converted into stocks;**
- **the tender winner cannot vote for the reorganization or liquidation of the joint-stock company;**
- **the tender winner may vote on a number of issues upon written consent of the state property management body.**

Issues requiring compulsory consent include the following:

- **introduction of amendments and additions to statutory documents of the joint-stock company;**
- **mortgage, rent, alienation of property of the joint-stock company, if the cost of this property exceeds 10% of the charter capital;**
- **mortgage and alienation of real estate;**
- **obtaining credit in the amount exceeding 10% of the cost of net assets of the joint-stock company;**
- **establishment of economic companies (partnerships);**
- **emission of securities, not converted into the shares of the joint-stock company;**

- **approval of the annual report, balance sheet, profit and loss accounts, as well as the distribution of profits and losses of the joint-stock company.**

It is obvious that in some spheres (in particular, mortgage and alienation of property, obtaining credits) the rights of the state are considerably broader than the rights it would enjoy if it had in property a blocking parcel of shares or if it employed the special right.

In accordance with item 7, article 21 of the Law on Privatization, if an investor fails to fulfill the requirements, the investor shall not merely be deprived of the possibility to receive the object of purchase and sale in property, but also lose the purchasing sum and investments he has contributed seeking to fulfill the conditions.

Matter for discussion

At present, the Constitutional Court of the Russian Federation is considering the issue of recognizing this clause of the Law on Privatization unconstitutional. The aforementioned norm signifies non-repayable repossession of an owner's property without a court decision and violates the principle of equal protection of private and state property.

It is also worth mentioning that the issue of exercising the functions of ownership and usage of the privatized object by the buyer (tender winner) before the transfer of property rights needs additional deliberation.

In the practice of holding the tenders there are a lot of terminated agreements and cases of non-return of stock to state property. According to the Russian RFFI, on January 1, 2001, the number of disrupted sale and purchase agreements on results of the tenders reached 34, including 13, where the packages of shares have not been returned to state property (compared to 32 and 12, accordingly on 01.01.2000). On the whole, from the start of mass-scale privatization via tenders with investment (social) conditions, 202 agreements on the sale and purchase of shares have been concluded, which is rather modest, considering the scopes of privatization (on January 1, 2001, 66% of the overall number of state enterprises have been privatized).

4.2. Principal Mechanisms of State Participation in the Management of Joint-Stock Companies.

The principal mechanisms of participation of the state in the management of joint-stock companies whose shares are in state property, include the following[16]:

1. Representing state interests by state employees, as well as citizens who are not workers of ministries or state agencies;

2. Transfer of stock into management on proxy;

3. Using stocks as security (for instance, pledge) with the transfer of management rights on these stocks.

[16] Report on the Survey «Management of Parcels of State-Owned Stocks of Joint-Stock Companies." RFPR, 1998.

First Mechanism

The normative basis of the mechanism of representation of state interests has been created by the Edict of the RF President #1200 of June 10, 1994 "On Some Measures to Ensure State Management of the Economy." In accordance with item 4 of this Edict, the following persons may be appointed as state representatives in the managerial bodies of companies:

- state employees – on the basis of a decision of the Russian President, the RF Government, the relevant federal executive authorities, or the Russian Federal Property Fund;

- other citizens of the Russian Federation – on the basis of agreements on representation of the interests of the state, concluded in accordance with the civil legislation. Agreements with citizens of the Russian Federation on representation of interests of the state are concluded by the Russian Federation State Committee for State Property Management, the Russian Federal Property Fund, or their territorial branches.

The duties of state representatives include the coordination with the federal executive authorities of draft decisions they are going to support and their votes on a particular list of issues. In accordance with item 8 of the aforementioned Edict, representatives of the state in managerial bodies of joint-stock companies must submit reports on the activity of these companies in the form established by the Government to the federal executive authorities not less frequently than twice a year.

The main shortcomings of the mechanism of representing state interests by state employees include the following:

- low efficiency of the adopted decisions and insufficient economic initiative, due to the need of written coordination of significant issues considered by the board of directors with the state executive authorities;

- insufficient responsibility of state representatives for the results of management;

- lack of interest in stock management for the benefit of the state.

The main problem of the institution of state representatives consists in the objective difficulty of establishing personal responsibility for the management of joint-stock companies. Representatives of the state adopt decisions both on their own initiative and on the basis of written directives.

Although the Edict envisions a possibility of representing the interests of the state by citizens who are not state employees, this issue has been duly concretized only two years later.

The normative basis of representing state interests by citizens who are not state employees has been developed by the Decree of the RF Government #625 of May 21, 1996 "On Ensuring the Representation of State Interests in Managerial Bodies of Joint-Stock Companies (Economic Partnerships), Part of whose Stocks (Shares, Deposits) are Fixed in Federal Property."

This Decree has established the possibility of concluding agreements with solicitors on representation of interests of the state.

In principle, this mechanism could step up the solution of tasks of boosting the interest and qualification of state representatives. However, this mechanism is also based on compulsory coordination of certain issues between the solicitor and the principal, in which case the solicitor shall not be responsible for the negative consequences of decisions for which he voted on written instructions of the principal.

Due to the lack of explicit indication of the sources of funds to pay the solicitor's salary and compensation of his expenses, the mechanism of representing state interests by professional managers, who are not state employees, has not become broadly spread.

Second Mechanism

The normative basis of the mechanism of transferring shares into management on proxy is regulated by the Edict of the RF President #1660 of December 9, 1996 "On the Transfer of Shares of Joint-Stock Companies Created in the Process of Privatization into Proxy Management" and the Decree of the RF Government #989 of August 7, 1997 "On the Order of Transfer of Shares of Joint-Stock Companies Created in the Process of Privatization into Proxy Management and Conclusion of Agreements on Proxy Management of those Shares." This mechanism enables to overcome some drawbacks of the institution of state representatives: a proxy manager should deposit a pledge, which somewhat increases his responsibility. The state representative does not need to coordinate his votes in advance, which raises the efficiency and flexibility of enterprise management.

The practice of transferring stocks into proxy management has been developed with the adoption of the Law of November 30, 1995 "On Financial-Industrial Groups." In accordance with item 1, article 15 of this Law, one of the measures of state support of the activity of financial-industrial groups is the transfer of the parcels of shares of participants of the group, temporarily fixed in state property, into proxy management of the central company of this financial-industrial group. A very small number of financial-industrial groups have managed to receive the stocks fixed in state property into proxy management, and even less of them could effectively use these stocks for the management of their member enterprises.

The mechanism of proxy management is mainly oriented on the management of stocks, rather than business. Consequently, on the one hand, it is dominated by the tasks of preparing parcels of shares for sale (the prime objective of a proxy manager is the elevation of the market value and liquidity of shares), and on the other hand, its practical employment inevitably entails problems connected with compulsory licensing of the proxy manager to exercise stock management activity (although within the frames of this mechanism the proxy manager is not empowered to alienate the shares granted into his proxy management or to impose charge on them).

In this connection, it is important to seek new legal forms of proxy representation of state interests on the management of enterprises on the basis of stocks in state property.

Third Mechanism

The mechanism of pledge of state-owned stocks is normatively determined by the RF Presidential Edict #889 of August 31, 1995 "On the Order of Pledge of Stocks Constituting Federal Property in 1995." After twelve mortgage deals conducted at the end of 1995 with the shares of the largest enterprises, the mechanism has not received any further development.

This mechanism is based on the granting of credits to the state on the security of parcels of shares in state property and envisions that the voting on the pawned shares shall be carried out by the pawnbroker (creditor) at his discretion, but on a number of issues (close to the issues requiring coordination before the rights on shares passes over to the winner of a commercial tender) it is necessary to gain written consent of the Russian Goskomimuschestvo.

In the period of 1996-1997, all mortgaged shares have been sold, hence this mechanism has not become a means of enterprise management, but a means of their privatization, and with a considerable loss for the budget at that.

4.3. Role of Representatives of the State in Adopting Decisions on Management Issues in Joint-Stock Companies.

The legislatively established rights of the state to participate in the management of joint-stock companies are far from always in practical demand. We can give the most characteristic examples where the role of the state in the management of joint-stock companies does not correspond to the amount of rights and abilities.

1. Many state representatives in joint-stock companies participate in the work of the boards of directors quite irregularly and even do not attend the general meetings of shareholders.

2. It is quite a common situation when the number of representatives of the state in the managerial bodies of joint-stock companies does not match the number of shares in state property.

3. In a number of joint-stock companies representatives of the state were persons who were not employees of ministries or agencies (as a rule, dismissed from work at the aforementioned organizations in connection with reorganization, liquidation of personnel cuts), who had not concluded an agreement on representation of state interests and therefore enjoyed no right to participate in the work of the boards of directors on behalf of the state. Very often such "state representatives," included on the boards of directors without any legal grounds, use their position in their personal interests, which frequently disagree with the interests of the state.

4. Representatives of the state report on their work in joint-stock companies quite irregularly. As a rule, the reports of state representatives are a mere formality. Some representatives fail to report at all.

5. Many representatives of the state in managerial bodies of joint-stock companies do not initiate at the sessions of the boards of directors and shareholders' meeting the consideration of issues of improvement of the financial position of enterprises, raising the efficiency of their activity, canceling arrears on salaries, payments to budgets of all levels and to extra-budgetary funds.

The state representatives have insufficiently used their authority to dismiss the heads of joint-stock companies with durable delays of salaries, established by the Decree of the Russian Government of February 22, 1997, #214 "On Authorities of Representatives of the State in Managerial Bodies of Joint-Stock Companies, Part of Shares of Which Constitute Federal Property, in Case of Emergence of Indebtedness of these Companies on Salaries, Compulsory Payments to Budgets of All Levels and Insurance Premiums to State Extra-Budgetary Funds."

In accordance with item 1 of this Decree, if a joint-stock company, part of shares of which are in federal property, has arrears on salaries, compulsory payments to budgets of all levels and insurance premiums to state extra-budgetary funds, representatives of the state in the managerial bodies of this joint-stock company must:

- demand the convocation of a session of the board of directors of this joint-stock company and inclusion, in the established order, in the agenda of this session of a report of the executive body of the company on the size and reasons of the aforementioned arrears and measures taken to cancel them;

- take, in the established order, measures for early termination of authority of the corresponding executive bodies of the joint-stock company in case of unsatisfactory activity aimed at canceling the arrears and, if necessary, convening an extraordinary general meeting of shareholders.

The participation of representatives of the federal executive authorities (as well as the bodies of local self-government) in the work of the boards of directors of joint-stock companies, whose shares are fixed in state property, is often nominal. In many cases representatives of the state evade both the solution of important economic and social problems emerging in the process of the companies' functioning, and the representation of the state interests in the companies, which have a tremendous importance for ensuring national security and the functioning of the Russian economic system in general.

6. The unqualified actions of the state representatives in many joint-stock companies have become a reason of underpayment to the federal and local budgets and led to the weakening of positions of the state in the companies, entailing a whole number of other negative consequences.

7. The actions of state representatives in joint-stock companies quite often become the reason of all sorts of conflicts in the company leadership, which sometimes paralyze the work of managerial bodies of joint-stock companies and undermine the companies' economic position. Moreover, the differences in the views of different state authorities on the management of some or other joint-stock company often result in conflicts between state representatives. The conflicting parties in such instances are either representatives of different federal bodies, or different levels of state authorities (federal and RF members).

4.4. Assessment of Efficiency of an Enterprise with State Participation in the Capital

Considering the role of the state as a proprietor and participant of corporate governance, it is important to take into account the financial results of activity of state enterprises. From the viewpoint of evaluation of the role and place of the state sector in domestic industry, it is particularly interesting to compare the results of performance of enterprises of the state sector and the aggregate total of enterprises in the industry. It is expedient to accept as the basic characteristic for comparison the share of profitable enterprises in their overall number. Table 4 presents this comparison for different industrial branches.

Table 4

Comparison of Profitability of Industrial Enterprises in the State Sector with Similar Indices of the Aggregate Total of Industrial Enterprises (in 1997)[17]

Industrial branch	Share of profitable enterprises in the aggregate total			
	In the branch in general	In the state sector	Within the frames of the federal property	Within the frames of property of RF members
Fuel and energy complex	64%	60%	56%	62%
Metallurgy	47%	50%	58%	38%
Chemical and petrochemical industry	56%	50%	51%	48%
Mechanical engineering and metal processing	57%	61%	65%	49%
Forestry, wood-processing, pulp and paper industry	29%	30%	35%	23%
Industry of construction materials	46%	47%	54%	40%
Light industry	36%	48%	63%	31%
Food industry	56%	54%	61%	52%

Among the above economic branches, the share of profitable enterprises in the state sector differs significantly from the industrial branch as a whole only in the light industry. In the other industries, the difference in the indices does not exceed 5-6%. In half of the branches, the industrial complex in general exceeds the state sector according to this characteristic, and in the other half – it is inferior to it. This prompts the conclusion that from the point of view of financial results of activity, the state sector does not demonstrate any noticeable differences from the industrial complex as a whole.

Table 4 also helps compare the financial results of activity of enterprises constituting federal property and the property of the Russian Federation members. As we can see, the enterprises of the RF members are more profitable than the federal economic entities only in the fuel and energy complex. The situation in all the other economic sectors is the opposite: the share of profitable enterprises among the entities owned by the federal center surmounts the

[17] Based on data of the information-reference system «Alba”

corresponding index for the aggregate industrial enterprises of regional subordination, as a matter of fact, quite noticeably in some branches (by 20% in metallurgy, by 32% in the light industry). Therefore, from the point of view of financial results, enterprises in the federal property look more impressive than industrial facilities belonging to the Russian Federation members.

Diagram 5 enables to compare the data on the contribution of enterprises with a mixed form of property to the gross industrial output with the data on the share of such enterprises in the overall volume of industrial facilities. It is expedient to make comparison only among large and medium enterprises. Looking at industry as a whole, the production volume of private firms is, on the average, noticeably higher than that of state enterprises, but considerably lower than that of enterprises with a mixed form of property.

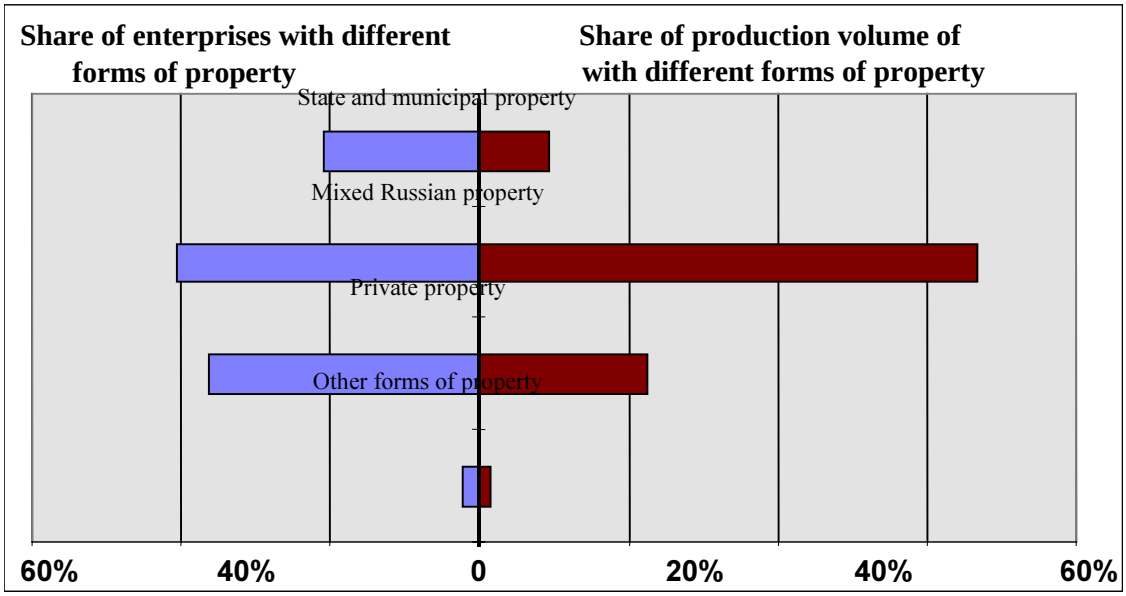


Diagram 5. Comparison of the share of enterprises with different forms of property in the overall number of enterprises with their share in the aggregate production volume (only for large and medium enterprises, on the basis of data of the RF Goskomstat for the end of 1997)

One of the possible methods of making a comparative evaluation of the efficiency of industrial enterprises representing different forms property is the comparison of the average labour productivity (i.e. the annual volume of industrial output per one worker) in the corresponding groups of enterprises. Apparently, such appraisal should be made for a comparable group of enterprises.

Diagram 6 shows the estimated average labour productivity for groups of enterprises constituting three basic forms of property in Russia: state, mixed and private[18]. The data are presented for economic branches, which is necessary, as the labour productivity in different branches is quite disparate. To make comparison convenient, all the presented figures are based on the average labour productivity in the economic branches. It is also necessary to mention that the selection of large and medium enterprises as the basis for comparison guarantees both the

[18] Due to the lack of reliable data on the number of employees of large and medium enterprises in the highlighted industrial sectors, we can only estimate the average labour productivity within the frames of the indicated categories. Nevertheless, the error in the estimate for each of the sectors does not exceed 3-5% and does not play a decisive role.

correctness of the comparison and the conclusions based on it, as the average number of employees of large and medium enterprises with all the forms of property under scrutiny is approximately the same – within the range of 400-800 persons.

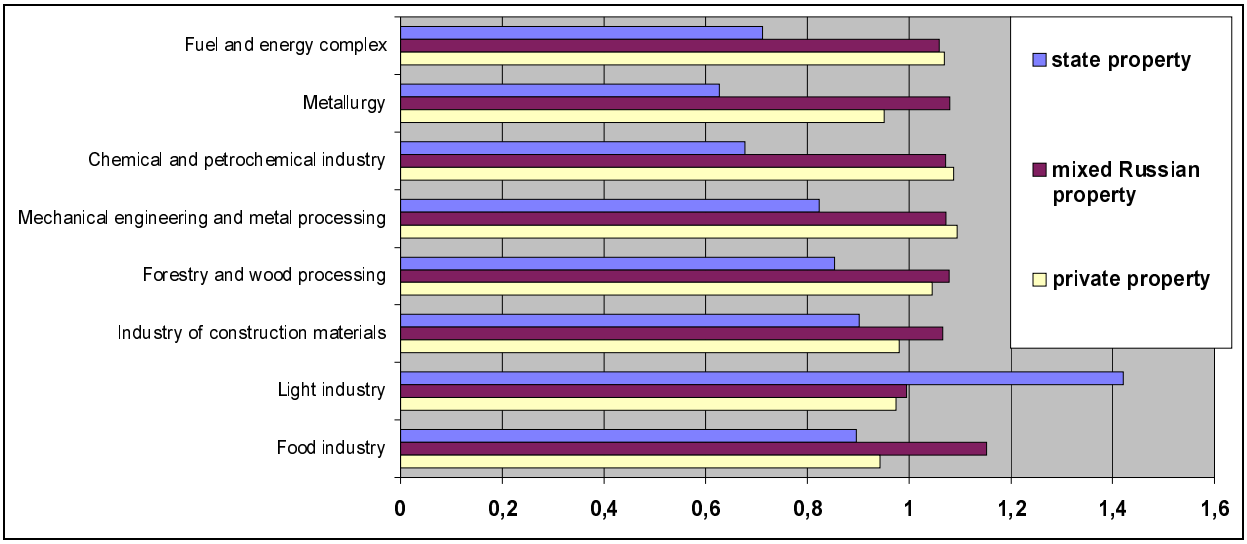


Diagram 6. Average labour productivity of large and medium enterprises with different forms of property in the basic branches of industry in 1997 (based on data of the RF Goskomstat)

The enterprises of the state sector in all the aforementioned industrial branches, except the light industry, are characterized with the lowest labour productivity among the considered forms of property. Private firms and enterprises with mixed forms of property in the majority of sectors have quite similar indices of average labour productivity. The presented data suggest the assumption that enterprises of the state sector (which in the majority of cases are state unitary enterprises) in the industry as a whole and in its individual branches function less efficiently than private firms. At the same time, enterprises with a mixed form of property are characterized with a productive efficiency which is, at least, not worse than that of the private companies.

This assumption is largely backed with the results of the survey conducted by the Leontiev Center[19] in 1995-1996 and aimed, generally speaking, at the demonstration of efficiency of privatization of industrial enterprises.

The results of this survey demonstrate that the results of privatization are unequivocal:

- according to characteristics of economic efficiency, the privatized enterprises with a share of the state over 25% perform better than the state enterprises by 21%, and privatized enterprises with a less than 25% state share work better than the state enterprises by 42% (in favour of auctioning and "deep" privatization);

- according to characteristics of financial stability, privatized enterprises with over 25% state share are 5.41 times better than state enterprises, and privatized

[19] "Comparative Analysis of Economic Results of Activity of the Russian Enterprises with Different Forms of Property." Moscow, St.Petersburg, International Center for Socioeconomic Research "Leontiev Center," 1996.

enterprises with less than 25% state share operate 2.18 times better than state enterprises (in favour of auctioning, but not in favour of "deep" privatization);

- according to characteristics of solvency, state enterprises do better than the privatized enterprises with over 25% state share – by 14%, and privatized enterprises with less than 25% share of the state perform 7% better than state enterprises (in favour of "deep" enterprises, but not in favour of auctioning).