Russian Corporate Governance Reform: Recent Changes and New Challenges

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Persistent efforts have been taken in the last few years to improve corporate governance in Russia. The recent positive changes in this field are rather significant. It allows saying the corporate governance reform is currently underway. The primary goal of this Chapter is to summarize relevant achievements of recent years.

Consistent reforms resulted in introduction of the dividend payment pattern "issuer – nominal holder – shareholder", which is more convenient both to shareholders and to a joint-stock company; the period for shareholders to receive dividends was reduced to 35-45 days from making the relevant payment decision.

The earlier missing delisting regulation was introduced: now investors are informed about the delisting to be held well in advance. Minority shareholders are enabled to influence a delisting resolution, and there are compensation arrangements, should the resolution be adopted.

The recent legal changes eased share issue procedures considerably – the length of some procedures was cut back; the preliminary document filing with the registration authority was introduced; the lists of instances when a prospectus or a placement report need not be registered in case of an issue were expanded. The mechanisms to secure shareholders' associated rights were fully maintained or even strengthened.

The updated law provides a shareholder with new protections against violations of his/her/its pre-emptive right: (a) a shareholder may require that the company indemnifies against losses caused by such violation; (b) or require that the company provides him/her/it with the appropriate number of shares to be paid for at the placement cost.

Since September 1, 2014 a public company has not been entitled to place preferred stock with the par value lower than that of ordinary shares, which protects ordinary shareholders from dilution of their percentage in votes.

The earlier unenvisaged right of members of a joint-stock company's Board of Directors to accede the company's information and documents has been formalized in law since September 1, 2014, too.

There have been some major changes in issuer transparency and investor access to information in recent years, which simplified shareholder and investor access to the relevant information:

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- drafting and publication of IFRS annual audited and semi-annual non-audited consolidated financial statements became a mandatory requirement for public companies;[2]

- the law established a number of requirements aimed at advance notification of shareholders of the date of drafting the list of persons entitled to participate in the general shareholders' meeting and of the date of drafting the list of persons entitled to receive dividends (the second of these dates is communicated to shareholders after they become aware of the dividend amount approved by the shareholders' meeting);

- according to the new requirements, a joint stock company must send the meeting records electronically to nominal holders that forward them to their customers - shareholders;

- law changes obliged non-public companies to publish announcements of meetings on their websites (in addition to publication in printed media, which is allowed for such companies); and

- applicable law encourages issuers to disclose (in addition to conventional mailing by registered mail) a pre-emptive right notice as a material fact.

In addition to the above, some other, more "targeted" changes occurred in issuer transparency. These changes were focused on eliminating particular drawbacks noticed by active investors mostly (it concerned the requirements to disclose information on the number of shareholders, on the shareholders' meeting quorum notification procedure and voting procedures for depositary receipts).

The Law on the Central Bank was supplemented with the article defining the Bank of Russia as an authority in charge of supervision over issuer compliance with the joint stock companies law and supervision in the field of corporate relations in joint stock companies, in order to protect shareholders' and investors' rights and legal interests. Thus, unlike with the earlier applicable law, the regulator was explicitly vested with the right to check activities of issuers and participants in corporate relations, in particular, with the right to send them mandatory instructions to eliminate the joint stock companies law violations detected.

The explanations given in a series of court orders by the Supreme Arbitration Court of the Russian Federation (SAC RF) on such critical corporate governance issues as indemnification of a legal entity against losses by members of its management bodies, determination of losses and allocation of the burden of proof in legal proceedings should be noted among positive changes in the judicial practice.

For instance, it is for the first time in the law enforcement practice that the Supreme Arbitration Court laid down a whole concept of *the conflict of interests* and also introduced the notion of *actual interest* and established the *presumption of unethical practices on the*

[2] Hereinafter, public companies mean the joint-stock companies obliged to disclose information in the form of a quarterly report and notices of material facts. To put it simple, these are all joint-stock companies with over 500 shareholders. The notion of "non-public company" should be understood accordingly.

part of those directors that made decisions, concealing their conflict of interests. In addition, the Supreme Arbitration Court gave explanations to courts on what actions could be regarded as *contradicting corporate interests*.

The Supreme Arbitration Court defined a revolutionary standpoint that *corporate directors were to some extent responsible for what happened in the legal entities controlled by the company.* Another SAC explanation valuable for corporate governance went as follows: *approval of the general manager's actions by the corporate collegial body just as the director's actions in furtherance of the instructions given by the company's participants do not in themselves relieve the general manager from liability.* SAC also explained (and the concept was incorporated into the new version of the Russian Civil Code) the following: *only those collegial body members that voted against the respective resolution or were unable to take part in the meeting for valid reasons shall be relieved from liability*.

Another important SAC legal stance was that *any of the company's shareholders holding a sufficient stake might claim compensation for the company's losses from a director within three years from the time when the company's shareholders had learned or should have learned about the director's causing such losses*. In this case, the shareholder's longevity in the company does not matter.

SAC also changed the approach to the *burden of proving the amount of losses,* by indicating that, if the plaintiff substantiated the claim but was unable to prove the amount of losses precisely, the court had no right to deny the claim and had to estimate the losses to be recovered based on fairness and commensurate liability.

Making a major step to more fair allocation of the burden of proof in general, SAC worded the standpoint that, if the plaintiff provided rather strong evidence and convincing arguments to support the circumstance being proved, the *burden of proving the opposite fact would be borne by the defendant.* This interpretation operates in the opposite way – if the defendant proves something to substantiate a standpoint, the plaintiff will bear the burden of refutation of the appropriate circumstances.

In this way, changes of the recent years altered the regulation of different corporate relations aspects significantly for the benefit of shareholders and improved protection of their interests. On the one hand, it suggests the current corporate governance reform makes a good progress. On the other, this progress needs critical assessment as the above-mentioned achievements are just a small part of changes required. In this connection, the second part of the chapter covers the most important dimensions of the corporate governance reform, work on which has not been finalized so far.

First of all, it concerns the absence of the controlling person notion and the provisions on its liability for losses caused to a controlled legal entity through its fault in Russian corporate law.

The next important issue relates to the "affiliation" notion, as intertwined with many corporate governance dimensions. The applicable affiliation notion does not encompass many

obvious material cases of relatedness. In addition, it contains the exhaustive list of affiliation reasons, which enables to bypass the respective regulation easily. Meanwhile, the affiliation notion is a key one for many other provisions that govern the conflict of interests or take into account relatedness.

It is critical for Russian corporate governance to eliminate the described problems. If they are eliminated, Russian regulation of the corporate relations between the "controlling person and the controlled legal entity" will be finally aligned with the best global practices and meet the essence of these relations. The provisions on liability of the controlling person, management body members, liability for losses caused by entering into a transaction with the conflict of interests, the institutes of mandatory offer and mandatory buyout will start working, too.

Better regulation of major stake purchases is another important dimension of improving the Russian economy investment appeal and upgrading corporate governance. In practice, the applicable provisions do not protect interests of minority shareholders at all. Shareholders with a major stake take advantage of regulation gaps and do not send the mandatory offer, if they do not want to. Or, even if they do, they do not fulfil it. On the contrary, there are no obstacles to such shareholders' artificial creating of conditions for forced repurchase from shareholders at the price suitable to them. Elimination of the respective gaps would upgrade corporate governance in Russia drastically.

Approval of joint-stock company transactions is another dimension that needs major regulation changes. At present, the respective provisions only apply to the transactions in which the company itself is a party. Materiality criteria for these transactions are determined based on the company's asset amount. The company does not formally control the transactions of legal entities that it controls.

It seems to be high time to change the concept of approval of the transactions to be entered into by public companies. Such companies draft consolidated IFRS statements containing the data that serves as rather reliable criteria for identification of the legal entities controlled by the company and for estimation of the consolidated asset value of the company's group. It is possible to introduce rules on approval by a company's management bodies of any transactions to be entered into not only by the company but also by the legal entities controlled by the company for these companies.

At the same time, when developing the respective provisions, it will be possible to abolish the current approval rules for a whole number of intra-group transactions (because control over withdrawal of assets from the group will be introduced at the company level). Setting up the minimum materiality threshold, below which related party transactions are to be concluded without any approval, would also be a positive measure.

Introduction of such regulation would entail some positive consequences. Firstly, the board of directors and the general shareholders' meeting of a public company will be relieved from reviewing an array of minor transactions. Secondly, they will be authorized to approve the transactions that are really important for the entire group and that do not fall into their

consideration now. Finally, it will be possible to move assets between the company and the legal entities controlled by it easier, while their material withdrawal from the group will be controlled by the board of directors and the general shareholders' meeting.

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Recent years saw rather many critical changes in corporate law. In the near future, this work should be continued actively as the applicable legal provisions cannot efficiently regulate many aspects of corporate relations anymore. Further significant changes are required for upgrading corporate governance in Russia.