

SESSION I: THE ROLE AND MAIN FUNCTIONS OF THE BOARD IN CORPORATE GOVERNANCE
PART B: THE SITUATION IN RUSSIA

Background Paper on
BOARDS OF DIRECTORS - LEGISLATION AND PRACTICE

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¹ **Introduction**

The Board of Directors, as a body to which shareholders delegate a considerable part of their authorities on joint-stock company management, occupies a key position within the system of corporate governance. The company Board of Directors carries out general guidance of the company activity within the frames of its competence. The present document will look into the issues of formation of the Board of Directors, its authority and responsibility, and analyze some practical aspects of activity of the Boards of Directors of some Russian companies, included in the corporate governance quality rating, carried out by the Institute of Corporate Law and Governance.

The legal basis of activity of the Russian companies' Boards of Directors consists in the Federal Law of 26.12.95 #208-FZ "On Joint-Stock Companies" (hereinafter referred to as the Law).

In accordance with the Law, the creation of a Board of Directors (Supervisory Board) is obligatory only for joint-stock companies with more than fifty shareholders – owners of voting stocks.

If the number of shareholders – owners of voting shares is less than fifty, a Board of Directors does not have to be formed, and its functions may be carried out by the general shareholders' meeting.

According to the Law, members of the Board of Directors shall be elected at the annual general meeting of shareholders. Therefore, the maximal term of authority of members of the Board of Directors is one year, upon the expiry of which his authorities are either suspended or, in the event if his reelection for a new term, reemerge. Persons elected to the Board of Directors may be reelected an unlimited number of times. Only a natural person may be a member of the Board.

Order of Nominating Candidates to the Board of Directors

It has already been mentioned that the regular elections of the Board of Directors should take place annually, at the annual general meeting of shareholders. In this connection, the Law specifies the range of persons empowered to participate in working out the agenda of the general annual meeting of shareholders.

The rights to introduce proposals to the agenda of the annual shareholders' meeting, including the nomination of candidates to the Board of Directors, are granted to shareholders (shareholder) of the company, holding jointly not less than 2% of the voting stocks of the company.

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.

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Elections of members of the Board of Directors are obligatorily carried out by **cumulative vote** in joint-stock companies with more than one thousand shareholders – owners of the company equities. In the other companies cumulative vote shall be carried out if it is stipulated in the charter.

Therefore, the actual composition of the Board of Directors is formed by shareholders at the general shareholders' meeting. Neither the company employees nor suppliers, consumers and creditors may formally participate in the elections of the Board of Directors, if they are not shareholders.

It should be mentioned that the cumulative vote, as the only possible method of electing the Board of Directors, is not practiced in all countries. For example, according to the research of Rafael La Port, Florencio De Salinez, A.Schleifer, R.D.Vishnya "Law and Finance," only one of the G7 nations, the United States, employs cumulative voting. Among fifteen countries (Argentina, Brazil, Mexico, Chile, Greece, Portugal, South Korea, the Philippines, Indonesia, Malaysia, Taiwan, Thailand, India, Turkey, South Africa), only Thailand, Argentina, the Philippines and Taiwan have cumulative voting.

It is necessary to emphasize the positive role of legislatively endorsing cumulative voting for the Russian practice of corporate governance. Thanks to this norm, minority shareholders could elect their representatives to the Boards of Directors.

The numerical composition of the Board of Directors is determined by the company Board or by decision of the general meeting of shareholders, in accordance with the Law.

The number of directors on the Board of a public joint-stock company with more than one thousand shareholders – owners of equities and other voting stocks of the company – shall not be less than seven members, and in a company with more than ten thousand shareholders – not less than nine members.

If the number of board members of a company becomes lesser than half of the number envisaged by the Charter, the company must convene an extraordinary general meeting of shareholders to elect a new Board of Directors. The remaining members of the company Board shall be empowered only to adopt a decision to convene such extraordinary general meeting.

Therefore, if a Board of Directors, whose numerical composition is less than the established number, adopts any decisions other than the convocation of a shareholders' meeting, such decisions may be contested in court as they have been taken by a body without due authorization.

The analysis of charters of a number of Russia's major companies showed that they contain clauses, inconsistent with the Law, envisaging a possibility of extending the term of office of the Board of Directors. In practice, however, none of the companies has ever applied these charter clauses.

Executive Directors

If a company has both a Board of Directors and an Executive Board (the company's collegial executive body) working at the same time, according to the Law, members of the collegial executive body cannot constitute the majority on the Board of Directors.

As a matter of fact, this requirement of the Law concerns only members of the Executive Board and does not spread on other employees of the company. As a result, members of the Executive Board and other top managers constitute the majority on the Board of Directors of some companies. For example, in six out of twenty-five Russian companies rated by the Institute of Corporate Law and Governance, members of the executive managerial body and company employees constitute over a half of the Board of Directors.

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Premature Termination of Authority of Members of the Board of Directors

The authority of any member of the Board of Directors may be terminated before time on decision of the general meeting. But if members of the Board of Directors had been elected by cumulative vote, a decision on early termination of authority may be adopted only with respect to all members of the Board.

As the term of office of the Board of Directors is one year, and it should be elected annually at the annual shareholders' meeting, it is possible to terminate the authorities of the Board of Directors ahead of schedule only at an extraordinary general meeting. The right to convene such meeting is granted to: a shareholder (shareholders) owning not less than 10 percent of the voting shares of the company on the date of filing the claim; the company Board of Directors on its own initiative; the company auditing commission (inspectors); an auditor.

The charters of some companies contain clauses complicating premature termination of authority of the Board of Directors. They set conditions that a decision on premature termination of authority of the Board should be taken by three quarters of the votes. As a matter of reference, according to the general rule, the decisions are adopted at a general meeting by a simple majority vote.

It is noteworthy that according to the interpretation of the Law by the Russian Federal Commission for Securities (FKCB), premature termination of authority of the Board of Directors and election of a new Board constitute one integral issue. Consequently, the clause requiring the adoption of a separate decision on termination of authority of the old Board of Directors for premature termination of authority of board members is illegal.

Restrictions against Combining by one Person of the Post of Chairman of the Board of Directors and Individual Executive Body (General Director)

The Law prohibits the combining of posts of Chairman of the Board of Directors and General Director.

The companies abide by this requirement. A close analysis of the compositions of the Boards of Directors of some companies reveals the following. The Chairman of the Board of Directors is often a company employee, for instance, Deputy General Director (Deputy Chairman of the Executive Board), i.e. a person appointed by the General Director. The Board of Directors, whose functions should include control over the activity of the Executive Board and the General Director, is headed by a person accountable to the General Director. Moreover, in practice General Directors are always included in the Boards of Directors. Therefore, the point at issue is merely formal abidance by the Law, which considerably undermines the accountability of managers to the Board of Directors and the objectivity of assessment of the managers' activity.

Participation of Independent Directors in the Board of Directors

The Law does not contain any requirements of compulsory inclusion of so-called "independent directors" – persons not connected with the company by business relations – in the Board of Directors.

According to the Law, an independent director is a member of the Board, not combining his post with a position in the executive managerial body of the company.

The definition of "independent director" given by the Law is slightly narrower than the notion of independent director accepted in international practice. An independent Board member should not be connected by any relationships with the company, apart from his work on the Board of Directors, with holders of a considerable number of shares, members of the Executive Board, as it may influence the

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independence of his decisions. A director, not authorized with executive functions, would not necessarily be “independent.”

In order to ensure the objectivity of the adopted decisions and maintain a balance of interests of various groups of shareholders, the Board of Directors should include independent directors. Their objective is to make an independent estimate of the managers’ activity, introduce their independent opinion in discussion of the company strategy and other issues connected with the company’s activity.

The recognition of the necessity of involving independent directors in the work of the Board of Directors has become a recent tendency. This issue has been the center of attention during the past year. For example, in the period from November 15, 2000, to February 15, 2001, the Association of Managers with participation of the Association for Protection of Investors’ Rights, with support of the Center for International Private Enterprise and with participation of the United States Agency for International Development, has conducted the survey “Role of Independent Directors in the Management of the Russian Enterprises.” The principal part of the survey was conducted in the form of an opinion poll of heads of Russia’s major enterprises, as well as international and Russian investment organizations functioning in Russia.

Upon results of the survey, the Associations have formulated their own definition of an independent director. A member of the Board of Directors may be considered independent (professional) if he (she):

- works on a professional basis, i.e. the work as member of the Board (Boards) of Directors is his main occupation;
- works in the interests of the entire joint-stock company, rather than some particular shareholder (group of shareholders), irrespective of the latter’s share in the company;
- is a member of a professional association of directors (institute of independent directors), which could guarantee his professionalism and objectivity by monitoring the observance of standards of professional ethics.

The survey participants have highlighted a number of positive aspects of presence of independent directors. In their opinion, an independent director:

- ensures objectivity of public information on the company’s activity;
- increases investors’ trust towards the company;
- stimulates the establishment of contacts between the company and potential investors;
- contributes to improvement of the company image, including on the world markets.

According to results of the survey in general, both the heads of enterprises and investors see considerable advantages in the presence of independent directors on the Boards of Directors. The recognition of the important role of an independent director by subjects of corporate relations prompts the assertion that independent directors will find a place of prominence in the Russian practice of corporate governance.

RAO EES Russia has formulated its notion of an independent director in the draft Corporate Management Code of RAO EES Russia:

An independent member of the Board of Directors (as well as his/her spouse, parents, children, brothers, sisters):

- shall not be a representative of a shareholder – owner of two and more percent of the voting stocks of the company;
- shall not be connected with the company by any relations (labour, contractual), other than participation in the work of the Board of Directors and ownership of shares in the amount not exceeding 0.5% of the voting stocks;
- shall not render legal, consultative and other services to RAO EES Russia and its affiliated persons;

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- shall not be connected with RAO EES Russia and its affiliates by labour relations in the course of five years preceding the election and during the execution of his/her functions;
- shall not be a representative of the state authorities.

As the Code has not been approved yet, but only submitted for discussion by all interested persons, time will show how RAO EES Russia will fulfill these requirements.

It is necessary to mention in conclusion that the Russian FKCB, within the frames of elaboration of the Russian Code of Corporate Behavior, also attempted to make a definition of an independent director. This definition deserves special attention. Apparently, after the adoption of the Code, the following criteria will be considered as fundamental.

An independent director is a director who:

- does not maintain labour relations with the company or its affiliated persons;
- does not receive remuneration from the company or its affiliates, except the compensation paid for fulfillment of functions on the Board of Directors, on decision of the general shareholders' meeting;
- is not a relative of in-law of a person who is or has been a member of the company managerial bodies or its affiliated during the past three years;
- does not own more than 25% of the company's voting shares.

The latter criterion of the definition considerably widens the notion of independence, which makes such mechanism of protection of shareholders' rights as participation of independent directors on the Board ineffective.

In accordance with the Federal Law "On Competition and Restriction of Monopolistic Activity on Commodity Markets," persons enjoying the right to manage more than 20 percent of the overall number of votes provided by shares comprising the charter capital, are affiliated persons of a legal person.

In our opinion, it is impossible and incorrect to expect that the person owning a considerable package of shares would be unbiased in his decisions and would not maintain only his personal interests.

Directors – Representatives of Minority Shareholders

Speaking of independent directors, it is necessary to dwell on the activity of the Association for Protection of Investors' Rights, which implements the Program of Promoting Candidates to the Boards of Directors of the Russian Emitting Entities. On results of the year 2000, 17 representatives of the investment community were elected to the Boards of Directors of 25 enterprises.

The problems of imperfection of the Russian corporate governance, broad practice of violation of shareholders' rights have become the reason for emergence of such mechanism of protection of investors' rights as elections of representatives of minority shareholders to the Boards of Directors, backed by joint effort of shareholders – members of the Association for Protection of Investors' Rights.

It is a custom to refer to directors elected within the frames of the Program of the Association for Protection of Investors' Rights as independent. However, in the given case this definition is somewhat inaccurate, as one of the main tasks of the director is the representation of interests of minority shareholders – members of the Association for Protection of Investors' Rights, who have elected him/her, to the Board of Directors.

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As there is no generally accepted definition of an independent director, the companies, with rare exception, have not formulated their own criteria of independence either, and the information whether some or other director is independent is not disclosed.

At present, the **requirements of information disclosure on members of the Board of Directors** boils down to disclosure of data on their jobs over the past five years and during the reporting year, including combined jobs, as well as their shares in the charter capital (shares of stocks) of the emitting entity, its subsidiaries and affiliates.

Review of the Composition of the Boards of Directors (on the state of 01.01.2001)

Average statistical composition of the Board of Directors, calculated on the basis of data on 24 companies*.

	Average for 24 companies
Numerical composition of the Board of Directors	12
Number of members of the Board of Directors, representatives of the state	2**
Number of members of the Board of Directors, company employees	4
Number of members of the Board of Directors, members of the collegial executive body of management	3***
Number of members of the Board of Directors, representatives of shareholders, owning 5% and more shares (except the state)	2
Number of members of the Board of Directors, representatives of the Association for Protection of Investors' Rights	Represented in 11 out of 24 companies

* Aeroflot, Bashinformsvyaz, GAZ, Gazprom, EES Russia, Irkutskenergo, Krasny Oktyabr, Kubanelektrosvyaz, Kuzbassenergo, Lenenergo, Lukoil, MGTS, Mosenergo, Norilsk Nickel, PTS, Rostelecom, Severstal, Sibneft, Surgutneftegaz, Tatneft, GUM Trading House, Uralsvyazinform, Elektrosvyaz Rostov Region, YUKOS.

** In the present case, representatives of the state include the officials of the federal and regional authorities, as well as city mayors. The Russian Federation and/or members of the Russian Federation have a share only in 12 companies.

*** Six companies (25%) do not form a collegial executive body.

The presence of representatives of minority shareholders, promoted to the Board of Directors within the frames of the Program of the Association for Protection of Investors' Rights, has a positive impact on the practice of corporate governance by companies. According to the results of the rating of the quality of corporate management in 25 Russian companies, conducted by the Institute of Corporate Law and Governance, the companies, which have representatives of minority shareholders on their Boards of Directors, are rated higher in the final table (see Supplement #1).

The following information presents standard compositions of the Boards of Directors in different economic sectors.

Regional communication companies:

As a rule, the Board of Directors includes:

- a representative of the regional administration;
- several representatives of OAO Svyazinvest – the controlling shareholder;
- managers of the company itself.

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The charters of the majority of companies envisage the necessity of coordinating (receiving consent) some decisions of the Board of Directors with OAO Svyazinvest.

Regional power companies:

As a rule, the Board of Directors includes:

- a representative of the regional administration;
- usually, about a half of the board are representatives of RAO EES Russia;
- managers of the company itself.

Oil companies:

As a rule, the Board of Directors includes managers of the joint-stock company and top managers of companies connected with the joint-stock company.

API representatives are not included in the Board of Directors.

Metallurgical companies (Norilsk Nickel, Severstal):

The Boards of Directors consist of managers and representatives of controlling shareholders.

State holdings (RAO EES Russia, OAO Aeroflot, OAO Gazprom):

The prevailing number of Board members consists of state officials (in Gazprom – a little less than a half of the board). Moreover, several members of the Executive Board are always represented on the Board of Directors. There are API representatives.

Some general conclusions:

The Boards of Directors mainly consist of the company managers, representatives of the controlling shareholder, and companies connected with the joint-stock company. The Board of Directors includes the General Director (President) of the company.

If an enterprise plays a prominent role in the regional economy, is a major taxpayer, its Board usually includes a representative of the administration of the region where the company operates. For energy companies and partially communication enterprises, the participation of representatives of the administration is also explained by the fact that according to the existing rules, the regional authorities participate in working out the tariff policy and, besides that, the enterprises have to carry the burden of social support.

The presence of institutional investors, strategic and portfolio foreign investors among the shareholders of some companies influences the composition of the Board of Directors, enabling to reach a relative balance between directors – managers and representatives of the controlling shareholder and external directors – representatives of the interests of minority shareholders.

The compositions of the Boards of Directors of some companies are quite stable. For example, most members of the Boards of Directors of OAO Krasny Oktyabr, OAO Lenenergo, OAO Surgutneftegaz, AO GUM Trading House, have been reelected for a second term.

Possibility to Establish Special Requirements to Persons Elected to the Board of Directors

According to the Law, requirements to persons elected to the Board of Directors of a company may be set by the company charter or an internal document, approved by the general shareholders' meeting. The Law does not specify any particular membership criteria.

The analysis of charters of the leading Russian companies shows that the introduction of requirements to candidates has not become commonly spread so far. However, some companies have included such

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requirements into their charters. Out of the 25 rated companies, 17 have not yet introduced any requirements to candidates.

Let's consider several examples. Persons with higher professional education may be elected to the Board of Directors of OAO Irkutskenergo.

The Statute on the Board of Directors of OAO Lukoil contains special requirements to candidates. According to the Statute, a natural person not younger than 25 years old, with higher education and flawless reputation may be elected member of the Board of Directors.

The Board of Directors of OAO Rostelecom cannot include persons with restricted capabilities and deprived of the right to conduct the corresponding activity. Shareholders working at OAO Rostelecom cannot constitute more than one third of OAO Rostelecom Board of Directors.

The managers and controlling shareholders of some companies use this clause of the Law in order to prevent the participation of undesirable persons in the Board of Directors. For instance, in accordance with the Charter of OAO Tatneft, a shareholder or representative of shareholders – legal persons, holding in property not less than 100 thousand company equities (about 0.004% of the total amount of equities) on the day of election, may be elected to the company Board of Directors.

Adoption of Decisions by the Board of Directors

The Board of Directors adopts decisions on its sessions and fixes them in protocols.

The Law specifies the list of persons who have a right to convene sessions of the company Board of Directors. The Board of Directors may be convened:

- by Chairman of the company Board of Directors on his own initiative;
- on demand of a member of the Board of Directors;
- on demand of the auditing commission (inspector) of the company;
- on demand of the company auditor;
- on demand of the company executive body, as well as other persons stipulated by the company Charter.

In addition to the above list, the charters of some companies grant the right to convene the Board of Directors to shareholders – owners of not less than a certain percentage of shares, as well as to General Directors.

Competence of the Board of Directors:

In accordance with the Law, the competence of the Board of Directors includes general guidance of the company's activity, with the exception of issues referred by the Law to exclusive competence of the general shareholders' meeting.

The principal issues referred by the Law to exclusive competence of the Board of Directors are:

- determination of priority areas of activity of the company;
- convening an annual and extraordinary general meetings of the company shareholders and other issues connected with the preparation and holding of the general meeting of shareholders;
- increasing the charter capital of the company by raising the nominal cost of the shares or by placing shares by the company within the limits of quantity and category (type) of the proclaimed shares, if the company Charter or decision of the general meeting of shareholders have

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authorized it with such functions. *(A decision on the placement of shares on closed subscription may be adopted only by the general meeting of shareholders of the joint-stock company. The exclusion is the placement of shares only among the holders of shares and securities converted into stocks, if shareholders have a possibility to purchase the placed shares and securities converted into stocks in proportion to the number of shares in their property.)*

- placement of bonds and other securities by the company, if the company Charter does not stipulate otherwise;
- establishment of the market cost of property in cases specified by the Law;
- forming an executive body of the company and premature termination of its authority, establishment of the size of its remuneration and compensation, if the company Charter refers it to its competence;
- recommendations concerning the size of remuneration and compensation of members of the company auditing commission (inspector) and determining the cost of services of an auditor;
- setting up affiliates and opening the company's representations;
- concluding major deals connected with the purchase and alienation of the company property, the cost of which is more than 25, but not more than 50 percent of the balance cost of the company assets;
- concluding deals in which there is an interest of affiliated persons;
- other issues envisaged by the Law and the company Charter.

The Law stipulates that all matters referred to exclusive competence of the company Board of Directors cannot be passed over for decision to the company's executive body.

It is noteworthy that the Law does not consider the control over the activity of the management as a separate issue. Perhaps, this is the reason why the charters of many companies, with rare exception, do not regulate this issue.

The mechanisms of control over the activity of the Executive Board, including the approval of plans and the subsequent monitoring and assessment of results of their activity in comparison with the approved plans are usually not defined by the charters and internal documents of the companies. In practice, according to the protocols, the Boards of Directors usually consider at their sessions the plans of financial-economic and production activity and reports on implementation of those plans. Besides that, the Boards of Directors of some joint-stock companies – regional communication operators annually consider at their sessions the Questionnaire of Intentions of the OAO General Director on the level of development of communication means and the main indices of economic activity for the current year. However, this Questionnaire is coordinated in advance with the controlling shareholder (OAO Svyazinvest).

The analysis of charters and internal documents regulating the activity of the company managerial bodies shows that the Boards of Directors have not worked out a system of definitions and criteria of appointment and substitution of members of the Executive Board, and a transparent system of remuneration of members of the Executive Board. Moreover, in a number of companies the Board of Directors is empowered to terminate the authority of the Executive Board before time only on consent of the Executive Board Chairman.

The competence indicated in the Law can be qualified as standard or basic, which the Boards of Directors may supplement or concretize, proceeding from the specifics of the company's activity.

For example, the competence of the Board of Directors of OAO Aeroflot includes such important issues as concluding deals:

- on the purchase and sale of aircraft;
- on long-term rent of aircraft with subsequent transfer of property rights;

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- on the pledge of aircraft as insurance of financing and refinancing of credits.

The analysis of the charter clauses concerning the competence of the managerial bodies has shown that there are two figurative groups of companies.

- (1) The company executive bodies are empowered with broad authorities. However, the charter does not regulate the problems of control over the activity of the Executive Board and the General Director by the Board of Directors.
- (2) The competence of executive bodies of management in the sphere of concluding various deals is restricted because of the extended authorities of the Board of Directors.

In accordance with the Charter of OAO Lukoil, the competence of the Executive Board includes, among other things, the approval of the budget and investment program of the company and control over their fulfillment; designing the company's organizational structure, appointment of representatives of the company President in the Russian Federation constituencies and in foreign states; elaboration and implementation of a common strategy of development of the company's subsidiaries, including the organization of a single production-technological, financial, pricing, marketing and other policy; appointment of heads of the company's subsidiaries or recommendations to the subsidiaries' managerial bodies on appointment of their leaders.

The General Director of OAO Tatneft has a right, among other things, to establish the size of remuneration of members of the Executive Board*, adopt decisions on issues referred to the competence of a participant in a subsidiary. Among the issues constituting the competence of the Executive Board, the following deserve particular attention:

- coordination of production programs and balances of subsidiary and subordinate companies;
- taking decisions on attracting means of subsidiary and/or subordinate companies for financing target programs;
- formulating external and internal pricing policy (in our opinion, this issue should be referred to the competence of the Board of Directors in order to avoid the conclusion of deals based on non-market principles).

The competence of the General Director of OAO Lenenergo in the sphere of concluding various deals is noticeably narrower due to the extended authorities of the Board of Directors, including on the following issues**:

- attracting loans by obtaining credits and issuing bills, if the total indebtedness on loans exceeds 1% of the revenues;
- placement of means on deposits in one commercial bank to the total sum exceeding 10 million rubles;
- delegation of debit indebtedness rights to the total sum of 25 million rubles.

In accordance with the Charter of OAO Kubanelectrosvyaz, deals, whose subject is the property costing from 3% to 25% of the balance cost of the company assets and which constitute the competence of the Executive Board, shall be coordinated with the Board of Directors**. The Board of Directors issues decisions not only on the problem of the company's participation in other organizations, but also on the alteration of the share of such participation, which considerably restricts the authority of the General Director.

* In accordance with the Law, this constitutes the competence of the Board of Directors.

** In accordance with the Law, the executive bodies are empowered to conclude deals, whose subject is the property costing up to 25% of the balance cost of the company assets, independently.

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The Law does not regulate the priority of considering issues by the Board of Directors, their obligatory nature and frequency. At present, there are no statistic data reflecting how much time the Boards of Directors allocate to consideration of some or other question.

The sessions of the Boards of Directors of companies, placing their stock publicly (i.e. the majority of joint-stock companies created during privatization) should be held not less than 4-5 times a year. This is explained by the need to quarterly approve and disclose the report of a stock emitting entity. Besides, the competence of the Board of Directors includes problems of preparation of the general shareholders' meeting.

The following table shows the number of sessions of the Boards of Directors of a number of major Russian companies in 2000.

Company name	Number of sessions held in 2000*
ОАО Vypelkom	33
ОАО NK YUKOS	21
ОАО Irkutskenergo	21
ОАО Sibneft	19
ОАО Rostovelektrosvyaz	19
РАО EES Russia	18
ОАО Uralsvyazinform	17
ОАО PTS	16
ОАО MGTS	15
АО Mosenergo	12
ОАО Lenenergo	12
ОАО Gazprom	11
ОАО Rostelecom	9
Annual average	16

(* according to the presented protocols)

Order of Adopting Decisions by the Board of Directors

The decisions at the session of the Board of Directors are adopted by a simple majority vote of those present, if the Law, the company Charter or its internal document regulating the order of convocation and holding of sessions of the Board of Directors does not stipulate otherwise.

Every member of the Board of Directors has one vote. If the votes are equally divided, the Charter may envisage the casting vote of the Chairman of the Board of Directors. According to the Law, the quorum for holding a session of the Board of Directors should not be less than half of the elected members of the Board of Directors.

The delegation of a vote by one member of the Board of Directors to another is prohibited.

The decision on a major transaction, whose subject is the property costing from 25% to 50% of the balance cost of the company assets on the date of passing a decision on such transaction, shall be passed unilaterally by the Board of Directors, not taking into consideration the votes of dropout members of the Board.

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If the Board of Directors fails to reach consensus on the question of a major transaction, this issue may be submitted for consideration of the general shareholders' meeting on decision of the Board of Directors.

The decision to conclude a deal, in which there is an interest:

If the number of shareholders – owners of voting shares is less than one thousand, shall be adopted by the Board of Directors by the majority vote of directors not interested in the deal.

If the number of shareholders – owners of voting stocks is one thousand or more, shall be adopted by the majority vote of independent directors, not interested in the deal.

The definition of independence of directors, formulated by the Law, has been presented *vide supra*.

The Law envisages a considerable exception from this rule:

The decision on conclusion of a deal, in which there is an interest, shall be adopted by the general meeting of shareholders – owners of voting shares by a majority vote of shareholders, not interested in the deal, in the following cases:

- if the sum of payment of the deal and the cost of property constituting its subject exceed 2% of the company assets;
- if the deal and (or) several interconnected deals constitute the placement of voting shares of the company or other securities, converted into voting shares, in the amount exceeding 2% of the voting shares placed by the company before.

Responsibility of Members of the Board of Directors

Members of the Board of Directors, both those with and without executive powers, act as shareholders' trustees. The loss of shareholders' trust may lead to premature termination of authority of a Board member.

In accordance with the Law, members of the Board of Directors, discharging their rights and duties, must:

- act in the company interests;
- exercise their rights and duties towards the company in good faith and sensibly.

Therefore, members of the Board of Directors bear responsibility before the company. According to the Law, directors should conscientiously and prudently serve the interests of the joint-stock company and shareholders in general. The principle of prudence and *bona fides* requires from a member of the Board of Directors to act with due attention and discretion, take all the necessary measures to discharge his/her functions.

According to the Law, members of the company Board of Directors are responsible before the company for losses inflicted on the company by their faulty actions (inaction), if the federal law does not establish other bases and measure of responsibility. However, members of the Board of Directors, who had voted against the decision which entailed losses, or who had not participated in the voting, shall not carry responsibility.

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In other words, members of the Board of Directors shall be responsible for the violation of the principle of “bona fides and prudence” by the Board of Directors, entailing losses to the company.

According to the Law, the bases and measure of responsibility of members of the Board of Directors should be determined with account for the usual conditions of business turnover and other circumstances, significant for the case.

Therefore, the shareholders should consider the risk involved in business. The above norm protects the directors, as poor financial results may be connected not only with dishonest actions of directors.

In accordance with the Law, a company or a shareholder (shareholders), jointly owning not less than 1% of the placed equities of the company, shall be empowered to apply to court with a claim to a member of the Board of Directors to compensate the losses inflicted on the company by his/her faulty actions (inaction), if the federal law does not establish other grounds and measures of responsibility.

Obligations of Member of the Board of Directors to Disclose Information on his/her Interest in Carrying out Transactions by the Company

The Law recognizes a Board of Directors member interested in carrying out a transaction by the company if he (she), his (her) spouse, parents, children, brothers, sisters, as well as all affiliated persons:

- are parties to such transaction or participate in it as representatives or mediators;
- own 20% or more voting shares (stocks, stakes) of a legal person, which is a party to the transaction or participates in it as a representative or mediator;
- occupy posts in the managerial bodies of a legal person, which is a party to the transaction or participates in it as a representative or mediator.

A member of the Board of Directors must convey to the Board of Directors, the auditing commission (inspector) and auditor of the company the information on known transactions underway or anticipated, in which he/she may be recognized an interested person. It is worth mentioning that neither the “interested” member of the Board of Directors, nor the company itself has a duty to publicly disclose such information.

According to the Law, an interested person carries responsibility before the company in the Measure of losses inflicted by him/her on the company.

Transactions Involving the Company Stock

Legislation does not contain any special norms regulating the transactions with the company securities in circulation by members of the Board of Directors.

A member of the Board has a right to purchase, sell, carry out other transactions with the company shares in his property on the secondary market without any sort of restrictions. Information on the number of shares in property of a member of the Board of Directors and on its alteration is subject to disclosure.

However, as mentioned above, in the event of emission of shares, the participation of the Board of Directors member (his/her affiliated persons) in subscription to stocks is possible only if the Board of Directors approves the purchase of the placed stocks. Moreover, if the number of shares purchased by a member of the Board of Directors (his/her affiliated person) exceeds 2% of the previously placed stocks, it is necessary to receive consent of the consent of the general meeting of shareholders.

Despite the norms set by the Law, there is presently no system of control over the observance of the legislation by the Board of Directors. In practice, the Boards of Directors are not accountable for the

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adopted decisions (for inaction of members of the Board of Directors). The reason lies largely in the unsatisfactory system of legal practice in Russia (including the inefficient performance of many courts), the gaps in the acting legislation, disunited and passive positions of minority shareholders.

Effective levers of responsibility for non-disclosure of information, including on affiliated persons, on the conflict of interests of the Board of Directors members, have not been established yet. There is no practice of attracting independent directors to the work on the Boards, particularly in the quantity enabling not only to monitor the adopted decisions, but also to influence the company's activity. As a consequence, such mechanism as setting up committees at the Boards of Directors is not working.

The solution of the above problems should enhance the role and responsibility of the Board of Directors.

Familiarization of Members of the Board of Directors with the Company's Affairs

In order to exercise his/her functions, a member of the Board of Directors should have a possibility to receive all the necessary information on the company's activity.

The Law does not set requirements to the order of granting information on the company to members of the Board of Directors. As a result, some members of the Board of Directors gain advantages over the other directors in receiving information.

For example, according to the Charter of OAO Lenenergo, a Board member's right to access the company information and documents may be restricted if it may lead to dishonest competition. However, neither a definition of dishonest competition for the purposes of the Charter, nor the order of establishing such cases have been specified, which may result in the violation of rights of members of the Board of Directors and shareholders whom they represent.

Boris Fyodorov, member of the Boards of Directors of RAO EES Russia and OAO Gazprom of the 2000 convocation, has often mentioned the difficulties he encountered in obtaining information.

The Institute of Corporate Law and Governance has conducted the study of the procedures of entering into office of the newly elected members of the Board of Directors and informing them of the company activity, practiced by the companies. Only three out of the 21 companies under survey have reported the existence of such procedures.

Committees of the Board of Directors

The creation of special committees at the Boards of Directors on key directions of activity of the Board, working permanently on the basis of rules established by the Board, ensuring the independence and responsibility of their decision, has not become widely spread up till now. This is largely explained by the fact that the Russian corporate governance is still at the stage of early development. Besides that, one of the considerable requirements to the activity of such committees, guaranteeing their efficient performance, is the mandatory attraction of independent directors. It has already been mentioned herein that the presence of independent directors on the Boards has so far not become a commonly accepted practice for the Russian corporations.

So far, only a few companies have reported the creation of committees: OAO Sibneft, OAO VypelKom, OAO YUKOS. RAO EES Russia stated its intention to set up such committees in its Draft Corporate Management Code.

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OAO Sibneft is one of the first Russian companies, which has adopted in addition to the main Charter of the company a Corporate Governance Charter, spelling out the main principles, on which the company intends to base its activity.

The Corporate Governance Charter envisages the creation of special committees within the frames of the Board of Directors. The most important among them are the Committee for Promotion of Managerial Staff, the Committee for Remunerations, and the Auditing Commission, as well as the Committee for Work with Minority Shareholders.

The Corporate Governance Charter stipulates that not less than 25% of the Board of Directors or three of its members, depending on which is more, shall be represented by independent directors. They shall be independent from the company leadership and free of any sort of restricting factors, capable of seriously influencing the expression of their independent opinion. At present, the company does not abide by this clause of the Charter of Corporate Governance. In the company's opinion, the attraction of independent directors is hampered by the outstanding question of their remuneration. In accordance with the information received from the company, the Committee for Remunerations is working on the resolution of this problem.

Remuneration on Members of the Board of Directors

In accordance with the Law, the payment of remunerations and compensation of losses connected with the discharging of functions by member of the Board of Directors shall be carried out upon decision of the general shareholders' meeting.

The size of such payments shall be decided by the general shareholders' meeting.

As a rule, the companies do not disclose information on the size of remuneration paid to members of the Boards of Directors and managers under the pretext that this information is confidential.

Analysis of corporate documents has demonstrated that so far the companies have not developed transparent criteria of remuneration and compensation of expenses connected with the exercising of functions by the Board of Directors.

The problems of disclosing this information are characteristic of many Russian companies. For example, nine out of the 25 companies rated by the Institute of Corporate Law and Governance do not disclose the information on remuneration of members of the managerial bodies at all.

The companies usually explain the situation with disclosure of information on remuneration by the assumption that such data constitutes personal information on private life of a citizen and, consequently, is referred to the category of confidential information. This assertion is debatable. Firstly, shareholders have a right to know how much the company management costs them. Secondly, it would be fair to expect that the persons occupying high posts in the management of a joint-stock company, acknowledging their responsibility before the shareholders, would undertake the obligation to disclose such information while assuming office.

In our opinion, the main reason of non-disclosure of information on the size of remunerations is the reluctance of the company to attract attention to data on real incomes of the company managers.

It should be noted that the Federal Law "On Protection of Rights and Legal Interests of Investors on the Stock Market" envisages responsibility for offense in the sphere of information disclosure. At present, the Russian FKCB uses its legal authority to impose fines on emitting organizations for non-disclosure of information. However, the grounds for imposing fines have so far been untimely presentation of quarterly

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reports. The violations connected with incomplete disclosure of information have up till now not been a subject of consideration of the Russian FKCB.

Unlike the majority of Russian companies, OAO NK YUKOS discloses general information on remuneration of members of the Board of Directors and management in its quarterly reports. At the annual shareholders' meeting (2000), OAO NK YUKOS has passed a decision to specify the total sum spent on annual remuneration of members of the Board of Directors, as well as on quarterly compensation of expenses connected with the exercising of functions by members of the Board of Directors in the amount equivalent to 400 000 US dollars. Moreover, the issues connected with the order and terms of payment of remunerations and compensations to members of the Board of Directors have been assigned to the Board itself.

RAO EES Russia informs in its quarterly report that remunerations to members of the Board of Directors are not paid. The information on remuneration of managers is referred to confidential information. The company proclaimed in its Draft Code of Corporate Governance that the terms of remuneration would be established in such way so as to ensure the attraction and participation in the company's work of highly skilled specialists, motivate their honest and effective activity. The remuneration of members of the Board of Directors and the Executive Board should be competitive to comparable companies. The size of remuneration of members of the Board of Directors should depend on the results of the company activity and the results of activity of the Board of Directors.

In the spring of 2001, the Russian FKCB sent a letter to RAO EES Russia, demanding to disclose information on remuneration of managers. It is unclear why FKCB demanded the disclosure of information only of RAO EES Russia, although it is far from being the only offending company.

OAO Lukoil has adopted a Statute on Remuneration of Directors and Managers of OAO Lukoil. The Statute envisages long-term incentive payments carried out in the form of fixing packages of the company shares in the managers' property. On November 24, 2000, the Board of Directors has adopted a decision to fix, as of November 1, 2000, a certain amount of "shares fixed de bene esse" in property of the company leaders. The only outstanding problem is to clarify the status of "shares fixed de bene esse." Moreover, not a single quarterly report discloses information on remunerations paid during the reporting period to members of the company managerial bodies.

Programs of Advanced Training of Members of the Board of Directors

The surveys of the Boards of Directors show that they include many directors, qualified in different spheres. At the same time, the present-day situation requires from a member of the Board of Directors considerable experience and knowledge in the sphere of finances and book-keeping in the industry of his company's profile, knowledge of the international market, etc. Various training courses could help directors exercise their activity. Considering that directors are quite busy people, the programs of their advanced training should not be designated for a lengthy period of time.

Our research of the matter has revealed a lack of practice of training the members of the Boards of Directors. Moreover, the companies do not consider it necessary. At the same time, the budget of OAO Krasny Oktyabr for the current year envisages expenses on the training of members of the Board of Directors, within the frames of which directors are expected to study corporate norms. According to the data of OAO YUKOS, workshops have been organized for the previous Board of Directors on the subjects: development of the oil extractive industry, company development, etc. A newly elected member of the Board of Directors of OAO Vympelcom is familiarized with the rules of trade, rules of information disclosure, etc.

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Conclusion

The Russian corporate governance is presently going through a new stage in its development. The preceding, post-privatization period was characterized with the struggle for “control” over enterprises in conditions of under-developed corporate legislation and a poor law application system, which has largely generated the current problems and conflicts connected with the violation of shareholders’ rights. In conditions of redistribution of property, control over the management had no decisive meaning for the proprietors, therefore the activity of the Boards of Directors carried largely a formal nature.

Today, the structure of joint-stock capital of the majority of joint-stock companies created during privatization is rather stable – there is a controlling shareholder (group of affiliated shareholders), or “stable” groups of proprietors have formed.

The shareholders are being faced with the problem of raising the business efficiency, including by means of setting up mechanisms of control over the activity of managers and their incentive. In this connection, the significance of the Boards of Directors, as bodies ensuring effective management of the company, grows. Consequently, such mechanisms of protection of shareholders’ rights as the institute of independent directors, setting up committees within the frames of the Boards of Directors, increasing the transparency of the Boards’ activity, will develop.

Supplement 1

Corporate Governance Rating (CORE-Rating)
On the state of 01.01.2001

Rating place	Companies	Final rating appraisal (as % of the maximal possible)
1	Vypelcom	82.12
2	GUM Trading House**	71.51
3-4	Irkutskenergo	68.37
3-4	Lenenergo**	68.37
5	Peterburg Telephone Network**	62.08
6	Rostelecom**	61.49
7	Krasny Oktyabr**	60.31
8	Rostovelektrosvyaz**	59.92
9	Kuzbassenergo	59.14
10-11	Mosenergo	58.35
10-11	Uralsvyazinform	58.35
12	EES Russia**	57.37
13	Tatneft	55.8
14	Bashinformsvyaz	54.22
15	Aeroflot**	53.83
16	MGTS	52.85
17	Gazprom**	52.26
18	Severstal	50.88
19	Sibneft	49.9

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20-21	Kubanelektrosvyaz**	49.71
20-21	Lukoil	49.71
22	NK YUKOS	45.38
	HIGH RISK ZONE	
23	Gaz**	44.6
24	Norilsk Nickel	44.2
25	Surgutneftegaz	43.81

** - Companies whose Boards of Directors include representatives of minority shareholders, promoted within the Program of the Association for Protection of Investors' Rights.

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