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Russian Capital Markets and Shareholder Litigation: Quo Vadis?

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ABSTRACT

This Article examines Russian securities law, case law, and market data. To an international observer, Russian capital markets and securities law may appear ostensibly ordinary, albeit placed within an unstable socioeconomic milieu. Securities law and disclosure rules seem somewhat similar to those in the U.S., whereas corporate law provisions are an amalgam of U.S.-U.K.-West European principles. At the same time, a number of hidden trends affect capital markets, the heart of any economy. Those trends upend this fluid Westernized amalgam and may even be linked to the communist past of the country.

The capital market portico is typically propped up by robust market infrastructure, public enforcement, private actions, and disclosure rules. Reporting rules enable investors and regulators to act upon the information and improve market monitoring. Out of the four elements, it appears that only the Russian reporting requirements are of adequate quality. Does this single pillar provide sufficient support to the Russian capital markets? It is unlikely that without better shareholder monitoring and more efficient market infrastructure, the mandatory disclosure regime will singlehandedly prop up the capital market machinery. The Article urges Russian policymakers to take, first, a more pro-shareholder and pro-plaintiff view on private litigation, public enforcement, and corporate governance, and, second, a more pro-private-exchange policy stance.

1. Introduction

To an international observer, Russian capital markets and securities law may appear ostensibly ordinary, albeit placed within an unstable socioeconomic milieu.

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Securities law and disclosure rules seem somewhat similar to those in the U.S.,¹ while corporate law provisions, such as the mandatory bid rule, the Corporate Governance Code,² or the short-form merger provisions,³ and litigation fundamentals⁴ are an amalgam of U.S.-U.K.-West European principles. At the same time, a number of hidden trends affect capital markets, the heart of any economy. Those trends upend this fluid Westernized amalgam and may even be linked to the communist past of the country.

As a starting point, this research addresses the prerequisites necessary for a healthy capital market. First and foremost, a market needs investors. What are investors typically concerned about? They worry about their projected return and risks, which, among other things, depend on information asymmetry between a firm's insiders and outsiders as well as agency costs. The next question, therefore, is to assess how an economy controls those risks. The first mechanism, typically, is market infrastructure and various intermediaries. The second is public enforcement. The third is private enforcement, usually in the form of class actions. Public and private enforcement should be accompanied by reporting rules, which enable investors and regulators to act upon the information.⁵

This Article examines all four elements and focuses on the interaction between the common traits one would normally expect of securities markets and law and the domestic elements that interfere with the application of Westernized black letter law. The Article proceeds as follows: Part 2 examines various monitoring mechanisms and corporate ownership patterns. Part 3 sets forth the principal underpinnings of securities law and enforcement. Part 4 covers shareholder litigation.

¹ See Part 3.

² Bank Rossii [Bank of Russia], *O kodekse korporativnogo upravleniya*, No. 06-52/2463, 10.4.2014, available at www.cbr.ru/finmarkets/files/common/letters/2014/Inf_apr_1014.pdf.

³ *Federalniy Zakon* [Statute] “*Ob aktsionernih obshchestvakh*”, 26.12.1995, No. 208-Φ3 (as amended) (hereinafter “FZ About Corporations”), arts. 84.1-84.8. For a discussion of the related procedures and share price appraisal, see, e.g., *Postanovlenie Federal'nogo arbitrazhnogo suda Moskovskogo okruga*, 11.06.2014, No. Φ05-5146/14, Case No. A40-9424/13-22-89.

⁴ See Part 4.

⁵ Without adequate information verification mechanisms and protection of non-controlling shareholders, “securities cannot be offered at a price equal to their pro-rata claim on projected future cash flow... [and n]on-control shares sell at a steep discount.” M. B. Fox, ‘Ongoing Issues in Russian Corporate Governance’, *Columbia Journal of Transnational Law*, 52 (2014), 435, 456, 452-4.

2. Institutional Monitoring, Exchanges, and Financial Infrastructure

2.1. Exchanges and Market Infrastructure

There are a variety of institutional preconditions and reputational intermediaries that help investors minimize their risks, including agency costs and adverse selection.⁶ This Section primarily discusses exchanges, a necessary condition for capital market development and a crucial part of market infrastructure.⁷

At first glance, the general economic trends molding the Russian exchanges do not differ from those in the rest of the world. Following the examples of NYSE Euronext, Nasdaq, ICE, and other exchanges, major Russian exchanges created the Moscow Exchange.⁸ It is “the largest Russian exchange both in terms of turnover and the extensive client base.”⁹ The industry is also vertically integrated from trading to clearing and settlement, *i.e.*, there are “vertical silos.”¹⁰

This structure is not unusual *per se*.¹¹ What sets Russian exchanges apart is the participation of the State, which owns more than a quarter of the shares of stock of the Moscow Exchange through either the Central Bank of Russia or state-related institutions.¹² Public ownership of capital market infrastructures and exchanges is uncommon. It also does not seem to be a transitory phenomenon caused by either a

⁶ See generally B. S. Black, ‘The Legal and Institutional Preconditions for Strong Securities Markets’, *UCLA Law Review*, 48 (2001), 781; R. J. Gilson and R. H. Kraakman, ‘The Mechanisms of Market Efficiency’, *Virginia Law Review*, 70 (1984), 549, 596-609, 613-22, 629-34; J. C. Coffee, *Gatekeepers: The Professions and Corporate Governance* (Oxford University Press 2006), 103-316.

⁷ The scholarship on the role of exchanges, including their self-regulatory and market-monitoring capacity, and their interaction with securities regulations is rich and venerable. See, e.g., A. C. Pritchard, ‘Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers’, *Virginia Law Review*, 85 (1999), 925, 963-83; P. G. Mahoney, ‘The Exchange as Regulator’, *Virginia Law Review*, 83 (1997), 1453; T. L. Hazen, ‘The Financial Industry Regulatory Authority and the National Exchanges’, 4 *Treatise on the Law of Securities Regulation* (West 2017) § 14:26; A. Ferrell, ‘The Case for Mandatory Disclosure in Securities Regulation Around the World’, *Brooklyn Journal of Corporate, Financial and Commercial Law*, 2 (2007), 81, 103-09; J. C. Coffee and H. A. Sale, ‘Redesigning the SEC: Does the Treasury Have a Better Idea?’, *Virginia Law Review*, 95 (2009), 707, 768-74.

⁸ See generally Y. Guseva, ‘KGB’s Legacy: Transplanting Efficient Financial Infrastructures without Efficiency’, *University of Pennsylvania Journal of International Law*, 36 (2015), 525, 612-13.

⁹ Moscow Exchange, Deutsche Bank is now a Market Maker for Futures on Federation Government bonds (OFZ), available at <http://www.moex.com/n2586/?nt=201>. See also *Moskovskaya Birzha, Investoram i aktsioneram*, available at <http://moex.com/s565>.

¹⁰ See Natsionalniy kliringoviy centr, Aktsionery (2015), available at <http://nkcbank.ru/viewCatalog.do?menuKey=7>; Natsionalniy raschetniy depozitariy, Aktsionery (2016), available at <https://www.nsd.ru/ru/about/structure/shareholders/>.

¹¹ Guseva, ‘KGB’s Legacy’, 591-610.

¹² Compare *Moskovskaya Birzha, Godovoy otchet 2013* [Moscow Exchange, Annual Report 2013], available at http://www.moex.com/ru/Report/2013/aktsii_page.html; Moscow Exchange, Annual Report 2015, available at <http://2015.report-moex.com/en/corporate-governance/to-shareholders-and-investors/capital/>.

lack of private capital or the recent recession. For instance, in 2014, the Central Bank announced a sale of 11% of its shares. The sale was oversubscribed,¹³ which indicated investors' interest in the Exchange. Since the sale, however, state-related entities and the Central Bank have been in no hurry to part with the remaining shares.¹⁴ Such continuous ownership signals that it may be a deliberate policy decision emblematic of overarching economic fundamentals.¹⁵

Unfortunately, the risks associated with state ownership and with a monopoly may amplify one another. A monopoly is usually inferior to competition. It isolates the monopolist from the market pressures and leads to deadweight losses and price and product inefficiencies. So may government involvement in the operations and ownership of private corporations.¹⁶

State ownership, in some cases, may be justified by a market failure, which only the state is able to correct, thus, "provid[ing] the greatest net contribution to society."¹⁷ In this sense, the Russian State may either correctly believe that its ownership of trading and clearing facilities is "efficiency maximizing given the local conditions" or simply adhere to "the 'legacy of the KGB,' *i.e.*, a possibly mistaken belief that in private transactions, socioeconomic problems may be mitigated by reinforcing the state."¹⁸ In either case, the question is whether a combination of state ownership *and* consolidated market environment produces net benefits.

Currently, there seem to be no perceptible long-term benefits. In 2009, for example, the largest 12 issuers accounted for 65.5% of the public debt market.¹⁹ More

¹³ Moscow Exchange, Public Relations Department, Moscow Exchange diversifies investor base after Central Bank sells 11% stake (Jul 2., 2014), available at <http://moex.com/n5788>.

¹⁴ See, e.g., Moscow Exchange, Annual Report 2015; *Moskovskaya Birzha, Sostav Aktsionerov* (Sept. 30, 2015), available at <http://moex.com/s1343>.

¹⁵ See, e.g., Fox, 'Ongoing Issues', 439-40.

¹⁶ The analysis of the comparative efficiency of private firms vis-a-vis state-owned enterprises is multifaceted. The traditional consensus seems to be that private enterprises are more efficient. See generally P. W. Macavoy et al., *Privatization and State-Owned Enterprises: Lessons from the United States, Great Britain and Canada* (1989). See also P. MacAvoy and G. McIsaac, *The Performance and Management of United States Federal Government Corporations*, *ibid.* 77-136; M. Schill, 'Privatizing Federal Low Income Housing Assistance: The Case of Public Housing,' *Cornell Law Review*, 75 (1990), 878, 881-8; D. Daniel Sokol, 'Competition Policy and Comparative Corporate Governance of State-Owned Enterprises,' *BYU Law Review*, Vol. 2009 (2009), 1713, 1720-42; M. Pargendler, 'The Unintended Consequences of State Ownership: The Brazilian Experience', *Theoretical Inquiries in Law*, Vol. 13 (2012), 503; M. Pargendler, 'State Ownership and Corporate Governance', *Fordham Law Review*, Vol. 80 (2012), 2917; A. Boardman and A. Vining, 'Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-Owned Enterprises', *Journal of Law and Economics*, 32 (1989), 1.

¹⁷ Fox, 'Ongoing Issues', 440.

¹⁸ Guseva, 'KGB's Legacy', 535.

¹⁹ *Federalnaya sluzhba po finansovim rinkam, Itogi 2009 goda* 24-25 (2010) (on file with the author) (observing, *inter alia*, that the number of defaults was as many as 215).

recent statistics show that only about 800 issuers trade shares of stock and various bonds on the Moscow Exchange, the largest exchange in the country.²⁰ The monthly Moscow Exchange turnover remains somewhat low, while shares are comparatively illiquid and trading thin.²¹ Some scholars estimate that out of about 300 large public corporations, shares of only about 90 of them are relatively liquid.²² To conclude, for a variety of reasons, some of which are beyond the scope of this Article, the major Russian exchange does not appear to be as efficient as its private homologues in other jurisdictions.

2.2. Alternative Monitoring Mechanisms

Investors and creditors can rely on alternative institutional mechanisms that provide monitoring, which makes a securities exchange less relevant. An example is traditional lenders in a bank-based system. Lenders may engage in relational financing, ensure better borrower monitoring, and, ultimately, create reputational capital. The ensuing positive externalities benefit other parties with insufficient information about the borrower.²³ Such beneficiaries range from various unsecured creditors and trade creditors to employees and, possibly, minority shareholders.

Traditionally, Russia has been a bank-based system. Despite the prolonged recession, bank financing has remained relatively steady.²⁴ However, defaults and delinquent payments may soon become a reason for concern. In January 2016, the rate

²⁰ See, e.g., *Moskovskaya Birzha, Spisok cennyh bumag, dopušennyh k torgam* (Nov. 12, 2015), available at <http://moex.com/ru/listing/securities.aspx>.

²¹ For instance, the monthly turnover in May 2014 was RUB 36.4 trillion with the shares, depository receipts and investment fund units' turnover reaching only RUB 824 billion. Moscow Exchange, Public Relations Department, *Moscow Exchange's turnover was RUB 36.4 trln in May 2014* (June 2, 2014), available at <http://moex.com/n5585>. In March 2016, “[s]econdary market turnover in stocks, RDRs and investment fund units was RUB 870.5 bln.” Moscow Exchange, *Moscow Exchange Trading Volumes in March 2016* (April 4, 2016), available at <http://www.moex.com/n12531/?nt=120>. See also Moscow Exchange Annual Report 2015, available at <http://2015.report-moex.com/en>.

²² O. Shvirkov, ‘Infrastruktura korporativnogo upravleniya v Rossii’, in *Investitsii v stranah BRIC: Otsenka riska i korporativnogo upravleniya v Brazii, Rossii, Indii i Kitae* (S. Borodina and O. Shvirkov eds., 2010), ch. 2 and p. 41.

²³ See generally R. E. Scott, ‘A Relational Theory of Secured Financing’, *Columbia Law Review*, 86 (1986), 901; J. M. Shepherd, F. Tung and A. H. Yoon, ‘What Else Matters for Corporate Governance?: The Case of Bank Monitoring’, *Boston University Law Review*, Vol. 88 (2008), 991.

²⁴ According to the data of the Central Bank, bank loans to non-financial domestic business entities were RUB 7.242 billion as of February 1, 2008, and already RUB 20.062 billion as of January 1, 2016. *Tsentralniy Bank Rossii* [Central Bank of Russia], *Dinamičeskie rjady pokazatelej ot del'nyh tablic Obzora bankovskogo sektora Rossijskoj Federacii* (June 2016), available at www.cbr.ru/analytics/?PrId=bnksyst. See also Central Bank of Russia, *O dinamike razvitija bankovskogo sektora Rossijskoj Federacii v iune 2015 goda* (2015), available at www.cbr.ru/analytics/print.aspx?file=bank_system/din_razv_15_06.htm&pid=bnksyst&sid=ITM_1155 (stating that the total amount as of June 2015 was RUB 40 trillion).

of defaults on the “loans to the non-financial industries” rose to an alarming 6.8%.²⁵ Moreover, as the economy stagnates – or if, in the worst case scenario, it plunges into recession - due to the economic sanctions, regulatory issues, and structural economic inefficiencies, banks naturally fail.²⁶ The relational capital created through bank financing is lost. The dissipation of the positive externalities of bank monitoring and bank failures per se should force enterprises to seek other sources of capital and investors to look to other monitoring institutions.

2.3. Foreign Capital Markets

Until recently, investors and firms could look beyond domestic securities markets. About 150 large Russian companies have tapped into international capital markets and have issued Depositary Receipts (DRs), Eurobonds, and other instruments.²⁷ Some issuances were structured as Regulation S and Rule 144A offerings. DRs are traded mostly over-the-counter (OTC) or on the London Stock Exchange.²⁸ Thus, either foreign exchanges or sophisticated institutional investors performed monitoring functions, forcing cross-listing companies to improve their disclosure policies and corporate governance.²⁹

Specifically, in a public offering, there are a reputable foreign exchange with its listing rules and a foreign securities regulator with its reporting requirements and the threat of enforcement. In a private placement, sophisticated investors perform similar functions. These mechanisms ensure that a company, particularly a firm from a developing market, sends verifiable and credible signals regarding the quality of its earnings, management, operations, and transparency. This signaling inures to the benefit of all investors.

Russian companies may have lost an opportunity to tap into foreign capital markets in the future. First, extensive economic sanctions have been imposed on Russia and some state-owned enterprises. Risk-averse institutional investors may prefer to steer clear of Russian firms and to avoid even the corporations not directly

²⁵ *Central Bank of Russia, O dinamike razvitija bankovskogo sektora Rossijskoj Federacii v yanvare 2016 goda* (2016), available at <http://www.cbr.ru/analytics/?PrId=bnksyst>.

²⁶ See, e.g., H. Amos, ‘Russia's Biggest Banking Crashes of the Last 2 Years’, *The Moscow Times* (Sept. 13, 2015), available at www.themoscowtimes.com/business/article/russia-s-biggest-banking-crashes-of-the-last-2-years/530049.html.

²⁷ See, e.g., Bank of New York, DR Directory, available at www.adrbnymellon.com/directory/dr-directory; A.G. Aganbegian, ‘Vozrastajušij korporativnyj dolg pered inostrannymi investormi – «petlja na šee» nacional’noj èkonomiki,’ *Jurnal Dengi i Kredit* [Journal of Money and Credit] (3/2013), at 8, available at http://www.cbr.ru/publ/MoneyAndCredit/aganbegyan_03_13.pdf; M. Y. Matovnikov, ‘Problema rossijskogo vnešnego korporativnogo dolga namnogo složnee, čem kažetsja,’ *Jurnal Dengi i Kredit* [Journal of Money and Credit] (9/2013), available at http://www.cbr.ru/publ/MoneyAndCredit/matovnikov_09_13.pdf.

²⁸ Bank of New York, DR Directory.

²⁹ See generally Y. Guseva, *Extraterritoriality of Securities Law Redux: Litigation Five Years after Morrison v. National Australia Bank*, 2017 COL. BUS. L. REV. 199, 217-38 (examining relevant sources).

affected by the sanctions. In addition, international credit rating agencies may be withdrawing from Moscow,³⁰ a move that is bound to reduce the transparency of Russian firms. Finally, even if the economy is no longer in a recession, economic growth remains slow. Are foreign investors willing to continuously provide capital to and closely monitor firms located in a shrinking economy?

2.4. Domestic Capital Markets and Policy Signaling

The lack of alternatives brings us back to *domestic* securities markets and *domestic* investors. As discussed, investors worry about information asymmetry and agency costs and, importantly, may be vulnerable to predation by managers and controlling shareholders.

Consider, for instance, their concerns regarding leverage. As the good old pecking order theory hypothesizes, whenever external capital is needed, managers prefer to issue debt as opposed to equity. This preference is related to information asymmetry and its effect on the cost of financing.³¹ The Russian market provides an example of this order – corporate debt instruments dominate trading on the Moscow Exchange.³² Between 2005 and 2013, the international debt of Russian companies was steadily rising from about \$100 billion to as much as \$564 billion.³³ According to some estimates, various forms of foreign debt recently accounted for about one third of the indebtedness of domestic companies.³⁴ Scholars also suspect that large Russian corporations have high debt ratios.³⁵ Importantly, a considerable percentage of the international debt of non-financial Russian corporations possibly comes from companies affiliated with their shareholders.³⁶ To sum up, a reasonable outside

³⁰ A. Baraulina and A. Andrianova, ‘Vladimir Putin Starts His Own Ratings Firm’, *Bloomberg* (March 17, 2016), available at www.bloomberg.com/news/articles/2016-03-17/putin-starts-own-rating-firm-as-fleeing-americans-leave-void.

³¹ See S. C. Myers, ‘The Capital Structure Puzzle’, *The Journal of Finance*, Vol. 39, No. 1983 (Jul. 1984), 575-92.

³² *Obshhee kolichestvo torguemykh cennykh bumag* (Oct. 1, 2016), available at <http://moex.com/ru/listing/securities.aspx>.

³³ Aganbegian, ‘Vozrastajušij korporativnyj dolg’, at 3 and 5.

³⁴ *Ibid.* See also Matovnikov, ‘Problema rossijskogo vnešnego korporativnogo dolga namnogo složnee, čem kažetsja’, at 43.

³⁵ *Ibid.* Aganbegian, ‘Vozrastajušij korporativnyj dolg’, at 5-7.

³⁶ See Matovnikov, ‘Problema rossijskogo vnešnego korporativnogo dolga namnogo složnee, čem kažetsja’, at 45-46. For related rules and analysis, see *Nalogovyy kodeks* RF, Aug. 5, 2000, No. 117-FZ (as amended, Jul. 13, 2015), art. 269; Ignatov et al., ‘Nedostatočnaja kapitalizacija: sudebnoe rešenie prinjato, voprosy ostalis’, *Nalogovaja politika i praktika*, No. 4 (112) (Apr. 2012), available at <http://nalogkodeks.ru.omega.mtw.ru/wp-content/uploads/2012/11/4-74-77.pdf>; A. Kemenova and P. Polit, *Primenenie pravil tonkoj kapitalizacii k zajmam ot sestrijskih kompanij*, Rodl & Partner (2012), available at http://www.roedl.com/ru/de/publikationen/newsletter/newsletterarchive/newsletter_rusland/newsletter_rusland/newsletter_rusland_mai_juni_2012rossiiskii_pravovoi_obzor_vypusk_mai_ijun_2012/aktualnye_novosti_

investor should worry about excessive leverage and determine if corporate borrowers can and *intend* to properly service debt.³⁷ After all, shareholders have the lowest priority in bankruptcy.³⁸

In a recessionary economy, the probability of bankruptcy may be considerable. To put flesh on the bones of insolvency risk, I reviewed the Tax Authority's database to determine how often Russian companies "disappear" from the map. By October 2002, the total number of all for-profit enterprises was 217,685. 39,179 of them were private or public corporations, of which 36,025 were registered prior to July 2002. After the first decade of transition, the numbers were seemingly stable as only 4,030 companies, including 818 corporations, failed or were reorganized according to the Tax Authority's reports.³⁹

This rate of "accretion" and "attrition" changed in the past ten years. In the first five months of 2014, there were 209,302 for-profit entities and 2,541 corporations, only 1,228 of which were registered prior to July 2002. LLCs, at 176,816, predominated, although only 5,293 of them were registered before July 2002, implying a fast "attrition" rate. What is surprising is the rate of corporate failures with the liquidation of 7,087 corporations and 170,240 other entities.⁴⁰ The numbers suggest that investors have reasons to worry about the likelihood of liquidation or reorganization.

An outside shareholder should also be concerned about consistent ownership concentration. By 2008, Russia already became not merely a "concentrated" ownership jurisdiction but a "super-concentrated" market where many majority shareholders held more than 50% of the shares of stock of their respective firms. Research suggests that the role of minority shareholders is insignificant.⁴¹ This status

v_oblasti_nalogov_i_prava/primenenie_pravil_tonkoi_kapitalizacii_k_zaimam_ot_sestrinskikh_kompanii.html
.

³⁷ Before the financial crisis and recession, debt ratios were explained by lower risks, economic growth, and tax rules. See, e.g., T.P. Cheremisina, 'Rossiyskie kompanii i effect finansovogo richaga', *EKO* (2007), available at http://ecotrends.ru/images/Journals/2000-2009/2007/N03/3_Articles/002Cheremisina2007_03.pdf.

³⁸ *Federalniy Zakon "O nesostoyatel'nosti (bankrotstve)"*, 26.10.2002, No. 127-FZ (as amended), arts. 134 and 148.

³⁹ *Federalnaya nalogovaya sluzhba* [Federal Tax Service], *Otchet o rabote po gosudarstvennoj registracii juridičeskikh lic*, 1.10.2002, Form No. 1-IOP, available at https://www.nalog.ru/rn77/related_activities/statistics_and_analytics/forms/4171537/.

⁴⁰ *Federalnaya nalogovaya sluzhba*, *Svedenia o rabote po gosudarstvennoj registracii juridičeskikh lic*, 1.06.2014, Form No. 1-IOP, available at www.nalog.ru/rn77/related_activities/statistics_and_analytics/forms/4558837/

⁴¹ See generally L.S. Ruzhanskaya, 'Koncentracija sobstvennosti i formirovanie osnovnyh tipov kontrolja v rossijskikh kompanijah', *Žurnal "Korporativnye Finansy"*, No. 1 (5) (2008), 5-6, available at <https://cfjournal.hse.ru/article/view/1702/2425>; T. Dolgopiatova, 'Koncentratsia sobstvennosti v rossijskoy obrabativayushey promishlennosti: empiricheskie otsenki', *Izvestiya UrGEU*, No. 4(66) (2016), available at <https://cyberleninka.ru/article/v/kontsentratsiya-sobstvennosti-v-rossiyskoy-obrabatyvayushey-promyshlennosti-empiricheskie-otsenki>; A.E. Molotnikov, 'Kontrolirujušie, krupnye i minoritarnye akcionery:

quo may entail serious costs for minority shareholders, including lower dividend payout ratios, higher agency costs, and lower corporate asset valuation.⁴²

There are currently no explicit preconditions for the emergence of dispersed ownership patterns, which often evolve through the gradual involvement of minority shareholders, “the eventual break-up of the control blocks,”⁴³ and institutions such as exchanges actively fostering more dispersed ownership.⁴⁴ This is a junction where the Moscow Exchange, as a key institution in the national market, becomes crucial.

This future role of the Exchange may be gleaned from the policies of the Russian State, a shareholder and regulator. On the one hand, creating robust capital markets is an acknowledged federal policy objective.⁴⁵ On the other hand, the genuineness of this policy signal is ambiguous. Various interest groups, scholars, and even courts have expressed support for the concentrated ownership system. Concentrated ownership is perceived, *inter alia*, as a way to promote ownership safety and stability in light of the threat of takeovers and as an economic stimulus to improve investment decisions, operational decision-making, and labor productivity.⁴⁶ This

problemy vzaimodejstviya i pravovogo regulirovaniya’, *Akcionernoe obšestvo: voprosy korporativnogo upravlenija*, No. 11 (54) (Nov. 2008), available at www.aojournal.ru/journal/lib/archive/detail/ArticleID/50/%D0%9D%D0%9E%D0%AF%D0%91%D0%A0%D0%AC-11-54-2008; Y. Litvinova, ‘Lichnyy control – luchshaya zashita sobstvennosti’, *Workshop Proceedings, Higher School of Economics* (Feb. 10, 2010), available at <https://iq.hse.ru/news/177674573.html> (discussing a presentation by Professor T. Dolgopiatova); O. Lazareva et al., ‘A Survey of Corporate Governance in Russia’, Working Paper No. 103 CEFIR / NES Working Paper Series (2007), 5-6 and 17-20, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997965 (discussing statistics on concentrated ownership).

There is, however, some evidence that sizeable minority shareholders are emerging, that ownership concentration is reduced, and that more independent directors are joining corporate boards. See, e.g., L.S. Ruzhanskaya, ‘Nužen li krupnym rossijskim akcioneram sovet direktorov: praktika ural’skih kompanij’, *Izvestija Ural’skogo federal’nogo universiteta*, No. ½ (2009); T.G. Dolgopjatova, ‘Koncentracija sobstvennosti v rossijskoj promyšlennosti: evoljucionnye izmenenija na mikrourovne’, *Jurnal Novoy ekonomicheskoy asociatsii* (2010), 80-99, available at www.econorus.org/repec/journal/2010-8-80-99r.pdf; O. Shvyrkov, ‘V sovetah direktorov kompanij usilivaetsja nezavisimaja sostavljajušaja’, *Promishlennik Rossii* (Nov. 2012), available at <http://promros.ru/magazine/2012/nov/oleg-shvyrkov-v-sovetah-direktorov-kompanij-usilivaetsya-nezavisimaya-sostavlyayuschaya.phtml>.

⁴² See, e.g., P.V. Kuznetsov and A.A. Muraviev, ‘Struktura aktsionernogo kapitala i rezultaty deyatelnosti firm v Rossii’, *Ekonomicheskij Jurnal VSE* [Journal of Economics], No. 4 (2000), pp. 475-504, 491-493; Fox, ‘Ongoing Issues’, 443, 447-56.

⁴³ J. C. Coffee Jr., ‘Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between ‘Lumpers’ and ‘Splitters’’, *Columbia Law and Economics Working Paper* No. 363 (2010), 56.

⁴⁴ *Ibid.* 6-7, 38-41.

⁴⁵ See Rasporiajenie Pravitelstva Rossijskoy Federatsii [Order of the Government of the RF], 29.12.2008, No. 2043-p, Strategija razvitija finansovogo rynka Rossijskoy Federatsii na period do 2020 goda, available at www.cbr.ru/sbrfr/archive/fsfr/archive_ffms/ru/press/russia2020/strategy2020/index.html.

⁴⁶ Compare Ruzhanskaya, ‘Koncentracija sobstvennosti’, at 6; V.A. Korolev and A.S. Semenov, ‘Preimušestva i riski prisutstvija v kompanii kontrolirujušego akcionera’, *Žurnal «Akcionernoe obšestvo: voprosy korporativnogo upravlenija»*, No. 2 (2012), available at www.cfin.ru/investor/ao/controlling_stake.shtml; A.A. Bikova, M.A. Molodchik and E.G. Shamilova, ‘Koncentratsia sobstvennosti kak mehanizm korporativnogo

practical approach also permeates the judicial interpretation of the Corporations Statute and regulators' statements. In one case, for instance, the Constitutional Court of Russia, upholding the legality of short-form mergers,⁴⁷ noted that:

When a majority shareholder, intending to continue investing in... the improvement of production and development of new competitive products, and interested in improving the efficiency of corporate management... effectively singlehandedly determines the strategy of the corporation's development, it is necessary to establish... a balance of the legal interests of the majority shareholder, who has the right to purchase the [remaining minority shares], and the corporation itself, which attempts to reduce [its] costs, on the one hand, and, on the other hand, [the interests of] minority shareholders...

Based on the logic of corporate law [and] policy needs, the lawmaker has a right... to give preference to the interests of the majority shareholders whenever [there is] an insignificantly small amount of shares to be purchased, not allowing minority shareholders, even as a group, to influence corporate management, [but] at the same time, not precluding an opportunity for their disapproval of transactions, in which the corporation, the majority shareholder, and her affiliated persons are interested. Otherwise, a considerable misbalance in the amount of rights... and responsibilities [of the majority and the minority] leads to a reduction in the efficiency of corporate management.⁴⁸

Consider another statement, which speaks for itself. In October 2015, the vice-president of the Central Bank, the federal securities market regulator, suggested that minority shareholders should be denied the right to request certain additional information from issuers. His arguments were as follows:

“If a minority shareholder begins to perform a monitoring function, that means that he does not trust the board of directors, internal and

upravlenia v rossijskikh publicnykh kompaniyah: vlianie na finansovie rezultaty deyatelnosti', *Prikladnaya ekonometrika* [Applied Econometrics], Vol. 45, 50-74 (2017). See also P.A Kanapuhin and M.E. Skliarova, 'Specifikatsia i realizatsia prav sobstvennosti v firme', 134-152 (Centr Razvitiia Nauchnogo Sotrudnichestva 2014).

⁴⁷ *Opredelenie Konstitucionnogo Suda Rossijskoj Federacii, "Po zhalobam grazhdan Ju.Ju. Kolodkina i Ju.N. Shadeeva na narushenie ih konstitucionnykh prav polozhenijami stat'i 84.8 Federal'nogo zakona "Ob akcionernyh obshhestvah" vo vzaimosvjazi s chast'ju 5 stat'i 7 Federal'nogo zakona "O vnesenii izmenenij v Federal'nyj zakon "Ob akcionernyh obshhestvah" i nekotorye drugie zakonodatel'nye akty Rossijskoj Federacii", 3.07.2007, No. 681-O-II.*

⁴⁸ *Ibid.* ss. 3; 5.

external audit [, and] why is he then a shareholder at all, what is the mission of an investor?”⁴⁹

One may expect that by the time this paper goes to print, the rights of minority shareholders to request information, including information about interested transactions, will be severely curtailed.⁵⁰

If the authorities view an outside minority shareholder as a nuisance, she has reasons to be concerned about the risks associated with the super-concentrated ownership system, thin exchange trading, and the absence of alternative monitoring mechanisms. Her expected return and risks would reflect the discount associated with her minority stake, increased agency costs, low stock liquidity, and information losses.⁵¹

3. Securities Regulation and Public Enforcement

3.1. Disclosure Rules

When a capital market does not evolve organically, law and public and private enforcement may operate as necessary stimulants. In this sense, what comes first – the law or the market conditions – may be irrelevant.⁵² The fact remains that investors need information to exercise their rights and to assess and control agency costs. An institutionalized disclosure system, in theory, should improve market efficiency, transparency, and price informativeness⁵³ as well as reduce the information asymmetry between minority investors and control persons.⁵⁴

As recently as a decade ago, scholars routinely expressed concerns regarding the quality of disclosure in Russia.⁵⁵ In the past several years, the regulators have made

⁴⁹ Y. Bazanova, ‘Minoritarii mogut lishit'sja prava zaprashivat' dopolnitel'nuju informaciju u jemitenta’, *Vedomosty* (Oct. 23, 2015), available at www.vedomosti.ru/economics/articles/2015/10/23/614046-minoritarnie-aktsioneri.

⁵⁰ See FZ About Corporations, art. 91 (amended by *Federalniy zakon*, 29.07.2017, No. 233-ФЗ).

⁵¹ See, e.g., Fox, ‘Ongoing Issues’, 443-4, 454-6, 460-2 (discussing pertinent examples and the value of disclosure and civil liability for disclosure violations).

⁵² After all, “the largest and, arguably, most successful capital markets exhibit strong disclosure and securities regulation,” even if we have little evidence whether “these markets thrive because of regulation or in spite of it.” C. Leuz and P. Wysocki, ‘The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research’, *Journal of Accounting Research*, Vol. 54, Issue 2 (2016), 525–622, 599.

⁵³ M. B. Fox, ‘Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment’, *Virginia Law Review*, 85 (1999), 1335, 1338-39, 1357-68.

⁵⁴ See generally, Fox, ‘Ongoing Issues’.

⁵⁵ See, e.g., The National Council on Corporate Governance, *Corporate Governance and Economic Growth in Russia* (2004), 16-18, 62-4; *White Paper on Corporate Governance in Russia*, Russian Corporate Governance Roundtable, Organisation for Economic Co-operation and Development and World Bank (2002), available at <http://www.oecd.org/daf/ca/corporategovernanceprinciples/2789982.pdf>, 22-23; D. V. Vasilyev, ‘Corporate

great strides in their efforts to reduce these risks through better statutory rules and the adoption of International Financial Reporting Standards.⁵⁶ Today, corporations generally provide information to the public through licensed disclosure agencies, on their own webpages, and at their offices.⁵⁷ Listed issuers should send duplicate notices to exchanges.⁵⁸ In the U.S., the integrated disclosure system simplifies an issuer's reporting obligations. In Russia, the rules are slightly more fragmented and tailored to the primary market and the secondary market. However, the law allows incorporation by reference for prospectus purposes.⁵⁹

A company issuing securities to the public must disclose a standardized prospectus, information on the commencement of sales, and other data. It must also file a closing report.⁶⁰ Detailed rules apply to prospectuses, including their approval by boards, CEOs, and CFOs; audit requirements; confirmation by independent appraisers; and registration requirements.⁶¹ A prospectus must “reflect all circumstances that may have a substantial effect [*sushestvennoe vlianie*] on the decision to acquire securities.”⁶² This definition seems fairly similar to the concept of materiality and the Supreme Court's test in *Basic v. Levinson*.⁶³

A Russian issuer may find an exemption from the default registration requirements.⁶⁴ To a U.S. lawyer, the rules on exempt offerings may look like a crazy quilt of quasi-U.S. exemptions. The exemptions are broad and span various Regulation

Governance in Russia: Is There Any Chance of Improvement?’ (2000), available at www.imf.org/external/pubs/ft/seminar/2000/invest/pdf/vasil2.pdf; Guseva, ‘KGB's Legacy’, 560-67; Fox, ‘Ongoing Issues’, 443-7.

⁵⁶ See generally OECD Russia Corporate Governance Roundtable, *Summary of Proceedings* (Dec. 2016), available at <http://www.oecd.org/corporate/ca/Summary-Record-Russia-Corporate-Governance-Roundtable-2016-EN.pdf>; *Federalniy Zakon “O rinke tsennikh bumag”*, 22.04.1996, No. 39-Φ3 (as amended) (hereinafter “FZ About Securities”), arts. 22 and 30 (governing prospectuses and reporting obligations); *Polojenie “O Raskritii informatsii emitentami emissionnoh tsennikh bumag”*, approved by the Bank of Russia on 30.12.2014, No. 454-II (hereinafter “New Polojenii O Raskritii”). Cf. *Prikaz FSFR Rossii*, 04.10.2011, No. 11-46/Π3-Н, *Polojenie “O raskritii informatsii emitentami emissionnoh tsennikh bumag”*; *Prikaz FSFR Rossii*, 28.02.2012, No. 12-9/Π3-Н, *Polojenie “O poriadke i srokah raskritiya insiderskoy informatsii lits ukazannih v punktah 1-4, 11 i 12 statii 4 FZ ‘O protivodeystvii nepravomernomu ispolzovaniiu insiderskoy informatsii i manipulirovaniyu rinkom i o vnesenii izmeneniy v otdelnie zakonodatelnie akty Rossiyskoy Federatsii’”*. See also Fox, ‘Ongoing Issues’, 452.

⁵⁷ New Polojenie o Raskritii, Parts I, II, IV-VI.

⁵⁸ New Polojenie o Raskritii, Part I, Ch. 2.

⁵⁹ FZ About Securities, art. 22(5).

⁶⁰ New Polojenie o Raskritii, Part III, Ch. 8, and Appendix 2.

⁶¹ New Polojenie o Raskritii, Part III, Ch. 8.

⁶² FZ About Securities, art. 22(3).

⁶³ *Basic Incorporated v. Max L. Levinson*, 485 U.S. 224, 231-2 (1988) (citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)).

⁶⁴ Filing a prospectus is not always required. FZ About Securities, arts. 19-22.

D- and Regulation A-type restrictions, including the rules prohibiting general solicitation, limiting the maximum number of offerees other than qualified investors, defining the number of “unqualified” investors, restricting the maximum amount of proceeds, and others.⁶⁵

Periodic reporting obligations are imposed in a manner similar to the requirements of the Securities Exchange Act of 1934. For instance, a company that has registered a prospectus or listed its securities becomes a reporting issuer.⁶⁶ The law requires disclosure of quarterly reports comparable to the Form 10-Q, annual audited and interim financial statements, and current reports.⁶⁷ Similar to Sarbanes-Oxley, the Russian statute requires that CEOs and CFOs sign most reports, thus, confirming their accuracy.⁶⁸ An additional disclosure obligation comes from the corporate law rules on annual reports, which also should be signed by chief executives and often are approved by boards.⁶⁹

Current reporting requirements, somewhat analogous to the familiar Form 8-K, cover disclosure of all “substantial events,” *i.e.*, information that “in the case of its disclosure may produce substantial effect on the price... of the securities of an issuer.”⁷⁰ Put differently, this is, probably, *material* information, which is impounded in the share price, moves the price, and influences decisions of reasonable investors.

Possibly building on Regulation S-K,⁷¹ the statute and the Central Bank regulations enumerate various current events that an issuer must disclose.⁷² For instance, incremental changes in the share ownership of 5% or more of the shares owned by individual investors or affiliates are reportable as “substantial” events.⁷³ These rules aim to reduce the opacity of control ownership. The requirements cover not only the shareholders owning 5% or more of the shares of stock but also their control persons.⁷⁴ Similarly, the disclosure rules address various scenarios where the management may enter into interested transactions with affiliated corporations and impose an obligation on issuers to disclose their affiliated persons.⁷⁵ In sum, the new

⁶⁵ FZ About Securities, art. 22.

⁶⁶ FZ About Securities, art. 30(4); New Polojenie o Raskritii, Part IV, Ch. 10.

⁶⁷ FZ About Securities, art. 30(6-14); New Polojenie o Raskritii, Parts IV-VII.

⁶⁸ *Ibid.*

⁶⁹ New Polojenie o Raskritii, Part VII. See also FZ About Corporations, art. 88.

⁷⁰ FZ About Securities, art. 30(13); New Polojenie o Raskritii, Part V, Ch. 12, s. 12.1.

⁷¹ 17 C.F.R. §§ 229.10 et seq. (2017).

⁷² See generally FZ About Securities, art. 30(14); New Polojenie o Raskritii, Part V.

⁷³ FZ About Securities, art. 30(14).

⁷⁴ See, e.g., New Polojenie o Raskritii, Appendix 3, Part B, Ch. VI, s. 6.2; FZ About Securities, art. 30(14), (19), and (20).

⁷⁵ See, e.g., New Polojenie o Raskritii, Part V, Chs. 12, 15, 26, 45, and 46; Part VII, Chs. 69, 71.1, and 73.

disclosure rules have been substantially improved and are modelled on Western templates.

More disclosure inevitably signifies additional compliance costs for corporate issuers. Not surprisingly, some Russian firms complained about their excessive costs in court. Reaffirming the broad regulatory mandate to promote the policy of full disclosure, the Russian Supreme Court upheld a lower court's decision supporting the securities market regulator's position. The Court stated that the "legislature... granted the [regulators] the authority to determine... the scope [and] manner of disclosure... and [to create] a publicly available system of disclosure in the securities market."⁷⁶

3.2. Enforcement Policies

3.2.1. Administrative and Criminal Liability

The presence of more active regulators rigorously enforcing disclosure policies may be necessary in an emerging market like Russia.⁷⁷ Indeed, the number of administrative offenses in this area seems to be on the rise,⁷⁸ while shareholder litigation is still in its infancy.

What are the major violations? One of the typical offenses is a failure to publish required reports and inaccurate, incomplete and misleading disclosure, which are all grounds for administrative liability.⁷⁹ Other offenses included in the Administrative Code are insider trading, registrar violations, refusal to call a meeting of shareholders, market manipulation, violations of the mandatory bid rule, and others.⁸⁰

The Securities Market Statute itself also contains extensive public enforcement provisions, particularly for the primary market. The Central Bank, for instance, may issue orders similar to the SEC's stop and refusal orders. The Bank cooperates with the Attorney General (*Prokuratura*) in cases where it believes corporate officers and directors are criminally liable and brings actions in federal courts to annul an issue as void.⁸¹

⁷⁶ *Opređenje Verhovnogo Suda RF*, 18.1.2011, No. KAC10-673. See also *Reshenie Verhovnogo Suda RF*, 2.11.2010, No. ГКПИ10-888.

⁷⁷ Fox, 'Ongoing Issues', 447, 454 (emphasizing the role of regulators).

⁷⁸ *Regionalnoye Otdelenie FSFR v Sibirskom federalnom okruge, Otčet o dejatel'nosti Regional'nogo otdelenija Federal'noj služby po finansovym ryнкam v Sibirskom federal'nom okruge za 2012 god* 61 (2013) (on file with the author) (mentioning that the number of administrative reports doubled between 2011 and 2012).

⁷⁹ *New Polojenie o Raskritii*, Part I, Ch. II; *Kodeks Rossijskoj Federacii ob administrativnyh pravonarúšenijah* [Administrative Code] (hereinafter "KOAP"), 30.12.2001, No. 195-Ф3 (as amended), art. 15.19 (1) and (2).

⁸⁰ See, e.g., KOAP, arts. 15.20-15.23.1; 15.28-15.30.

⁸¹ See, e.g., FZ About Securities, arts. 51(3) and (4); 21; and 26.

Violations of securities law may entail criminal and administrative liability for the officers and directors of an issuer.⁸² There is no criminal liability for legal entities.⁸³ A key distinction between various types of the liability regimes is the requirement of scienter and knowledge. The law generally only criminalizes acts committed with the knowledge of misstatements or omissions and intentional violations of securities law which caused substantial losses to individuals, legal entities, or the state.⁸⁴

3.2.2. Enforcement Efficiency

Assessing enforcement efficiency is often imprecise and always onerous. Consider, for instance, that Russia moved from the twin-peak regulatory system of financial supervision to a consolidated single-regulator system.⁸⁵ In 2013, one division of the Central Bank and its regional offices were assigned to deal with the offerings and everything related to *issuers*, while a separate division of the “protection of consumers of financial services and minority shareholders” was charged with the task of reviewing *individual* complaints.⁸⁶ Since pre- and post-2013 agency reports are not fully comparable, the resultant information loss obscures enforcement analysis.

By way of example, the formerly independent federal securities regulator published an annual report in 2009 stating that it had conducted 42 investigations of issuers and that its regional divisions had examined 10,555 cases.⁸⁷ As of the time of this writing, the Central Bank has yet to produce a similarly detailed report. Based on a cursory examination of its new database of enforcement notices, in the first quarter of 2016, there were 30 enforcement actions involving disclosure violations and eight actions related to shareholder meetings, in most cases resulting in fines imposed on the offenders.⁸⁸

It is possible that in the short term, separating shareholder complaints from issuer oversight has produced information losses among separate divisions of the

⁸² See, e.g., FZ About Securities, art. 51(4); KOAP, Arts. 15.17 and 15.19. See also FZ About Securities, arts. 19-20 (setting forth the basic rules on registration).

⁸³ *Ugolovnyj kodeks Rossijskoj Federacii* (hereinafter “Criminal Code”), 13.06.1996, No. 63-Φ3, art. 19 (as amended).

⁸⁴ See, e.g., Criminal Code, arts. 185 and 185.1. See also KOAP, arts. 15.17 and 15.19.

⁸⁵ *Ukaz Prezidenta RF “Ob uprazhnenii Federal'noj sluzhby po finansovym rynkam, izmenenii i priznanii utrativshimi silu nekotoryh aktov Prezidenta Rossijskoj Federacii”*, 25.07.2013, No. 645.

⁸⁶ Press-sluzhba Banka Rossii, ‘*Ob uprazhnenii Sluzhby Banka Rossii po finansovym rynkam*’, 28.02.2014, available at http://cbr.ru/press/pr.aspx?file=28022014_212328cbrfr.htm.

⁸⁷ *Federalnaja Sluzhba po Finansovym Rynkam, Itogi 2009 goda 28 (2009)*, available at www.cbr.ru/sbrfr/archive/fsfr/archive_ffms/ru/about/activity_results/annual_reports/printable.php@print=1.html.

⁸⁸ *Tsentralniy Bank Rossii, Administrativnoe proizvodstvo*, available at www.cbr.ru/finmarkets/?PrtId=supervision_adm_proc.

Central Bank. However, how exactly that structural change may affect future investigative efforts is yet to be seen.

3.2.3. The Pros and Cons of Administrative Liability

In terms of procedural rules, administrative cases appear to be a slam dunk. For example, if a corporation *can* publish a report but *does not* make a bona fide effort to do so, administrative liability follows naturally.⁸⁹ An issuer violates the Administrative Code by not disclosing the required information in the manner and time prescribed by law and by disclosing incomplete, erroneous, or misleading information.⁹⁰ Unsurprisingly, the no-fault cases where courts find for corporate issuers are rare and may involve very unusual circumstances. An example is an inability to publish reports online because an issuer has no access to the Internet.⁹¹

Unfortunately, the simplicity of the application of administrative norms does not translate into their efficiency or adequate deterrence. Efficiency and deterrence depend in large measure on whether administrative liability is perceived as an important event or merely trivia.

One way to think about the value of public enforcement and liability is by comparing statutory fines with corporate profits. By law, if an issuer fails to comply with the reporting rules, a fine may be imposed on its officers, directors, and the issuer itself. The amount of the penalty for various violations ranges from RUB 20,000 to RUB 50,000 for a natural person and from RUB 500,000 to 1 million for corporations.⁹² The fines for disclosure violations by control persons and affiliates are between RUB 1,000 and 20,000, depending on the offender's status as an executive. The respective maximum fine for legal persons is RUB 500,000.⁹³ As of the date of this writing, \$1 was worth about RUB 60. The remaining math is simple. Consider also that a 2014 decision of the Constitutional Court urges courts to lower statutory fines taking into account the culpability of the wrongdoer, the seriousness of an offence, public policy considerations, and relevant extenuating circumstances.⁹⁴

With that in mind, think of a large aluminum company which omits material information about the compensation of its management company and the “substantive

⁸⁹ See, e.g., *Postanovlenie Federalnogo arbitrazhnogo suda Moskovskogo okruga*, 26.11.2013, No. Ф05-14240/2013, Case No. A40-30770/13-72-263 (discussing liability for nondisclosure of an audit report).

⁹⁰ KOAP, art. 15.19.

⁹¹ *Postanovlenie Federalnogo arbitrazhnogo suda Zapadno-Sibirskogo okruga*, 9.03.2011, No. Ф-0419/2011, Case No. A70-5522/2010.

⁹² KOAP, art. 15.19.

⁹³ KOAP, art. 15.19.

⁹⁴ *Postanovlenie Konstitucionnogo Suda RF*, 25.02.2014, No. 4-II.

terms” of the management agreement in its annual report.⁹⁵ The management company is, in fact, a part of the same holding structure. It is an offshore entity registered in the Netherlands and appointed as the sole executive authority of many subsidiaries of the holding.⁹⁶ The free float of the shares of the holding is below 20%.⁹⁷

An individual complains about incomplete disclosure to the regulator, the regulator investigates, a fine in the amount of RUB 700,000 is imposed on the issuer, and the issuer, *i.e.*, the aluminum company, files a complaint to set aside the penalty.⁹⁸ Even if the court sides with the regulator and upholds the fine, as it did in the aluminum holding case,⁹⁹ is the infinitesimal amount of the penalty a sufficient deterrent against future violations of this kind? In the described case, the fine was indisputably negligible in comparison with the consolidated profits and assets of the multimillion-dollar aluminum giant and its subsidiary.¹⁰⁰

An enforcement action, of course, can carry reputational repercussions, which may be much more severe than a formal penalty.¹⁰¹ Through the resultant share price reaction, replacement of unscrupulous executives, or higher cost of capital, investors demand that untrustworthy firms pay risk premiums. Without such market-imposed penalties, personal gains of both control persons and the corporation *per se* may offset the direct financial losses from a fine. Hence, the cost-benefit analysis of a firm’s insiders systematically would be in favor of securities law violations.

The true reputational value of administrative penalties and investigative proceedings in Russia at this point is unknown. Moreover, if a market is not efficient enough, the information on enforcement actions may not be properly valued and incorporated into share prices. As a result, outside investors can hardly take solace in the administrative liability alone. Even though public enforcement may lead to

⁹⁵ See *Postanovlenie Federalnogo arbitrazhnogo suda Vostočno-Sibirskogo okruga*, 9.10.2013, Case No. A74-6004/2012; Guseva, ‘KGB’s Legacy’, 564-5.

⁹⁶ See, e.g., OAO “Rusal Sayanal,” *Godovoy otchet za 2011 god*, Protokol No. 36 ot 29 maja 2012 goda, available at www.rusal.ru/investors/info/; Otkrytoe akcionerное obšestvo “RUSAL Bratskij aljuminievij zavod,” *Prospekt tsennih bumag* (29.04.2010), available at www.rusal.ru/investors/files/Prospect.pdf.

⁹⁷ RUSAL, *Struktura akcionerov*, 2016, available at www.rusal.ru/investors/to_shareholders/structure/.

⁹⁸ See *Postanovlenie Federalnogo arbitrazhnogo suda Vostočno-Sibirskogo okruga*, 09.10.2013, Case No. A74-6004/2012.

⁹⁹ *Ibid.*

¹⁰⁰ See RUSAL, *Financial Statements*, available at http://rusal.ru/en/investors/financial_stat.aspx.

¹⁰¹ See, e.g., J. M. Karpoff and J. R. Lott, Jr., ‘The Reputational Penalty Firms Bear from Committing Criminal Fraud’, *Journal of Law and Economics*, 36 (1993), 757–802; J. M. Karpoff et al., ‘The Cost to Firms of Cooking the Books’, *Journal of Financial and Quantitative Analysis*, 43 (2008), 581-612 (citing, *inter alia*, D. L. Murphy, R. E. Shrieves and S. L. Tibbs, ‘Determinants of the Stock Price Reaction to Allegations of Corporate Misconduct: Earnings, Risk, and Firm Size Effects’, *Journal of Financial and Quantitative Analysis*, 43 (2009), 581-612).

disclosure of the omitted information or correction of misleading reports, it may not deter future violations in similar circumstances.

4. Shareholder Litigation

4.1. Disclosure Rules and Violations

A counterweight to the enforcement of questionable potency is shareholder litigation. Does Russian law fare better on that score? The liability provisions under the federal securities law, including standing and the elements of the cause of action, are linked to the discussed above registration and disclosure requirements. An issuer is liable for investor losses resulting from the false, incomplete, and/or misleading information provided by the issuer.¹⁰² The statutory liability provisions cover both the secondary market and the primary market offerings.¹⁰³

In terms of standing, any *investor* or *owner of securities* may bring an action for damages. Unfortunately, the statute is somewhat incomplete as to *when* an investor has standing to sue under the securities law. There is no established practice that would support the interpretation similar to that of *Blue Chip Stamps*, which limits standing to purchasers and sellers of securities.¹⁰⁴ The statutory language is also somewhat unclear.

The securities statute specifies the types of actionable misstatements and omissions, which can be not only false but also merely incomplete and/or misleading.¹⁰⁵ In addition to showing misleading information, several elements are usually required to state a cause of action for damages. Those elements include, *inter alia*, loss causation, damages, and the evidence that the defendant acted unlawfully, in bad faith, and in violation of her duties.¹⁰⁶ Normally, damages are compensatory, whereas punitive damages are unavailable.¹⁰⁷

The statute seems particularly unforgiving when it comes to Directors and Officers (D&Os). Not only may they be subject to criminal and administrative liability, but also private investors have a cause of action directly against D&Os. Recall that

¹⁰² FZ About Securities, art. 51(1.1).

¹⁰³ *Ibid.* See also *ibid.*, art. 22(3).

¹⁰⁴ *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

¹⁰⁵ FZ About Securities, arts. 51(1.1) and 22.

¹⁰⁶ See, e.g., *Postanovlenie Arbitrazhnogo suda Moskovskogo okruga*, 12.10.2015, No. Ф05-13931/2015, Case No. A41-83402/14; *Postanovlenie Federalnogo arbitrazhnogo suda Moskovskogo okruga*, 10.10.2002, Case No. КГ-А40/6531-02; *Opredelenie Verhovnogo Suda RF*, 23.10.2015, No. 305-ЭС15-12647, Case No. А40-117175/14.

¹⁰⁷ See, e.g., FZ About Securities, arts. 51; 22.1(3); 25(6); 26(12); 30(11); *Graždanskij kodeks Rossiyskoy Federatsii* [Civil Code], Part I, 30.11.1994, No. 51-Ф3 (as amended), art. 15; *Postanovlenie Semnadsatogo arbitrazhnogo appeliatsionnogo suda*, 10.09.2010, No. 17АП-8598/2010-ГК, Case No. А60-12478/2010.

periodic reports and prospectuses should be approved by the issuer and its board of directors and signed or certified by a number of persons, including the CEO and the CFO, who thereby confirm the accuracy of the disclosed information.¹⁰⁸ In the clearly Sarbanes-Oxley style, the next logical step is liability - persons who signed and approved (or voted for the approval of) the reports and prospectuses, as well as auditors, are “jointly and secondarily” liable to investors for the losses caused by the misleading information, half-truths, and misstatements contained in such reports and prospectuses.¹⁰⁹

The Russian statute also shows traces of an eclectic mixture of Sections 11 and 12 of the U.S. Securities Act. For instance, just like in the U.S., although the liability in the public offerings context is broad, the reach of these provisions is somewhat undercut by the short statute of repose. Plaintiff may either bring an action for rescission of a single transaction as void [*“priznanie nedeystvitelnoy”*] or attempt to invalidate an offering as such. The first type of actions must be brought within six months after the transaction at issue, while in the second case, plaintiffs have only three months after the registration of a closing report upon completion of an offering.¹¹⁰ A practical difference between the two actions is that when a sale of securities in an offering is void, that will not result in the annulment of the whole offering.¹¹¹

Court may annul an offering if, *inter alia*, registration documents contain misleading information that has caused a “substantial violation of the rights... of investors”¹¹² and in cases where violations are not otherwise curable.¹¹³ Various parties, including the Bank of Russia, authorities in charge of the registration of the defendant, and security holders, have standing to bring claims under the Statute.¹¹⁴ Under these provisions, investors may recover from the issuer and third parties participating in the offering the consideration paid for the securities at issue and their losses.¹¹⁵

4.2. The Overlap of Securities and Corporate Law

Another option for an aggrieved shareholder is to proceed under corporate law, which, incidentally, does not make much difference in terms of venue. In Russia,

¹⁰⁸ See, e.g., FZ About Securities, arts. 30(10) and (11); 25(6); and 22.1.

¹⁰⁹ *Ibid.* arts. 30(11); 25(6); and 22.1(3).

¹¹⁰ *Ibid.* arts. 25 and 26(6), (9), and (10) (amendments of 23.07.2013, No. 251-Ф3).

¹¹¹ *Ibid.* art. 26(10).

¹¹² *Ibid.* art. 26(7).

¹¹³ *Ibid.*

¹¹⁴ *Ibid.* art. 26(6) and (10). See also *ibid.* art. 26(4) and (5) (detailing the Central Bank’s authority regarding incomplete offerings).

¹¹⁵ *Ibid.* art. 26(11) and (12).

federal courts have jurisdiction over both corporate and securities law disputes.¹¹⁶ It is difficult for an issuer registered in Russia to avoid the jurisdiction of Russian courts in disputes related to Russian capital markets and securities issued in Russia.¹¹⁷

Naturally, corporate law provisions dovetail with securities law. For instance, a corporation may issue only the classes of securities provided for in the federal statutes.¹¹⁸ The actual issuance and acquisition procedures are specified in corporate charters and should be in compliance with federal law, including the securities laws.¹¹⁹ There is also an overlap in the reporting requirements related to certain corporate actions.¹²⁰ The disclosure principles under both statutes are in accord: public companies must disclose certain information, including annual corporate reports, financial statements, and securities prospectuses.¹²¹ In a similar vein, the Corporations Statute and the Securities Statute are cross-referenced with respect to petitioning the securities regulator, *i.e.*, the Central Bank, for reporting exemptions, decisions that require a shareholder vote.¹²²

Thus, an aggrieved party, in theory, has some flexibility. In certain circumstances, it may be more advisable to sue a corporation under the Corporations Statute instead of the Securities Statute. For instance, decisions regarding listing on a stock exchange,¹²³ changes in the authorized share capital,¹²⁴ share repurchase programs,¹²⁵ or issuance of securities convertible into common stock¹²⁶ are often approved by shareholders. A nonvoting shareholder or a shareholder voting against certain decisions may bring an action in court if such decisions are not in compliance with the law or the corporate charter and “violate her rights.”¹²⁷ By contrast, some

¹¹⁶ See *Arbitrazhnyj processual'nyj kodeks Rossijskoj Federacii*, 24.07.2002, No. 95-Ф3 (as amended) (hereinafter “APC”), arts. 27-33 and 225.1.

¹¹⁷ See, e.g., APC, arts. 247-248 (setting forth the jurisdiction of Russian courts regarding claims involving foreign entities, securities issued in Russia, state property, privatization, etc.). See also arts. 27; 33; 34-38; and 225.1 (setting forth the general rules on jurisdiction and venue in corporate and other disputes). See also *Postanovlenie Semnadsatogo arbitrazhnogo appeliatsionnogo suda*, 27.01.2011, No. 17АП-13828/2010-ГК, Case No. А50-26203/2010 (discussing venue and jurisdictional issues); ConsultantPlus, *Pravovie novosti*, “*Obiedinenie Visshego Arbitrazhnogo Suda i Verhovnogo Suda RF*,” (06.03.2014).

¹¹⁸ FZ About Corporations, arts. 27-33.

¹¹⁹ *Ibid.* arts. 33 and 39(5).

¹²⁰ See, e.g., *ibid.* arts. 41 and 69(6), (7).

¹²¹ *Ibid.* arts. 89-92.

¹²² *Ibid.* arts. 92 and 92.1; FZ About Securities, art. 30.1.

¹²³ FZ About Corporations, art. 48.

¹²⁴ *Ibid.* arts. 48 and 27-29.

¹²⁵ *Ibid.* art. 29.

¹²⁶ *Ibid.* art. 33.

¹²⁷ *Ibid.* art. 49(7).

corporate issues, such as approvals of interested transactions or offerings of securities not involving changes in the authorized capital, are often within the authority of the board of directors.¹²⁸ A shareholder has standing to bring an action for annulment of a board's decision that has been made in violation of the federal laws or the corporate charter and "violates the rights" of *either* the corporation *or* the plaintiff-shareholder.¹²⁹

Bringing an action under the Corporations Statute, however, is not easy. For one, Russia has a super-concentrated ownership market. Hence, the likely plaintiffs in these cases are minority shareholders. Since the pretrial discovery and procedural rules do not favor plaintiffs without considerable financial backing,¹³⁰ many individual shareholder claims should become negative value suits. An objecting shareholder also faces evidentiary hurdles in establishing elements of her case whenever insiders and control persons engage in interested transactions.¹³¹

More importantly, there are statutory "anti-strike suit" provisions and restrictions on derivative actions. First, derivative suits may be brought only by shareholders of not less than one percent of the outstanding common stock.¹³² Second, the Corporations Statute grants federal courts the discretion to dismiss shareholder complaints seeking annulment of the decisions of boards and of general meetings on the following grounds: if a violation per se is insubstantial, if a decision of a board or a general meeting has caused no damages to the plaintiff (or the corporation), and when a shareholder's vote would not have altered the decision.¹³³ The oddity of this norm is that in the environment where concentrated ownership is ubiquitous, a minority shareholder's vote is *ab initio* insignificant. Next, add to that the business judgment rule, a version of which also exists in Russia, shielding boards from excessive shareholder scrutiny and dissatisfied objecting shareholders.¹³⁴ In sum, the foregoing

¹²⁸ *Ibid.* art. 65.

¹²⁹ *Ibid.* art. 68(6). See also *Postanovlenie Trinadtsatogo arbitrazhnogo apelljacionnogo suda*, 24.12.2014, No. 13АП-26738/2014, Case No. A56-52103/2013.

¹³⁰ For relevant examples, see, e.g., P. B. Maggs et al., *Law and Legal System of the Russian Federation* (6th ed. 2015), 511-17, 549-54; Fox, 'Ongoing Issues', 444-6.

¹³¹ *Ibid.*

¹³² FZ About Corporations, art. 71(5).

¹³³ See generally FZ About Corporations, arts. 68(6) and 49(7). *Postanovlenie Pjatanadcatogo arbitrazhnogo apelljacionnogo suda*, 17.06.2011, No. 15АП-4773/2011, Case No. A32-26592/2010 (finding that a minority-shareholder-plaintiff, owning 3.94% of the voting shares, failed to make a showing that his individual vote could have changed the results of a general meeting of shareholders and that he suffered damages). See also *Postanovlenie Trinadtsatogo arbitrazhnogo apelljacionnogo suda*, 24.12.2014, No. 13АП-26738/2014, Case No. A56-52103/2013 (discussing similar arguments in respect of a decision of a board of directors where the "quorum was present" despite procedural violations, and where plaintiff's vote could not have changed the results of the vote at issue).

¹³⁴ For a pertinent discussion, see, e.g., *Postanovlenie Plenuma Vysshego Arbitrazhnogo Suda RF*, 30.07.2013, No. 62, "O nekotoryh voprosah vozmeshhenija ubytkov licami, vhodjashhimi v sostav organov juridicheskogo

statutory provisions may tip the scales in favor of corporate insiders and against outside minority shareholders.

4.3. Directors and Officers: Liability and Doctrinal Uncertainties

In my research, I encountered a curious exception to the restrictive shareholder litigation rules. At some point, actions against individual directors and officers had become a topic so litigious and controversial that it necessitated the issuance of separate guidelines by the Supreme *Arbitrazh* Court.¹³⁵ In the Guidelines, issued in 2013, the Court reminds judges that there are normal risks associated with entrepreneurship, commercial activities, and business decisions, whose upside and downside judges cannot and often should not second-guess.¹³⁶

D&Os should act reasonably and in good faith and are liable only for the losses resulting from violations of their duties.¹³⁷ Lower courts and the Supreme Court have emphasized that the general presumption of good faith in civil law relations equally applies to executives of commercial entities.¹³⁸ The plaintiff has the burden of proving bad faith. D&Os also have such defenses as voting against a matter or abstaining from voting on a contested matter. Loss causation is another key element of the cause of action against D&Os.¹³⁹ The ultimate liability is joint and several.¹⁴⁰ Even though these elements appear to set a high bar for plaintiffs, the case law is far from settled.

In some cases, judicial reasoning has occasionally strayed off course. Consider the following appeal from a decision of an appellate court, referred to as a “cassational” appeal or “appeal in cassation.” In that case, the plaintiff corporation was not timely in its filings under the securities law and had to pay a fine. At about the same time, the

lica”, available at www.arbitr.ru/as/pract/post_plenum/90841.html (“*Postanovlenie Plenuma Vysshego Arbitrazhnogo Suda RF*, 30.07.2013, No. 62”).

¹³⁵ *Ibid.*

¹³⁶ *Ibid.* s. 1.

¹³⁷ *Ibid.* ss. 2 and 3; FZ About Corporations, art. 71 (1) and (2). See also *Opređenje Verhovnogo Suda RF*, 25.11.2015, No. 304-ЭC15-15037, Case No. A27-12161/2014. In certain cases, however, the *Arbitrazh* Court took a broader view on D&O liability. An example is interested transactions. See *Vishshiy Arbitrazhniy Sud, Postanovlenie Plenuma, “O nekotorykh voprosakh, svyazannykh s osparivaniem krupnykh sdelok i sdelok s zainteresovannost’ju”*, 16.05.2014, No. 28, s. 12.

¹³⁸ *Opređenje Verhovnogo Suda RF*, 02.12.2016, No. 305-ЭC16-16148, Case No. A40-149545/2015.

¹³⁹ FZ About Corporations, art. 71 (1) and (2).

¹⁴⁰ FZ About Corporations, art. 71(4). For relevant judicial analysis of the D&O liability provisions, see, e.g., *Postanovlenie Plenuma Vysshego Arbitrazhnogo Suda RF*, 30.07.2013, No. 62, s. 1; *Postanovlenie Semnadsatogo arbitrazhnogo apelljacionnogo suda*, 07.12.2011, No. 17АП-11994/2011-ГК, Case No. A60-9997/2011; *Postanovlenie Semnadsatogo arbitrazhnogo apelljacionnogo suda*, 10.09.2010, No. 17АП-8598/2010-ГК, Case No. A60-12478/2010 (discussing loss causation and other elements of the cause of action); *Postanovlenie Arbitrazhnogo suda Ural'skogo okruga*, 11.03.2012, No. Ф09-1238/12, Case No. A60-9997/2011 (discussing joint liability of directors under the Civil Code, arts. 15 and 1080, and FZ About Corporations, art. 71).

plaintiff terminated its CEO and brought an action in court claiming that the CEO's inaction caused damages to the company due to her failure to comply with the reporting obligations under the securities statutes.

The court emphasized that the CEO was not the sole authority responsible for the filing of the reports. Another problem was that the CEO was appointed after some financial documents had been altered by the plaintiff. The court concluded that not only did the plaintiff fail to sustain the burden of proof and to establish that the CEO had all necessary information to prepare the reports, but also the CEO was not even in office when some reports were due.¹⁴¹

Although the "cassational" decision is correct on its face, the facts of the case were indisputable and must not have led to three rounds of proceedings. Indeed, defendants must be in office either as members of the board or as executives at the time when losses occur and when their actions may have prevented the losses. It is surprising that these matters are litigated at all.

There are also suits that are clearly meritorious and illustrate that Russian corporations and shareholders have been successfully suing executives who are responsible for the accuracy and timeliness of reporting, fail to provide reports to the securities regulator, and thus occasion fines and enforcement actions. For instance, recall that for liability to accrue, D&Os must act in violation of their duties and that D&Os approve and/or sign various reports under the securities law and the Corporations Statute. In a 2015 case, shareholders brought a derivative action against the CEO and the board for disclosure of misleading information in quarterly reports. The courts took judicial notice of a previous enforcement action and a pertinent court decision upholding the regulatory penalties. The "unlawful nature" of the actions of an executive, damages, and loss causation were thus easily established.¹⁴²

Another interesting case is a 2015 Supreme Court decision upholding the liability of a CEO on similar grounds. In short, a shareholder filed a complaint with the securities regulator regarding erroneous stock ownership records. Another shareholder of the same issuer also filed a complaint alleging violations of her rights under the Corporations Statute, which, *inter alia*, allows shareholders to review certain corporate documents before shareholders' meetings. Civil penalties were subsequently imposed by the securities market regulator for the violations. The corporation paid the fines.

¹⁴¹ *Postanovlenie Federal'nogo arbitrazhnogo suda Zapadno-Sibirskogo okruga*, 20.05.2011, Case No. A46-9028/2010. See also *Postanovlenie Sed'mogo arbitrazhnogo apelljacionnogo suda*, 8.03.2015, No. 07АП-1351/2015, Case No. A27-12161/2014 (discussing joint and several liability and timing issues).

¹⁴² *Postanovlenie Federal'nogo arbitrazhnogo suda Zapadno-Sibirskogo okruga*, 04.02.2015, No. Ф04-14094/2014, Case No. A45-6881/2014. Cf. *Opredelenie Verhovnogo Suda RF*, 25.11.2015, No. 304-ЭС15-15037, Case No. A27-12161/2014 (setting forth a more lenient approach).

A derivative action against the CEO of the issuer followed on the heels of the enforcement actions. The lawsuit was brought by the very same shareholder who had complained to the securities regulator about the ownership record violations. After several successive appeals, the Supreme Court upheld the decisions of the lower courts finding the CEO liable. The Court also underscored that the CEO “did not ensure compliance with the requests of [the complaining shareholders, including the plaintiff,] and thereby caused damages to the corporation in the form of the enforcement penalties.”¹⁴³

If the purpose and value of D&O litigation are improving disclosure and shareholder participation and thus achieving more accurate share prices and better corporate governance, then this “partnership” of the public and private enforcement regimes may generate significant net benefits. Russian courts, however, do not seem to be focusing on these economic aspects of enforcement and shareholder litigation. At times, they even ignore the fact that by law, corporate reports are signed by executives.

For instance, in a 2016 decision, the same Supreme Court affirmed the lower courts’ decisions which suggested that neither the securities law nor the corporate law imposed the obligation to make disclosure decisions regarding quarterly reports, current reports, and information on affiliated persons solely on a chief executive officer. To the Court, even though the securities regulator had imposed several fines on the issuer for various reporting violations, and even though those administrative decisions had established the culpability of the issuer, its CEO was not automatically liable for the losses caused to the issuer by the enforcement action and penalties.¹⁴⁴ Instead, the Court embraced a “novel” argument that the issuer had, in addition to the CEO, compliance officers and separate departments in charge of preparing the reports. So much for the similarity to Sarbanes-Oxley.

Another troubling aspect of that Supreme Court decision was a complete lack of any meaningful economic analysis. The Court limited its analysis to a recital of the lower courts’ discussion of the profitability and assets of the company. By way of example, the Court repeated the lower courts’ findings that under the two-decade leadership of the CEO-defendant, from 1997 to 2015, the assets of the issuer had increased one hundred fold. The Court viewed this as evidence that the CEO acted reasonably, efficiently, and in good faith.¹⁴⁵ The courts merely cited the data provided by the accounting department of the issuer, the book value of the assets, and declared dividends. The courts even accentuated that the issuer was a large regional taxpayer.

¹⁴³ *Opredelenie Verkhovnogo Suda Rossiyskoy Federatsii*, 23.10.2015, No. 305-ЭС15-12647, Case No. A40-117175/14.

¹⁴⁴ *Opredelenie Verkhovnogo Suda RF*, 05.12.2016, No. 306-ЭС16-17579, Case No. A57-31170/2015.

¹⁴⁵ *Ibid.* See also *Postanovlenie Arbitrazhnogo suda Povolzhskogo okruga*, 13.10.2016, No. Ф06-13024/2016, Case No. A57-31170/2015.

Obviously, this approach is staggeringly shallow and inadequate. The case either represents another example of the lack of judicial expertise in Russia or suggests that large corporations and their executives may easily turn the tide and defeat shareholders in court in the future. In either case, the 2016 decision may chill future suits against executives.

4.4. Procedural Issues: Class Actions and Litigation Costs

Note that in the foregoing cases, the plaintiffs *relied* on an existing enforcement decision. One shareholder even first reported the violation to the regulator and then used the fine as evidence of the violation by the defendant. This is not surprising. Proving securities or corporate law violations is always costly, in part due to the enormous information asymmetry between the plaintiff shareholders and the management or majority shareholders. If an outside shareholder has to assemble and plod through public records to reduce the information asymmetry and to make her case against the insiders, her pretrial costs are bound to be high. It is thus understandable why shareholders not only in Russia but also in other countries prefer “follow-on” cases where evidence is more easily obtainable.¹⁴⁶

Reliance on public enforcement assumes heightened importance in Russia due to the gaps in the private litigation framework. On the one hand, procedural law has provisions allowing parties to demand documents from various public entities and to petition the court to secure pretrial evidence, particularly if there are reasons to believe that the evidence may be destroyed.¹⁴⁷ Various forms of injunctions are also available in cases where plaintiff attempts to prevent a recalcitrant party from hiding its assets or otherwise thwarting future enforcement. The court may issue a temporary restraining order or injunction with respect to, *inter alia*, shares of stock of an issuer, transfers of shares by transfer agents, or the assets of the issuer.¹⁴⁸ Finally, by law, a party that cannot gain access to relevant evidence in the hands of another may petition

¹⁴⁶ Private litigants naturally attempt to economize on their resources and tag along on the heels of government enforcement actions. For procedural aspects, examples, criticism, and cost-benefit analysis, see, e.g., A. M. Rose, ‘Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5’, *Columbia Law Review*, 108 (2008), 1301; J. Coffee, ‘The Globalization of Entrepreneurial Litigation: Law, Culture, and Incentives’, *University of Pennsylvania Law Review*, 165 (2017), 1895, 1916-22; D. Nagy, R. Painter and M. Sachs (eds.), *Securities Litigation and Enforcement* (2012) 678, 694, and 708.

¹⁴⁷ See generally Maggs et al., ‘Law and Legal System’, at 553. See also Linklaters, *Collective Actions Across the Globe – a Review* 19 (2011); APC, arts. 72 and 135.

¹⁴⁸ APC, arts. 225.6; 90; 91; and 99; *Postanovlenije Plenuma Vysshego Arbitrazhnogo Suda Rossijskoj Federacii*, 12.10.2006 (as amended), No. 55, “*O primenenii arbitrazhnymi sudami obespechitel'nyh mer*”. See also *Postanovlenie Arbitrazhnogo suda Vostochno-Sibirskogo okruga*, 21.08.2012, Case No. A19-5297/2012.

the court to request such evidence directly. The requested evidence usually should be presented to the court.¹⁴⁹

On the other hand, cases illustrate that the Russian discovery rules are difficult to make effective.¹⁵⁰ In one of the famous and generally unsuccessful actions by the shareholders of TNK-BP, a large oil company, the plaintiff secured a favorable ruling requesting evidence from a subsidiary of British Petroleum (BP) and TNK-BP but was defeated on appeal. The plaintiff sought evidence on how the company had assessed, *inter alia*, the prospects of a successful strategic partnership with Rosneft, one of the major Russian oil companies with close ties to the government. Overturning the trial court's decision, the appellate court observed that the plaintiff attempted to pass its obligation to assess damages onto the defendant/appellant inasmuch as the plaintiff requested from the appellant "documents evaluating the damages... [and the] economic valuation that BP... prepared... [in the course of negotiating] the strategic partnership agreement with Rosneft..."¹⁵¹ The court did not examine whether the plaintiff could obtain adequate information from public filings, run similar financial analysis at low cost, and mount a successful challenge to the management of the powerful oil corporations.

The pretrial information asymmetry is not the only impediment to shareholder litigation. A plaintiff must always tread carefully because Russia is a "loser pays" jurisdiction. An outside minority investor must tease out complicated financial and operational information from public records and, possibly, retain financial experts to evaluate the evidence lest she faces the "loser pays" rule's wrath.

By law, the losing party pays "the costs of legal representation" of the winning party.¹⁵² This "English rule" is not unusual. Indeed, many civil law jurisdictions have "loser pays" provisions.¹⁵³ Russian courts also have the equitable power to reduce the costs and fees payable by the losing party to a "reasonable" amount.¹⁵⁴ Unfortunately,

¹⁴⁹ APC, art. 66(4) and (7).

¹⁵⁰ See, e.g., *Postanovlenie Vosmogo arbitrazhnogo apelliatsionnogo suda*, 17.10.2011, Case No. A70-6990/2011; *Postanovlenie Federal'nogo arbitrazhnogo suda Zapadno-Sibirskogo okruga*, 20.12.2011, Case No. A70-6990/2011.

¹⁵¹ *Postanovlenie Vosmogo arbitrazhnogo apelliatsionnogo suda*, 17.10.2011, Case No. A70-6990/2011. In the opinion of the Court of Appeals, complying with the request of the lead plaintiff's counsel was unfeasible because the request did not specify the time period and the documents that the plaintiff requested.

¹⁵² APC, art. 110. See also *ibid.*, arts. 106-109. See also *Postanovlenie Plenuma Verhovnogo Suda RF, "O nekotorykh voprosakh primeneniya zakonodatel'stva o vozmeshhenii izderzhok, svyazannykh s rassmotreniem dela"*, 21.01.2016, No. 1.

¹⁵³ See, e.g., Coffee, 'The Globalization of Entrepreneurial Litigation', 1899-1901 and 1911-12.

¹⁵⁴ See APC, art. 110(2). See also *Opreделение Verkhovnogo Suda RF*, 14.12.2015, No. 309-KT14-6958, Case No. A60-14520/2013 (discussing relevant judicial guidelines); I. Marisin and V. Kuznetsov, *Class and Group Actions 2017, Russia, International Comparative Legal Guides*, Nov. 18, 2016, s. 6, available at www.iclg.co.uk/practice-areas/class-and-group-actions/class-and-group-actions-2017/russia; *Postanovlenie Arbitrazhnogo suda Ural'skogo okruga*, 11.08.2015, No. Ф09-1811/14, Case No. A60-14520/2013.

what is *reasonable* is always an open-ended question.¹⁵⁵ An investor weighing her options before filing a complaint has to make an *ex ante* assessment of the potential litigation costs and should be prepared to foot the bill for the fees of both parties.

There is a pertinent provision that allows parties to enter into binding agreements on the distribution of future litigation costs.¹⁵⁶ While a useful provision in itself, it, however, presupposes that *both* parties have adequate information and are represented by competent attorneys. This parity and adequacy of representation are hamstrung by the absence of an experienced plaintiffs' bar and contingency fees.¹⁵⁷

Traditionally, the highest judicial authorities, including the Constitutional Court, did not welcome contingency fee arrangements.¹⁵⁸ The Russian market for legal services, fortunately, is guided by supply and demand like any other market. Based on my conversations with practicing attorneys, lawyers have begun using separate agreements allowing to "split" final judgments with plaintiffs. Yet, at least under the official approach, individual lawsuits may be expensive, unfeasible, and inefficient considering the costs and risks of litigation vis-à-vis the losses of an individual investor. Although this paper is not advocating a full-scale transplantation of the American style "entrepreneurial litigation" and agrees with the view that "[m]uch of the world remains skeptical" of it,¹⁵⁹ it equally acknowledges that in Russia, litigation costs may easily "exceed the recovery, even if victory were certain," effectively converting shareholder suits into negative value claims.¹⁶⁰

Russian law does have provisions allowing several plaintiffs to join their forces and thus reduce per-plaintiff costs. In this sense, claim aggregation through class actions and group actions may be an important shareholder protection tool helping small investors overcome the collective action and cost-benefit hurdles. Russian law

¹⁵⁵ See, e.g., *Postanovlenie Plenuma Verhovnogo Suda RF, "O nekotorykh voprosakh primeneniya zakonodatel'stva o vozmeshhenii izderzhkek, svyazannykh s rassmotreniem dela"*, 21.01.2016, No. 1, ss. 12 and 13.

¹⁵⁶ APC, art. 110(4).

¹⁵⁷ See, e.g., Marisin and Kuznetsov, *Class and Group Actions*, s. 7.

¹⁵⁸ *Informacionnoe pis'mo Prezidiuma Vysshego Arbitrazhnogo Suda RF*, 29.09.1999, No. 48, "O nekotorykh voprosakh sudebnoj praktiki, vznikajushchih pri rassmotrenii sporov, svyazannykh s dogovorami na okazanie pravovykh uslug"; *Informacionnoe pis'mo Prezidiuma Vysshego Arbitrazhnogo Suda RF*, 05.12.2007, No. 121, "Obzor sudebnoj praktiki po voprosam, svyazannym s raspredeleniem mezhdru storonami sudebnykh rashodov na oplatu uslug advokатов i inyh lic, vystupajushchih v kachestve predstavitelej v arbitrazhnykh sudah", s. 6; *Postanovlenie Konstitucionnogo Suda RF*, 23.01.2007, No. 1-II, "Po delu o proverke konstitucionnosti polozenij punkta 1 stat'i 779 i punkta 1 stat'i 781 Graždanskogo Kodeksa Rossijskoj Federacii v svyazi s žalobami Obščestva s ograničennoj otvetstvennost'ju "Agentstvo korporativnoj bezopasnosti" i graždanina V.V. Makeeva"; S.G. Pepeliaev, *Kompensatsia rashodov na pravovuju pomošč' v arbitrazhnykh sudah* (2013); S. G. Pepeliaev, *Gonorar uspeha i vozmeščenie sudebnykh rashodov*, Advokatskaya palata Moskovskoy oblasti (Dec. 29, 2013), available at www.apmo.ru/uid287/?show=theme&id=328.

¹⁵⁹ Coffee, 'The Globalization of Entrepreneurial Litigation', 1898.

¹⁶⁰ *Ibid.* at 1900.

also allows representative securities law actions, which may be brought by investor associations or securities regulators.¹⁶¹

Group actions are essentially similar to the joinder of parties under the Federal Rules of Civil Procedure.¹⁶² The procedure hinges on the commonality of the plaintiffs' or defendants' rights, obligations, questions of law or fact, and claims, which arise out of the same legal relationship and, therefore, may be raised in the same proceedings. All participating plaintiffs are identified individually.¹⁶³

The new 2009 class actions regime is different. To date, actual cases have been few and far between. My own search of various databases generated between two and three dozen decisions, many of which were trial and appellate court rulings regarding the same disputes.

Class actions have been primarily designed for business-related, corporate and securities market disputes.¹⁶⁴ Initiating an action is simple. First, an investor plaintiff, *i.e.*, "lead plaintiff," files a lawsuit. In her submission, the plaintiff indicates at least five investors, who are effectively the first identified class members "opting in" to the class action.¹⁶⁵ The complaint should also identify the class based on a specific legal relationship at issue.¹⁶⁶ This requirement, theoretically, is similar to the commonality of questions of law and fact and the typicality of claims and defenses. The actual class is thereafter defined by court. Afterwards, a notice offering to join the class action is published or mailed to the class members.¹⁶⁷

Despite the ostensible procedural simplicity, Russian courts have struggled with class actions, sending cases through multiple rounds of appeals, converting them into individual actions, treating them as "joinder," or misinterpreting the "same legal

¹⁶¹ See, e.g., APC, arts. 53 and 225.10; FZ "O zashite prav i zakonnih interesov investorov na rinke tsennikh bumag", 05.03.1999, No. 46-Φ3 (as amended), arts. 14 and 18 (stating the authority of the Bank of Russia and rights of investor associations).

¹⁶² APC, art. 46.

¹⁶³ *Ibid.*

¹⁶⁴ APC, art. 225.11. For examples of the proposals to extend class actions, see, e.g., *Komissija Assotsiatsii juristov Rossii po konstitucionnomu zakonodatel'stvu i gosudarstvennomu stroitel'stvu i Komissija Assotsiatsii juristov Rossii po pravovoj kul'ture i propagande prava, Zakluchenie, O nekotorykh konstitucionno-pravovykh i institucional'nykh aspektakh vvedeniya v Rossii instituta kollektivnykh iskov* (Dec. 26, 2013), available at <http://alrf.msk.ru/news/itogi-sovmestnogo-zasedaniya-komissii-assotsiatsii>; D. Magonya, 'Class Actions in Russia', *Russian Law Journal*, Vol. I, No. 1 (2013), 57-65; D. M. Zabrodin, 'Grupповые иски в гражданском процессуальном праве России: проблема порядка присоединения к группе', *Zakony Rossii: Opit, analiz, praktika*, No. 9 (2012), 65-9.

¹⁶⁵ APC, arts. 225.10; 225.12; and 225.13.

¹⁶⁶ APC, arts. 225.13 and 225.10.

¹⁶⁷ APC, art. 225.14.

relationship” and the respective class.¹⁶⁸ The current lack of judicial expertise, a valuable commodity in corporate law development, is a serious impediment to creating an efficient legal regime.¹⁶⁹

There is also another, even more detrimental issue. The game per se may have been rigged to the extent that the current class action procedure may limit investors’ access to justice.¹⁷⁰ Namely, they can opt in, but they cannot opt out. There is nothing in the Procedural Code about how an investor may effectively opt out of an ongoing class action and bring an individual suit. In theory, an investor does not have to join in the first place if she does not want to benefit from the class action judgment. In practice, the statutory language urges the investor to opt in by rewarding opting in and penalizing abstention.

The consequences of not joining a class action lawsuit are as follows. First, if a class action is still pending, the court declines to review the merits of an individual plaintiff’s claim and informs the plaintiff of her right to join the pending class action. Second, a claim brought after the class action judgment will be dismissed.¹⁷¹ It is unclear if another shareholder may bring a similar action on the heels of a dismissed action.¹⁷² Possibly, the class action judgment may have a *res judicata* effect binding the parties that have not joined the action. The most puzzling question is as follows: does the original decision bind all investors who have not exercised their right to opt in?

¹⁶⁸ See, e.g., *Konceptsiya edinogo Grazhdanskogo processualnogo kodeksa Rossiyskoy Federatsii, Reshenie Komiteta po grazhdanskomu, ugovnomu, arbitrazhnomu i processualnomu zakonodatelstvu GD FS RF*, 8.12.2014, No. 124(1), ss. 50.6.3-50.6.4, available at www.consultant.ru/document/cons_doc_LAW_172071/ (hereinafter “Concept”); *Postanovlenie Federal’nogo arbitrazhnogo suda Zapadno-Sibirskogo okruga*, 26.05.2011, Case No. A46-5540/2010 (discussing the concept of the “same legal relationship”); *Postanovlenie Vos’mogo arbitrazhnogo apelljacionnogo suda*, 28.01.2011, Case No. A46-5540/2010 (same); *Postanovlenie Arbitrazhniy suda Severo-Zapadnogo okruga*, 17.02.2015, No. Ф07-9113/2014, Case No. A56-28967/2014 (discussing procedural mistakes in a trial court).

¹⁶⁹ In Russia, there is a “lack of a strong, effective, business-savvy judiciary.” Fox, ‘Ongoing Issues’, 454-5. On the value of judicial expertise, see generally R. Romano, *The Genius of American Corporate Law* (1993), pp. 32-51; R. Romano, ‘The State Competition Debate in Corporate Law’, *Cardozo Law Review*, 8 (1987), 709, 719, and 722.

¹⁷⁰ For a discussion of the relevant provisions of the procedural law, see, e.g., C.A. Alehina and D.A. Tumanov, ‘Problemy zashity interesov gruppy lits v arbitrazhnom processe’, *Zakony Rossii: opit, analiz, praktika*, No. 1 (2010), available at https://zakon.ru/publication/sa_alexina_da_tumanov_problemy_zashity_interesov_gruppy_lits_v_arbitrazhnom_processe?AspxAutoDetectCookieSupport=1; Y.G. Streltsova, ‘O nekotorykh slojnostyah prakticheskogo primeneniya gl. 28.2 APC RF’, *Pravo i politika*, No. 4 (2010), 718-33; Zabrodin, ‘Grupповие iski v grazhdanskom processualnom prave’; Magonya, ‘Class Actions in Russia’, 61.

¹⁷¹ APC, art. 225.16.

¹⁷² See, e.g., *Postanovlenie Vos’mogo arbitrazhnogo apelljacionnogo suda*, 02.02.2012, Case No. A70-6990/2011.

As case law slowly accumulates, courts gradually explain procedural issues. Some decisions state that if a class cannot be certified because claims are not common to the class, potential class members do not lose their right to bring an action in court.¹⁷³ Several successive individual actions may be brought by different plaintiffs.¹⁷⁴ Courts also have reduced the costs of lead plaintiffs by pointing out that lead plaintiffs are not required to send notices regarding every filing to all identified class members.¹⁷⁵

Nevertheless, the confusing rules urging opt-ins and penalizing opt-outs are still in place. The provisions are either a product of bad drafting and legislative oversight or a deliberate effort to thwart class actions, which suggests interest group capture. Having tougher procedural rules for class actions and fewer individual suits accrues only to the benefit of corporate defendants and their control persons.

Together with the loser pays and other procedural provisions, the new opt-in regime may pose additional problems to plaintiffs. Some, for instance, may not even learn of a pending action in time to exercise their right to opt in.¹⁷⁶ Recall also the notorious derivative action brought by the shareholders of TNK-BP, a major oil company. The defendants were members of the board of directors of TNK-BP and held executive offices in either BP plc itself or a subsidiary of BP. The suit concerned a famous deal between Rosneft, a corporation with ties to the Russian government, and BP plc. TNK-BP, Rosneft, and the BP subsidiary participated in the capacity similar to that of parties in interest. The complaint alleged, *inter alia*, that due to the actions of the directors, who did not disclose to the board of TNK-BP the negotiations between BP plc and Rosneft and *de facto* breached their fiduciary duties as members of TNK-BP's board, the strategic partnership agreement and related share exchange caused losses to TNK-BP.

The trial court gave the plaintiff about a month to publish a notice inviting the shareholders to join the class and, in addition, gave the opting-in shareholders twenty days to inform the lead plaintiff. The final class members were under the 1% ownership threshold required under the Corporations Statute. The court denied the motion to

¹⁷³ *Postanovlenie Odinnadcatogo arbitrazhnogo apelljacionnogo suda*, 7.10.2011, Case No. A65-2305/2011.

¹⁷⁴ *Postanovlenie Trinadtsatogo arbitrazhnogo apelljacionnogo suda*, 28.02.2014, Case No. A56-52103/2013 (allowing the second plaintiff's claim and holding that the preclusive procedural provisions on class actions did not apply).

¹⁷⁵ See, e.g., *Postanovlenie Federal'nogo arbitrazhnogo suda Ural'skogo okruga*, 09.04.2014, No. Ф09-1811/14, Case No. A60-14520/2013.

¹⁷⁶ For instance, in one case, on December 9, 2010, a court established a notice period until January 18, 2011. The notice to join the class was published in a regional newspaper on January 13, 2011. Did the publication put the shareholders on notice of the pending action and give them sufficient time to join the class? See *Postanovlenie Pjattadcatogo arbitrazhnogo apelljacionnogo suda*, 17.06.2011, No. 15АП-4773/2011, Case No. A32-26592/2010. Commentators expressed concerns regarding the procedure and the limited right to appeal procedural decisions. Zabrodin, 'Grupповые иски в гражданском процессуальном праве', 67; Magonya, 'Class Actions in Russia', 61; Streltsova, *O nekotoryh slojnostiah prakticheskogo primeneniya gl. 28.2 APC RF*. See also APC, art. 270.

extend the notice period and found that the shareholders lacked standing to bring a derivative action. The appellate court upheld that decision.¹⁷⁷

The sufferings of the minority shareholder plaintiff were far from over at that point. After all, Russia is a “loser pays” jurisdiction – the losing party is liable for the payment of the winning party’s litigation expenses. The BP subsidiary sued the plaintiff for the litigation expenses and miscellaneous fees in the amount of about half a million euros.¹⁷⁸ This case not only underscores the intersection of the substantive corporate and securities law provisions with the procedural rules but also demonstrates that class actions place a considerable financial burden on minority investors.

To conclude, evidence seems to point either toward continuous interest group capture or, at the very least, toward a pro-issuer policy stance. By the same token, the proposed procedural reforms may also be viewed as pro-defendant. While the proposed reforms address some of the foregoing ambiguities, including the current no opt-out policy potentially denying shareholders their day in court,¹⁷⁹ the reformers also argue that the filing procedure is too simple and must be changed. The current rules require that lead plaintiff identify in the complaint first five class members. The proposed bills argue that it is a very low number and predicate the need to raise this threshold on its inefficiency and wasteful simplicity.¹⁸⁰ In suggesting a more difficult procedure, the proposals respond to the calls of the “community of entrepreneurs.”¹⁸¹ If passed, the bills would make it less feasible for a plaintiff such as a minority shareholder to initiate a class action, let alone to see her day in court.

5. Conclusions

Quo vadis, Russian markets? Recall the four pillars that a shareholder relies on to control agency costs, information asymmetry, and other risks. The capital market portico is typically propped up by robust market infrastructure, public enforcement,

¹⁷⁷ *Postanovlenie Vos'mogo arbitrazhnogo apelljacionnogo suda*, 02.02.2012, Case No. A70-6990/2011.

¹⁷⁸ *Postanovlenie Vos'mogo arbitrazhnogo apelljacionnogo suda*, 14.08.2012, Case No. A70-6990/2011; *Postanovlenie Federalnogo arbitrazhnogo suda Zapadno-Sibirskogo okruga*, 01.10.2012, Case No. A70-6990/2011. See also *Postanovlenie Plenuma Verhovnogo Suda RF, "O nekotoryh voprosah primeneniya zakonodatel'stva o vozmeshhenii izderzhkek, svjazannyh s rassmotreniem dela,"* 21.01.2016, No. 1, ss. 1; 6; and 8; *Postanovlenie Odinnadcatogo arbitrazhnogo apelljacionnogo suda*, 09.09.2014, Case No. A65-2305/2011 (discussing the application of the fee allocation provisions).

¹⁷⁹ The proposals concern changes in the general civil procedural law and the Code of Civil Procedure. See Concept, ss. 50.6.3; 50.6.4; and 50.13.

¹⁸⁰ *Ibid.* ss. 50.7.

¹⁸¹ See *Komissia Associatsii yuristov Rossii po konstitucionnomu zakonodatelstvu i gosudarstvennomu stroitelstvu i Komissia Associatsii yuristov Rossii po pravovoy culture i propaganda prava, Zakluchenie 'O nekotorykh konstitucionno-pravovykh i institutsionalnykh aspektah vvedeniya v Rossii instituta kollektivnykh iskov'* 1-2, 26.12.2013, available at alrf.msk.ru/ftpgetfile.php?id=112.

private actions, and disclosure rules. Out of all four, it appears that only the reporting requirements are of adequate quality. Does this single pillar provide sufficient support to the Russian capital markets? Is the game worth the candle or should minority shareholders and Russian investors in general give up?

I would like to add my voice to those who urge Russian policymakers to take, first, a more pro-shareholder and pro-plaintiff view on private litigation, public enforcement, and corporate governance, and, second, a more pro-private-exchange policy stance. It is unlikely that without better shareholder monitoring and more efficient market infrastructure, the mandatory disclosure regime will singlehandedly prop up the capital market machinery.