

SESSION VI: PREVENTING ABUSIVE SELF-DEALING

3 Case Studies on
ABUSIVE SELF-DEALING
by

Mr. Oleg Fedorov
Expert, National Association of Securities Market Participants (NAUFOR)
Russia

CASE STUDY I: PROBLEMS OF CORPORATE GOVERNANCE IN RUSSIA: CASE OF PROTECTION OF SHAREHOLDERS' RIGHTS AGAINST OAO NK YUKOS HOLDING COMPANY

1. OAO NK YUKOS is Russia's second-largest producer and the largest processor of oil that controls the second-largest oil reserves in the country. Since 1997 the Company's three oil-producing subsidiaries – Tomskneft VNK, Samaraneftegaz and Yuganskneftegaz – have been producing at least 40 million tons (250 million barrels) of oil per year.

2. In March of 1999 NK YUKOS' producing companies held extraordinary meetings that passed resolutions that were without precedent for a company of this size:

- the meetings voted for the sale during 5 years (1997 through 2001) of all produced oil, largely in favour of NK YUKO, total volume 253 million tons (1600 million barrels), price 250 rubles/ton (\$1.6/barrel at the meeting date). The aggregate value of the transaction when it was approved by the meeting: \$2.5 billion. Market value of the above volume of oil at an average price of \$15 per barrel: \$24 billion;
- the meetings voted for closed placement with offshore companies of 80 percent of Tomskneft VNK stock for \$24.6 million; 70 percent of Samaraneftegaz stock for \$6.7 million; and 66 percent of Yuganskneftegaz stock for \$38.9 million; the transactions was paid with bills of exchange issued by the oil-producing companies themselves. In practice this means that all producing companies were sold for \$70 million;
- it was decided to transfer company assets, market value around \$2.8 billion, to more than 100 new companies during the period from 1997 through 2001; the assets to be transferred were not named;
- amendments were passed to the company charter that place restrictions on the rights of minority shareholders;
- dissenting shareholders were invited to sell their shares to the company (a mandatory step under the law); but the offered price was such that all shareholders of VNK Tomskneft, Samaraneftegaz and Yuganskneftegaz, excepting NK YUKOS, could get \$5 million, \$1.5 million and \$10 million respectively for their stakes in the above subsidiaries equal to 46 percent- 49 percent. **What the Board of Directors actually did was to set, with some help from an independent appraiser, the market value of the three subsidiaries at \$33 million – and the appraisal was made even before the company passed the resolutions!**

P.S.: In December of 1997 the financial group Rosprom-Menatep (the de-facto owner of controlling interest in NK YUKOS) paid around \$800 million to buy only 44 percent of the stock of OAO VNK (production volume: around 10 million tons per year). This figure is quite interesting as compared with the above valuations of the subsidiaries.

3. According to YUKOS representatives, all transaction prices were based on an independent appraiser's opinions! To be sure, the shareholders did not get access to these opinions or to the list of the property that had been appraised.

4. Before or after the meetings nobody took the trouble of explaining to the shareholders the reason why the resolutions should be taken (with the exception of the new issue that was intended to become a weapon against Dart Management).

5. It is obvious that the approved transactions are detrimental to the interests of the subsidiaries and the lawful interests of their shareholders. They run counter to their principal goal, i.e., generation of profits for their shareholders.

6. It is obvious that the transaction prices and the buyback prices were not market –level prices and that they were set deliberately at a very low level.

7. If such things are possible at all, this means that proper law does not exist or that law enforcement does not exist or that shareholders do not use their rights, and the government refuses to deliver on its promises of help to shareholders.

8. According to the shareholders, before the operation YUKOS managers had a 40 percent stake in NK YUKOS and negligible stakes in the subsidiaries; and after the distribution of the new issue they obtained control over 80 percent to 90 percent of the vote in every oil-producing company.

9. All these resolutions passed because a judge in the town of Mosalsk attached 25 percent to 33 percent of the voting stock in each subsidiary several days before the meeting – a court decision so grossly unlawful as to be without precedent. This decision attached the share packages that were likely to block the passage of the above resolutions. The meetings were called on quorums of 54 percent to 60 percent of the voting stock, of which 90 percent to 95 percent belonged to YUKOS. NK YUKOS buys oil from its subsidiaries at \$10 while the holding company's production costs amount to \$27 (figures based on company director Khodorkovsky's interview with the newspaper Kommersant). And when the meeting elected the Board of Directors of OAO Yuganskneftegaz, the Credentials Commission rejected 635 ballot slips that had been cast for the representative of Dart Management.

10. Tomskneft VNK called its meeting in defiance of a court ruling that had declared the Board of Directors's decision to call the meeting null and void. On June 4, 1999, Tomskneft VNK called a new extraordinary meeting with the same agenda. By that date the blocking stock package was already free from attachment. When the shareholders came to the meeting venue in Moscow, they saw a notice posted on the door saying that the night before the meeting the Board of Directors had relocated the venue "for technical reasons" to the town of Mosalsk 300 kilometres from Moscow. The most stubborn shareholders rode to Mosalsk for three hours, only to find an empty room in the process of being renovated with two tables and seven chairs in it; they were told that the meeting had already taken place and had done its business.

11. YUKOS makes no secret of the fact that the resolution to have a new issue was aimed at diluting the Dart companies' stake and at weakening their positions during the runup to the reorganisation of the holding company. However, Dart's companies had stakes ranging from 10 percent to 13 percents in each of the YUKOS subsidiaries while 25 percent to 33 percent of shares in each subsidiary had been attached before the meeting. The holder of a package Dart controlled could not by any means constitute an obstacle to Company operations under effective law – provided Company operations are legal of course.

12. In the summer of 1999 NK YUKOS Board of Directors decided **unanimously** to have a new issue equal to 25 percent at 25 cents per share; at the same time it suggested to all shareholders the ratios to be used in the exchange of the shares of the producing companies for those of NK YUKOS. If applied, the exchange ratios suggested by YUKOS gave all minority shareholders around 6 percent of NK YUKOS in exchange for all shares of the three producing companies (around 40 percent in each company). At the time of the offer (i.e., when NK YUKOS itself issues its shares) such exchange ratios show that YUKOS

itself appraised all its oil-producing companies at **\$88 million**. As compared with the March buyback offer relating to the subsidiaries themselves, the new offer was 2.5 times better, but NK YUKOS stock was not liquid at the time.

13. Unfortunately, the ploys that were used in the summer of 1999 to curtail the shareholders' rights are not few and far between in Russia. They did constitute a precedent though because in the YUKOS case several such ploys were used at the same time; the unfavourable consequences for the shareholders and the companies themselves were huge; and they were used against the shareholders of one of the largest Russian companies.

14. On the other hand, the shareholder's behaviour also created a precedent. For the first time a large number of portfolio investors joined forces to safeguard their rights and lawful interests. Around 1/3 of the shareholders of the subsidiaries who had voted against the resolutions at the meetings represented the following companies: Brunswick Warburg, OFG, Credit Suisse First Boston, Troika Dialog, Hermitage Capital Management, Unifund, NIK NIKoil, Prosperity Capital Management, Morgan Grenfell Securities, MDM Bank, Dart Management Group companies, etc.

15. The shareholders used nearly the entire range of available tactics: they suggested that YUKOS management give up the plans to have a new issue and discuss with the shareholders the terms for company restructuring; went to federal courts and courts of arbitration; filed claims with prosecutors' offices at different levels, including the General Prosecutor's Office; made public a statement addressed to the Chairman of the Government; filed complaints with the Federal Securities Commission; went for help to self-regulating organisations and to stock exchanges, and distributed press releases.

16. The NAUFOR offered an active assistance to the shareholders, but we can state that the shareholders could only use half of their potential.

17. On the other hand, the shareholders had to tackle their problems with little or no help from any quarter. The Government did not answer the shareholders' collective letter to the Chairman of the Government that appeared in the Government's Rossiiskaya Gazeta. All Government agencies would give no assistance to the shareholders. The Prosecutor's Office was silent. The only exception was the Federal Securities and Exchange Commission, but all it could do was refuse to register the Tomskneft VNK issue. OAO Yuganskneftegaz' and OAO Samaraneftgaz' issues were registered. In courts of arbitration the cases had their ups and downs and, as usual, they dragged on and on. A key target for the shareholders was to try to challenge the Mosalsk judge's ruling. In the opinion of the shareholders' lawyers and NAUFOR experts, the Mosalsk judge made 7 flagrant violations of the effective legislation. To begin with, he did not have competence to consider the case; and when he took it on and levied attachment on the shares, the ruling was guilty of a gross violation of the law of procedure and that of enforcement proceedings. There were no grounds for attaching the shares. Significantly, when the shareholders tried to appeal against the ruling at the local, Oblast and General Prosecutor's Office and to file a complaint against the judge's actions with a Grievances Commission and a higher-level Oblast Court, all they got was a stone wall of silence and further violations of the law of procedure. All complaints were left unheeded or, in breach of law, were sent to the very same judge the shareholders had complained against. None of the legal Russian instruments for appealing against a judge's unlawful actions proved to be of any effect.

18. In December of 1999 the Dart companies sold their stakes in the YUKOS subsidiaries. When they started negotiations (to sell the stock), Dart Management officers, in violation of earlier commitments, did not notify the other shareholders. Following the negotiations and after the first transactions with NK YUKOS' shares a number of other shareholders who were not willing to fight for their rights exchanged their shares on the terms suggested by YUKOS. The remaining members of the group controlled between themselves 1 percent to 4 percent of the chartered capital of the YUKOS subsidiaries. The shares the

group members had could not longer make any impact on the terms on which Dart Management companies sold their shares to YUKOS, and the interests of the remaining shareholders could have been taken into account in these transactions. After Dart Management sold its shares, many shareholders decided to exchange their stock on YUKOS terms.

19. One can state that as of today YUKOS has attained its goal though the company committed gross violations of general principles of corporate governance used in world practice. Regardless of the terms the remaining small group of shareholders may accept, YUKOS controls an absolute majority of the vote and can pass any resolutions. YUKOS did not use the available legal methods of going over to a single share that make it possible to optimise taxation and safeguard the shareholders' lawful rights and interests.

20. One can also state that the shareholders and their representatives found that they were incapable of consolidating their resources and of making a united front to protect themselves.

21. One can state that the judicial system and effective company law does not help preclude such violations or help shareholders recover their rights.

22. One can state that in practice government agencies tend to withhold assistance to investors and that Russia does not have a realistic policy aimed at protecting their interests.

Supplement to the NK YUKOS report

Profile of NK YUKOS Group in 1997 through 1999

23. NK YUKOS was privatised in 1996 and 1997.

24. When they were privatised, its subsidiary oil-producing companies (Yuganskneftegaz and Samaraneftgaz) constituted around 80 percent of the value of NK YUKOS.

25. VNK was privatised in December of 1997.

26. The Rosprom-Menatep Group acquired a controlling interest in VNK (44 percent) for \$800 million.

27. Yearly oil production volume from 1997 (including Tomskneft): 41 million to 44 million tons..

28. The Company exports 30 to 40 percent of produced oil; 10 percent of produced oil is sold in Russia (domestic prices are 2/3 of the world prices). The company processes 50 percent to 60 percent of produced oil.

29. Production cost in 1999: \$27 per ton (\$3.7 per barrel)

(source: Mikhail Khodorkovsky's interview to the newspaper Kommersant and the magazine Expert)

Case Study II: Brief History of Actions Undertaken to Protect the Rights of Shareholders of OAO Vyksa Steel Works

30. At its February 12, 1999, extraordinary meeting OAO Vyksa Steel Works voted in favour of having a new issue of shares equal to 82 percent of the Company's chartered capital. The nominal price of a share

was set at 200 rubles (\$8.1) and the entire issue of 850,000 shares (82 percent of the chartered capital) was placed by closed subscription to ZAO Metallresourcekompleks.

31. To the shareholders who had not supported the transaction the issuer's Board of Directors suggested a buyback at 67 rubles per share (\$2.7), citing an independent appraiser's opinion. Law requires the buyback price to be equal to the distribution price, i.e., the two must be identical. The issuer insisted that the market price of (previously issued) shares was 67 rubles per share, and that new shares might not under law be distributed below their nominal price – in this case 200 rubles. However, in accordance with Article 77 of Federal Law 208/95 a Board of Directors sets a market price with an eye on 4 factors: published asked and bid prices for securities; an appraiser's opinion; the value of the Company's net assets and the price the buyer is willing to pay for all of the Company's voting shares. Characteristically, neither the shareholders nor NAUFOR or the Federal Securities Commission saw an appraiser's opinion. In the most recent transactions the Company's shares went for \$150 apiece (prior to the 1997/1998 crisis). On the day of the meeting the Company's net assets per share were equal to 1450 rubles (\$60). The buyer accepted the price (200 rubles) and acquired 82 percent of the shares. This indicates that the price was set too low, and the appraiser's opinion, if any, was quite doubtful.

32. The issuer's shareholders (Troika Dialog, Brunswick Capital, F.S.Rinaco) challenged the issue terms as being in conflict with law and prior to the meeting went for help to the Federal Securities and Exchange Commission and the NAUFOR. The Vyksa Steel Works minority shareholders controlled between them 30 percent of the vote and could simply vote down the suggested issue at the meeting. The NAUFOR had notified the Vyksa shareholders and nominee holders in due time that the Company planned to attack their rights at the meeting. A NAUFOR representative who watched the proceedings to prevent any transgressions came out in support of the shareholders' interests: he read out the NAUFOR's address to the issuer's Board of Directors. But many shareholders were passive in the protection of their own interests, and the minority shareholders failed to collect enough vote to block the suggested transaction.

33. The issue resolution having passed, the meeting formed a group comprised of 18 Vyksa shareholders (controlling around 8 percent of all shares) to consolidate efforts to protect their rights and press for a fair market buyback price. These shareholders decided that they will either have the resolution overturned or get a fair buyback price. Pursuant to Article 76 of Federal Law 208, Article 443 and paragraph 2 of Article 445 of the Civil Code of the Russian Federation, in a counter demand to the issuer, they insisted on a buyback price of 1450 rubles per share as they saw this price as lawful and fair.

34. They worked out tactics for the protection of Vyksa shareholders' rights both in and out of court. Then they filed claims against the Vyksa Steel Works (seeking to challenge the meeting's resolution and complaining that they had been coerced into selling their shares) and they filed a collective complaint with the Russian Federal Exchange Commission. The Commission found that the shareholders' claims were reasonable.

35. Minutes were taken of all shareholder-NAUFOR conferences; such minutes were available on NAUFOR Internet site, including all documents. In search of a compromise, the NAUFOR arranged for the dissenting shareholder group to negotiate with Metallinvestbank, a bank that represented the issuer.

36. Metallinvestbank is Vyksa's chief creditor representing it at negotiations that worked actively with the NAUFOR to reach a settlement which the shareholders would accept. Negotiations went on for more than four months and resulted in a compromise. In the course of the negotiation the position of the Federal Exchange Commission and that of the NAUFOR that kept a close eye on the talks to protect law and Vyksa shareholders' interests was of crucial importance.

37. Metallinvestbank offered to the Vyksa Steel Works' shareholders that, acting in due form, disagreed with the issuer's buyback price, another buyback price that was more than 4 times higher than the initial offer (\$10 per share instead of \$2.7). Even though the shareholders had paid far higher prices for these shares as they bought them before the 1998 crisis, they found that the bank's offer was a fair market price. By accepting the price the shareholders proved that they did not mean to force the issuer to agree to better-than-the-market terms.

38. According to the NAUFOR, one would definitely be warranted to claim that Metallinvestbank's actions have written a new chapter in the history, regrettably brief so far, of the formation in Russia of civilised forms of corporate governance. Significantly, the enterprise, having realised the importance of keeping its investors' confidence, settled differences with its shareholders out of court.

P.S.: After a successful completion of negotiations and the buyback, shareholders who were not initial members of the dissenting group asked the NAUFOR to let them join the group. But the NAUFOR could only protect those of the shareholders who had decided to stand on their right to proper buyback terms in due time and who had acted through proper channels.

Case Study III: On Restructuring the Sibur Holding Company and Actions of a Group of Shareholders of OAO Sibneftegazpererabotka (SNGP).

39. Privatised in 1999, OAO SIBUR (Sibirsko-Uralskaya PetroleumGasChemical Company) brings together all elements of the technological chain from gas processing to production of automobile tires. The Company holds a de-facto monopoly over the processing of associated petroleum gas that is produced by Tyumen-based oil-producing companies.

40. Nearly all of SIBUR'S assets are represented by 38 percent of ordinary (more than 50 percent of voting) shares of Sibneftegazpererabotka that, in turn, owns 38 percent of ordinary (more than 50 percent of voting) shares in its gas-processing plants.

41. The financial situation of the gas-processing plants does not rule out that bankruptcy proceedings can be instituted against them. In fact, the first proceedings have already started. In the summer of 1999 the SIMUR-Tyumen Company was set up; as a founders' contribution is received the capital assets of Sibneftegaspererabotka (SNGP) and its subsidiary gas-processing plants.

42. Shareholder meetings that took place at the SNGP and all gas-processing plants in May and June of 1999 followed the same kind of scenario.

43. At a June 22, 1999, shareholder meeting the general director said that there was "a need to safeguard the Company's existing protection/technological unity **and to protect its assets from possible bankruptcy.**" To this end SNGP board of directors "opted for the transfer of assets worth a total of 925,070,000 rubles as a contribution to the 'new company's' chartered capital. The list of the assets to be transferred was not spelled out. What's more, the shareholders were not even told what name the 'new company' would have and what stake SNGP would hold in that company. The director said that SNGP was willing to buy back the shares of the shareholders who objected to the transfer of assets. The shareholders were not invited to get any shares of the "new company." The transaction was approved by holders of 72 percent of shares.

44. The assets to be transferred to a 'new company' were not valued by an independent appraiser.

45. The Company called its meetings in flagrant breach of procedure.

46. Law says that shareholders who do not vote or vote against the transfer are entitled to demand a buy-

back of their shares. The Company's Board of Directors set a share market value at 2 kopecks (0.02 ruble) per share. This valuation was based on an appraiser's opinion. This opinion was arrived at with a great deal of violations of the Law "On Appraising Operations"; it did not mention the appraisal procedure or the assets that were appraised. The person who did the appraisal was not licensed to perform it. Part of SNGP's shares is owned by the government (1.89 percent). Effective law says that if the government holds a stake in a company, the market value of its stake must be appraised by a government agency. This rule was not complied with.

47. The shareholders regarded the valuation as too low and, in accordance with the Civil Code of the Russian Federation, filed a counterclaim pursuant to the Law "On Joint-Stock Companies." The demanded a buy-back at a price tied to the Company's net assets per share. According to the shareholders, the net assets per share is equal to 0.24 ruble. The shareholders decided to make SNGP buy back their shares at the market price or to challenge the meeting's decision to make the transaction with the SNGP assets. The government, one of the Company's shareholders, that was represented by the Russian Federal Property Fund supported the shareholders.

48. Pursuant to the Law "On Appraising Operations" shareholders went to court that overruled the appraiser's opinion which the Board of Directors had relied upon to determine the share market price for the buy-back of the SNGP shares.

49. But late last August the shareholders began to receive standard-form letters saying that the assets-transfer transaction that had been approved by the annual meeting did not in fact rank as a large transaction, hence it did not entitle the shareholders to demand a buy-back. Moreover, the Company accepted the claim that had been filed by an individual seeking to have the decision of the annual meeting overturned. This tactic is usually used in Russia when a Company is interested in such a decision. Technically this was true as the book value of the Company's property was stated as equal to 16 percent of the book value of its assets. The shareholders could not check this figure as the Company did not disclose to them what property was involved in the transaction or the book value of each transferred facility. The property was transferred to the new company by decision of the Director, not by decision of the shareholder meeting. But when the Company's Board of Directors and Director had called the meeting, they said that the transaction was a large one; this situation suggests that Article 71 of the Federal Law 203 was violated on several counts (this article requires the Board of Directors and the Director to act in the best interests of the Company and its shareholders).

50. In this case the shareholders came across a gap in law. The problem is that the book value of the property (capital assets) which the Company relies upon to generate all added value may prove to be but a fraction of the Soviet-period capital investments that cannot be sold today or that are technologically obsolete. Moreover, they cannot be sold. The market value of such "dead" assets may be equal to zero; in fact, it may even be expressed in negative figures (because of taxes, etc.), while the market value of the operating capital assets is comparable with the market value of the entire enterprise. Regrettably, when a transaction is planned, law does not require the appraisal of the market value of a Company's assets prior to the completion of such transactions. **It would make sense to appraise in this manner any assets valued at more than 10 percent of the book value, or any fixed capital assets with a book value equal to more than 25 percent of the Company's fixed capital assets.**

51. Following the meeting SNGP itself re-leased the equipment it had transferred to Sibur-Tyumen. The terms of the lease were not disclosed to the shareholders. It became known that even before the meeting the controlling interest in all gas-processing plants that were earlier held by SNGP had been sold to the Company's largest debtor by decision of the general director. The SNGP general director was a high-level officer or chairman of the Board of Directors in the Company that acquired the shares of the gas-processing plants and in Sibur-Tyumen, i.e., **he was interested in the transaction. Neither transaction had been valued by an independent appraiser, nor were they even discussed by the Board of**

Directors (much less by a general meeting even though law requires such transactions to be discussed by a general meeting!). After such transactions the shareholders could not hope that the price of their shares could recover, whatever the circumstances. They decided to challenge all these transactions in which the director had an interest. When they realised this, the owners of the holding company decided to buy back the shares.

52. SIBUR continues to build a vertically integrated petrochemical company. In business terms the Company has been pursuing the right objective. But in the process the Company does not always respect laws and the principles of corporate governance, which has been reflecting on its business reputation ever since the time the Company was set up.

Sibneftegazpererabotka's Profile

53. Sibneftegazpererabotka is an open joint-stock company with a chartered capital of 1,793 million rubles. Its chartered capital is divided into 7,172,508,116 shares, par value 25 kopecks (0.25 ruble), of which 75 percent are ordinary and .25 percent are preferred shares.

54. As of January 1, 1999, Sibneftegazpererabotka has 96,588 shareholders.

The Company's chief shareholders are the following:

 OAO SIBUR (38 percent),

 Calstream Ltd, Cyprus (11,29 percent)

 Gazprombank (22,76 percent).

 The government's stake in the Company is equal to 1.89 percent.

55. Sibneftegazpererabotka's most important facilities are 10 gas-processing plants and pipelines.

In 1998 Sibneftegazpererabotka received 1.9 billion cubic meters of natural gas.

The Company produced the following:

 1.7 billion cubic meters of compressed gas;

 21,000 tons of light hydrocarbons;

 32,000 tons of stable gasoline;

 0.2 thousand tons of propane.

56. Sibneftegazpererabotka receives supplies of crude materials from oil-producing companies based in Tyumen Oblast.

57. As of the beginning of 1999 the Company's borrowings were equal to 221 million rubles (including bank loans equal to 6.5 million rubles); its payables, 2,105 million rubles; and its receivables, 1,531 million rubles.

58. As of January 1, 1999, the Company's back taxes were equal to 226 million rubles.

Conclusions

59. Having studied the above cases and other projects that drew in 1998 through 2000 the attention of the NAUFOR and of the Co-ordination Centre for Protection of Investor rights, one would be warranted to make the following conclusions:

An efficient management and a high-quality corporate governance is key to the creation of a well-functioning corporate securities market in Russia.

60. The following are the key players that can have an influence on corporate governance in Russia: the Government of the Russian Federation; government regulatory agencies (the Federal Securities and Exchange Commission), the State Property Ministry, the Ministry for AntiMonopoly Policy), lawgivers (with respect to the legislative base), courts of law, the Justice Ministry (enforcement of court rulings), issuing corporations themselves, shareholders (investors) and professional communities, and international financial organisations.

61. The cases we considered let us arrive at a number of conclusions on the role of the above players and on the direction they should follow.

62. Government of the Russian Federation. The Government has stated that among the major objectives on its program is to attract investors and protect their rights. In actual fact, when investors went to the Government for help against YUKOS - a very high-profile case -- they did not get as little as a pro-forma answer. Unable to get any clear signals from the Government, Government agencies do not interfere into the processes of corporate governance and protection of shareholder rights, and they yield to pressure from tycoons. The experience of Novgorod Oblast indicates that investors appreciate a day-to-day and open-minded government-investor interaction, and that such interaction produces favourable medium-term results. It is necessary to re-create a Government commission for the protection of investor rights that would be structured as a commission that was created by Decree No.730 of the President of the Russian Federation in 1997. The commission should include representatives of the Co-ordination Centre for Protection of Investor Rights and of other investor organisations.

63. Regulators. An active position of the Federal Securities and Exchange Commission was an exception rather than a rule in this process. Investors sensed that the state authorities had not received any clear signals from the Government regarding the protection of investor rights. The Federal Securities and Exchange Commission and the Control Chamber of the Russian Federation supported the investors but failed to help them recover their rights. The Federal Securities and Exchange Commission's administrative powers and financing is clearly inadequate; in fact, whatever powers it does have are not used fully or with due efficiency. The Commission has not filed a single suit on its own in support of a shareholder. The Commission's staffers responsible for protection of investor rights obviously have workloads they are not capable of handling.

64. It is clearly necessary to expand (or rather create) an administrative mechanism to control the operation of appraisers and the process of determination of the market value of joint-stock companies. Tougher requirements should apply to appraisers, and the procedure for the determination of companies' market price should be spelled out in more detail. Precise rules are required for defining what an affiliated or interested person is; and compliance with these rules should be monitored regularly by the Federal Securities and Exchange Commission and the Ministry for AntiMonopoly Policy.

65. Legislative Base. The legislation in force has glaring gaps. Gaps are very bad in laws regarding the determination of the market price of property and Company shares and regulating who may and may not be a Company's affiliated persons. Price fixing is the chief objective and tool of many "corporate measures" aimed at tapping chartered capital to rectify management's mistakes or resolve management's problems. Shareholders have unjustifiably narrow procedural rights. Enforcement procedures are very vague with respect to ownership rights to non-documentary securities and procedures for calling shareholder meetings and recovery of company documents. Law formulas stating the responsibility of the persons who are guilty of doing damage to a company or shareholders offer little hope that they can be effectively enforced in court.

66. Courts of Law and Justice Ministry. Court trials are too long. If overdue, even a favourable ruling may be quite useless to a shareholder. Judges should cooperate with regulators and professional investor communities, which will help judges become more professional and get a better idea of business usage.

Such contacts with the Higher Court of Arbitration of the Russian Federation and the Higher Court of the Russian Federation will help provide proper and timely explanations of enforcement practice. This is an urgent problem, in particular as Russian laws are amended very frequently. A glaring illustration of this need is provided by the failure of all attempts to challenge the ruling of the Mosalsk judge in tribunals at nearly every level. Investors' being prejudiced against the Russian judicial system prevents investors from going to court to resolve conflicts and expands the role of problem resolution methods that give the Russian market a bad image. A professional, independent and efficient court of law is capable of improve investor confidence in the market, but for this to become possible courts should provide examples of protection of shareholder rights. This example demonstrates the need for an interpretation of law that would enable shareholders to challenge a resolution taken at a meeting prior to which a stock package is attached which, if unattached, could prevent the passage of such resolution, unless a valid court ruling supports the reasons for the attachment after the meeting. Unless this is done, holders between them of 30 percent of shares can pass at a shareholder meeting ANY resolution, however detrimental to the interests of the holders of the remaining 70 percent of the stock, and such resolution will be unchallengeable. It is necessary to convince judges that is it essential to have issuers to be fully compliant with the law-prescribed procedures.

67. Issuers. They definitely play a pivotal role in the formation in Russia of a corporate and managerial culture. Managers and company owners are clearly better capable than minority shareholders of attaining whatever targets have been set; they have more financial resources and a greater potential for lobbying their interests. A clear-cut line of demarcation is emerging in Russia between those issuers who make a show of neglecting shareholder rights and those who come out in favour of "meeting investors halfway." Such processes should be hailed and promoted, even though it will have some time to check the sincerity of protestations of love for investors. In our case the YUKOS management attained its objective and hopes that this episode in its history will be forgotten in the future. Up until now there have been lots of cases where shareholder rights are openly neglected; to add insult to injury, insufficient knowledge of legal procedures and lack of understanding of importance of compliance with corporate governance principles for the future of a company is another widespread affliction.

68. Professional Communities. Drawing on its Program for the Protection of Investor Rights, the NAUFOR has been taking the most vigorous line among all self-regulating organisations on the protection of investor rights. The NAUFOR initiated the creation of the Co-ordination Centre for the Protection of Investor Rights (chairperson D.V.Vasiliev). The NAUFOR and the Co-ordination Centre have been offering an active assistance to shareholders in the protection of their interests in a number of projects. The NAUFOR regularly voiced shareholder positions, co-ordinated their actions, went for help to Government authorities and filed court suits to protect shareholders. With participation or at the initiative of the NAUFOR three cases went to the Higher Court of Arbitration of the Russian Federation. The NAUFOR suggested that all Russian exchanges lower investor risks by expanding listing conditions and penalising offending issuers (range of penalties: from media reports to exclusion from listing). The exchanges explained that this project was premature, hard to implement and in conflict with the interests of the market and those of issuers. This reaction is evidence of their narrow-minded approach toward the protection of investor rights and of a lack of a long-term market development policy. Since 2000 the burden of responsibility for further implementation of the Program for Protection of Investor Rights will be shouldered by the Co-ordination Centre. It will seek to change the attitude of all the above organisations toward protection of investor rights and set the stage that would be conducive to the operations of any investors, both foreign and domestic.

69. Investors. Investors are becoming aware of the importance of corporate governance as criteria in the choice of an investment target. Law gives them a chance to influence company corporate policy. But it is commonly observed that portfolio investors as such are not capable of putting up a stiff fight in defence of their assets or even keep a close eye on the Company plans and situation. Problems are at their worst when portfolio investors do not control a package that can block resolutions they do not like. But even

when they do have such a package, consolidating such package at a meeting is a problem. Some of the investors would not do this in principle; others have a weak personnel and information support that prevents them from monitoring corporate risks, protecting shareholders rights and preventing violations. Portfolio investors need to use all their rights to get seats on the Company Auditing Commission and Board of Directors. They should pool their resources and give great powers to their representatives (nominee holders) with respect to the formulation of the agenda and the undertaking of actions helping shareholders to make use of their rights to buyback or information disclosure. Regrettably, today shareholders have very few tools for the protection of their rights. The most efficient tools to date have been media scandals and collective investor protests (the Vyksa Steel Works, SNGP, Moscow Refinery, Surgutneftegaz, to cite just a few examples).

70. International Financial Organisations. International Financial Organisations can help civilised corporate culture take root in Russia if the International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, International Monetary Fund will only provide loans on condition that Russia makes due changes to its legislation, improve its judicial and law-enforcement system and improve regulators' operation; if part of the money will be used to set up and support systems for the disclosure of information on market players (like the SCREEN "Issuer") and the support of operation of investor associations seeking to protect shareholder rights and improve the corporate governance culture; if programs will be elaborated and implemented to teach government authorities, the judicial and enforcement system, lawgivers and issuers the principles and mechanisms of corporate governance.