Chapter 17

Enforcement and Remedies

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The Chairman's Checklist

- ✓ Does the Supervisory Board encourage the company's key executives and personnel to go beyond mere compliance with the minimum standards set out in the legal and regulatory framework for corporate governance?
- ✓ Does the Supervisory Board try to resolve all major conflicts with shareholders and other parties prior to judicial and/or administrative authorities becoming involved?
- ✓ Does the company have effective mechanisms in place for resolving conflicts? Does the Supervisory Board have a conflict resolution committee? How active is it in resolving conflicts?
- ✓ Does the company record conflicts and the measures taken for their resolution? Does the Corporate Secretary play a role in this process?
- ✓ Has the Supervisory Board included provisions of the Federal Commission for the Securities Market's Code of Corporate Conduct in its charter and by-laws, or chosen to draft its own, company-level corporate governance code?

Effective corporate governance involves the interplay of five key elements:

- Normative rules of corporate conduct embodied in the legal and regulatory framework, company charters, and other internal corporate documents;
- Formal enforcement of the legal rules in the courts by shareholders, companies, and/or regulators, and through regulatory agencies including the sanctions available to stock exchanges to enforce their rules;
- Voluntary standards of conduct above and beyond the minimum standards established by applicable laws and regulations;
- Alternate dispute resolution mechanisms; and
- Market forces that sanction poor conduct by driving down share prices and credit ratings of companies.

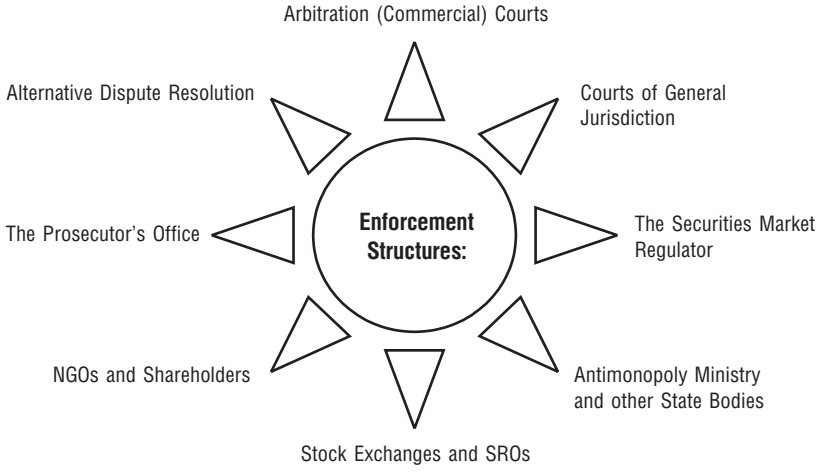
This chapter addresses the mechanisms for, and practical issues associated with, the enforcement of corporate governance related rights.

A. General Overview

1. Enforcement Structures

The different structures involved in the enforcement of corporate governance are summarized in Figure 1.

Figure 1: Enforcement Structures



Source: IFC, March 2004

2. Available Remedies

The Civil Code includes a non-exhaustive list of remedies available for the protection of civil rights.[127] Some of these remedies are available to shareholders and companies, and serve as a basis for various types of claims raised with relevant authorities, including the Federal Commission for the Securities Market (FCSM).

[127] Civil Code (CC), Article 12.

The list of remedies for disputes between shareholders, management, and companies includes:

- Acknowledgement of rights;
- Restoring the condition that existed prior to the violation of the right, and preventing violations of rights;
- Nullification of transactions;
- A decision ordering performance of an obligation in kind;
- Award of damages;
- Award of liquidated damages;[128]
- Termination or modification of mutual rights and duties of parties; and
- Other remedies provided by law and/or agreement.

B. Enforcement by Judicial Authorities

1. Court Jurisdiction

a) Subject-Matter Jurisdiction of Arbitration Courts and Courts of General Jurisdiction

Two types of courts normally enforce shareholder rights: arbitration courts and courts of general jurisdiction. Arbitration courts and courts of general jurisdiction have different jurisdictions with regard to commercial disputes and play different roles in enforcement.[129] With the 2002 adoption of the new Arbitration Procedure Code and Civil Procedure Code, the role of courts of general jurisdiction has been greatly reduced in company disputes.

Arbitration courts have jurisdiction over disputes between companies and shareholders.[130] Generally, arbitration courts consider all commercial cases and other cases relating to business and economic activities, irrespective of the status of the parties, i.e. whether they are individuals, legal entities, or individual entrepreneurs.[131]

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[128] Liquidated damages are defined as the amount required to satisfy a loss resulting from breach of contract, which is usually agreed in the contract itself.

[129] For more information see Handbook on Commercial Dispute Resolution in the Russian Federation (Washington, D.C.: U.S. Department of Commerce, 2000, Chapters 2 and 5. See also: www.mac.doc.gov/ggp.

[130] Arbitration Procedure Code, Article 33, Clause 1, Paragraph 4.

[131] Arbitration Procedure Code, Article 27, Clause 1.

Company Practices in Russia: Courts of general jurisdiction in some Russian regions still consider corporate cases, although they are not supposed to. The Plenum of the Supreme Court issued a Resolution in 2003, which states that all disputes between shareholders and companies arising from the activities of companies (except for labor disputes) fall under the jurisdiction of arbitration courts and may not be considered by courts of general jurisdiction.[132]

There is, however, an exception to this rule. When several related claims cannot be separated and some of these claims need to be tried and resolved by a court of general jurisdiction, the court of general jurisdiction considers the complaint as a whole, even if some of the claims are within the jurisdiction of an arbitration court.[133]

b) Venue in Corporate Litigation

After the appropriate type of court has been selected, a plaintiff should decide where to file an action. Generally, an action is filed with an arbitration court at the location or place of residence of the defendant.[134] Thus, in most cases a shareholder, for example, would file an action against the company at the company's place of state registration.[135]

There are certain exceptions to this rule. First, in some cases a plaintiff may choose the venue. Other exceptions relevant to corporate litigation are:[136]

- A claim against a defendant whose location or place of residence is unknown may be filed where his property is actually located or at his last known location in the Russian Federation;
- If a claim is filed against several defendants, it may be filed at the location of any of the defendants at the discretion of the plaintiff;
- A claim against a defendant located or residing in a foreign country may be filed at the location of the defendant's property on the territory of the Russian Federation;

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[132] Supreme Court Resolution No. 2 on Certain Issues Arising in Connection with the Adoption of the Civil Procedure Code, 20 January 2003, Section 3.

[133] Civil Procedure Code, Article 22, Clause 4.

[134] Arbitration Procedure Code, Article 35.

[135] Law on Joint Stock Companies (LJSC), Article 4, Clause 2.

[136] Arbitration Procedure Code, Article 36.

- A claim arising from a contract that indicates the place of execution may be filed at the place of execution; and
- A claim against a legal entity arising from the activities of a branch or representative office may be filed at the location of the branch or representative office.

Parties may change the venue of an action by agreement before the acceptance of the case by an arbitration court.[137]

In addition to these rules, the Arbitration Procedure Code establishes rules on exclusive territorial jurisdiction over certain claims. This means that only a court located at the place defined in accordance with the following rules may adjudicate cases:[138]

- A bankruptcy notice may only be filed with an arbitration court at the location of the debtor;
- An "application for establishing circumstances of legal significance" or declaratory judgment[139] should be filed with an arbitration court at the location or place of residence of the plaintiff, except for applications relating to the legal status of immovable property, which are filed with a court at the location of the property;
- An application challenging a bailiff's decisions or actions (omissions) should be filed with an arbitration court at the location of the bailiff;
- An application related to a dispute between Russian legal entities that have activities or property on the territory of a foreign country should be filed with an arbitration court at the place of state registration of the defendant on the territory of the Russian Federation; and
- A counterclaim may be filed only with the same court as the original action.[140]

If an arbitration court admits a case in violation of venue rules, the case should be transferred to the appropriate arbitration court.[141] That court must try any

[137] Arbitration Procedure Code, Article 37.

[138] Arbitration Procedure Code, Article 38.

[139] The closest U.S. legal equivalent to "an application for establishing circumstances of legal significance" is "declaratory judgment".

[140] There are some other rules for the definition of an exclusive jurisdiction; however, they are not relevant to corporate relations and disputes in this field.

[141] Arbitration Procedure Code, Article 39, Clause 2, Paragraph 3.

claim accepted by an arbitration court in accordance with venue rules, even if in the future the claim falls under the jurisdiction of another court.[142]

It should be noted that there are no special rules for determining the venue of an action filed against a company. These actions are filed with a court in accordance with the Arbitration Procedure Code rules.

Company Practices in Russia: Problems arise when companies are located far from shareholders (or from their place of registration). Traveling to a distant court and staying there throughout the litigation can be expensive. Another way for shareholders to protect their rights is to file an action by registered letter and inform the court that a trial may be held in absentia.[143]

The Civil Procedure Code rules for determining the venue of actions are largely similar to the Arbitration Procedure Code rules.[144]

2. Provisional Remedies

a) General Provisions

The Arbitration Procedure Code provides for temporary measures aimed at securing a claim or the property interests of the plaintiff (provisional remedies). Provisional remedies may be granted upon application of an interested person at any stage of the proceedings if failure to do so impedes (or renders impossible) the execution of a court decision, or when the execution of a decision may take place abroad, and to prevent inflicting damages on the plaintiff.[145] Provisional remedies must be proportionate to the damages sought in the claim.[146] When applying for a protective measure, the plaintiff must prove that the remedy is necessary to secure the execution of a court decision.

Since the Arbitration Procedure Code does not contain any special rules for the application of provisional remedies in companies, the general rules provided

[142] Arbitration Procedure Code, Article 39, Clause 1.

[143] Arbitration Procedure Code, Article 156, Clause 2.

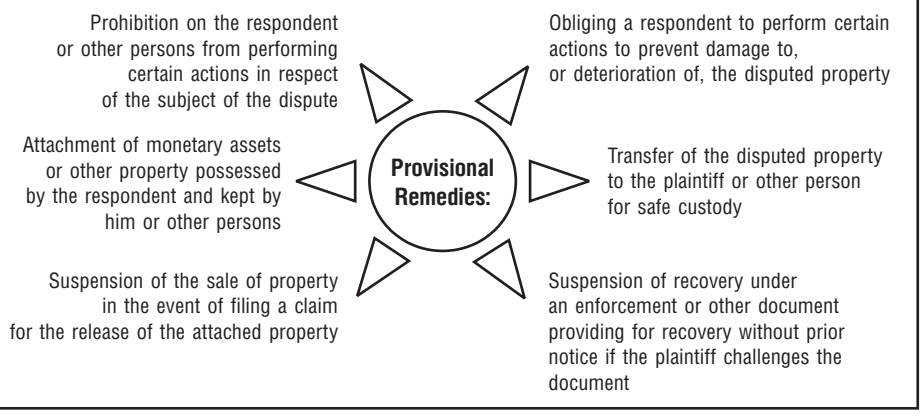
[144] Arbitration Procedure Code, Articles 23 — 33.

[145] Arbitration Procedure Code, Article 90, Clause 2.

[146] Arbitration Procedure Code, Article 91, Clause 2.

by Chapter 8 of the Arbitration Procedure Code apply. However, the Supreme Arbitration Court has interpreted provisions regarding provisional remedies as discussed, which are shown in Figure 2.[147]

Figure 2: Provisional Remedies



Source: IFC, March 2004

An arbitration court has the right to grant any other protective measure it finds necessary, or several remedies simultaneously.

The plaintiff may apply for provisional remedies at any stage of the proceedings before the adoption of a court decision that concludes consideration of the case.[148] This application must be filed with the same court that is hearing the main case. The arbitration court must consider the application the day after its receipt at the latest, without notification of the parties.[149] An arbitration court order imposing provisional remedies is subject to immediate execution.[150] Copies of the court order to grant provisional remedies must be sent to the parties in the case on the day after its issue at the latest.[151]

147 Arbitration Procedure Code, Article 91.

148 Arbitration Procedure Code, Article 92, Clause 1.

149 Arbitration Procedure Code, Article 93, Clause 1.

150 Arbitration Procedure Code, Article 96, Clause 1.

151 Arbitration Procedure Code, Article 93, Clause 6.

Company Practices in Russia: A company against which provisional remedies have been taken sometimes learns of this only when its property (bank accounts, securities, etc.) has already been attached and its activities paralyzed. Unscrupulous plaintiffs often abuse provisional remedies by initiating suits aimed at receiving specific provisional remedies, especially during hostile takeovers.

b) Preliminary Provisional Remedies

Besides provisional remedies, the Arbitration Procedure Code provides for the application of preliminary provisional remedies, which, unlike ordinary provisional remedies, are applied before filing an action.[152] An application for these remedies may be filed not only with the arbitration court that has, or will have, jurisdiction in respect of the main claim, but also with the arbitration court at the location of:

- The plaintiff; or
- Monetary assets or other property in respect of which the plaintiff is seeking provisional remedies; or
- The alleged violation of the plaintiff's rights.

Except for the special provisions embodied in the Arbitration Procedure Code, preliminary provisional remedies are regulated by the same rules as ordinary provisional remedies.

If the person who has applied for the preliminary provisional remedies does not file an action within the period defined in the court order on the imposition of such measures (not more than 15 days), the preliminary provisional remedies are revoked by the court.[153]

c) Protection of Defendant Rights

Provisional remedies may result in the violation of a defendant's rights and legitimate interests. To protect the defendant, an arbitration court may, upon the application of the defendant or on its own initiative, demand that the plaintiff agree to hold the defendant harmless against possible losses (plaintiff's security bond).[154]

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[152] Arbitration Procedure Code, Article 99.

[153] Arbitration Procedure Code, Article 99, Clause 5.

[154] Arbitration Procedure Code, Article 94.

If an arbitration court decides to demand a plaintiff's bond, the order should be issued, at the latest, on the day after the date when the court receives the application for provisional remedies. In this event, the court will not consider an application for provisional remedies until confirmation that the defendant's interests have been secured. The amount of the security should be established within the limits of the claim of the plaintiff and may not be less than half of the claim. The Arbitration Procedure Code also allows a defendant to apply for the reimbursement of damages incurred because of provisional remedies.

An order dissolving a protective measure may be issued conditional upon the defendant paying a security bond into the court's account equal to the plaintiff's claim (defendant's security bond).[155] Thus, a defendant may file a motion to replace a protective measure with the temporary payment of a sum of money. However, the decision whether to grant this motion is at the court's discretion.

d) Protection Against Abusive Use of Provisional Remedies

One downside associated with the application of provisional remedies is the potential for abuse by unscrupulous plaintiffs in the course of hostile takeovers.

Company Practices in Russia: The Arbitration Procedure Code does not provide an exhaustive list of protective measures; a court may use any protective measure it finds reasonable. For example:

- Shares may be seized and later sold through the Federal Property Fund;
- Movable and immovable property may be attached;
- The register may be seized and removed by the bailiff;
- Supply agreements may be frozen;
- Implementation of decisions may be suspended; and
- Governing bodies may be ordered to stop their activities.

As a result, company activities may potentially be paralyzed, its property confiscated, and management could be transferred to the plaintiff.

Although the Arbitration Procedure Code allows a defendant to apply for reimbursement of losses incurred due to provisional remedies, an application may be filed only after the arbitration court's decision dismissing the claim takes effect.[156] However, if a plaintiff withdraws the claim, no such decision will be

[155] Arbitration Procedure Code, Article 94, Clause 2.

[156] Arbitration Procedure Code, Article 98.

rendered[157] and, therefore, a defendant would not have the right to apply for reimbursement of losses.[158] As a result, plaintiffs often file frivolous claims to obtain a court order on provisional remedies. After a period, the plaintiff withdraws its claim and thus makes itself immune from liability for the defendant's losses. Since the arbitration court does not have to provide for the plaintiff's security bond, the plaintiff does not have to reimburse the losses borne by the defendant because of such provisional remedies. These losses may be significant enough to bankrupt even large companies.

To compensate for the lack of clear definitions in the law, and to offset the abuse of provisional remedies, the Plenum of the Supreme Arbitration Court has adopted a resolution dealing with this issue (Resolution 11).[159] Although it does not solve all problems associated with provisional remedies, Resolution 11 is extremely important, since it may become an effective deterrent to abuse during hostile takeovers. The most important provisions of Resolution 11 include:

- Provisional remedies must conform to the protection sought in the claim, i.e. they should:[160]
  - — Directly relate to the subject of the dispute;
  - — Be proportionate to the protection sought; and
  - — Be necessary and sufficient to ensure the execution of a judicial decision or to prevent damage which the plaintiff may incur.

[157] In this case, a court order on the termination of proceedings is issued. Arbitration Procedure Code, Article 151.

[158] An arbitration court may not accept withdrawal of a claim if it contravenes the law or violates the rights of other persons (Arbitration Procedure Code, Article 49, Clause 5). Thus, an arbitration court may not accept renunciation of a claim in these cases. A respondent whose interests have suffered due to the application of protective measures should oppose the plaintiff's intent to withdraw its claim on the basis of the Arbitration Procedure Code, Article 49, Clause 5.

[159] The Plenum of the Supreme Arbitration Court Resolution No. 11 on the Practice of the Review by Arbitration Courts of Requests for Prohibition of Convocation of the General Meeting of Shareholders as a Protective Measure (Resolution No. 11), 9 June 2003.

[160] Resolution No. 11, Section 1.

- A prohibition to hold a General Meeting of Shareholders (GMS) may not be used as a protective measure.
- Since the GMS is the highest governing body of the company, a prohibition effectively prevents the company from carrying on its business. A prohibition of a GMS is contrary to the purpose of provisional remedies, which are intended to protect plaintiff's interests and not to deprive another person of the ability or right to carry on its lawful activities.[161]
- The court may not grant any protective measure that amounts to a prohibition of a GMS (i.e. the Supreme Arbitration Court has sought to prevent evasion of Resolution 11 by arbitration courts). For example, no court may interfere in:[162]
  - — Calling a GMS;
  - — Preparing the shareholders list;
  - — Providing premises for the GMS;
  - — Sending voting ballots; and
  - — Summarizing the results of voting on agenda items.

However, a court may prohibit a GMS from taking decisions on certain items if they are the subject-matter of the case or directly relate to it. A court may also prohibit a company, its bodies or separate shareholders from acting upon a GMS decision in respect of certain matters.[163]

In any case, when deciding whether a protective measure should be applied, the court must make sure that it would not hinder or render impossible the execution of the court decision in case of satisfaction of the claim. If a plaintiff requests a protective measure because a failure by the court to grant such measure would cause material damages, he should prove the likelihood of damages, its amount, its connection with the object of the dispute, and the necessity and sufficiency of the protective measure to prevent damages.[164]

[161] Resolution No. 11, Section 2, Paragraph 2.

[162] Resolution No. 11, Section 2, Paragraph 4.

[163] Resolution No. 11, Section 3.

[164] Resolution No. 11, Section 4, Paragraph 2.

When granting provisional remedies, the court should take into consideration that such measures not stop (or significantly impede) the company activities or result in violation of legislation by a company.

Best Practices: The Supreme Arbitration Court has issued an Information Letter on provisional remedies. Although the provisions of this Information Letter are only recommendations, they are important for the protection of shareholder rights. Its most important provisions are:[165]

- An attachment of securities means the prohibition for a defendant to dispose of these securities, including the prohibition of all transactions with the securities, even if these transactions do not result in the transfer of rights in these securities. The transfer of attached securities to a nominee is also prohibited.
- When an arbitration court applies provisional remedies, it should explicitly define the nature and scope of the remedies. For example, the attachment of shares does not automatically mean that a shareholder may not vote these shares at a GMS nor does it suspend the right to receive dividends. Thus, if an order of an arbitration court on provisional remedies does not expressly state that a shareholder may not participate in the governance of a company or that a person may not accrue any income on the attached securities, the owner of the attached securities retains these rights.
- When applying a protective measure, only an arbitration court may impose limitations on shareholder rights. A bailiff in executing a court order for application of provisional remedies may only enforce it in exact accordance with its text.[166] A bailiff may not impose any other limitations, except for those expressly stipulated in an order.
- The voting shares owned by a shareholder, whom an arbitration court prohibited from voting at the GMS shall, nonetheless, be counted for a quorum purposes.

[165] Information Letter No. 72, the Supreme Arbitration Court, on the Review of Arbitration Courts Practice in Application of Protective Measures in Lawsuits concerning the Circulation of Securities, 24 June 2003, Sections 1, 2, 4, 5, 6 and 7.

[166] Law on Executive Procedure, Article 51, Clause 2, provides that when executing a court decision, a bailiff may define the scope, manner, and periods of legal restraints on the right to use attached property. However, since an order for application of protective measures is not a decision (an act that adjudicates a case on its merits), a bailiff may not impose any additional legal restraints on the right to use the attached property.

- If an arbitration court attaches the securities of a defendant as a protective measure, the attachment shall not prevent another arbitration court from attaching the same securities in connection with another claim for the nullification of a purchase agreement involving the securities.
- If securities of a defendant are attached by an arbitration court as a protective measure in connection with a claim for the nullification of a purchase agreement, the securities may also be attached pursuant to an enforcement order issued in another case.
- If shares owned by the defendant are irrelevant to the issue and are part of assets upon which the production activity of the company is dependent, these shares may be attached only when the defendant has no other assets that may be attached.
- When attaching securities as a protective measure, an arbitration court should indicate the exact title and number of the attached securities in the writ of execution. A bailiff may not select securities to be attached at his discretion.
- When securities are the subject of a claim, the possibility of their disposal is a valid ground for their attachment as a protective measure.

e) Application of Provisional Remedies by Courts of General Jurisdiction

Courts of general jurisdiction may sometimes try corporate cases. Consequently, courts of general jurisdiction may also issue provisional remedies. In this case, Civil Procedure Code provisions apply.[167]

The grounds for application of provisional remedies and the list of remedies are generally the same as established by the Arbitration Procedure Code.[168]

It should be remembered that Resolution 11 issued by the Supreme Arbitration Court is not legally binding for courts of general jurisdiction. Although Resolution 11 interprets the provisions of the Arbitration Procedure Code that relate to provisional remedies, some judges of courts of general jurisdiction may not accept any references to it. The Supreme Court issued the clarification on the application of provisional remedies in corporate disputes in Resolution 2, according to which

[167] Civil Procedure Code, Chapter 13.

[168] See Section B.2.a of this Chapter. Although the Civil Procedure Code allows the court to provide for the plaintiff's security bond, it does not contain any specific provisions on the amount of such security, terms, and other conditions of its application.

the prohibition to hold a GMS may not be used as a protective measure because it violates the Constitution, which grants the right of peaceful assembly to every citizen of the Russian Federation.

3. Statute of Limitations

If a claim is filed after the expiration of a limitations period established by law, a court may consider the case and pass acts (orders on provisional remedies, decisions, resolutions, etc.) only when the defendant does not object to the admission of the case by the court.

A general limitations period of three years from the moment when a plaintiff learned, or should have learned, of the violation of his right, is found in the Civil Code.[169] To declare a voidable transaction invalid and apply consequences of its invalidity, a one year limitation period is established from the date of the cessation of the coercion or threat under which the transaction was made, or from the moment when the plaintiff learned, or should have learned, about other circumstances which are grounds for the nullification of the transaction.[170] To apply the nullification consequences of a transaction void from inception (*ab initio*), the Civil Code establishes a limitations period of ten years from the beginning of the execution of the transaction.[171]

The Company Law provides for a special limitation period for suits seeking to invalidate a GMS decision. Any such decision may be contested within six months of the moment when the shareholder first knew about, or should have known about, the GMS.[172] Clearly, if a decision taken by the GMS is invalidated and that particular GMS had the election of the General Director on its agenda, then there is a significant risk that all transactions he made on behalf of the company could be invalidated as well. This risk was reduced when a shorter limitation period was established on 1 January 2002.

4. Types of Claims

Legislation does not identify types of claims and thus does not establish any special rules for their consideration. All claims, notwithstanding the remedy sought

[169] CC, Articles 196 and 200.

[170] CC, Article 181, Clause 2.

[171] CC, Article 181, Clause 1.

[172] LJSC, Article 49, Clause 7.

by the plaintiff, are filed with the court in accordance with the general rules of jurisdiction established in the Arbitration and Civil Procedure Codes. However, the following types of claims regarding companies can be distinguished in theory:

- Claims to appeal decisions of the company's governing bodies;
- Claims to compel governing bodies to carry out certain actions or to refrain from certain actions;
- Claims to reimburse the damages caused by actions of company officials and claims against the company for damages; and
- Claims regarding corporate transactions.

5. Administrative Procedures in Arbitration Courts

Besides the above mentioned cases (which arise from private-law relations), certain cases in the field of corporate governance arise from administrative and other public-law relations (public cases). Administrative bodies may consider some of these cases,[173] while others fall under the jurisdiction of arbitration courts.

Arbitration courts try such public cases as challenges to the normative and non-normative acts of state bodies and the actions thereof, some administrative offences (other than those falling under the jurisdiction of the FCSM and other executive bodies), and challenges of decisions of state bodies on administrative liability. It should be noted that arbitration courts have jurisdiction only in public cases that relate to business and economic activities.

Those public cases that fall under the jurisdiction of arbitration courts are tried in accordance with the general rules of arbitration procedure (including the rules on jurisdiction), unless the Arbitration Procedure Code provides otherwise.[174]

a) Appealing Legal Acts and Actions of State Bodies and Officials

Legal acts may be appealed in arbitration courts only if they affect the plaintiff's rights and legal interests in the field of business or other economic activities.

Challenges to normative legal acts[175] of the President, the Russian Government, and federal executive bodies fall under the exclusive jurisdiction of the Supreme

[173] See Section D of this Chapter.

[174] Arbitration Procedure Code, Article 189, Clause 1.

[175] Arbitration Procedure Code, Chapter 23.

Arbitration Court.[176] Since the FCSM is a federal executive body, its normative acts may be challenged only in the Supreme Arbitration Court, which, in this case, is the court of first instance. Non-normative (individual) acts[177] of the President, the Government, State Duma, and Federation Council also fall under the exclusive jurisdiction of the Supreme Arbitration Court.[178] However, non-normative legal acts of federal and local executive bodies (including non-normative rulings and orders of the FCSM) should be challenged in an arbitration court at the location of the body or official whose act is being challenged.

Filing of an appeal does not suspend the operation of the contested legal act during dispute resolution proceedings.[179] On the other hand, a court may suspend the operation of the non-normative legal act at the request of the applicant.[180]

Cases of this type must (as a rule) be concluded within two months from the filing of an application with the arbitration court.[181]

b) Arbitration Court Authority over Administrative Offences

Arbitration courts may hold legal entities and individual entrepreneurs administratively liable for offences under the jurisdiction of arbitration courts. In corporate relations, arbitration courts may try such offences as improper management of a legal entity and performing transactions and other actions in transgression of authority.[182]

An application shall be filed with the arbitration court at the offender's location or place of residence[183] by the regulatory body that has such authority.[184] The administrative hearing must (as a rule) be completed within 15 days after an application has been filed. If necessary, this term may be extended for one month.[185]

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[176] Arbitration Procedure Code, Article 34, Clause 2.

[177] Arbitration Procedure Code, Chapter 24.

[178] Arbitration Procedure Code, Article 34, Clause 2, Paragraphs 1 and 2.

[179] Arbitration Procedure Code, Article 193, Clause 3.

[180] Arbitration Procedure Code, Article 199, Clause 3.

[181] Arbitration Procedure Code, Article 194, Clause 1; Article 200, Clause 1.

[182] See Section D.2.b of this Chapter.

[183] Arbitration Procedure Code, Article 203.

[184] Arbitration Procedure Code, Article 202, Clause 2.

[185] Arbitration Procedure Code, Article 205, Clause 1 and 2.

Any decision of a regulatory body on administrative liability may be appealed to the arbitration court at the applicant's location or place of residence.[186] The right to challenge decisions of regulatory bodies on administrative liability is an important measure to protect one's rights and legal interests.

Such cases must be decided (as a rule) within ten days of the filing of an application.[187] Another important rule is that the burden of proof of an administrative violation is on the regulatory body.

The 2002 Code of Administrative Offences provides for a new administrative sanction — disqualification of managers. A disqualified manager may not hold any managerial office in any legal entity within the period of disqualification (from six months to three years).[188] Among other things, this person may not be a General Director or a Supervisory Board member. Only a court of general jurisdiction or an arbitration court may apply this sanction.

The Code of Administrative Offences stipulates the following situations when this sanction may be applied:

1) In case of repeated violations of labor legislation by the manager.[189] These cases are tried by magistrates (the judges of the lower level of courts of general jurisdiction);[190]
2) In cases of improper management of a legal entity and of performing transactions and other actions in transgression of authority.[191] Only arbitration courts have jurisdiction in respect of these offences;[192]
3) In case of filing of documents containing knowingly false statements with the state bodies responsible for state registration of legal entities.[193] This offence falls within a magistrate's jurisdiction.[194]

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[186] Arbitration Procedure Code, Article 208, Clause 1.

[187] Arbitration Procedure Code, Article 210, Clause 1.

[188] Code of Administrative Offences, Article 3.11.

[189] Code of Administrative Offences, Article 5.27, Clause 2.

[190] Code of Administrative Offences, Article 23.1, Clause 1.

[191] Code of Administrative Offences, Article 14.21; Article 14.22.

[192] Code of Administrative Offences, Article 23.1, Clause 3.

[193] Code of Administrative Offences, Article 14.25, Clause 4.

[194] Code of Administrative Offences, Article 23.1, Clause 1.

Company Practices in Russia: Director/manager disqualification is quite often used in the course of hostile takeovers as a means to "behead" a company, or to remove a person from the Supervisory Board. In fact, the more power is concentrated in the hands of a General Director, the more dangerous this sanction becomes. In practice, corporate raiders usually seek to apply Clause 2 of the Article 5.27 of the Code of Administrative Offences, since violations of labor law are (relatively) easy to prove and such violations are tried by courts of general jurisdiction, which may make companies even more vulnerable to the abuse of this sanction.

6. Enforcement Authority of the Prosecutor's Office and Criminal Liability of Directors and Managers

Other parties besides courts have enforcement powers. One such body is the Prosecutor's Office (prokuratura), which may be involved in both civil and criminal litigation in the field of corporate governance.

a) The Prosecutor's Office in Civil Litigation

The Arbitration Procedure and Civil Procedure Codes provide for specific rules that govern the Prosecutor's Office's rights and enforcement capabilities in cases considered in arbitration courts and courts of general jurisdiction.

A prosecutor is entitled to file a claim for invalidation of transactions made by legal entities with an arbitration court, including companies the authorized capital of which includes an interest of the Russian Federation, its political subdivisions, or municipalities. A prosecutor applying to an arbitration court has the procedural rights, and discharges the procedural duties, of the plaintiff.[195]

Prosecutors are not generally authorized to participate in suits among shareholders, companies and their management. Prosecutors have the right to file an application to protect the rights, freedoms, and lawful interests of citizens, or an indefinite group of persons, or of the interests of the Russian Federation.[196] The prosecutor can file an application only if the citizen cannot apply to the court personally because of poor health, age, incapacity, or other valid reasons.

[195] Arbitration Procedure Code, Article 52.

[196] Civil Procedure Code, Article 45.

A prosecutor has the right to initiate administrative proceedings if he discovers the fact of an administrative violation.

Moreover, a prosecutor has the right to file an action with an arbitration court for the invalidation of a legal act in the field of business and other economic activities, if the prosecutor deems this act illegal.

Company Practices in Russia: There are some recorded cases of prosecutors filing cases to defend shareholder interests. However, it has become a matter of policy that the Prosecutor's Office generally does not become involved in corporate disputes.

With the adoption of the new Arbitration Procedure and Civil Procedure Codes, the role of the prosecutor in civil litigation has diminished significantly. In the past, the Prosecutor General and his deputies had the right to file general supervision appeals. Today this right has been given to the parties involved in a dispute. As for the prosecutors, they may file supervision appeals only within the scope of their competence established by the relevant articles of the Arbitration Procedure and Civil Procedure Codes.

b) Prosecutor's Office in Criminal Litigation

Besides being involved in civil and commercial litigation, the Prosecutor's Office has an important role in criminal litigation.

Current Russian legislation does not provide for the criminal liability of legal entities. Only individuals, including managers, directors, and shareholders, can be subject to such liability. To enforce their rights, criminal offence victims should address their claims to the Prosecutor's Office or to the police. All criminal cases are considered in courts of general jurisdiction.

Criminal offences are listed in the Criminal Code. Other laws and secondary legislation cannot criminalize any actions. The following groups of criminal offences relate to corporate governance:[197]

- Offences related to the disclosure of information, such as the illegal receipt and disclosure of information classified as a commercial, tax, or banking

[197] Criminal Procedure Code, Article 151, Clause 2, Paragraph 2 provides that police investigators investigate these offences.

secret,[198] and refusal to provide information when required to do so by legislation;[199]
- Offences related to the issuance of securities;[200]
- Offences in the field of bankruptcy, such as illegal actions in the course of bankruptcy,[201] deliberate bankruptcy,[202] and fictitious bankruptcy;[203] and
- Offences related to the abuse of authority by management[204] and commercial bribery.[205]

It should be noted that investigators have the right to conduct searches and seize documents and other evidence (including correspondence) while investigating a criminal case.

Company Practices in Russia: The "cooperation" of law-enforcement bodies, and especially the assistance of investigators, is often sought by corporate raiders in the course of illegal takeover campaigns.

Although criminal offences related to corporate governance are investigated by investigators of the Ministry of the Interior (i.e. police investigators), the role of the prosecutor's office is nevertheless significant.

One of the most important enforcement rights of the prosecutor is the right to give consent to initiate a criminal prosecution (or to start prosecution, in certain circumstances) when the actions of an individual constitute a crime.[206] After an investigation is finished, a prosecutor must examine the bill of indictment presented by an investigator and either endorse it and refer the case to court, or

[198] Criminal Code, Article 183. Illegally procured information is often used by executive bodies when making decisions.

[199] Criminal code, Article 185.1.

[200] Criminal Code, Article 185.

[201] Criminal Code, Article 195. Illegal bankruptcy schemes are often used in the practice of hostile takeovers both by the attackers and the attacked.

[202] Criminal Code, Article 196.

[203] Criminal Code, Article 197.

[204] Criminal Code, Article 201. Abuse of authority refers to extraordinary and related party transactions.

[205] Criminal Code, Article 204.

[206] Criminal Procedure Code, Article 20, Clause 4.

cancel the prosecution.[207] Another important authority the prosecutor is vested with is his right and duty to prosecute a case.[208] In other words, a prosecutor appears in court on behalf of the state to pursue a charge against an offender. The prosecutor's participation is necessary in almost every criminal case.

Criminal prosecution is an effective tool for the protection of shareholders' rights. Sometimes the simple threat of criminal prosecution may lead to the cessation of illegal actions.

7. Execution of Court Acts and the Role of Bailiffs

After a court renders its judgment, it becomes binding on the parties in the case. A bailiff service executes court decisions. The Law on Bailiffs and the Law on Execution Procedure vest bailiffs with extensive enforcement powers in order to provide for timely, complete, and proper execution.[209] Some of these powers are significant as they relate to the seizure of company property (including securities), transfer of management, etc.

The demands of bailiffs are binding on all bodies, organizations, officials, and citizens on the territory of the Russian Federation. Non-fulfillment of a bailiff's demands (or interfering with a bailiff's duties) may result in liability.[210]

Bailiffs act on the basis of execution orders, i.e. writs of execution issued by courts, court orders, decisions of bodies authorized to consider administrative offences, etc. The majority of execution orders are issued by courts, either because of a court decision or as a protective measure to secure the interests of the plaintiff. Bailiffs are obliged (as a rule) to execute court orders within three days.[211]

The Law on Execution Procedure establishes an open list of compulsory execution measures, including attachment of the debtor's property and seizure of certain objects for transfer to a creditor. The bailiff can execute any order included in the writ of execution.[212]

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[207] Criminal Procedure Code, Article 221.

[208] Criminal Procedure Code, Article 246.

[209] Law on Bailiffs, Article 12.

[210] Law on Bailiffs, Article 14.

[211] Law on Execution Procedure, Article 9, Clause 2.

[212] Law on Execution Procedure, Article 45.

Generally, bailiffs perform executive actions at the location of the debtor or its property. However, a bailiff may perform executive actions on territory outside his district if needed.[213]

Company Practices in Russia: Bailiffs who are involved in hostile takeover attempts often abuse their right to execute actions outside their district. In order to make enforcement procedures more effective, it is important to prevent the abuse of bailiff authorities. Formal procedural guarantees against abuses do, however, exist. For example, bailiffs should use their rights and fulfill their obligations according to the law, and not permit the infringement of the rights and legal interests of citizens and organizations when carrying out their activities.[214]

As a rule, executive actions should be performed within two months from the date when the bailiff receives a court order. In some cases, orders are subject to immediate execution.[215]

Damages inflicted by a bailiff upon citizens and organizations are subject to compensation in conformity with the civil legislation of the Russian Federation. The actions of bailiffs, including the issuance of orders to start an executive action, may be appealed to the respective court within 10 days.[216]

C. Alternative Dispute Resolution

An alternative to enforcement by judicial authorities is private commercial arbitration. In general, arbitration is believed to be cheaper and faster than going through the courts.

Company Practices in Russia: Arbitration is frequently used in Russia as a means of alternative dispute resolution. However, due to unclear wording of the Arbitration Procedure Code, Article 33, there is a strong tendency to avoid the use of commercial arbitration as a means to resolve corporate disputes.

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[213] Law on Execution Procedure, Article 11.

[214] Law on Bailiffs, Article 13.

[215] Law on Execution Procedure, Article 13.

[216] Law on Execution Procedure, Article 9.

Arbitration is not prohibited by law. However, arbitral decisions will be revoked if it is found that an arbitration tribunal lacks jurisdiction to try the case.[217] The Arbitration Procedure Code states that disputes between shareholders and companies fall under the "special jurisdiction" of arbitration courts.[218] Actually, the precise meaning of the phrase "special jurisdiction" is (as yet) unclear. Although Article 33 does not state that arbitration tribunals[219] may not resolve corporate disputes, the words "special jurisdiction" may be interpreted in this way.

To transfer a dispute to the arbitration tribunal, an arbitration agreement normally must be concluded between parties. An arbitration agreement is a contract that empowers a private tribunal to try a case while depriving the state court of its jurisdiction. An arbitration agreement may be incorporated in a contract (in this case it is called an arbitration clause), or it may be concluded as a separate agreement in addition to an existing contract, or as an agreement between the parties to a dispute before judgment is reached by a state court.

Company Practices in Russia: In practice, using arbitration clauses in corporate contracts appears to be limited:

An arbitration clause may be included in the text of a contract for the sale and purchase of shares. However, standard stock exchange contracts do not normally include arbitration clauses.

Nevertheless, the Law on the Securities Market states that disputes between stock exchange participants, and between stock exchange participants and their customers may be resolved by arbitration tribunals.[220] This could be interpreted to allow exchanges to include arbitration clauses in standard stock exchange contracts, thus permitting arbitration. As for disputes between issuers and registrars, an arbitration clause may be included in a contract with a registrar.

Another means of alternative dispute resolution is mediation, in other words, the settlement of disputes with the assistance of a (professional) mediator. A me-

[217] Arbitration Procedure Code, Article 233, Clause 3, Paragraph 1.

[218] Arbitration Procedure Code, Article 33.

[219] Note: Arbitral tribunals (treteiskie sudi) are not the same as arbitration courts. Arbitration courts in Russia have nothing in common with what is usually meant under this term in other countries and in international commercial practice. These are state courts that deal with business and other economic matters. In the present text, the term "arbitration tribunals" is used to distinguish private commercial arbitration institutions from state arbitration courts.

[220] Law On Securities Market, Article 15.

diator does not adjudicate the issues in dispute or force a compromise; only the parties, of their own will, may achieve a settlement. Any corporate dispute may be solved by means of mediation. A contractual settlement reached by means of mediation has the same legal nature as any other valid agreement and is enforceable by filing an action with an arbitration court. On the other hand, settlements reached between the parties in the course of proceedings in an arbitration court and affirmed by the court may be enforced by means of a writ of execution issued by a court.

D. Enforcement by Regulators and Administrative Authorities

In addition to judicial authorities and private commercial arbitration, some regulators and administrative authorities may also be involved in corporate governance enforcement.

1. Enforcement by the Federal Commission for the Securities Markets

The principal regulator dealing with corporate governance enforcement is the FCSM. The FCSM has significant powers over companies, registrars, and other participants of the securities market.

Most of the FCSM enforcement powers are embodied in the Law on the Securities Market. They are summarized below and discussed in detail in other parts of this Manual.

a) Authority over Professional Participants of the Securities Market

Professional participants of the securities market are legal entities that engage in the following activities: broker's activities, dealer's activities, securities management, clearing, depositary activities, keeping registers of securities' owners, and organization of trade on the securities market.[221] Only entities engaged in these activities are considered professional participants of the securities market.

The FCSM has the authority to suspend or revoke licenses of professional participants of the securities market in the event they violate securities legislation.[222] This authority, however, may be misused. For example, the revocation of an Ex-

[221] Law on the Securities Market, Chapter 2.

[222] Law on the Securities Market, Article 42, Clause 6.

ternal Registrar's license causes the shareholder register to be transferred to another Registrar. In some cases, the new Registrar (if acting unfairly or unprofessionally) may make changes to the shareholder register that may violate shareholder rights and hinder management in exercising its rights.

Company Practices in Russia: The transfer of shareholder registers from one External Registrar to another through the revocation of the Registrar's license by the FCSM, though possibly illegal, is a sought-after tool by "corporate raiders" in the course of hostile takeovers. Companies should, therefore, attempt to engage the services of Registrars with the proper investment of time and resources to ensure that the company contracts for the services of a Registrar who is as competent and user-friendly as possible.

In addition, the FCSM has the right to give orders to professional participants of the securities market including Registrars. These orders are binding unless reversed by the FCSM or by a court.

b) Right to Seek the Liquidation of a Company

The FCSM has the authority to bring an action to an arbitration court to liquidate any legal entity that breaches the provisions of securities legislation, and to impose penalties on such entities.[223]

c) Right to Assist Other Law-Enforcement Agencies

The FCSM can send materials to law-enforcement agencies and file suits with a court of law or arbitration court on matters within the FCSM's scope of authority (including the nullification of securities transactions).[224] In this case, the FCSM can protect shareholders and help resolve governance-related disputes. If any actions of the issuer's officers are based in criminal law, the FCSM submits its findings to the Prosecutor's Office.[225]

d) Right to Apply Administrative Liability

The FCSM has the right to hear allegations of certain administrative offences committed in the securities market. Most of these offences relate directly or in-

[223] Law On the Securities Market, Article 42, Clause 20.

[224] Law On the Securities Market, Article 44, Clause 8.

[225] Law On the Securities Market, Article 51, Clause 3.

directly to the protection of shareholder rights. The FCSM has authority to consider the following groups of offences:

- Offences on information filing and disclosure,[226] and the use of insider information;[227]
- Violations such as the prevention of an investor from exercising his rights to manage a company;[228] and
- Offences in the course of securities transactions such as the violation of the rules for keeping the shareholder register,[229] and refusal to transfer the shareholder register to a Registrar.[230]

e) Additional Powers of the Federal Commission for the Securities Markets

The Law on the Protection of Rights and Legitimate Interests of Investors in the Securities Market (Investor Protection Law) bestows additional enforcement powers on the FCSM. The FCSM can be joined as a party to court proceedings in pursuance of its duties and to protect rights of individual investors and interests of the state.[231]

The FCSM may intervene in company actions by filing a claim with a court:[231]

- To protect governmental, public, civic, or investor interests;
- To liquidate a legal entity or terminate operations of an individual entrepreneur engaged in professional activities in the securities market without a license (this applies to all licensed professional participants of the securities market, including stock exchanges, brokers/dealers, registrars, nominal holders of securities, and depositories);
- To cancel share issues;
- To invalidate a securities transaction; and
- As otherwise provided for by law.

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[226] Code of Administrative Offences, Article 15.19. Good corporate governance provides for the full and timely disclosure of information to shareholders and investors as required by both the law and a company's by-laws. Non-disclosure of information leaves shareholders and potential investors in the company unable to make informed investment decisions or learn about the real state of operations of the company.

[227] Code of Administrative Offences, Article 15.21.

[228] Code of Administrative Offences, Article 15.20.

[229] Code of Administrative Offences, Article 15.22.

[230] Code of Administrative Offences, Article 15.23.

[231] Investor Protection Law, Article 14, Clause 1.

[232] Investor Protection Law, Article 14, Clause 2.

2. Enforcement by Other Regulatory Bodies

Almost every regulatory body has enforcement powers although most do not directly relate to corporate governance.

a) Antimonopoly Ministry

Some regulators play a very important role in monitoring business. One of most significant roles in this field belongs to the Ministry of Antimonopoly Policy and Entrepreneurship Support (MAP). Certain actions of market participants require MAP's preliminary consent, and some other actions require subsequent notification.[233] In order to ensure the enforcement of antimonopoly legislation, MAP may issue an order providing for the compulsory division of a company,[234] and file a claim to an arbitration court for the liquidation of a company.[235]

b) Other Regulatory Bodies

Besides regulatory offences dealt with by the FCSM, there are a number of other offences provided for in the Code on Administrative Offences that can be raised by shareholders whose rights were violated by management actions. These are the following:

- Improper management of a legal entity, that is, the use of managing powers contrary to the legitimate interests of the legal entity and/or legitimate creditor interests, which results in a decrease in the organization's own capital, and/or damages.[236] This offence is tried by courts on the grounds of reports drawn up by the Federal Financial Rehabilitation Service.[237]
- Performing transactions or other actions in transgression of authorities.[238] This offence is also tried by courts on the grounds of reports drawn up by the Federal Financial Rehabilitation Service.[239]

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[233] Antimonopoly Law, Articles 17 and 18.

[234] Antimonopoly Law, Article 19, Clause 1.

[235] Antimonopoly Law, Article 6, Clause 5.

[236] Code of Administrative Offences, Article 14.21.

[237] Code of Administrative Offences, Article 23.1, Clause 1; Article 28.3, Clause 2, Paragraph 10.

[238] Code of Administrative Offences, Article 14.22.

[239] Code of Administrative Offences, Article 23.1, Clause 1; Article 28.3, Clause 2, Paragraph 10.

- A gross violation of bookkeeping rules, violation of procedures for keeping accounting documents, and the filing of incorrect accounting reports. Violations are deemed gross in case of a 10% misstatement of the amounts of taxes and fees to be paid, or in cases of a 10% misstatement on any line item on an accounting form.[240] These offences are tried based on reports drawn up by the tax authorities.[241]

The Ministry of the Interior is responsible for the investigation of criminal offences in the field of corporate relations.[242]

E. Stock Exchanges and Self-Regulatory Bodies

In addition to enforcement by judicial and regulatory authorities, stock exchanges and self-regulatory organizations may sanction corporate misconduct. Specific sanctions involve suspension of trading and de-listing of securities.

1. Listing Rules

At present, Russian stock exchanges do not play a significant role in enforcement of corporate governance rights when compared with analogous institutions in the U.S., U.K., and other countries. Moreover, they do not have detailed corporate governance guidelines or rules that could affect Supervisory Board structure, committees, or other governance aspects.

Best Practices: The New York Stock Exchange (NYSE) provides listing rules that cover board structures, committees, and disclosure and audit requirements, among many other issues. New NYSE corporate governance rules demand that:

- Boards have a majority of independent directors;
- Nominating, corporate governance, and compensation committees be composed entirely of independent directors;
- Companies adopt and disclose corporate governance guidelines;

[240] Code of Administrative Offences, Article 15.11.

[241] Code of Administrative Offences, Article 23.1, Clause 1; Article 28.3, Clause 2, Paragraph 5.

[242] See Section B.6 of this Chapter.

- Companies adopt and disclose a code of business conduct and ethics for directors, officers, and employees, and promptly disclose any waivers of the code for directors or officers; and
- Foreign issuers disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under NYSE listing standards.

For companies that repeatedly or blatantly violate NYSE listing standards, suspension and de-listing remain the ultimate penalties. However, suspending trading or de-listing a company may be harmful to the very shareholders that the NYSE listing standards seek to protect. Therefore, for most violations, the NYSE will issue a public reprimand.

Some Russian stock exchanges, however, require issuers to either comply with the FCSM Code or their own company codes.

For example, the Russian Trading System (RTS) provides for several types of listings, two of which (Level A, Tier 1 Quotation and Level A, Tier 2 Quotation) require compliance with the FCSM Code. Companies receive a Level A, Tier 1 rating if they produce accounting statements according to US GAAP or International Financial Reporting Standards (IFRS) and document compliance with the FCSM Code.[243] In order for companies to receive a Level A, Tier 2 rating, they only need document compliance with the FCSM Code's Chapter 7 on information disclosure.

The Moscow Interbank Currency Exchange (MICEX) listing rules are similar. In order for the issuer to list its securities on Quotation Level A, Tier 1, an issuer should "comply with the requirements of the FCSM Code or requirements of their own code enacted in accordance with that Code." This requirement is easier to implement, and many issuers prefer to enact their own codes. In order to list on Quotation Level A, Tier 2, the issuer must simply comply with the information disclosure requirements in Chapter 7 of the FCSM Code.

Many Russian issuers have raised concerns about the vagueness of the RTS and MICEX listing requirements. It is expected that RTS and MICEX will issue clarifications describing the format and contents of their compliance documents.

[243] RTS Listing Rules, Articles 5.2.4, 5.2.6, 5.3.4.

Company Practices in Russia: Like the NYSE, the RTS and MICEX can de-list securities in case of violation of the listing rules.[244] In practice however, no issuers have (yet) been de-listed. Major stock exchanges may themselves have a conflict of interest as pseudo-regulatory bodies since they stand to lose clients if they are too rigorous in applying sanctions. The perception is that exchanges may relax their standards rather than lose companies to competing exchanges.

It is important to note that there is a fundamental difference between NYSE listing rules and RTS and MICEX rules. NYSE listing standards are requirements by the stock exchange rather than a reference to a non-binding code. When Russian companies develop codes, they are not obliged to follow the recommendations of the FCSM Code. Accordingly, Russian issuers have considerably more freedom than their NYSE counterparts.

2. Self-Regulatory Organizations

Most countries with developed securities markets have self-regulatory organizations (SROs) that play an important role in enforcing professional behavior among market participants.

At present, there is only one SRO of professional market participants in Russia possessing an official permission of the FCSM — the Professional Association of Registrars and Depositaries (PARTAD). The National Association of Participants of the Securities Market (NAUFOR) has not been re-registered by the FCSM.

Other professional organizations, for example associations of accountants and auditors, institutes of directors (such as the Independent Directors Association and Russian Institute of Directors), institutes of corporate secretaries, and institutes for internal auditors could also eventually play leadership roles in the future in regulating their respective professions, and consequently specific corporate governance matters, as is the case in many OECD countries.

F. Public Pressure

Though shareholder activism is just emerging in Russia, shareholders and the public can exert considerable influence over companies. The mass media plays an

[244] RTS Listing Rules, section 3.

important role in publicizing conflicts. In Russia, the first successful shareholder campaigns have already produced enormous publicity. In the case of RAO United Entergy System (RAO UES) for example, the Russian and foreign media have played a significant role in the strengthening the position of shareholders against management.

1. Non-Governmental Organizations

NGOs can help shareholders exercise their rights.

a) The Russian Investor Protection Association

In April 2000, the Russian Investor Protection Association (IPA) was formed with the assistance of the World Bank. The goal of IPA is to combine investor efforts in defense of minority shareholders. IPA members include sizeable domestic and international investors with considerable experience in the Russian market. Besides being a well-established center of shareholder activism, IPA helps enforce member rights in court.

Public associations of individuals who are investing in securities are entitled to protect the rights and interests of investors and, in particular, may apply to court to protect the rights and interests of investors in accordance with procedural legislation of the Russian Federation.[245] The law does not explicitly state whether claims should be filed with the court of general jurisdiction or with the arbitration court.

b) The Russian Union of Industrialists and Entrepreneurs

In 2002, the Russian Union of Industrialists and Entrepreneurs (RSPP) established a tribunal on corporate ethics to resolve conflicts that involve alleged ethics violations by its members. Although the tribunal may consider member violations, most of its cases in 2003 addressed hostile takeovers.

The Rules for Consideration of Disputes by the Russian Union of Industrialists Commission on Corporate Ethics (the Rules) govern procedural aspects of applications to the court, selection of arbiters, jurisdiction, evidence, sanctions, and other issues. The Rules are to be amended and clarified following consideration of pilot cases by the tribunal. The tribunal will consider whether companies

[245] Law on Protection of Rights and Interests of Investors in Securities Markets, Article 18.

violated the charter of the RSPP, the Rules, the Declaration of Principles of Activities of the Russian Union of Industrialists, or the FCSM Code.

The RSPP tribunal has the authority to issue recommendations to parties guilty of ethical standard violations, recommend their exclusion from the RSPP, and include them on a list of undependable business partners.

2. Shareholder Activism

Shareholder activism is not yet a Russian tradition. Most shareholder initiatives have come from foreign investors with experience in their home jurisdictions. Yet activism is an effective way of asserting shareholder rights. In an environment where the court system is often perceived to be ineffective, investors may achieve more tangible results than the judiciary.

While some investors have enough wherewithal to assert themselves against corporate powerhouses, many are too small. One way for small shareholders to protect their rights is to pool their efforts. The RAO UES case, presented as Mini-case 1, is the best example of shareholder activism to date. It is perhaps the only example of a successful assertion of minority shareholder interests against a large company in which a controlling stake is held by the state.

Mini-Case 1: Minority Shareholders vs. RAO Unified Energy Systems

In 2000, minority shareholders of RAO UES, owning approximately 10% of voting shares of the company, joined in an effort to call an Extraordinary General Meeting of Shareholders (EGM) to assert their right to participate in a planned RAO UES restructuring on fair and transparent terms.

Investors, led by several major foreign investment banks and hedge funds, proposed the following items for the EGM agenda:

- To prohibit the Supervisory Board, Executive Board, and their respective chairmen from approving or carrying out any restructuring plan involving changes to the capital structure of RAO UES and its subsidiaries, as well as other entities without the approval of $^3/_4$-majority of voting shares at the GMS;
- To lower the number of votes required to approve the early termination of the Chairman of the Executive Board;
- To require that most transactions with the assets of RAO UES and its subsidiaries (including subsidiaries of such subsidiaries), and the liquidation

and reorganization of subsidiaries, would be subject to shareholder approval; and

- To remove the Chairman of the Executive Board and call for the election of a new Chairman.

The EGM was not held due to a decision by the state, which owns a controlling block of shares.

However, shareholders succeeded in creating a working group with managers and the state aimed at protecting shareholders interests, and improving transparency in Russian power sector reform. In 2001–2003, most of the proposals were approved as charter amendments.

Despite the fact that shareholders failed, the case is the most successful in the history of the Russian securities market to date.

G. Self-Enforcement

1. The Federal Commission for the Securities Market's Code of Corporate Conduct

The FCSM Code introduces a high standard of corporate governance to Russian businesses. Like many foreign codes, the FCSM Code is voluntary. The chief incentives for complying with the FCSM Code are the "comply or explain" policies of stock exchanges, public pressure, and market forces.

All market participants can, in one way or another, contribute to the application of the FCSM Code's standards. Law firms, accountants, and investment banks (foreign and domestic) can advise their corporate clients on the value of adhering to recognized standards for good corporate governance. Compliance can be encouraged by: introducing a system of reporting to shareholders and the markets; making stock exchange listings contingent upon filing compliance statements; promoting openness in relations between companies and public organizations; and incorporating the FCSM Code's recommendations into company charters and by-laws.

Company Practices in Russia: General business customs are an independent, enforceable source of law.[246] A general business custom is defined as "an established rule of behavior which is not stipulated by existing legislation, but is widely used in certain areas of business operations, regardless of whether it is actually documented." To become a general business custom, a recommendation of the FCSM Code would need to:

- Become an established rule of behavior (have a sustainable and relatively fixed content);
- Be widely applied in corporate governance as practiced by companies; and
- Be judicially recognized as a general business custom.

It should be noted that, in practice, general business customs are also used in the field of international trade and merchant shipping. It is impossible to predict which articles of the FCSM Code might, with time, be incorporated into general business customs. This will only become clear when companies begin to use the FCSM Code more widely.

The FCSM Code may also be implemented as the result of one or more large institutional investors, either Russian or foreign, making its adoption a precondition for investment in a company. The FCSM Code embodies standards of good corporate governance that emphasize the protection of minority shareholder rights, the importance of transparency in corporate decision-making, and the accountability of directors and managers to shareholders — all values of particular importance to institutional investors.

The Russian state, acting as an investor/shareholder, also has a potential interest in the FCSM Code by virtue of these same values and may require that the companies in which it holds shares adopt the FCSM Code and make its provisions legally binding in their day-to-day business.

Alternatively, some of the FCSM Code's recommendations may, with time, find their way into legislation and regulations.

[246] CC, Article 5.

2. Self-Enforcement Through Internally Established Procedures

Charters and other company by-laws are legally binding, and viewed by courts as quasi-sources of law governing the operations of companies in addition to the Company Law and securities legislation. Incorporation of the provisions of the FCSM Code into corporate charters and by-laws makes them binding on a company's business and, thus, enforceable in courts.

The Company Law includes numerous discretionary standards and definitions allowing companies to include in their charters (and other by-laws) detailed rules that are not provided for by existing legislation. Examples include modification of the quorum required for approval of certain transactions, the option to apply procedures for approval of an extraordinary transaction to other transactions, special procedures for dismissing managers, and the introduction of rules and procedures governing the operations of governing bodies above and beyond those stipulated by legislation. It is important, however, that charters and by-laws not contradict legislation.

Best Practices: Making amendments to the existing by-laws and/or development of new by-laws with the above list is not the only method to make recommendations of the FCSM Code binding. Companies may also develop their own governance codes based on the FCSM Code. A number of large companies have already done so.

It is advisable that, in creating their company-level corporate governance codes, companies should adhere to the rules of the FCSM Code and use its definitions and wording as appropriate. At the same time, companies may reflect in their codes any special requirements based on their operations. Another possibility is to develop codes that are binding for all companies within a holding structure (group of companies). Companies may have their codes approved by the GMS or by resolution of the Supervisory Board.

The preparation of codes of conduct by each company should be accompanied by appropriate amendments to their charters and by-laws. Only then will it be possible to speak of an adequate, all-encompassing transformation of the corporate governance policies of each individual company.

3. Internal Dispute Resolution

The FCSM Code contains a number of recommendations dealing with extra-judicial resolution of corporate conflicts. The term "corporate conflict" means a dispute between a governing body of the company and a shareholder, and a dispute between shareholders, if it affects the interests of the company.[247]

It is reasonable for conflicts to be resolved by the Supervisory Board.[248] For this purpose, the Supervisory Board may create a special corporate conflict resolution committee, which may be a permanent or an ad hoc committee. It is important that those tasked with conflict resolution be completely independent from the matters to be considered.

To identify corporate conflicts at the earliest possible stage, and to ensure that they receive due attention from the company, its officers and employees, it is good practice that the Corporate Secretary of the company register inquiries, letters and demands filed by shareholders, conduct their preliminary evaluation, and forward them to the corporate body which is most competent at resolving each particular conflict.[249] The powers of corporate bodies with respect to consideration and resolution of corporate conflicts should be clearly delineated. At the same time, their common task is to find a lawful and reasonable solution that is in the interests of the company.

With the consent of the shareholders involved in a corporate conflict, corporate bodies may participate in negotiations between the shareholders, provide them with available information and documents related to the conflict, explain provisions of the Company Law and company charter and by-laws, provide shareholders with advice and recommendations, prepare draft conflict resolution documents to be signed by the shareholders, and — acting on behalf of the company and within their respective scope of competence — assume obligations before shareholders to the extent that this may be conclusive to the resolution of the conflict.[250]

The conflict may be resolved by signing an agreement between the shareholder(s) and the company. This agreement may take the form of a resolution of the relevant governing body. To ensure the objectivity of conflict resolution,

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[247] FCSM's Code of Corporate Conduct (FCSM Code), Chapter 10, Section 1.1.1.

[248] FCSM Code, Chapter 10, Section 2.1.2.

[249] FCSM Code, Chapter 10, Section 1.1.2.

[250] FCSM Code, Chapter 10, Section 3.1.2.

none of the interested persons should participate in the resolution process. For instance, if the interests of the General Director are, or may be, affected by the conflict, it should be referred for resolution to the Supervisory Board or to its conflict resolution committee. If the conflict affects the interests of a Supervisory Board member, that member should not participate in the resolution process. Naturally, consideration of a corporate dispute by governing bodies does not preclude judicial recourse.