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SESSION VI: THE ROLE OF BOARDS OF DIRECTORS IN OVERSEEING DISCLOSURE

PRACTICAL DIFFICULTIES IN INTRODUCING AUDIT COMMITTEES IN A RUSSIAN COMPANY

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[1] If we are to speak about attracting investment, including foreign investment, to development of the Russian corporations today, we should not regard this issue through the eyes of the company (proceeding only from how much the company needs), but through the eyes of investors: is this company worthy of investment?

Besides, one should not forget that, unfortunately, during the past decade Russia and the Russian corporations were not an exemplar object of investment, among other reasons due to the imperfection of the shareholders' rights protection system.

This is why today the existence of legislation and company charters complied on its basis, does not provide investors with guarantees that they shall not be deceived, that their investment shall not vanish into thin air, and the investors themselves shall not be stuck off the shareholders lists. There is no guarantee that the company will adhere to the honest practice of corporate government, as in the majority of cases the rights and interests of shareholders are violated exclusively within the frames of the acting legislation.

That is, besides such commonly accepted economic criteria as investment reimbursement period, return per each invested ruble or dollar, the company is also evaluated from the point of view of additional safety guarantees of these investments, additional convenient investment conditions. And as far as developing markets are concerned, serious competition exists in this sphere.

The management of RAO EES Russia is trying to build its relations with shareholders and potential investors precisely on these principles.

One of the reasons why this acquires special significance for us today is the fact that the company enters a stage of restructuring and reform. Although it is an objective reality, it is an extremely complicated and painful process not only from the point of view of procedure and technology, but also from the point of view of rights and interests of shareholders participating in it.

Any reform, just as well as a revolution, cannot proceed painlessly for some or other persons. This is reality, confirmed by practice, and it should be reckoned with.

Any reform is doomed, if the majority of its participants are not interested in it.

This is why we consider it very important to do everything to minimize the possible negative consequences for shareholders already at the stage of preparation, and even more so in the process of the reform.

This task is extremely difficult, considering that RAO is practically a semi-state owned enterprise and taking into account the existing restrictions and attempts to impose additional restrictions on

[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.

participation of foreign capital (even though capital has no nationality and works wherever the conditions are the most favorable and comfortable for it).

It is also necessary to bear in mind the extremely non-homogenous structure of the company joint capital and, consequently, of the shareholders' interests.

In particular:

The interests of *the state (on the federal and regional level*) have a strategic (durable) nature and are based on:

- the company's importance for the economy and political stability of the country;
- acknowledgment of the need for technical and technological modernization of the holding, whose fixed assets are hopelessly morally and physically obsolete and are beginning to fall apart in the direct sense of the word;
- a striving towards market transformations of the economy.

On the regional level, there is also the interest in solving local political and economic tasks.

Portfolio investors, including foreign risk funds, funds with a reputation of honest businessmen, as well as the Russian problem brokers, have short-term, purely speculative financial interests, oriented on current liquidity of the company stock. After the losses sustained in August 1998, they react to any other financial damage very painfully.

Institutional shareholders, unlike portfolio ones, are oriented on a longer investment period (2-5 years), therefore their prevailing financial interests are medium-term, with maximal guarantees.

The interests of representatives of *the Russian business*, including the company suppliers and creditors-suppliers, consumers, and regional banks, in each particular case are determined by the main financial source, plus the latter's financial-crediting interest.

Working people and pensioners, who have received the company stock during privatization, are interested in the preservation of jobs, a stable salary and the maintenance of the social facilities.

There is and can be no segregation of shareholders into first- and second-rate, significant and insignificant, nasty and complaisant ones.

Without a portfolio capital, one may well forget about the strategic capital, for the former paves the way to the latter.

Without state participation, the existence of a company like RAO EES Russia, carrying out the functions of economic and political safety of the state, is also deemed hardly probable, although in the majority of cases state participation in business is damaging to the business.

And so on, and so forth. Moreover, it is necessary to bear in mind that RAO EES Russia is a holding with the presence of the aforementioned groups both in the central and affiliated bodies. Try to evaluate at least the scope of possible combinations of interests.

And if we recall the conflict of last spring, which had a follow-up in the summer this year and was connected with the upcoming reorganization of the company, it was rooted, in fact, not in dissimilarity of interests of shareholders and the management, but of the shareholders themselves, or rather, different groups of shareholders, listed above.

What does the company do today to solve this problem?

It provides maximum information on the company itself, including in addition to the data the company must disclose under the law.

It keeps dual financial records: based on the Russian legislation and on IAS. This year we have switched over not only to annual, but also to half-year accounting on the basis of IAS.

We provide quarterly information for the analysts of companies, which are our shareholders or holders of depositary receipts for the company stock, in a language they understand – unlike the Russian financial statements.

We hold regular meetings of the company management with the shareholders in Russia and abroad, as well as extraordinary meetings on events of particular importance for the company.

The company works on upgrading the system of observing shareholders' rights.

It attracts internationally recognized consultants and advisers on improvement of reporting and corporate management.

The company is working on the Corporate Management Code, which would, in addition to legislative and charter requirements, enable to achieve a certain balance of interests of the corporation participants, by formalizing in the Code the agreements and accords between all corporation participants, including different groups of shareholders (from the point of view of interests), representatives of supervisory bodies and the company management.

On the whole, it is great that Russia has finally acquired such new notions as "the principles of corporate governance," based on the world practice and experience of civilized corporate behavior, "the code of corporate government," relying on these principles, as well as the first attempts to elaborate such code.

It is important, however, that these notions should not become another pretty advertising slogan, not backed by the practice of its utilization.

One thing causes concern here, however: unfortunately, we are once again trying to embark on "our own" route.

Specifically, the Federal Commission for Securities (FKCB) offers its own version of a directive code, worked out by a regulator and descended to companies for fulfillment.

Instead of initiating amendments to the legislation, based on the PRINCIPLES of corporate government, the Commission has engaged in the elaboration of a standard CODE, to all appearances, mandatory for the Russian companies.

This is absurd for the following reasons:

One of the main objectives of the Code is to secure a balance of interests not only between the management and the shareholders, but also between different groups of shareholders.

I have already mentioned the example of RAO. But it is only one company, whereas each company has its own shareholders, and hence, its own combination of interests, characteristic precisely of this particular firm.

This is why the development of any universal pattern for the settlement of these interests is absurd in its very essence. On top of this, practice shows that directive requirements (descended from the top, but not demanded from the bottom) are usually doomed. And in this case the companies focus all their intellectual and other resources on ingenious evasion of these requirements, rather than on their observance.

I consider it necessary to touch upon one more issue.

There has been much talk of late about the need to strengthen the authority of the Russian companies' boards of directors, entering independent directors on the boards, handing to the boards of directors some responsibilities of the companies' executive bodies, including the adoption of decisions on operative issues related to financial and economic activity.

This is an important and far from simple issue.

In my opinion, such proposals ought to be tested by the concept of responsibility, and not in some general (public) understanding, but concrete administrative and criminal responsibility for some or other decisions and actions.

Today, the board of directors of a Russian company, including its chairman (which is in fact an observation body), is irresponsible, and so is the general shareholders' meeting.

The provision that the chairman of the board of directors can be reelected at any moment is not evidence of responsibility, but rather the opposite – a possibility to shirk responsibility.

The vagueness of provisions of the Law on Joint-Stock Companies concerning the responsibility of board members and chairman (article 71), the uncertainly of the notions of "honesty and reasonableness," faulty and inculpable" actions, the possibility to evade responsibility by abstaining from vote, lack of criteria and procedures of determining losses, as well as of judicial practice, the actual responsibility for some or other actions (especially if the point at issue concerns transactions sealed by contracts and signed by the head of the executive body due to his position) lies precisely on the head of the executive body (the general director, the chairman of the company board).

Moreover, his position is between the devil and the deep blue sea: if he abides by the faulty decisions of the board, he shall carry administrative and criminal responsibility, and if he refuses to fulfill them, it provides grounds to reelect (remove) him.

The appeal to the legislation and to the practice of different countries where the boards of directors consist of persons (often the largest company co-owners), carrying personal responsibility (including with their own money) for damage inflicted on the company by their decisions and actions is in this case, so to say, out of place.

So, if we are to speak of enhancing the role of the board of directors in decisions taken by the company, particularly those concerning the deals, it is necessary to begin with legislatively fixing such distinctions and specifying the responsibility of the company managerial bodies.

Before this is done, any proposals on raising the role of the boards of directors, any talk about the so-called independent directors are nothing but an attempt to shirk responsibility, which is a real and gross violation, above all, of the rights and interests of shareholders.