

INFORMATION DISCLOSURE AND THE EXISTING PRACTICE OF CORPORATE GOVERNANCE IN THIS SPHERE

Presentation on by

Mr. Alexander Ikonnikov
Executive Director, Investors Protection Association
Russia

¹ Information disclosure is a fundamental principle of corporate governance. Information disclosure acquires special importance for the Russian stock market, which is so far not regulated by the so-called external mechanisms of corporate government.

The experience of investors' work in Russia shows that their successful performance requires a more thorough analysis of non-financial information than in other countries (corporate documents, information on decisions adopted by the company, data periodically disclosed by emitting bodies, etc.). The monitoring of such information is extremely important for forecasting shareholders' risks connected with "washing away" of their share in the charter capital, with the impossibility of exercising their voting right at general shareholders' meetings, etc.

The events of the current year have shown that the information disclosed during transactions altering the companies' corporate structure is insufficient. This concerns the information supply of the procedure of transfer to uniform stock, company restructuring, and so forth.

The following examples are based on the most illustrative cases, where a lack of the necessary information led to conflicts between minority shareholders and the company management, which have received broad publicity in Russia in 2000.

"Surgutneftegaz"

General description of the situation

At the beginning of 2000, NK "Surgutneftegaz" was one of the largest Russian oil holdings, and OAO "Surgutneftegaz" was one of its subsidiaries.

The administration of NK "Surgutneftegaz" and OAO "Surgutneftegaz" have announced the transfer to uniform stock (consolidation).

On 10.02.2000, an extraordinary general meeting of OAO "Surgutneftegaz" shareholders was held by correspondence for consolidation purposes, where the shareholders approved 12 billion ordinary shares and agreed on a one-year suspension of the right of preferential purchase of stocks placed by open subscription.

12 billion shares of OAO "Surgutneftegaz" were supposed to be exchanged for the stocks of NK "Surgutneftegaz" and shares in the charter capitals of other enterprises of "Surgutneftegaz" group.

During the extraordinary general meeting of OAO "Surgutneftegaz" shareholders, the holders of OAO "Surgutneftegaz" preference shares have not been granted a voting right on the issue of approval 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 revisions.

the declared 12 billion ordinary shares. In the opinion of some holders of preference stocks, this infringed their rights for the following reasons.

The size of dividend on preference shares depends on the total number of shares placed. The increase of the amount of shares in circulation cuts the size of net profit allocated as dividend per one preference share. The adoption of a decision by the general meeting to add to the charter a provision concerning the number of declared shares for the purposes of subsequent increase of the charter capital by placing additional stocks within the declared limits may be evaluated as restriction of the rights of holders of preference shares.

Therefore, according to the Law “On Joint-Stock Companies,” the shareholders should have been granted a voting right on the issue of the declared stocks, and in case of their non-participation in the shareholders’ meeting or voting against the decision on the declared shares, they should have been granted a right to demand that the company buy out their stocks.

Evaluation of the Consolidation Plan Proposed by the Company Leadership

The following conclusions have been made on the basis of analysis of the consolidation plan proposed by “Surgutneftegaz” headmen:

The information contained in addresses of NK “Surgutneftegaz” to investors was absolutely insufficient to enable the shareholders to adopt a justified positive decision on participation in the exchange of stock:

- data on exchange rates were missing;
- there was no information on the possibility of transactions posing interest for persons affiliated to the “Surgutneftegaz” group and major deals in the process of transition to uniform stock;
- data on guaranteed observance of the interests of minority shareholders during the transition to uniform shares were missing;
- there was no information as to what quantity of issued OAO “Surgutneftegaz” shares was planned to be exchanged for NK “Surgutneftegaz” stock, and what amount was to be exchanged for the shares of enterprises incorporated in the group;
- information on attraction of professional valuers was absent.

Problems related to consolidation of the “Surgutneftegaz” group have become a subject of broad discussion in the investment community. In this connection, the then Coordinating Center for Protection of Rights and Legal Interests of Investors recommended that the shareholders vote at the extraordinary shareholders’ meeting of OAO “Surgutneftegaz” on 10.02.2000 against all items on the agenda.

Such recommendations were based on the following:

- Extreme insufficiency of information on consolidation presented by the management.
- Loss of the blockading package of stock by minority holders of OAO “Surgutneftegaz” ordinary shares. After the emission, their share would decrease, as they would no longer enjoy the right of preferential purchase of stock.
- The loss of cost of stocks belonging to NK “Surgutneftegaz” minority shareholders. The shareholders of NK “Surgutneftegaz” were offered 12 billion ordinary shares of the new OAO

“Surgutneftegaz” emission in exchange for 52.4% of OAO “Surgutneftegaz” shares, owned by them as shareholders of NK “Surgutneftegaz” (some 16 billion shares), and for marketing enterprises constituting nearly 100-percent property of NK “Surgutneftegaz”.

➤ Restriction of the rights of holders of preference shares, the size of dividends on which depends on the total number of placed stocks. Allocations from net profit as dividends per one preference share would drop 28%.

➤ Increase of the risks connected with OAO “Surgutneftegaz” corporate management, as, in shareholders’ estimates, the share of persons affiliated with the “Surgutneftegaz” group would grow substantially in the company administration.

➤ Increase of the risk of drop of the stock cost in connection with the lack of any sort of information on the NK “Surgutneftegaz” role in the new corporate system and on the plans of its further existence. Emergence of risks connected with further disposal by NK “Surgutneftegaz” of the package of OAO “Surgutneftegaz” shares in its property.

Therefore, the above example is a graphic illustration of the problem of information disclosure in the volume necessary for investors for adopting leveled and justified decisions. A shortage of data forces investors to take active measures in protection of their rights and legal interests.

It is also noteworthy that in the course of preparation for transition to uniform stocks, NK “Surgutneftegaz” has handed 2 billion shares of OAO “Surgutneftegaz” with an overall estimated cost of \$600 million to “Surgutneftegaz” Non-State Pension Fund.

The information disclosed by NK “Surgutneftegaz” and OAO “Surgutneftegaz” suggests the conclusion that “Surgutneftegaz” Non-State Pension Fund (hereinafter referred to as NPF SNG) has acquired 6.4% of OAO “Surgutneftegaz” shares from NK “Surgutneftegaz”. According to approximate estimations based on the stock quotas, the cost of the 6.4% package of OAO “Surgutneftegaz” shares exceeded \$600 million, or some R 16 billion. The cost of assets, in accordance with OAO NK “Surgutneftegaz” balance sheet on the 3rd quarter, was R 17 billion.

Despite shareholders’ questions, **OAO “Surgutneftegaz” has not disclosed detailed information on such transaction** (on the purposes of such deal, on the cost of OAO “Surgutneftegaz” package of stock, as estimated by NK “Surgutneftegaz” Board of Directors, etc.).

Therefore, this deal may be generally classified as a major deal and transaction, posing the interest for persons affiliated to the company. However, the information on the order of conducting this deal has not been disclosed either.

RAO “Norilsk Nickel”

General description of the situation

RAO “Norilsk Nickel” is a major seller of metallurgical output of its subsidiaries in Russia and one of the world’s largest suppliers of this produce. The RAO affiliated companies manufacture industrial output. The RAO subsidiaries account for some 20% of the world extraction of nickel, approximately 10% of extraction of cobalt, and 4% of copper. On the domestic market, RAO “Norilsk Nickel” subsidiaries extract about 96% of nickel, 65% of copper, and 95% of cobalt on the national territory. Its affiliate, OAO “Norilsk Mining Company”, is the most valuable asset of the RAO, with a revenue surmounting 80% of the total sales proceeds in the group.

On September 19, 2000, RAO “Norilsk Nickel” Board of Directors has announced its intention to reorganize the “Norilsk Nickel” group and purchase the company Norimet Limited.

Restructuring shall be conducted in four stages.

On stage one, a closed subscription has already been held to the newly emitted stock of OAO “Norilsk Mining Company” with an exchange rate during placement equal to 1.322 shares of OAO “Norilsk Mining Company” per each 1,000 shares of RAO “Norilsk Nickel”.

Moreover, on February 11, 2000, the Board of Directors has taken a decision, and on April 20, 2000, the corresponding agreements have already entered into force, on the purchase of Norimet Limited by RAO “Norilsk Nickel” in exchange for 37.9% of stocks of OAO “Norilsk Mining Company”.

On the second stage, the charter capital of OAO “Norilsk Mining Company” shall be increased, and the newly issued stocks shall be placed among the shareholders in accordance with their shares.

On stage three, it is planned to include OAO “Norilsk Mining Company” in the List of RTS Trading System.

On the fourth stage, the proposal of exchange of RAO “Norilsk Nickel” stock for the shares of OAO “Norilsk Mining Company” shall be made.

Assessment of the Restructuring Plan Proposed by the Company Leadership

The restructuring plan, submitted by the company, was a subject of discussion by a broad circle of investors.

Having analyzed the information on RAO “Norilsk Nickel” restructuring strategy, disclosed by the joint-stock company, investors stated that the volume of information on the order of implementation of the plan was insufficient. This provision has naturally aroused concern among the shareholders, as according to the restructuring plan, the minority shareholders of RAO “Norilsk Nickel” cannot influence the adopted decisions.

Many minority shareholders were indignant that they were merely faced with the fact of the ongoing changes and they were kept in the dark during the first stage of the restructuring. Key decisions had already been made before the restructuring plan was presented to the shareholders.

According to the developed strategy, all decisions connected with the exchange of RAO “Norilsk Nickel” stocks (including the determining of exchange rates) shall be taken by the shareholders of OAO “Norilsk Mining Company”, which used to be the RAO subsidiary before the reorganization plan was launched.

Therefore, the adoption of the principal decisions on restructuring has been taken outside the competence of the RAO shareholders. Consequently, minority shareholders of RAO “Norilsk Nickel” cannot participate in elaboration of these decisions. Minority shareholders are actually deprived of a possibility to choose, and if they do not participate in the exchange of shares on the offered conditions, they could lose most of their investment.

The initial stages of the restructuring plan (the sale of OAO “Norilsk Mining Company” shares and the purchase of Norimet company), which are crucial, arouse the biggest amount of questions.

The following may be said with respect to the first stage:

Shareholders are concerned that the acquisition of Norimet was a transaction which could be qualified as the so-called interested deal, the approval of which constitutes the authority of the general meeting of shareholders (not interested in the transaction). This was their objection to the company representatives.

The Company has up till now failed to reveal information on the former owners of Norimet. Besides that, the information on the size of actual ownership of the holding stock by the controlling shareholder is not disclosed. Therefore, the question whether the transactions of alienation of OAO “NGK” stock and acquisition of Norimet were deals recognized as interested in accordance with the law and, consequently, requiring mandatory approval of the general meeting of shareholders not interested in the transaction, remains open.

The alienation of part of the shares of OAO “Norilsk Mining Company”, which is the most valuable asset of the RAO, and the purchase of Norimet was based on the Rosexpertiza evaluation of the cost of the deal. The decision to conclude the above major deal was within the competence of the company Board of Directors. As the Board of Directors did not include representatives of minority shareholders, the latter could in no way influence the decision, including by means of selecting the valuator for this transaction.

RAO “EES Russia”

General description of the situation

Another Russian company, which announced the alteration of its corporate structure is RAO “EES Russia.” The situation with this company is slightly different from the former two.

EES Russia remains the world’s largest highly automated complex engaged in production, transmission and distribution of electric power, and centralized operative technological management of these processes. Electric energy produced by the holding exceeds 70% of all electricity in Russia.

In the beginning of the current year, the RAO “EES Russia” management submitted the Concept of Company Restructuring for consideration of the Board of Directors.

Having analyzed the Concept, the investors have arrived at the conclusion that the document has been elaborated without consideration of the interests of minority shareholders.

Shareholders, which own the company, are entitled to expect that in the event of any actions directly affecting their property the company management shall take the necessary measures to protect their rights. They are also entitled to receive detailed information on the economic implications of the undertaken changes. Moreover, this should be done before the launching of any concrete measures, otherwise the stockholders shall have no opportunity to adopt decisions concerning the disposal of their property.

In the given case, minority shareholders have initially come across a lack of understanding by the management of the need for open dialogue with the company shareholders in order to consider their interests and supply them with timely information.

Only joint effort undertaken by the shareholders within the frames of the Association for Protection of Investor’s Rights has resulted in the amelioration of the situation. Perhaps, the reason of mutual misunderstanding was, among other things, the incorrect presentation of information and failure to attract minority shareholders to elaboration of the restructuring programme at its initial stage.

Common examples connected with information disclosure

The information distribution channels are as important as the contents of the information. In many Russian companies, the access to and receipt of information turns out to be complicated and costly for many shareholders. For example, the charter of OAO "Surgutneftegaz," which has approximately fifty thousand shareholders, stipulates that the shareholders shall be notified of the general meeting in the regional newspaper Neft Priobya. Moreover, in the period of the shareholders' meeting, the information on the items on its agenda was available for all interested shareholders in the city of Surgut.

Many companies are trying to use modern technologies for distributing information through their own Web sites. The information published on Internet sites may be roughly divided into three categories: press releases, production activity, information for stockholders. The latter includes, as a rule, financial accounts, data on the composition of the Board of Directors and the company Management.

As an example, the practice of non-financial information disclosure on sites of OAO "Gazprom," OAO "Sibneft," RAO "Norilsk Nickel," RAO "EES," and OAO "Surgutneftegaz" was analyzed. The protocols of general meetings and quarterly reports were published only on the RAO "EES" site.

This suggests the conclusion that the companies do not utilize in full measure all opportunities at their disposal for information disclosure.

Moreover, there have been cases of refusal of companies to present information to their shareholders. For example, OAO "Surgutneftegaz" and NK "Surgutneftegaz". One of the company stockholders has come across a whole bunch of formal obstacles on the part of OAO "Surgutneftegaz" and its authorized representative OOO Invest-Zaschita in receiving the copies of the protocols of the general shareholders' meetings. This rouses extreme concern, as such documents should be the most open and accessible for the shareholders.

Conclusions

Information disclosure is a pivotal issue for creation of honest practice of corporate management in Russia.

In this connection, it is necessary to highlight the following problems:

1. On the level of state regulation

Creation and maintenance of an accessible system of information disclosure, enabling the investors to exercise and protect their rights, the lack of which may turn out to be one of the negative factors determining the development of the stock market.

For the purpose of tackling this issue, the Russian Federal Commission for Securities (FSCM) has created a server of information disclosure, as the enhancement of the level of information transparency of the market is one of the critical objectives of the state in the sphere of development of the stock market, in accordance with the Concept of Development of the Stock Market in the Russian Federation. However, information on quarterly reports and significant facts has not been renewed on this server since July 2000.

Improvement of the normative base regulating information disclosure.

Insurance of information disclosure to holders of American Depositary Receipts for the stocks of Russian enterprises.

2. On the Level of Joint-Stock Companies

Timely and complete disclosure of information by emitting entities on corporate events, including major deals and transactions posing interest for persons affiliated to the company. Disclosure of information on the enterprise property structure and on correlation of their rights with the rights of other proprietors. The practice of corporate government in the Russian companies demonstrates the reluctance of large shareholders and other persons, which control or may control the company, to disclose such information about them.

In case of exercising measures aimed at changing the company corporate structure, timely supply of shareholders with the necessary information and taking their interests into consideration, including by granting them a possibility of participating in the adoption of the corresponding decisions.

Elevating the role of the company Board in disclosure of non-financial information. Development of the institution of independent directors.

3. On the level of the market

Development of the system of information disclosure SCRIN “Emitent,” created by the self-regulated organization NAUFOR on initiative of the market.

Raising the responsibility and role of financial consultants in disclosing non-financial information by the Russian enterprises.