



INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group



Good corporate governance contributes to a company's competitiveness and reputation, facilitates access to capital markets, and thus helps develop financial markets and spur economic growth. With this in mind, the International Finance Corporation and the U.S. Department of Commerce have combined their efforts to provide Russian managers, directors, and shareholders with a practical tool to implement good corporate governance practices – the Russia Corporate Governance Manual. This Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. It follows the recommendations of the FCSM's Code of Corporate Conduct and refers to internationally accepted principles of good corporate governance.

“Corporate governance is vital to the interests of every economy, and government has a role to play in establishing the framework for reform - but it is companies that have the tough job of putting governance reform into practice. This is where the Corporate Governance Manual can provide excellent help. It offers a comprehensive workbook for company directors, officers, and advisers in taking up the challenge of corporate governance improvement. Shareholders and stakeholders alike should applaud IFC for bringing practical, and professional advice within reach of every boardroom.”

Anne Simpson, Manager,
Global Corporate Governance Forum

“Corporate governance reform in Russia is the continuation of the more general processes of change affecting the country as a whole. Taken together, these developments have created a new environment, new rules regulating the relationships between the market and regulators, between shareholders, shareholders and managers, etc. In the business community there is a growing awareness of the benefits of corporate governance reform, and companies are now working on improving the quality of their corporate governance ...”

Ruben K. Vardanian, President of Troika Dialogue; Chairman of the Board,
OJSC Rosgosstrakh; and Chairman of the RSPP Corporate Governance Committee

“Good corporate governance is a key driver of financial transparency and managerial accountability, essential ingredients for national prosperity in a global economy. We congratulate the U.S. Department of Commerce and the International Financial Corporation of the World Bank for their initiative in bringing about the publication of the Russia Corporate Governance Manual.”

Andrew B. Somers, President,
American Chamber of Commerce in Russia

Questions on corporate governance should be addressed to the IFC Russia Corporate Governance Project, via CGPRussia@ifc.org

An electronic version of the Manual is available on the website of the International Finance Corporation under www.ifc.org/rcgp and the U.S. Department of Commerce under www.mac.doc.gov/ggp

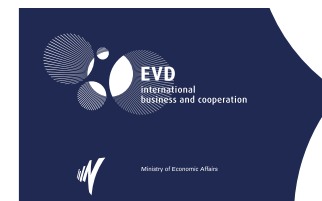
The Russia Corporate Governance Manual

I Part I Corporate Governance Introduced



Prepared and Published by the International Finance Corporation and the U.S. Department of Commerce

In Partnership with the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs and the Swiss State Secretariat for Economic Affairs



The Russia **Corporate Governance** Manual

Part I

Corporate Governance Introduced

Prepared and Published by the International Finance Corporation
and the U.S. Department of Commerce

In Partnership with the Agency for International Business
and Cooperation of the Dutch Ministry of Economic Affairs
and the Swiss State Secretariat for Economic Affairs

First edition: 10,000 copies in Russian, 1,500 copies in English.

Published in 6 Parts

Printed in Moscow, Russia.

ISBN 5-9614-0085-9

Copyright © 2004 International Finance Corporation
2121 Pennsylvania Ave. NW, Washington, DC 20433, United States of America
A Member of the World Bank Group

Design copyright © 2004 Alpina Business Books

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, for commercial purposes without the prior permission of the International Finance Corporation.

Disclaimer

The Russia Corporate Governance Manual (Manual) is distributed with the understanding that neither the authors, nor the organizations and countries they represent, nor the publisher is engaged in rendering legal or financial advice. The material in this Manual is set out in good faith for general guidance, and no liability can be accepted for loss or expense incurred as a result of relying on the information contained herein.

This publication is not intended to be exhaustive. While the utmost care has been taken in preparing the Manual, it should not be relied upon as a basis for formulating business decisions. On all financial issues and questions, an accountant, auditor, or other financial specialist should be consulted. A lawyer should be consulted on all legal issues and questions. As the laws in the Russian Federation are constantly changing, legal rules referred to herein may be obsolete or superceded by new legislation at the moment of the publication of this Manual. References to laws and regulations in this Manual reflect those in effect as of March, 2004.

All references to the male gender throughout this Manual apply to both sexes, unless otherwise indicated.

Any views in this Manual are those of the authors and do not necessarily represent the views of the governments of the Netherlands, Switzerland, or the United States; or the U.S. Department of Commerce, the International Finance Corporation, or the World Bank Group.

This Manual is distributed subject to the condition that it shall not, by way of trade or otherwise, be lent, re-sold, hired out, or otherwise circulated on a commercial basis without the International Finance Corporation's prior consent.

An electronic version of the Manual is available on the Website of the International Finance Corporation under www.ifc.org/rcgp, as well as the U.S. Department of Commerce under <http://www.mac.doc.gov/ggp>.

“Russia has a strategic goal: to become a country that makes competitive goods and renders competitive services. All our efforts are committed to this goal. We understand that we have to solve questions pertaining to the protection of owners’ rights and the improvement of corporate governance and financial transparency in business in order to be integrated into world capital markets.”

President Vladimir Putin
at a Session of the World Economic Forum,
Moscow on 30 October 2001

*“All successful companies are successful in the same way.
All unsuccessful companies are unsuccessful in different ways.”*

Adapted from Leo Tolstoy’s “Anna Karenina”

The Importance of Good Corporate Governance for Russia

During the last decade, policy makers, regulators, and market participants around the world have increasingly come to emphasize the need to develop good corporate governance policies and practices. An increasing amount of empirical evidence shows that good corporate governance contributes to competitiveness, facilitates corporate access to capital markets, and thus helps develop financial markets and spur economic growth.

Today, both domestic and foreign investors place an ever greater emphasis on the way that corporations are operated and how they respond to their needs and demands. Investors are increasingly willing to pay a premium for well-governed companies that adhere to good board practices, provide for information disclosure and financial transparency, and respect shareholder rights. Well-governed companies are also better positioned to fulfill their economic, environmental, and social responsibilities, and contribute to sustainable growth.

Improvement in corporate governance practices can improve the decision-making process within and between a company's governing bodies, and should thus enhance the efficiency of the financial and business operations. Better corporate governance also leads to an improvement in the accountability system, minimizing the risk of fraud or self-dealing by company officers. An effective system of governance should help ensure compliance with applicable laws and regulations, and further, allow companies to avoid costly litigation. Also, Russian companies should stand to benefit from a better reputation and standing, both at home and in the international community.

It is with this in mind that the International Finance Corporation — a member of the World Bank Group — the U.S. Department of Commerce, and the governments of the Netherlands and Switzerland have combined their efforts to provide Russian open joint stock companies with a practical tool to implement good corporate governance practices. The Russia Corporate Governance Manual outlines structures and procedures for establishing and maintaining effective corporate governance, and shows how the various parts of a company interact. In addition, model internal corporate documents and other practical tools are annexed to assist companies in implementing the many recommendations made throughout this Manual. The Manual targets those individuals directly involved in the governance of Russian companies (Russian shareholders, directors, and managers) and

The Russia Corporate Governance Manual

is designed to inform them of their respective rights and responsibilities within the corporate system.

As most of Russia's large and mid-size enterprises were privatized into open joint stock companies, this Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. In addition, it follows the recommendations of the Russian Code of Corporate Conduct, developed under the auspices of the Federal Commission for the Securities Market. Finally, the Manual refers to generally accepted international principles of corporate governance.

We at the International Finance Corporation and U.S. Department of Commerce look forward to continued cooperation with Russian companies, market participants, government authorities, and other stakeholders in advancing ongoing corporate governance reforms. A concerted effort can move the corporate governance debate from theory to practice, helping Russia in its progress toward a better business and economic environment.

Donald L. Evans
Secretary of Commerce
U.S. Department of
Commerce

James D. Wolfensohn
President
World Bank

Peter L. Woicke
Executive Vice President
International Finance
Corporation







Forward by the Federal Service for Financial Markets

The development of financial markets in Russia is inseparably linked to corporate governance reforms. The quality of corporate governance is one of the key factors affecting the country's investment climate.

Political and macroeconomic stability in Russia have resulted in high rates of economic growth and have created a favorable environment for Russian businesses to shift their strategic focus from short-term to long-term development. Positive changes have also occurred in the legal and regulatory corporate governance framework. New regulations provide for better shareholder rights protection, establish new rules for conducting General Meetings of Shareholders, and significantly improve information disclosure regimes. The national corporate governance standards set forth in the Code of Corporate Conduct have established a comprehensive benchmark for analyzing corporate governance practices and formulating standards of corporate ethics.

Compliance with the provisions of the Code of Corporate Conduct will make companies more transparent and thus attractive to potential investors. Recent developments demonstrate that corporate governance improvements are beginning to be viewed by Russian companies as an important method to gain a competitive advantage. Compliance with corporate law and the provisions of the Code of Corporate Conduct is a necessary precondition for companies to participate in the capital markets and, as a result, reduce their cost of capital.

The Federal Service for the Financial Markets considers the translation of corporate governance principles into company practices as one of its most important tasks.

The Russia Corporate Governance Manual, developed by the International Finance Corporation and the U.S. Department of Commerce, allows Russian companies to better understand the economic value of good corporate governance, and recommends practical steps that companies may take to improve their corporate governance. I am confident that the publication of this Manual will help many Russian companies fulfill their goals and raise capital in financial markets.

O.V. Vjugin,
Head of Federal Service for the Financial Markets



Forward by the Ministry of Economic Development and Trade

The need to improve corporate governance is one of the key challenges faced by Russian business today. Better corporate governance, in addition to improved economic performance, allows companies to reduce their financial and operational risks, and significantly raises their attractiveness to investors.

That is why the government of the Russian Federation works systematically to improve the corporate governance framework for Russian companies. Over the period from 2001 to 2002 two fundamental corporate governance documents were published in Russia: the Code of Corporate Conduct and the White Paper on Corporate Governance. The Code of Corporate Conduct is a summary of the key principles of best corporate governance practices, setting a standard for Russian companies on how to develop their own system of corporate conduct and providing practical recommendations on how to implement these principles. The White Paper on Corporate Governance in Russia, published by the OECD together with the Russian Ministry of Economics, offers an overview of the existing state of corporate governance in the country and presents recommendations for policy makers and legislators, as well as best practices for the private sector. The publication of these documents came as a result of a comprehensive analysis of corporate governance standards and practices both in Russia and the developed economies of the West, and marked an important milestone of Russia's integration into the global economy

The Russia Corporate Governance Manual pays significant attention to the recommendations of both the Code of Corporate Conduct and the White Paper on Corporate Governance in Russia, and also provides comments on a number of the most important provisions of said documents.

At the same time the Manual takes into account not only the practices of Russian joint stock companies and the specifics of the national stock market, but also the experience of many other developed and emerging economies. The Manual further offers a vast number of practical examples based on corporate governance practices of many large and well-known international companies.

An international team of Russian and Western experts from the World Bank's International Financial Corporation prepared the Manual. Well known scholars, businessmen, specialists in finance, stock market and corporate law, including experts from the Ministry of Economic Development and Trade of the Russian Federation, participated in the preliminary discussion and reviews of the publication.

We believe that this Manual will help raise awareness of important corporate governance issues, assist our companies in strengthening their competitive position, and become a useful tool for implementing international standards of corporate governance in Russian companies.

German Gref,
Ministry of Economic
Development and Trade



About the U.S. Department of Commerce

The U.S. Department of Commerce (USDoC) seeks to increase trade opportunities for U.S. companies and promote U.S. exports and investment. Weak rule of law, lack of adequate intellectual property rights protection, and corruption create barriers to trade, investment, and overall economic development, particularly in emerging markets. To address these concerns and establish a level playing field for U.S. companies, USDoC created a Good Governance Program. Currently, the Program is engaged in activities in 11 countries in the Caucasus, Central Asia, Eastern Europe, Latin America, and Russia. The Program works with the private and public sectors in promoting sustainable reform in the following four program areas:

- Business Ethics/Anti-Corruption;
- Commercial Dispute Resolution;
- Corporate Governance; and
- Intellectual Property Rights.

The Good Governance Program encourages fairness, transparency, and accountability in corporate governance practices in emerging market economies by engaging in cooperative programs with private sector organizations and by establishing a private-public sector dialogue. In Russia, the Program supported efforts of several non-governmental organizations (NGOs) to develop an *Independent Director Code* and a *Declaration of Principles of the Professional Community of Corporate Directors*. The Program conducts intensive “train-the-trainer” programs that provide select professionals the skills and expertise to implement good business and corporate governance practices at all levels, including companies, business associations, NGOs, stock exchanges, and educational institutions.

About the International Finance Corporation

The International Finance Corporation (IFC) is a member of the World Bank Group. IFC was established in 1956 to encourage private sector activity in developing countries. It does this primarily through three types of activities: financing private sector projects, helping companies in the developing world to mobilize financing in international financial markets, and providing advisory services and technical assistance to companies and governments.

IFC is a leader among multilateral financial institutions in integrating corporate governance considerations into all phases of the investment process. IFC’s long history of and practical experience in structuring investments, appraising investment opportunities, and nominating board members has allowed it to put corporate governance principles into action. A focus on good corporate governance practices in client companies allows IFC to manage risks and add value to its clients. In addition to the benefits to individual client companies, working to improve corporate governance,

The Russia Corporate Governance Manual

contributes more broadly to IFC's mission to promote sustainable private sector investment and strengthen capital markets in developing countries.

The IFC Russia Corporate Governance Project (RCGP) is a technical assistance project within the framework of the IFC Private Enterprise Partnership that aims to improve corporate governance practices in Russia. Its four main objectives are to:

- Assist Russian companies in implementing corporate governance through corporate trainings, consultations, and assessments, and thus facilitate their access to outside capital;
- Advise public sector officials on legislative and regulatory reform in corporate governance;
- Develop curricula for universities and other educational institutions to help train the next generation of managers, investors, and policy makers; and
- Support key institutions and change agents, including the press and NGOs to help build sustainable practices and raise awareness.

About the Swiss State Secretariat for Economic Affairs

The Swiss State Secretariat for Economic Affairs (seco) is the Swiss government's department in charge of economic policy. In terms of foreign trade policy, seco is active in shaping efficient, fair, and transparent rules for the world economy.

Seco represents Switzerland in the large multilateral trade organizations as well as in international negotiations. Seco is also involved in efforts to reduce poverty in the form of economic development assistance. Its development cooperation division is the competence center for sustainable economic development and the integration of developing and transition countries and their companies into the global economy.

Seco included corporate governance in its economic development assistance programs in 2000. Its overall support for the IFC Private Enterprise Partnership and its RCGP is one such example of development assistance.

About the EVD, the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs

The Agency for International Business and Cooperation (EVD) is part of the Dutch Ministry of Economic Affairs. Its mission is to promote and encourage international business and international cooperation. As a state agency and a partner to businesses and public-sector organizations, the EVD aims to help them achieve success in their international operations. A growing network of organizations, government institutions, and companies have come to rely on the EVD for information about foreign markets, governments, and trade and industry. Many of them do benefit from the financial programs, previously run by Senter Internationaal and now administered by the EVD.

PREFACE

Background

In April 2002, the USDoC and IFC, in partnership with Senter Internationaal and seco, agreed to jointly and cooperatively develop, publish, and distribute a corporate governance manual for open joint stock companies in Russia. This effort was initiated by and undertaken in cooperation with the Federal Commission for the Securities Market, the Ministry of Economic Development and Trade, the American Chamber of Commerce in Russia, the Russian Institute of Directors, the Independent Directors Association, and the Investor Protection Association.

The RCGP along with the USDoC's Good Governance Program coordinated the development of this Manual. Representatives from the private sector, regulators, educational institutions, international organizations, the Russian government, and others provided feedback through a series of roundtables and public commentary. In total, six roundtables were organized in cooperation with leading Russian organizations active in the field of corporate governance, and the Manual was placed on the internet for further public commentary. The result of this inclusive consultation process is guidance that meets the needs of business, is practical in nature and easy to use, and provides detailed insight into the evolving Russian corporate governance system.

Purpose and Target Audience

This Manual provides executives, directors, and shareholders of Russian open joint stock companies with a comprehensive summary of the corporate governance framework and practices prevalent in Russia today, and a practical toolkit designed to help implement good governance in practice. It provides readers with:

- An overview of the legislative and regulatory requirements related to corporate governance, as well as references to the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) and internationally recognized corporate governance principles;
- Recommendations on how to fulfill the governance obligations of open joint stock companies;

The Russia Corporate Governance Manual

- Practical examples of how corporate governance standards can be implemented, and guidance for executives and directors in meeting their obligations with respect to the governance of the enterprise; and
- General outlines of authorities, obligations, and procedures of the governing bodies of open joint stock companies.

This Manual also provides government officials, lawyers, judges, investors, and others with a framework for assessing the level of corporate governance practices in Russian companies. Finally, it serves as a reference tool for the educational institutions that will train the next generation of Russian managers, investors, and policy makers on good corporate governance practices.

How to Use this Manual

This Manual has been divided into and is published in six parts:

- Part I: Corporate Governance Introduced
- Part II: Good Board Practices
- Part III: Shareholder Rights
- Part IV: Disclosure and Transparency
- Part V: Special Focus Section
- Part VI: Annexes

The first four parts contain chapters that focus on core corporate governance issues, such as a company's board structure, information disclosure practices, and shareholder rights. Part five focuses on corporate governance issues of particular importance in the Russian context, namely corporate governance concerns during a company's reorganization, within holding structures, and relating to enforcement. Part six, finally, offers practical tools in the form of model documents, for example company codes, by-laws, and contracts. All issues are closely examined through Russian law and regulations, the FCSM Code and, when applicable, internationally recognized best practices.

While it is recommended to read the entire Manual to gain a full understanding of the corporate governance framework in Russia, it is not necessary to read all the chapters in chronological order. The reader is encouraged to begin with a topic of interest and follow the links and references included in the text for guidance to other chapters.

Examples, illustrations, and checklists are included to make the Manual clear and useful. The following tools will reappear at various intervals in the text:

- The **Chairman's Checklist** is intended to help the Chairman of the Supervisory Board focus Board discussions on key corporate governance issues faced by companies.

The Chairman's Checklist

- ✓ Does the company have a clear distribution of authority between shareholders, Supervisory Board members and managers? Has the company properly established an Executive Board
- ✓ Do the General Director and all members of the Executive Board possess the knowledge and skills necessary to manage the company? Is there a transparent division of tasks among the members of the Executive Board, such as operations, marketing, finance, legal, etc.?

- **Best Practices** summarizes the main provisions of the FCSM Code, the OECD Principles of Corporate Governance, as well as leading national standards from other countries.

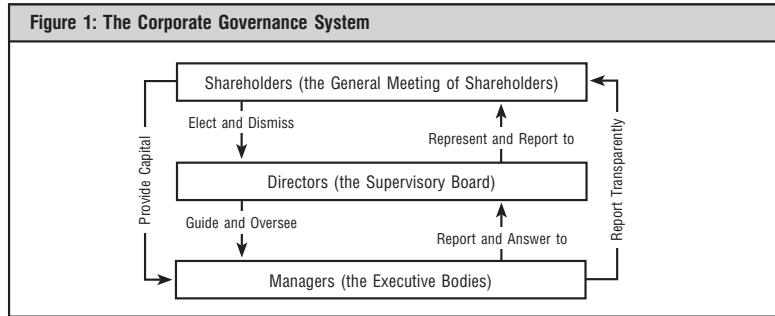
Best Practices: Independent directors can make a substantial contribution to important decisions of the company, especially the evaluation of executive performance and in the resolution of conflicts of interest. Independent Board members give investors additional confidence that the Supervisory Board's deliberations will be free of obvious bias.¹⁰¹ Companies are advised to disclose information about independent Board members in the annual report.¹⁰²

- **Company Practices in Russia** illustrates how Russian companies currently approach corporate governance issues. It highlights red flags, i.e. common corporate governance abuses that occur, and model company practices in good corporate governance.

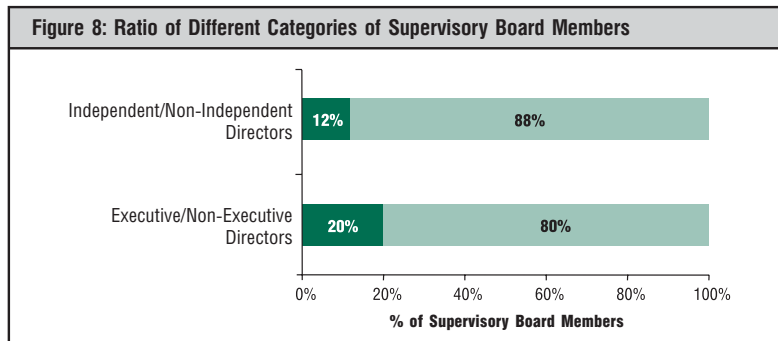
Company Practices in Russia: Many Russian companies are controlled by a single shareholder or group of shareholders that are well informed about the affairs of the company and able to closely monitor the company's management. On the other hand, the remaining ownership is often widely dispersed and many of these, often minority, shareholders lack the resources and information to effectively monitor management and defend themselves against the potential abuses of large shareholders. In these types of companies, independent directors take on special importance.

The Russia Corporate Governance Manual

- **Figures, tables, and other illustrations** are included to illustrate key concepts.



Source: IFC, March 2004



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

- **Mini-cases** illustrate abstract concepts and show the real problems that companies face.

Mini-Case 1: A company has 2,500 minority shareholders holding a total of 3,000 voting shares and one majority shareholder holding a total of 12,000 voting shares. The Supervisory Board has nine members. The 2,500 shareholders hold 27,000 votes (3,000 shares × 9 votes) and the majority shareholder has 108,000 votes (12,000 shares × 9 votes). The total number of votes that all shareholders can use to elect the candidates to the Supervisory Board is 135,000 votes (9 votes × 15,000 shares). The nine candidates that receive the most votes are elected to the Supervisory Board.

- Detailed references to law and regulation guide the reader to original texts.
- The IFC RCGP Corporate Governance Progression Matrix for Russian Companies is included in Annex 1 to allow the reader to assess the level of corporate governance in Russian companies, develop areas for improvement, and measure progress made.

		Level 1: Compliance with legal and regulatory requirements	Level 2: Initial steps to improve corporate governance are made	Level 3: Advanced corporate governance system	Level 4: Corporate Governance leadership
I. Commitment to CG	Legal Compliance	✓ The company has developed and follows a valid charter according to Russian legislation with provisions on the protection of shareholder rights and the equitable treatment of shareholders, distribution of authority between the General Meeting of Shareholders (GMS), the Supervisory Board and executive bodies, and information disclosure and transparency of the company's activities.	✓ The company has developed and follows by-laws regulating the activities and working procedures of the corporate bodies approved by the GMS (the GMS, the Supervisory Board, the Executive Board, and Revision Commission).	✓ The company has developed and follows a comprehensive set of internal documents that are recommended by the Federal Commission of the Securities Market Code of Corporate Conduct (FCSM Code) and are approved by the Supervisory Board.	✓ The company has adopted a company level corporate governance code and code of ethics, and follows internationally recognized best practices of corporate governance.
	Company Practice	✓ n/a	✓ The company has a person/officer responsible for the implementation of corporate governance policies in the company. ✓ The company follows the main recommendations of the FCSM Code and discloses information to the FCSM on a comply or explain basis.	✓ The company has a designated office(r) responsible only for ensuring the development of, compliance with, and periodic review of corporate governance policies and practices in the company (for example, the Corporate Secretary). ✓ The company has an explicit and clearly stated plan in place to improve its governance practices and has taken initial steps to implement this plan.	✓ The company has formally established a committee of the Supervisory Board responsible for supervising the governance policies and practices of the company (e.g. Corporate Governance Committee). ✓ The Company is publicly recognized as a national leader and among the global leaders in corporate governance.

Acknowledgements

The preparation and publication of this Manual has involved the participation and efforts of a large number of dedicated people.

This Manual was prepared in its entirety by Dr. Davit Karapetyan (Deputy Project Manager, IFC), under the supervision of Sebastian Molineus (Project Manager, IFC) and Igor Abramov (USDoC, Good Governance Program Director). Chapter 13 was drafted by Tatiana Ivanova (Deputy Project Manager, IFC); Chapters 11, 15, and 16 by Leiden University's Institute of East European Law and Russian Studies (Dr. Rilka Dragneva, Associate Professor and Prof. Dr. William B. Simons, Director). Chapter 17 was drafted by Coudert Brothers LLP (Barry Metzger, Senior Partner, Derek Bloom, Partner, Dr. Kirill Ratnikov, Senior Associate, and Peter Baranovsky, Paralegal). The following people worked on or contributed to the development of earlier versions of this Manual, under the supervision of Dr. Gregory Maassen (Senior Corporate Governance Specialist,

The Russia Corporate Governance Manual

IFC): Dr. Davit Karapetyan (Chapters 1, 2, 8, 9, 10, 12, and 14); Igor Aksenov (Chapters 4 and 5); Polina Kalnitskaya (Chapters 3, 6, and 7); Galina Efremova (Chapter 14); and Natalya Kosheleva (Chapter 15). The following people contributed to the development of the model documents contained in the Annexes: Igor Aksenov (Annexes 6, 9, 11, 13, 14, and 26); Galina Efremova (Annexes 7, 20, 26, 28, and 29); Alexander Kaleniouk (Annex 27); Polina Kalnitskaya (Annex 3, 12, and 15); Irina Krassikova (Annexes 20, 25, and 26); and Ilya Poluyakhtov (Annexes 22 and 23).

The IFC and USDoC would like to thank Alexander Berg (Senior Specialist, the World Bank), Dr. Rilka Dragneva and Prof. Dr. William B. Simons (both Leiden University), Richard Frederick (Independent Consultant), Tatiana Medvedeva (Senior Advisor on Legal Issues, Center for Capital Market Development), Dr. Gunila Molineus (Associate, Salans), Motria Onyschuk-Morozov (Senior Operations Manager, IFC), and Roswell B. Perkins (Retired Partner, Debevoise & Plimpton LLP) for their in-depth reviews and invaluable comments on the entire Manual. This Manual benefitted greatly from their contributions. Further important contributions on specific chapters were received from Garry Black, Oleg Sokolov and Peter Gyarmati (Partner, Principal and Consultant, respectively, KPMG), Marc-Andreas Klein (Sr. Compensation and Benefits Officer, the World Bank), Darrin Hartzler and Desmond O'Maonaigh (Senior Program Officer and Deputy Project Manager, respectively, IFC), and Simon C.Y. Wong (McKinsey & Company). The IFC and USDoC received numerous comments and suggestions, namely from Catherine Duriez, Elena Abrosimova (Senior lawyer and lawyer, respectively, EU TACIS Russia Corporate Governance Facility) and Fianna Jesover (Administrator, OECD); and within the IFC RCGP, from Karina Dashko, Maria Gracheva, Natalya Arabova, Andrei Bushhev, Andrei Kozlov, Alexander Eliseev, Maxim Titov, Alexander Kaleniouk, Natalya Sayfuranova, Ilya Poluyakhtov, Egor Paschina, Svetlana Kravchuk, Olga Anikina, Mikhail Kuznetsov, Olga Martynova, Yan Fedyanin, Irina Detochka, Nikolay Piotrovich, and Paul Jude Baker. Finally, the IFC and USDoC jointly extend their gratitude to the over 50 roundtable participants that provided further comments and offered helpful suggestions.

The final edit of the English version of this Manual was conducted by Richard Frederick (Independent Consultant). Paul-Jude Baker (Intern, IFC), Janet Katz (Liaison, American Bar Association, Central European and Eurasian Law Initiative), and Elizabeth Ramborger (Good Governance Program Officer, USDoC) also made valuable contributions to the editing process. This Manual was translated into

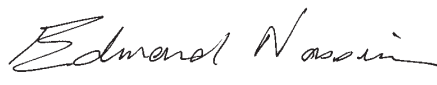
Russian by Tatyana Rybina and Olga Nikiforova (independent consultants). The translation of Annexes 3, 5, 17, 18, 24, 29, and 30 was conducted by Tatiana Govorukhina (Translator, IFC). Maria Gracheva (Editor, IFC) also played an important role, translating Annexes 4, 8, and 9, and editing the initial translations for the roundtable discussion. IFC RCGP staff also provided valuable editorial comments. The final edit of the Russian version of this Manual was conducted by Olga Nikiforova.

This Manual was produced with the generous support from the Dutch Ministry of Economic Affairs (Annelies M.L. Drost, Coordinator for International Financial Institutions, and Jasper K. Wesseling, Manager, Central and Eastern Europe, both with the Agency for International Business and Cooperation (EVD)) and the Swiss State Secretariat for Economic Affairs (Davorka Rzehak, Projects Officer, and Claude Barras, Head of Division, both with the Investment Promotion Division). Overall support was provided by Christian Grossmann (Director, Private Enterprise Partnership, IFC) and Mike Lubrano (Principal Financial Specialist, Corporate Governance Unit, IFC). This Manual could not have been produced without the organizational support of Elizabeth Ramborger and Zarema Arutyunova (Good Governance Program Managers, USDoC), and Anna Turina and Marina Vorobyova (Project Assistant and Communications Associate, respectively, IFC). Additional thanks go to Igor Belikov (General Director, the Russian Institute of Directors); Alexander Filatov (General Director, the Independent Directors Association); Alexander Ikonnikov (General Director, the Investor Protection Association); Andrew Somers (President, the American Chamber of Commerce in Russia); and Tatiana Raguzina (Senior Director for Strategic Planning and Policy, the American Chamber of Commerce in Russia); and, finally, to the American Chamber of Commerce, Russian American Business Council, and Russian Union of Industrialists and Entrepreneurs.

Igor Abramov
Director
Good Governance Program
USDoC



Edward Nassim
Director
Central and Eastern Europe
IFC



Frequently Used Abbreviations and Acronyms

Annual General Meeting of Shareholders	=	AGM
Board of Directors	=	Supervisory Board or Board
Chairman of the Supervisory Board	=	Chairman
Closed Joint Stock Company	=	Closed Company
Collective Executive Body, Directorate, Management Board	=	Executive Board
Extraordinary General Meeting of Shareholders	=	EGM
Federal Commission for the Securities Market	=	FCSM
FCSM Code of Corporate Conduct	=	FCSM Code
General Meeting of Shareholders	=	GMS
Law on Joint Stock Companies	=	Company Law or LJSC
Limited Liability Company	=	LLC
Meeting of the Supervisory Board	=	Board meeting
Member of the Board of Directors	=	Supervisory Board member or director
Non-Governmental Organization	=	NGO
Open Joint Stock Company	=	Company
OECD Principles of Corporate Governance	=	OECD Principles
Sole Executive Body, Chief Executive Officer	=	General Director

Contents

PREFACE.....	XI
<i>Background</i>	<i>xi</i>
<i>Purpose and Target Audience</i>	<i>xi</i>
<i>How to Use this Manual</i>	<i>xii</i>
<i>Acknowledgements</i>	<i>xv</i>
<i>Frequently Used Shortenings and Acronyms</i>	<i>xviii</i>
PART I – CORPORATE GOVERNANCE INTRODUCED	
Chapter 1. <i>An Introduction to Corporate Governance</i>	1
Chapter 2. <i>The General Governance Structure of a Company</i>	27
Chapter 3. <i>The Internal Corporate Documents</i>	44
PART II – GOOD BOARD PRACTICES	
Chapter 4. <i>The Supervisory Board</i>	1
Chapter 5. <i>The Executive Bodies</i>	75
Chapter 6. <i>The Role of the Corporate Secretary</i>	103
PART III – SHAREHOLDER RIGHTS	
Chapter 7. <i>An Introduction to Shareholder Rights</i>	1
Chapter 8. <i>The General Meeting of Shareholders</i>	33
Chapter 9. <i>Corporate Governance Implications of the Charter Capital</i>	91
Chapter 10. <i>Dividends</i>	119
Chapter 11. <i>Corporate Governance Implications of Corporate Securities</i>	137
Chapter 12. <i>Material Corporate Transactions</i>	171
PART IV – INFORMATION DISCLOSURE AND TRANSPARENCY	
Chapter 13. <i>Information Disclosure</i>	1
Chapter 14. <i>Control and Audit Procedures</i>	49
PART V – SPECIAL FOCUS SECTION	
Chapter 15. <i>Corporate Governance in Groups of Companies</i>	1
Chapter 16. <i>Corporate Governance Implications of Reorganizations</i>	25
Chapter 17. <i>Enforcement and Remedies</i>	51

The Russia Corporate Governance Manual

PART VI – ANNEXES

IMPORTANT NOTE	1
PART I – CORPORATE GOVERNANCE INTRODUCED	3
<i>Annex 1: The IFC Corporate Governance Progression Matrix for Russian Companies</i>	<i>4</i>
<i>Annex 2: A Model Charter</i>	<i>9</i>
<i>Annex 3: Table of Charter Provisions</i>	<i>41</i>
<i>Annex 4: A Model Company Corporate Governance Code</i>	<i>55</i>
<i>Annex 5: A Model Code of Ethics</i>	<i>73</i>
PART II – GOOD BOARD PRACTICES	81
<i>Annex 6: A Model By-Law for the Supervisory Board</i>	<i>83</i>
<i>Annex 7: A Model By-Law for the Supervisory Board's Audit Committee</i>	<i>109</i>
<i>Annex 8: A Model By-Law for the Supervisory Board's Corporate Governance Committee</i>	<i>119</i>
<i>Annex 9: A Model By-Law for the Supervisory Board's Nominations and Remuneration Committee</i>	<i>127</i>
<i>Annex 10: A Model By-Law for the Supervisory Board's Strategic Planning and Finance Committee</i>	<i>135</i>
<i>Annex 11: A Model By-Law for the Executive Bodies</i>	<i>143</i>
<i>Annex 12: A Model By-Law for the Corporate Secretary</i>	<i>155</i>
<i>Annex 13: A Model Contract with the Non-Executive Director</i>	<i>163</i>
<i>Annex 14: A Model Employment Contract with the General Director</i>	<i>171</i>
<i>Annex 15: A Model Employment Contract with the Corporate Secretary</i>	<i>183</i>
<i>Annex 16: Model Minutes for a Supervisory Board Meeting</i>	<i>191</i>
<i>Annex 17: A Model Checklist for the Supervisory Board's Self-Evaluation</i>	<i>195</i>
<i>Annex 18: A Model Definition of an Independent Director</i>	<i>199</i>
PART III – SHAREHOLDER RIGHTS	201
<i>Annex 19: A Model By-Law for the General Meeting of Shareholders</i>	<i>203</i>
<i>Annex 20: A Model By-Law on Dividends</i>	<i>229</i>
<i>Annex 21: A Model Notice of the General Meeting of Shareholders</i>	<i>235</i>
<i>Annex 22: A Model Power of Attorney (from an individual)</i>	<i>237</i>
<i>Annex 23: A Model Power of Attorney (from a legal entity)</i>	<i>239</i>
<i>Annex 24: Time Charts for the Preparation of the Extraordinary General Meeting of Shareholders</i>	<i>241</i>
PART IV – INFORMATION DISCLOSURE AND TRANSPARENCY	245
<i>Annex 25: A Model By-Law on Information Disclosure</i>	<i>247</i>
<i>Annex 26: A Model By-Law for the Revision Commission</i>	<i>263</i>
<i>Annex 27: A Model By-Law on Risk Management</i>	<i>273</i>
<i>Annex 28: A Model By-Law on Internal Control</i>	<i>283</i>
<i>Annex 29: Guidelines on the Annual Report</i>	<i>303</i>
<i>Annex 30: Glossary of English-Russian Corporate Governance Terminology</i>	<i>315</i>



Chapter 1

An Introduction to **Corporate Governance**

Table of Contents

A. CORPORATE GOVERNANCE EXPLAINED	4
1. <i>Defining Corporate Governance</i>	4
2. <i>The Role of Stakeholders</i>	7
3. <i>A Brief History</i>	8
4. <i>The International Scope of Good Corporate Governance</i>	10
5. <i>Distinguishing Corporate Governance</i>	11
B. THE BUSINESS CASE FOR CORPORATE GOVERNANCE	12
1. <i>Stimulating Performance and Improving Operational Efficiency</i>	13
2. <i>Improving Access to Capital Markets</i>	15
3. <i>Lowering the Company's Cost of Capital and Raising the Value of Assets</i>	16
4. <i>Building a Better Reputation</i>	18
C. THE COST OF CORPORATE GOVERNANCE	18
D. THE CORPORATE GOVERNANCE FRAMEWORK IN RUSSIA	20
1. <i>Specifics of Corporate Governance in Russia</i>	20
2. <i>The Legal and Regulatory Framework</i>	21
3. <i>The FCSM Code of Corporate Conduct</i>	23
4. <i>The Institutional Framework</i>	25

The Chairman's Checklist

- ✓ Do all directors and key executives understand the concept of corporate governance and its significance to the company and its shareholders?
- ✓ Has the Supervisory Board developed a clear and explicit governance policy, and a plan to improve the company's governance practices? Have steps been taken to implement this plan?
- ✓ Has the company formally nominated an individual, for example the Corporate Secretary, or established a Supervisory Board committee or similar body responsible for supervising the corporate governance policies and practices of the company?
- ✓ Are key officers familiar with the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) and the OECD Principles of Corporate Governance? Does the company follow the main recommendations of the FCSM Code and disclose information on compliance to shareholders and stakeholders in its annual report?
- ✓ Is the company familiar with the main institutions active in the field of corporate governance that can serve as external resources for the company?

Corporate governance has become an increasingly popular term in Russia since the late 1990s. Not only has Russia witnessed a transformation in the role of the private sector in economic development and job creation, but corporate scandals, global competition, and various domestic and international efforts have made corporate governance a household name.

Unfortunately, few companies appear to truly appreciate the depth and complexity of this topic. Indeed, corporate governance reforms are often introduced superficially and used as a public relations exercise rather than as a tool to introduce the structures and process that enable the company to gain the trust of its shareholders, reduce vulnerability to financial crises, and increase the company's ability to access capital. Introducing internal structures and processes built on the principles of fairness, transparency, accountability, and responsibility is a difficult task that requires an ongoing commitment by the company.

This chapter defines corporate governance, makes a business case for its implementation, and provides an overview of the legal, regulatory, and institutional frameworks for corporate governance in Russia today.

A. Corporate Governance Explained

1. Defining Corporate Governance

There is no single definition of corporate governance that can be applied to all situations and jurisdictions. The various definitions that exist today largely depend on the institution or author, as well as country and legal tradition. For example, a regulator such as the Russian Federal Commission for the Securities Market (FCSM) is likely to define corporate governance differently than a corporate director or institutional investor.¹

The International Finance Corporation and its Russia Corporate Governance Project define corporate governance as “the structures and processes for the direction and control of companies.” The Organization for Economic Cooperation and Development (OECD), which in 1999 published its Principles of Corporate Governance offers a more detailed, definition of corporate governance as

“the internal means by which corporations are operated and controlled [...], which involve a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and

¹ The FCSM takes a broad, public sector view and its definition states that “corporate governance affects the performance of economic entities and their ability to attract the capital required for economic growth.” On the other hand, the Council of Institutional Investors, an organization of large labor and corporate pension funds whose assets exceed US\$2 trillion, takes the shareholder perspective and asserts that “in general, [...] corporate governance structures and practices should protect and enhance accountability to, and ensure the equal financial treatment of, shareholders.” (See also: http://www.cii.org/dcwascii/web.nsf/doc/governance_index.cm).

Chapter 1. An Introduction to Corporate Governance

shareholders, and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.”²

Most definitions that center on the company itself (an internal perspective) do, however, have certain elements in common, which can be summarized as follows:

- **Corporate governance is a system of relationships, defined by structures and processes:** For example, the relationship between shareholders and management consists of the former providing capital to the latter to achieve a return on their (shareholder) investment. Managers in turn are to provide shareholders with financial and operational reports on a regular basis and in a transparent manner. Shareholders also elect a supervisory body, often referred to as the Board of Directors or Supervisory Board, to represent their interests. This body essentially provides strategic direction to and control over the company’s managers. Managers are accountable to this supervisory body, which in turn is accountable to shareholders through the General Meeting of Shareholders (GMS). The structures and processes that define these relationships typically center on various performance management and reporting mechanisms.
- **These relationships may involve parties with different and sometimes contrasting interests:** Differing interests may exist between the main governing bodies of the company, i.e. the GMS, Supervisory Board and General Director (or other executive bodies). Contrasting interests exist most typically between owners and managers, and are commonly referred to as the principal-agent problem.³ Conflicts may also exist within each governing body, such as between shareholders (majority vs. minority, controlling vs. non-controlling,

² OECD Principles of Corporate Governance (see also: www.oecd.org).

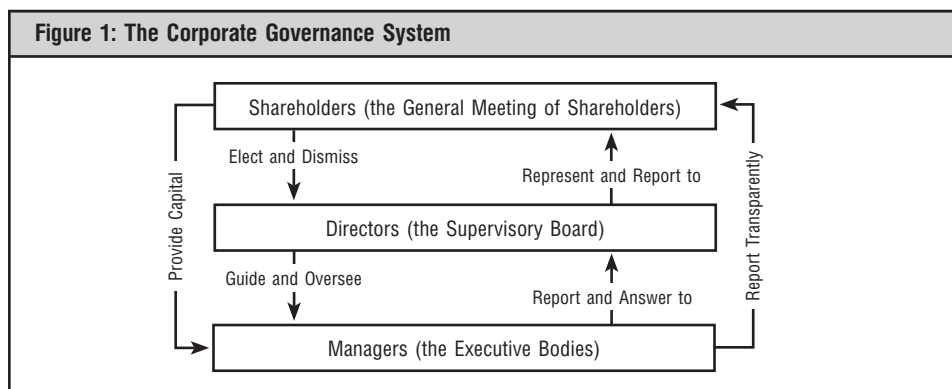
³ The principal-agent problem is defined as follows by the Oxford Dictionary of Economics: “The problem of how Person (A) can motivate Person (B) to act for (A’s) benefit rather than following his self-interest.” In a company setting, Person (A) is the investor (or principal) and (B) the manager (or agent). Managers at times may follow different goals than investors (e.g. building business empires rather than creating shareholder value), act dishonestly and, at times, even in an incompetent manner. This essentially creates three types of agency costs: (i) divergence costs (i.e. managers that do not maximize the investors’ wealth); (ii) monitoring costs (investors have to develop and implement control structures), including replacement costs; and (iii) incentive costs (costs incurred by investors to remunerate and incentivize their managers). The core role of a corporate governance system is to reduce total agency costs, thus maximizing the value of the company to investors.

The Russia Corporate Governance Manual

individual vs. institutional) and directors (executive vs. non-executive, outside vs. inside, independent vs. dependent); and each of these contrasting interests needs to be carefully observed and balanced.

- **All parties are involved in the direction and control of the company:** The GMS, representing shareholders, takes fundamental decisions, for example the distribution of profits and losses. The Supervisory Board is generally responsible for guidance and oversight, setting company strategy and controlling managers. Executives, finally, run the day-to-day operations, such as implementing strategy, drafting business plans, managing human resources, developing marketing and sales strategies, and managing assets.
- **All this is done to properly distribute rights and responsibilities — and thus increase long-term shareholder value.** For example, how can outside, minority shareholders prevent a controlling shareholder from gaining benefits through related party transactions, tunneling, or similar means.⁴

The basic corporate governance system and the relationships between the governing bodies are depicted in Figure 1.



Source: IFC, March 2004

The external aspect of corporate governance, on the other hand, concentrates on relationships between the company and its stakeholders. Stakeholders are those individuals or institutions that have an interest in the enterprise; such an interest

⁴ Corporate Governance: A Framework for Implementation, the World Bank. See also: <http://www.worldbank.org/html/fpd/privatesector/cg/docs/gcgfb booklet.pdf>.

may arise through legislation or contract, or by way of social or geographic relationships. Stakeholders include investors, but also employees, creditors, suppliers, consumers, regulatory bodies and state agencies, and the local community in which a company operates. Some commentators also include consideration of the environment as an important entry on the list of stakeholders.

2. The Role of Stakeholders

Many international codes, including the OECD Principles, discuss the role of stakeholders in the governance process. The role of stakeholders in governance has been debated in the past, with some arguing that stakeholders have no claim on the enterprise other than those specifically set forth in law or contract. Others have argued that companies fulfill an important social function, have a societal impact and must, accordingly, act in the broad interests of society. This view recognizes that companies should, at times, act at the expense of shareholders.

Interestingly, there is a consensus that modern companies cannot effectively conduct their businesses while ignoring the concerns of stakeholder groups. However, there is also an agreement that companies which consistently place other stakeholder interests before those of shareholders cannot remain competitive over the long run.

Best Practices: A key aspect of corporate governance is concerned with ensuring the flow of external capital to firms. Corporate governance is also concerned with finding ways to encourage stakeholders to undertake socially efficient levels of investment in firm-specific human and physical capital. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of resource providers including investors, employees, creditors, and suppliers. Corporations should recognize that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating co-operation among stakeholders. The governance framework should acknowledge that the interests of the corporation are served by recognizing the interests of stakeholders and their contribution to the long-term success of the corporation.⁵

⁵ OECD Principles of Corporate Governance, Annotations to Principle III on the Role of Stakeholders in Corporate Governance. See also: www.oecd.org.

The degree to which stakeholders participate in corporate governance largely depends on national laws and practices, and may vary from country to country. Employee representation on the Supervisory Board is one example of such stakeholder participation mechanisms; governance processes that consider stakeholder viewpoints for certain key decisions is another.

In any event, directors and managers will want to give due consideration to this complex issue and to the stakeholders' role in the governance of the company.

3. A Brief History

Corporate governance systems have evolved over centuries, often in response to corporate failures or systemic crises. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England. Similarly, much of the securities law in the U.S. was put in place following the stock market crash of 1929. There has been no shortage of other crises, such as the secondary banking crisis of the 1970s in the U.K., U.S. savings and loan debacle of the 1980s, and, closer to home, the 1998 financial crisis in Russia.

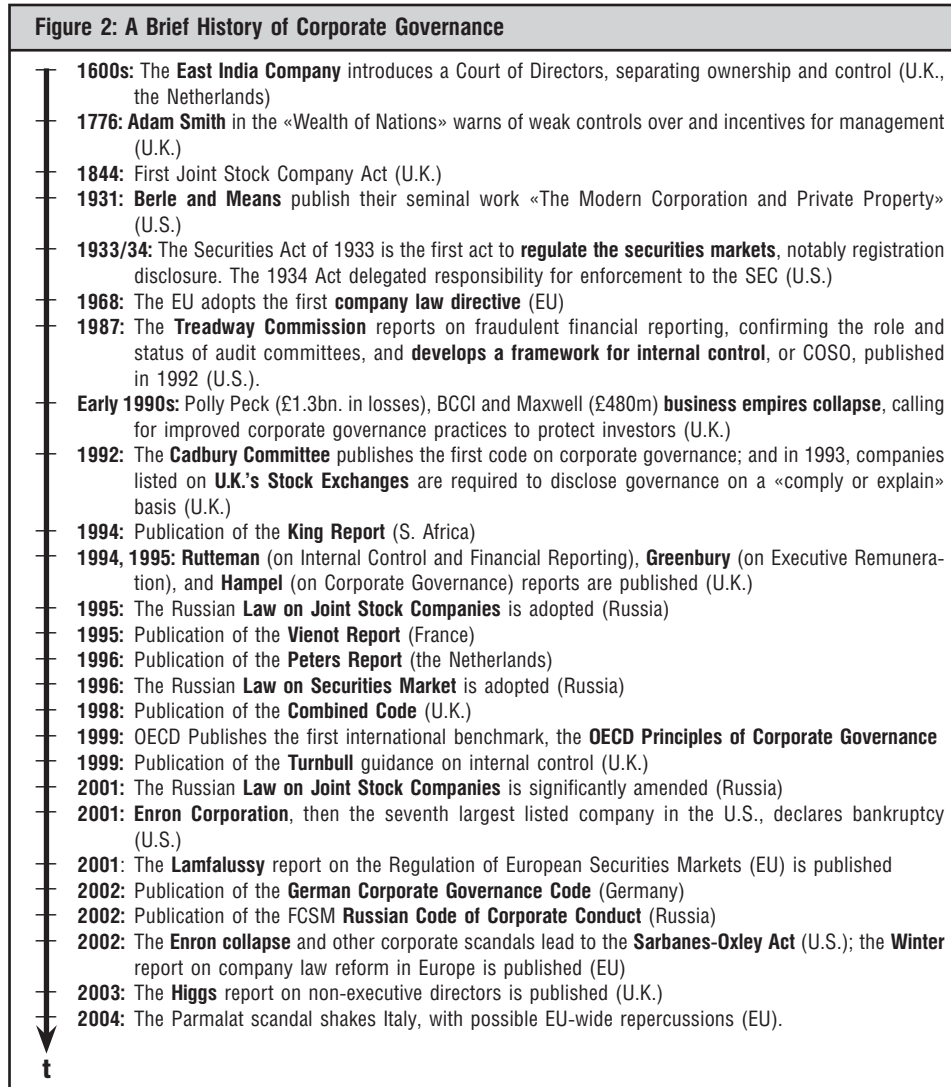
The history of corporate governance has also been punctuated by a series of well-known company failures. The early 1990s saw the Maxwell Group raid the pension fund of the Mirror Group of newspapers and witnessed the collapse of Bearings Bank. The new century likewise opened with a bang, with the spectacular collapse of Enron in the U.S., the near-bankruptcy of Vivendi Universal in France, and the recent scandal at Parmalat in Italy. Each of these corporate failures — often occurring as a result of incompetence or outright fraud — was swiftly met by new governance frameworks, most notably the many national corporate governance codes and the Sarbanes-Oxley Act.

In Russia too, much has changed since the rampant asset stripping and transfer pricing abuses that took place during the early days of transition, not to mention the abuses that took place during Russia's two privatization phases. The 1998 financial crisis perhaps brought the harshest response. However, the legal and regulatory framework has improved dramatically in recent years. The adoption of the Company Law in 1995 and its subsequent update in 2001, together with the adoption of amendments to the Law on the Securities Market in 2002, are but two examples of the many positive changes to the legal and regulatory framework. The publication of the FCSM Code certainly must be hailed as a landmark for

Chapter 1. An Introduction to Corporate Governance

Russian corporate governance, providing the first ever benchmark on this subject for Russian companies.

Figure 2 illustrates some highlights in the history of corporate governance, largely from the western world.



Source: IFC, March 2004

4. The International Scope of Corporate Governance

Numerous codes of best practices and corporate governance principles have been developed over the last ten years. Worldwide, over 100 codes have been written in some 40 countries and regions.⁶ Most of these codes focus on the role of the Supervisory Board (or Board of Directors) in the company. A handful are international in scope.⁷

Among these, only the OECD Principles address both policy makers and businesses, and focus on the entire governance framework (shareholder rights, stakeholders, disclosure, and board practices). The OECD Principles have gained worldwide acceptance as a framework and reference point for corporate governance. Published in 1999 and revised in 2004, they were developed to provide principle-based guidance on good governance.

The OECD corporate governance framework is built on four core values:

- **Fairness:** The corporate governance framework should protect shareholder rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violations of their rights.
- **Responsibility:** The corporate governance framework should recognize the rights of stakeholders as established by law, and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.
- **Transparency:** The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the company, including its financial situation, performance, ownership, and governance structure.

⁶ For a complete list of country codes of corporate governance, see the website of the European Corporate Governance Institute under www.ecgi.com.

⁷ Corporate governance codes of international scope include the OECD Principles of Corporate Governance (www.oecd.org), recommendations of the European Association of Securities Dealers (EASD — www.easd.com), the Corporate Governance Guidelines of the Confederation of European Shareholders Associations (www.wfic.org/esh), the International Corporate Governance Network's Statement on Global Corporate Governance Principles (ICGN — www.icgn.org), and the Commonwealth Association for Corporate Governance (CACG — www.cacg-inc.com).

- **Accountability:** The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and shareholders.

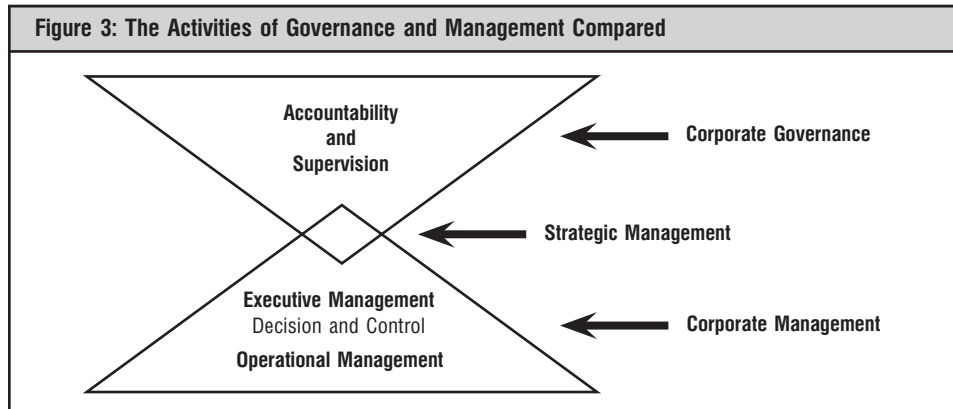
Many national codes of governance, including the FCSM Code, have been developed based on the OECD Principles. The OECD Principles can serve as an excellent reference point for international practice and are recommended reading for those interested in understanding some of the principles that underlie national standards.

Best Practices: The FCSM Code states that: "The principles of corporate conduct set forth in this chapter form the basis of the recommendations contained in the chapters of this Code that follow, and also serve as fundamental guidelines to be observed in the absence of specific recommendations. These principles have been drafted according to the OECD's Principles of Corporate Governance, international [...] practice, as well as experience accumulated in Russia since the enactment of the Federal Law On Joint Stock Companies."⁸

5. Distinguishing Corporate Governance

Corporate governance must not be confused with corporate management. Corporate governance focuses on a company's structure and processes to ensure fair, responsible, transparent, and accountable corporate behavior. Corporate management on the other hand focuses on the tools required to operate the business. Corporate governance is situated at a higher level of direction that ensures that the company is managed in the interest of its shareholders. One area of overlap is strategy, which is dealt with at the corporate management level and is also a key corporate governance element. Figure 3 illustrates the difference between corporate governance and corporate management.

⁸ FCSM Code, Chapter 1, Introduction.



Source: Robert I. Tricker, *Corporate Governance*, 1984

Corporate Governance must also not be confused with public governance, which deals with the governance structures and systems within the public sector.

Corporate governance must further be distinguished from good corporate citizenship, corporate social responsibility, and business ethics. Good corporate governance will certainly reinforce these important concepts. But while companies that do not pollute and invest in socially responsible projects or run charitable foundations often benefit with superior reputation, public goodwill, and even better profitability, corporate governance is and remains distinct from these concepts.

B. The Business Case for Corporate Governance

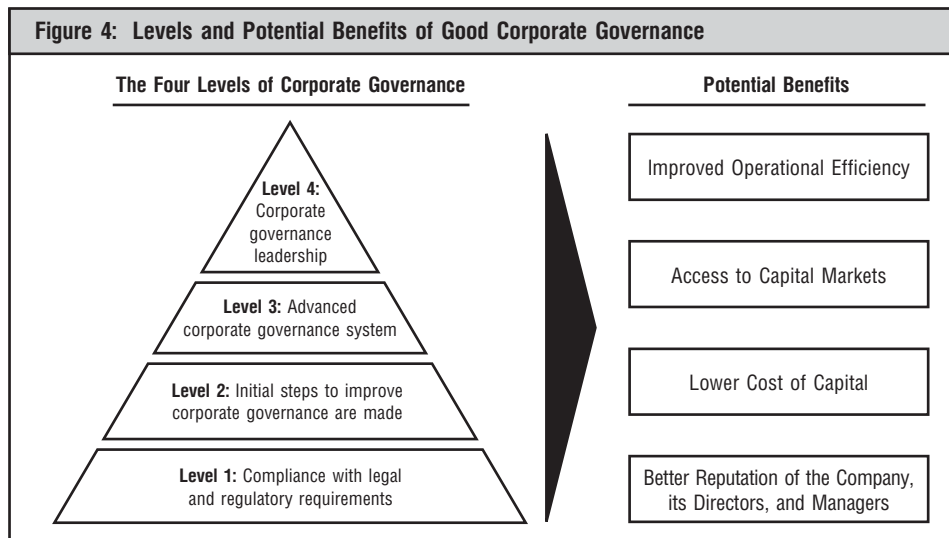
Good corporate governance is important on a number of different levels.

At the company level, well-governed companies tend to have better and cheaper access to capital, and tend to outperform their poorly governed peers over the long-term. Companies that insist upon the highest standards of governance reduce many of the risks inherent to an investment in a company. Companies that actively promote robust corporate governance practices need key employees who are willing and able to devise and implement good corporate governance policies. These companies will generally value and compensate such employees more than their competitors that are unaware of, or ignore, the benefits of these

policies and practices. In turn, such companies tend to attract more investors who are willing to provide capital at lower cost.

More generally, well-governed companies are better contributors to the national economy and society. They tend to be healthier companies that add more value to shareholders, workers, communities, and countries in contrast with poorly governed companies that may cause job losses, the loss of pensions, and even undermine confidence in securities markets.

Some of the building blocks, or levels, and specific benefits of good governance are depicted in Figure 4 and discussed in further detail below.

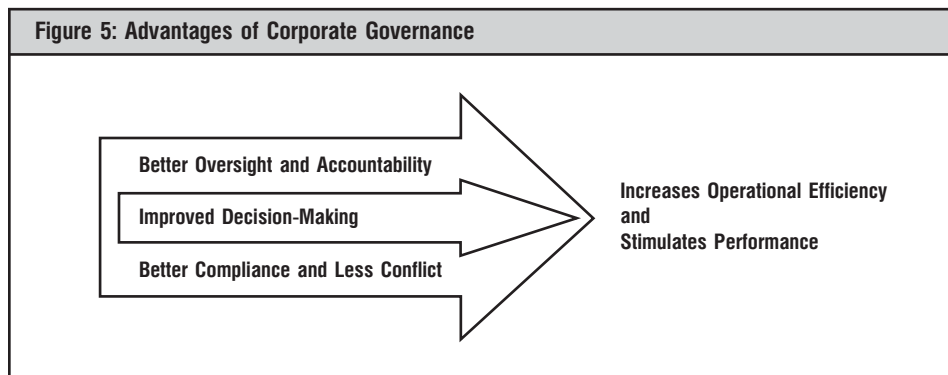


Source: IFC, March 2004

→ See also the IFC corporate governance progression matrix in Part VI, Annex 1.

1. Stimulating Performance and Improving Operational Efficiency

There are several ways in which good corporate governance can improve performance and operational efficiency, as illustrated in Figure 5.



Source: IFC, March 2004

Improvement in the company's governance practices leads to an improvement in the accountability system, minimizing the risk of fraud or self-dealing by the company's officers. Accountable behavior, combined with effective risk management and internal controls, can bring potential problems to the forefront before a full-blown crisis occurs. Corporate governance improves the management and oversight of executive performance, for example by linking executive remuneration to the company's financial results. This creates favorable conditions not only for planning the smooth succession and continuity of the company's executives, but also for sustaining the company's long-term development.

Adherence to good corporate governance standards also helps to improve the decision-making process. For example, managers, directors and shareholders are all likely to make more informed, quicker and better decisions when the company's governance structure allows them to clearly understand their respective roles and responsibilities, as well as when communication processes are regulated in an effective manner. This, in turn, should significantly enhance the efficiency of the financial and business operations of the company at all levels. High quality corporate governance streamlines all the company's business processes, and this leads to better operating performance and lower capital expenditures,⁹ which, in turn,

⁹ Paul A. Gompers, Joy L. Ishii and Andrew Metrick, Corporate Governance and Equity Prices, NBER Working Paper No. w8449, August 2001.

Chapter 1. An Introduction to Corporate Governance

may contribute to the growth of sales and profits with a simultaneous decrease in capital expenditures and requirements.

An effective system of governance practices should ensure compliance with applicable laws, standards, rules, rights, and duties of all interested parties, and further, should allow companies to avoid costly litigation, including those costs related to shareholder claims and other disputes resulting from fraud, conflicts of interest, corruption and bribery, and insider trading. A good system of corporate governance will facilitate the resolution of corporate conflicts between minority and controlling shareholders, executives and shareholders, and between shareholders and stakeholders. Also, company officers will be able to minimize the risk of personal liability.

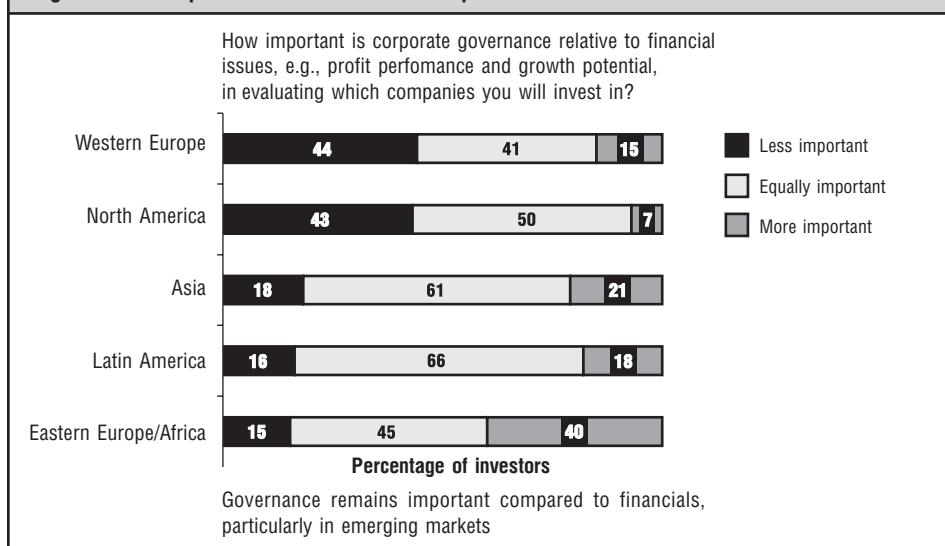
2. Improving Access to Capital Markets

Corporate governance practices can determine the ease with which companies are able to access capital markets. Well-governed firms are perceived as investor-friendly, providing greater confidence in their ability to generate returns without violating shareholder rights.

Good corporate governance is based on the principles of transparency, accessibility, efficiency, timeliness, completeness, and accuracy of information at all levels. With the enhancement of transparency in a company, investors benefit from being provided with an opportunity to gain insight into the company's business operations and financial data. Even if the information disclosed by the company is negative, shareholders will benefit from the decreased risk of uncertainty.

Of particular note is the observable, if recent trend among investors to include corporate governance practices as a key decision-making criterion in investment decisions. The better the corporate governance structure and practices, the more likely that assets are being used in the interest of shareholders and not being tunneled or otherwise misused by managers. Figure 6 illustrates that corporate governance practices can take on particular importance in emerging markets where shareholders do not always benefit from the same protections as are available in more developed markets.

Figure 6: The Importance of Governance Compared to Financial Statements



Source: McKinsey & Company, Global Investor Opinion Survey, July 2002

Finally, new listing requirements on many stock exchanges around the world require companies to adhere to increasingly strict standards of governance. Companies wishing to access both domestic and international capital markets will need to adhere to specific corporate governance standards.

3. Lowering the Company's Cost of Capital and Raising the Value of Assets

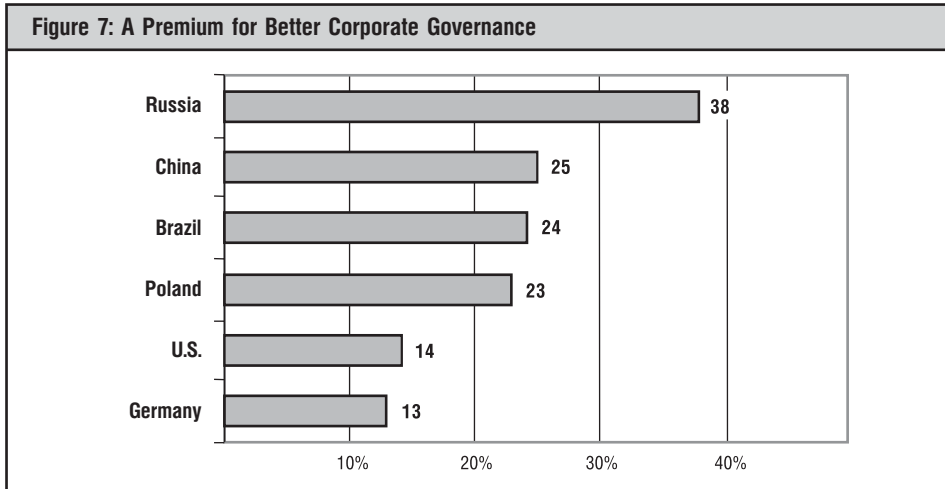
Companies committed to high standards of corporate governance are typically successful in obtaining reduced costs when incurring debt and financing for operations, and in this way, they are able to decrease their cost of capital. The cost of capital depends upon the level of risk assigned to the company by investors: the higher the risk, the higher the cost of capital. These risks include the risk of violations of investor rights. If investor rights are adequately protected, the cost of equity and debt capital may decrease. It should be noted that investors providing debt capital, i.e. creditors, have recently tended to include a company's corporate governance practices (for example transparent ownership structure and appropriate financial reporting) as a key criterion in their investment decision-making process. Thus, the implementation of a good corporate governance system

Chapter 1. An Introduction to Corporate Governance

should ultimately result in the company paying lower interest rates and receiving longer maturity on loans and credits.

The level of risk and cost of capital also depend on a country's economic or political situation, institutional framework, and enforcement mechanisms. Corporate governance at a particular company thus plays a crucial role in emerging markets, which often do not have as good a system of enforcing investor rights as countries with developed market economies.

This holds particularly true in countries such as Russia where the legal framework is relatively new and still being tested, and where courts do not always provide investors with effective recourse when their rights are violated. This means that even modest improvements in corporate governance relative to other companies can make a large difference for investors and decrease the cost of capital.¹⁰ Figure 7 tellingly demonstrates that a majority of investors are willing to pay a premium for a well-governed company; this premium amounts to 38% for Russian companies. At the country level, studies show that Russia has considerably higher borrowing costs than many other countries due to corruption, opaque legislation and judicial practices, weak corporate governance, uncertainty, and arbitrariness.¹¹



Source: McKinsey & Company, Global Investor Opinion Survey, July 2002

¹⁰ Leora F. Klapper, Inessa Love, Corporate Governance, Investor Protection and Performance in Emerging Markets, World Bank Policy Research Working Paper 2818, April 2002.

¹¹ The Opacity Index, PricewaterhouseCoopers, January 2001 (<http://www.opacity-index.com>).

At the same time, there is a strong relationship between governance practices and how investors perceive the value of company assets (such as fixed assets, receivables, product portfolio, human capital, research and development, and goodwill).

4. Building a Better Reputation

In today's business environment, reputation has become a key element of a company's goodwill. A company's reputation and image effectively constitute an integral, if intangible, part of its assets. Good corporate governance practices contribute to and improve a company's reputation. Thus, those companies that respect the rights of shareholders and creditors, and ensure financial transparency and accountability, will be regarded as being an ardent advocate of investors' interests. As a result, such companies will enjoy more public confidence and goodwill.

This public confidence and goodwill can lead to higher trust in the company and its products, which in turn may lead to higher sales and, ultimately, profits. A company's positive image or goodwill is moreover known to play a significant role in the valuation of a company. Goodwill in accounting terms is the amount that the purchase price exceeds the fair value of the acquired company's assets. It is the premium one company pays to buy another.

C. The Cost of Corporate Governance

Good governance entails real costs. Some of the costs include hiring dedicated staff such as corporate secretaries, experienced and independent directors, internal auditors, or other governance specialists. It will likely require the payment of fees to external counsel, auditors, and consultants. The costs of additional disclosure can be significant as well. Furthermore, it requires considerable managerial and Supervisory Board time, especially in the start-up phase. These costs tend to make implementation considerably easier for larger companies that may have the resources to spare than smaller companies whose resources may be stretched quite thin.

Best Practices: Corporate governance is most, if not solely, applicable to larger, open joint stock companies that are publicly traded on an exchange. A large, dispersed shareholder base, where controlling shareholders and managers can wield extraordinary powers and potentially abuse shareholder rights, often defines such companies. Large companies are moreover important elements of a country's economy and thus require close public scrutiny and attention. This holds particularly true in Russia, where the 23 largest business groups control 35% of the country's industry by sales (RUR 1.7 trillion or approximately U.S. \$ 60 billion) and at least 16% of its employment (1.44 million people).¹² Moreover, the 42 largest companies by market capitalization make up 98% of the total value of all listed companies in Russia;¹³ and of these, three alone (RAO UES, Gazprom and MPS) make-up 13.5% of Russia's GDP.

Notwithstanding, corporate governance is beneficial to all companies, irrespective of size, legal form, number of shareholders, ownership structure or other characteristics. Of course, a one-size-fits-all approach should be avoided and companies should carefully apply corporate governance standards. For example, smaller companies may not require a full set of Supervisory Board committees or a full-time Corporate Secretary. On the other hand, even a small company may benefit from an advisory body.

A company will not always see instant improvements to its performance due to better corporate governance practices. However, returns, while sometimes difficult to quantify, generally exceed the costs in particular over the long term. This is especially true when one takes into account potential risks of losses in jobs, pensions, invested capital and the disruption that may be caused to communities when companies collapse. In some cases, systemic governance problems may undermine faith in the financial markets and threaten market stability.

Finally, it must be noted that corporate governance is not a one-time exercise but rather an ongoing process. No matter how many corporate governance structures and processes the company has in place, it is advisable to regularly update and review them. Markets tend to value long-term commitment to good governance practice rather than a single action or "box-ticking" exercises.

¹² The World Bank, From Transition To Development, A Country Economic Memorandum for the Russian Federation, April 2004.

¹³ Standard & Poor's, Concentration of Ownership and Corporate Governance in Russia – What Drives the Trend? EuroWeek, March 2003.

D. The Corporate Governance Framework in Russia

1. Specifics of Corporate Governance in Russia

While many argue that corporate governance models are converging, important differences remain. All countries have a unique history, culture, and legal and regulatory framework, each of which influences a company's corporate governance framework. The following is a list of features that characterize Russia's corporate sector.

Concentrated ownership. Although the early 1990s witnessed a relatively dispersed ownership structure in the follow-up to the privatization phase — if only briefly and formally — most Russian companies today are controlled by a single controlling shareholder or small group of shareholders. This holds true not only for the natural resource sector, such as oil production and processing, but communications, metallurgy and forestry as well. This concentrated ownership structure often results in minority shareholder abuses. Insider dominance and the weak protection of external shareholders/investors has largely contributed to the underdevelopment of the capital markets in Russia; to date, there are only a handful of companies listed on Russia's two major stock exchanges.¹⁴ A trend, albeit nascent, towards IPOs and thus more dispersed ownership can however be witnessed. Whether these majority shareholders are truly willing to reduce or even exit their investments, remains to be seen.

Little separation of ownership and control. Most controlling shareholders also act as the company's General Director and sit on the Supervisory Board. Those companies that do separate ownership and control often do so only on paper. Such companies typically suffer from weak accountability and control structures (effectively, the majority/controlling shareholders oversee themselves in their function as directors and managers), abusive related party transactions, and poor information disclosure (insiders have access to all information and are unmotivated to disclose to outsiders).

Unwieldy holding structures. Major business groups in the form of holding companies control companies in most industries. While holding structures can serve legitimate purposes, complex business structures, cross-shareholdings, pyra-

¹⁴ As of February 2004, there are eight companies listed on Tier A, Level 1, 14 companies on Tier A, Level 2, and 16 companies on Tier B on the RTS stock exchange.

mid structures, and other arrangements to create opaque ownership structures can make the company difficult to understand for shareholders and investors. Such structures are often used to expropriate and circumvent the rights of individual shareholders. Poor consolidated accounting, or even the absence thereof, is a further corporate governance issue that has yet to be tackled.

Reorganization. On the other hand, many of these holding structures are currently being reorganized for various reasons. Some controlling shareholders have discovered a desire to build and run proper businesses — based on good corporate governance — thus leaving a positive legacy behind. Others seek to properly transfer their businesses to the next generation or sell their stakes to outside investors. This process may still take place outside the legal system and is often marked by conflicts, although many of the criminal takeovers that marked the 1990s have subsided.

Inexperienced and inadequate Supervisory Boards. The concept of supervisory bodies was only introduced with Russia's transition to a market economy. Such a supervisory structure did not exist in state-owned enterprises during the Soviet Union. General Directors often seek to bypass this supervisory structure, seeking direct contact with the controlling shareholder (in as much as they are not one and the same person). The role of Supervisory Boards often remains unclear, with some taking on authorities that belong to the GMS and others becoming actively involved in the company's day-to-day management. Strong, vigilant and independent Supervisory Boards remain a rarity.

2. The Legal and Regulatory Framework

Russia's legal and regulatory framework for corporate governance has improved dramatically but remains nascent. The first comprehensive piece of legislation was approved in late 1995 when the Law on Joint Stock Companies was adopted. By that time, however, many companies had already been created, most in the wake of the first phase of privatization, and a proper corporate governance structure to guide companies was largely absent.

Today, all commercial enterprises, regardless of their legal form, are subject to a comprehensive set of laws, regulations, and governmental decrees as illustrated in Figure 8. In addition to the general legal and regulatory framework, there are legal acts that deal in more detail with specific corporate forms in Russia such as joint stock or limited liability companies.

The Russia Corporate Governance Manual

Figure 8: Principal Laws and Regulations Impacting Corporate Governance

Law / Regulation	Applicability	Comments
Civil Code	All commercial entities	Regulates basic governance framework
Company Law	Joint Stock Companies (JSCs)	Regulates founding, operation, and liquidation/reorganization of JSCs
Securities Law	JSCs that have publicly issued securities	Regulates procedures of issuance and circulation of securities; information disclosure
FCSM Regulations	JSCs that have publicly issued securities	Expands upon the Company and Securities Law
Secondary Regulations (tax, bankruptcy, etc.)	All commercial entities	Regulates specific issues for commercial entities
Listing Requirements	JSCs listed on a stock exchange	Regulates access to trading for issuers and investors

Source: IFC, March 2004

For example, the Civil Code and the Company Law apply to all joint stock companies in Russia.¹⁵ In addition to this general rule, companies in the banking, investment and insurance industries, as well as agribusinesses and state- or municipally-owned companies, need to comply with specific legislation.¹⁶ Securities legislation (the Law on the Securities Market) and regulations by the FCSM also apply to publicly traded companies.

Russian companies are also subject to other laws including, among others, laws on taxation, the registration of legal entities, bankruptcy, accounting, and auditing. Where appropriate, this Manual refers to these and other legal acts.

The list of legal acts in Figure 8 is far from complete. Moreover, Russian legislation continues to change as it develops and improves. For example, the Company Law has been amended several times in order to eliminate inconsisten-

¹⁵ Law on Joint Stock Companies (LJSC), Article 1, Clause 2.

¹⁶ LJSC, Article 1, Clauses 3–5.

Chapter 1. An Introduction to Corporate Governance

cies in provisions that regulate the activities of governing bodies, securities issues, the exercise of shareholder rights, and other matters.

Finally, Russian companies are being encouraged to adhere to voluntary codes of corporate governance such as the FCSM Code through listing requirements.

Best Practices: The corporate governance framework typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments, and business practices that are the result of country specific circumstances, history, and tradition. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc. in this area will therefore vary from country to country. As new experiences accrue and business circumstances change, the content and structure of this framework needs to be adjusted.¹⁷ Companies will need to carefully monitor such adjustments on a regular basis, and update their governance systems accordingly.

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

The FCSM Code was presented to the private sector in April 2002 and draws upon generally accepted principles of corporate governance, including the OECD Principles.

Best Practices: Good corporate governance practices are focused on respect for the lawful interests of all participants in corporate activities. They can improve the quality of a company's operations by means of, among other things, increasing the value of corporate assets, creating jobs and enhancing the financial stability and profitability of the company. Trust among all those involved in corporate activities is at the root of the effective operation of a company and the ability to attract investment. The Principles of Corporate Governance [...] are aimed at the creation of trust in relations arising in connection with corporate governance.¹⁸

¹⁷ OECD Principles of Corporate Governance, Annotations to the OECD Principles of Corporate Governance, Ensuring an effective corporate governance framework. See also: www.oecd.org.

¹⁸ FCSM Code, Chapter 1, Introduction.

While the FCSM Code is voluntary, there is some “force” behind its recommendations. Recently the FCSM issued a “methodological recommendation” to enforce compliance with its Code by publicly listed companies on a “comply” instead of “comply-or-explain basis.”¹⁹ This “methodological recommendation” deviates from standard disclosure practices found on most western exchanges, which require companies to disclose on a “comply-or-explain basis”, allowing them to deviate from certain recommendations that may not be applicable. Russian stock exchanges have since amended their listing requirements. More specifically, the Moscow Interbank Currency Exchange (MICEX) now requires that companies listed on Tier-A, Level 1 confirm their compliance with all recommendations contained in the FCSM Code.²⁰ On the same exchange, companies listed on Tier A, Level 2 are only required to comply with the recommendations contained in Chapter 7 of the FCSM Code on information disclosure.²¹ Similar rules on both levels are stipulated for listing securities on the RTS stock exchange.²²

Best Practices: The following principles of corporate conduct are fundamental guidelines underlying the formation, operation, and enhancement of a company’s system of corporate governance:²³

1. Corporate practice should provide shareholders with a real opportunity to exercise their rights in relation to the company.
2. Corporate governance practice should provide for the equitable treatment of all shareholders. Shareholders should have access to effective recourse in the event of a violation of their rights.
3. Corporate governance practice should provide for the direction and control by the Supervisory Board of the executive bodies of the company, and for the accountability of the Supervisory Board to shareholders.

¹⁹ FCSM Instruction No. 03-1169/r on the Approval of Methodological Recommendations for the Exercise of Control by the Organizers of Trade on Securities Market over the Compliance by Joint Stock Companies with the Provisions of the Code of Corporate Conduct, 18 June 2003, Section 2. Russia’s two leading stock exchanges are MICEX and RTS.

²⁰ Annex 1d, Rules of Listing, Access to Placement and Trade on the Moscow Interbank Currency Exchange, Section 9.

²¹ Annex 1d, Rules of Listing, Access to Placement and Trade on the Moscow Interbank Currency Exchange, Section 10.

²² Rules for the Access to Circulation of Securities, RTS stock exchange, Articles 5.2.6 and 5.3.4.

²³ FCSM Code, Chapter 1, Sections 1–7.

4. Corporate governance practice should ensure that executive bodies manage the day-to-day activities of the company without undue interference, in good faith, and solely in the interests of the company, and ensure that executive bodies report in full and on a timely basis to the Supervisory Board and shareholders.
5. Corporate governance practice should, in particular, provide for the full, timely, and accurate disclosure of all material information (including information about a company's financial position, financial indicators, and ownership and management structure) in order to enable shareholders and investors to make informed decisions.
6. Corporate governance practice should ensure compliance with applicable laws as related to the statutory or contractual rights of all stakeholders. Corporate governance practice should, more generally, encourage the consideration of the interests of stakeholders, including employees, even when they are not expressly set forth in law, and support active cooperation between the company and stakeholders with a view to increasing the assets and value of the company, and to creating new jobs.
7. Corporate governance practice should provide for the effective control over the financial and business operations of the company to protect the rights and lawful interests of shareholders.

4. The Institutional Framework

There are numerous institutions that make-up the institutional framework for corporate governance in Russia today, too many to list exhaustively. The following institutions have at least one core activity focusing on corporate governance.

Table 1: Corporate Governance Related Institutions in Russia	
Courts	
The Supreme Arbitration Court	www.arbitr.ru
Public Sector Institutions	
Federal Service for the Financial Markets	www.fcsm.ru
Ministry of Economic Development and Trade	www.economy.gov.ru
State Duma	www.duma.gov.ru

The Russia Corporate Governance Manual

Table 1: Corporate Governance Related Institutions in Russia	
Private Sector Institutions and Market Participants	
MICEX	www.micex.ru
RTS	www.rts.ru
Standard & Poor's	www.standardandpoors.ru
Troika Dialog	www.troika.ru
NGOs	
Association of Managers	www.amr.ru
Association of Russian Banks	www.arb.ru
Chamber of Commerce and Industry	www.tpprf.ru
Guild of Investment and Financial Analysts	www.gifa.ru
Independent Directors Association	www.naid.ru
Institute of Corporate Law and Governance	www.iclg.ru
Institute of Internal Auditors	www.iaa-ru.ru
Institute of Professional Auditors	www.e-ipar.ru
Institute of Professional Directors	www.fipd.ru
Investor Protection Association	www.corp-gov.ru
Moscow Chamber of Commerce and Industry	www.mtpp.org
National Association of Stock Market Participants	www.naufor.ru
Professional Association of Registrars, Transfer Agents, and Depositaries (PARTAD)	www.partad.ru
Russian Institute of Directors	www.rid.ru
Russian Institute of Stock Market and Management	www.ismm.ru
Russian Union of Industrialists and Entrepreneurs	www.rsppr.ru
International Organizations	
Global Corporate Governance Forum (GCGF)	www.gcgf.org
International Finance Corporation (IFC)	www.ifc.org
Organization for Economic Cooperation and Development (OECD)	www.oecd.org
The World Bank	www.worldbank.org
Universities	
Higher School of Economics – Center for Corporate Governance	www.hse.ru



Chapter 2

The **General Governance Structure** of a Company

Table of Contents

A. WHAT IS A JOINT STOCK COMPANY?	29
1. <i>The Definition of a Company</i>	29
2. <i>Open and Closed Joint Stock Companies</i>	30
3. <i>The Advantages of Open Joint Stock Companies over Other Legal Forms</i>	31
4. <i>Regulatory Distinctions Based on the Number of Shareholders</i>	33
B. THE GOVERNANCE STRUCTURE OF A COMPANY	35
1. <i>The General Meeting of Shareholders</i>	36
2. <i>The Supervisory Board</i>	37
3. <i>The Executive Bodies</i>	39
4. <i>The Revision Commission</i>	40
5. <i>Supervisory Board Committees</i>	40
6. <i>The Control and Revision Service (Internal Audit Function)</i>	41
7. <i>The Corporate Secretary</i>	41

The Chairman's Checklist

- ✓ Does the company's legal form best reflect the interests of the owners? Are other forms better suited to advance such interests? What are the advantages and disadvantages of the alternatives?
- ✓ In addition to the General Meeting of Shareholders, Supervisory Board and Revision Commission, has the company established an Executive Board, Supervisory Board committees, and an Internal Audit Function (Control and Revision Service)? Have these bodies been given the appropriate structures and proper resources to be effective? Does the company have a Corporate Secretary?

Company Law defines a joint stock company's status and provides for the structure of its governing bodies. The Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) further includes recommendations to establish additional governing bodies, for example Supervisory Board committees, the Corporate Secretary, and the Control and Revision Service. This chapter discusses the concept and governance structure of companies as they are defined by the Company Law and as recommended by the FCSM Code. The authorities, functions, and structures of the governing bodies are described in more detail in other chapters of this Manual.

A. What Is a Joint Stock Company?

1. The Definition of a Company

The Civil Code²⁴ and the Company Law²⁵ define a company as:

- A commercial entity,
- Whose charter capital is divided into a specified number of shares,
- Certifying the company participants' (shareholders') rights in relation to the company.

²⁴ Civil Code (CC), Article 96, Clause 1.

²⁵ Law on Joint Stock Companies (LJSC), Article 2, Clause 1, Paragraph 1.

Companies are the only legal entities that can issue shares. The shareholders are normally not liable for the company's obligations. Their risk is limited to the loss of the value of the shares they hold in the company.²⁶

2. Open and Closed Joint Stock Companies

Legislation distinguishes between open and closed joint stock companies.²⁷ Open companies require higher charter capital, and are subject to stricter and more complex rules regarding their governance and disclosure. Closed companies may be better suited for smaller enterprises for which a simple structure is usually preferable. Open companies are generally better suited for larger and growing companies that might wish to raise money in the equities markets.

	Open Companies	Closed Companies
Number of Shareholders ²⁸	No limit.	Maximum of 50.
Minimum Charter Capital ²⁹	1,000 times the minimum wage on the date of registration.	100 times the minimum wage on the date of registration.
Issuance of Shares ³⁰	Open subscription. A closed subscription is permitted unless the charter or legislation provides otherwise.	Closed subscription (only among founders or other pre-determined groups of persons). Cannot issue shares through an open subscription.
Transferability of Shares ³¹	No restrictions. Neither the consent of other shareholders nor the company is required.	Restricted. Other shareholders (and the company, if specified by the charter) have a right of first refusal.

²⁶ LJC, Article 2, Clause 1; CC, Article 96, Clause 1.

²⁷ LJC, Article 7, Clause 1.

²⁸ LJC, Article 7, Clauses 2 and 3.

²⁹ LJC, Article 26. The Law on the Minimum Amount of Payment for Labor (minimum wage) of 2 June 2000, Article 4. As of 1 September 2003, the minimum charter capital of an open company is 1,000 times RUR 100 (RUR 100,000), for a closed company 100 times RUR 100 (RUR 10,000).

³⁰ LJC, Article 7, Clauses 2 and 3.

³¹ LJC, Article 7, Clauses 2 and 3.

Chapter 2. The General Governance Structure of a Company

	Open Companies	Closed Companies
Supervisory Board ³²	Mandatory for an open company with 50 or more shareholders with voting rights.	Voluntary.
Disclosure ³³	The company must disclose a wide range of information regarding its financial position and operations.	The company must disclose certain information if it issues bonds or other securities to the public. Otherwise, no legal requirements to publicly disclose information.

Under certain circumstances, e.g. when the number of shareholders exceeds 50, closed companies must be transformed into open companies.³⁴ It is also possible for a closed company to voluntarily transform itself into an open company and vice-versa by following legal requirements, for example, by increasing the charter capital to meet higher minimum requirements.³⁵

! As this Manual focuses on open joint stock companies, each reference to company, or open company, means “open joint stock company”.

3. The Advantages of Open Joint Stock Companies over Other Legal Forms

a) Legal Forms of Commercial Entities

Russian law allows for the establishment of the following types of commercial entities:

- Production cooperatives;
- General partnerships;
- Limited partnerships;
- Limited liability companies;

³² LJSC, Article 64, Clause 1, Paragraph 2.

³³ LJSC, Article 88, Clause 3; Article 92, Clauses 1 and 2.

³⁴ LJSC, Article 7, Clause 3, Paragraph 3.

³⁵ LJSC, Article 26.

- Joint stock companies (open or closed); and
- Additional liability companies.

Company Practices in Russia: Limited Liability Companies (LLCs) are the most popular form of commercial entity in Russia today, totaling 1,642,095 companies as of 1 January 2003.³⁶ Closed joint stock companies are the second most common form, totaling 385,697 as of 1 January 2003. Open companies come in at third — 59,815. However, only 33,340 of these companies have reported to the State Statistics Commission as of 1 January 2003, which could be an indication that only these companies are actually operating.

b) Advantages of Open Compared to Closed Companies and LLCs

The open company offers many advantages, including:

- **Access to investors:** Open companies have greater opportunities to attract investment at lower cost. Furthermore, the scale of capital-intensive companies, such as airlines and power plants, is so large that few individual lenders or equity investor could provide the needed capital.
- **Free transferability of shares:** Shares of the company can be transferred without the consent of other shareholders, the company, or its management.
- **Limitation on the risks to shareholders:** The risks carried by shareholders are limited to the value of their investment and duties set by Russian legislation. Shareholders are not normally liable for the legal and financial obligations of a company.
- **Diversification of risks:** The risks of an open company are spread over a large number of shareholders.

c) Disadvantages of Open Companies

The principal economic advantage of the open company form is the ease with which it can access the financial markets. However, this special access is not without disadvantages. A number of organizational, legal, and regulatory hurdles

³⁶ State Commission of the Russian Federation on Statistics (GOSKOMSTAT), 2003.

Chapter 2. The General Governance Structure of a Company

must be cleared for a company to have the right to offer its securities to investors. An open company requires:

- **Compliance with securities regulations**, while LLCs are generally outside the purview of such regulation.
- **A complex organizational structure** that is designed to protect shareholders from abuse and allow professional managers to run the company. The company bears the costs associated with supporting its governing bodies.
- **Compliance with disclosure and other regulations.** An open company must at least publish annual reports and annual financial statements. Reporting may be more frequent. An External Auditor must audit the annual financial statements of the company. The company must comply with more rigorous legislation and regulation, and should follow codes and standards designed to protect shareholder rights. It must ensure the proper registration of shares.
- **Shareholders willing to invest in the company.** The company should be able to attract shareholders willing to risk investing in the company. There are costs associated with marketing an offering to investors and in maintaining good investor relations once shares have been floated.
- **Professional management.** The separation of ownership and control provides investors with the possibility to hire professional managers who devote their efforts and skills to run the company. The separation of ownership and control also provides professional managers with access to the capital needed to manage the company. Finding, developing, and retaining trustworthy professional managers is, however, a difficult task.
- **Higher minimum charter capital** than other legal forms.

4. Regulatory Distinctions Based on the Number of Shareholders

There are some differences in the regulation of companies with a small and large number of shareholders with voting rights. These differences are designed to provide for enhanced shareholder protection and/or easier administration of a company with a large number of shareholders.

The Russia Corporate Governance Manual

Table 2: Difference in Regulation According to the Number of Shareholders	
Number of Shareholders	Specific Provisions
One	<ul style="list-style-type: none"> The company may not have as its sole shareholder another commercial entity comprised of one person.³⁷ The rules on preparing and conducting the General Meeting of Shareholders (GMS) are not applicable.³⁸
Fewer than 50 ³⁹	<ul style="list-style-type: none"> The Supervisory Board is optional.⁴⁰
50 and more	<ul style="list-style-type: none"> The legal form of open company is mandatory.⁴¹ An External Registrar is mandatory.⁴² A Supervisory Board with at least five members is mandatory.⁴³
More than 100	<ul style="list-style-type: none"> Mandatory use of voting ballots.⁴⁴ A Counting Commission is mandatory.⁴⁵
More than 500	<ul style="list-style-type: none"> The External Registrar performs the functions of a Counting Commission.⁴⁶
1,000 and more	<ul style="list-style-type: none"> Independent directors decide on the market value of the company's assets.⁴⁷ A minimum of seven Supervisory Board members is required.⁴⁸ A mandatory bid is required.⁴⁹ → See also: Part III, Chapter 12, Section B. Voting ballots should be distributed before the GMS.⁵⁰ Special rules on the approval of related party transactions apply.⁵¹ → See also: Part III, Chapter 12, Section C.

³⁷ LJSC, Article 10, Clause 2, Paragraph 2.

³⁸ LJSC, Article 47, Clause 3.

³⁹ As far as the law does not provide for a specific provision regarding the respective company, the rules applying to a company with less shareholders continues to apply.

⁴⁰ LJSC, Article 64, Clause 1, Paragraph 2.

⁴¹ LJSC, Article 7, Clause 3, Paragraph 2. LJSC, Article 94, Clause 4 provides that closed companies, which were established before January 1, 1996 may have more than 50 shareholders and may choose not to transform into an open company.

⁴² LJSC, Article 44, Clause 3, Paragraph 2. This provision is applicable only to companies with more than 50 shareholders.

⁴³ LJSC, Article 66, Clause 3, Paragraph 1.

⁴⁴ LJSC, Article 60, Clause 1, Paragraph 2.

⁴⁵ LJSC, Article 56, Clause 1, Paragraph 1.

⁴⁶ LJSC, Article 56, Clause 1, Paragraph 2.

⁴⁷ LJSC, Article 77, Clause 1, Paragraph 2. The definition of an "independent director" is used only for the purposes of related party transactions.

⁴⁸ LJSC, Article 66, Clause 3, Paragraph 2.

⁴⁹ LJSC, Article 80, Clause 2.

⁵⁰ LJSC, Article 60, Clause 2, Paragraph 2.

⁵¹ LJSC, Article 83, Clause 3.

Chapter 2. The General Governance Structure of a Company

Number of Shareholders	Specific Provisions
More than 10,000	<ul style="list-style-type: none">• A minimum of nine Supervisory Board members is required.⁵²
More than 500,000	<ul style="list-style-type: none">• The charter may provide that voting ballots are published.⁵³• For the rescheduled GMS, the charter may provide for a quorum that is lower than the standard quorum.⁵⁴

B. The Governance Structure of a Company

Legislation provides companies with substantial flexibility in establishing their governance structure. The bodies required by Company Law depend on how many shareholders the company has.

- **For Companies with Less than 50 Shareholders:**

A company with less than 50 shareholders with voting rights must have at least the following bodies:

- GMS;
- General Director; and
- Revision Commission (or a person who performs the functions of the Revision Commission).

In addition, it may establish the following governing bodies at its discretion:

- Supervisory Board; and
- Executive Board.

- **For Companies with 50 and More Shareholders:**

A company with 50 or more shareholders with voting rights must have a Supervisory Board in addition to the bodies required for a company with less than 50 shareholders. An Executive Board may be established at the company's discretion.

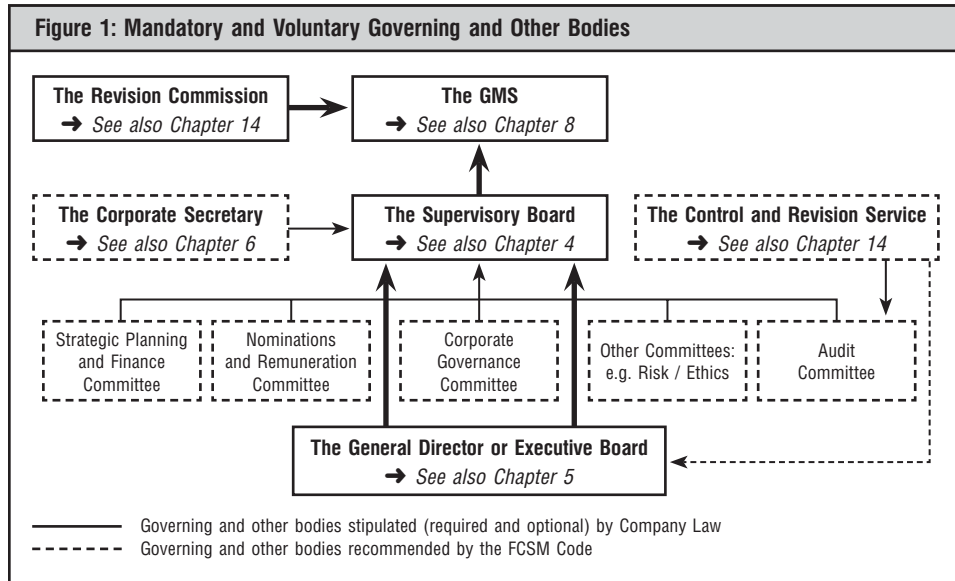
⁵² LJSC, Article 66, Clause 3, Paragraph 2.

⁵³ LJSC, Article 60, Clause 2, Paragraph 4.

⁵⁴ LJSC, Article 58, Clause 3, Paragraph 2.

The Russia Corporate Governance Manual

The mandatory and voluntary governing and other bodies and their responsibilities, as set forth by the Company Law and FCSM Code respectively, are summarized in Figure 1.



Source: IFC, March 2004

1. The General Meeting of Shareholders

The GMS is the highest governing body of the company.⁵⁵ Through the GMS, shareholders make and approve certain fundamental decisions. The GMS approves nominations for Supervisory Board membership. In addition, it approves the annual report and the financial statements, the External Auditor, the distribution of profits and losses (including the payment of dividends), changes in the charter capital, and extraordinary transactions.

→ See Part III, Chapter 8.

⁵⁵ LJSC, Article 47, Clause 1, Paragraph 1.

2. The Supervisory Board

The Supervisory Board plays a central role in the corporate governance framework. The Supervisory Board is responsible for guiding and setting the company's strategy and business priorities, including the annual financial and business plan, as well as guiding and controlling managerial performance. It acts in the interests of the company, protects the rights of all shareholders, oversees the work of the General Director and the Executive Board, as well as the systems of financial control. An effective, professional, and independent Supervisory Board is essential for the implementation of good corporate governance practices.

Best Practices: Russian companies are essentially able to choose between three different corporate governance frameworks, depending on the structure of the company's supervisory body:⁵⁶

- **The one-tier, or unitary board system** is characterized by a single supervisory body that governs the company, and includes both executive and non-executive members. In such a setting, the supervisory body is often called the Board of Directors. Of particular note is that the position of General Director and Chairman are often held by the same person, although this particularity is forbidden in Russia under the Company Law.⁵⁷ This governance structure can facilitate strong leadership structures and efficient decision-making. Non-executive and independent directors, however, play a crucial role in monitoring managers and reducing agency costs. This system is typical for companies based in countries with a common law tradition, for example the U.S. and the U.K.
- **The two-tiered, or dual system**, on the other hand, is characterized by the existence of distinct supervisory and management bodies. The former is commonly referred to as the Supervisory Board, the latter as the Executive Board. Under this system, the day-to-day management of the company is handed down to the Executive Board, which is then controlled by the Supervisory Board (which in turn is elected by the GMS). These two bodies have distinct authorities and their composition cannot be mixed, i.e. members of the Executive Board cannot sit on the Supervisory Board and vice-versa. The advantage of the two-tiered system is a clear oversight

⁵⁶ In Russia, the Company Law essentially allows Russian companies to choose between these systems. However, it does not distinguish functionally between the Supervisory Board and the Board of Directors. In fact, these two terms are used interchangeably.

⁵⁷ LJSC, Art. 66, Clause 2, Paragraph 2.

mechanism, but it has been criticized for inefficient decision-making. This system is most famously represented in Germany.

- Russian companies are allowed to choose a third governance structure, **the hybrid system**, which is essentially an amalgam between the two above-mentioned models. This system allows companies to establish a Supervisory Board and Executive Board, with the distinction that up to 25% of the Supervisory Board may be comprised of Executive Board members. This system is distinct to Russia.

The Russian legal framework allows companies to essentially choose between these different systems and adapt them to different business environments. Regardless of which system a company chooses, it must realize:

1. There is always a trade-off between efficiency and control. When the agency problem and conflict of interests is high, shareholders may choose the two-tiered system, but must realize that a tight monitoring governance system could tie managers' hands and render business operations and decision-making inefficient. On the other hand, when shareholders and managers trust each other and the company needs better efficiency to explore more business opportunities, the company may choose a more pro-management oriented, one-tier board system.
2. While all systems have many elements in common, important differences do exist and these will affect the supervisory body's authority, structure, and operations, and consequently the duties and obligations of directors.⁵⁸
3. The company should seek to have a supervisory structure that is duly elected by shareholders, is sufficiently independent of management, understands that its role is to represent all shareholders including minorities, and is empowered to guide, supervise, and replace managers.

An open company in Russia with more than 50 shareholders must establish a Supervisory Board.⁵⁹ Smaller companies may let the GMS carry out the functions

⁵⁸ These differences are embedded in, among other things, national legislation (legal tradition), organizational theory (composition requirements and functional distribution of authorities), and corporate culture, and will affect the supervisory body's authority, structure, and operations. This Manual will not further discuss distinct features of one- and two-tiered systems. The Board of Directors in a unitary system corresponds to the Supervisory Board of a two-tiered system. Further in this Manual, the term "Supervisory Board" will be used to mean both the Supervisory Board and the Board of Directors.

⁵⁹ CC, Article 103, Clause 2. This provision appears to be inconsistent with the LJSC, Article 64, Clause 1, which states that the functions of a Supervisory Board may only be carried out by the GMS in a company with less than 50 shareholders with voting rights. However, these two provisions can also be interpreted to complement each other, with the LJSC providing for detailed requirements.

Chapter 2. The General Governance Structure of a Company

of the Supervisory Board.⁶⁰ However, a Supervisory Board is often useful even for smaller companies that have no legal obligation to establish this body.

→ *For a discussion on the advantages and disadvantages of a Supervisory Board for a smaller company, see Part II, Chapter 4, Section A.1.*

3. The Executive Bodies

a) The General Director

Every company must have a General Director.⁶¹ The General Director is responsible for the day-to-day management of the company. The General Director is accountable to the Supervisory Board and the GMS. Legislation, the charter and by-laws, and the contract signed between the General Director and the company regulate the authority and election of the General Director, as well as relations with other governing bodies.

→ *On the authority of the General Director, see Part II, Chapter 5, Section A.1.*

b) The Executive Board

The Executive Board is composed of the General Director and the top executives of the company. It may be referred to as a “management board”, “managerial board”, “executive team”, “directorate” or “collective executive body” among others. The term “Executive Board” is used for the purposes of this Manual.

A company may, at its discretion, establish an Executive Board.⁶² The Executive Board is responsible for the day-to-day management of the company, and carries out the strategy set by the Supervisory Board. While an Executive Board is voluntary, the FCSM Code recommends that all companies establish one, and that the General Director chair it.⁶³

→ *For a discussion on the advantages and disadvantages of an Executive Board, see Part II, Chapter 5, Section A.*

⁶⁰ LJSC, Article 64, Clause 1.

⁶¹ LJSC, Article 69, Clause 1, Paragraph 1.

⁶² LJSC, Article 69, Clause 1, Paragraph 1.

⁶³ FCSM Code, Chapter 4, Section 1.1.

c) The External Manager

The GMS can delegate the authority of the General Director to an External Manager (commercial organization or individual entrepreneur).⁶⁴ Under certain circumstances and if provided for by the charter, the Supervisory Board may suspend the powers of the External Manager.

Company Practices in Russia: Companies in financial distress often choose to delegate their day-to-day management to an External Manager. External Managers are often firms specializing in crisis or turnaround management and thus ideally suited for such companies.

→ See Part II, Chapter 5, Section A.3.

4. The Revision Commission

Companies are required to have a Revision Commission or an individual who performs the functions of a Revision Commission.⁶⁵ The Revision Commission is a separate body of the company, elected by the GMS, that oversees the financial and economic activities of the company, and reports directly to the GMS.

→ See Part IV, Chapter 14, Section A.

5. Supervisory Board Committees

Supervisory Board committees are not provided for by legislation. However, the FCSM Code recommends the establishment of committees (in particular an Audit Committee) to handle sensitive Supervisory Board functions. The discussion in this Manual as to the authority, composition, and functions of individual Supervisory Board committees is based on recommendations of the FCSM Code and best practices.

→ See Part II, Chapter 4, Section D, as well as Part IV, Chapter 14, Section C.

⁶⁴ LJSC, Article 69, Clause 1, Paragraph 3.

⁶⁵ LJSC, Article 85, Clause 1.

Chapter 2. The General Governance Structure of a Company

6. The Control and Revision Service (Internal Audit Function)

Although it is not mandatory, companies may establish a Control and Revision Service the purpose of which is to carry out internal control procedures on a daily basis. The Control and Revision Service should be independent of the General Director and Executive Board members. The Control and Revision Service reports directly to the Supervisory Board, typically to the Audit Committee,⁶⁶ but may also report administratively to the General Director or Executive Board.

→ See Part IV, Chapter 14, Section D.

7. The Corporate Secretary

Companies may find it necessary to appoint a Corporate Secretary to ensure that the governing bodies comply with procedural requirements. The Corporate Secretary can assist the Supervisory Board with the organization of the GMS, Supervisory Board meetings, and with the performance of other duties. The Corporate Secretary may also ensure proper information disclosure, maintain corporate records, and notify the Chairman and/or the Supervisory Board of violations of corporate procedures.⁶⁷

→ See Part II, Chapter 6.

⁶⁶ FCSM Code, Chapter 8, Article 1.1.2.

⁶⁷ FCSM Code, Chapter 5.

Chapter 3

The **Internal Corporate Documents**

Table of Contents

A. THE COMPANY CHARTER	46
1. Charter Provisions	46
2. When to Amend the Charter	48
3. Who Can Amend the Charter	48
4. How to Amend the Charter	49
5. Registration of Charter Amendments	50
6. When Charter Amendments Become Effective	52
7. Disclosure of the Charter	52
B. THE BY-LAWS OF THE COMPANY	53
1. Types of By-Laws	53
2. How to Adopt and Amend By-Laws	54
C. COMPANY CODES OF CORPORATE GOVERNANCE.....	55
D. COMPANY CODES OF ETHICS	57
1. What Is a Code of Ethics	57
2. Why Adopt a Code of Ethics	57
3. How to Implement a Code of Ethics	58

The Chairman's Checklist

- ✓ Does the company have a valid charter, with provisions on the protection of shareholder rights, equitable treatment of shareholders, division of authority among the governing bodies, and information disclosure?
- ✓ How detailed is the charter compared to by-laws? Do the charter and by-laws merely copy the exact language of legislation?
- ✓ Is the charter freely available to interested parties and accessible on the internet?
- ✓ Has the company developed by-laws as recommended by the Federal Commission for the Securities Market's Code of Corporate Conduct? If yes, were these by-laws approved by the Supervisory Board or the General Meeting of Shareholders? Does the company regularly consult and follow its by-laws?
- ✓ Has the company adopted its own corporate governance code? If so, does the company code touch upon the principles of fairness, responsibility, transparency, and accountability? Does the company code provide recommendations on the relationship between the corporate bodies, notably the interaction between the Supervisory Board and General Director or Executive Board?
- ✓ Has the company identified a core set of values? Does the company have a code of ethics based on these values?

The charter is the founding document of a company. No company can be established without a charter.⁶⁸ A charter establishes a company, and determines its structure and purpose. It is fundamental to a company's system of corporate governance, ensuring the protection and equitable treatment of shareholders, distribution of authorities between the governing bodies, and disclosure and transparency of the company's activities. It also plays an important public role in relation to third parties since it provides information about the company, especially on its corporate governance system. The company is required to register the charter and its amendments with a state registration authority.⁶⁹

⁶⁸ Civil Code (CC), Article 98, Clause 3; LJSC, Article 11, Clause 1.

⁶⁹ CC, Article 51; Law on Joint Stock Companies (LJSC), Article 11, Clause 1; Articles 13 and 14; Law on State Registration of Legal Entities, Article 12.

The company may, and under certain circumstances must, adopt by-laws that expand the charter provisions. By-laws are useful in regulating detailed procedures for the company's governing bodies and can help avoid unwieldy charters that are difficult to understand and amend.

Company-level corporate governance codes and ethics codes allow the company to make its governance structure more transparent, and demonstrate the company's commitment to good corporate governance and good business practices.

This chapter examines corporate governance issues as related to charter provisions, and explains when and how a charter and by-laws can be amended, and how the amendments are registered. It further touches upon the important role that company-level corporate governance and ethics codes play.

A. The Company Charter

1. Charter Provisions

The charter must include minimum provisions related to the company's structure and charter capital, the authority of the governing bodies, and shareholder rights. Regardless of the company's activities, ownership and management structure, the charter must include the following mandatory provisions:⁷⁰

- Full and abbreviated name of the company;
- Location of the company;
- Legal type of company (open or closed);
- Number, nominal value, and types of shares (common or preferred), and the classes of preferred shares issued by the company;
- Shareholder rights by type and class;
- Amount of charter capital;
- Structure and authority of the company's governing bodies, and the procedure for the adoption of decisions by these bodies;
- Procedure for preparing and conducting the General Meeting of Shareholders (GMS);

⁷⁰ LJSC, Article 11, Clause 3.

Chapter 3. The Internal Corporate Documents

- Issues that must be resolved by a super-majority or a unanimous vote of the GMS, the Supervisory Board, and the Executive Board;
- Period within which the company holds the Annual General Meeting of Shareholders (AGM);
- Information concerning branches and representative offices of the company;⁷¹ and
- Amount of the reserve fund and the amount of annual deductions from the net profits of the company to the reserve fund.⁷²

In addition to the foregoing mandatory provisions, the Company Law requires certain additional provisions under specific circumstances.

Finally, other provisions are permitted as long as they do not conflict with the Company Law or other legislation.⁷³ These provisions give the company and its shareholders great flexibility in organizing the company structure, including its activities, financial structure, and shareholder rights. In other words, the charter largely determines the characteristics and activities of the company.

→ *For more information on specific types of charter provisions, see the model charter in Part VI, Annex 2 and the table of charter provisions in Annex 3.*

Company Practices in Russia: Many Russian companies copy the exact language of legislation into the charter and/or include many extraneous details. Neither practice contributes to the quality of the charter. The charter should include the information required by legislation (not the text of legislation) and other provisions that are needed for sound corporate governance. For example, the Company Law's Article 78, Clause 1 defines extraordinary transactions and permits the company charter to expand upon the definition. Instead of copying this provision, the company may want to specify what other transactions important to the company shall require the same approval regime as extraordinary transactions. In addition, the charter may stipulate provisions that are recommended by the FCSM Code and best suit the company's objectives.

⁷¹ LJSC, Article 5, Clause 6.

⁷² LJSC, Article 35, Clause 1, Paragraphs 1 and 2.

⁷³ LJSC, Article 11, Clause 3, Paragraph 3.

2. When to Amend the Charter

The charter must be amended when changes occur that affect any mandatory provisions. For example, amendments to the charter are required when the company:

- Reorganizes;⁷⁴
- Changes the amount of its charter capital;⁷⁵
- Changes the rights attached to different types and/or classes of shares;⁷⁶ and
- Establishes or liquidates a branch or a representative office.⁷⁷

The charter must also be brought into conformity with changes in legislation when new requirements are introduced that affect charter provisions.

3. Who Can Amend the Charter

As a rule, only the GMS has the authority to amend the charter.⁷⁸ However, under specific circumstances, special regimes, as illustrated in Table 1, are introduced whereby the amendments can be made by:⁷⁹

- The GMS, but upon the submission of a prior report by the Supervisory Board;
- The Supervisory Board; or
- A relevant state agency.

Circumstances	Competent Body	Legal Requirements
The company increases the charter capital by increasing the nominal value of issued shares.	The GMS	<ul style="list-style-type: none"> • Report by the Supervisory Board on the results of the share issue with a new nominal value; and • GMS' decision to increase the charter capital.

⁷⁴ LJSC, Article 15.

⁷⁵ LJSC, Article 11, Clause 3; Articles 28 and 29.

⁷⁶ LJSC, Article 11, Clause 3; Articles 31 and 32.

⁷⁷ LJSC, Article 11, Clause 3; Article 5, Clause 6.

⁷⁸ CC, Article 103, Clause 1; Article 48, Clause 1. There appears to be an inconsistency between the LJSC, Article 12, and the CC, Article 103, Clause 1, Section 1. The CC states that the decision to amend the charter falls under the exclusive authority of the GMS, while the LJSC provides for circumstances when other bodies can amend the charter.

⁷⁹ LJSC, Article 12, Clauses 2–5.

Chapter 3. The Internal Corporate Documents

Circumstances	Competent Body	Legal Requirements
The company increases the charter capital by issuing additional shares.	The GMS or Supervisory Board	<ul style="list-style-type: none">• Report by the Supervisory Board on the results of the share issue; and• Decision of the GMS or the Supervisory Board, if the Supervisory Board has such authority, to increase the charter capital.
The company decreases the charter capital by purchasing outstanding shares.	The GMS	<ul style="list-style-type: none">• Report by the Supervisory Board on the acquisition of shares; and• GMS' decision to decrease the charter capital.
The Supervisory Board establishes or liquidates representative offices and/or branches.	The Supervisory Board	<ul style="list-style-type: none">• The Supervisory Board's decision to establish or liquidate representative offices and/or branches.
The government, a state agency, or a municipal entity create or terminate a golden share arrangement.	The government, a state agency, or a municipal entity	<ul style="list-style-type: none">• The decision of the government, the state body, or a municipal entity to create or terminate golden shares.

4. How to Amend the Charter

Preparing amendments to the charter requires legal drafting skills and specialized knowledge of legislation.

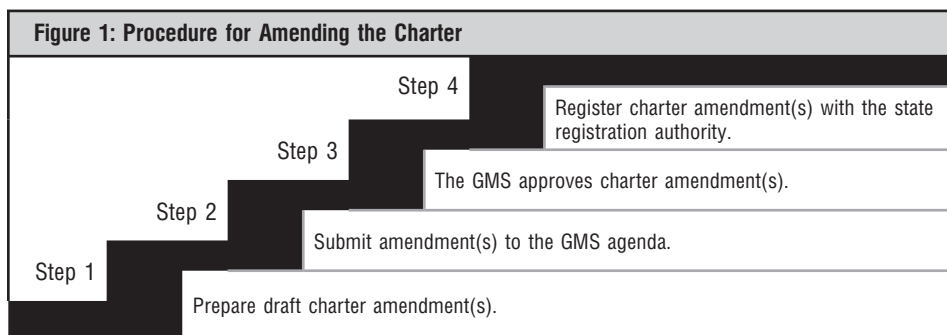
Best Practices: It is accepted practice that the company through its legal counsel/department prepares the charter amendments in cooperation with outside legal consultants and with the participation of the Corporate Secretary. The General Director should closely follow the process.

There are three ways a company can amend its charter:

- Changing existing charter provisions;
- Adding new charter provisions; or
- Approving an entirely new version of the charter (redrafting the charter), which is useful when many changes must be made.

The Russia Corporate Governance Manual

Figure 1 illustrates the procedure for amending the charter. The procedure for restating the charter is similar.



Source: IFC, March 2004

The GMS has the authority to approve the charter amendments with a $\frac{3}{4}$ -majority vote of shareholders participating in the GMS (unless the charter provides for a higher percentage of votes).⁸⁰ The approval of charter amendments that limit the rights of preferred shareholders requires two votes:⁸¹

- A $\frac{3}{4}$ -majority vote of all preferred shareholders of a particular class whose rights will be affected as a result of charter amendments (unless the charter provides for a higher percentage of votes); and
- A separate $\frac{3}{4}$ -majority vote of all other shareholders with voting rights participating in the GMS (unless the charter provides for a higher percentage of votes).

5. Registration of Charter Amendments

All amendments made to the charter must be registered with a state registration authority.⁸² As of 1 June 2004, the Ministry of Taxes and Collections is responsible for the registration of legal entities and charter amendments, and now serves

⁸⁰ LJSC, Article 49, Clause 4.

⁸¹ LJSC, Article 32, Clause 4, Paragraph 2.

⁸² The procedure for registering the charter is regulated by the Civil Code, the Company Law, and the Law on the State Registration of Legal Entities. See LJSC, Article 14.

Chapter 3. The Internal Corporate Documents

as the state registration authority.⁸³ The state imposes a fee for registering charter amendments of not more than RUR 2,000 each time amendments are registered.⁸⁴

The state registration authority must register charter amendments within five working days⁸⁵ from the day the company has submitted the following documents:⁸⁶

- Signed application form;
- Decision to amend the charter;
- Text of charter amendments; and
- Receipt verifying the payment of the state duty for the registration.

The official submission date is the date on which the state registration authority receives all required documents in the correct form.⁸⁷ The requirements for documents and the form of the written application are specified by law.⁸⁸

The registration is officially completed when the state registration authority registers the new charter or charter amendments in the registration books.⁸⁹

In case of charter amendments related to branches and/or representative offices, simplified procedures require the company to submit the following documents:

- A signed notification form; and
- The Supervisory Board's decision regarding a branch and/or a representative office.

The state registration authority must register charter amendments in the registration books within five days of the day the documents are submitted to the registration authority. The company is entitled to receive proof of registration in writing from the register.⁹⁰

⁸³ Resolution of the Government of the Russian Federation No. 319, 17 May 2002.

⁸⁴ Law on State Duty, Article 4, Clause 1.

⁸⁵ Law on State Registration of Legal Entities, Article 8, Clause 1.

⁸⁶ Law on State Registration of Legal Entities, Article 17, Clause 1.

⁸⁷ Law on State Registration of Legal Entities, Article 9, Clause 2.

⁸⁸ Resolution of the Government of the Russian Federation No 439, 19 June 2002.

⁸⁹ Law on State Registration of Legal Entities, Article 11, Clause 2.

⁹⁰ Law on State Registration of Legal Entities, Article 19, Clauses 1 and 2.

6. When Charter Amendments Become Effective

Charter amendments become effective at different times for the company and its shareholders, as well as third parties:

- **The company and its shareholders:** Charter amendments become effective upon the GMS approval;
- **Third parties:** Charter amendments become effective only after registration (or the proper notification of the state registration authority in case of amendments to provisions related to branches and representative offices).⁹¹ However, if third parties relied upon the amendments after they were adopted by the relevant governing body, but before state registration, the company must comply with these amendments as if they had been registered at the time of the *bona-fide* act.⁹²

7. Disclosure of the Charter

The charter is an important source of information for shareholders and potential investors. The original charter document must be kept at the offices of the executive bodies.⁹³ Shareholders, the External Auditor, and other interested parties have the right to inspect the original charter at the company's headquarters within seven days after filing a request.⁹⁴

Best Practices: It is good practice for companies to allow shareholders to view the original charter and provide shareholders with copies within five days.⁹⁵

Copies of the latest registered charter and amendments must be provided to shareholders on request. The company may not charge shareholders for more than the cost of making copies.⁹⁶

⁹¹ Law on State Registration of Legal Entities, Article 19, Clause 3; LJSC, Article 14, Clause 2.

⁹² CC, Article 52, Clause 3.

⁹³ LJSC, Article 89, Clause 2.

⁹⁴ LJSC, Article 11, Clause 4; Article 91, Clause 2.

⁹⁵ Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 7, Section 3.1.1.

⁹⁶ LJSC, Article 91, Clause 2.

Best Practices: It is customary to provide copies of the charter to shareholders free of charge.

In practice, there is little justification for not providing shareholders and other interested parties with immediate access to the charter by posting it on the internet, which is a technically simple and cost effective solution.

→ For more on information disclosure included in the charter, see Part IV, Chapter 13.

B. The By-Laws of the Company

1. Types of By-Laws

By-laws are internal company documents that supplement and specify charter provisions. The following by-laws are mandatory:⁹⁷

- By-laws for the Revision Commission;
- By-laws for the executive bodies if established; and
- By-laws for branches and representative offices if established.

Other by-laws are optional. A company has the discretion to adopt other by-laws providing detailed procedures for the company's governing bodies. In any case, the company's by-laws must be consistent with the charter and cannot conflict with legislation.

Best Practices: Although certain provisions must be or should remain stipulated in the charter, by-laws have several advantages:

- By-laws do not need to be registered with the state registration authority, saving the company resources by avoiding registration fees and bureaucratic procedures;
- By-laws require a simple majority vote of shareholders with voting rights participating in the GMS, making it easier to adjust to changing circumstances;

⁹⁷ LJSC, Article 85, Clause 2, Paragraph 2; Article 70, Clause 1; Article 5, Clause 4.

- By-laws provide for the same level of shareholder protection as the charter, since the GMS approves most by-laws, in particular, those affecting shareholder rights; and
- Not all by-laws require shareholder approval. Some by-laws are approved by the Supervisory Board which requires simpler approval procedure compared to the GMS.

At the same time, certain provisions must appear either in the charter or by-laws:⁹⁸

- The way the GMS approves procedural (technical) decisions;
- The procedure for organizing and conducting Supervisory Board meetings; and
- The quorum needed for conducting valid Executive Board meetings.

2. How to Adopt and Amend By-Laws

If by-laws for the governing bodies are to be adopted, they must be approved by a simple majority vote of shareholders participating in the GMS.⁹⁹ The Supervisory Board submits the proposed by-laws for the GMS approval unless the charter provides otherwise.¹⁰⁰

The Supervisory Board has the power to adopt by-laws other than those for the company's governing bodies, for example, on information disclosure. The charter may grant the General Director or Executive Board the right to adopt all by-laws with the exception of those for the governing bodies.¹⁰¹

The Supervisory Board, and possibly the Executive Board, adopts by-laws with a simple majority vote. The charter and by-laws can stipulate a greater percentage of votes necessary for the Supervisory Board to approve by-laws.¹⁰²

⁹⁸ LJSC, Article 49, Clause 5; Article 68, Clause 1; Article 70, Clause 2.

⁹⁹ LJSC, Article 48, Clause 1, Section 19; Article 49, Clause 2.

¹⁰⁰ LJSC, Article 49, Clause 3.

¹⁰¹ LJSC, Article 65, Clause 1, Section 13.

¹⁰² LJSC, Article 68, Clause 3, Section 1.

Table 2: An Overview of Company By-Laws				
By-Laws by Topic	Who Approves the By-Laws	Required	Recommended	See in Annexes
Executive Board	GMS	✓	✓	✓
Revision Commission	GMS	✓	✓	✓
Branches and Representative Offices ¹⁰³	Supervisory Board or Executive Bodies ¹⁰⁴	✓		
GMS	GMS		✓	✓
Supervisory Board	GMS		✓	✓
Control and Revision Service (Internal Audit Function)	Supervisory Board		✓	✓
Information Policy	Supervisory Board or Executive Bodies		✓	✓
Dividend Policy	Supervisory Board or Executive bodies		✓	✓
Corporate Secretary	Supervisory Board or Executive Bodies		✓	✓
Ethical Standards	Supervisory Board		✓	✓
Risk Management	Supervisory Board or Executive Bodies		✓	✓
Supervisory Board Committees	Supervisory Board		✓	✓

C. Company Codes of Corporate Governance

A company-level corporate governance code is a principle-based statement on the company's corporate governance practices. It is intended to make the company's governance structure more transparent and demonstrate the company's commitment to good corporate governance by developing and furthering:

- Responsible, accountable, and value-based management;
- An effective Supervisory Board and executive bodies that act in the best interests of the company and its shareholders, including minority shareholders, and seek to enhance shareholder value in a sustainable manner; and

¹⁰³ Only if these are established by the company.

¹⁰⁴ The General Director or the Executive Board can only do so if authorized by the charter.

- Appropriate information disclosure and transparency, as well as an effective system of risk management and internal control.

By adopting, following, and updating a company-level corporate governance code on a regular basis, the company confirms its desire to demonstrably lead and promote good corporate governance. To foster the confidence of its shareholders, employees, investors, and the public, a company-level corporate governance code should, however, go beyond the established legal and regulatory framework and embrace both nationally and internationally recognized best corporate governance practices.

Company Practices in Russia: Some Russian companies have voluntary corporate governance codes or guidelines in addition to their charter and by-laws. Most of these codes are brief and simple statements of principle. They generally reflect the desire of the Supervisory Board and management to conduct the operations of the company in an honest, fair, legal, and socially responsible manner.

Company codes and guidelines may cover a vast number of topics including:

- **General issues of corporate governance:**
 - Goals and objectives of the company;
 - Relationship between the shareholders and the Supervisory Board;
 - Relationship between the Supervisory Board and the General Director or Executive Board; and
 - Relationship between controlling shareholders and minority shareholders.
- **Good Supervisory Board Practices:**
 - Composition, including the number of independent directors;
 - Number and structure of committees;
 - General working procedures; and
 - Remuneration of non-executive directors.
- **Good Executive Board Practices:**
 - Executive remuneration; and
 - Interaction and relationship with the Supervisory Board.
- **Shareholder Rights:**
 - On organizing and conducting the GMS;
 - Minority shareholder protection;
 - Disclosure of related party transactions; and
 - The company's dividend policy.

- **Disclosure and Transparency Issues:**
 - Internal control function, including risk management;
 - Policy on the use of audit and consulting services and External Auditor rotation; and
 - Accounting and disclosure policies and standards.
- **Accountability of the Company to Stakeholders:**
 - Communications with investors and investor relations.

Which topics to cover will depend upon the issues of greatest relevance to the company.

As a rule, company codes are approved by the Supervisory Board, communicated to shareholders and investors, and published on the company's internet site. Company codes or guidelines must be consistent with legislation, as well as the charter and by-laws, and should generally follow the provisions of the FCSM Code. They cannot, however, replace the charter and by-laws.

→ See Part VI, Annex 4 for a model company-level corporate governance code.

D. Company Codes of Ethics

1. What Is a Code of Ethics

A Code of Ethics (also referred to as a code of conduct, or ethics or responsibility statement) is a basic guide of conduct that imposes duties and responsibilities on a company's officers and employees towards its stakeholders, including, among others, colleagues, customers and clients, business partners (e.g. suppliers), government, and society.

2. Why Adopt a Code of Ethics

A company may wish to adopt a Code of Ethics because it:

- **Enhances the company's reputation/image:** A company's reputation and image constitutes an integral, if intangible, part of its assets. Establishing a Code of Ethics is an effective way to communicate the value a company places on good business practices.

- **Improves risk and crisis management:** A Code of Ethics can bring potential problems to management's and directors' attention before a full-blown crisis occurs in that a Code of Ethics sensitizes and encourages employees to react to ethical dilemmas.
- **Develops a corporate culture and brings corporate values to the forefront:** A Code of Ethics developed by and widely distributed to the company's officers and employees can help build a cohesive corporate culture, based on a shared set of values, that helps guide employees in their daily work.
- **Advances stakeholder communications:** A Code of Ethics also has a strong demonstration effect towards the company's stakeholders during times of crisis, communicating the company's commitment to ethical behavior and underlining that possible transgressions are exceptions rather than the rule.
- **Avoids litigation:** A Code of Ethics, in combination with an effective ethics program, can help minimize litigation risk resulting from fraud, conflict of interest, corruption and bribery, and insider trading.

3. How to implement a Code of Ethics

Every company is different in terms of size and industry, and each has a different business culture, set of values, and ethically sensitive operational areas. A Code of Ethics should reflect these differences.

A company's Code of Ethics should go beyond simple rules and, instead, focus on core values. Before drafting a Code of Ethics, it is fundamental that a company has identified and formulated its values.¹⁰⁵

Drafting a Code of Ethics goes beyond paper. Developing a Code is at least as much process as outcome. In assessing the need for a Code of Ethics, the company should begin by studying its internal ethics climate, the amount and type of ethical guidance its employees and officers receive, and the risk the company faces without such a Code.¹⁰⁶ As a second step, the company should seek buy-in from every part of the organization, from senior management to workers, if the Code is to truly

¹⁰⁵ For more information on how to design, manage, and implement Code of Ethics, see Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise* (Washington, D.C.: U.S. Department of Commerce, 2004). See also: www.mac.do.gov/ggp.

¹⁰⁶ Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, Chapter 3, pp. 45–46 and Chapter 5, pp. 93–97.

Chapter 3. The Internal Corporate Documents

guide the company's ethical practice.¹⁰⁷ Most importantly, the company should ensure that a broad consultative process takes place within the company.¹⁰⁸ By the time the Code of Ethics is submitted for the Supervisory Board's approval, every employee should be familiar with the Code and have played a role in drafting it — a process that ensures buy-in and helps with its implementation.

The company must also recognize that the “tone at the top” matters, and that public and demonstrable commitment by senior management and directors is a key component to the implementation of a Code of Ethics.

A Code of Ethics should be user-friendly, i.e. provide practical guidance to the company's management and employees on how to handle ethics problems that may arise in the day-to-day course of business.¹⁰⁹ In support of a Code of Ethics, the company may wish to establish an ethics training program,¹¹⁰ as well as appoint an ethics officer and create an ethics office and/or establish a Supervisory Board Ethics Committee to advise and educate officers and employees, and provide guarantees for confidential counseling.

The Code of Ethics should be subject to continuous change, revision, and renewal by the Supervisory Board's Ethics Committee.

→ *For a model company Code of Ethics, see Part VI, Annex 5.*

¹⁰⁷ Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, pp. 53–56.

¹⁰⁸ Many companies choose to establish a working group or task force to produce a first draft of the company's Code of Ethics for the Supervisory Board's approval, consisting of representatives from every level. See also: Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, pp. 57–61.

¹⁰⁹ The Code of Ethics itself should include a practical procedure for raising an ethical issue (“first go to your supervisor, then to...”), and even a procedure for suggesting changes in the Code. The Code should also include an ethical decision-making model (“Step 1: Check your facts, Step 2...”). See also: Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, Chapter 6, pp. 138–144.

¹¹⁰ A practical ethics training program should be organized around cases that might arise within the context of an employee's daily work and be organized in an interactive manner. See also: Kenneth Johnson and Igor Abramov, *Business Ethics: A Manual for Managing a Responsible Business Enterprise*, Chapter 7, pp. 155–165.



INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group



Good corporate governance contributes to a company's competitiveness and reputation, facilitates access to capital markets, and thus helps develop financial markets and spur economic growth. With this in mind, the International Finance Corporation and the U.S. Department of Commerce have combined their efforts to provide Russian managers, directors, and shareholders with a practical tool to implement good corporate governance practices – the Russia Corporate Governance Manual. This Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. It follows the recommendations of the FCSM's Code of Corporate Conduct and refers to internationally accepted principles of good corporate governance.

“Corporate governance is vital to the interests of every economy, and government has a role to play in establishing the framework for reform - but it is companies that have the tough job of putting governance reform into practice. This is where the Corporate Governance Manual can provide excellent help. It offers a comprehensive workbook for company directors, officers, and advisers in taking up the challenge of corporate governance improvement. Shareholders and stakeholders alike should applaud IFC for bringing practical, and professional advice within reach of every boardroom.”

Anne Simpson, Manager,
Global Corporate Governance Forum

“Corporate governance reform in Russia is the continuation of the more general processes of change affecting the country as a whole. Taken together, these developments have created a new environment, new rules regulating the relationships between the market and regulators, between shareholders, shareholders and managers, etc. In the business community there is a growing awareness of the benefits of corporate governance reform, and companies are now working on improving the quality of their corporate governance ...”

Ruben K. Vardanian, President of Troika Dialogue; Chairman of the Board,
OJSC Rosgosstrakh; and Chairman of the RSPP Corporate Governance Committee

“Good corporate governance is a key driver of financial transparency and managerial accountability, essential ingredients for national prosperity in a global economy. We congratulate the U.S. Department of Commerce and the International Financial Corporation of the World Bank for their initiative in bringing about the publication of the Russia Corporate Governance Manual.”

Andrew B. Somers, President,
American Chamber of Commerce in Russia

Questions on corporate governance should be addressed to the IFC Russia Corporate Governance Project, via CGPRussia@ifc.org

An electronic version of the Manual is available on the website of the International Finance Corporation under www.ifc.org/rcgp and the U.S. Department of Commerce under www.mac.doc.gov/ggp

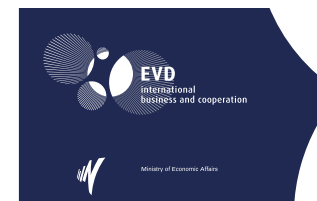
The Russia Corporate Governance Manual

II Part II

Good Board Practices

Prepared and Published by the International Finance Corporation and the U.S. Department of Commerce

In Partnership with the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs and the Swiss State Secretariat for Economic Affairs



The Russia **Corporate Governance** Manual

Part II

Good Board Practices

Prepared and Published by the International Finance Corporation
and the U.S. Department of Commerce

In Partnership with the Agency for International Business
and Cooperation of the Dutch Ministry of Economic Affairs
and the Swiss State Secretariat for Economic Affairs

First edition: 10,000 copies in Russian, 1,500 copies in English.

Published in 6 Parts

Printed in Moscow, Russia.

ISBN 5-9614-0085-9

Copyright © 2004 International Finance Corporation
2121 Pennsylvania Ave. NW, Washington, DC 20433, United States of America
A Member of the World Bank Group

Design copyright © 2004 Alpina Business Books

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, for commercial purposes without the prior permission of the International Finance Corporation.

Chapter 4

The **Supervisory Board**



Table of Contents

A. THE SUPERVISORY BOARD'S AUTHORITY	10
1. <i>When to Establish a Supervisory Board</i>	10
2. <i>An Overview of the Supervisory Board's Authority</i>	11
3. <i>The Supervisory Board's Authority in Relation to Strategic Oversight and Control</i>	12
4. <i>The Supervisory Board's Authority in Relation to Shareholder Rights</i>	19
5. <i>The Supervisory Board's Authority in Relation to Assets and the Charter Capital</i>	21
6. <i>The Supervisory Board's Authority in Relation to Control, Disclosure, and Transparency</i>	22
B. THE ELECTION AND DISMISSAL OF DIRECTORS	23
1. <i>The Election and Term of Directors</i>	23
2. <i>The Nomination of Candidates for the Supervisory Board</i>	24
3. <i>Information About Supervisory Board Nominees</i>	25
4. <i>The Election of Directors</i>	26
5. <i>The Election of Directors When Lacking a Quorum</i>	29
6. <i>The Dismissal of Directors</i>	29
C. THE COMPOSITION OF THE SUPERVISORY BOARD	30
1. <i>The Number of Directors</i>	30
2. <i>Who Can Be a Director</i>	31
3. <i>Qualifications of Directors</i>	32
4. <i>Categories of Directors</i>	34

D. THE STRUCTURE AND COMMITTEES OF THE SUPERVISORY BOARD	42
1. <i>Chairman</i>	42
2. <i>Supervisory Board Committees</i>	44
3. <i>The Chairman of a Supervisory Board Committee</i>	49
E. THE WORKING PROCEDURES OF THE SUPERVISORY BOARD.....	50
1. <i>The Chairman and Supervisory Board Meetings</i>	50
2. <i>Supervisory Board Meetings</i>	51
3. <i>The First Supervisory Board Meeting</i>	51
4. <i>The Schedule of Supervisory Board Meetings</i>	52
5. <i>Who Has the Right to Convene a Supervisory Board Meeting</i>	53
6. <i>Proper Notice for Supervisory Board Meetings</i>	54
7. <i>The Quorum for Supervisory Board Meetings</i>	54
8. <i>How Directors Can Participate in Supervisory Board Meetings</i>	55
9. <i>The Consideration of Written Opinions (Absentee Ballots)</i>	56
10. <i>Supervisory Board Decisions</i>	57
11. <i>The Minutes of Supervisory Board Meetings</i>	58
12. <i>The Corporate Secretary and Supervisory Board Meetings</i>	59
F. THE DUTIES AND LIABILITIES OF DIRECTORS.....	60
1. <i>The Duty of Care</i>	61
2. <i>The Duty of Loyalty</i>	61
3. <i>Director Access to Information</i>	65
4. <i>Liabilities of Directors</i>	65
5. <i>When Directors Are Relieved from Liability</i>	66
6. <i>Who Can File a Claim Against Directors</i>	67
7. <i>The Minutes of Supervisory Board Meetings and Director Liability</i>	67
8. <i>Protection from Liability for Directors</i>	67

G. EVALUATION AND EDUCATION OF THE SUPERVISORY BOARD AND DIRECTORS	68
1. <i>Self-Evaluation by the Supervisory Board</i>	69
2. <i>Education and Training</i>	69
H. THE REMUNERATION OF DIRECTORS	70
I. SUMMARY CHECKLIST TO DETERMINE THE SUPERVISORY BOARD'S EFFECTIVENESS	73

The Chairman's Checklist

The Supervisory Board's authority:

- ✓ Is the Supervisory Board's focus on protecting the interests of the company and its shareholders? Do all Supervisory Board members understand the role and priorities of the Supervisory Board? Does the Supervisory Board have sufficient powers according to the charter to fulfill its oversight duties? Have these authorities been properly communicated? Does the Supervisory Board use its powers in practice?
- ✓ What is the Supervisory Board's role with respect to the company's governance, organization of the General Meeting of Shareholders, protection of company assets, resolution of conflicts, and supervision of internal controls and risk management? How effective is the Board in guiding and setting strategy? Does the Supervisory Board have the tools to properly oversee the operational and financial performance of the company? Is a succession plan in place, in particular for the General Director?
- ✓ Is the Supervisory Board's authority distinct from management's, both on paper and in practice?

The Supervisory Board's election:

- ✓ Who nominates candidates to the Supervisory Board? Is sufficient information provided to shareholders on nominees? How does the Supervisory Board influence the nomination process?
- ✓ Does the Supervisory Board ensure that all shareholders understand how cumulative voting works?

The Supervisory Board's composition:

- ✓ Has the Supervisory Board designed, articulated, and implemented policies relating to its size, composition and mix-of-skills, breadth of experience, and other pertinent qualities?
- ✓ Is the Supervisory Board's composition, considering its competencies and mix-of-skills, suited to its oversight duties and the development of its strategy?
- ✓ How effectively does the Supervisory Board work as a team?

- ✓ Does the company have independent directors? Is the Supervisory Board constituted of a majority (in the case of companies with an Executive Board, a $\frac{3}{4}$ -majority) of non-executive directors?
- ✓ How effective is the Supervisory Board's leadership, both at the Board and committee level?
- ✓ Is the number of directors consistent with the needs of the company? Does the company have enough directors to establish Supervisory Board committees?

The Supervisory Board's structure and committees:

- ✓ Does the Supervisory Board have Audit, Nominations and/or Remuneration committees? What are the costs and benefits of these or other committees? Are there sufficient independent (or non-executive) directors to chair and sit on these committees? Do Supervisory Board committees have sufficient resources, both human and financial, to properly fulfill their functions?
- ✓ How well informed are non-committee members about the committee's deliberations? Is the information prepared by the committee for the Supervisory Board adequate for effective decision-making?
- ✓ Do Audit Committee members have sufficient expertise on financial issues? Do they have access to information from the Revision Commission, the External Auditor, the Internal Audit Function, and the executive bodies on the financial and economic activities of the company?

The Supervisory Board's working procedures:

- ✓ Has the Supervisory Board identified, prioritized, and scheduled key issues that should be reviewed on a regular basis? Has the Board identified the information it requires to properly analyze these key issues?
- ✓ Does the Chairman take an active role in organizing the work of the Supervisory Board? Does the Supervisory Board meet regularly in accordance with a fixed schedule?
- ✓ Does the Chairman encourage a free and open exchange of views?
- ✓ Are procedures in place that ensure the proper preparation and conducting of Supervisory Board meetings, e.g. advance notification on agenda issues, distribution of materials and documents, proper determination of the quorum, voting through absentee ballots, and preparation of the minutes? How efficient are Supervisory Board meetings in practice?

- ✓ Is the information provided to directors focused, succinct, and to the point, allowing for effective decision-making? Are key issues and risks highlighted? Do the materials contain annexes with further relevant details?
- ✓ How does the Supervisory Board ensure that it properly oversees the executive bodies? Does it receive periodic reports and updates from the executive bodies? Does the Supervisory Board invite members of the executive bodies to Board meetings to inform its members on key issues? How well does the Supervisory Board interact with senior management, including the General Director? Does the Board provide wise counsel and clear direction? Does it challenge management sufficiently? How does it balance oversight against micro-management?

The Supervisory Board's duties and liabilities:

- ✓ Do all Supervisory Board members understand their duty to act reasonably and in good faith in the best interests of the company and its shareholders? Do directors properly prepare themselves for Board meetings? Does the Supervisory Board give proper consideration to the interests of other stakeholders?
- ✓ Does the company have contracts with directors? Do such contracts describe their duties and liabilities? Are directors indemnified?

The Supervisory Board's self-evaluation and training:

- ✓ Does the Supervisory Board conduct annual self-evaluations? Has the Board developed performance indicators or benchmarks for its work? Is this process credible and are the results made available to shareholders?
- ✓ Does the Supervisory Board conduct regular training events on corporate governance and other issues? Do all directors attend training sessions? Does the company hold an induction training for new directors to acquaint them with the company's strategy and operations?

The Supervisory Board's remuneration:

- ✓ Is the remuneration of directors competitive? Are all directors paid the same amount? Is the remuneration structured in a manner that provides incentives to take on additional responsibilities, for example, the chairmanship of a committee?

- ✓ Does the remuneration package jeopardize a director's independence? Does the total remuneration package constitute a significant portion of a director's total annual income?
- ✓ Does the Supervisory Board and its Nominations and Remuneration Committee periodically review the remuneration paid to directors? Is the remuneration of directors disclosed on an individual basis?
- ✓ Does the company have a policy in place that prohibits personal loans or credits to its directors?
- ✓ Are executive and non-executive directors compensated in the same manner? Does the company have a policy on (not) remunerating executive directors for their service on the Supervisory Board beyond their executive remuneration package?

An effective, professional, and independent Supervisory Board is essential for good corporate governance.¹ The Supervisory Board acts in the best interests of the company and its shareholders. It sets the strategy of the company, protects shareholder rights, and oversees the executive bodies and financial operations of the company.²

While the Supervisory Board cannot substitute for talented professional managers, or change the economic environment in which a company operates, it can influence the performance of the company through its strategic oversight and control over management. Supervisory Board activities may go entirely unnoticed when an economy is strong, share prices are rising, and everything appears to be going well. On the other hand, when things go badly, the Supervisory Board becomes the center of attention and the importance of the Supervisory Board becomes clear.

¹ The Supervisory Board in a two-tiered board system corresponds to a Board of Directors in a unitary board system. Although the Company Law in Russia allows both unitary and two-tiered board systems to exist, in addition to a hybrid model, it functionally does not distinguish between the Supervisory Board and the Board of Directors. Throughout this Manual, the term «Supervisory Board» is used.

See Part I, Chapter 2, Section B.2 for a more detailed discussion on different Board models.

² Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 3.

Mini-Case: Certainly, the catastrophic collapse of Enron in the U.S. served to focus public and government attention on boards and corporate governance. The following illustration shows some of the shortcomings of the Enron Board that contributed to the company's downfall, the loss of many thousands of jobs and pensions, and ultimately a loss in faith in U.S. financial markets. On 7 May 2002, the U.S. Senate concluded the following with respect to the role of the Board in Enron's collapse and bankruptcy:³

- **Fiduciary Failure:** The Enron Board failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the U.S.
- **Lack of Independence:** Financial ties between the company and certain Board members compromised the independence of the Enron Board.
- **Conflicts of Interests:** Despite clear conflicts of interests, the Enron Board approved an unprecedented arrangement allowing Enron's Chief Financial Officer to establish and operate private equity funds that transacted business with Enron and profited at Enron's expense.
- **Excessive Compensation:** The Enron Board approved excessive compensation for company executives, failed to monitor the cumulative cash drain caused by Enron's FY 2000 annual bonus and performance unit plans, and failed to monitor or halt a company-financed, multi-million dollar, personal credit line.
- **High-Risk Accounting:** The Enron Board knowingly allowed Enron to engage in high risk accounting practices.
- **Extensive Undisclosed Off-the-Book Activity:** The Enron Board knowingly allowed Enron to conduct billions of dollars in off-the-book activity to make its financial condition appear better than it was, and failed to ensure adequate public disclosure of material off-the-books liabilities that contributed to Enron's collapse.

The legal regime of the Supervisory Board is characterized by mandatory requirements, but is also accompanied by a degree of flexibility enabling companies to tailor their internal organization to their own needs and circumstances.

³ 107th Congress, 2nd Session, Report by the Permanent Subcommittee on Investigations, The Role of the Board of Directors in Enron's Collapse, 8 July 2002.
See also: http://www.senate.gov/~gov_affairs/070902enronboardreport.pdf.

This chapter describes the authority, election and dismissal, composition, structure, working procedures, duties and liabilities, evaluation, and remuneration of the Supervisory Board. It also discusses corporate governance principles and standards found in the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), and other best practices.

A. The Supervisory Board's Authority

1. When to Establish a Supervisory Board

A company with 50 or more shareholders with voting right must establish a Supervisory Board.⁴ Companies with fewer than 50 shareholders with voting rights may choose not to establish a Supervisory Board.

Best Practices: Supervisory Boards can add value even to companies with fewer than 50 shareholders, specifically when they take on an advisory function. Such supervisory bodies are often referred to as "Advisory Boards" and can provide outside expertise and guidance to the company's General Director and managers.

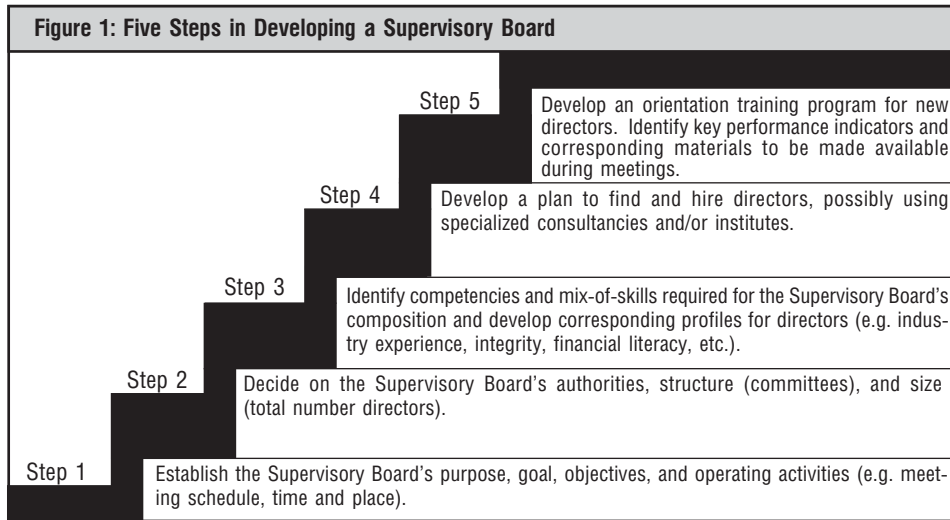
If a company with fewer than 50 shareholders with voting rights decides not to have a Supervisory Board, then:⁵

- The charter must identify a person or body to organize the General Meeting of Shareholders (GMS) and approve the agenda of the GMS; and
- The GMS has the authority to make decisions on all other matters that fall under the Supervisory Board's authority.

A company that wishes to establish a Supervisory Board will want to take the following steps illustrated in Figure 1:

⁴ Law on Joint Stock Companies (LJSC), Article 64, Clause 1.

⁵ LJSC, Article 64, Clause 1, Paragraph 2.



Source: IFC, March 2004

2. An Overview of the Supervisory Board's Authority

The Company Law defines the Supervisory Board's authority.⁶ The Supervisory Board is responsible for setting the company's strategy and business priorities, as well as guiding and controlling managerial performance, and for making decisions on matters that do not fall under the GMS authority. In essence, the role of the Supervisory Board is to direct and not to manage. In some cases, the charter may delegate certain GMS powers to the Supervisory Board. The charter can assign additional powers to the Supervisory Board as well.⁷

Best Practices: When additional powers and authorities are granted to the Supervisory Board in the charter, these should correspond with the typical functions of the Supervisory Board to avoid ambiguity with respect to the division of powers between the GMS, Supervisory Board, General Director, and/or Executive Board.⁸

Matters under the Supervisory Board's authority cannot be delegated to the General Director or the Executive Board.⁹

⁶ LJSC, Article 65.

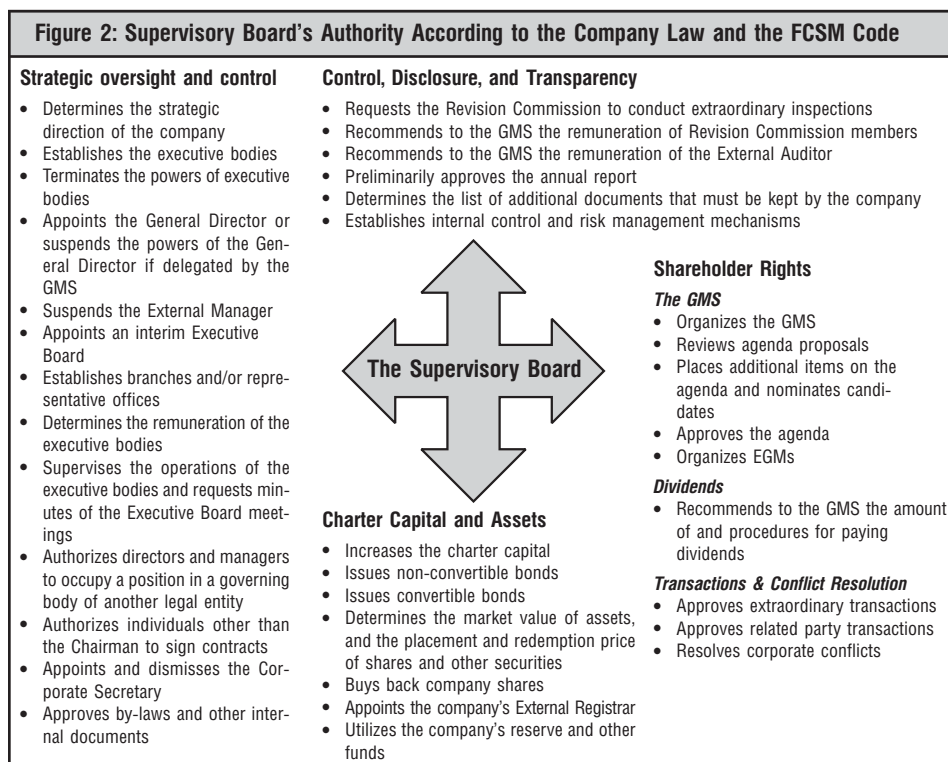
⁷ LJSC, Article 65, Clause 1, Paragraph 2, Section 18.

⁸ FCSM Code, Chapter 3, Section 1.5.

⁹ LJSC, Article 65, Clause 2.

As illustrated in Figure 2, the Supervisory Board has the authority to make decisions in the following areas:

- The strategic oversight and control over management, as well as the election (when provided by the charter) and oversight of the General Director and Executive Board;
- The organization of the GMS;
- The charter capital and assets of the company;
- Disclosure and transparency; and
- Other areas determined by the Company Law and charter.



Source: IFC, March 2004

3. The Supervisory Board's Authority in Relation to Strategic Oversight and Control

The Supervisory Board plays an important role in the company's strategic oversight and control. The Supervisory Board has the following authorities in this area:

a) Setting Company Priorities and Strategic Direction

The Supervisory Board has the authority to determine the priorities and strategic direction of the company.¹⁰

Best Practices: The Supervisory Board should:¹¹

- Set the strategic direction of the company;
- Approve financial and business plans on an annual basis; and
- Establish and oversee internal control procedures.

The Supervisory Board sets the company's strategic direction in the context of the market environment, the financial position, and other factors.¹² The strategic and business plans of the company should be reviewed and evaluated at least on an annual basis. The evaluation should also cover production, marketing, and planned investments. Finally, the Supervisory Board should approve a single document that contains financial projections for one year.

Good corporate governance principles also suggest that:

- The General Director and the Executive Board seek the approval of the Supervisory Board for transactions that fall outside the scope of the financial and business plan (non-standard operations);¹³
- The company develop by-laws or other internal documents with detailed procedures for the General Director and the Executive Board for obtaining the approval of operations that fall outside the scope of the financial and business plan;¹⁴ and
- The Supervisory Board be given the right to veto the decision of the General Director and the Executive Board to implement any non-standard operations, provided such veto can be justified.¹⁵

The Supervisory Board is not, however, involved in the day-to-day management of the company, which is the responsibility of the executive bodies.

¹⁰ LJSC, Article 65, Clause 1, Section 1.

¹¹ FCSM Code, Chapter 1, Sections 3.1. and 7.1.

¹² FCSM Code, Chapter 3, Section 1.1.

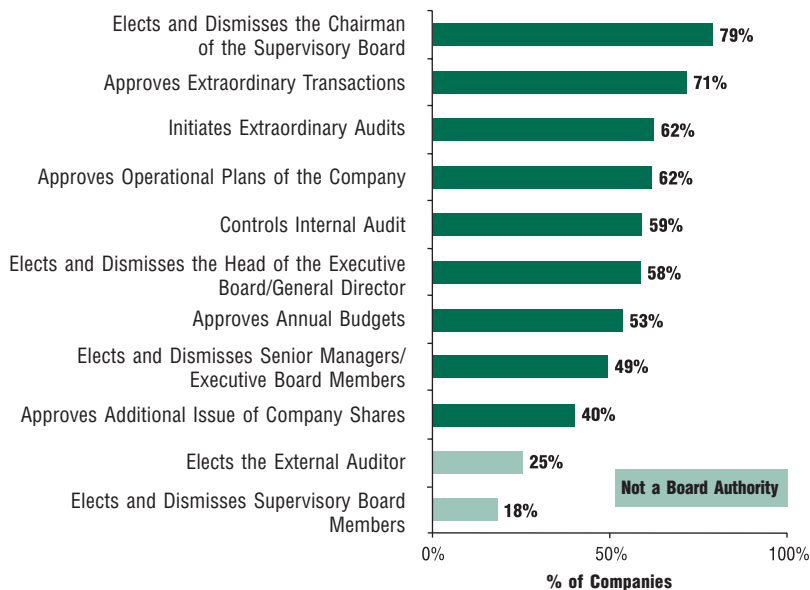
¹³ FCSM Code, Chapter 4, Section 1.2.

¹⁴ FCSM Code, Chapter 4, Section 1.2; Chapter 8, Section 2.2.3.

¹⁵ FCSM Code, Chapter 8, Section 2.2.3.

Company Practices in Russia: The most common functions performed by Supervisory Boards of Russian companies include electing and dismissing the Chairman of the Supervisory Board (79%), approving extraordinary transactions (71%), approving operational plans (62%), and approving annual budgets (53%), as depicted in Figure 3.¹⁶ In addition, Supervisory Boards generally elect and dismiss the Chairman of the Executive Board (General Director), top managers, and Executive Board members. However, one in four Supervisory Boards decides upon the selection of an independent External Auditor, and 18% elect and dismiss their own members. Under Russian legislation, these rights are reserved for shareholders.¹⁷ Companies that violate rules regarding the election of Auditors also tend to violate rules regarding the appointment and dismissal of Supervisory Board members.

Figure 3: Functions Performed by Supervisory Boards in Russia



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

¹⁶ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

¹⁷ LJC, Article 48, Clause 1, Sections 4 and 10.

b) Establishing the Executive Bodies

The Supervisory Board has the authority to establish the executive bodies provided that the charter gives this authority to the Supervisory Board.¹⁸ If the charter is silent on this matter, then the Company Law dictates that this is a power of the GMS.

c) Terminating the Executive Bodies' Powers

With the power to create executive bodies comes the authority to terminate them.¹⁹ The Supervisory Board cannot, however, terminate the authority of the executive bodies if the authority to elect such bodies lies with the GMS.

d) Suspending the Executive Bodies' Powers

If the power to create and terminate executive bodies remains with the GMS, the charter can provide the Supervisory Board with the authority to suspend the powers of the General Director and External Manager. The Supervisory Board is not, however, able to suspend the powers of the Executive Board.

e) Appointing Interim Executive Bodies

When the power to create executive bodies resides with the GMS and the charter provides the Supervisory Board with the authority to suspend the powers of the General Director or External Manager, the Supervisory Board shall appoint interim executive bodies together with the decision on the suspension of powers, as illustrated in Table 1.

Table 1: Instances When the Supervisory Board May Appoint Interim Executive Bodies	
An interim General Director ²⁰	<ul style="list-style-type: none"> • When the Supervisory Board has exercised the right to suspend the powers of the General Director provided by the charter; or • When the General Director is unable to fulfill his duties; or • When the Supervisory Board has exercised the right to suspend the powers of the External Manager provided by the charter; or • When the External Manager is unable to fulfill its duties.

¹⁸ LJSC, Article 48, Clause 1, Section 8. See also: LJSC, Article 65, Clause 1, Section 9; Article 69, Clause 3, Paragraph 1.

¹⁹ LJSC, Article 48, Clause 1, Section 8. See also: LJSC, Article 65, Clause 1, Section 9; Article 69, Clause 4, Paragraph 2.

²⁰ LJSC, Article 69, Clause 4, Paragraphs 3 and 4.

Table 1: Instances When the Supervisory Board May Appoint Interim Executive Bodies

An interim Executive Board ²¹	<ul style="list-style-type: none">• When the charter has reserved the power to establish the Executive Board for the GMS; and• When the number of acting Executive Board members is less than the quorum set by the charter or by-laws.
--	--

In these circumstances, the decision to appoint an interim executive body must be accompanied by a decision to hold an Extraordinary General Meeting of Shareholders (EGM) to elect new executive bodies.

Best Practices: A reasonable timeframe to hold the EGM is within 60 days of the appointment of the interim executive body.

f) Concluding Contracts with the Executive Bodies

The Chairman has the power to sign contracts between the company and members of the executive bodies.²² The Supervisory Board can also designate a person other than the Chairman to enter into contracts with members of the executive bodies.²³

Best Practices: Although legislation does not specify who determines the terms of contracts with managers, including their remuneration, it is recommended that the Supervisory Board do this.²⁴

It is common practice internationally for the Supervisory Board's Remuneration Committee, chaired and comprised of independent directors, to set the remuneration of the General Director and other senior managers. The German Corporate Governance Code, for example, states that the compensation of the Executive Board is determined by the Supervisory Board based on a performance assessment. Criteria for determining the level of compensation are: the tasks of the Executive Board members; their performance; the economic (financial) situation of the company; and, in particular, the performance outlook compared to competing companies.²⁵

→ *For more information on executive remuneration, see Chapter 5, Section G.*

²¹ LJSC, Article 70, Clause 2, Paragraph 1.

²² LJSC, Article 69, Clause 3, Paragraph 2.

²³ LJSC, Article 69, Clause 3, Paragraph 2.

²⁴ FCSM Code, Chapter 3, Section 1.4.3.

²⁵ The German Corporate Governance Code, 4.2.2. See also: www.ecgi.org/codes/country_documents/germany/code_200305_en.pdf and www.corporate_governance_code.de

g) Supervising the Executive Bodies' Operations

The executive bodies must be accountable to the Supervisory Board and shareholders.²⁶

Best Practices: The executive bodies normally report to shareholders during the GMS. Most shareholders, in particular minority shareholders, are not able to effectively supervise management. This task is the responsibility of the Supervisory Board, which oversees the executive bodies on behalf of all shareholders.²⁷ In order for the Supervisory Board to fulfill its oversight function, the charter needs to provide it with sufficient authorities on a wide range of issues, including the authority to supervise the financial and business operations of the company.²⁸

When establishing and selecting an Executive Board, an appropriate balance must be struck between exercising oversight over the General Director and allowing him sufficient autonomy to conduct corporate affairs. The dangers of weak oversight are well known; managers can operate in their own personal interests, and defraud shareholders. There are, on the other hand, dangers associated with excessive oversight; these include micro-management, and the politicization of managerial decision-making. Both weak and excessive oversight can lead to economic inefficiencies and legal problems. As a consequence, charters, by-laws, and other policy documents should be developed with a view towards dividing responsibilities among the governing bodies of the company on the basis of what body is best suited for a particular task. Managerial tasks should, clearly, be left to professional managers. Oversight tasks should be carried out by oversight bodies, such as the Supervisory Board and GMS.

The Supervisory Board, for example, has the authority to request the minutes of Executive Board meetings.²⁹ The Supervisory Board further decides whether the General Director or an Executive Board member can occupy a position in a governing body of another legal entity,³⁰ in order to avoid a conflict of interest that may prevent the General Director and other executives from properly fulfilling their functions.

²⁶ LJSC, Article 69, Clause 1.

²⁷ See also: FCSM Code, Chapter 3, Section 1.4.1.

²⁸ FCSM Code, Chapter 3, Section 1.2.1. The FCSM Code recommends that these procedures be developed taking into consideration the requirements of the Law on Countering Legalization of Income Generated by Illegal Means (Money Laundering).

²⁹ LJSC, Article 70, Clause 2, Paragraph 2.

³⁰ LJSC, Article 69, Clause 3, Paragraph 4.

Best Practices: The Supervisory Board must understand what to monitor. A number of key issues every Supervisory Board will want to closely monitor should include the:

- Company's overall performance, especially in comparison to competing companies;
- Executive bodies' compliance with law and internal procedures, including on corporate governance, risk management and internal control, as well as ethics;
- Executive bodies' performance, both at the team and individual level;
- Implementation of the company's strategy;
- Company's marketing and sales targets;
- Company's financial results; and
- Relations with key stakeholders, including the company's shareholders, as well as employees, suppliers, and customers.

h) Appointing the Corporate Secretary

Although the Company Law is silent about the Supervisory Board's authority to appoint the Corporate Secretary, the Supervisory Board can be vested with this power in the charter.³¹

Best Practices: Appointing the Corporate Secretary, and defining the terms and conditions of the contract with the Corporate Secretary, including the amount of remuneration, should fall under the Supervisory Board's authority.³² Moreover, the Corporate Secretary should be accountable to and supervised by the Supervisory Board in accordance with the terms and conditions of his employment contract.

→ *For more information on the Corporate Secretary, see Chapter 6.*

i) Approving By-laws

The Supervisory Board approves the by-laws and other internal documents, excluding those that must be approved by the GMS or the executive bodies of the company.³³

³¹ LJSC, Article 65, Clause 1, Section 18.

³² FCSM Code, Chapter 5, Section 2.1.

³³ LJSC, Article 65, Clause 1, Section 13.

Best Practices: The FCSM Code advises that the Supervisory Board approve the by-laws dealing with the company's:

- Dividend policy;³⁴
- Information policy;³⁵
- Ethical standards;³⁶
- Control and Revision Service;³⁷
- Risk management;³⁸
- Audits of the financial and business activity of the company;³⁹ and
- Corporate Secretary.⁴⁰

→ For more information on by-laws and their approval, see Part I, Chapter 3, Section B, as well as model by-laws contained in Annexes under Part VI.

j) Establishing Branches and Representative Offices

The establishment of the company's branches and representative offices lies within the Supervisory Board's authority.⁴¹ However, the Company Law does not address the Supervisory Board's authority to terminate branches and representative offices.

4. The Supervisory Board's Authority in Relation to Shareholder Rights

a) Organizing the General Meeting of Shareholders⁴²

The Supervisory Board has the authority, and sometimes the obligation, to include items on the agenda.⁴³

³⁴ FCSM Code, Chapter 9, Section 1.1.1.

³⁵ FCSM Code, Chapter 7, Section 4.1.1; Chapter 3, Section 2.3.1.

³⁶ FCSM Code, Chapter 3, Section 4.12.

³⁷ FCSM Code, Chapter 8, Section 1.1.1.

³⁸ FCSM Code, Chapter 3, Section 1.2.2.

³⁹ FCSM Code, Chapter 8, Section 3.1.3.

⁴⁰ FCSM Code, Chapter 5.

⁴¹ LJSC, Article 65, Clause 1, Section 14.

⁴² The general aspects of organizing the GMS, including the role of the Supervisory Board, are discussed at length in Chapter 8. In this section, this process is approached from the perspective of the Supervisory Board and focuses on the GMS agenda.

⁴³ LJSC, Article 49, Clause 3; Article 54, Clause 2; LJSC, Article 53, Clause 7, Paragraph 2.

The Supervisory Board must include items on the agenda of the GMS upon request of a shareholder (or a group of shareholders) owning at least 2% of voting shares. Items that the Supervisory Board can add to the agenda of the GMS are the approval of:⁴⁴

- Reorganizations;⁴⁵
- The composition and liquidation of a Creditors' Committee;⁴⁶
- The amount of dividends;⁴⁷
- The transfer of the General Director's authority to an External Manager;⁴⁸ and
- The annual report.⁴⁹

→ For more information on who can request an EGM, see Part III, Chapter 8, Section D.

There are certain items that only the Supervisory Board may include on the agenda of the GMS, unless the charter also provides this right to shareholders and/or other permitted parties. These items are shown in Figure 4.

b) Resolving Corporate Conflicts

Best Practices: A key Supervisory Board function is to establish a system of compliance with corporate procedures. The Supervisory Board's responsibility is to take all necessary steps to prevent and resolve conflicts that may arise between shareholders and the company.⁵⁰ It may appoint officers to implement systems of enforcement. The Supervisory Board may also form a Conflict Resolution Committee to this end.

→ For more information on corporate conflicts and on the Supervisory Board's Conflict Resolution Committee, see Section D.2 of this Chapter and Part V, Chapter 17, Sections G.2 and G.3, respectively.

⁴⁴ There appears to be an inconsistency between LJSC, Articles 16–21, which provides that decisions of the GMS on different types of reorganization and liquidation of the company can be submitted to the agenda of the GMS only by the Supervisory Board, and LJSC, Article 49, Clause 3, which states that these decisions can be submitted to the agenda of the GMS by the Supervisory Board if the charter does not provide otherwise.

⁴⁵ LJSC, Article 16, Clause 2; Article 17, Clause 2; Article 18, Clause 2; Article 19, Clause 2; and Article 20, Clause 2.

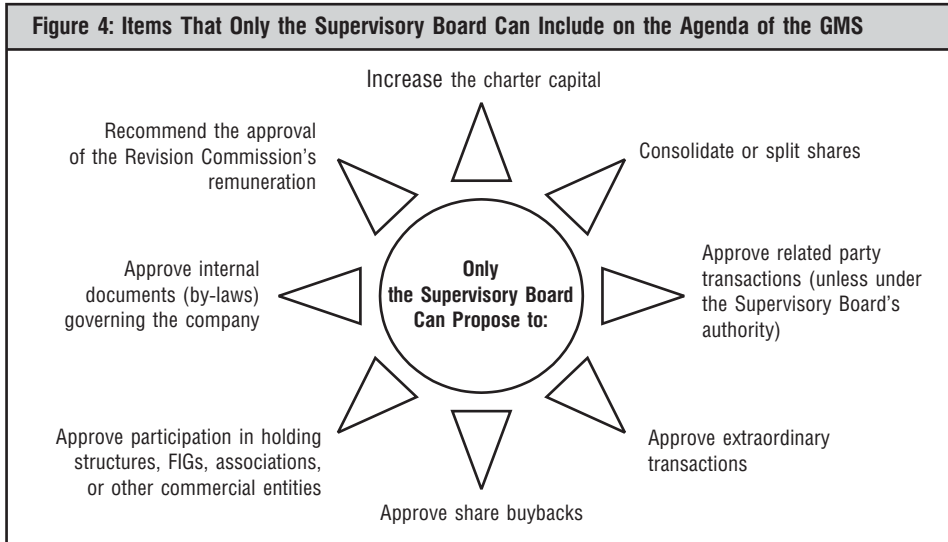
⁴⁶ LJSC, Article 21, Clause 2.

⁴⁷ LJSC, Article 42, Clause 3.

⁴⁸ LJSC, Article 69, Clause 1, Paragraph 3.

⁴⁹ LJSC, Article 88, Clause 4; Article 54, Clause 2.

⁵⁰ FCSM Code, Chapter 3, Sections 1.3.1-1.3.2.



Source: IFC, March 2004

5. The Supervisory Board's Authority in Relation to Assets and the Charter Capital

The Supervisory Board has the authority to decide on whether to issue non-convertible bonds and other non-convertible securities if the charter does not provide otherwise.⁵¹ In contrast, the Supervisory Board has the authority to decide on the issue of convertible bonds and other convertible securities only if this authority has not been provided to the GMS in the charter.⁵²

In addition, the Supervisory Board has the authority to set the market value of assets, the placement price, and the redemption price of shares and other securities.⁵³

→ For more information on charter capital, see Part III, Chapter 9, and on bonds and other securities, see Chapter 11.

⁵¹ LJSC, Article 65, Clause 1, Section 6; Article 33, Clause 2, Paragraph 1.

⁵² LJSC, Article 65, Clause 1, Section 6; Article 33, Clause 2, Paragraph 2.

⁵³ LJSC, Article 65, Clause 1, Section 7.

6. The Supervisory Board's Authority in Relation to Control, Disclosure, and Transparency

a) Preliminarily Approving the Annual Report

The executive bodies are responsible for preparing financial statements and for financial reporting.⁵⁴ The Supervisory Board verifies and authorizes the annual report and financial statements for submission to the GMS for final approval.⁵⁵ This must be done no later than 30 days before the Annual General Meeting of Shareholders (AGM) is held.

b) Implementing Risk Management

The Supervisory Board should ensure that systems for evaluating and managing risks are in place. Some of the key Supervisory Board duties are outlined in the box below and in Figure 5.

Best Practices: Risk management is an important function of the Supervisory Board.⁵⁶ The Supervisory Board should ensure that systems are established that enable the company to assess and control risks.⁵⁷ Among other things, the Supervisory Board should:

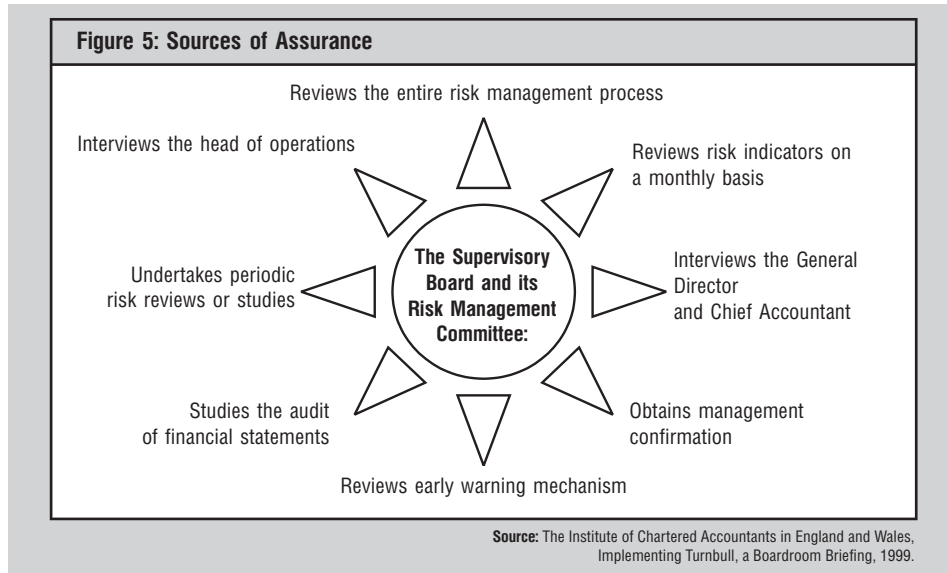
- Approve risk management procedures and ensure compliance with such procedures (these procedures should provide that the company and its employees notify the Supervisory Board promptly of all substantial deficiencies in risk management mechanisms);
- Analyze, evaluate, and improve the effectiveness of the internal risk management procedures on a regular basis;
- Develop adequate incentives for the executive bodies, departments, and employees to apply internal control systems;
- Establish a Risk Management Committee of the Supervisory Board when necessary; and
- Ensure that the company complies with legislation and charter provisions.

⁵⁴ LJSC, Article 88, Clause 2.

⁵⁵ LJSC, Article 88, Clause 4.

⁵⁶ Companies engaged in banking, investment, or insurance activities should, at a minimum, follow the risk management requirements established by regulatory authorities of the Russian Federation, such as the Central Bank.

⁵⁷ FCSM Code, Chapter 3, Section 1.2.2.



c) Specifying Additional Documents that Must Be Kept by the Company

The company must keep certain documents such as the founders' agreement, charter, by-laws, and annual report. Both the Supervisory Board and other governing bodies have the authority to specify additional documents that must be kept by the company.⁵⁸

→ For more information on the annual report, see Part IV, Chapter 13, Section C.4 and Part VI, Annex 29.

B. The Election and Dismissal of Directors

1. The Election and Term of Directors

The GMS elects directors⁵⁹ for a term that starts from the moment that they are elected until the next AGM.⁶⁰ If a new AGM is not held within the period pro-

⁵⁸ LJSC, Article 89, Clause 1.

⁵⁹ LJSC, Article 48, Clause 1, Section 4.

⁶⁰ LJSC, Article 47, Clause 1, Paragraph 3. See also: LJSC, Article 66, Clause 1, Paragraph 1.

vided for by the Company Law, i.e. from 1 March to 30 June, the authority of directors terminates automatically, except for their authority to prepare, convene, and conduct the AGM.⁶¹

There are no limitations as to how many times a directors can be re-elected.⁶²

Best Practices: Companies can maintain their vitality and ability to adapt to new challenges by changing the composition of their Supervisory Board. Non-executive directors may indeed lose some of their (independent) edge if they remain on a Board too long. A company may wish to impose term-limits, either for the entire Supervisory Board or a certain percentage, to keep its members focused. Either way, reappointment should not be automatic, but a conscious decision by the shareholder(s) and the director concerned.

In accordance with French law, for example, a director's mandate may not exceed six years unless the GMS decides to renew this mandate, and directors older than 70 years may not exceed one-third of board membership. In this respect, the Hellebuyk Commission recommends that directors' mandates not exceed four years and the number of directors over 65 years not exceed one-third of the board membership.⁶³ The French Corporate Governance Code (Vienot II) in turn provides that the duration of a directors' term of office, set by the by-laws, should not exceed a maximum of four years, in order to enable shareholders to rule upon their appointment with sufficient frequency.⁶⁴

2. The Nomination of Candidates for the Supervisory Board

A shareholder (or a group of shareholders) owning at least 2% of voting shares has the right to nominate candidates for the Supervisory Board.

→ *The procedure for nominating candidates for the Supervisory Board is discussed at great length in Part III, Chapter 8, Section B.1.*

⁶¹ LJSC, Article 66, Clause 1, Paragraph 1.

⁶² LJSC, Article 66, Clause 1, Paragraph 2.

⁶³ AFG ASFFI (Association Francaise de la Gestion Financiere). Hellebuyck Commission Recommendations on Corporate Governance, § II.D.4 (June 29, 1998). See also: <http://www2.eycom.ch/corporate-governance/reference/pdfs/8/en.pdf>.

⁶⁴ Report of the Committee on Corporate Governance ("the Vienot II Report"), July 1999. See also: <http://www2.eycom.ch/corporate-governance/reference/pdfs/11/en.pdf>.

3. Information About Supervisory Board Nominees

Information about Supervisory Board nominees must be submitted to persons entitled to participate in the GMS before the Meeting.⁶⁵ The Company Law itself does not specify what information must be disseminated. It permits the charter to specify the required information.⁶⁶

Best Practices: Shareholders should receive sufficient information to determine the ability of Supervisory Board nominees to fulfill their duties and, if applicable, to ascertain their independence. Some useful items of information include:⁶⁷

- The identity of the candidate;
- The identity of the shareholder (or the group of shareholders) that nominated the candidate;
- The age and educational background of the candidate;
- The positions held by the candidate during the last five years;
- The positions held by the candidate at the moment of his nomination;
- The nature of the relationship the candidate has with the company;
- Other Supervisory Board memberships or official positions held by the candidate;
- Other nominations of the candidate for a position on the Supervisory Board or official positions;
- The candidate's relationship with affiliated persons of the company;
- The candidate's relationship with major business partners of the company;
- Information related to the financial status of the candidate, and other circumstances that may affect the duties and independence of the candidate as a Board member; and
- The refusal of the candidate to respond to an information request of the company.

→ *For information on the timeline for the disclosure of this information, see Part III, Chapter 8, Section B.4.*

⁶⁵ LJSC, Article 52, Clause 3.

⁶⁶ LJSC, Article 53, Clause 4.

⁶⁷ FCSM Code, Chapter 3, Section 2.3.1.

4. The Election of Directors

All directors must be elected with cumulative voting.⁶⁸ Cumulative voting is a system that helps minority shareholders pool their votes to elect a representative for the Supervisory Board.

The election of directors cannot be done if a GMS is held by written consent.⁶⁹

a) How Cumulative Voting Works

Cumulative voting works as follows:

- Candidates for the Supervisory Board are voted on collectively, i.e. as a group;
- Each shareholder has a maximum number of votes equal to the number of directors that must be elected (according to the charter or a decision of the GMS) multiplied by the number of voting shares held;
- Shareholders can allocate their votes to one candidate or divide them among several candidates as they please;
- The top X candidates with the most votes are considered elected, whereby X equals the number of Supervisory Board members to be elected as specified by the charter or the decision of the GMS.

Mini-Case 1: The following mini-case illustrates how shareholders, in particular minority shareholders, can calculate the minimum number of votes required to elect one Supervisory Board member. Once they know this, it will help them organize their collective action to put their representative on the Supervisory Board.

In this case, a company has 2,500 minority shareholders holding a total of 3,000 (or 20% of) voting shares, and one majority shareholder holding a total of 12,000 (or 80% of) voting shares. The charter states that the Supervisory Board has nine members. The 2,500 minority shareholders hold 27,000 votes (3,000 shares × 9 votes) and the majority shareholder has 108,000 votes (12,000 shares × 9 votes). The nine candidates that receive the most votes are elected to the Supervisory Board.

⁶⁸ LJSC, Article 66, Clause 4, Paragraph 1.

⁶⁹ LJSC, Article 50, Clause 2.

A formula can be used to calculate a minimum number of votes to elect one director:

$$\frac{nS}{D + 1} + 1 = \frac{9 \times 15,000}{9 + 1} + 1 = 13,501 \text{ shares}$$

where D — the number of directors to be elected, S — the number of outstanding voting shares and n — the total number of directors the majority shareholder wants to elect ($n = 9$ directors in this example).

For this formula to work, shareholders must know the number of voting shares the company has in total (S), how many directors must be elected (D), and how many candidates they want to elect to the Supervisory Board.

The formula indicates that shareholders must have 13,501 votes to ensure that one director is elected. Minority shareholders in this example hold 27,000 votes which will enable them to elect at least one director, should they vote collectively.

b) Cumulative Voting and Collective Action

Cumulative voting increases the chance that minority shareholders elect a representative to the Supervisory Board. In order to be effective, minority shareholders must organize themselves to vote. For this, they must:

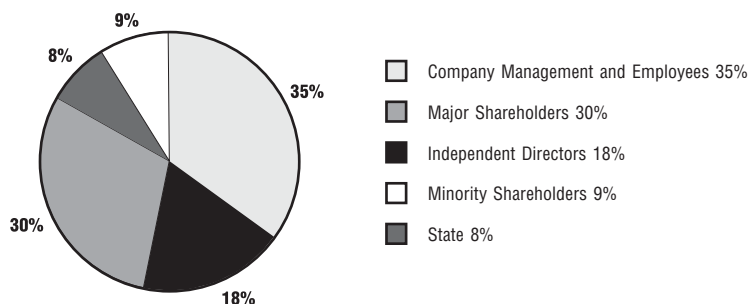
- Have the resources and skills to campaign for candidates;
- Make use of the shareholder list to contact other shareholders; and
- Be able to use cumulative voting strategically.

Mini-case 1 above illustrates the importance of collective action and voting strategy.

Company Practices in Russia: Representatives of major shareholders (35%), management and employees (30%) are the most common types of directors, as depicted in Figure 6. Independent directors (18%) and minority shareholder representatives (9%) still constitute a minority on most Supervisory Boards. A positive correlation exists between the number of shareholders in a company and the number of representatives of majority shareholders on the Supervisory Board. Hence, Supervisory Boards of large companies with many shareholders tend to include more representatives of large shareholders.⁷⁰

⁷⁰ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

Figure 6: The Structure of the Average Russian Supervisory Board



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

c) Cumulative Voting and Fractional Shares

Fractional shares also count when Supervisory Board members are elected. Fractional votes may not be further divided. Fractional votes may only be cast for one candidate.⁷¹ The following mini-case shows how this rule works in practice.

Mini-Case 2: Shareholder A has 5.1 voting shares. During the GMS, the shareholders are to elect nine Supervisory Board members through cumulative voting. Shareholder A is able to cast 45.9 votes (5.1×9). In this case, Shareholder A will cast the 45 votes as desired. Shareholder A must cast the remaining 0.9 votes for one candidate and cannot divide the fraction (0.9) into smaller fractions (for example, 0.4 to Supervisory Board candidate B and 0.5 to Supervisory Board candidate C).

d) Relationship Between the Number of Directors and the Effectiveness of Cumulative Voting

There is a direct relationship between the effectiveness of cumulative voting and the number of directors: the higher the number of directors to be elected, the greater the opportunity for minority shareholders to elect a representative to the Supervisory Board.

⁷¹ FCSM, Regulation No. 17/ps, on Additional Requirements to the Procedure of Preparing, Calling and Conducting the General Meeting of Shareholders, 31 May 2002, Section 2.14.

The Company Law requires that a company with less than 1,000 shareholders with voting rights elect a minimum of five Supervisory Board members.⁷² Thus, a shareholder (or a group of shareholders) holding roughly 16.7% of the total number of voting shares could elect one director.⁷³

A company with more than 1,000 shareholders with voting rights must have at least seven Supervisory Board members.⁷⁴ Thus, a shareholder (or a group of shareholders) holding roughly 12.5% of the total number of voting shares could elect one director.

A company with more than 10,000 shareholders with voting rights must have at least nine Supervisory Board members.⁷⁵ In this case, a shareholder (or a group of shareholders) holding a mere 10% of voting shares can secure one position on the Supervisory Board.

5. The Election of Directors When Lacking a Quorum

Commonly, if the number of directors becomes less than the quorum, the Supervisory Board no longer can make valid decisions. It must subsequently organize an EGM to elect a new Supervisory Board. This should be done as soon as possible to have a Supervisory Board that is able to make valid decisions.⁷⁶

→ *For more information on the Supervisory Board's role in preparing for the EGM, see Part III, Chapter 8, Section D.*

6. The Dismissal of Directors

In the ordinary course of business, directors are elected at every AGM. Only the GMS can dismiss directors before the end of their term.⁷⁷ Since the Supervisory Board is elected with cumulative voting, the GMS can only terminate the authority of all directors collectively, not of individual members.⁷⁸ Such a GMS will in practice be an EGM.

⁷² LJSC, Article 66, Clause 3, Paragraph 1.

⁷³ Using the figures in the mini-case in section B.6.a) then $((1 \times 15,000) / 5 + 1) + 1 = 2,501$ shares.
 $(2,501 / 15,000) \times 100\% = 16.7\%$

⁷⁴ LJSC, Article 66, Clause 3, Paragraph 2.

⁷⁵ LJSC, Article 66, Clause 3, Paragraph 2.

⁷⁶ LJSC, Article 68, Clause 2.

⁷⁷ LJSC, Article 66, Clause 1, Paragraph 3; Article 48, Clause 1, Paragraph 4.

⁷⁸ LJSC, Article 66, Clause 1, Paragraph 3.

Best Practices: The Company Law does not specify the grounds for dismissing Supervisory Board members. Grounds may include providing false information to the company as a candidate for the Supervisory Board, willful neglect of Supervisory Board responsibilities, or conviction of a criminal act.

C. The Composition of the Supervisory Board

1. The Number of Directors

The total number of directors must be fixed in the charter or by decision of the GMS.⁷⁹ The Company Law provides for the following minimum number of directors depending on the number of shareholders:⁸⁰

- At least five directors for companies with 1,000 and fewer shareholders with voting rights;
- At least seven directors for companies with more than 1,000 shareholders with voting rights; and
- At least nine directors for companies with more than 10,000 shareholders with voting rights.

The charter or decision of the GMS can, however, provide for a greater number of directors than the minimum number legally required.

Best Practices: Companies should choose a Supervisory Board size that will enable it to:⁸¹

- Hold productive and constructive discussions;
- Make prompt and rational decisions; and
- Efficiently organize the work of its committees, if these are established.

⁷⁹ LJSC, Article 66, Clause 3, Paragraph 1.

⁸⁰ LJSC, Article 66, Clause 3, Paragraphs 1 and 2.

⁸¹ FCSM Code, Chapter 3, Section 2.1.4.

The number of directors should be guided by legal requirements, and the specific needs of the company and its shareholders. Most companies in Russia tend to have between six and ten directors.⁸²

Having either too few or too many directors can be a problem for effective decision-making. A small Supervisory Board may not allow the company to benefit from an appropriate mix-of-skills and breadth of experience; a larger Supervisory Board is typically more difficult to manage, and can make consensus building time-consuming and difficult. The challenge in selecting the correct Supervisory Board size is striking an appropriate balance.

2. Who Can Be a Director

There are legal requirements of eligibility for directors:

- Only individuals with “full dispositive capacity” can be directors. Directors should have the capacity to acquire and exercise civil law rights by their actions, be able to create civil law obligations, and fulfill these rights and obligations;⁸³
- A legal entity cannot be a director, although an individual who happens to be a representative of a legal entity can be elected to the Supervisory Board. In this case, the individual elected to the Supervisory Board may only serve in his capacity as a director and not as a representative of the legal entity, i.e. he must act in the interest of the company on whose Supervisory Board he is sitting and not of the company he is representing;⁸⁴

→ *For more information on the fiduciary duties of a director, see Section F.2 in this Chapter.*

- Revision Commission members cannot be directors;⁸⁵
- Counting Commission members cannot be directors;⁸⁶ and

⁸² FCSM-ISMM-INVAS Survey; 2002 (see www.rid.ru).

⁸³ Civil Code (CC), Article 21.

⁸⁴ LJSC, Article 66, Clause 2, Paragraph 1.

⁸⁵ LJSC, Article 85, Clause 6 Paragraph 1.

⁸⁶ LJSC, Article 56, Clause 2.

- An Executive Board member or the General Director of Company A can only be a director of Company B after the Supervisory Board of Company A has given its consent.⁸⁷

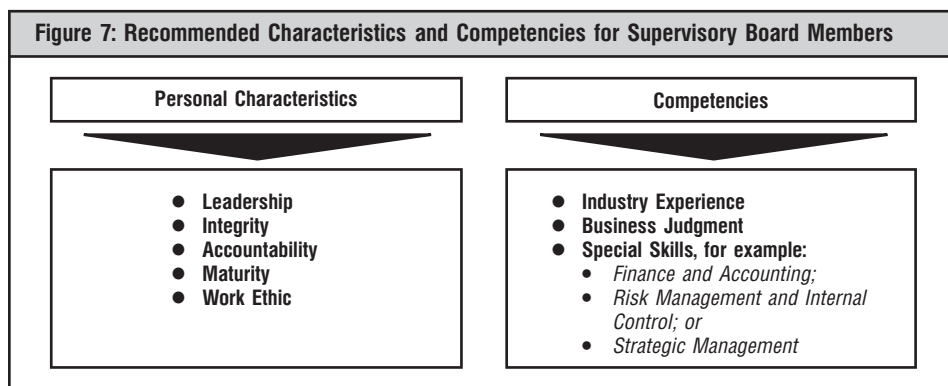
Best Practices: To avoid conflicts of interest, individuals should not be elected to the company's Supervisory Board when they are:⁸⁸

- A director of a competing company;
- A manager of a competing company; or
- An employee of a competing company.

Nominees for the Supervisory Board should also not be related to suppliers, affiliated persons, as well as employees of the independent External Auditor.

3. Qualifications of Directors

Directors should possess the necessary skills and experience to contribute to the work of the Supervisory Board. Figure 7 illustrates the personal characteristics and competencies required for this task.



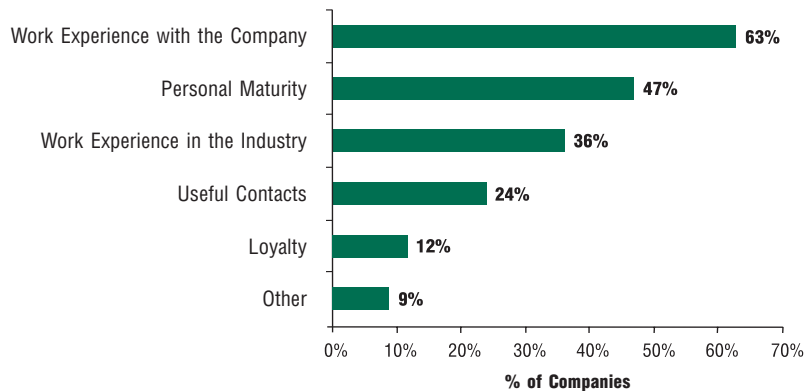
Source: IFC, March 2004

⁸⁷ LJSC, Article 69, Clause 3.

⁸⁸ FCSM Code, Chapter 3, Section 2.1.3.

Company Practices in Russia: As indicated in Figure 8, Russian companies feel that work experience within the company and the industry, as well as personal maturity are important criteria when electing directors. Other popular criteria include contacts and loyalty to the company. On the other hand, criteria such as independence, expertise, and leadership are not mentioned.⁸⁹ It can thus be inferred that the benefits of independent directors are not fully understood by Russian companies.

Figure 8: Main Criteria Used in Electing Supervisory Board Members



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

There are no legal requirements with regard to the qualification criteria of directors. As a consequence, such criteria need to be specified elsewhere. For example, companies may find useful to include qualifications in their internal company documents, as described in the following box.

Best Practices: The charter should set forth the qualification criteria of directors.⁹⁰ Directors should have the following qualifications:

- The trust of shareholders, other directors, managers, and employees of the company;
- The ability to relate to the interests of all stakeholders and make well-reasoned decisions;
- The professional expertise and education needed to be effective;

⁸⁹ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

⁹⁰ FCSM Code, Chapter 3, Section 2.1.3.

- International business experience, knowledge of national issues and trends, knowledge of the market, products, and competitors; and
- The ability to translate knowledge and experience into solutions.

It may, however, be difficult for the company to determine whether a potential director possesses these qualifications. Moreover, a brief description of such qualifications in the company's charter may lead to ambiguity and thus be of little use. Instead, companies may wish to include the above criteria in their by-laws or other internal documents. Indeed, many companies in the U.S. use corporate governance guidelines for this purpose.

Shareholders should be informed of the directors' qualifications, and the list of candidates for the Supervisory Board should indicate whether, at the time of election, the candidate is or will be:⁹¹

- The General Director;
- An Executive Board member;
- An officer or employee of the company; and
- Able to meet the qualifications of an independent director.

The background of candidates for the Supervisory Board should be checked for a criminal record and for past administrative offences that are not *de minimis* in nature. Both are likely to preclude the membership of such candidates on the Supervisory Board as the FCSM Code calls for directors with impeccable character.⁹²

4. Categories of Directors

International practice and domestic law distinguish between different categories of directors according to the degree to which such directors are involved in the affairs of (or are related to) the company. The three categories are executive, non-executive, and independent directors.

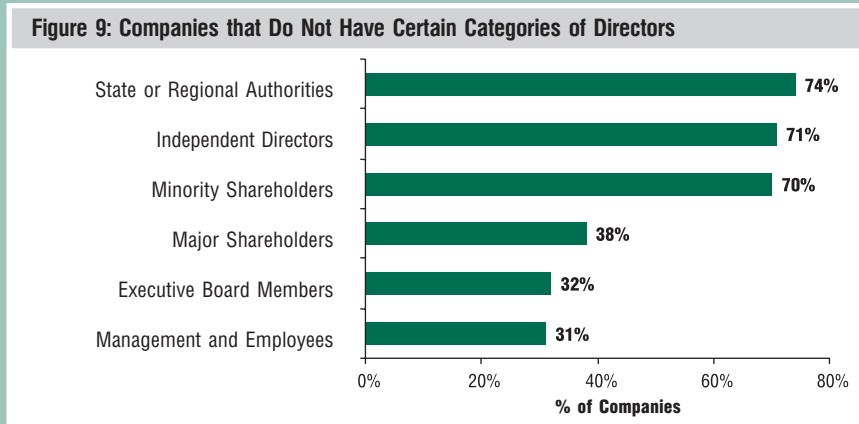
Company Practices in Russia: Many Russian companies are controlled by a single shareholder or a group of shareholders (often the General Director and/or the Chairman) who are well informed about the affairs of the company and able to closely monitor the company's management. The remaining ownership is often widely dispersed and many of these, often minority, shareholders lack the resources and information to effectively monitor management and defend themselves against the potential abuses of large shareholders. In these types of companies, independent directors take on special importance.

A survey of companies in Russia's regions found that only 18% of companies follow the FCSM Code's recommendations that independent directors make up at least

⁹¹ FCSM Code, Chapter 3, Section 2.3.3.

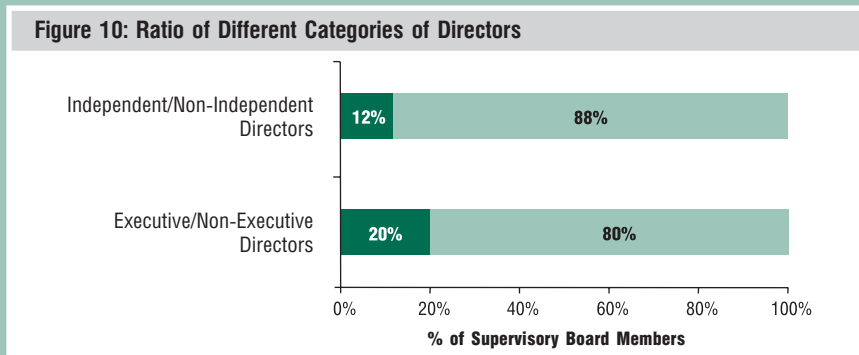
⁹² FCSM Code, Chapter 3, Section 2.1.1.

1/4 of the Supervisory Board, and no less than three people (see Figure 6 above). Further, only 29% of companies have any independent directors (Figure 9).⁹³ Minority shareholders are also poorly represented, with 70% of the surveyed companies having no minority shareholder representative on their Supervisory Board.



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

Figure 10 shows that among Supervisory Boards that have both executive and non-executive members, the overall ratio of executives to non-executives is one to four.⁹⁴ The ratio of independent to non-independent directors, at one to nine, leaves much room for improvement on the average Russian Supervisory Board.



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

⁹³ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

⁹⁴ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.1, page 21, August 2003 (see www.ifc.org/rcgp).

a) Executive Directors

Executive directors can be defined as those that also hold an executive position in the company, namely that of:

- The General Director;
- An Executive Board member; or
- A manager of the company who is not an Executive Board member.

The Company Law does not refer to executive directors as a general category; it does, however, limit the number of Executive Board members that can be Supervisory Board members. Executive Board members can occupy a maximum of $\frac{1}{4}$ of the total number of Supervisory Board seats.⁹⁵

Best Practices: Many Russian companies have Supervisory Board dominated by executive directors. To circumvent the above-mentioned legal provision, stating that Executive Board members can occupy a maximum of $\frac{1}{4}$ of the total number of Supervisory Board seats, many Russian companies simply choose not to create an (or disband an already existing) Executive Board. However, Russian companies wishing to adhere to good corporate governance practices should not follow the letter but rather the spirit of the law, and limit the number of executives, rather than Executive Board members, to $\frac{1}{4}$ of total number of directors.

Further, the General Director cannot serve as the Chairman of the Supervisory Board at the same time (in international practice, so-called “CEO-duality”).⁹⁶

Executive directors are, by definition, not independent.

b) Non-Executive Directors

Non-executive directors are Supervisory Board members that do not hold an executive position in the company. Effective non-executive directors should have the following personal attributes:

⁹⁵ LJSC, Article 66, Clause 2.

⁹⁶ LJSC, Article 66, Clause 2.

- Integrity and high ethical standards;
- Sound judgment;
- The ability and willingness to challenge and probe; and
- Strong interpersonal skills.

Best Practices: Most international and national codes of corporate governance recommend that (Supervisory) Boards be composed of a majority of non-executive directors who contribute:

- An outside perspective and greater impartiality in their judgments;
- Additional external experience and knowledge; and
- Useful contacts.

In Germany, for example, no more than two former members of the Executive Board or *Vorstand* may be members of the Supervisory Board so as to ensure the Supervisory Board's independent oversight capability.⁹⁷

In most EU countries, non-executive directors normally exercise oversight of the financial and strategic decision-making functions of the company. Apart from these, there are three areas in need of disinterested monitoring by non-executive directors:⁹⁸

- Nomination of directors;
- Remuneration of senior managers and directors; and
- Internal and external audit.

In the U.K., the Higgs report groups the role of the non-executive director around four issues:⁹⁹

1. **Strategy:** Non-executive directors should constructively challenge and contribute to the development of strategy.
2. **Performance:** Non-executive directors should scrutinize the performance of management in meeting agreed upon goals and objectives, and monitor the reporting of performance.

⁹⁷ The German Corporate Governance Code, 5.4.2. See also: www.ecgi.org/codes/country_documents/germany/code_200305_en.pdf.

⁹⁸ Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, November 2002, page 60. See also: europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf.

⁹⁹ Derek Higgs, Review of the role and effectiveness of non-executive directors, January 2003. See also: www.dti.gov.uk/cld/non_exec_review/pdfs/higgsreport.pdf.

3. **Risk:** Non-executive directors should satisfy themselves that financial information is accurate, and that financial controls and systems of risk management are robust and defensible.
4. **People:** Non-executive directors are responsible for determining appropriate levels of remuneration for executive directors, have a prime role in appointing, and where necessary removing, senior management, and in succession planning.

The Company Law refers to non-executive directors in the context of restricting the number of executive directors that may sit on the Supervisory Board. Table 2 summarizes the relevant legal provisions concerning executive and non-executive directors' functions.

Can a director be a member of the Executive Board?	Yes, but Executive Board members cannot occupy more than 25% of Supervisory Board seats.
Can a director be a General Director?	Yes, unless prohibited by the charter.
Can the Chairman of the Supervisory Board be the General Director?	No.
Can the Chairman of the Supervisory Board be a member of the Executive Board other than the General Director?	Yes, unless prohibited by the charter.

Non-executive directors may, depending on their ties to the company, be independent or non-independent.

c) Independent Directors

Russian law does not define the concept of independent directors. The Company Law does, however, refer to independent directors under specific circumstances to determine the position of individuals engaged in related party transactions and to prevent possible conflicts of interests. For these purposes, the

¹⁰⁰ LJSJ, Article 66, Clause 2, Paragraph 2.

requirements for the “independence” of directors are wider than those for a non-executive position. In this respect, an independent director is defined as an individual who has not been in any of the following positions at the time of the approval of a business transaction, or during one year immediately preceding the approval of such a transaction:¹⁰¹

- The General Director, the External Manager, an Executive Board member or a member of the governing bodies (Supervisory Board, General Director and Executive Board) of the External Manager; or
- A person whose spouse, parents, children, brothers, and sisters by one or both parents are the External Manager or hold a position in the governing bodies of the External Manager; or
- A person whose adoptive parents or adopted children are the External Manager or hold a position in the governing bodies or the External Manager; or
- An affiliated person other than a director of the company.

→ *For more information on affiliated persons, see Part III, Chapter 12, Section B.1.*

Best Practices: Independent directors can make a substantial contribution to important decisions of the company, especially in evaluating executive performance, setting executive and director remuneration, reviewing financial statements, and in resolving corporate conflicts.¹⁰² Independent directors give investors additional confidence that the Supervisory Board’s deliberations will be free of obvious bias. Companies are advised to disclose information about independent directors in the annual report.¹⁰³

In contrast to the Company Law, the FCSM Code discusses the concept of independent directors and defines which Supervisory Board members can be defined as independent. More specifically, the FCSM Code disqualifies directors from being independent if they answer “YES” to one or more of the following questions in Table 3:

¹⁰¹ LJSC, Article 83, Clause 3, Paragraph 2.

¹⁰² FCSM Code, Chapter 3, Section 2.2.2.

¹⁰³ FCSM Code, Chapter 3, Section 2.2.5.

Table 3: Are Directors on Your Supervisory Board Independent According to the FCSM Code?

	Yes	No
Is the director an officer or an employee of the company, or the External Manager of the company? Has the director been an officer or an employee of the External Manager of the company over the last three years?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director an officer of another company in which any of the officers of the company is a member of the Nominations and Remuneration Committee of the Supervisory Board of that company?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director an affiliated person of an officer of the company, of the External Manager or of an officer of the External Manager of the company?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director an affiliated person of the company or an affiliated person of persons affiliated with the company?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director a party to a contract with the company whereby the director could acquire property of the company (or receive money) with a value of 10% or more of the total annual income of the said director, excluding the remuneration he receives for his work as a director?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director a major business partner of the company (i.e., a business partner involved in transactions with the company where the total annual amount of transactions is 10% or more of the book value of company assets)?	<input type="checkbox"/>	<input type="checkbox"/>
Is the director a representative of the state?	<input type="checkbox"/>	<input type="checkbox"/>
Has the director been a Supervisory Board member of the company during the last seven years?	<input type="checkbox"/>	<input type="checkbox"/>

If a director ceases to be independent, the director should immediately notify the Supervisory Board with an explanation of why the criteria of independence as specified in the FCSM Code no longer apply.¹⁰⁴ The Supervisory Board is then advised to:

- Notify shareholders that the director is no longer independent;
- Call an EGM to elect new Supervisory Board if the number of independent directors is below the minimum that is recommended by the FCSM Code;¹⁰⁵ and
- Disclose information about independent directors in the annual report of the company, giving shareholders the opportunity to verify any changes in the status of independent directors.¹⁰⁶

¹⁰⁴ FCSM Code, Chapter 3, Section 2.2.4.

¹⁰⁵ FCSM Code, Chapter 3, Section 2.2.4.

¹⁰⁶ FCSM Code, Chapter 3, Section 2.2.5.

In any event, independent directors should refrain from actions that may compromise their independent status.

The minimum number of independent directors should be at least $\frac{1}{4}$ of the total Supervisory Board seats and no less than three.¹⁰⁷ This should enable independent directors to influence the decision-making process of the Supervisory Board and introduce a wider spectrum of opinions to Supervisory Board deliberations. While these minima are useful benchmarks, they are by no means sufficient to ensure an absence of bias. The circumstances of each Supervisory Board are likely to be different. In some cases, the minimum may be sufficient for balanced deliberation; in others, a larger number of independent and assertive directors may be necessary to counterbalance a dominant General Director.

Other international and national codes of corporate governance have stricter definitions for independent directors. In the U.K. for example, a non-executive director is considered independent when the Board of Directors determines that the director is independent in character and judgment, and there are no relationships or circumstances which could affect, or appear to affect, the director's judgment. Such relationships and circumstances would include those, in which the director:¹⁰⁸

- Is a former employee of the company or group until five years after employment (or any other material connection) has ended;
- Has, or has had, within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director, or senior employee of a body that has had such a relationship with the company;
- Has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance related pay scheme, or is a member of the company's pension scheme;
- Has close family ties with any of the company's advisers, directors, or senior employees;
- Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- Represents a significant shareholder; or
- Has served on the Supervisory Board for more than 10 years.

¹⁰⁷ FCSM Code, Chapter 3, Section 2.2.3.

¹⁰⁸ The Combined Code on Corporate Governance, July 2003, Section 1, A.3.1. See also: www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf.

The large number of definitions with their detailed qualifications may give rise to confusion. In reality, understanding and defining independence need not be complex. The Council of Institutional Investors (CII), a grouping of some of the world's largest institutional investors, defines an independent director plainly in the following way: "Stated most simply, an independent director is a person whose directorship constitutes his or her only connection to the corporation." This cuts to the heart of the matter. For those interested in learning how to apply this simple definition in practice, the CII also lists specific circumstances that compromise independence.¹⁰⁹

Finally, it should be noted that director independence is not a panacea. The New York Stock Exchange is a telling example. In 2003, the exchange was enveloped in a scandal over the excessive compensation of its chief executive officer, despite the fact that compensation levels had been approved by a committee staffed and chaired by independent directors.

→ For the IFC's definition on independence, see Part VI, Annex 18.

D. The Structure and Committees of the Supervisory Board

1. Chairman

The Supervisory Board members elect their Chairman by a simple majority vote of all directors if the charter does not provide otherwise.¹¹⁰ The Supervisory Board may re-elect its Chairman at any time. Another Supervisory Board member may substitute for the Chairman in his absence.¹¹¹ The Chairman must be a Supervisory Board member and cannot be the General Director.¹¹²

Best Practices: The ability of the Chairman to properly discharge his duties depends on his being vested with sufficient and appropriate powers, and on his personal and professional qualifications. The Chairman should have an out-

¹⁰⁹ For more information on the CII and their definition of director independence (in English), see: http://www.cii.org/independent_director.asp.

¹¹⁰ LJSC, Article 67, Clause 1.

¹¹¹ LJSC, Article 67, Clause 3.

¹¹² LJSC, Article 66, Clause 2, Paragraph 2.

standing professional reputation and should be of the highest integrity, be committed to the interests of the company, and enjoy the trust of shareholders and the other directors.¹¹³

There should be a clear division of responsibilities at the head of the company between the running of the Supervisory Board and the executive responsibility for the running of the company's day-to-day operations — both on paper, as required by law, and in actual practice. Companies should define the authority of the Chairman, as well as that of the General Director, in as much detail as possible in the by-laws or other internal documents.¹¹⁴

The Chairman has the authority to:¹¹⁵

- Prepare, organize, and preside over Supervisory Board meetings;
- Preside over the GMS when the charter does not provide otherwise;
- Enter into contracts with the General Director, Executive Board members, and the External Manager;¹¹⁶ and
- Perform any other duties as specified in the charter and by-laws.

Best Practices: The Chairman's other duties, or responsibilities, should be defined in the by-laws for the Supervisory Board. In addition, the company may wish to draft a position description, or terms of reference, which could contain the following elements:¹¹⁷

The Chairman:

- Provides leadership and ensures for the Supervisory Board's effectiveness;
- Establishes, implements, and reviews procedures that govern the Supervisory Board's work;

¹¹³ FCSM Code, Chapter 3, Section 4.1.1.

¹¹⁴ FCSM Code, Chapter 3, Section 4.1.1.

¹¹⁵ LJSC, Article 67, Clause 2.

¹¹⁶ LJSC, Article 69, Clause 3, Paragraph 2.

¹¹⁷ These model terms of reference contain elements from the "Review of the Role and Effectiveness of Non-executive Directors," by Derek Higgs, January 2003; and the Report of the NACD Blue Ribbon Commission on Director Professionalism, Appendix B.

- Schedules a Supervisory Board meeting calendar and coordinates it with the Board's committee chairs;
- Organizes and presents meeting agendas, and ensures that all directors receive appropriate information on a timely basis;
- Periodically interacts with the General Director, and acts as a liaison between the Supervisory Board and executives;
- Ensures for accurate, timely, and clear information to and from the other directors;
- Ensures for effective communication with shareholders;
- Arranges regular evaluations of the Supervisory Board's performance, as well as of its committees and individual directors;
- Facilitates the effective contribution of non-executive and/or independent directors, and enables constructive relations between executive and non-executive directors; and
- Carries out other duties as requested by the GMS and the Supervisory Board as a whole, depending on need and circumstance.

2. Supervisory Board Committees

As the business environment continues to become more complex, the demands on and responsibilities of the Supervisory Board and its members continue to grow. Supervisory Board committees are widely considered a key tool for Supervisory Boards to effectively deal with such challenge. More specifically, committees:

- Permit the Supervisory Board to handle a greater number of complex issues in a more efficient manner, by allowing specialists to focus on specific issues and provide detailed analysis and recommendations back to the Board;
- Allow the Supervisory Board to develop subject-specific expertise on the company's operations, most notably on financial reporting, risk, and internal control; and
- Enhance the objectivity and independence of the Supervisory Board's judgment, insulating it from potential undue influence of managers and controlling shareholders.

It is of crucial importance that committees are understood to be part of the Supervisory Board. It is the Supervisory Board that establishes committees, sets their terms of reference through committee by-laws, appoints their members, and turns their recommendations into actions. It is of particular importance that Board committees make recommendations to the Supervisory Board and not make decisions on its behalf.

To streamline the operations of committees, the Supervisory Board should approve by-laws for each Supervisory Board committee.¹¹⁸

Company Practices in Russia: Of the companies that participated in the IFC's regional survey, only 3.3% have specialized Supervisory Board committees. Of these, not a single one is chaired by an independent director. The prevalence of Supervisory Board committees is low regardless of the Supervisory Board's size.¹¹⁹

a) Types of Committees

The FCSM Code recommends that companies establish a number of committees. However, caution is called for. A large number of committees can be hard to manage and may lead to a fragmentation of the Supervisory Board. It is advisable to establish committees as the need arises, starting with the most critical ones, and then establishing others as experience is gained. The Supervisory Board may establish either permanent or *ad-hoc* Board committees. The most important committee from the shareholder perspective is the Audit Committee. Some of the committees that a company should consider establishing are described in Table 4.

¹¹⁸ FCSM Code, Chapter 3, Section 4.7.2.

¹¹⁹ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

The Russia Corporate Governance Manual

Table 4: Different Types of Committees		
	Functions	Recommendations for the Committee's Composition
Audit Committee ¹²⁰	<ul style="list-style-type: none"> • Develops recommendations for the Supervisory Board on the selection of the External Auditor; • Interacts with the company's External Auditor and Revision Commission; • Supervises the company's financial and business operations, and the implementation of the financial and business plan; • Monitors the Internal Audit Function; • Evaluates internal control procedures; • Develops internal control and risk management procedures; and • Develops recommendations for the Supervisory Board's approval of non-standard operations.¹²¹ <p>→ For more information on the Audit Committee, see Part IV, Chapter 14, Section C, and Annex 7.</p>	<p>The Audit Committee should be composed entirely of independent directors. If this is not possible, the Audit Committee should be chaired by an independent director and be composed solely of non-executive directors.</p> <p>The charter (or by-laws) should set forth the qualifications of Committee members. In particular, Audit Committee members need to be financially literate, and understand accounting and financial reporting.¹²²</p>
Strategic Planning and Finance Committee ¹²³	<ul style="list-style-type: none"> • Defines strategy and objectives, as well as key performance indicators; • Determines operational priorities; • Develops dividend policy; and • Evaluates the long-term productivity of the company's operations. <p>→ For a model by-law for the Supervisory Board's Strategic Planning and Finance Committee, see Part VI, Annex 10.</p>	<p>(No specific recommendation made by the FCSM Code.) Members of the Committee need experience in the industry in which the company is active. The Committee will likely benefit from members with other areas of expertise such as finance and operations.</p>
Ethics Committee ¹²⁴	<ul style="list-style-type: none"> • Ensures that the company complies with ethical standards and contributes to the creation of an atmosphere of trust within the company. • Detects and prevents violations by the company of legislation and ethical standards. <p>→ For a model Code of Ethics, see Part VI, Annex 5.</p>	<p>(No specific recommendation made by the FCSM Code.) Members of the Committee must be of the highest integrity, enjoy the trust of all shareholders, and be knowledgeable on legal and ethical standards.</p>

¹²⁰ FCSM Code, Chapter 3, Sections 4.8–4.12.

¹²¹ FCSM Code, Chapter 3, Section 4.9; Chapter 8, Sections 1.1.2, Paragraphs 2, 1.2, 1.4, 2.2, and 2.3.

¹²² FCSM Code, Chapter 8, Section 1.3.2.

¹²³ FCSM Code, Chapter 3, Section 4.8.

¹²⁴ FCSM Code, Chapter 3, Section 4.12.

Table 4: Different Types of Committees		
	Functions	Recommendations for the Committee's Composition
Nominations and Remuneration Committee ¹²⁵	<ul style="list-style-type: none"> • Defines the qualifications of Supervisory Board members; • Develops the company's remuneration policy, specifies basic principles and criteria for determining the amount of remuneration payable to: <ul style="list-style-type: none"> – Supervisory Board members; – The General Director; – Executive Board members; and – Heads of major divisions of the company. • Develops criteria for the performance evaluation of these persons; • Performs periodic evaluations of the General Director and Executive Board members; • Defines benefits available to these persons (including life insurance, health insurance, and non-governmental pension benefits); • Determines qualifications of candidates for positions in executive bodies and heads of major divisions of the company; • Prepares the terms and conditions of employment contracts between the company and the General Director and Executive Board members; • Conducts preliminary assessments of candidates for the positions of General Director and Executive Board members; • Prepares recommendations for the Supervisory Board with respect to the reappointment of the General Director and Executive Board members; and • Considers the company's personnel policy, including matters related to wages and salaries. <p>→ For a model by-law for the Supervisory Board's Nominations and Remuneration Committee, see Part VI, Annex 9.</p>	<p>The Nominations and Remuneration Committee should be composed of independent directors. If this is not possible, the Committee should be chaired by an independent director and be composed of non-executive directors.¹²⁶</p>
Corporate Conflicts Resolution Committee ¹²⁷	<ul style="list-style-type: none"> • Ensures that shareholder rights are appropriately and specifically defined in the company's charter, by-laws, and company-level corporate governance code, and develops policies and procedures for the protection of these rights; • Develops and periodically conducts reviews of the company's conflict resolution policy and procedures; and • Develops recommendations for the Supervisory Board on how to effectively deal with corporate conflicts between and among the company, its shareholders, directors, and managers. <p>→ For a model by-law for the Supervisory Board's Corporate Governance Committee, see Part VI, Annex 8.</p>	<p>The Corporate Conflicts Resolution Committee should be composed of independent directors. When this is not possible, an independent director should chair the Committee. Members should, at a minimum, be non-executive directors.</p>

¹²⁵ FCSM Code, Chapter 3, Section 4.10.1.

¹²⁶ FCSM Code, Chapter 3, Section 4.10.3.

¹²⁷ FCSM Code, Chapter 10, Section 2.1.2.

b) Authority of Supervisory Board Committees

The Supervisory Board is a collective body in which:

- All members have equal rights and duties (the charter may provide that the Chairman have a decisive vote in case of a tie vote);
- All members bear joint and several liability; and
- Members act together as a body according to specific decision-making procedures.

This implies that although certain tasks can be delegated to Supervisory Board committees, the ultimate decision-making responsibility rests with the entire Supervisory Board. Committee members do not have more legal rights than any other Supervisory Board member, although they will have additional responsibilities and obligations.

c) The Composition of Supervisory Board Committees

Supervisory Board committees should only be composed of Supervisory Board members. Other parties, most notably managers, may be invited to present or elaborate on particular issues, but have observer status only, i.e. are precluded from conferring or deciding on particular issues.

Best Practices: Experienced and knowledgeable directors should staff Supervisory Board committees.¹²⁸ There needs to be a sufficient number of directors to accomplish the work at hand. Since the work of Supervisory Board committees may involve time-consuming reviews, the participation of directors in multiple Supervisory Board committees should be restricted. Supervisory Board committees may, from time to time, require the assistance of outside advisors to assist committees with their work. These advisors must, however, not receive Supervisory Board member status.

Many stock exchanges further recommend that Supervisory Board committees be composed of and/or chaired by independent directors. The listing requirements of some stock exchanges, for example the NYSE, go further and require a majority of independent directors, as well as the Audit and Nominations and Remuneration Committees to be composed solely of independent directors.

¹²⁸ FCSM Code, Chapter 3, Section 4.7.1.

d) The Role of the Chairman in Relation to Supervisory Board Committees

Best Practices: The Chairman should:¹²⁹

- Take into account the views of directors on the need to create committees;
- Nominate directors for positions in committees; and
- Take necessary administrative measures to ensure that committees perform their tasks.

3. The Chairman of a Supervisory Board Committee

The Chairman of a committee is responsible for its effectiveness, regardless of his other duties. The committee Chairman forms an effective team, organizes productive committee meetings, and provides intellectual leadership on complex issues.

Best Practices: The Chairman of a committee plays an important role in organizing its work. Committees should be chaired by non-executive directors.¹³⁰ Ideally, these directors should also be independent. This holds particularly true for the Audit and Nominations and Remuneration Committees which, according to best corporate governance practices, are to be chaired by independent directors.

Committee chairmen should keep the Chairman of the Supervisory Board informed about their work. In addition, the committee chairmen should be present at the GMS to respond to shareholder questions.¹³¹

¹²⁹ FCSM Code, Chapter 3, Section 4.1.5.

¹³⁰ FCSM Code, Chapter 3, Section 4.7.3.

¹³¹ FCSM Code, Chapter 2, Section 2.1.1.

E. The Working Procedures of the Supervisory Board

The Supervisory Board is a governing body, which operates according to a procedure defined by the Company Law, the charter, or the by-laws.

1. The Chairman and Supervisory Board Meetings

The Chairman has the authority to:¹³²

- Call, organize, and preside over Supervisory Board meetings;
- Prepare the minutes of Supervisory Board meetings;
- Cast a deciding vote at Supervisory Board meetings in case of a tie vote (if this is provided for by the charter); and
- Sign the minutes of the Supervisory Board meeting (when it is presided over by him).

Best Practices: More specifically, the Chairman facilitates the work of the Supervisory Board by:¹³³

- Setting the agenda of the meetings;
- Facilitating decision-making on agenda items;
- Encouraging open discussions on issues in a friendly and constructive atmosphere;
- Providing Supervisory Board members with an opportunity to express their points of view on matters being discussed; and
- Steering the Supervisory Board towards a consensus.

In doing so, the Chairman should act with conviction and, at all times, in the best interests of the company. Moreover, the by-laws or other internal documents should impress upon the Chairman the responsibility to:¹³⁴

- Take steps to ensure that all directors receive information required for the resolution of agenda items in a timely fashion;
- Encourage directors to freely express their opinions on agenda items and other issues;
- Openly discuss opinions of directors; and
- Initiate the drafting of the Supervisory Board's decisions.

¹³² LJSC, Article 67, Clause 3; Article 68, Clauses 3 and 4.

¹³³ FCSM Code, Chapter 3, Sections 4.1.2-4.1.3.

¹³⁴ FCSM Code, Chapter 3, Section 4.1.2.

2. The Supervisory Board Meetings

The Supervisory Board must follow legal requirements in making valid decisions, or risk having them overruled by the courts upon complaints.¹³⁵

Best Practices: Directors should ensure that Supervisory Board and committee meetings are well-organized and held on a regular basis. Directors should actively participate in Supervisory Board meetings, and each director should:

- Take part in discussions and voting;
- Participate in the work of Supervisory Board committees;
- Demand a Supervisory Board meeting to discuss matters of concern;¹³⁶ and
- Notify the Supervisory Board when they are unable to attend meetings.¹³⁷

In addition, Supervisory Board members should have sufficient time for the performance of their functions. The Supervisory Board should develop rules to regulate the participation of its members on Supervisory Boards of other companies.¹³⁸ For example, in Australia, a chairmanship of a listed company is considered the equivalent of three directorships, and the maximum acceptable number of directorships or equivalent positions for an individual should not exceed five.¹³⁹ The general rule for directorship on several Supervisory Boards should however be based on time-constraints: if a director does not have the time, he should not take on the responsibility.

3. The First Supervisory Board Meeting

Best Practices: The first meeting of a newly elected Supervisory Board should be held no later than one month after it is elected. As a matter of convenience, the first Supervisory Board meeting can be organized to follow the GMS. The

¹³⁵ LJSC, Article 68, Clauses 2 and 3.

¹³⁶ FCSM Code, Chapter 3, Section 3.2.2.

¹³⁷ FCSM Code, Chapter 3, Section 3.2.1.

¹³⁸ FCSM Code, Chapter 3, Section 3.2.3.

¹³⁹ Australian Certified Public Accountants, Corporate Governance Health Checks, Financial Reporting Framework — The Way Forward (www.cpaaustralia.com.au/07_information_centre/16_media_releases/2002/1_0_20020708_mr.asp).

Chairman of the Supervisory Board is typically elected during this meeting. In addition, it is recommended that the first Supervisory Board meeting:¹⁴⁰

- Define and confirm the priorities of the Supervisory Board;
- Establish committees if appropriate; and
- Elect committee chairmen.

A company may also wish to develop an induction training for new Supervisory Board members that covers, among other topics, an overview of the company's:

- Industry and sector of operation;
- Business operations;
- Current financial situation;
- Strategy;
- Business risks; and
- Key employee background and skills.

4. The Schedule of Supervisory Board Meetings

The charter or the by-laws must specify the procedures for convening and conducting Supervisory Board meetings.¹⁴¹

Best Practices: The Supervisory Board should have a working plan in addition to a schedule for meetings that includes the topics to be addressed.¹⁴² The Supervisory Board should hold regular meetings. According to the FCSM Code, the Supervisory Board should meet every six weeks.¹⁴³ The Supervisory Board may, however, wish to hold meetings as often as deemed necessary. Here is some guidance on conducting productive and efficient Supervisory Board meetings:

- **Develop an annual calendar of meetings.** This will allow directors to slot the meetings in their agenda. Note that this calendar should serve as a guide, i.e. the Supervisory Board should hold additional meetings when warranted and, vice-versa, cancel meetings when there are no issues to be resolved.

¹⁴⁰ FCSM Code, Chapter 3, Section 4.2.2.

¹⁴¹ LJSC, Article 68, Clause 1.

¹⁴² FCSM Code, Chapter 3, Section 4.2.1.

¹⁴³ FCSM Code, Chapter 3, Section 4.2.1.

- **Set an agenda well in advance.** Directors will thus be able to properly focus on and prepare for the task at hand. The Chairman may wish to send a draft agenda in advance, allowing for comments and suggestions.
- **Place important issues at the beginning of the agenda.** Directors often have other commitments and might need to leave early. Scheduling meetings for the early, rather than latter part of the day is thus often more conducive to foster interactive discussions.

In addition to regular meetings, the Supervisory Board needs to organize a meeting to review and approve the annual report.¹⁴⁴ This Board meeting needs to take place at least 30 days prior to the AGM.

Company Practices in Russia: According to the latest surveys, Supervisory Boards of Russian companies meet between eight¹⁴⁵ and 11 times a year.¹⁴⁶

5. Who Has the Right to Convene a Supervisory Board Meeting

The Chairman normally convenes regular Supervisory Board meetings. He also has the obligation to convene a Supervisory Board meeting upon the request of the following parties:¹⁴⁷

- Supervisory Board members;
- The Revision Commission;
- The External Auditor;
- The General Director and the Executive Board; and
- Other persons specified by the charter.¹⁴⁸

¹⁴⁴ LJSC, Article 88, Clause 4.

¹⁴⁵ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.2.1, page 26, August 2003 (see www.ifc.org/rcgp).

¹⁴⁶ FCSM-ISMM-INVAS Survey (2002), see also: www.rid.ru.

¹⁴⁷ LJSC, Article 68, Clause 1.

¹⁴⁸ For example, a shareholder or a group of shareholders holding 2% or more of voting shares of the company. See FCSM Code, Chapter 3, Section 4.2.3; Chapter 3, Section 4.13.

6. Proper Notice for Supervisory Board Meetings

Best Practices: Directors should properly prepare themselves to participate effectively in meetings.¹⁴⁹ They should not vote on items on which they have not been fully informed or which they do not understand. The necessary information and materials should be sent to director together with the notice of the Supervisory Board meeting sufficiently in advance of the meeting to enable each director to thoroughly review the information.¹⁵⁰ Two weeks can be considered sufficient. The by-laws or other internal documents should determine the form of the notice and the way materials are delivered that is most convenient and acceptable to all directors (for example by mail, telegraph, teletype, telephone, or e-mail).¹⁵¹

7. The Quorum for Supervisory Board Meetings

A quorum is the minimum number of directors that must participate in a meeting for decisions to be valid. The charter must specify the quorum, which cannot be less than one half of the number of elected directors.¹⁵²

If the number of acting directors becomes less than the required quorum, the Supervisory Board no longer has the authority to make decisions other than to convene an EGM for the election of new directors.¹⁵³

Best Practices: For a few very important corporate actions, the charter, by-laws, or other internal documents should establish stricter quorum requirements than those set by the Company Law. A quorum of $\frac{2}{3}$ of the total number of directors should be required to:¹⁵⁴

- Approve strategic plans, and the financial and business plan;

¹⁴⁹ FCSM Code, Chapter 3, Section 4.5.

¹⁵⁰ FCSM Code, Chapter 3, Section 4.5.2.

¹⁵¹ FCSM Code, Chapter 3, Section 4.5.3.

¹⁵² LJSC, Article 68, Clause 2.

¹⁵³ LJSC, Article 68, Clause 2.

¹⁵⁴ FCSM Code, Chapter 3, Section 4.15.

- Approve the company's dividend policy and recommend dividend payments;
- Submit to the GMS a proposal for the reorganization or liquidation of the company; and
- Decrease or increase the charter capital.

In addition, the quorum should be set so as to ensure that independent directors are required for the quorum to exist.¹⁵⁵

8. How Directors Can Participate in Supervisory Board Meetings

Directors can participate in voting when they are:

- Physically present at the meeting;
- Participating by conference call or other means of communication (when allowed by the charter or by-laws); or
- Absent, but have presented a written opinion (when allowed by the charter or by-laws).

Best Practices: Certain items are of such importance that directors need to be physically present. These items include:¹⁵⁶

- The approval of the strategic plan, and the approval of the company's financial and business plan;
- Calling the AGM, and making decisions on items related to the organization of such Meeting;
- The preliminary approval of the annual report of the company;
- Convening or refusing a request by third parties to convene an EGM;
- The election of the Chairman;
- The creation and early termination of the authority of executive bodies;
- The suspension of the General Director and the appointment of an interim General Director;
- The reorganization or liquidation of the company; and
- Increasing the charter capital and issuing shares.

¹⁵⁵ FCSM Code, Chapter 3, Section 4.14.

¹⁵⁶ FCSM Code, Chapter 3, Section 4.4.

A director cannot delegate his right to vote at a Supervisory Board meeting to another person, including to another director.¹⁵⁷

Best Practices: When participating in Supervisory Board meetings, each director should:

- Listen and understand oral presentations;
- Ask questions. This is particularly important for presentations or reports given by executives during Supervisory Board meetings, especially when these materials are presented in a complex or ambiguous manner; and
- Request supporting materials. When presented with a particular issue that does not correspond to the director's area of expertise, additional information in the form of studies, independent appraisals or opinions, and other documentation on the subject should be requested prior to the meeting.

9. The Consideration of Written Opinions (Absentee Ballots)

The charter or by-laws can specify that written opinions of directors can be considered in determining the existence of a quorum for Supervisory Board meetings, and the validity of the voting results.¹⁵⁸

Best Practices: The charter, by-laws, or other internal documents should enable Supervisory Board members to make decisions by absentee vote. However, for resolutions required by the charter to be adopted by voting in person, the votes of absentees expressing their opinion in written form should not be counted for the quorum.¹⁵⁹ Companies should develop procedures for absentee voting, including the deadline for the delivery of voting ballots and deadline for the return of completed ballots. It should give directors enough time to receive the ballots and make decisions on agenda items.¹⁶⁰

¹⁵⁷ LJSC, Article 68, Clause 3, Paragraph 2.

¹⁵⁸ LJSC, Article 68, Clause 1.

¹⁵⁹ FCSM Code, Chapter 3, Section 4.3.1.

¹⁶⁰ FCSM Code, Chapter 3, Section 4.3.2.

10. Supervisory Board Decisions

Supervisory Board decisions must be approved by a simple majority vote unless the Company Law, the charter, and/or by-laws require a higher percentage of votes.¹⁶¹

Table 5: Decisions That Must Be Made Unanimously or by a Supermajority Vote of All Directors	
Supervisory Board decisions requiring unanimity:	Supervisory Board decisions requiring the approval of a 3/4-majority:
<ul style="list-style-type: none"> Increasing the charter capital by issuing and placing additional shares (when the Supervisory Board has this authority).¹⁶² Approving an extraordinary transaction.¹⁶³ <p>→ For more information on extraordinary transactions, see Part IV, Chapter 12, Section A.</p>	<ul style="list-style-type: none"> Suspending the powers of the General Director or the External Manager for any reason.¹⁶⁴ Approving an interim General Director. Conducting an EGM to approve the new General Director or the External Manager.¹⁶⁵

How decisions on related party transactions are approved depends on the number of shareholders. More specifically:¹⁶⁶

- A simple majority of directors that are not interested parties in companies with 1,000 or fewer shareholders with voting rights;
- A simple majority of independent directors that are not interested parties in companies with more than 1,000 shareholders with voting rights.

¹⁶¹ LJSC, Article 68, Clause 3, Paragraph 1.

¹⁶² LJSC, Article 28, Clause 2.

¹⁶³ LJSC, Article 79, Clause 2.

¹⁶⁴ If the formation of executive bodies falls within the authority of the GMS, and if the charter gives the right to approve the decision to the Supervisory Board.

¹⁶⁵ LJSC, Article 69, Clause 4, Paragraph 3.

¹⁶⁶ LJSC, Article 83, Clauses 2 and 3.

11. The Minutes of Supervisory Board Meetings

The Supervisory Board must keep minutes of its meetings.¹⁶⁷ Minutes must be prepared within three days after the meeting and must be kept in the company archives. At a minimum, the minutes must contain the following:

- Location and time of the meeting;
- Names of the persons who participated in the meeting;
- Agenda of the meeting;
- Agenda items and the voting results; and
- A description of Supervisory Board decisions.

The Chairman is responsible for the accuracy of the minutes and must sign them.¹⁶⁸

Best Practices: As legal and regulatory requirements of directors become more onerous, minutes are an important record to show that the Supervisory Board has discharged its duty of care. Under good corporate governance practices, the minutes will include the voting of each individual director.¹⁶⁹ The company may also consider having each director sign the minutes.

→ *For more information on the importance of minutes for the liability of directors, see Section F.7 of this Chapter.*

The Supervisory Board is often required to designate a secretary of the Supervisory Board to take notes and help prepare the minutes. In international practice, the Corporate Secretary often serves as the secretary of the Supervisory Board and may sign the minutes as well.

→ *To view a model set of minutes, see Part VI, Annex 16.*

Minutes only provide a brief summary of the Supervisory Board meeting. Verbatim reports, however, contain a word-for-word account of discussions held.

¹⁶⁷ LJSC, Article 68, Clause 4; Article 89, Clause 1.

¹⁶⁸ LJSC, Article 68, Clause 4.

¹⁶⁹ FCSM Code, Chapter 3, Section 4.16.1.

Best Practices: Regardless of whether the company chooses to keep minutes and/or verbatim reports, the following documents should be preserved together with these reports:¹⁷⁰

- The voting ballots; and
- The written opinions of directors who were not able to attend.

Each director should also be given a summary of the deliberations of the Supervisory Board. The company should establish a procedure which ensures that all directors will be provided with:¹⁷¹

- Copies of the minutes and/or verbatim reports; and
- Reports detailing the outcome of the voting.

This should be done within a reasonable amount of time after the meeting, but no later than the next Supervisory Board meeting.

12. The Corporate Secretary and Supervisory Board Meetings

Best Practices: The Corporate Secretary should be responsible for administrative and organizational matters with respect to preparing and conducting Supervisory Board meetings.¹⁷² While the decision to conduct a Supervisory Board meeting is made by the Chairman, the Corporate Secretary should be responsible for handling such matters as:¹⁷³

- Notifying all directors of Supervisory Board meetings;
- Sending voting ballots;
- Collecting completed ballots and absentee ballots;
- Ensuring compliance with the procedures for Supervisory Board meetings; and
- Keeping the minutes and verbatim reports.¹⁷⁴

→ *For more information on the Corporate Secretary, see Part II, Chapter 6.*

¹⁷⁰ FCSM Code, Chapter 3, Section 4.16.1.

¹⁷¹ FCSM Code, Chapter 3, Section 4.16.2.

¹⁷² FCSM Code, Chapter 5, Section 1.2.1.

¹⁷³ FCSM Code, Chapter 5, Section 1.2.2.

¹⁷⁴ FCSM Code, Chapter 5, Section 1.2.3.

F. The Duties and Liabilities of Directors

Directors shall act in good faith, with diligence and due care, and in the best interests of the company.

Best Practices: In some countries, including Russia, the Supervisory Board is legally required to solely act in the interest of the company (without specifying the interest of the company towards its shareholders and/or stakeholders). Acting solely in the best interest of the company can however encourage management to entrench themselves, and shareholders (and indeed the legislator) will need to carefully consider whether to require directors to act in the best interests of shareholders as well.

Standards for the interpretation of the terms “good faith,” “due diligence,” and “due care,” as well as standards for professional behavior, develop over time in a country’s judicial system, economy, and corporate culture.¹⁷⁵

The Company Law dictates that directors must act reasonably and in good faith.¹⁷⁶ There is also a general requirement for a person authorized to act on behalf of the company, based on law or the charter, to act “reasonably and in good faith”.¹⁷⁷ It is important to note that when a court action is brought against an individual and there is a question of whether this individual acted reasonably and in good faith, reasonableness and good faith are presumed.¹⁷⁸ However, neither the Company Law nor the Civil Code defines “good faith” or “reasonableness.”

Turning to other jurisdictions for guidance, for example the U.S. and U.K., the concepts of reasonableness and good faith are viewed as fundamental principles of a director’s duty, notably that of care and loyalty.

¹⁷⁵ When explaining these duties, the Manual refers to general provisions of the Civil Code and the Company Law on the one hand, and the FCSM Code and internationally recognized corporate governance principles on the other.

¹⁷⁶ LJSC, Article 71, Clause 1.

¹⁷⁷ CC, Article 53, Clause 3.

¹⁷⁸ CC, Article 10, Clause 3.

1. The Duty of Care

Supervisory Board members are responsible for exercising their rights and discharging their duties in good faith, with care, and in a professional manner.

Best Practices: A director should:¹⁷⁹

- Act honestly and in good faith;
- Refrain from being passive;
- Use care and prudence to the maximum extent that could be expected from a good director in a similar situation under similar circumstances;
- Not cause the company to act unlawfully;
- Regularly attend and actively participate in Supervisory Board meetings;
- Place matters on the agenda of Supervisory Board meetings, and demand such meetings when necessary;
- Ensure that an efficient and effective system of internal control is in place;
- Demand that the General Director and Executive Board members provide adequate information to the Supervisory Board so that its members are properly informed on corporate matters;¹⁸⁰ and
- Exercise a reasonable amount of supervision over management.

2. The Duty of Loyalty

The duty of loyalty is of central importance to the governance framework, underpinning the effective implementation of key corporate governance issues, for example, monitoring of related party transactions and establishing remuneration policies for managers and non-executive directors.

The duty of loyalty requires directors to exercise their powers in the interests of the company as a whole. Simply put, directors should not allow personal interests to prevail over the company's interests. The duty of loyalty usually prohibits directors from:

- Participating in a competing company;
- Entering into any transaction with the company without first disclosing the transaction and obtaining Supervisory Board or GMS approval;

¹⁷⁹ FCSM Code, Chapter 3, Section 3.1.1.

¹⁸⁰ FCSM Code, Chapter 3, Section 3.1.2.

- Using corporate property and facilities for personal needs;
- Disclosing non-public, confidential information; and
- Using company information or business opportunities for private advantage, i.e. personal profit or gain.

It is also a key principle for directors who are working within the structure of a group of companies: even though a company might be controlled by another enterprise, the duty of loyalty for a director relates to the company and all its shareholders, and not to the controlling company of the group.¹⁸¹

Best Practices: The duty of loyalty requires the director to act in the best interest of the company regardless of:¹⁸²

- Who nominated and elected such member; and
- Pressures from other directors, shareholders, or other individuals to take actions or make decisions that are not in the best interest of the company.

It is of fundamental importance that, in carrying out its duties, the Supervisory Board should not be viewed, or act, as an assembly of individual representatives for various constituencies.¹⁸³ While specific directors may indeed be nominated or elected by certain shareholders (and sometimes contested by others), it is an important feature of the Supervisory Board's work that directors when they assume their responsibilities carry out their duties in an even-handed manner with respect to all shareholders. This principle is particularly important to establish in the presence of controlling shareholders that are able to select all directors.

Further, directors and affiliated persons (for example, family, friends, and business partners) should not accept gifts from persons interested in Supervisory Board decisions, or accept any other direct or indirect benefits. An exception can be made for symbolic gifts that are given as a common courtesy or souvenirs that are given during official events. These exceptions should be described in by-laws or other internal documents of the company.

¹⁸¹ OECD Principles of Corporate Governance, Annotations to Principle V.A. on the Responsibility of the Board. See also: www.oecd.org.

¹⁸² FCSM Code, Chapter 3, Section 3.1.3.

¹⁸³ OECD Principles of Corporate Governance, Annotations to Principle V.B. on the Responsibility of the Board. See also: www.oecd.org.

a) Conflicts of Interest

A director should not discharge his duties if there is a conflict of interest between him and the company and its shareholders.

Best Practices: A conflict of interest may arise when:¹⁸⁴

- The company enters into a transaction in which a director is interested;
- A director, directly or indirectly, acquires shares of the company;
- A director accepts an official position on the Supervisory Board of a competing company; and/or
- When a director enters into contractual relations with a competing company.

The Company Law addresses the issue of conflicts of interest within the context of related party transactions.¹⁸⁵

→ *For more information on related party transactions and the role of directors in such transactions, see Part III, Chapter 12, Section C.3.*

Directors should refrain from actions that may potentially result in a conflict between their own interests and the interests of the company. They are also advised to refrain from voting in situations where they have a personal interest in the matter in question. Directors should immediately inform the Supervisory Board through the Corporate Secretary about any potential conflicts of interest.

A director must disclose to the Supervisory Board, the Revision Commission and the External Auditor information about:¹⁸⁶

- Legal entities in which he, either individually or together with affiliated parties, possesses at least 20% of the equity;¹⁸⁷

¹⁸⁴ FCSM Code, Chapter 3, Section 3.1.4.

¹⁸⁵ LJSC, Article 83, Clauses 2 and 3.

¹⁸⁶ LJSC, Article 82.

¹⁸⁷ However, holdings of less than 20% of the equity in other legal entities should not be necessarily construed as an absence of a potential conflict of interest.

- Legal entities in which he holds a position in the Supervisory Board and/or executive bodies; and
- Any pending or planned transactions of the company in which he can be considered an interested party.

b) Confidentiality of Information

Best Practices: Directors should not disclose confidential information or use their access to company information for their personal interests or the interests of third parties. The personal use of confidential information ultimately damages shareholders.¹⁸⁸ It is recommended that:¹⁸⁹

- Directors take steps to protect confidential information;
- Directors not disclose information or use it in their own interests;
- Standards for the use of confidential information be specified in the internal documents of the company; and
- Contracts between the company and directors stipulate the obligation of directors to not disclose confidential information for a period of ten years after they leave the company.

To create an effective mechanism to prevent the unauthorized use of confidential information, the company should require directors to:¹⁹⁰

- Notify the Supervisory Board in writing of their intention to enter into transactions that involve securities of the company or its subsidiaries; and
- Disclose information about previous transactions with securities of the company in accordance with the procedures for disclosing material facts as specified by securities legislation.

c) Formalization of the Duties of Directors

Best Practices: The company should develop and incorporate into its internal documents a list of clearly defined duties of Supervisory Board members.¹⁹¹

- *For a list of duties of directors, see the model by-law for the Supervisory Board in Part VI, Annex 6.*

¹⁸⁸ FCSM Code, Chapter 3, Section 3.3.

¹⁸⁹ FCSM Code, Chapter 3, Section 3.3.

¹⁹⁰ FCSM Code, Chapter 3, Section 3.3.

¹⁹¹ FCSM Code, Chapter 3, Section 3.4.

3. Director Access to Information

Best Practices: It is essential for directors to have access to the information they need to properly discharge their duties, including full and accurate responses to their inquiries from members of the executive bodies, and other company officers.¹⁹²

The company should create a mechanism to ensure that directors are provided with information about the most important financial and business developments of the company, as well as other developments that may have an impact on shareholder interests. The by-laws or other internal documents should provide that the General Director, Executive Board members, and heads of major divisions have the duty to promptly submit full and reliable information to the Supervisory Board.¹⁹³

The company's internal documents should include the right of directors to demand information from the executive bodies.¹⁹⁴

→ See Part VI, Annex 6 for a model by-law for the Supervisory Board and a list of materials to be made available to directors prior to Supervisory Board meetings.

4. Liabilities of Directors

Directors can be held liable for losses caused to the company resulting from their wrongful behavior.¹⁹⁵ The preconditions for establishing liability are:

- Specific conduct or a failure to act;
- Fault, including both negligent and intentional conduct;
- Losses to the company; and
- Causality between the director's behavior and losses.

If there are several directors that caused losses to the company, they are jointly and severally liable.¹⁹⁶ The representatives of state or municipal entities on

¹⁹² FCSM Code, Chapter 3, Section 4.6.

¹⁹³ FCSM Code, Chapter 3, Section 4.6.

¹⁹⁴ FCSM Code, Chapter 3, Section 3.4.

¹⁹⁵ LJSC, Article 71, Clause 2; CC, Article 401, Clause 1.

¹⁹⁶ LJSC, Article 71, Clause 4.

the Supervisory Board are liable to the same extent as other directors.¹⁹⁷ It is important that customary business practices and other relevant circumstances be taken into consideration to determine the grounds and the amount of liability of directors.¹⁹⁸

Best Practices: The company should:¹⁹⁹

- Encourage directors to perform their duties in a proper way;
- Take measures to terminate the authority of directors who are responsible for inflicting losses; and
- Hold directors responsible when they do not fulfill their obligations towards the company.

5. When Directors Are Relieved from Liability

Managing the affairs of a company is a complex process with the risk that decisions made by the Supervisory Board, acting reasonably and in good faith, will ultimately prove wrong and entail adverse consequences for the company. Directors cannot generally be held liable for decisions made in good faith.

Moreover, directors cannot be held liable for losses if they:²⁰⁰

- Voted against the decision taken by the Supervisory Board that resulted in adverse circumstances; or
- If they did not participate in the Supervisory Board meeting when such a decision was made. (This means that the presence of the directors was not counted for the quorum of the Supervisory Board meeting.)

Directors are not relieved from liability after they have resigned from the Supervisory Board or when they are dismissed from the Supervisory Board for actions and decisions made during their tenure as a director.

¹⁹⁷ LJSC, Article 71, Clause 6.

¹⁹⁸ LJSC, Article 71, Clause 3.

¹⁹⁹ FCSM Code, Chapter 3, Sections 6.1.1 and 6.1.2.

²⁰⁰ LJSC, Article 71, Clause 2.

6. Who Can File a Claim Against Directors

The company or a shareholder (or a group of shareholders) holding at least 1% of common shares have the right to file a claim in court against directors to cover the losses of the company that resulted from decisions taken by the Supervisory Board.²⁰¹

7. The Minutes of Supervisory Board Meetings and Director Liability

Best Practices: To effectively enforce provisions that regulate the liability of directors, it is recommended that the company keep detailed minutes (and possibly verbatim reports) of meetings.²⁰² As stated above, if a decision passed by the Supervisory Board results in the company incurring losses, only those directors who voted for such a decision are liable. Therefore, it is important for the Supervisory Board to keep detailed minutes of Supervisory Board meetings to determine who voted for a certain decision and who can be held liable.²⁰³

8. Protection from Liability for Directors

Best Practices: Most companies should allow their directors to protect themselves from, or at least limit the liability for, losses incurred while they fulfilled their duties. Such mechanisms are:²⁰⁴

- Officer and director liability insurance; and
- Provisions in the charter and by-laws that indemnify directors against claims, litigation expenses, and liabilities in certain circumstances.

²⁰¹ LJSC, Article 71, Clause 5.

²⁰² FCSM Code, Chapter 3, Section 4.16.1.

²⁰³ FCSM Code, Chapter 3, Section 4.16.1.

²⁰⁴ In Western companies, directors are often protected by the presumption that if they acted in good faith and in a manner they considered to be in the best interests of the company, they should not be held liable for losses caused to the company by their decisions. This is called the “business judgment rule” and it can be used to protect directors from liability.

Companies may reimburse a director for expenses incurred in defending a claim related to his role as a Supervisory Board member, if he acted:

- Honestly;
- In good faith;
- In the best interests of the company; and
- In compliance with law, the charter, and by-laws.

A company may wish to obtain liability insurance for directors to cover the risk that their actions might result in losses to the company or third parties. Liability insurance for directors should allow the company to use civil law remedies more productively. It is also often needed to attract competent directors.²⁰⁵

G. Evaluation and Education of the Supervisory Board and Directors

To be effective, Supervisory Boards should have the necessary resources to develop and maintain the knowledge and skills of its directors. Training programs, based on periodic evaluations of the Supervisory Board and its members, are fundamental to this end.

Best Practices: The importance of Supervisory Board evaluations is widely recognized in the international business community. The FCSM Code also recommends that:²⁰⁶

- The Supervisory Board evaluate its performance annually; and
- The annual report reflect the results of the performance evaluation.

The performance evaluation of the Supervisory Board and its members may be carried out by:

- Directors through self-evaluation; and/or
- Consultants, professional associations, and corporate governance rating organizations.

²⁰⁵ FCSM Code, Chapter 3, Section 6.1.2.

²⁰⁶ FCSM Code, Chapter 3, Section 5.1.3.

An alternative approach calls for confidential Supervisory Board peer evaluations coordinated by an external party, such as legal counsel or specialized consultants.

1. Self-Evaluation by the Supervisory Board

A self-evaluation is a useful tool for the Supervisory Board to privately assess the quality of its work. Through critical reflection and self-evaluation, directors can be more responsive to shareholders, investors, and other stakeholders. Self-evaluation methods include:

- Organizing a retreat and inviting an outside facilitator;
- Organizing a special Supervisory Board meeting to evaluate the work of the Supervisory Board or, alternatively, setting aside time during a regular meeting to address performance issues;
- Designing checklists that Supervisory Board members can use to assess their work; and
- Participating in specialized training programs, thereby providing directors the opportunity to critically reflect on their performance, and develop and share new ideas.

→ See the model checklist for the Supervisory Board's self-evaluation in Part VI, Annex 17.

Best Practices: Another useful way to evaluate the Supervisory Board is to invite a consultant, advisor, institute of directors, or rating agency to independently assess the Supervisory Board. Rating agencies for example, not only evaluate the Supervisory Board, but also evaluate other aspects of the company's corporate governance system.

2. Education and Training

The evaluation of the Supervisory Board and its members can reveal important insights into the Board's strengths and weaknesses. This information can also be used by the Supervisory Board to identify training needs, both collectively and individually. Corporate training events take on added importance in the context of transition economies, as directors need to be kept abreast of changes to the legal and regulatory framework, as well as best practices. All this makes a company

education policy for the Supervisory Board and its directors a key success factor in developing and supporting a competent, knowledgeable, and vigilant Board.²⁰⁷

Company Practices in Russia: Only 5.6% of companies organized paid training events for directors during 2002.²⁰⁸ On average, such companies spent U.S. \$ 9,671 per year. Larger companies tend to pay more attention to the organization of trainings for directors. 14% of companies with over U.S. \$ 3.3 million in turnover organized trainings on corporate governance for their directors during the last year, compared to 6.1% of companies with turnover of U.S. \$ 1.6 to 3.3 million.

Even fewer companies (3.9%) used the services of consulting firms to assist them on corporate governance issues. Overall, fees spent on consulting services were U.S. \$ 15,333 on average per company per year.

H. The Remuneration of Directors

Directors may be remunerated for their work. The amount of such remuneration is determined by the GMS.²⁰⁹

The issue of director remuneration is one of the more contentious in the field of corporate governance, and companies are advised to choose a cautious and circumspect approach to the question of Supervisory Board remuneration. Excessive compensation plans are often perceived as an unjustified privilege of power. As a consequence, it is of the utmost importance that director compensation be competitive, yet stay within reasonable limits.

An important distinction in this respect must however be made between executive and non-executive directors. As a rule, executive directors do not receive additional fees for their participation on the Supervisory Board. Their executive compensation packages are generally thought to include Supervisory Board duties. Non-executive directors, on the other hand, should be remunerated. The most

²⁰⁷ At present, there are several organizations that offer director education programs in Russia, including the Independent Director Association (www.independentdirector.ru) and the Russian Institute of Directors (www.rid.ru). The IFC and its Russia Corporate Governance Program also offer corporate training events on corporate governance (www.ifc.org/rcgp).

²⁰⁸ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.1, pages 26–27, August 2003 (see www.ifc.org/rcgp).

²⁰⁹ LJSC, Article 64, Clause 2.

common form of remuneration for non-executive directors is a monetary fee. For example, directors can receive:

- An annual fee (which may be paid in the form of shares in lieu of cash);
- A fee, based upon meeting attendance;
- Fees for additional work, such as for work on Supervisory Board committees; and
- Fees for additional responsibilities, such as for serving as the Chairman of the Supervisory Board or one of its committees.

Directors can also be reimbursed for travel costs and other business expenses.

Best Practices: The remuneration payable to directors should be equal for all non-executive directors.²¹⁰ Moreover, the fees that a company pays should be competitive, i.e. sufficient to attract competent individuals. They should be set so that they are neither very much below nor above director fees paid at a peer group of companies. Setting a reasonable level of director remuneration is particularly important in order not to jeopardize the special status of independent directors. Independent or not, a director's judgment may be clouded if he receives a significant percentage of his total income in the form of a director fee. A director who relies on Board compensation for his livelihood will soon become beholden to the company, and may not be relied upon to fill his responsibilities in an unbiased manner.

The Supervisory Board should regularly review the remuneration of directors.

Best Practices: Ideally, this should be done either by a remuneration committee, composed entirely of independent directors, or by the independent directors. The company should disclose its remuneration plan and the remuneration of each director, either on an individual basis or in the aggregate, in its annual report. The former is easiest to implement when all Board members receive the same fees with a simple statement in the annual report: "All non-executive directors receive fees of EUR _____ per year."

Great care needs to be exercised in establishing performance-based remuneration, in particular, stock-based remuneration. Performance-based remuneration is generally considered a factor that impinges director independence.

²¹⁰ FCSM Code, Chapter 3, Section 5.1.

Best Practices: While stock-based remuneration is common in the U.S., it is a good deal less common elsewhere and considerable controversy still surrounds it. Stock-based remuneration plans and, in particular, stock option plans are complex arrangements. While they are generally thought to provide incentives for managers and directors, they can also have a significant impact upon the company and shareholders.

- Stock options, it is argued, cause directors to focus on short-term performance and stock price movements.
- If stock option grants are large, they may also create complicity between directors and executives who stand to make enormous sums from short-term price movements.
- Shareholders risk share dilution when large option plans are granted.
- Finally, large option grants have not prevented managers from manipulating companies and financial information to their benefit.

Consequently, option plans are coming under increasing scrutiny. Such plans require careful consideration, good planning, and special disclosure. Companies may be best served by avoiding stock options for directors.

If a company chooses to implement stock option plans, it should be transparent about the costs in terms of share dilution. The company should also be transparent about the accounting methods used to measure the costs of stock and option grants. Best practices would call for shareholder approval of stock- or option-based compensation plans that could dilute shareholder value or affect profits.

Personal loans or credits to the company's directors are also a minefield and a potential source of controversy that companies would be well advised to avoid.

Company Practices in Russia: Some 70% of companies do not have a remuneration policy for Supervisory Board members.²¹¹ The average annual compensation of Supervisory Board members in companies with less than 1,000 shareholders is U.S. \$ 475. Larger companies tend to pay higher fees. Companies with over 1,000 shareholders pay fees of U.S. \$ 1,200 per annum. The low level of remuneration compared to the importance of the Supervisory Board is striking. Whatever the explanation, it seems clear that director remuneration needs to receive greater attention. Transparent systems of remuneration, capable of attracting qualified directors, need to be put in place.

²¹¹ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.2.1, page 21, August 2003 (see www.ifc.org/rcgp).

Finally, as a matter of good practice, directors that are remunerated for their services should sign a contract with the company.

I. Summary Checklist to Determine the Supervisory Board's Effectiveness²¹²

Questions	Yes	No
1. Has the Supervisory Board recently devoted a significant amount of time and serious thought to the company's longer-term objectives, and to the strategic options open to it for achieving them? If so, have these deliberations resulted in a Board consensus or decision on its future objectives and strategies, and have these been put in writing?	<input type="checkbox"/>	<input type="checkbox"/>
2. Has the Supervisory Board consciously thought about and reached formal conclusions on what is sometimes referred to as its basic corporate philosophy that is, its value system, its ethical and social responsibilities, its desired 'image' and so forth? If so, have these conclusions been set forth in explicit statements of policy, for example, in respect of terms of employment? Does the company have formal procedures for recording and promulgating major Supervisory Board decisions as policy guidelines for line managers?	<input type="checkbox"/>	<input type="checkbox"/>
3. Does the Supervisory Board periodically review the organizational structure of the company, and consider how this may have to change in future? Does it review and approve all senior appointments as a matter of course? Are adequate human resource development programs in place?	<input type="checkbox"/>	<input type="checkbox"/>
4. Does the Supervisory Board routinely receive all the information it needs to ensure that it is in effective control of the company and its management? Have there been any unpleasant surprises, for example, unfavorable results or unforeseen crises that could be attributed to a lack of timely or accurate information?	<input type="checkbox"/>	<input type="checkbox"/>
5. Does the Supervisory Board routinely require the General Director to present his annual plans and budgets for their review and approval? Does the Board regularly monitor the performance of the General Director and his immediate subordinate managers in terms of actual results achieved against agreed plans and budgets?	<input type="checkbox"/>	<input type="checkbox"/>

²¹² Source: Parker, Hugh, Letters to a New Chairman, (1990) London: Director Publications, pp. 12–14. (As cited in Cadbury, Adrian, Corporate Governance and Chairmanship, (2002) Oxford University Press, pp. 47–48.)

The Russia Corporate Governance Manual

6. When the Supervisory Board is required to take major decisions on questions of future objectives, strategies, policies, major investments, senior appointments, etc., does it have adequate time and knowledge to make these decisions soundly — rather than finding itself overtaken by events and, in effect, obliged to rubber-stamp decisions already taken or commitments already made?	<input type="checkbox"/>	<input type="checkbox"/>
---	--------------------------	--------------------------

If the answers to all of these questions are yes, it is safe to say that the company's Supervisory Board can be considered effective. If the answers are negative, or perhaps not clear, then the company needs to re-evaluate the composition and role of its Supervisory Board.



Chapter 5

The **Executive Bodies**



Table of Contents

A. THE EXECUTIVE BODIES AND THEIR AUTHORITIES.....	78
1. <i>The Authority of the General Director</i>	80
2. <i>The Authority of the Executive Board</i>	80
3. <i>The Authority and Qualifications of the External Manager</i>	83
B. THE COMPOSITION OF THE EXECUTIVE BODIES.....	84
1. <i>Who Can Be a General Director or an Executive Board Member</i>	84
2. <i>Qualifications of the General Director and Executive Board Members</i>	85
3. <i>The Composition of the Executive Board</i>	86
C. THE FORMATION AND TERMINATION OF THE EXECUTIVE BODIES.....	87
1. <i>The Election of the Executive Bodies by the General Meeting of Shareholders</i>	88
2. <i>The Appointment of the Executive Bodies by the Supervisory Board</i>	91
D. THE WORKING PROCEDURES OF THE EXECUTIVE BODIES.....	92
1. <i>The Chairman of the Executive Board</i>	92
2. <i>Executive Board Meetings</i>	92
3. <i>The Right to Call an Executive Board Meeting</i>	93
4. <i>Meeting Notification</i>	94
5. <i>The Quorum of Executive Board Meetings</i>	94
6. <i>Voting During Executive Board Meetings</i>	95
7. <i>The Minutes of Executive Board Meetings</i>	95
E. THE DUTIES AND LIABILITIES OF THE MEMBERS OF THE EXECUTIVE BODIES.....	96
F. PERFORMANCE EVALUATIONS.....	96
G. THE REMUNERATION AND REIMBURSEMENT OF THE EXECUTIVE BODIES.....	97
1. <i>Remuneration Policy</i>	98
2. <i>Employment Contracts for Executives</i>	99
3. <i>Severance Payments to the General Director and Executive Board Members</i>	101

The Chairman's Checklist

- ✓ Does the company have a clear delineation and separation of authorities between shareholders, directors, and managers? Has the company properly established an Executive Board? Does the charter clearly distinguish the powers of the General Director from those of the Executive Board?
- ✓ Do the General Director and all Executive Board members possess the knowledge and skills necessary to manage the company? Do they perform their functions on a full-time basis? Is there a transparent division of tasks among the Executive Board members, such as operations, marketing, finance, and legal?
- ✓ Who elects members of the executive bodies? Is the General Director sufficiently involved in the nomination process or other executives?
- ✓ Do the executive bodies meet regularly to discuss the affairs of the company? Are these meetings well prepared with an agenda and reference materials distributed in advance (in writing and/or electronically)?
- ✓ Do the General Director and the Executive Board regularly and adequately inform the Supervisory Board about all operations of the company? Do the executive bodies provide all relevant information to the Supervisory Board, the Revision Commission, and the External Auditor in a timely manner?
- ✓ Do all members of the executive bodies clearly understand their duties to act reasonably and in good faith in the best interests of the company? Does the Supervisory Board take measures to ensure that managers who fail to act in accordance with these duties are held liable under civil, administrative, and/or criminal law?
- ✓ Are thorough performance reviews of the executive bodies based on key performance indicators periodically conducted? Does the Supervisory Board rigorously evaluate executives at least annually, if not more frequently? Does the Supervisory Board clearly link performance and remuneration when deciding on executive remuneration?
- ✓ Do all directors fully understand how stock options function? Are all directors and shareholders aware of the different methods of recording and reporting the cost of stock options? Has the Supervisory Board critically examined the use of options as an incentive tool, ensured that option grants are not merely a management giveaway, and communicated this fully and effectively to shareholders?

The executive bodies manage the company's day-to-day activities. They implement the strategic direction set out by the Supervisory Board and/or the General Meeting of Shareholders (GMS), and are an essential part of the company's governance structure.²¹³ This chapter describes the authorities, composition, formation, and working procedures of executive bodies, as well as their interaction with the Supervisory Board, their duties and liabilities, evaluation, and remuneration.

A. The Executive Bodies and Their Authorities

According to the Company Law, executive bodies can be either:²¹⁴

- A single-person executive body, i.e. General Director; or
- A collective executive body, i.e. the Executive Board, consisting of the General Director and one or more managers.

A company must always have a General Director. The formation of the Executive Board and the employment of an External Manager are, on the other hand, optional.

Best Practices: The Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) recommends that the company establish an Executive Board.²¹⁵ It argues that the management of the company's day-to-day activities is complex, requiring a collective rather than individual approach. An Executive Board also facilitates discussion and coordination among key managers on important issues. The Executive Board assembles the key resources at the General Director's disposal to help achieve the company's goals.

As a rule, the executive bodies have the authority to decide all issues that do not fall under the authority of the GMS and/or the Supervisory Board.²¹⁶ Matters

²¹³ Law on Joint Stock Companies (LJSC), Article 69, Clauses 1 and 2; FCSM Code, Chapter 4, Introduction.

²¹⁴ LJSC, Article 69, Clause 1.

²¹⁵ FCSM Code, Chapter 4, Section 1.1.

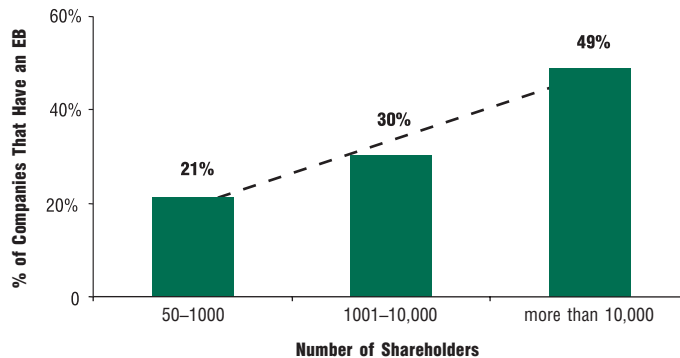
²¹⁶ LJSC, Article 69, Clause 2, Paragraph 1.

that do fall within the authority of the GMS and/or the Supervisory Board cannot be delegated to the executive bodies.²¹⁷ Furthermore, the charter must specify the authority of the executive bodies.²¹⁸

Company Law allows the company to employ an External Manager, which is typically either a commercial organization (management organization) or an individual entrepreneur (manager), to fulfill the role of an executive body.

Company Practices in Russia: An ever increasing number of Russian companies have Executive Boards. A survey of governance practices in Russia's regions shows that the larger the company, the more likely it is to have an Executive Board.²¹⁹ Larger companies may need an Executive Board to deal with more complex business models and organizational structures. Smaller companies typically have simpler business models and fewer resources to establish formal structures. (See Figure 1.)

Figure 1: Existence of an Executive Board (EB)



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

²¹⁷ LJS, Article 48, Clause 2; Article 65, Clause 2.

²¹⁸ LJS, Article 11, Clause 3, Paragraph 1.

²¹⁹ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.2, page 29, August 2003 (see www.ifc.org/rcgp).

Best Practices: The work of the executive bodies should be guided by a financial and business plan that is approved annually by the Supervisory Board.²²⁰ The financial and business plan should contain basic guidelines for the daily operations of the company. Good corporate governance principles further recommend that:²²¹

- The General Director and Executive Board seek the approval of the Supervisory Board for transactions that fall outside the scope of the financial and business plan (non-standard operations);²²²
- The company develop by-laws or other internal documents detailing procedures for the General Director and Executive Board to obtain such approval from the Supervisory Board; and
- The Supervisory Board have the right to veto decisions made by the General Director and Executive Board to implement non-standard operations.

1. The Authority of the General Director

The authority of the General Director is defined by the Company Law and summarized in Figure 2.²²³

2. The Authority of the Executive Board

If the company establishes an Executive Board, the charter must define the authority of the General Director and the Executive Board,²²⁴ in particular since the Company Law does not do so. Such division of authority is at the discretion of the company.

²²⁰ FCSM Code, Chapter 1, Section 7.1.

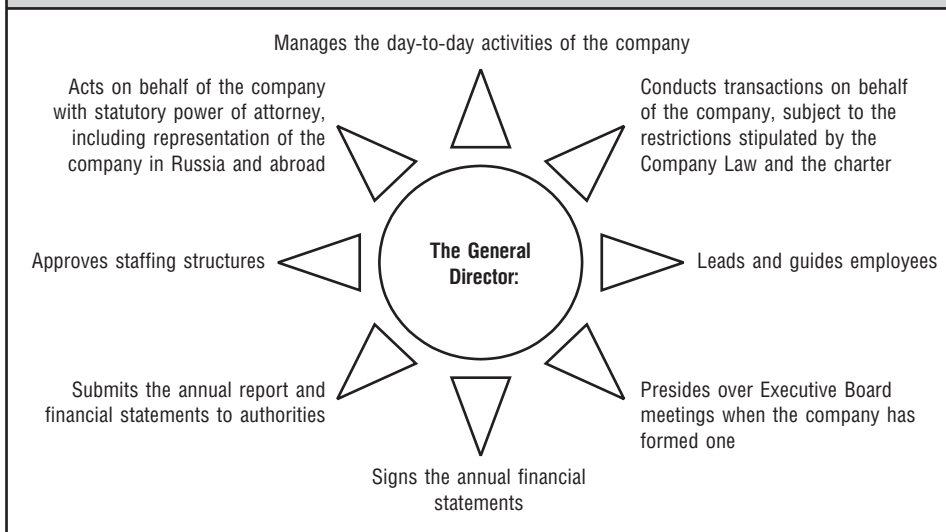
²²¹ FCSM Code, Chapter 4, Section 1.2.

²²² FCSM Code, Chapter 8, Section 2.2.3.

²²³ LJSC, Article 69, Clause 2, Paragraphs 1–3; Article 88, Clause 2. FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparing, Calling, and Conducting the General Meeting of Shareholders, 31 May 2002, Section 3.7.

²²⁴ LJSC, Article 69, Clause 1, Paragraph 2.

Figure 2: The Authorities of the General Director



Source: IFC, March 2004

Best Practices: The company charter should define the Executive Board's authority to:²²⁵

- Develop documents on the priority area(s) of the company's operations;
- Develop the business plan(s) of the company;
- Approve by-laws or other internal documents;
- Approve transactions with a value of 5% and more of the company's assets with the requirement that the Supervisory Board be immediately notified;
- Approve real estate transactions and loans that are not part of the ordinary course of business;
- Appoint the heads of the company's branches and representative offices;
- Approve issues on the agenda of the GMS of wholly-owned subsidiaries unless these issues must be approved by the Supervisory Board of the parent company;
- Appoint individuals who represent the company during the GMS of wholly-owned subsidiaries and instruct them on how to vote during the GMS;
- Nominate candidates for the General Director, the Executive Board, the External Manager, the Supervisory Board, and other governing bodies of wholly-owned subsidiaries;

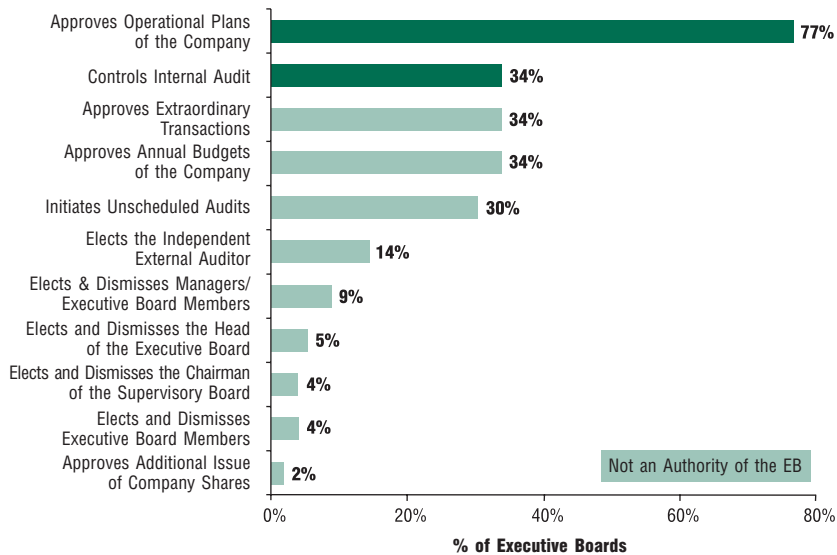
²²⁵ FCSM Code, Chapter 4, Sections 1.1.2 — 1.1.5.

The Russia Corporate Governance Manual

- Approve internal work schedules;
- Approve job descriptions for all management-level employees of the company;
- Approve employment contracts for mid-level managers; and
- Approve collective labor contracts.

Company Practices in Russia: Both the Company Law and the FCSM Code define the authorities of the governing bodies. However, these bodies often confuse their authorities in practice. This holds particularly true for executive bodies. While misunderstandings may go unnoticed, they are technically illegal and may result in the reversal of decisions and, in some cases, even litigation. Figure 3 illustrates how executive boards in a sample of Russian companies have assumed some powers of the Supervisory Board and the GMS.²²⁶

Figure 3: Functions Performed by Executive Boards (EB)



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

²²⁶ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.2, page 30, August 2003 (see www.ifc.org/rcgp).

3. The Authority and Qualifications of the External Manager

The GMS can delegate the authority of the General Director to an External Manager by written agreement.²²⁷

Best Practices: The GMS can only delegate the authority of the single-person executive body. Thus, in cases when the General Director is the Chairman of the Executive Board, the GMS must first dissolve the Executive Board and then delegate the General Director's authority.

The GMS can only decide on the delegation of the authority of the General Director to an External Manager upon the recommendation of the Supervisory Board.

Best Practices: The Supervisory Board should provide the GMS with a clear justification for the use of an External Manager and explain the:²²⁸

- Reasons;
- Risks;
- Costs;
- Individuals who are accountable to the Supervisory Board on behalf of the External Manager;
- Other companies that are managed by the External Manager; and
- Identity of the Supervisory Board members, executive bodies and major shareholders of the External Manager, as well as any and all information that may be required to identify potential conflicts of interests.

The External Manager fulfills the functions of the General Director and is accountable to the Supervisory Board and the GMS. The Company Law does not specify the requirements of the agreement with the External Manager other than that the Chairman, or another individual who is duly authorized, sign the contract on behalf of the company.²²⁹

²²⁷ LJSC, Article 69, Clause 1, Paragraph 3.

²²⁸ FCSM Code, Chapter 1, Section 4.2; Chapter 4, Sections 2.1.7 – 2.1.9.

²²⁹ LJSC, Article 69, Clause 3, Paragraph 2.

Best Practices: The Supervisory Board and the GMS should have access to:²³⁰

- Documents that prove that the External Manager has sufficient financial resources or adequate liability insurance in the event of failure to perform obligations in accordance with the contractual agreement with the company, as well as the External Manager's financial statements;
- The charter of the External Manager (if it is a legal entity); and
- The contract with the External Manager including the:²³¹
 - Goals that the External Manager is asked to achieve;
 - Remuneration of the External Manager;
 - Standards of liability applicable to the External Manager;
 - Procedures for the removal of the External Manager (contract termination clause);
 - List of reports, which the External Manager must submit to the Supervisory Board and the GMS, including the periodicity of these reports.

Further, the External Manager should not work for a competing company in any capacity or have any significant connections with such company.

The GMS may terminate the authority of the External Manager at any time.²³² Note that the contractual agreement between the company and External Manager will also need to be terminated and that (additional) compensation may be payable to the External Manager for premature termination of his employment agreement.

B. The Composition of the Executive Bodies

1. Who Can Be a General Director or an Executive Board Member

Any individual can be the General Director or an Executive Board member. Restrictions do, however, exist:

- Only individuals with “full dispositive capacity” can be members of the executive bodies. This means that a person must have the capacity to acquire

²³⁰ FCSM Code, Chapter 4, Section 2.1.9.

²³¹ FCSM Code, Chapter 4, Section 2.1.10.

²³² LJSC, Article 69, Clause 4, Paragraph 1.

and exercise civil law rights by his actions, be able to create for himself civil law obligations, and be able to fulfill these rights and obligations;²³³

- A legal entity cannot be an Executive Board member;
- The Chairman of the Supervisory Board cannot be the General Director;²³⁴
- Revision Commission members cannot be a member of the executive bodies;²³⁵
- Counting Commission members cannot be a member of the executive bodies;²³⁶ and
- A member of the company's executive bodies can only be a member of the executive bodies or Supervisory Board of another company after the Supervisory Board has given its consent.²³⁷

Best Practices: Best practices dictate that individuals should not be appointed to executive bodies when they are:²³⁸

- Directors of a competing company;
- Managers of a competing company; or
- Employees of a competing company.

The General Director should not be engaged in any business activities other than those related to the management of the company and the governance of its subsidiaries.²³⁹

2. Qualifications of the General Director and Executive Board Members

Members of the executive bodies can only be effective when they have adequate financial and human resources, as well as the necessary knowledge, skills, time, and experience to exercise their duties.²⁴⁰

²³³ Civil Code (CC), Article 21.

²³⁴ The General Director can, however, hold any other position on the Supervisory Board, including the position of Deputy Chairman.

²³⁵ LJSC, Article 85, Clause 6.

²³⁶ LJSC, Article 56, Clause 2.

²³⁷ LJSC, Article 69, Clause 3, Paragraph 4.

²³⁸ FCSM Code, Chapter 4, Section 2.1.3.

²³⁹ FCSM Code, Chapter 4, Section 2.1.4.

²⁴⁰ FCSM Code, Chapter 1, Section 4.2; Chapter 4, Section 2.1.4.

Best Practices: The charter or by-laws should specify the qualifications of members of the executive bodies as well as heads of major divisions.²⁴¹ Members of the executive bodies, including the External Manager, should generally satisfy the following requirements:²⁴²

- To enjoy the trust of shareholders, directors, other managers, and employees of the company;
- To own the ability to relate to the interests of all stakeholders and to make well-reasoned decisions;
- To possess the professional expertise and education to be an effective General Director and manager;
- To possess (international) business experience, knowledge of national economic, political, legal, and social issues, as well as trends and knowledge of the market, products, and competitors (national as well as international); and
- To have the ability to translate knowledge and experience into practical solutions that can be applied to the company.

Moreover, a background check on candidates should be conducted for a possible record of criminal or administrative offenses. Evidence of such offenses would likely result in the rejection of a candidate.

3. The Composition of the Executive Board

The number of Executive Board members, together with their duties and responsibilities, is set forth in the company's charter.²⁴³

Company Practices in Russia: A Russian company's Executive Board will typically consist of the General Director and between five and seven other members. Figure 4 illustrates the number of Executive Board members in Russian companies of different sizes.²⁴⁴

The size of the Executive Board will need to be adapted to the specific circumstances of the company and, consequently, will vary in composition. The Executive Board might include the following persons:

²⁴¹ FCSM Code, Chapter 4, Sections 2.1.1 and 2.1.8.

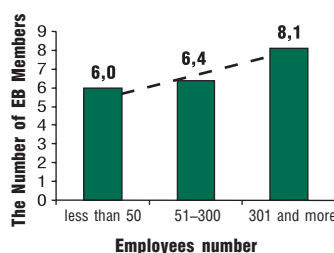
²⁴² FCSM Code, Chapter 4, Section 2.1.4.

²⁴³ LJSC, Article 11, Clause 3.

²⁴⁴ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.2, page 29, August 2003 (see www.ifc.org/rcgp).

- The General Director;
- The Chief Operating Officer;
- The Chief Financial Officer;
- Chief Legal Counsel;
- Marketing and Sales Director;
- Head of Purchasing;
- Head of Research and Development;
- Head of Information Technology;
- Head of Public/Investor Relations;
- Heads of Business/Product Lines;
- The General Director of a dependent company or subsidiary; and/or
- The Human Resources Director.

Figure 4: The Number of Executive Board (EB) Members



Source: IFC, Regional Survey on Corporate Governance, August 2003

C. The Formation and Termination of the Executive Bodies

The Company Law is flexible on who elects the executive bodies. It allows for the following options:²⁴⁵

- The election of the General Director and Executive Board members by the GMS; or
- The election of the General Director and Executive Board members by the Supervisory Board if the charter provides so; or
- The election of the General Director by the GMS and of Executive Board members by the Supervisory Board if the charter provides so.

Best Practices: High-level personnel decisions, in general, and the selection of Executive Board members, more specifically, are best accomplished by the General Director, in tandem with the Supervisory Board. Personnel decisions

²⁴⁵ LJSC, Article 48, Clause 1, Section 8; Article 65, Clause 1, Section 9; Article 69, Clause 3, Paragraph 1.

should not be political decisions. The assessment of the skills and qualifications of potential Executive Board members is best done by someone who works day in and day out with potential candidates. Shareholders or Supervisory Boards that insist on close control over this process may be better served by developing policies that specify outcomes rather than getting involved in the details of selection. Drafting precise and effective terms of reference for key executive positions is but one example. At the very least, proposals for membership on the Executive Board should be closely coordinated with the General Director, by having him nominate and the Supervisory Board approve candidates.

1. The Election of the Executive Bodies by the General Meeting of Shareholders

Best Practices: The involvement of the GMS in the election of executive bodies can empower shareholders to decide on who should run the company. It is also better suited to protect the rights of shareholders since they not only vote on managers but also have the right to propose candidates. The FCSM Code recommends that the GMS elect the executive bodies.²⁴⁶

On the other hand, almost every other corporate governance system has the Supervisory Board elect the General Director. The Supervisory Board is in a better position compared to shareholders to set the key criteria for what kind of General Director the company needs, organize proper succession planning, and search for such a person. For this purpose, the Supervisory Board may even establish an independent Nominations Committee, which will be in charge of making a recommendation as to potential candidates for the position of General Director. Shareholder interests are not adversely affected, as the Supervisory Board members are bound by their duties of loyalty and care to act in the best interests of the company and its shareholders. It is especially advisable to delegate this power to the Supervisory Board in countries in transition such as Russia, where Supervisory Boards are nascent in their development *vis-à-vis* controlling shareholders, and need to be strengthened. Finally, because management oversight is one of the Supervisory Board's main authorities, the Board's authority to dismiss the General Director should coincide with the authority to elect this important individual.

²⁴⁶ FCSM Code, Chapter 1, Section 4.2.

Legislation does not specify the minimum and maximum periods for which members of the executive bodies are elected. The charter, by-laws, or the employment agreement can specify the period for which the General Director and Executive Board members are elected. Members of the executive bodies can be re-elected at will.

Company Practices in Russia: In practice, the executive bodies are often elected for a period between three and five years. This is considered sufficient time for a manager to become acquainted with the company's business and not to be constrained by short-term goals.

a) Nomination of Candidates for Executive Bodies

→ *The procedure for nominating candidates for the executive bodies is discussed in Part III, Chapter 8, Section B.1.*

b) Information About Candidates for the Executive Bodies

Information on candidates for the executive bodies must be submitted to shareholders before the GMS.

Best Practices: Shareholders should have the opportunity to receive sufficient information (in writing and/or electronic form) about candidates for the position of General Director and the Executive Board before the GMS. Up-to-date information should also be made available to all shareholders during the GMS.²⁴⁷ The information about candidates for the executive bodies should include the:²⁴⁸

- Identity of the candidate;
- Age and educational background of the candidate;
- Position(s) held by the candidate during the last five years;
- Position(s) held by the candidate at the moment of his nomination;
- Relationship(s) that the candidate has with the company;
- Membership(s) of the candidate in the Supervisory Board of other legal entities, or any other positions held in such entities;
- Information on the nomination(s) of the candidate for a position in the executive bodies and other positions of other legal persons;
- Relationship(s) of the candidate with affiliated persons;

²⁴⁷ LJSC, Article 52, Clause 3, Paragraph 3.

²⁴⁸ FCSM Code, Chapter 4, Section 2.2.1. See also: LJSC, Article 53, Clause 4.

- Relationship(s) that the candidate has with major business partners of the company;
- Information related to the financial status of the candidate and other circumstances that may affect the duties of the candidate as a member of the executive bodies; and
- Refusal of the candidate, if any, to provide information to the company.²⁴⁹

It is recommended that candidates present a written statement to the GMS that indicates their willingness to accept the position of General Director or Executive Board member, should they be elected.²⁵⁰ In the absence of such statement, candidates should verbally confirm that they are willing to accept the position during the GMS.

Companies may include provisions in the charter specifying the information that must be provided to shareholders about candidates for the executive bodies.²⁵¹

c) The Election of the Executive Bodies by Written Consent

The Company Law does not prohibit shareholders from electing members of the executive bodies during a GMS that has been conducted without the physical presence of shareholders.²⁵² It is possible, therefore, to elect members of the executive bodies during a GMS that has been held by written consent.

d) The Election of Members of the Executive Bodies When the Executive Board Has an Insufficient Number of Members

If the number of Executive Board members becomes less than the quorum specified by the charter or by-laws, the Supervisory Board must:²⁵³

- Appoint an interim Executive Board; and
- Organize an Extraordinary General Meeting of Shareholders (EGM) to elect a new Executive Board.

²⁴⁹ FCSM Code, Chapter 4, Section 2.2.1.

²⁵⁰ FCSM Code, Chapter 2, Section 1.3.6.

²⁵¹ LJSC, Article 53, Clause 4; FCSM Code, Chapter 2, Section 2.1.4.

²⁵² LJSC, Article 50, Clause 2.

²⁵³ LJSC, Article 70, Clause 2.

e) The Suspension of the General Director's Authorities

In circumstances where the power to form and terminate executive bodies belongs to the GMS, the charter can provide the Supervisory Board with the authority to suspend the powers of the General Director or External Manager.

→ *For more information on the suspension and appointment of interim executive bodies, see Chapter 4, Section A.3.*

f) The Authority of the Interim General Director

An interim General Director has the same authority as the General Director unless the charter specifies otherwise.²⁵⁴

Best Practices: An example of a limitation of an interim General Director's authority could be a prohibition to conclude significant transactions without prior Supervisory Board approval, or to conclude transactions in excess of a certain monetary threshold. It is also good practice to limit the power of the interim General Director to make decisions regarding the hiring and firing of personnel.

g) The Termination of the Authority of the Executive Bodies

The GMS can terminate the authority of executive bodies it has established.²⁵⁵ Members of the executive bodies are dismissed by a simple majority vote of shareholders participating in the GMS.²⁵⁶ The GMS cannot terminate the authority of the executive bodies if the charter gives the Supervisory Board the authority to establish the executive bodies.

2. The Appointment of the Executive Bodies by the Supervisory Board

The procedures for the appointment and dismissal of members of the executive bodies are less onerous when the Supervisory Board has the authority to establish executive bodies. When the charter allows, the executive bodies are appointed by the Supervisory Board and can be dismissed at any time by this same body. The company will, however, as mentioned above, need to comply with employment

²⁵⁴ LJSC, Article 69, Clause 4, Paragraph 6.

²⁵⁵ LJSC, Article 48, Clause 1, Section 8.

²⁵⁶ LJSC, Article 49, Clause 2.

contracts regarding notice, cause, and possible severance payments. A simple majority of votes of Supervisory Board members is sufficient to appoint members of the executive bodies, unless the charter or by-laws require a higher percentage.²⁵⁷

D. The Working Procedures of the Executive Bodies

1. The Chairman of the Executive Board

The General Director presides over Executive Board meetings.²⁵⁸ For Executive Board meetings, the General Director (or Chairman of the Executive Board) has the authority to:²⁵⁹

- Convene, organize, and preside over Executive Board meetings;
- Sign all documents, decisions, and minutes of the Executive Board; and
- Perform any other duties as specified in the charter and by-laws.

Best Practices: In addition, the Chairman of the Executive Board can:

- Facilitate discussions and decision-making, and create a constructive atmosphere; and
- Take steps to ensure that all members are sufficiently prepared to contribute to the work of the Executive Board.

2. Executive Board Meetings

The charter and the by-laws shall establish:²⁶⁰

- The frequency of Executive Board meetings;
- The procedures for organizing and conducting Executive Board meetings; and
- The procedures for making decisions during Executive Board meetings.

Best Practices: The precise frequency of meetings should, however, ultimately depend on the unique circumstances of each company.

²⁵⁷ LJSC, Article 68, Clause 3.

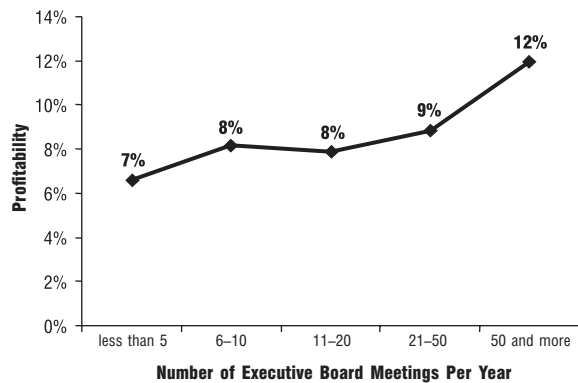
²⁵⁸ LJSC, Article 69, Clause 1.

²⁵⁹ LJSC, Article 70, Clause 2.

²⁶⁰ LJSC, Article 70, Clause 1.

Company Practices in Russia: The effectiveness of an Executive Board is likely to be greatly enhanced by frequent meetings. The FCSM Code recommends that the Executive Board meet at least once a week.²⁶¹ The IFC survey shows a large gap between this recommended number and actual practice.²⁶² In fact, only 3% of Executive Boards follow the FCSM Code's recommendation. It is interesting to note that, based on survey results, greater frequency of Executive Board meetings correlates with an increase in profitability (see Figure 5).

Figure 5: Executive Board Meetings and Profitability



Source: IFC, Regional Survey on Corporate Governance, August 2003

3. The Right to Call an Executive Board Meeting

The General Director has the right to convene a meeting of the Executive Board.²⁶³

Best Practices: The Executive Board is a hands-on, problem-solving mechanism. Other Executive Board members should also have a voice in calling Executive Board meetings and setting the meeting agenda.²⁶⁴

²⁶¹ FCSM Code, Chapter 4, Section 4.1.1.

²⁶² IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.2, page 29, August 2003 (see www.ifc.org/rcgp).

²⁶³ LJSC, Article 70, Clause 2.

²⁶⁴ FCSM Code, Chapter 4, Section 4.1.1.

The charter or by-laws must specify the procedures for convening and conducting Executive Board meetings.²⁶⁵

4. Meeting Notification

Since the Executive Board is a management tool, it will likely need to respond to the changing demands of the company and its external environment, and be prepared to act quickly. While rapid response is necessary, it may make careful and extensive preparation for meetings difficult and, in some cases, impossible. Obviously, Executive Board members should be as well prepared as practical. To the extent possible, they should be notified in advance to give them time to prepare in order to effectively participate in meetings.

Best Practices: Executives should not vote on agenda items unless they are well informed. Whenever possible, materials should be sent to Executive Board members in advance, together with the notice and the meeting agenda.²⁶⁶ This may, however, not always be the case and, under some circumstances, sound decision-making may not be possible. Decision-making may be postponed when members:

- Cannot be notified in a timely manner; or
- Have not received the required information on time; or
- Have not been provided with sufficient time to prepare for the meeting.

The by-laws or other internal documents should determine the form in which notice and materials are to be delivered to Executive Board members in the most convenient and appropriate way.

5. The Quorum of Executive Board Meetings

The quorum of Executive Board meetings refers to the number of members that must participate in the meeting before it can make a valid decision. The charter or by-laws set the quorum, which cannot be less than one half of the total number of Executive Board members.²⁶⁷ Any Executive Board meeting that lacks a quorum cannot make valid decisions.

²⁶⁵ LJSC, Article 70, Clause 1.

²⁶⁶ FCSM Code, Chapter 4, Sections 4.1.3 – 4.1.4.

²⁶⁷ FCSM Code, Chapter 4, Section 4.1.4.

6. Voting During Executive Board Meetings

A simple majority of Executive Board members who participate in the meeting is sufficient to approve Executive Board decisions, unless the charter or by-laws require a supermajority vote.²⁶⁸ The Company Law does not however envisage a supermajority vote for any Executive Board decision.

The Company Law prohibits the transfer of the right to vote from one Executive Board member to another.²⁶⁹ Each Executive Board member has one vote. The charter can specify that the Chairman of the Executive Board can cast a deciding vote in the case of a tie.

7. The Minutes of Executive Board Meetings

The Executive Board must keep minutes of each of its meetings.²⁷⁰ The Company Law does not specify when the minutes must be prepared, though it stipulates that minutes must be kept in the company archives.²⁷¹

Best Practices: The minutes of Executive Board meetings should include the following information:

- The location and time of the meeting;
- The names of the persons present at the meeting;
- The agenda of the meeting;
- The issues on the agenda, as well as the voting results on an individual basis;
- The decisions made by the Executive Board; and
- The rationale for the decisions.

The Chairman of the Executive Board must sign the minutes.²⁷²

The minutes of the Executive Board meeting must be made available upon the request of:

- Revision Commission members;
- The External Auditor;
- Supervisory Board members;²⁷³ or

²⁶⁸ LJSC, Article 70, Clause 2, Paragraph 1.

²⁶⁹ LJSC, Article 70, Clause 2, Paragraph 4. See also: FCSM Code, Chapter 4, Section 4.1.6.

²⁷⁰ LJSC, Article 70, Clause 2.

²⁷¹ LJSC, Article 89, Clause 1.

²⁷² LJSC, Article 70, Clause 2.

²⁷³ LJSC, Article 70, Clause 2.

- A shareholder (or a group of shareholders) possessing at least 25% or more of voting shares.²⁷⁴

Best Practices: The minutes of the Executive Board should also be made available to the Control and Revision Service (Internal Audit Function) of the company.²⁷⁵

If the company does not have an Executive Board, the decisions of the General Director must also be kept in the company archives. The charter should, in such cases, describe the procedures for the General Director to file his decisions.

E. The Duties and Liabilities of the Members of the Executive Bodies

The members of the executive bodies have the same duties of care and loyalty as Supervisory Board members, and are subject to the same liability standards as Supervisory Board members, unless either the charter, by-laws, or employment contract provide for stricter standards.

→ *For more information about the duties and liabilities of directors, see Chapter 4, Section F.*

F. Performance Evaluations

Periodic performance evaluations of the executive bodies are an important oversight tool. They can help create a system of constant performance management and improvement.

Best Practices: The charter or by-laws can stipulate that the performance of the executive bodies be evaluated by the Supervisory Board at least annually, if not more frequently. The Supervisory Board may also find it useful to receive evaluations on the performance of the executive bodies that are carried out by the General Director and Executive Board members themselves, through self-evaluation within the framework of the company's HR performance evaluation and planning process.

→ *For an example of a self-evaluation framework, see Chapter 4, Section G.*

²⁷⁴ LJSC, Article 91, Clause 1.

²⁷⁵ FCSM Code, Chapter 4, Section 4.1.5.

G. The Remuneration and Reimbursement of the Executive Bodies

The Company Law does not explicitly regulate who determines the remuneration of the executive bodies.

Best Practices: Executive remuneration is an important aspect in attracting managerial talent. Excessive executive remuneration packages on the other hand are often perceived as an unjustified privilege of power. Consequently, it is of the utmost importance that executive compensation be competitive, yet stay within reasonable limits, ideally in relation to a peer group of companies.

The remuneration of executive should not be left to the sole discretion of the executive bodies themselves.²⁷⁶ This should fall under the Supervisory Board's authority.²⁷⁷ Companies should state in their charters that the approval of executive remuneration is a prerogative of the Supervisory Board. It is important that the Supervisory Board take into consideration performance-related factors that are based on the company's key performance indicators when determining the remuneration of executives. Some of the issues that have a bearing on remuneration are:²⁷⁸

- Scope of responsibilities;
- Required type and level of qualifications;
- Experience of the candidates;
- Personal and business qualities of the candidates;
- Typical level of remuneration in the company and in the industry in general; and
- The financial performance of the company.

An executive's base salary is usually a function of his background and experience, whereas variable compensation is generally based upon the executive's performance.

²⁷⁶ FCSM Code, Chapter 3, Section 1.4.3.

²⁷⁷ FCSM Code, Chapter 1, Section 3.4.

²⁷⁸ FCSM Code, Chapter 3, Section 4.10.2.

1. Remuneration Policy

The remuneration of managers can consist of both a fixed and a variable component.

The fixed component typically consists of a base salary. The most important factor in determining an executive's base salary is compensation practice among a peer group of similar companies.

The most important factor in determining an executive's variable remuneration is his contribution towards the short and long-term financial performance of the company. The variable component often consists of an annual bonus and is based on key performance indicators. Variable compensation has come to represent a large part of an executive's remuneration package in many countries, to better motivate performance.

Best Practices: The FCSM Code recommends that remuneration be based upon performance-related criteria.²⁷⁹ There is a multitude of ways to link executive pay to individual and company performance. Some common financial indicators utilized in variable compensation plans are:

- Earnings before interest, taxes, depreciation and amortization (EBITDA);
- Operating profit;
- Return on Assets (ROA);
- Return on Investment (ROI) or Equity (ROE);
- Return on Capital Employed (ROCE);
- Economic Value Added (EVA); and
- Achievement of specific individual objectives.

There are many other financial indicators. Non-financial indicators are equally important and valuable in managing executive performance, and can be organized around:

- Customers — for example, customer satisfaction levels, retention rates and customer loyalty, and acquisition;
- Operational processes and efficiency — for example, quality measures, cycle time measures, cost measures, and after sales service; and
- Internal growth/knowledge management — for example, training programs, employee satisfaction rates, employee absenteeism, and employee turnover.

The Supervisory Board will want to carefully develop key performance indicators, and link executive remuneration to these indicators.

²⁷⁹ FCSM Code, Chapter 4, Section 5.1.2.

Moreover, executives often receive benefit plans consisting of a pension plan, medical and dental plan, savings plan, life insurance plan, and a disability plan.

Other prerequisites for senior executives include club memberships, use of a company car, chauffeurs, and similar perks.

Finally, some companies in western countries provide their executives with long-term incentive systems that may include stock options.

Best Practices: While remuneration is generally considered a responsibility of the Supervisory Board, stock- and option-based compensation is increasingly an issue for which shareholder approval is required. The reason is that equity compensation contains considerable hidden costs for shareholders. These costs are hidden since accounting practices do not generally reveal the true price-tag of option-based compensation plans. For this reason, more and more companies are attempting to disclose the true cost of option compensation. In addition, some exchanges such as the NYSE and the NASDAQ now require shareholder approval of all equity-based compensation plans.²⁸⁰

While remuneration plans may serve to attract top executive talent and motivate better performance, the field of executive remuneration is both complex and a lightning rod for shareholder and public criticism. Companies that introduce such plans, in particular stock-option plans, should do so with a good deal of circumspection and a maximum of transparency.

2. Employment Contracts for Executives

Legislation requires that the company conclude employment contracts with the General Director and Executive Board members.²⁸¹ These contracts must include:²⁸²

- The name of the General Director, or Executive Board member;
- The name of the company;
- The starting date of the contract;

²⁸⁰ New York Stock Exchange Corporate Accountability and Listing Standards Committee, June 6, 2002.

²⁸¹ Labor Code, Article 275.

²⁸² Labor Code, Article 57.

The Russia Corporate Governance Manual

- The rights and duties of the General Director, or Executive Board member;
- The rights and duties of the company;
- Remuneration; and
- The term of the contract.

Best Practices: The contract should include additional items such as:

- Sanctions to be applied for failing to carry out one's responsibilities;
- Benefits and other privileges (e.g. discounts on purchases of company shares, health insurance, reimbursement for housing costs);
- Indemnification;
- Confidentiality clauses during the term of the contract and after the executive leaves the company regardless of the reason for leaving;
- Non-competition clauses during the service period and after the executive leaves the company for whatever reason;
- A commitment to protect the interests of the company and its shareholders; and
- Grounds for early termination.

The Company Law is not explicit with regard to who is responsible for negotiating contracts with members of the executive bodies.

Best Practices: The GMS is not expressly vested with the power to negotiate contracts. Good business sense and a reasonable interpretation of the Company Law suggest that the Supervisory Board should do so. At a minimum, good corporate governance practices would require the Supervisory Board to approve contracts with members of the executive bodies.

Regardless, executives should never determine their own remuneration. The Supervisory Board and, ideally, an independent Remuneration Committee should do so. To avoid potential conflicts of interest, executive directors should not vote on their own employment contracts.²⁸³ In summary, it is recommended that:

- Executive directors be counted for the quorum of the Supervisory Board; and
- The votes of executive directors not be counted when approving the terms and conditions of their own employment contracts.

²⁸³ FCSM Code, Chapter 3, Section 1.4.3.

3. Severance Payments to the General Director and Executive Board Members

Executives may, under certain circumstances, be dismissed without cause and yet receive severance payments. This may occur when a company has been acquired and the acquirer wishes to install new management. These severance plans are sometimes referred to as golden parachutes. Golden parachutes can be defined as a clause in an executive's employment contract specifying that he will receive large benefits in the event that the company is acquired and the executive's employment is terminated. These benefits can take the form of severance pay, a bonus, stock options, or a combination thereof. Like other forms of compensation, golden parachutes are often the object of criticism.

Severance agreements may, however, be in the interest of shareholders since they can avoid prolonged and costly litigation and public relations problems. Nevertheless, caution should be applied when putting them in place, and the assistance of competent outside advisors should be sought. The approval of severance payments should be a priority for the Supervisory Board and, possibly, the GMS.

Best Practices: The FCSM Code recommends that the employment contracts of the General Director and Executive Board members include a provision for severance payments when their employment contracts are terminated prematurely.²⁸⁴

²⁸⁴ FCSM Code, Chapter 4, Section 5.1.3.



Chapter 6

The **Role** of the **Corporate Secretary**

Table of Contents

A. THE ROLE OF THE CORPORATE SECRETARY	106
1. <i>The Need for and Importance of the Corporate Secretary</i>	106
2. <i>The Qualifications of a Corporate Secretary</i>	108
3. <i>The Independence of the Corporate Secretary</i>	110
4. <i>The Appointment of the Corporate Secretary</i>	111
B. THE AUTHORITY OF THE CORPORATE SECRETARY	113
1. <i>General Provisions</i>	113
2. <i>Developing Corporate Governance Policies and Practices</i>	114
3. <i>Supporting the Supervisory Board</i>	114
4. <i>Protecting Shareholder Rights</i>	117
5. <i>Providing for Information Disclosure and Transparency</i>	119
C. PROFESSIONAL ASSOCIATIONS OF CORPORATE SECRETARIES	121

The Chairman's Checklist

- ✓ Does the company have a Corporate Secretary? Does the company need a Corporate Secretary? What contributions can a Corporate Secretary make to the company's governing bodies?
- ✓ Is the position of Corporate Secretary filled on a full-time basis, or does the Corporate Secretary combine his functions with other duties?
- ✓ Does the Corporate Secretary have an adequate mix of professional and personal skills and competencies?
- ✓ How does the company regulate the activities of the Corporate Secretary? Has the company mentioned the position of Corporate Secretary in its charter or by-laws, or even drafted a by-law for the Corporate Secretary?
- ✓ Does the Supervisory Board ensure that the Corporate Secretary has access to all information necessary to perform his duties? Are directors and managers obliged to provide the Corporate Secretary with all information requested or needed by the Secretary to properly fulfill his duties? Does the Corporate Secretary serve as an effective link between the Supervisory Board and executive bodies?
- ✓ What is the Corporate Secretary's role in ensuring timely and material disclosure to investors and the public? Does the Corporate Secretary work together with the company's legal and investor relations departments?
- ✓ What role does the Corporate Secretary play in planning and organizing the General Meeting of Shareholders?
- ✓ How does the Corporate Secretary assist the Supervisory Board in preparing for and conducting Board meetings? Does the Corporate Secretary play a meaningful role in Supervisory Board training and evaluation?

The Russia Corporate Governance Manual

The work of the Corporate Secretary is essential to the governance and administration of a company.²⁸⁵ The Corporate Secretary helps the governing bodies perform their duties and execute their responsibilities. This chapter focuses on the functions, qualifications, and authorities of the Corporate Secretary, and the role that the Corporate Secretary plays in implementing good corporate governance practices.

A. The Role of the Corporate Secretary

1. The Need for and Importance of the Corporate Secretary

Many companies have Supervisory Board secretaries. The Corporate Secretary, on the other hand, is a position relatively new to most Russian companies. Though not mentioned in legislation, considerable time is devoted to the Corporate Secretary's responsibilities in the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code).

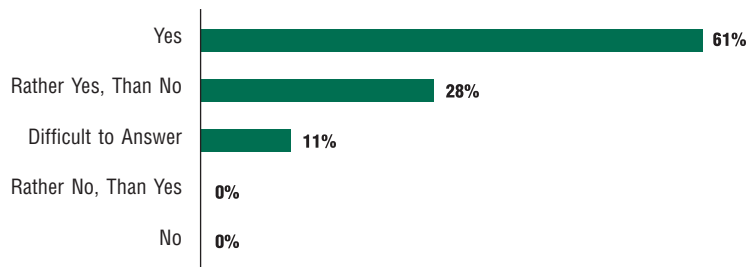
The Corporate Secretary ensures that the governing bodies follow existing internal corporate rules and policies, and changes them, or institutes new ones, when appropriate. The Corporate Secretary can also assist in establishing and maintaining clear communication between the various governing bodies of the company in compliance with the company's charter, by-laws, and other internal regulations. In addition, the Corporate Secretary helps to ensure that the governing bodies adhere to all relevant regulatory requirements, both domestic and possibly foreign. Accordingly, the Corporate Secretary, often acts as an adviser to directors and senior executives on regulatory requirements, listing rules, and legislation related to corporate governance. The Corporate Secretary may also identify gaps in corporate governance matters and propose ways to address such weaknesses.

Figures 1 and 2 demonstrate the increasingly prevalent view that the Corporate Secretary can play an important role in Russian companies, and also indicates the types of companies that might benefit the most from the creation of such a position.

²⁸⁵ Because this chapter is largely based on recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) on the Corporate Secretary, as well as international best practices, such recommendations are not highlighted in the "Best practices" boxes as in other chapters of this Manual to ensure user-friendly reading.

Company Practice in Russia: An increasing number of companies in Russia are introducing the position of Corporate Secretary. 47% of surveyed companies stated that they have a Corporate Secretary whose main function is to provide legal support to the Supervisory Board.²⁸⁶ An increasing number of companies also understand that Corporate Secretaries contribute to improved corporate governance.

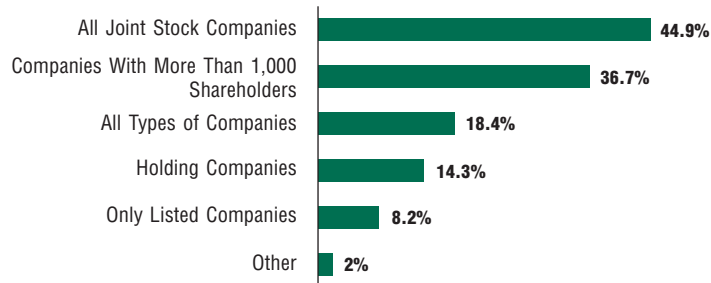
Figure 1: Does the Corporate Secretary's Work Improve Corporate Governance?



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

Most companies consider the position of Corporate Secretary of great importance for joint stock companies, especially for companies with more than 1,000 shareholders.

Figure 2: Types of Companies that Require a Corporate Secretary



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

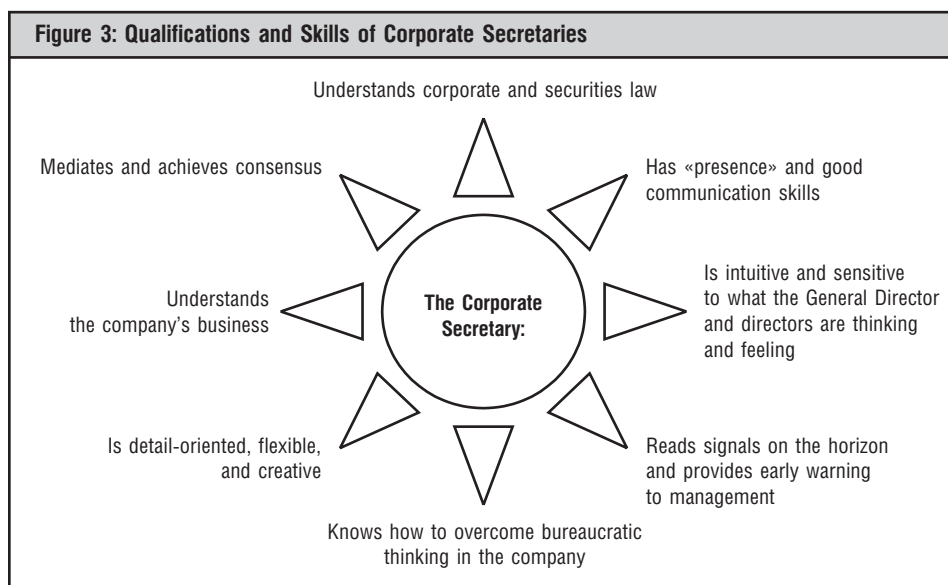
²⁸⁶ IFC — Russian Institute of Directors Survey on the Work of Corporate Secretaries in Russian Companies, April 2003 (see also: www.ifc.org/rcgp).

2. The Qualifications of a Corporate Secretary

A full-time staff member, exclusively dedicated to this task, can best fulfill the functions of the Corporate Secretary.²⁸⁷

When selecting a Corporate Secretary, the Supervisory Board should look for an individual with the highest qualifications and skills. The Supervisory Board will need to assess the candidate's education, work experience, professional qualities, and skills. The charter should outline the general requirements for candidates,²⁸⁸ while the by-laws for the corporate secretary should contain more detailed and specific criteria for evaluating such candidates. A detailed job description is the responsibility of the Supervisory Board, and needs to be developed in conjunction with the contract.

The core qualifications for Corporate Secretaries are illustrated in Figure 3.



Source: IFC, March 2004

²⁸⁷ FCSM Code, Introduction to Chapter 5.

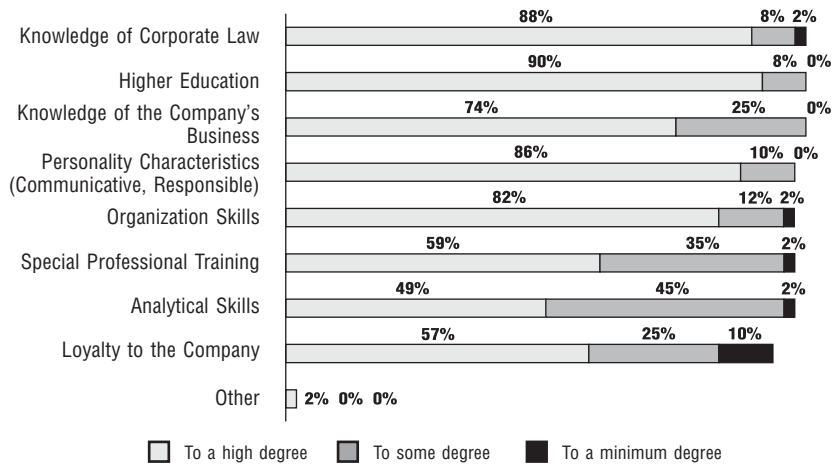
²⁸⁸ FCSM Code, Chapter 5, Section 2.2.1.

Chapter 6. The Role of the Corporate Secretary

The Corporate Secretary needs to be a person with an impeccable reputation.²⁸⁹ While the FCSM Code suggests that a company should avoid appointing individuals with a record of criminal or significant administrative offenses,²⁹⁰ it is better practice to exclude all such individuals from consideration for the position of Corporate Secretary.

Company Practice in Russia: Many Russian companies that have Corporate Secretaries appear to understand the required qualifications and mix-of-skills, as illustrated in Figure 4.²⁹¹

Figure 4: The Skills and Qualifications Required of a Corporate Secretary



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

More than 93% of surveyed companies feel that the Corporate Secretary would benefit from specialized training to more effectively meet the requirements of the position. Over 79% of companies were confident that it was necessary to develop a professional set of standards for Corporate Secretaries to ensure the highest degree of professionalism.

²⁸⁹ FCSM Code, Chapter 5, Section 2.2.2.

²⁹⁰ FCSM Code, Chapter 5, Section 2.2.2.

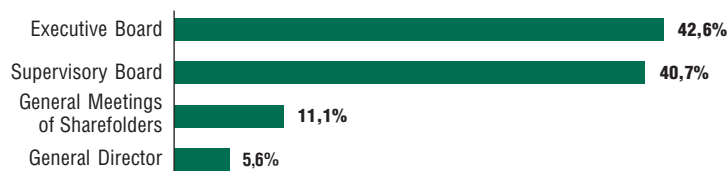
²⁹¹ IFC — RID Survey on the Work of Corporate Secretaries in Russian Companies, April 2003 (see also: www.ifc.org/rcgp).

3. The Independence of the Corporate Secretary

To act in the interests of the company and its shareholders at all times, the Corporate Secretary must be shielded from undue influence from management and other parties. The Corporate Secretary should thus be accountable to and controlled by the Supervisory Board.²⁹² He should not be an affiliated person of the company or its officers, e.g. a family member of the General Director or business partner of the company.²⁹³

Company Practice in Russia: Figure 5 shows that, in practice, most Corporate Secretaries surveyed have been subject to some degree of influence by executives that could compromise their independence. Approximately 43% report directly to either the General Director or the Executive Board.²⁹⁴

Figure 5: The Corporate Secretary Is Accountable to the:



Source: IFC-RID Survey on the Work of Corporate Secretaries, April 2003

The Corporate Secretary should devote sufficient time to his responsibilities and duties. Therefore, companies with a large number of shareholders, a large Supervisory Board and/or numerous Supervisory Board committees should prohibit the Corporate Secretary from concurrently holding other positions within the company or other legal entities.²⁹⁵ In smaller companies, the Legal Counsel or person holding a similar position, may carry out the duties of the Corporate Secretary.

²⁹² FCSM Code, Chapter 5, Section 2.1.

²⁹³ FCSM Code, Chapter 5, Section 2.2.4.

²⁹⁴ IFC — Russian Institute of Directors Survey on the Work of Corporate Secretaries in Russian Companies, April 2003 (see also: www.ifc.org/rcgp).

²⁹⁵ FCSM Code, Chapter 5, Section 2.2.3.

4. The Appointment of the Corporate Secretary

The procedure for selecting the Corporate Secretary should be set forth in the charter.²⁹⁶ The company's by-laws may, however, be better suited to regulate this issue in detail. The Corporate Secretary is designated either by appointment.²⁹⁷ Although the Company Law is silent about the authority to appoint a Corporate Secretary, the FCSM Code delegates this authority to the Supervisory Board. The Supervisory Board should define the terms and conditions of the employment contract, and specifically address the issues of remuneration, and termination.²⁹⁸

a) Information About Candidates

A nominee for the position of Corporate Secretary should provide the Supervisory Board with sufficient information to evaluate his candidacy. Candidates should, at a minimum, be required to provide information on:

- Educational background;
- Employment in other companies;
- Any relationship they may have with affiliated persons and/or major business partners of the company; and
- The number and type (class) of company shares they own, if any;
- Any other aspects and circumstances that may influence their performance as Corporate Secretary.

This information may be supplemented by personal references and interviews with directors and, in particular, with the Chairman, since a good personal rapport between the Chairman and other directors, and the Corporate Secretary will be important in maintaining effective working relationships. The Corporate Secretary should notify the Supervisory Board immediately of any changes in circumstances that may influence his ability to effectively serve as the company's Corporate Secretary.²⁹⁹

²⁹⁶ FCSM Code, Introduction to Chapter 5.

²⁹⁷ FCSM Code, Introduction to Chapter 5.

²⁹⁸ FCSM Code, Chapter 5, Section 2.1.

²⁹⁹ FCSM Code, Chapter 5, Section 2.2.5.

b) The Contract with the Corporate Secretary

The Supervisory Board may offer an employment contract to the Corporate Secretary. An employment contract can be a fixed, short-term contract.³⁰⁰ A fixed, short-term employment contract cannot be longer than five years.³⁰¹ As mentioned above, large companies are well advised to employ the Corporate Secretary on a full-time basis to allow them to properly execute their duties.

→ For a model employment contract with the Corporate Secretary, see Part VI, Annex 15.

c) The Office of the Corporate Secretary

Large companies may even find it necessary to establish an Office of the Corporate Secretary, staffed by several assistants. Additional staffing may be useful for companies with a large number of shareholders, a large Supervisory Board and/or numerous Supervisory Board committees.

Best Practice: Many foreign companies, particularly publicly listed companies, have an Office of the Corporate Secretary with several staff members. Figure 6 shows the situation in U.K. companies.

Figure 6: Correlation Between the Company's Size and the Number of Staff in the Corporate Secretary's Office

	Company Turnover (in £m)						
	All	Under 10	10-49	50-99	100-499	500-1,000	Over 1,000
	%	%	%	%	%	%	%
Number of Staff in the Corporate Secretary's Office							
1 Employee	25	58	50	10	20	5	5
2 Employees	23	23	21	43	27	18	8
3 Employees	23	16	26	24	22	32	19
4 Employees	11	3		13	19	14	14
5-10 Employees	16		3	10	11	27	49
Over 10 Employees	2				1	4	5

Source: Company Secretaries Responsibility and Salary Survey 2000/2001, Institute of Chartered Secretaries and Administrators

³⁰⁰ Labor Code, Article 58.

³⁰¹ Labor Code, Article 58; Article 59, Clause 16.

Chapter 6. The Role of the Corporate Secretary

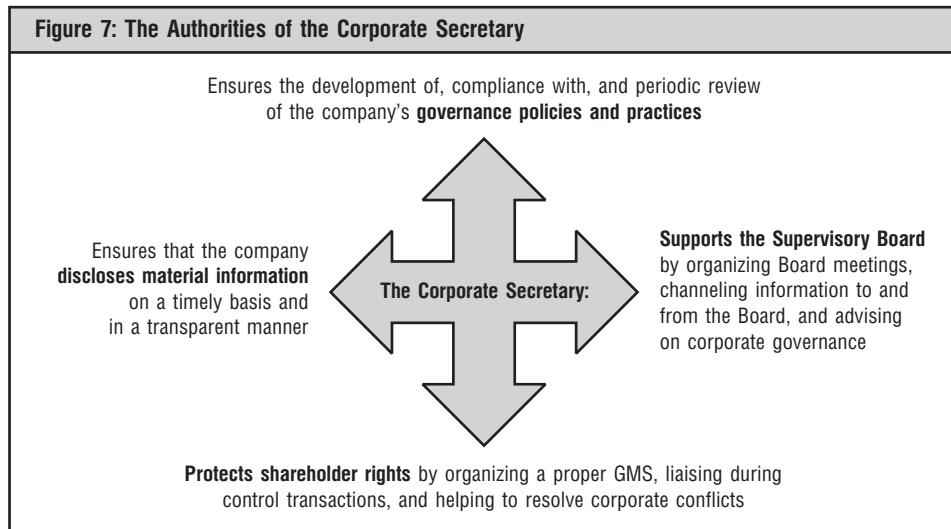
Should a company want to establish an Office of the Secretary, it may wish to specify the responsibilities of the Secretary's Office in the by-laws or other internal documents.³⁰²

B. The Authority of the Corporate Secretary

1. General Provisions

The Company Law does not discuss the position and authority of the Corporate Secretary. The FCSM Code recommends that the charter, by-laws or other internal documents define the Corporate Secretary's authority, and the duty of all governing bodies to assist the Corporate Secretary in discharging his duties.³⁰³

Figure 7 provides an overview of the Corporate Secretary's authorities.



Source: IFC, March 2004

³⁰² FCSM Code, Chapter 5, Section 1.6.2.

³⁰³ FCSM Code, Chapter 5, Section 1.6.1.

Company Practice in Russia: Figure 11, at the end of this Chapter, illustrates that the authority of Corporate Secretaries in Russian companies corresponds in practice to those recommended by the FCSM Code.

2. Developing Corporate Governance Policies and Practices

The Corporate Secretary is ideally suited to help the company and its Supervisory Board develop a system of corporate governance. More specifically, the Corporate Secretary can play an important role in the development of, compliance with, and periodic review of the company's governance policies and practices.

In developing an explicit and clearly stated plan to improve the company's corporate governance policies and practices, the Corporate Secretary lays the groundwork for reforms in this area. Perhaps more importantly, he can demonstrate the company's commitment to corporate governance by monitoring compliance with these policies, and informing the Supervisory Board of any breaches. Finally, by reviewing the company's policies on a regular basis (by keeping abreast of the latest developments in corporate governance, changes in the legal and regulatory framework, and international best practices) the Corporate Secretary ensures that the company's governance standards remain high and up-to-date.

3. Supporting the Supervisory Board

Most of the Corporate Secretary's time will be spent supporting the Supervisory Board as depicted in Figure 8.

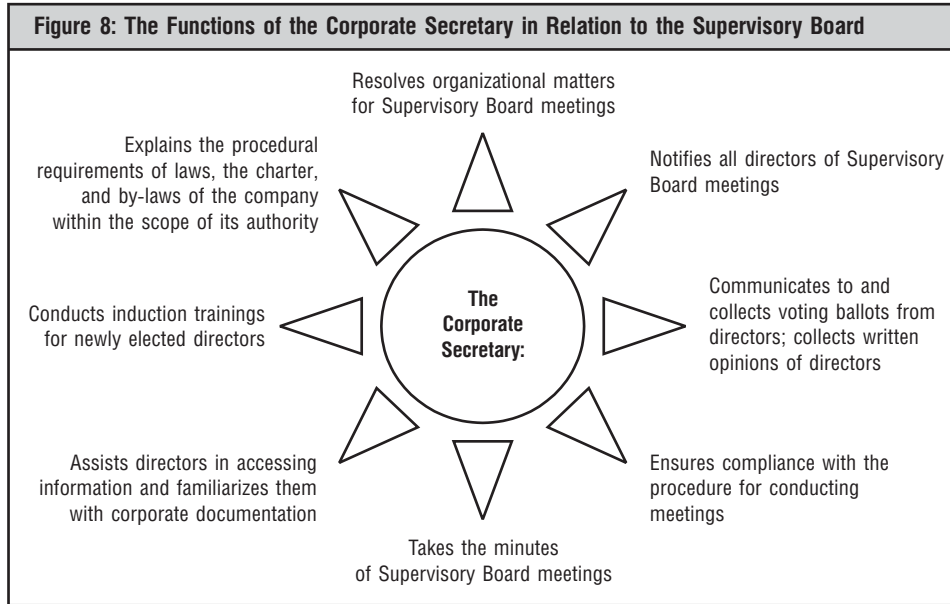
a) Organizing Supervisory Board Meetings

The Corporate Secretary is responsible for organizing Supervisory Board meetings.³⁰⁴ Although Supervisory Board meetings are ultimately the responsibility of the Chairman, the Corporate Secretary handles all administrative and organizational matters such as:

- Helping the Chairman to prepare the agenda;
- Developing presentations on substantive and procedural issues under discussion; and
- Preparing model briefs for boardroom discussions.

³⁰⁴ FCSM Code, Chapter 5, Section 1.2.1.

Chapter 6. The Role of the Corporate Secretary



Source: IFC, March 2004

It is also advisable that the Corporate Secretary give notice of Supervisory Board meetings to all directors and:³⁰⁵

- Distribute voting ballots to directors;
- Collect completed ballots and the written opinions of directors who are not physically present at the meeting; and
- Forward the ballots and written opinions to the Chairman.

In addition, the Corporate Secretary should help ensure that procedures for Supervisory Board meetings are followed. Along with the Chairman, the Corporate Secretary is advised to draft the minutes of Supervisory Board meetings.³⁰⁶

The Corporate Secretary should brief newly elected directors on:³⁰⁷

- The corporate procedures that regulate the operations of the Supervisory Board and other governing bodies;

³⁰⁵ FCSM Code, Chapter 5, Section 1.2.2.

³⁰⁶ FCSM Code, Chapter 5, Section 1.2.3.

³⁰⁷ FCSM Code, Chapter 5, Section 1.3.2.

The Russia Corporate Governance Manual

- The organizational structure and officers of the company;
- The company's internal documents;
- The decisions of the General Meeting of Shareholders (GMS) and the Supervisory Board that are in effect; and
- The availability of information required by directors for the proper discharge of their duties.

b) Providing the Supervisory Board with Access to Information

The Corporate Secretary plays a key role in assisting directors in obtaining the information they need for sound decision-making. The Corporate Secretary provides directors with timely and full access to:³⁰⁸

- The minutes of Executive Board meetings;
- Decisions approved by the General Director and the Executive Board;
- Documents from the General Director and the Executive Board;
- The minutes of meetings and reports prepared by the Revision Commission and the External Auditor; and
- Financial documents.

The company may wish to describe this role in the by-laws for the Supervisory Board, for the Corporate Secretary and/or on Information Disclosure.

c) Providing Legal Assistance to Directors on Governance Issues

The Corporate Secretary should assist directors with interpreting legal and regulatory acts related to corporate governance, including listing rules, corporate governance codes, and international regulations and developments. This also holds true for procedural issues regulated in the charter, by-laws, and/or other internal documents relating to preparing and conducting the GMS and Supervisory Board meetings, and on information disclosure.³⁰⁹ The Corporate Secretary should not, however, render legal advice that falls outside the scope of his duties. The duties of the Corporate Secretary should be clearly defined in relation to those of the company's Legal Counsel.

³⁰⁸ FCSM Code, Chapter 5, Section 1.3.1.

³⁰⁹ FCSM Code, Chapter 5, Section 1.3.3.

Chapter 6. The Role of the Corporate Secretary

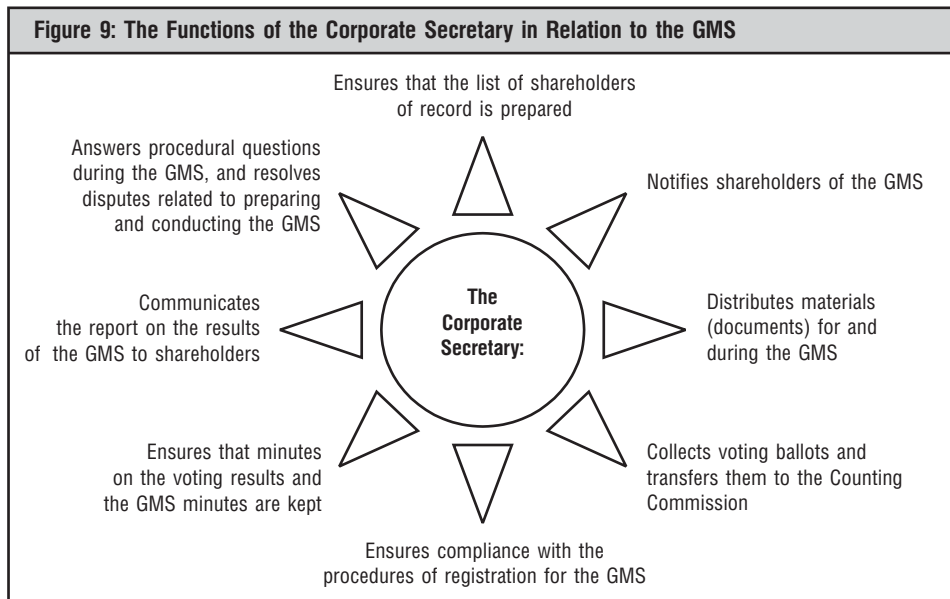
The Corporate Secretary should directly notify the Chairman of any possible violations of corporate procedures, if and when he becomes aware of such violations.³¹⁰ Such violations may include, among others:

- Alleged illegal acts or omissions of corporate officers or other corporate employees in fulfilling their legal duties and obligations; and
- Violations of procedures regulating the organization of the GMS, Supervisory Board meetings, the disclosure of information and protection of shareholder rights.

4. Protecting Shareholder Rights

a) Organizing the General Meeting of Shareholders

The Corporate Secretary plays an important role in organizing the GMS. Figure 9, shows the functions of the Corporate Secretary in this regard:³¹¹



Source: IFC, March 2004

³¹⁰ FCSM Code, Chapter 5, Section 1.7.

³¹¹ FCSM Code, Chapter 5, Section 1.1.

b) Liaising Between Shareholders During Control Transactions

The Corporate Secretary acts as a liaison between the controlling shareholder(s) in a buyout of common shares (and securities convertible into common shares) and the other shareholders of the company during a control transaction.³¹² The Corporate Secretary does this by ensuring that the mandatory offer is distributed to all shareholders. The Corporate Secretary should follow the procedures for the distribution of the mandatory offer to non-controlling shareholders as established in the Company Law.

c) Assisting in Enforcing Shareholder Rights

The Corporate Secretary:

- Ensures that the company takes proper notice of all duly submitted shareholder petitions; and
- Channels all duly submitted shareholder inquiries to the appropriate governing bodies and departments of the company.³¹³

The Corporate Secretary should try to resolve any conflicts, especially those concerning the maintenance of the shareholder register, promptly and fairly. If an External Registrar maintains the shareholder register, the Corporate Secretary should have the full authority to demand adequate and timely explanations regarding shareholder complaints directly from the Registrar. The terms and conditions of the agreement between the company and the Registrar should include the duty of the Registrar to give adequate and timely written explanations to the Corporate Secretary.³¹⁴

d) Assisting in Resolving Corporate Conflicts

The Corporate Secretary is responsible for recording corporate conflicts.³¹⁵ The Corporate Secretary registers inquiries, letters, or demands filed by shareholders, reviews these, and duly transmits them to the governing bodies that have the authority to resolve the conflict. The effectiveness of the company in preventing

³¹² FCSM Code, Chapter 6, Section 2.4.

³¹³ FCSM Code, Chapter 5, Section 1.5.

³¹⁴ FCSM Code, Chapter 5, Section 1.5.

³¹⁵ FCSM Code, Chapter 10, Section 1.1.2. The FCSM Code, Introduction to Chapter 10, defines corporate conflicts as conflicts between the governing bodies and shareholders, as well as conflicts among shareholders if such conflicts can substantially affect the company.

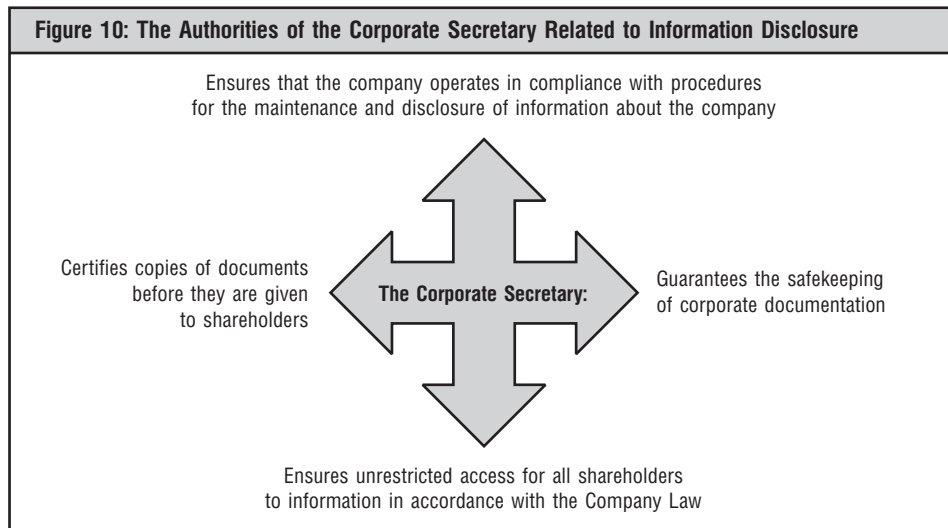
Chapter 6. The Role of the Corporate Secretary

and resolving conflicts depends on its responsiveness to all legitimate complaints. The Corporate Secretary also needs to periodically follow up on the status of complaints in order to make sure that they have been properly and fully addressed, and either resolved or rejected.

Conflicts can arise among Supervisory Board members, executives, and shareholders. The Corporate Secretary should notify the Chairman of any potential or existing conflict so that they can be dealt with appropriately.³¹⁶ Best practice suggests that the Corporate Secretary act as a liaison in case of conflicts among Supervisory Board members.³¹⁷

5. Providing for Information Disclosure and Transparency

The Corporate Secretary plays an important role in helping the Supervisory Board and General Director fulfill their respective obligations to disclose material information on a timely basis to the company's shareholders and financial markets. The Corporate Secretary's authority related to information disclosure is shown in Figure 10.³¹⁸



Source: IFC, March 2004

³¹⁶ FCSM Code, Chapter 4, Section 3.1.4.

³¹⁷ FCSM Code, Chapter 3, Section 3.1.4.

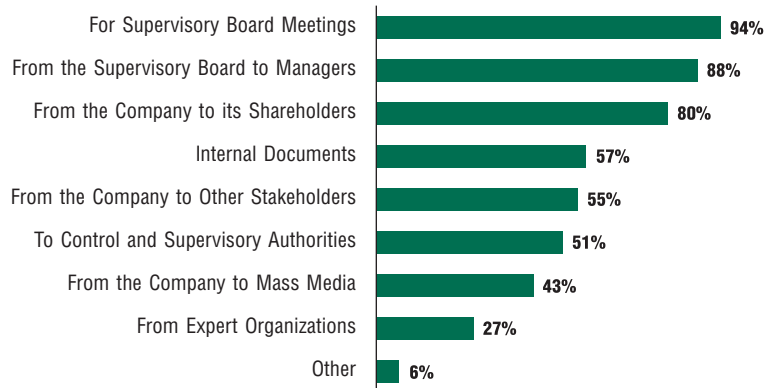
³¹⁸ FCSM Code, Chapter 5, Section 1.4; Chapter 7, Section 3.1.1.

The Russia Corporate Governance Manual

The Corporate Secretary also helps to ensure for transparent control procedures. More specifically, he acts as a liaison between the Revision Commission and the Supervisory Board and its Audit Committee, if established, when the Revision Commission conducts an inspection of the financial and economic activities of the company.³¹⁹ The results of the Revision Commission's inspection should be presented to the Supervisory Board's Audit Committee, and the initiator of the inspection together with the Corporate Secretary, within three days after the inspection of the Revision Commission has been completed.

Company Practice in Russia: Figure 11 illustrates the views of some Russian companies on the role that the Corporate Secretary plays in providing information about the company.³²⁰ Most companies agree that the Corporate Secretary should provide information in support of Supervisory Board meetings, and to management and shareholders. There is, however, considerably less agreement with respect to the Corporate Secretary's role in providing other types of information to outsiders, for example, control and supervisory authorities.

Figure 11: Percentage of Companies Where the Corporate Secretary Coordinates Information Flows



³¹⁹ FCSM Code, Chapter 8, Section 3.1.5.

³²⁰ IFC — Russian Institute of Directors Survey on the Work of Corporate Secretaries in Russian Companies, April 2003 (see also: www.ifc.org/rcgp).

C. Professional Associations of Corporate Secretaries

The position of Corporate Secretary is fairly new in the Russian market, although an increasing number of companies are establishing this position. This position requires a unique skills-set, as shown in Figure 3 above. Ad-hoc efforts are currently being implemented to promote the benefits of having a Corporate Secretary; training efforts are also being organized to train the nascent profession. In foreign markets, professional associations or institutes of corporate secretaries often perform this role.³²¹ Typically, such organizations unite corporate secretaries and have several functions, such as to:

- Promote good governance, management, and efficient administration of companies;
- Support and protect the character, status, and interests of member Corporate Secretaries;
- Promote the efficiency and usefulness of the service and standard of professional conduct provided by Corporate Secretaries;
- Train Corporate Secretaries;
- Comment on proposed and existing laws, rules, and regulations in areas of particular interest to member Corporate Secretaries; and
- Promote and assist in the voluntary exchange of information and experience relating to the duties, problems, and practices of Corporate Secretaries and their companies.

Establishing such a professional association in Russia would be an important step towards effectively promoting the introduction of Corporate Secretaries in Russian companies.

³²¹ For more information, see www.icsa.org.uk/news/guidance_intro.php.



INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group



Good corporate governance contributes to a company's competitiveness and reputation, facilitates access to capital markets, and thus helps develop financial markets and spur economic growth. With this in mind, the International Finance Corporation and the U.S. Department of Commerce have combined their efforts to provide Russian managers, directors, and shareholders with a practical tool to implement good corporate governance practices – the Russia Corporate Governance Manual. This Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. It follows the recommendations of the FCSM's Code of Corporate Conduct and refers to internationally accepted principles of good corporate governance.

"Corporate governance is vital to the interests of every economy, and government has a role to play in establishing the framework for reform - but it is companies that have the tough job of putting governance reform into practice. This is where the Corporate Governance Manual can provide excellent help. It offers a comprehensive workbook for company directors, officers, and advisers in taking up the challenge of corporate governance improvement. Shareholders and stakeholders alike should applaud IFC for bringing practical, and professional advice within reach of every boardroom."

Anne Simpson, Manager,
Global Corporate Governance Forum

"Corporate governance reform in Russia is the continuation of the more general processes of change affecting the country as a whole. Taken together, these developments have created a new environment, new rules regulating the relationships between the market and regulators, between shareholders, shareholders and managers, etc. In the business community there is a growing awareness of the benefits of corporate governance reform, and companies are now working on improving the quality of their corporate governance ..."

Ruben K. Vardanian, President of Troika Dialogue; Chairman of the Board,
OJSC Rosgosstrakh; and Chairman of the RSPP Corporate Governance Committee

"Good corporate governance is a key driver of financial transparency and managerial accountability, essential ingredients for national prosperity in a global economy. We congratulate the U.S. Department of Commerce and the International Financial Corporation of the World Bank for their initiative in bringing about the publication of the Russia Corporate Governance Manual."

Andrew B. Somers, President,
American Chamber of Commerce in Russia

Questions on corporate governance should be addressed to the IFC Russia Corporate Governance Project, via CGPRussia@ifc.org

An electronic version of the Manual is available on the website of the International Finance Corporation under www.ifc.org/rcgp and the U.S. Department of Commerce under www.mac.doc.gov/ggp

The Russia Corporate Governance Manual

III Part III Shareholder Rights



Prepared and Published by the International Finance Corporation and the U.S. Department of Commerce

In Partnership with the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs and the Swiss State Secretariat for Economic Affairs



The Russia **Corporate Governance** Manual

Part III

Shareholder Rights

Prepared and Published by the International Finance Corporation
and the U.S. Department of Commerce

In Partnership with the Agency for International Business
and Cooperation of the Dutch Ministry of Economic Affairs
and the Swiss State Secretariat for Economic Affairs

First edition: 10,000 copies in Russian, 1,500 copies in English.

Published in 6 Parts

Printed in Moscow, Russia.

ISBN 5-9614-0085-9

Copyright © 2004 International Finance Corporation
2121 Pennsylvania Ave. NW, Washington, DC 20433, United States of America
A Member of the World Bank Group

Design copyright © 2004 Alpina Business Books

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, for commercial purposes without the prior permission of the International Finance Corporation.

Chapter 7

An **Introduction** to **Shareholder Rights**



Table of Contents

A. GENERAL PROVISIONS ON SHAREHOLDER RIGHTS	4
1. <i>Reasons for Being a Shareholder</i>	4
2. <i>Types of Shares</i>	5
3. <i>Types of Shareholder Rights</i>	8
B. SPECIFIC SHAREHOLDER RIGHTS	8
1. <i>The Right to Vote</i>	8
2. <i>The Right to Appeal Decisions of the General Meeting of Shareholders</i>	12
3. <i>The Right to Receive Information About the Company</i>	13
4. <i>The Right to Freely Transfer Shares</i>	15
5. <i>Pre-Emptive Rights</i>	15
6. <i>The Right to Demand the Redemption of Shares</i>	18
7. <i>Shareholder Rights During the Liquidation of the Company</i>	19
8. <i>The Right to Review the Shareholder List</i>	21
9. <i>The Right to File a Claim on Behalf of the Company</i>	21
C. THE RIGHTS OF THE STATE AS A SHAREHOLDER	22
D. THE SHAREHOLDER REGISTER	23
1. <i>Maintaining the Shareholder Register</i>	23
2. <i>The Contents of the Shareholder Register</i>	24
3. <i>Accessing the Shareholder Register</i>	25
E. THE PROTECTION OF SHAREHOLDER RIGHTS	25
1. <i>Guarantees in the Company Law</i>	26
2. <i>Judicial Protection</i>	26
3. <i>Protection by the Federal Commission for the Securities Market</i>	27
4. <i>Non-Governmental Organizations for the Protection of Shareholder Rights</i>	28
5. <i>Shareholder Activism and Collective Action</i>	28
6. <i>Shareholder Agreements</i>	29
F. RESPONSIBILITIES OF SHAREHOLDERS	30

The Chairman's Checklist

- ✓ Does the company charter protect shareholder rights as stipulated by the Company Law and recommended by the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code)? Do all directors take appropriate measures to ensure that these rights are respected?
- ✓ Do all directors take measures to encourage shareholders to exercise their rights, in particular, the right to vote? Do shareholders exercise their rights collectively?
- ✓ Does the Supervisory Board provide shareholders with free access to company information beyond the requirements of the Company Law? Are shareholder requests processed properly and on time?
- ✓ Does the Supervisory Board ensure that an independent External Registrar maintains the shareholder register? Are shareholders provided with full and accurate information regarding their account from the Registrar?
- ✓ Does the Supervisory Board encourage shareholders to protect their rights by using all the mechanisms provided by legislation and the FCSM Code?
- ✓ Does the Supervisory Board ensure that the charter and other internal documents do not stipulate obligations of shareholders other than the ones that are clearly defined by the Company Law?

Shareholders rely on the rights they receive in return for their investment. For most shareholders, this includes the right to participate in the profits of the company. Other rights are also important, such as the right to vote on the Supervisory Board's composition, approve charter amendments and capital changes, approve the annual report and financial statements, and the right to access information about the company and its activities. Through these rights, shareholders ensure that the managers of the company do not misappropriate their investment.

The quality of investor protection has several corporate governance implications, such as the depth of capital markets, ownership patterns, dividend policy, and the efficiency of allocating resources.¹ Where laws are protective of shareholders and well enforced, shareholders are willing to invest their capital, and financial markets are broader and more valuable. In contrast, where laws do not adequately protect shareholders, the development of financial markets is stunted. When shareholder rights are protected by the law, and indeed by the company itself, outside investors are willing to pay more for financial assets such as equity. They pay more because they recognize that, with better legal protection, more of the firm's profit will return to them as dividends and/or capital gains as opposed to being expropriated by managers or controlling shareholders.

The mere “law on the books” is not necessarily sufficient to ensure that shareholder rights are adequately protected. Effective enforcement is also required. Tantamount to shareholder rights protection is the company's behavior itself — especially for Russian companies that do not benefit from an effective enforcement regime and continue to be blemished by the many corporate governance scandals during the privatization years.

This chapter provides an overview of shareholder rights and the rules a company must follow to protect these rights. Some specific rights, such as the participation in the General Meeting of Shareholders (GMS), are discussed in detail in other chapters of this Manual.

A. General Provisions on Shareholder Rights

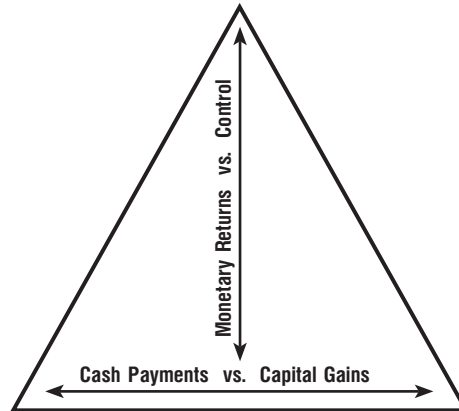
1. Reasons for Being a Shareholder

Investors purchase company shares for a variety of reasons. The most common reasons are shown in Figure 1.

¹ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, Investor Protection and Corporate Valuation, National Bureau of Economic Research, Working Paper 7403, October 1999.

Figure 1: Common Reasons for Becoming a Shareholder

Control: Shares provide investors with the opportunity to legally control the company and influence decision-making by nominating directors and, possibly, management. The greater the number of voting shares a shareholder holds, the greater the influence he wields.



Dividends: Dividends play an important role in the decision to invest. Regular dividend payments, especially if an investor holds a portfolio of shares, can generate predictable cash flows.

Capital Gains: Investors purchase shares to benefit from capital growth. Unlike dividends, shares need to be sold to realize the gains represented by rising share prices.

Source: IFC, March 2004

2. Types of Shares

Legislation specifies two types of shares: common and preferred. A company is required to issue common shares.² In addition, a company may also issue preferred shares.

→ For more information on charter capital and shares, see Chapters 9 and 11.

a) Common Shares

Owners of common shares have the right to participate in the decision-making of the company, most commonly exercised by voting during the GMS. They also have the right to share in the profits of the company either through dividends or through capital gains.

² Law on Joint Stock Companies (LJSC), Article 25, Clause 2, Paragraph 1.

Common shares have certain characteristics. The charter defines the number, nominal value, and rights attached to common shares.³ The aggregate nominal value of all issued common shares cannot be less than 75% of the charter capital.⁴ All common shares must have the same nominal value and must provide the same rights to their owners. Common shares cannot be divided into different classes or be converted into other securities of the company.⁵

b) Preferred Shares

A company has the right to issue various classes of preferred shares. The total nominal value of preferred shares of all classes cannot exceed 25% of the charter capital.⁶ All preferred shares of the same class must have the same nominal value and must provide the same rights to their owners.⁷ In contrast to common shares, preferred shares can be divided into classes depending on the rights and preferences attached to them.

Preferred shares can give their owners preferential rights associated with the distribution of dividends, liquidation value of shares, and voting rights attached to shares under specific circumstances.

The charter must specify the number of preferred shares issued by the company, as well as the nominal value and rights attached to preferred shares. In addition, the charter must specify the amount of dividends and/or the liquidation value of preferred shares or, alternatively, the procedure for determining the amount of dividends and the liquidation value of preferred shares.⁸

The charter can provide preferred shareholders of a specific class with the opportunity to convert their shares into common shares or other classes of preferred shares.⁹

The Company Law distinguishes preferred shares according to the dividend rights that they grant:¹⁰

³ LJSC, Article 11, Clause 3; Article 27, Clause 1.

⁴ LJSC, Article 25, Clause 2.

⁵ LJSC, Article 31, Clauses 1 and 3.

⁶ LJSC, Article 25, Clause 2.

⁷ LJSC, Article 32, Clause 1, Paragraph 2.

⁸ LSJC, Article 32, Clause 2.

⁹ LJSC, Article 32, Clause 3, Paragraph 1.

¹⁰ LJSC, Article 32, Clause 2, Paragraph 3.

Chapter 7. An Introduction to Shareholder Rights

- **Cumulative:** the charter can provide that unpaid dividends be accumulated and paid on a later date; and
- **Non-cumulative:** if the charter is silent, unpaid dividends shall not be accumulated.

The principal differences between common and preferred shares are summarized in Figure 2.

Figure 2: Comparison of Common and Preferred Shares		
	Common Shares	Preferred Shares
Mandatory	Yes , must always be issued	No , are optional
What is the percentage of shares that can be issued?	A minimum of 75% of the charter capital is mandatory	A maximum of 25% of the charter capital is allowed
Can different classes of shares be issued?	No , only one class of common shares may be issued	Yes , different classes of preferred shares can be issued
Can this type of share be converted into other securities?	No , common shares cannot be converted into preferred shares or other securities	Yes , preferred shares may be converted into common shares, if so provided for in the charter
Do shareholders have the right to vote during the GMS?	Yes , with certain exceptions	No , except under certain circumstances. → See Section B.1 of this Chapter
Can the charter grant additional rights to shareholders?	Yes	Yes

Source: IFC, March 2004

c) Voting Shares

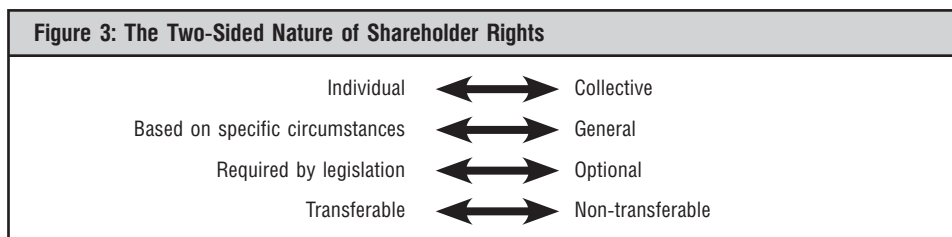
The Company Law also defines the term “voting share.” Common shares are always voting shares. Preferred shares can be voting shares under certain circumstances.¹¹

→ For more information on voting shares, see Chapter 8, Section C.11.

¹¹ LJSC, Article 49, Clause 1, Paragraph 2.

3. Types of Shareholder Rights

The Company Law distinguishes between the rights of individual shareholders and the rights held collectively by a group of shareholders. It is also possible to distinguish shareholder rights according to their nature. Some rights relate to the decision-making process and the organization of the company. Others relate to the capital and the return on shareholder investment (see Figure 3).



Source: IFC, March 2004

Figure 4 summarizes the rights of shareholders by types of shares, and by the percentage of shares held. Neither the company nor its shareholders can change these rights. The charter can, however, provide additional rights to shareholders as long as they are not prohibited by legislation.

B. Specific Shareholder Rights

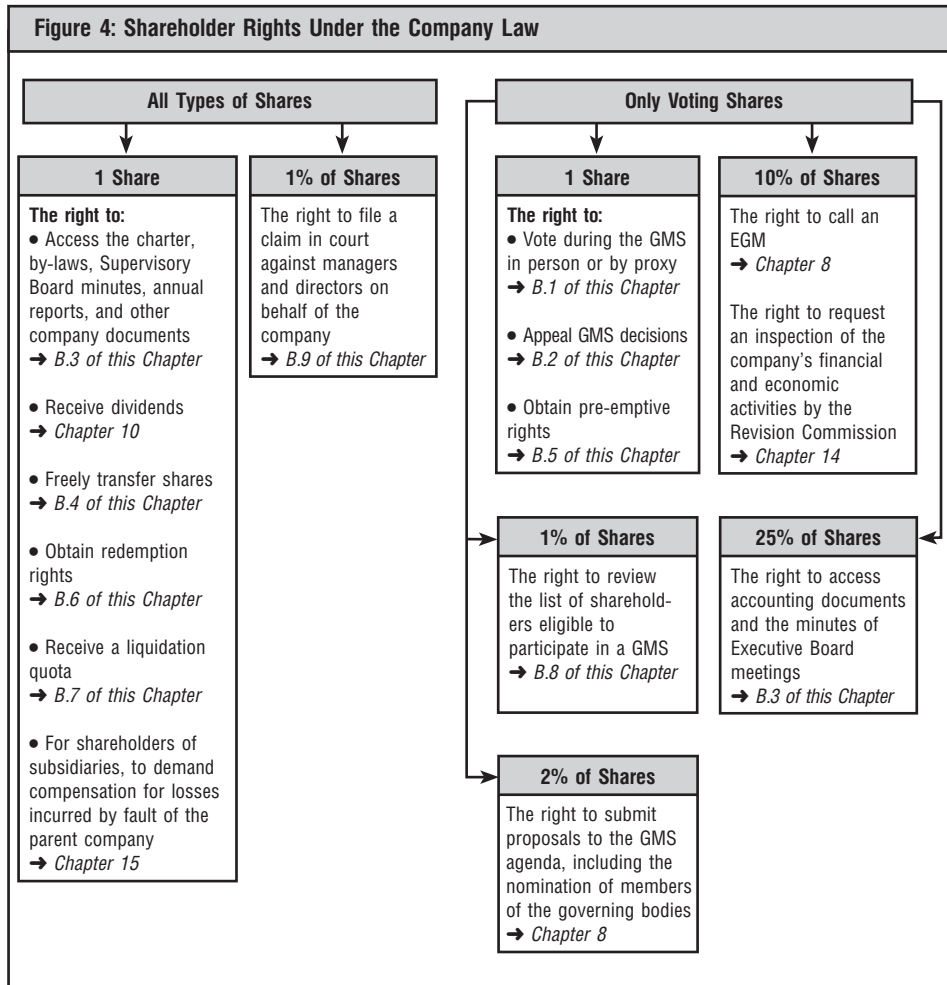
1. The Right to Vote

Shareholders can participate in the decision-making of the company through their right to vote during the GMS. Shareholders can, for example, control the long-term direction of the company by electing Supervisory Board members and by deciding on important matters that fall within the authority of the GMS.

The right to vote can be exercised personally or by a power of attorney.¹² A power of attorney provides its authorized holder (proxy) with the right to act on behalf of the shareholder and to make any decision the shareholder could have

¹² LJSC, Article 57, Clauses 1–2.

Chapter 7. An Introduction to Shareholder Rights



Source: IFC, March 2004

made during the GMS. Except for limitations provided by legislation,¹³ any individual can serve as a proxy as long as this person is given a written and duly executed power of attorney.

→ For more information on the GMS, see Chapter 8.

¹³ Civil Code (CC), Article 21.

a) The Right to Vote Common Shares

Common shares grant voting rights to their holders. However, there are some circumstances when common shares become non-voting. These circumstances are summarized in Table 1.

Table 1: Non-Voting Common Shares	
Preconditions	Legal Consequences
<p>Failure to fully pay for shares: When common shares placed to the company's founders are not fully paid for, unless the charter provides otherwise.</p>	Precludes voting on any issue during the GMS ¹⁴
<p>Limitations on the number of votes and/or shares that a single shareholder can possess: When a shareholder has more votes than the maximum established by the charter that can be used during the GMS</p>	Precludes casting more than the maximum number permitted by the charter on any issue during the GMS ¹⁵
<p>Treasury shares:¹⁶ When the company possesses issued common shares of the company because:</p> <ul style="list-style-type: none"> • The founders have not fully paid the shares within the period that they have to fully pay the common shares; or • The company redeemed common shares; or • The company fought back common shares. 	Precludes voting on all issues during the GMS
<p>The approval of related party transactions: Common shares that are owned by a shareholder who is an interested party in a related party transaction.</p>	Precludes voting on the approval of the related party transaction in which the shareholder is an interested party ¹⁷
<p>Waiver to extend the buy-out offer in control transactions:</p> <ul style="list-style-type: none"> • When common shares are owned by a controlling shareholder, including his affiliated parties; and • When the company has more than 1,000 common shareholders. <p>→ See Chapter 12.</p>	Precludes voting on the waiver of the controlling shareholder's obligation to buy-out the minority shareholders ¹⁸

¹⁴ LJSC, Article 34, Clause 1, Paragraph 3.

¹⁵ LJSC, Article 11, Clause 3.

¹⁶ LJSC, Article 34, Clause 1, Paragraph 5; Article 72, Clause 3, Paragraph 2; Article 76, Clause 6, Paragraph 2. Shares are commonly reacquired by a corporation to be retired or resold at a later date. Treasury shares are issued, but not outstanding, and are not taken into consideration when calculating earnings per share or dividends, or for voting purposes.

¹⁷ LJSC, Article 83, Clause 4.

¹⁸ LJSC, Article 80, Clause 2, Paragraph 2.

Table 1: Non-Voting Common Shares	
Preconditions	Legal Consequences
<p>Violation of rules on the acquisition of shares in control transactions:</p> <ul style="list-style-type: none"> • When a person (or a group of affiliated persons) acquires common shares that are equal to or exceed a total of 30% of common shares; and • When this person (or this group of affiliated persons) has not followed the procedures specified by the Company Law when acquiring these shares; and • When the company has more than 1,000 common shareholders. 	<p>Common shares (the acquired shares that cause the holdings to equal or exceed 30%) cannot be voted at the GMS¹⁹</p>
<p>Violation of rules on the acquisition of shares in control transactions:</p> <ul style="list-style-type: none"> • Each time a person (or a group of affiliated persons) acquires 5% of common shares; and • This person (or this group of affiliated persons) already possesses at least 30% of common shares; and • When this person (or this group of affiliated persons) has not followed the procedures specified by the Company Law when acquiring the additional 5% of common shares; and • When the company has more than 1,000 common shareholders. 	<p>Precludes voting on all issues during the GMS²⁰</p>
<p>Election and dismissal of Revision Commission members: When common shares are held by Supervisory Board members, the General Director, and Executive Board members.</p>	<p>Precludes voting on the election of Revision Commission members²¹</p>

b) The Right to Vote Preferred Shares

The Company Law limits the right of preferred shareholders to participate in voting during the GMS. Preferred shareholders normally do not have voting rights at the GMS except under specific circumstances when their rights are affected. These circumstances are summarized in Table 2.

¹⁹ LJSC, Article 80, Clause 6.

²⁰ LJSC, Article 80, Clause 7.

²¹ LJSC, Article 85, Clause 6, Paragraph 2.

Table 2: When Preferred Shares Become Voting Shares	
Circumstances	When Owners of Preferred Shares Can Vote
Reorganization or liquidation	The owners of preferred shares can vote on agenda items that are directly related to the reorganization and liquidation of the company ²²
Charter amendments that restrict preferred shareholder rights of a specific class	The owners of preferred shares of a specific class can vote on charter amendments restricting the rights attached to preferred shares of that specific class ²³
Non-declaration of dividends on non-cumulative preferred shares	The owners of non-cumulative preferred shares have the right to vote on all agenda items during the GMS until the first payment of dividends is made in full ²⁴
Partial payment of dividends on non-cumulative preferred shares	The owners of non-cumulative preferred shares have the right to vote on all agenda items during the GMS until the first payment of dividends is made in full ²⁵
Non-declaration of dividends on cumulative preferred shares	The owners of cumulative preferred shares have the right to vote on all agenda items during the GMS until the full payment is made of all accumulated dividends ²⁶
Partial payment of dividends on cumulative preferred shares	The owners of cumulative preferred shares have the right to vote on all agenda items during the GMS until the full payment is made of all accumulated dividends ²⁷

2. The Right to Appeal Decisions of the General Meeting of Shareholders

A shareholder has the right to appeal decisions of the GMS in court when:²⁸

- The decision is adopted in violation of legislation or charter provisions; and
- The decision violates the rights and lawful interests of the shareholder; and

²² LJSC, Article 32, Clause 4, Paragraph 1.

²³ LJSC, Article 32, Clause 4, Paragraph 2.

²⁴ LJSC, Article 32, Clause 5, Section 1.

²⁵ LJSC, Article 32, Clause 5, Section 1.

²⁶ LJSC, Article 32, Clause 5, Section 2.

²⁷ LJSC, Article 32, Clause 5, Section 2.

²⁸ LJSC, Article 49, Clause 7.

- The shareholder did not participate in the GMS or voted against this decision of the GMS.

A shareholder appealing a decision of the GMS must file his appeal with the court within six months after the shareholder learned or should have learned about the decision.²⁹

→ *For more information on appealing decisions of the GMS, see Chapter 8, Section E.5 and Part V, Chapter 17, Section B.*

3. The Right to Receive Information About the Company

The Company Law provides shareholders with the right to receive information about the company based on the percentage of shares held. Distinctions are made between any shareholder and a shareholder (or a group of shareholders) owning at least 25% of voting shares.

Any shareholder has the right to receive information about the activities of a company. The charter and by-laws can specify the procedures that the company and shareholders must follow for the distribution of information and documents. The information rights of common and preferred shareholders are depicted in Figure 5.³⁰

A company must also provide shareholders (or a group of shareholders) holding at least 25% of voting shares access to the:³¹

- Accounting documents;³² and
- Minutes of the Executive Board meetings.

The company must provide shareholders the opportunity to familiarize themselves with the above-mentioned documents at the premises of the company within seven days after a request was received.³³

²⁹ LJSC, Article 49, Clause 7.

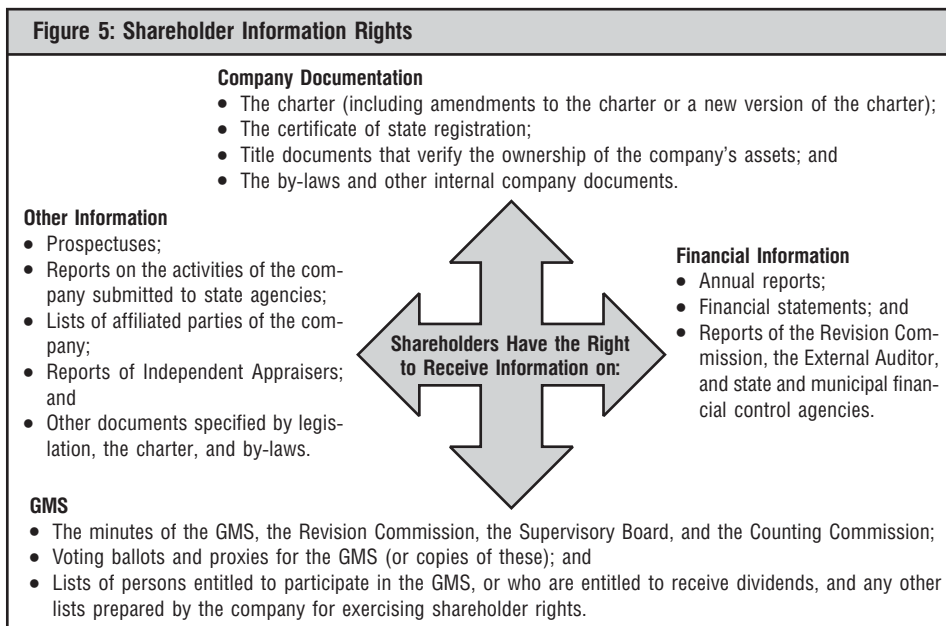
³⁰ LJSC, Article 89, Clause 1; Article 91.

³¹ LJSC, Article 91, Clause 1, Paragraph 1.

³² The Company Law is not clear about the definition of “accounting documents.” The primary accounting documents (which serve as the basis for the balance sheet and other financial statements) could be considered “accounting documents” pursuant to LJSC, Article 91, Clause 1, Paragraph 1. However, the primary accounting documents are also defined as confidential commercial information in accordance with the Law on Accounting, Article 9.

³³ LJSC, Article 91, Clause 2.

Figure 5: Shareholder Information Rights



Source: IFC, March 2004

Best Practices: It is good practice to provide the requested documents to the shareholders for their examination at the company's premises within five days after the request is received.³⁴

Upon the request of any shareholder, a company must also provide a copy of documents specified in Figure 5.³⁵

Best Practices: Although the Company Law does not provide a specific time frame within which copies must be given to shareholders, it is recommended that this be done within five days.³⁶

³⁴ Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 7, Section 3.1.1.

³⁵ LJSC, Article 91, Clause 2. The LJSC is not clear when the company must provide copies of these documents to shareholders.

³⁶ FCSM Code, Chapter 7, Section 3.1.1.

The company cannot charge shareholders more than the actual costs of copying the requested documents.³⁷

→ For more information on information disclosure, see Part V, Chapter 13.

4. The Right to Freely Transfer Shares

The owners of common and preferred shares of a company have the right to sell their shares at any time and at any price, without the consent of, or any pre-emptive right on the part of, the company and other shareholders.³⁸ This means that the company cannot restrict the free transferability of shares, regardless of type and class. Any charter provisions purporting to restrict the transferability of common and preferred shares are null and void.³⁹

→ For more information on the transfer of shares, see also Chapter 11.

5. Pre-Emptive Rights

In certain circumstances, shareholders have pre-emptive rights, which allow them to purchase shares or convertible securities on a priority basis before they are offered to third parties. Thus, a shareholder has the right to purchase newly issued shares in proportion to the number of shares he owns at the time the company decides to issue new shares or convertible securities of the same type and class.⁴⁰

The pre-emptive rights of shareholders cannot be detached from shares. This means that a shareholder cannot transfer his pre-emptive rights to another shareholder. Pre-emptive rights are only transferable together with shares.

a) The Purpose of Pre-Emptive Rights

Pre-emptive rights ensure that all shareholders of the same class are treated equally. They provide the opportunity to purchase new shares when the company wants to increase its charter capital. Pre-emptive rights help protect shareholders from dilution, which can result in losing some of their rights due to the decrease of the percentage of shares they hold.

³⁷ LJSC, Article 91, Clause 2.

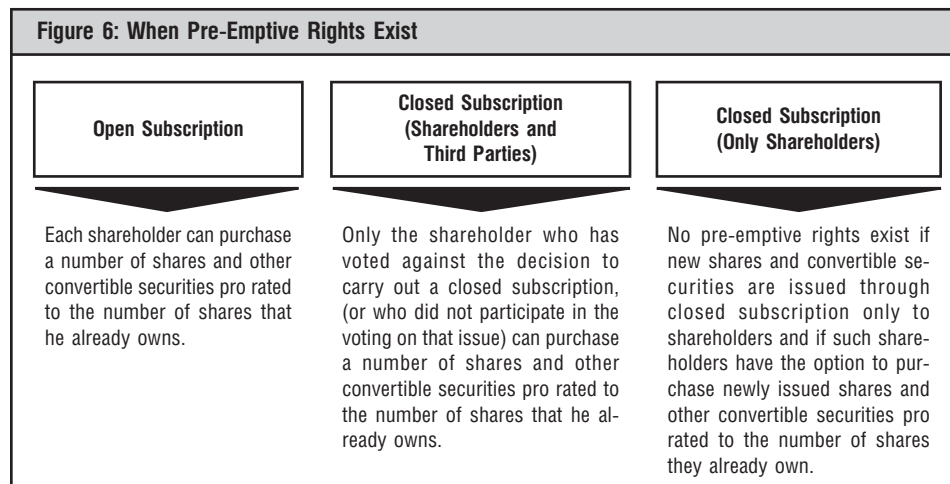
³⁸ Note that this Manual refers to open joint stock companies.

³⁹ LJSC, Article 7, Clause 2, Paragraph 3.

⁴⁰ LJSC, Article 40, Clause 1.

b) When Pre-Emptive Rights Exist

The existence of pre-emptive rights depends on the type of subscription (open or closed) and whether it is limited to the existing shareholders or whether third parties can purchase new shares. Figure 6 specifies the cases in which shareholders have pre-emptive rights.



Source: IFC, March 2004

→ For more information on open and closed subscriptions, see Chapter 9, Section B.3.

c) Pre-Emptive Rights and Fractional Shares

When shareholders exercise pre-emptive rights, fractions of shares (fractional shares) can result.⁴¹

A fractional share provides its owner a fraction of the rights attached to the full share of the specific type and class. For purposes of calculating the amount of the charter capital, all fractional shares must be added together. If, as a result,

⁴¹ LJSC, Article 25, Clause 3, Paragraph 1. For example, shareholder A has 123 common shares out of 1,000 common shares, which represent 12.3% of all common shares. If the company is placing 250 additional common shares, shareholder A will be entitled to purchase 12.3% of 250 shares or 30.75 shares.

a fractional share is left, the number of issued shares in the charter must indicate the fraction of a full share.⁴²

Fractional shares circulate together with full shares. If a shareholder acquires two or more fractional shares of the same type and class, these shares must be added together to create one full and/or one fractional share which is equal to the sum of these fractional shares.⁴³

d) The Procedure for Exercising Pre-Emptive Rights

The list of shareholders with pre-emptive rights must be compiled based on the shareholder register as of the date of the decision to issue additional shares or other convertible securities. The shareholders included in the shareholder list that have pre-emptive rights must be notified in the same manner as the notification of the GMS.⁴⁴ This notification must include information on:⁴⁵

- The number of shares or convertible securities to be issued;
- The placement price or the procedure for determining the placement price (including the placement price or the procedure for determining the placement price of additionally issued shares for shareholders with pre-emptive rights);
- The procedure for determining the number of shares and convertible securities that each shareholder has the right to purchase; and
- The period within which pre-emptive rights must be exercised.⁴⁶

A shareholder that has pre-emptive rights can exercise these rights fully or in part by submitting to the company:⁴⁷

⁴² LJSC, Article 25, Clause 3, Paragraph 3. If shareholder A owns 12.3 shares, shareholder B 34.5 shares, shareholder C 40.6 shares, and the remaining shareholders collectively own 50 shares, the charter must state the following number of issued shares of the company: $12.3 + 34.5 + 40.6 + 50 = 137.4$ shares.

⁴³ LJSC, Article 25, Clause 3, Paragraph 4. For example, shareholder A purchases one fractional share of 0.3 and the second fractional share of 0.6. As the result, shareholder A has one fractional share of 0.9.

⁴⁴ LJSC, Article 41, Clause 1, Paragraph 1. *See also: Chapter 8, Section B.4.*

⁴⁵ LJSC, Article 41, Clause 1, Paragraph 2.

⁴⁶ LJSC, Article 41, Clause 1, Paragraph 2 provides that this period cannot be less than 45 days from the date of submitting (presenting in person) or publishing the notification on pre-emptive rights. Before the expiration of this period, the company does not have the right to issue shares and other convertible securities to persons other than the shareholders who have pre-emptive rights.

⁴⁷ LJSC, Article 41, Clause 2, Paragraph 1.

- A written statement requesting the purchase of additionally issued shares or other convertible securities, which must include:
 - The name of the shareholder,
 - The place of residence (location) of the shareholder, and
 - The number of shares or convertible securities to be purchased by the shareholder; and
- A document verifying the payment for shares or other convertible securities.

If the placement of additional shares and other convertible securities calls for payment in-kind, the Company Law also grants shareholders with pre-emptive rights the right to pay in monetary form.⁴⁸

6. The Right to Demand the Redemption of Shares

A shareholder has the right to have the company redeem all or a part of his shares when the company:⁴⁹

- Reorganizes, and the shareholder voted against the decision or did not participate in the voting on this decision during the GMS;
- Concludes an extraordinary transaction approved by a decision of the GMS and the shareholder voted against this decision or did not participate in the voting on this decision;⁵⁰ or
- Adopts a new version of the charter or amends the charter by a decision of the GMS, which limits the rights of the shareholder, and the shareholder voted against this decision or did not participate in the voting on this decision.

To exercise his redemption rights, a shareholder must be informed about the right to demand the redemption of his shares. The notice of the GMS that must approve the decisions that can trigger the redemption rights must include the following information about the redemption rights:⁵¹

⁴⁸ LJSC, Article 41, Clause 2, Paragraph 2.

⁴⁹ LJSC, Article 75, Clause 1.

⁵⁰ LJSC, Article 75, Clause 1 provides that redemption rights arise only when the extraordinary transaction involves assets, the value of which is 50% or less of the book value of the company's assets. However, the Plenum of the Supreme Arbitration Court has interpreted this provision to include extraordinary transactions involving assets with a value of more than 50% of the book value of company's assets; see Resolution No. 19, the Plenum of the Supreme Arbitration Court, on Some Issues of Application of the Federal Law on Joint Stock Companies, 18 November 2003, Section 29.

⁵¹ LJSC, Article 76, Clauses 1 and 2.

Chapter 7. An Introduction to Shareholder Rights

- The right of shareholders to demand the redemption of all or part of their shares if they vote against or do not participate in the voting on specified agenda items;
- The redemption price the shareholders will receive if they demand redemption; and
- The procedure for exercising redemption rights.

The Supervisory Board must determine the redemption price, which cannot be less than the market value of shares to be redeemed as determined by an Independent Appraiser.

Shareholders have the right to submit a written request to the company to have their shares redeemed, which shall be done no later than 45 days after the GMS has approved the decision that gave rise to redemption rights.⁵² The request must contain the following information:⁵³

- The address of the shareholder who is demanding the redemption of his shares; and
- The number of shares the shareholder wants to redeem.

After the period for submitting requests for redemption has expired, the company must redeem the shares within 30 days.⁵⁴ The steps required to redeem shares are summarized in Figure 7.

7. Shareholder Rights During the Liquidation of the Company

Shareholders are residual claimants when a company is being liquidated, i.e. they will receive a portion of the assets remaining after creditor claims are satisfied. Owners of common shares have a right to receive a portion of the company's property in proportion to their holdings in the company. Owners of preferred shares have a right to receive the liquidation value of their preferred shares. The charter must determine the liquidation value for each class of preferred shares.

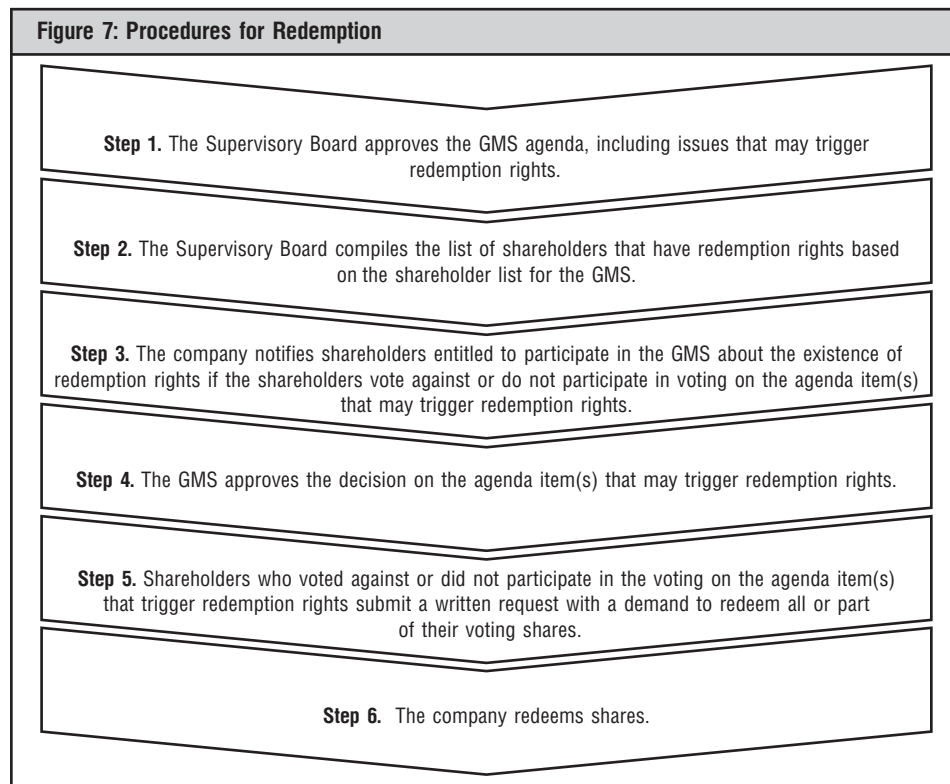
If the company has placed preferred shares of two or more classes, the charter must specify the priority of claims for each class of preferred shares.⁵⁵

⁵² LJSC, Article 76, Clause 3, Paragraph 2.

⁵³ LJSC, Article 76, Clause 3, Paragraph 1.

⁵⁴ LJSC, Article 76, Clause 4.

⁵⁵ LJSC, Article 32, Clause 2.



Source: IFC, March 2004

During liquidation, a company must first satisfy its obligations to creditors; then priority claimants (usually administrative expenses and salaries, wages, employee benefits, customer deposits, and taxes); and finally, the Creditors Committee divides the remaining assets among the shareholders following a specific order of priority:⁵⁶

- 1) Common and preferred shareholders that can exercise redemption rights have the first priority to exercise their rights;
- 2) Second priority is given to preferred shareholders for the payment of declared but unpaid dividends on preferred shares and to the payment of the liquidation value of preferred shares as specified by the charter; and

⁵⁶ LJSC, Article 23, Clause 1.

- 3) The claims of the other shareholders with common shares and preferred shares without a liquidation value are satisfied after the first and second priorities.

The company's assets must be distributed to each group in order of priority. For example, the company cannot pay the liquidation value of preferred shares until it has paid the full liquidation value of higher priority shares.

If the company does not have sufficient assets to pay all shareholders of the same priority class, then the assets must be distributed in proportion to the number of shares in the class.

8. The Right to Review the Shareholder List

The company must give registered shareholders holding at least 1% of voting shares the opportunity to inspect the shareholder list within three days of a request.

This right gives shareholders the opportunity to contact other shareholders and coordinate voting for collective action purposes. It is also important for verifying the information in the shareholder list, as well as exercising rights attached to shares.

The company is obliged to provide the following information:⁵⁷

- The shareholder list; or
- A document confirming that the inquiring shareholder is not included in the shareholder list.

In order to protect the privacy of shareholders, the company is not allowed to provide passport data and postal addresses to third parties without the shareholder's prior consent.

9. The Right to File a Claim on Behalf of the Company

A shareholder (or a group of shareholders) holding at least 1% of common shares has the right to file a claim with the court on behalf of the company to recover losses caused by:⁵⁸

- A Supervisory Board member;
- The General Director;

⁵⁷ LJSC, Article 51, Clause 4.

⁵⁸ LJSC, Article 71, Clauses 2 and 5.

- An Executive Board member; and/or
- The External Manager.

→ *For more information on the liability of directors and managers, see Part II, Chapter 4, Section F, and Chapter 5, Section E, respectively.*

C. The Rights of the State as a Shareholder

The state can participate in a company either as an ordinary shareholder or as the holder of a “golden share.” A golden share can be established to ensure the security of the state, or protect the morale, health, rights, and interests of its citizens.⁵⁹ Golden shares give agencies and subdivisions of the Russian Federation the right to:⁶⁰

- Propose items for the agenda of the GMS;
- Request an Extraordinary General Meeting of Shareholders (EGM);
- Veto the following decisions of the GMS:
 - Amendments to the charter or approval of a new charter,
 - Reorganization of the company,
 - Liquidation of the company, appointment of the Creditors Committee, or approval of the intermediary and final liquidation balance sheets,
 - Amendments to the charter capital, and
 - Approval of extraordinary and related party transactions; and
- Access all corporate documents.

The holder of a golden share may appoint a representative to the Supervisory Board and the Revision Commission. The representative can be replaced at any time by the body that appointed the representative. The representative is considered an official Supervisory Board or Revision Commission member.

Golden share rights can be established in the following circumstances:⁶¹

- Upon the privatization of assets of “a unitary enterprise;”⁶² or
- Upon the removal of a company from the government list of strategic companies irrespective of the number of state-owned shares.

⁵⁹ Law on the Privatization of State and Municipal Property, Article 38, Clause 1, Paragraph 1.

⁶⁰ Law on the Privatization of State and Municipal Property, Article 38, Clause 3.

⁶¹ Law on the Privatization of State and Municipal Property, Article 38, Clause 1.

⁶² For more details about ‘unitary enterprises’, see CC, Article 113.

Chapter 7. An Introduction to Shareholder Rights

The special rights under a golden share arrangement can be exercised starting from the moment when the state sells 75% of its shares in the company.⁶³

Best Practices: Although present in some other developed European countries, (foreign) investors are usually cautious about investing in companies with golden shares. Despite the fact that golden share arrangements can play a useful role in protecting the interests of the state and the public, it is recommended that state agencies carefully weigh all the pros and cons of implementing golden share arrangements for each company.

Golden shares are terminated by a decision of the body that made the decision to introduce them.⁶⁴

The Russian Federation, state agencies, and municipal entities can be shareholders without a golden share arrangement. In this case, their rights are identical to the rights of the company's other shareholders.

D. The Shareholder Register

The shareholder register is an important document that identifies the shareholders and the owners of other registered securities of the company. It can be used to verify the number, nominal value, types, and classes of shares and other registered securities held. The shareholder register is also maintained to secure shareholder rights, and to monitor the circulation of shares and other registered securities.

1. Maintaining the Shareholder Register

Companies must have a shareholder register that is either maintained by the company itself or an External Registrar.⁶⁵ The Registrar is a professional company which maintains shareholder registers pursuant to a contract with companies. In companies with more than 50 shareholders, an External Registrar must maintain the shareholder register.⁶⁶

⁶³ Law on the Privatization of State and Municipal Property, Article 38, Clause 5, Paragraph 1.

⁶⁴ Law on the Privatization of State and Municipal Property, Article 38, Clause 5, Paragraph 2.

⁶⁵ LJSC, Article 44, Clause 3, Paragraph 1.

⁶⁶ LJSC, Article 44, Clause 3, Paragraph 2.

A company that has transferred the register to an External Registrar remains liable for its proper maintenance and safekeeping.⁶⁷

If a company decides to change its External Registrar, it must either place an announcement in the media or inform all holders of securities in writing. The company must pay for the costs of the announcement.⁶⁸

2. The Contents of the Shareholder Register

The shareholder register must include information about the:⁶⁹

- Company that has issued securities;
- External Registrar (its branches and transfer agents), if the company uses a Registrar;
- Securities issued by the company;
- Persons (owners and nominal shareholders) and number, nominal value, and state registration number of securities of each type and class placed by the company that such persons own; and
- Details about the personal accounts of registered persons and transactions with securities requiring registration in such personal accounts.

Information about registered persons must include:

- Family name, first name, mailing address, and passport data of individuals; and
- Full company name, bank account number, mailing address of the legal entities, as well as the name of the registration agency, and the date and the serial number of the company's registration.

The company cannot be held liable for any losses caused to shareholders and owners of other securities if they fail to submit the necessary information for inclusion in the shareholder register.⁷⁰

⁶⁷ LJSC, Article 44, Clause 3, Paragraph 4.

⁶⁸ Law on the Securities Market, Article 8, Clause 3.

⁶⁹ LJSC, Article 44, Clause 1. See also: FCSM Regulation No. 27 on the Maintenance of the Register of Holders of Securities, Section 3 for more information that must be included in the shareholder register.

⁷⁰ LJSC, Article 44, Clause 5.

3. Accessing the Shareholder Register

The following parties have access to the shareholder register:

- The company;
- Owners of securities and nominal shareholders registered in the shareholder register; and
- State agencies, in cases specified by legislation.⁷¹

Although the company has the right to obtain information from the shareholder register, it does not have the right to disclose this information. Owners of registered securities and nominal shareholders are entitled to obtain information related to their personal accounts. They do not have the right to receive information related to other owners of securities of the company.

A shareholder or a nominal shareholder can receive information from the shareholder register in the form of an extract from his personal account. The extract must be provided upon the request of the shareholder or his representative within five working days.⁷² Information that must be included in the extract from the personal account is specified by legislation.⁷³

The entity that maintains the shareholder register of the company is liable for the completeness and reliability of the information specified in the extract.⁷⁴

E. The Protection of Shareholder Rights

The protection of shareholder rights lies at the center of corporate governance and is of particular importance for companies operating in emerging markets or transition economies. This protection is realized both internally, i.e. through internal corporate procedures and other guarantees envisaged by the Company Law and other legislation, and externally, i.e. through outside parties.

⁷¹ FCSM Regulation No. 27, on the Maintenance of the Register of Holders of Securities, Section 7, Clause 7.9.3.

⁷² Law on the Securities Market, Article 8, Clause 3.

⁷³ FCSM Regulation No. 27, on the Maintenance of the Register of Holders of Securities, Section 3, Clause 3.4.4.

⁷⁴ Law on the Securities Market, Article 8, Clause 3.

1. Guarantees in the Company Law

The Company Law provides many guarantees to realize and protect shareholder rights. Some of these guarantees are procedural in nature and relate to the organization of the GMS. Others are reflected in the respective obligations of the governing bodies and officers of the company, i.e. Supervisory Board members, the General Director, and Executive Board members.

Best Practices: It is important for the charter to ensure that shareholder rights, and the mechanisms designed to ensure and protect these rights, are clearly defined.

→ See also the model charter and company-level corporate governance code in Part VI, Annexes 2 and 4.

For example, the right of shareholders to make proposals to the GMS agenda is guaranteed by the following provisions of the Company Law related to the authority and obligations of the Supervisory Board:⁷⁵

- Directors cannot reject proposals on other than procedural grounds envisaged by the Company Law, thus preventing the removal from the agenda of questions that directors simply do not wish to address;
- Directors have to provide reasons when rejecting a proposal;
- Directors are required to review the proposal within a strictly defined time-period; and
- Directors are prohibited from making changes to the text of the proposal.

2. Judicial Protection

When shareholder rights are violated, shareholders have the right to judicial protection. This is a fundamental right guaranteed by the Constitution of the Russian Federation.⁷⁶ In addition, the Company Law provides remedies such as the right to appeal certain company decisions, and to sue directors and managers on behalf

⁷⁵ LJSC, Article 53.

⁷⁶ The Russian Constitution, Article 46, Section 1. According to the Russian Constitution, Article 18, such rights are directly applicable.

Chapter 7. An Introduction to Shareholder Rights

of the company. Table 3 provides examples of these rights, which are discussed in other chapters of this Manual.

Shareholder Action	Legal Basis
Appeal the refusal to enter data into the shareholder register.	LJSC, Article 45, Section 2, Paragraph 2.
Appeal decisions of the GMS.	LJSC, Article 49, Section 7.
Appeal the refusal of the Supervisory Board to call an EGM.	LJSC, Article 55, Section 7, Paragraph 2.
Compel directors and managers to reimburse the company for losses caused to the company by their wrongful acts.	LJSC, Article 71, Section 5.

→ For more information on enforcement of shareholder rights, see Part V, Chapter 17.

3. Protection by the Federal Commission for the Securities Market⁷⁷

Securities legislation provides the Federal Commission for the Securities Market (FCSM) with the authority to:⁷⁸

- Monitor activities of companies, brokers, stock exchanges and other professional participants of the securities market for compliance with securities legislation;
- Carry out inspections of the activities of these participants;
- Examine complaints from shareholders;
- File claims in court to protect the rights of shareholders, and to request the liquidation of entities that violate (shareholder rights) legislation; and
- File claims in courts to protect shareholder rights.

⁷⁷ In late March 2004 under government reorganization, the FCSM was replaced by the Federal Service for Financial Markets (FSFM). Its authorities are expected to be widened, with additional supervisory authority from the Antimonopoly and Finance Ministries. At the time of publishing this Manual, the authority of the new FSFM had not been finalized.

⁷⁸ Law on the Securities Market, Article 42, Clauses 10 and 19; Article 44, Clauses 6 and 7; Law on the Protection of Rights and Lawful Interests of Investors in the Securities Market, Articles 11 and 14.

The FCSM must examine complaints from shareholders within two weeks from the date a complaint is submitted.⁷⁹ Based on the results of the examination, the FCSM can issue a resolution to end the violating practice. Such a resolution can include penalties.

All individuals and legal entities in Russia must comply with the rulings of the FCSM. Its rulings can only be changed, amended, or repealed by the FCSM itself or a court decision.

4. Non-Governmental Organizations for the Protection of Shareholder Rights

Shareholders may seek assistance from associations, institutes, or other non-governmental organizations (NGOs) dedicated to the protection of shareholder rights. NGOs have the right to assist shareholders with:⁸⁰

- Filing a claim in court to protect shareholder rights; and
- Establishing special funds for the protection of shareholders interests.

NGOs can play an important role in exerting pressure on companies, in particular those companies that act with wanton disregard of shareholder interests. NGOs may do this in a number of different ways. They may become shareholders themselves and participate in the GMS. They may also conduct letter or media campaigns to exert pressure on companies and draw public attention to the issue of shareholder rights protection. They also serve as discussion platforms, contribute to the drafting of legislation, and the education of shareholders, directors, and managers.

→ *For a list of NGOs, see Part I, Chapter 1, Section D.4. For the role of NGOs in enforcement, see also: Part V, Chapter 17, Section F.1.*

5. Shareholder Activism and Collective Action

The protection of shareholder rights begins with good corporate behavior, an appropriate legal and regulatory framework, and appropriate enforcement procedures. Shareholders themselves must, however, also play a role in this process. Shareholders

⁷⁹ Law on the Protection of Rights and Lawful Interests of Investors in the Securities Market, Article 7.

⁸⁰ Law on the Protection of Rights and Lawful Interests of Investors in the Securities Market, Article 18.

Chapter 7. An Introduction to Shareholder Rights

are often the only parties who know about violations of their rights, and are in the best position to either file a complaint with the company or, ultimately, with the regulatory and judicial bodies.

Company Practices in Russia: The protection of minority shareholder rights remains a key concern for many (international) investors considering investing in Russian companies. Powerful owners/managers often pay little or no heed to minority shareholders. On the other hand, shareholders themselves are often passive, reflecting the lack of a shareholder culture among Russian investors. This comes as no surprise since citizens (often former employees of plants and factories) became shareholders practically overnight during the privatization phase, typically without having invested (material) funds before or having been educated about their rights. This makes the role of regulatory and supervisory bodies, as well as shareholder NGOs, even more important in ensuring that proper attention is paid to the protection of shareholder rights.

Another aspect of shareholder rights protection is collective action. Collective action is when a group of shareholders, who are unable to attain a right on an individual basis, combine their votes to reach a threshold to obtain the right collectively. Legislation provides for most of the above-mentioned rights to be exercised collectively. Moreover, the Company Law also provides shareholders with access to shareholder lists that helps them contact other shareholders to solicit their cooperation.

6. Shareholder Agreements

Shareholder agreements can be an important device for exercising collective action among shareholders. In fact, such agreements can enable minority shareholders to make use of minority rights (e.g. acquiring the 10% necessary to request an extraordinary inspection of business and economic affairs of the company). The situation is more complex if agreements are concluded between shareholders and the company (or one of its governing bodies). In those circumstances, shareholders may be “locked in” in a variety of ways, e.g. by obliging themselves to always vote in favor of proposals by directors or to always follow the instructions of management in matters relating to essential shareholder rights (the right to sell their shares, the right to receive dividends, and other rights).

Best Practices: Shareholder agreements can often be used to abuse shareholder rights and force (minority) shareholders to act in a certain way that is suitable for directors, managers and/or controlling shareholders. Therefore, such agreements must be carefully regulated. For example, in the U.K., shareholder agreements cannot require a shareholder to vote in one of the following ways:

- Always to follow the instructions of the company or one of its bodies;
- Always approve the proposals of the company or one of its bodies; and
- To vote in a specified manner or abstain in consideration of special advantages.

Shareholder agreements are, in principle, a form of private, civil law contract. Yet, because of their corporate governance implications, it is necessary to make certain provisions. First, shareholder agreements cannot substitute (or contradict) the founding documents of the company. It is the founding document (charter) that is mandatory, publicly regulated, and subject to disclosure (according to the state registration regime and/or securities regime). Second, it is necessary to prevent the above-mentioned forms of abuse of the ability to control the voting power of minority shareholders by prohibiting the inclusion of certain terms in such agreements. Lastly, it is necessary (particularly for publicly traded companies) to provide for greater transparency of voting control by requiring the disclosure of such arrangements.

F. Responsibilities of Shareholders

In addition to rights, shareholders also have responsibilities. The main legal responsibilities of shareholders are to:

- Pay the full value of shares that they have acquired;⁸¹ and
- Inform the Registrar about changes in their status.⁸²

Other responsibilities may exist. They may include disclosure obligations when certain thresholds of ownership are passed, or disclosure of the intent to acquire

⁸¹ LJSC, Article 34, Clause 1.

⁸² LJSC, Article 44, Clause 5.

Chapter 7. An Introduction to Shareholder Rights

further shares or gain control of a company. These additional responsibilities generally apply to larger shareholders, and are described throughout the Manual.

→ *For a discussion on the disclosure of beneficial ownership, see Part IV, Chapter 13, Section B.3.*

Under certain conditions, shareholders may be held liable despite their limited liability. In particular, this refers to controlling shareholders who have the opportunity to determine the actions of or give mandatory instructions to the company.⁸³

Best Practices: Finally, in some countries, shareholders, especially institutional investors, may be required to vote their shares. In other countries, there is no legal requirement but it may be considered a moral imperative. While no legal requirements for voting exist in Russia, good corporate governance depends heavily on the active participation of shareholders in the governance of the company.

⁸³ LJSC, Article 3, Clause 3, Paragraph 1.



Chapter 8

The **General Meeting** of **Shareholders**



Table of Contents

A. GENERAL PROVISIONS	38
1. <i>Types of General Meetings of Shareholders</i>	38
2. <i>The Authority of the General Meeting of Shareholders</i>	39
3. <i>Delegation of Authority</i>	43
B. PREPARING FOR THE ANNUAL GENERAL MEETING OF SHAREHOLDERS	43
1. <i>Drafting the Agenda</i>	43
2. <i>Making Key Decisions</i>	48
3. <i>Preparing the Shareholder List</i>	52
4. <i>Providing Proper Notice</i>	56
5. <i>Preliminarily Approving the Annual Report</i>	63
C. CONDUCTING THE ANNUAL GENERAL MEETING OF SHAREHOLDERS	63
1. <i>Shareholder Participation Options</i>	64
2. <i>Shareholder Registration</i>	66
3. <i>Verifying and Announcing the Quorum</i>	68
4. <i>Opening the Annual General Meeting of Shareholders</i>	69
5. <i>Electing the Counting Commission</i>	70
6. <i>Electing the Chairman of the Annual General Meeting of Shareholders</i>	71
7. <i>Electing the Secretary of the Annual General Meeting of Shareholders</i>	71
8. <i>Inviting Outside Guests as Observers</i>	72
9. <i>Presenting the Agenda and the Rules of Order</i>	72
10. <i>Discussing Agenda Items</i>	72
11. <i>Voting</i>	73
12. <i>Counting and Documenting Votes</i>	74
13. <i>Announcing the Voting Results and Decisions</i>	74
14. <i>Closing the Annual General Meeting of Shareholders</i>	75
15. <i>Archiving Voting Ballots</i>	75
16. <i>Preparing the Annual General Meeting of Shareholders Minutes</i>	75
17. <i>Notifying Shareholders of Voting Results and Decisions</i> <i>(After the Annual General Meeting of Shareholder)</i>	76
18. <i>Documents of the Annual General Meeting of Shareholder</i>	76

D. AN OVERVIEW OF THE EXTRAORDINARY GENERAL MEETING OF SHAREHOLDERS	78
1. <i>When to Conduct an Extraordinary General Meeting of Shareholders</i>	79
2. <i>Preparatory Procedures</i>	81
3. <i>Conducting the Extraordinary General Meeting of Shareholders by Written Consent</i>	83
E. DECISIONS OF THE GENERAL MEETING OF SHAREHOLDERS	84
1. <i>Decisions Requiring a Simple Majority Vote</i>	84
2. <i>Decisions Requiring a Supermajority Vote</i>	86
3. <i>Decisions Requiring a Unanimous Vote</i>	88
4. <i>Appealing Decisions</i>	88
F. THE GENERAL MEETING OF SHAREHOLDERS IN COMPANIES WITH A SINGLE SHAREHOLDER	89

The Chairman's Checklist

The Authority of the General Meeting of Shareholders (GMS):

- ✓ Are the powers of the GMS clearly set forth in the charter?
- ✓ Are there any powers of the GMS that the charter explicitly delegates to the Supervisory Board?

The Preparation for the Annual General Meeting of Shareholders (AGM):

- ✓ Does the Supervisory Board provide workable and timely mechanisms to include all legitimate shareholder proposals on the agenda?
- ✓ Does the Supervisory Board have a clear duty to ensure that the agenda is not changed after it has been sent to all shareholders?
- ✓ Are all shareholders properly notified of the AGM?
- ✓ Is sufficient information available for all shareholders to take well-informed decisions on agenda items?
- ✓ Does the charter require the company to provide additional information to shareholders (or others having recognized interests) on specific agenda items?
- ✓ Does the company properly inform all shareholders of the AGM on its website?

Conducting the AGM:

- ✓ Is the venue of the AGM convenient and easily accessible for all company shareholders?
- ✓ Are shareholders (or their representatives) who attend the AGM properly registered and do they have the opportunity to participate in the AGM?
- ✓ Does the Supervisory Board ensure that the quorum of the AGM is properly verified and properly recorded?
- ✓ Are members of the Supervisory Board, executive bodies, and Revision Commission, as well as the External Auditor, present during the entire AGM? Do shareholders have the right and opportunity to ask questions to executives and other presenters?
- ✓ Does the Supervisory Board ensure that effective and independent vote counting mechanisms are in place during the AGM, and that the voting results are properly recorded? Does the Supervisory Board ensure that all decisions are valid and that all applicable legal requirements are met?

Chapter 8. The General Meeting of Shareholders

- ✓ Are the voting results and decisions properly communicated to shareholders?

The Extraordinary General Meeting of Shareholders (EGM):

- ✓ Does the Supervisory Board convene an EGM when circumstances require?
- ✓ Does the Supervisory Board convene an EGM when the Revision Commission, the External Auditor, or a shareholder (or a group of shareholders) owning at least 10% of voting shares requests an EGM?

Shareholders are the main contributors of equity capital. However, shareholders do not always wish to participate in the day-to-day management of the company's affairs. Most shareholders lack the necessary time or skills to run a company. Thus, shareholders entrust professional managers to run the company's day-to-day operations, and elect directors to supervise and guide the work of these managers. However, this does not mean that shareholders completely give up their governance rights. Shareholders most commonly exercise their governance rights through the General Meeting of Shareholders (GMS).

The GMS is the highest governing body of a company.⁸⁴ It is through the GMS that shareholders express their will with respect to such important company matters as the approval of annual reports and financial statements, the election and dismissal of directors, the payment of dividends and distribution of company profits, reorganization, major corporate transactions, and the appointment of the External Auditor. The GMS also provides shareholders with the opportunity to, at least once a year, discuss these and other important matters, meet in person with their directors and managers, ask questions, and determine the future of the company. Hence, shareholders exercise their right to participate in the decision-making of the company through the GMS.

Preparing for and conducting the GMS is subject to detailed procedural requirements as determined by law, and corporate policies and procedures. This chapter describes the authorities of the GMS, its organization, and the legal requirements for adopting valid decisions.

⁸⁴ Law on Joint Stock Companies (LJSC), Article 47, Clause 1, Paragraph 1.

A. General Provisions

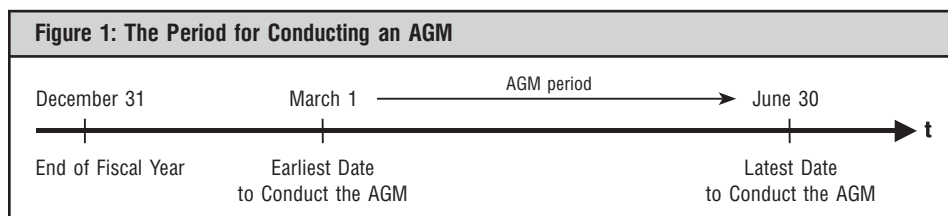
1. Types of General Meetings of Shareholders

There are two types of GMS: the Annual General Meeting of Shareholders (AGM) and Extraordinary General Meeting of Shareholders (EGM).⁸⁵

a) The Annual General Meeting of Shareholders

The Company Law requires companies to hold a GMS once every year.⁸⁶ This Meeting is called the AGM. The AGM must be held:⁸⁷

- Not earlier than two months after the end of the fiscal year; and
- Not later than six months after the end of the fiscal year.⁸⁸



Source: IFC, March 2004

In practice, this means that a company (whose fiscal year is the same as the calendar year) must hold its AGM between March 1 and June 30 of each year. The charter must determine the period or specific date when the AGM is to be held.⁸⁹

The AGM may not be held merely by written consent.⁹⁰ The AGM must provide shareholders the opportunity to attend (if desired, by mail-in ballots).

b) The Extraordinary General Meeting of Shareholders

All GMS other than the AGM are called the EGM.⁹¹ They are convened in response to specific company (or shareholder) needs, such as the issuance of ad-

⁸⁵ LJSC, Article 47, Clause 1.

⁸⁶ LJSC, Article 47, Clause 1, Paragraph 2.

⁸⁷ LJSC, Article 47, Clause 1, Paragraph 3.

⁸⁸ Law on Accounting, Article 14, Clause 1 uses the term “reporting period,” which is defined as a calendar year starting on January 1 and ending December 31.

⁸⁹ LJSC, Article 47, Clause 1, Paragraph 3.

⁹⁰ LJSC, Article 50, Clause 2.

⁹¹ LJSC, Article 47, Clause 1, Paragraph 3.

Chapter 8. The General Meeting of Shareholders

ditional shares, a corporate reorganization, or for the election of directors. Under certain circumstances, the company may be required to call an EGM.

The EGM may be held:

- With the physical participation of shareholders; or
- By written consent using mail-in ballots for decision-making.

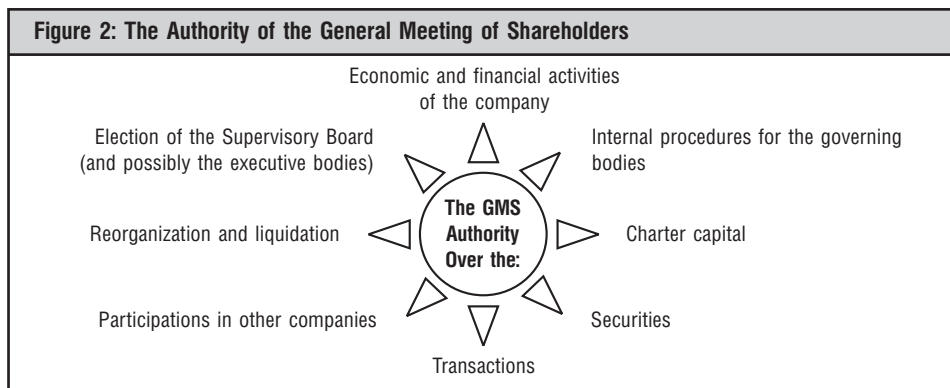
There are no limitations on the number of EGM that a company may conduct.

2. The Authority of the General Meeting of Shareholders

The authorities of the GMS are set forth in the Company Law⁹² and are also specified in the charter.⁹³ The charter may not, however, provide any additional authorities that are not permitted by legislation. The GMS may delegate some of its authorities to the Supervisory Board, such as the right to elect the General Director.

→ For more information on the separation of authorities between the GMS and the Supervisory Board, see Part II, Chapter 4, Section A.4.a. For more information on who should elect the General Director, see Part II, Chapter 5, Section C.1.

The authority of the GMS is summarized in Figure 2:



Source: IFC, August 2003

More specifically, the GMS has the authority related to:

⁹² LJSC, Article 48, Clause 1.

⁹³ LJSC, Article 11, Clause 3.

a) Reorganization and Liquidation of the Company:⁹⁴

- Reorganize the company;
- Liquidate the company and appoint members to the Creditors Committee; and
- Approve the interim and final liquidation balance sheets.

→ *For more information on reorganizations, see Part V, Chapter 16.*

b) Election of the Governing Bodies:⁹⁵

- Determine the number of directors, as well as to elect and dismiss them;
- Approve the remuneration of directors;
- Appoint and dismiss the General Director and Executive Board members (unless the charter delegates this authority to the Supervisory Board); and
- Transfer the authority of the General Director to the External Manager.

c) Control over the Company:⁹⁶

- Approve the by-laws for the Revision Commission;
- Elect and dismiss Revision Commission members;
- Approve the remuneration of the Revision Commission members;
- Request an extraordinary inspection by the Revision Commission;
- Appoint the External Auditor;
- Approve annual reports and annual financial statements; and
- Declare and pay dividends.

→ *For more information on internal and external control structures, see Part III, Chapter 14.*

d) Procedures for Governing Bodies:⁹⁷

- Amend the charter or approve a new version of the charter;
- Establish the procedures for conducting the GMS;
- Elect and dismiss Counting Commission members and set the number of its members; and

⁹⁴ LJSC, Article 48, Clause 1, Sections 2 and 3.

⁹⁵ LJSC, Article 48, Clause 1, Sections 4 and 8; Article 64, Clause 2; Article 69, Clause 1, Paragraph 3.

⁹⁶ LJSC, Article 48, Clause 1, Sections 9, 10, 10.1, and 11; Article 85, Clause 1, Paragraph 2; Clause 2, Paragraph 2, and Clause 3.

⁹⁷ LJSC, Article 48, Clause 1, Sections 1, 12, 13 and 19; Article 56, Clause 1.

Chapter 8. The General Meeting of Shareholders

- Approve the by-laws for the governing bodies of the company (the GMS, the Supervisory Board, the General Director, and the Executive Board).

e) Charter Capital:⁹⁸

- Increase the charter capital by increasing the nominal value of issued shares;
- Determine the number, nominal value, types, and classes of authorized shares that may be issued and placed by the company;
- Increase the charter capital by issuing additional shares (unless the charter delegates this authority to the Supervisory Board);
- Reduce the charter capital by decreasing the nominal value of issued shares; and
- Reduce the charter capital by reducing the number of issued shares by retiring treasury shares.

→ *For more information on the charter capital, see Chapter 9.*

f) Securities:⁹⁹

- Split and consolidate shares;
- Approve the buy-back of company shares in cases specified by the Company Law;
- Issue bonds and other convertible securities, unless the charter delegates this authority to the Supervisory Board; and
- Issue shares and other convertible securities through closed subscription.

→ *For more information on securities, see Chapter 11.*

g) Transactions:¹⁰⁰

- Approve extraordinary transactions;
- Approve related party transactions; and
- Waive the obligation of the controlling shareholder(s) to make a buy-out offer during control transactions.

→ *For more information on control transactions, see Chapter 12, Section B.*

⁹⁸ LJSC, Article 48, Clause 1, Sections 5–7.

⁹⁹ LJSC, Article 48, Clause 1, Sections 14 and 17; Article 33, Clause 2, Paragraph 2; Article 39, Clause 3.

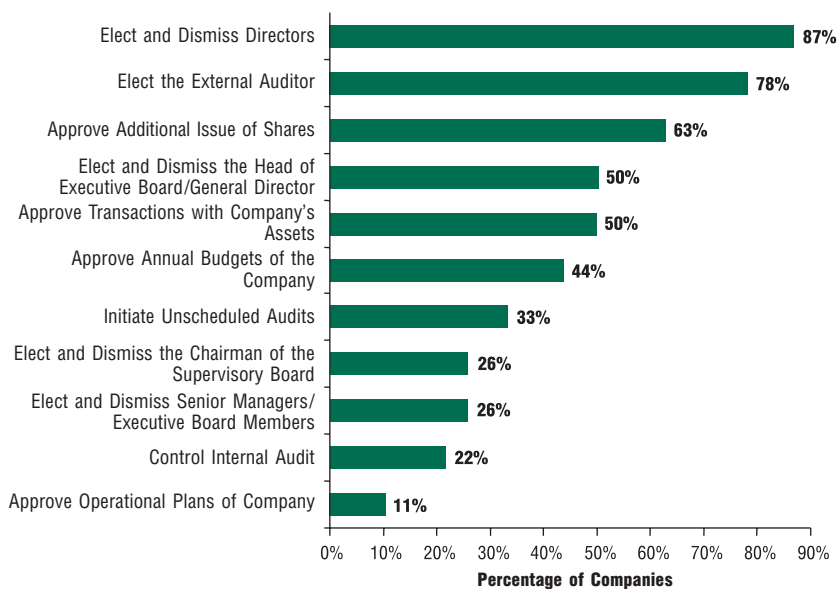
¹⁰⁰ LJSC, Article 48, Clause 1, Sections 15 and 16; Article 80, Clause 2, Paragraph 2.

h) Participation in Other Companies:¹⁰¹

- Authorize the company to participate in holding companies, financial and industrial groups, associations or other groups of commercial enterprises.

Company Practices in Russia: As depicted in Figure 3, most GMS appear to perform the functions assigned to them by law. The most common are electing and dismissing directors (87%), electing the External Auditors (78%), and approving additional issues of company shares (63%).¹⁰² More revealing than the functions performed by the GMS are the responsibilities that it is supposed to fulfill but does not. For example, in 19% of the surveyed companies, the GMS does not approve an independent External Auditor.

Figure 3: Powers of the GMS



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

¹⁰¹ LJSC, Article 48, Clause 1, Section 18.

¹⁰² IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.3.1, page 33, August 2003 (see www.ifc.org/rcgp).

3. Delegation of Authority

The authorities of the GMS may not be delegated to the executive bodies. However, the charter may delegate the following tasks to the Supervisory Board:¹⁰³

- Appointing and dismissing the General Director and Executive Board members;
- Increasing the charter capital by issuing additional shares; and
- Issuing bonds (and other convertible securities).

B. Preparing for the Annual General Meeting of Shareholders

Preparing for the AGM requires careful planning and adherence to procedural requirements. The procedures are set out in the Company Law¹⁰⁴ and regulations issued by the Federal Commission for the Securities Market (FCSM).¹⁰⁵ Additionally, The FCSM's Code of Corporate Conduct (FCSM Code) provides useful recommendations.

The steps that must be followed are summarized in Figure 4.

1. Drafting the Agenda

The first step in preparing for the AGM is to draft an agenda. The agenda structures the AGM, and lists issues that must be addressed.¹⁰⁶

a) Who May Submit Agenda Items

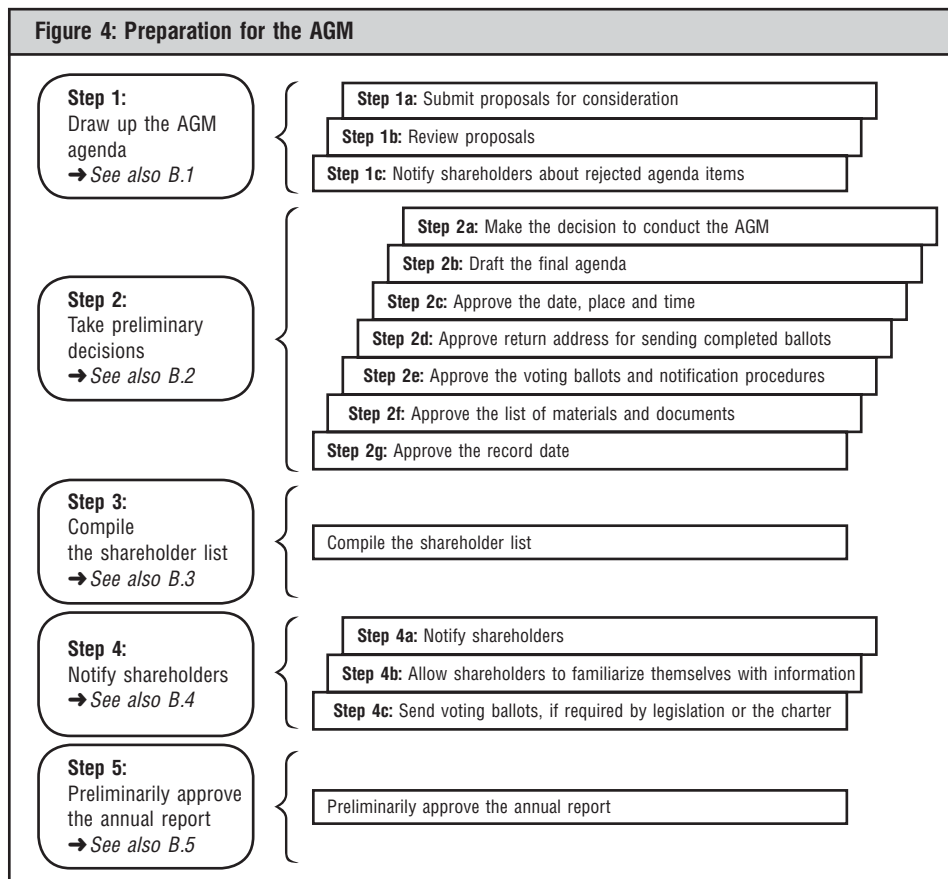
A shareholder (or a group of shareholders) holding at least 2% of voting shares may propose agenda items, including the nomination of candidates to the governing bodies.

¹⁰³ LJSC, Article 48, Clause 2, Paragraphs 1 and 2.

¹⁰⁴ LJSC, Articles 51 to 54.

¹⁰⁵ LJSC, Article 47, Clause 2. See also: FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparing, Calling and Conducting the General Meeting of Shareholders (FCSM Regulation No. 17/ps), 31 May 2002.

¹⁰⁶ Federal Commission for the Security Market's Code of Corporate Conduct (FCSM Code), Chapter 2, Section 1.4.1.



Source: IFC, March 2004

The signatory of the proposal is considered the individual who submits the proposal.¹⁰⁷ The date on which a shareholder's ownership should be verified is the date of legal submission.¹⁰⁸

¹⁰⁷ FCSM Regulation No. 17/ps, Section 2.2.

¹⁰⁸ FCSM Regulation No. 17/ps, Section 2.3.

b) How and When to Submit Agenda Proposals

Shareholders must submit proposals in writing:¹⁰⁹

- By regular mail to the General Director (or the External Manager). The postal address must be included in the State Register of Legal Entities, the charter, or the relevant by-laws. Proposals are considered submitted as of the postmark date; or
- By hand to the General Director (or to the Chairman of the Supervisory Board, the Corporate Secretary, or any other person entitled to receive mail on behalf of the company). The delivery must be verified by dated receipt. The date of receipt of such a proposal is deemed to be the date of submission; or
- By other means, such as e-mail or fax (if allowed by the charter and/or by-laws). In this case, the charter or by-laws determine the date of submission.

The company must receive proposals no later than 30 days after the end of fiscal year, unless the charter allows for a later submission.¹¹⁰

c) Required Proposal Information

A shareholder (or a group of shareholders) owning 2% or more of voting shares may propose any number of issues for the agenda. Each proposal must contain:¹¹¹

- The name of the submitting shareholder(s);
- The number, types, and classes of shares held by the shareholder(s);
- The text of the proposal (it may also contain proposed wording for shareholders to vote on); and
- The signature(s) of the submitting shareholder(s).

If a shareholder representative signs the proposal, a valid power of attorney must be attached.¹¹²

¹⁰⁹ LJSC, Article 53, Clause 3. FCSM Regulation No. 17/ps, Sections 2.1 and 2.4.

¹¹⁰ LJSC, Article 53, Clause 1.

¹¹¹ LJSC, Article 53, Clauses 3–4.

¹¹² FCSM Regulation No. 17/ps, Section 2.7.

Best Practices: Shareholder proposals should be included as separate items on the agenda. However, certain agenda items should be grouped together. For example, a decision on reorganization through spin-off may only be approved if the AGM also approves the following related issues:

- The spin-off procedure;
- Terms and conditions of the spin-off;
- The establishment of new companies as a result of reorganization;
- The procedure to convert the reorganized company's shares into shares of new companies; and
- The approval of a transfer balance sheet.

d) Information to Be Included in Candidate Proposals

A shareholder (or a group of shareholders) owning at least 2% or more of voting shares may propose candidates for the:

- Supervisory Board;
- General Director and Executive Board;¹¹³
- Counting Commission; and
- Revision Commission.

The number of candidates that may be proposed is limited to the size of the body specified in the charter or by-laws.¹¹⁴

Candidate proposals must contain the:¹¹⁵

- Name of candidates;
- Name of the body for which candidates are nominated;
- Name(s) of the shareholder(s) submitting the proposal;
- Number, types, and classes of shares held by the submitting shareholder(s); and
- Signature(s) of the shareholder(s).

¹¹³ LJSC, Article 53, Clause 1. Note that shareholders have the right to propose candidates for the position of General Director and Executive Board members only if the establishment of the company's executive bodies falls within the authority of the GMS. The charter must specifically address this.

¹¹⁴ LJSC, Article 53, Clause 1.

¹¹⁵ LJSC, Article 53, Clause 4; FCSM Regulation No. 17/ps, Section 2.8.

Chapter 8. The General Meeting of Shareholders

The charter, by-laws, or other internal documents of the company may require additional information.

As under item B.1.c above, if a shareholder representative signs the proposal, a valid power of attorney must be attached.¹¹⁶

Best Practices: Candidates should be informed of their nomination. In addition, the AGM documents should contain an agreement that, if elected, candidates will accept the position.¹¹⁷ In the absence of such an agreement, it is recommended that the candidate physically attend the AGM and verbally confirm his acceptance if elected, before shareholders vote on his candidacy.

e) Proposal Review by the Supervisory Board

The Supervisory Board must decide whether to accept or reject shareholder proposals within five days after the submission deadline. It may reject a proposal only when:¹¹⁸

- The proposal is not submitted within the period determined by law and the charter;
- A submitting shareholder (or a group of shareholders) does not possess at least 2% of voting shares;
- The proposal is incomplete or does not meet the legal requirements for proposals;
- The AGM does not have the authority to decide on the proposed item; or
- The proposal does not otherwise comply with legislation (for example, if the shareholder proposes to declare dividends when this recommendation may only be made by the Supervisory Board).

¹¹⁶ FCSM Regulation No. 17/ps, Section 2.7.

¹¹⁷ FCSM Regulation No. 17/ps, Section 2.8; FCSM Code, Chapter 2, Section 1.3.6.

¹¹⁸ LJSC, Article 53, Clause 5.

The Supervisory Board may not invoke any other grounds for rejecting proposals.

Best Practices: Companies should check the shareholder register to verify shareholders' right to participate in the AGM, rather than require shareholders to submit supporting documents.¹¹⁹

f) The Notification of Shareholders of Rejected Proposals

The Supervisory Board must notify shareholders within three days of making the decision if their proposals are rejected.¹²⁰ It must provide them with the text of its decision stating the reasons for the rejection. Legislation does not specify how shareholders should be notified when proposals are rejected. It is, however, recommended that they be notified by registered mail.

The rejection of or failure to make a decision on shareholder proposals may be appealed to a court.¹²¹

The Company Law does not require shareholders to be notified if their proposals are accepted.¹²² It is assumed that they will receive sufficient notification when they receive the agenda.

2. Making Key Decisions

As depicted on Figure 5, the Supervisory Board must make a number of key decisions in preparing for the AGM.¹²³

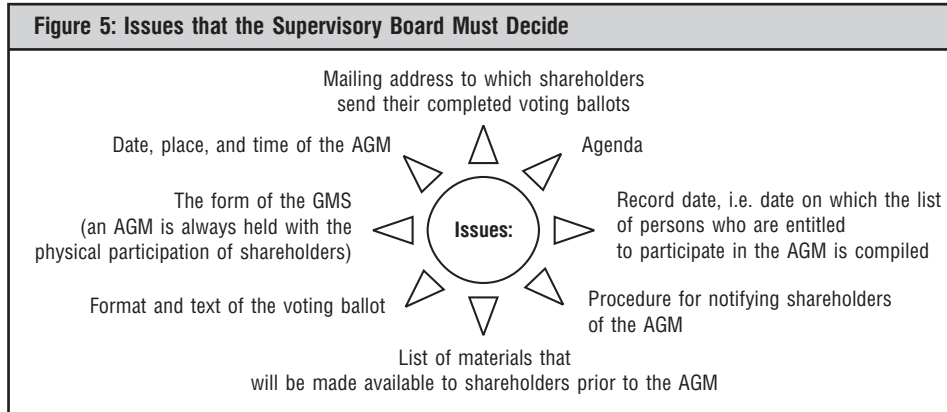
¹¹⁹ FCSM Code, Chapter 2, Section 1.5.

¹²⁰ LJSC, Article 53, Clause 6.

¹²¹ LJSC, Article 53, Clause 6.

¹²² LJSC, Article 53, Clause 6.

¹²³ LJSC, Article 54, Clause 1. LJSC, Article 60, Clause 2, Paragraph 2. The distribution of voting ballots prior to the AGM is mandatory for companies with 1,000 or more shareholders with voting rights; for companies with fewer than 1,000 shareholders with voting rights, only if required by the charter. (→ *For more information on voting ballots, see Section B.4 of this Chapter.*) LJSC, Article 60, Clause 1, Paragraph 2. Voting during the AGM must be done by ballot if the company has more than 100 shareholders with voting rights.



Source: IFC, March 2004

In addition to the requirements of the Company Law, the FCSM requires that the Supervisory Board decide on:¹²⁴

- Which classes of preferred shares grant voting rights to their owners on each agenda item; and
- When the registration of participants at the AGM shall start.

a) The Decision to Conduct the AGM

The Supervisory Board must decide to conduct the AGM before its preparation may start. As part of this decision, the Supervisory Board decides as to the final agenda; date, place, and time; address to which completed ballots must be sent; notification procedure and text of the voting ballot; list of materials; and record date.

b) The Date of the AGM

The company must conduct its AGM on a date that is determined by the charter.

Company Practices in Russia: In practice, the charter typically provides for a period of time within which the AGM must be held. The Supervisory Board then determines the exact date for each AGM, within the period stipulated by the charter.

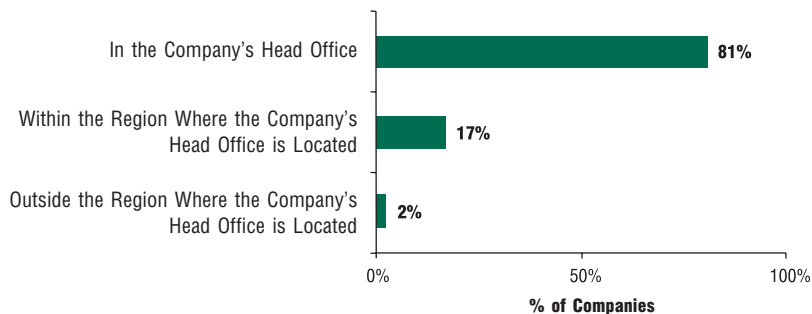
¹²⁴ FCSM Regulation No. 17/ps, Section 2.10.

c) The Place of the AGM

The company is required to conduct the AGM where it has its registered seat unless otherwise specified by the charter or by-laws.¹²⁵

Company Practices in Russia: Today most companies in Russia hold their GMS in easily accessible locations. This is in stark contrast to practices in the 1990s. Figure 6 shows that 81% of the companies in Russia's regions used their head office to host the GMS.¹²⁶ A further 17% held their GMS within the region where their head office was located, and only 2% of these companies held their GMS outside of the region in which they were located.

Figure 6: Common GMS Locations



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

Current company practices are consistent with the FCSM Code's recommendations that:¹²⁷

- The AGM should be held at a location and at a time that facilitates shareholders to participate and does not impose undue expenses upon them;
- The AGM should be held where the company is located or at a location defined by the charter;
- Companies that are located where access is difficult should choose a venue that is easy to access (for example, by public transport). This location should be specified in the charter;

¹²⁵ FCSM Regulation No. 17/ps, Section 2.9.

¹²⁶ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.3.1, page 32, August 2003 (see www.ifc.org/rcgp).

¹²⁷ FCSM Code, Chapter 2, Section 1.2. and 1.6.

Chapter 8. The General Meeting of Shareholders

- The premises should be able to accommodate all shareholders who want to participate; and
- Companies should estimate how many participants are likely to attend the AGM and plan accordingly.

d) Approving the Agenda

The Supervisory Board must approve the final AGM agenda. The agenda is composed of items that are:

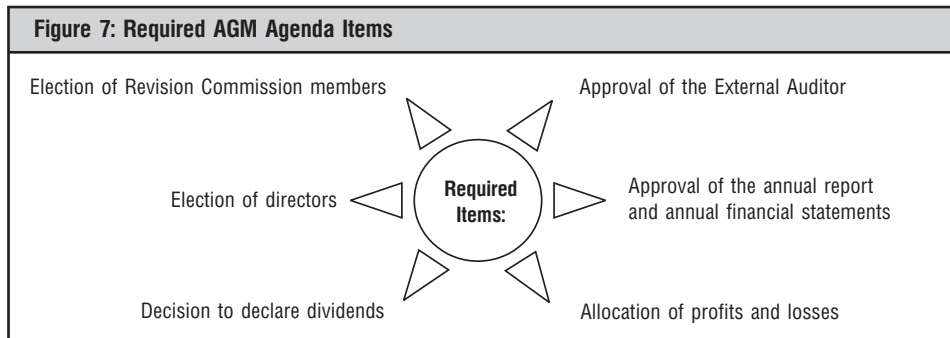
- Proposed by shareholders; and
- Included upon the Supervisory Board's initiative.

The Supervisory Board must include all shareholder proposals on the agenda that were not rejected. The Supervisory Board may not change the wording of any proposal, or the wording of the proposed decision to be taken on that item.¹²⁸ Once the Supervisory Board has approved the final agenda, it may not be changed.

The Supervisory Board may include:¹²⁹

- Items in addition to those required by the Company Law or those proposed by shareholders; and
- Additional candidates for governing bodies if shareholders failed to propose a sufficient number. It is good practice for the Supervisory Board to include a sufficient number of candidates to fill all positions for governing bodies.

Figure 7 shows the items that the agenda must include.¹³⁰



Source: IFC, March 2004

¹²⁸ LJSC, Article 53, Clause 7, Paragraph 1.

¹²⁹ LJSC, Article 53, Clause 7, Paragraph 2.

¹³⁰ LJSC, Article 54, Clause 2.

e) The Record Date

The record date, sometimes referred to as the fixing date, is the date used to determine who is entitled to participate in the AGM. The record date must be set by the Supervisory Board prior to the AGM, and may not be set at a date that is:¹³¹

- Earlier than the Supervisory Board's decision to conduct the AGM;
- More than 50 days prior to the AGM; and
- Less than 45 days prior to the AGM, if voting ballots must be sent.

3. Preparing the Shareholder List

The next step in preparing for the AGM is to compile the list of shareholders who are entitled to participate in the AGM. The shareholder list is based on information from the Registrar on the record date.¹³²

Once the Supervisory Board has set the record date, the General Director must tell the Registrar to compile the shareholder list.¹³³ The shareholder list is prepared for the Supervisory Board to:

- Determine which shareholders are entitled to participate in the AGM;
- Notify shareholders of the AGM;
- Determine which shareholders have the right to receive dividends; and
- Give shareholders the opportunity to verify that their rights are registered properly.

a) Who Should Be Included on the Shareholder List

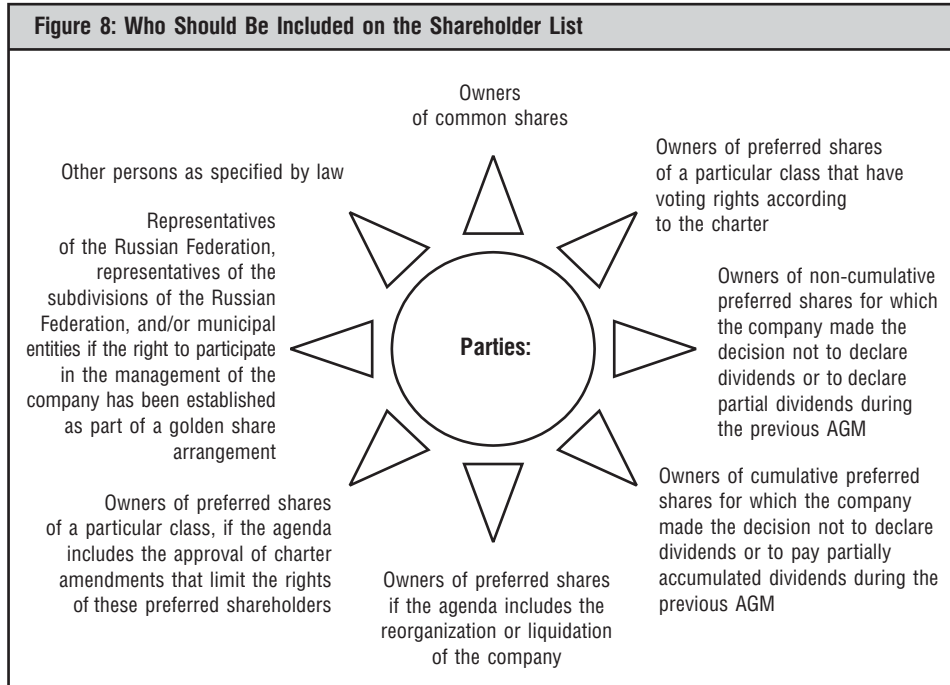
Only persons included on the shareholder list are entitled to participate in the AGM. Figure 8 depicts who should be included on the shareholder list.¹³⁴

¹³¹ LJSC, Article 51, Clause 1.

¹³² LJSC, Article 51, Clause 1, Paragraph 1.

¹³³ The holder of the shareholder register will typically be the company or an External Registrar. See also: Chapter 7, Section D.

¹³⁴ FCSM Regulation No. 17/ps, Section 2.11. All shares of the company must be fully paid. LJSC, Article 34, Clause 1, Paragraph 3 specifies that shares that are held by the founders of the company, but are not fully paid do not grant voting rights to their owners, unless the charter provides otherwise. Because of amendments to the LJSC, preferred shares with voting rights cannot be placed after January 1, 2002. Securities convertible into preferred shares



Source: IFC, March 2004

b) Nominal Shareholders and the Shareholder List

To ensure that all shareholders are included in the shareholder list, nominal shareholders (such as brokers, banks, and investment funds that manage shares on behalf of shareholders) are required to provide the company with information on the ultimate or beneficial owners they represent.¹³⁵

→ See also Part IV, Chapter 13, Section B.3 for more information on the disclosure of beneficial ownership.

with voting rights can not be converted into voting preferred shares after January 1, 2002. The amendments to the LJSK have eliminated the possibility of issuing preferred shares that have voting rights if this is specified by the charter. FCSM Regulation No. 17/ps does not specify these other persons.

¹³⁵ LJSK, Article 51, Clause 2.

c) Information in the Shareholder List

The shareholder list must contain information on each individual and legal entity including:¹³⁶

- Name;
- Identification details;
- The number, type, and class of shares held; and
- A mailing address in the Russian Federation.

d) Disclosure of Information in the Shareholder List

Two information disclosure situations may be differentiated:¹³⁷

- Disclosure to larger shareholders; and
- Verification by a shareholder of his own holdings.

In the first situation, the shareholder list should be made available to all shareholders who own at least 1% of voting shares. Information regarding physical persons, including their mailing address, may however only be disclosed with their permission.¹³⁸

In the second situation, shareholders are entitled to verify the accuracy of the information in the register about themselves and their holdings. If the shareholder is unable to verify his inclusion on the shareholder list, the company must issue a statement within three days of the request.

The Supervisory Board may amend the shareholder list after the record date only to restore the rights of persons who were omitted or to correct other errors.¹³⁹

e) Shareholder Obligations When Selling Shares After the Record Date But Prior to the Annual General Meeting of Shareholders

Shareholders lose voting rights when they sell their shares, as voting rights are transferred automatically to the new owner. However, as the shareholder list is not updated after the record date, the selling shareholder must ensure that the new shareholder may vote at the AGM. There are two ways for the selling shareholder to fulfill his obligation:¹⁴⁰

¹³⁶ LJSJ, Article 51, Clause 3.

¹³⁷ LJSJ, Article 51, Clause 4.

¹³⁸ LJSJ, Article 51, Clause 4.

¹³⁹ LJSJ, Article 51, Clause 5.

¹⁴⁰ LJSJ, Article 57, Clause 2.

Chapter 8. The General Meeting of Shareholders

- Grant a power of attorney to the new owner; or
- Participate in the AGM and vote in accordance with the instructions of the new owner.

In practice, these two options only work when the shareholder knows:

- **The identity of the buyer:** In Russia, as elsewhere in the world, shares are generally sold anonymously through intermediaries thus making it impossible for the seller to identify and contact the buyer. It gets more complicated when shares are sold to multiple shareholders or during multiple and sequential transactions.
- **The record date:** In practice, shareholders are not notified about the record date before they are notified of the AGM. This makes it difficult for the seller to know if he is obliged to act in order to allow the new shareholder to participate in the AGM.

Securities legislation further regulates this issue. In particular, if a shareholder sells his shares after the record date to multiple shareholders, then he is required to either: 1) vote based on the instructions of the new owners; and/or 2) give a power of attorney to all new owners specifying the number of shares the new owner may vote in accordance with the following:¹⁴¹

- If the instructions of the new owners coincide, their votes must be combined;
- If the instructions of new owners do not coincide, the seller must vote in accordance with the instructions of new owners;
- If the new owners receive power of attorney from the seller, the new shareholders must be registered in order to participate in the AGM, and they must be given new voting ballots;
- If voting shares are being circulated in foreign markets in the form of depositary receipts, voting must be based on the instructions of the depositary receipt holders.

→ *For more information on depositary receipts, see Chapter 11, Section G.*

¹⁴¹ FCSM Regulation No. 17/ps, Section 2.12.

4. Providing Proper Notice

Once the procedures set out in Section B.3 are completed, all shareholders of record must be notified of the AGM:¹⁴²

- No later than 20 days prior to the AGM; or
- No later than 30 days prior to the AGM if the agenda includes the reorganization of the company.

Best Practices: It is good practice that notification of the AGM:¹⁴³

- Allows sufficient time for all shareholders to prepare for the AGM;
- Is given to all shareholders;
- Allows sufficient time for shareholders to contact other shareholders; and
- Occurs at least 30 days in advance.

a) How to Notify

Shareholders must be notified of the AGM by:¹⁴⁴

- Registered mail, unless the charter provides otherwise; or
- Hand delivery with a delivery receipt; or
- Publication in a newspaper or other printed media with a large circulation, if provided by the charter.

Company Practices in Russia: An IFC survey of corporate governance practices in Russia's regions shows that most companies send announcements by registered mail and/or publish them in the print media, as shown in Figure 9 below.¹⁴⁵

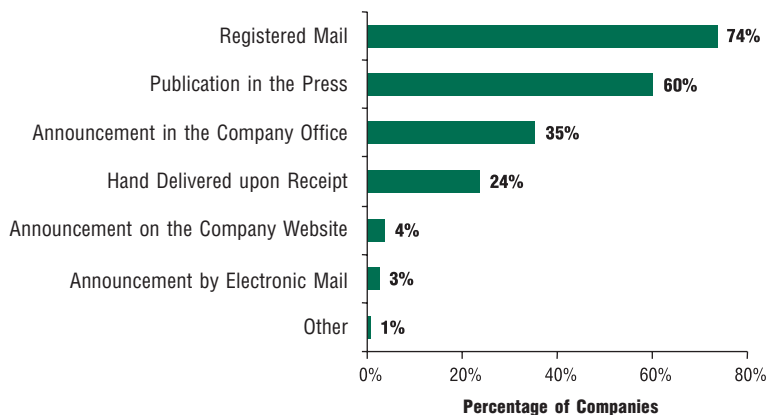
¹⁴² LJSJ, Article 52, Clause 1.

¹⁴³ FCSM Code, Chapter 2, Section 1.1.1.

¹⁴⁴ LJSJ, Article 52, Clause 1, Paragraph 3.

¹⁴⁵ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.3.1, page 31, August 2003 (see www.ifc.org/rcgp).

Figure 9: Method of AGM Notification



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

The company may also notify shareholders of an AGM by television or radio, or other methods such as the internet.¹⁴⁶ These other methods may not, however, replace those required by the Company Law and those specified in the charter.

Best Practices: Every reasonable effort should be made to inform shareholders of an upcoming AGM.¹⁴⁷ A broader reach may be achieved by:

- Permitting the use of e-mail and the internet;
- Using widely read print media to disseminate notice; and
- Using no less than two and, ideally, several publications to give notice.

b) Information that Is Included in the AGM Notification

The AGM notification must include information required by the Company Law and the FCSM.¹⁴⁸ In addition, the FCSM Code states that notification should

¹⁴⁶ LJSC, Article 52, Clause 1, Paragraph 4.

¹⁴⁷ FCSM Code, Chapter 2, Sections 1.1.3 and 1.1.4.

¹⁴⁸ LJSC, Article 52, Clause 2; FCSM Regulation No. 17/ps, Section 3.1; FCSM Code, Chapter 2, Section 1.1.2.

The Russia Corporate Governance Manual

contain sufficient information to enable shareholders to decide whether they will participate and how they will participate. Legal requirements and the FCSM Code's recommendations are summarized in Table 1.

Table 1: Information to Include in the AGM Notification		
Information	Required	Recommended
Full name and location of the company	✓	✓
Date, place, and time of the AGM	✓	✓
Mailing address for sending voting ballots (if applicable)	✓	✓
Record date of the AGM	✓	✓
Agenda	✓	✓
Procedures for receiving background materials	✓	✓
The time when the registration of participants starts	✓	✓
The place where registration takes place		✓
The person to whom shareholders may report violations of the registration procedure		✓

c) Information and Materials for the AGM

The Company Law and securities legislation list the background materials that must be made available to shareholders before the AGM.¹⁴⁹

Best Practices: Companies should identify additional materials that may need to be provided to shareholders in their charter.¹⁵⁰

Legal requirements and the FCSM Code's recommendations are summarized in Table 2.

¹⁴⁹ LJSC, Article 52, Clause 3, Paragraph 1; FCSM Regulation No. 17/ps, Sections 3.2 to 3.5;

¹⁵⁰ FCSM Code, Chapter 2, Section 1.3.1.

Chapter 8. The General Meeting of Shareholders

Table 2: AGM Materials		
Information (Materials)	Required	Recommended
Annual report and annual financial statements	✓	✓
Report of the Revision Commission	✓	✓
Report of the External Auditor	✓	✓
Recommendations of the Supervisory Board regarding the distribution of profits, including the amount of dividends and the procedure for the payment of dividends, and regarding the distribution of losses	✓	✓
Draft charter amendments, draft of the new version of the charter, if any	✓	✓
Draft by-laws, if any	✓	✓
Drafts of decisions of the AGM	✓	✓
Information on proposed candidates for the position of General Director, and for members of the Executive Board, Supervisory Board, Revision Commission, and Counting Commission	✓	✓
Consent of nominees to accept the position if they are elected	✓	✓
<p>Materials that must be made available when the agenda includes items that may trigger redemption rights:</p> <ul style="list-style-type: none"> • The report of an Independent Appraiser on the market value of the company shares; • The net assets of the company based on the financial statements for the last reporting period; and • The minutes of the Supervisory Board meeting, which determined the redemption price for shares, including the redemption price. 	✓	✓
<p>Materials that must be made available when the agenda includes the reorganization of the company:</p> <ul style="list-style-type: none"> • The justification of the terms and procedures of the reorganization, contained in the decision on the division, separation, or transformation, or in the contract on merger or accession approved by the Supervisory Board; • The annual reports and financial statements of all companies involved in the reorganization for the last three fiscal years or for all completed fiscal years if the company was established less than three years ago; and • The quarterly accounting documents for the quarter that precedes the date of the AGM. 	✓	✓

Table 2: AGM Materials		
Information (Materials)	Required	Recommended
The position of the Supervisory Board on each agenda item and any dissenting opinions. ¹⁵¹		✓

d) When and Where Materials Must Be Made Available

AGM materials must be made available at the premises of the company where the General Director is located and any other places specified in the AGM notification:¹⁵²

- 20 days prior to the AGM; or
- 30 days prior to the AGM, if the agenda includes the reorganization of the company.

Information may also be made available at other places, preferably in an area where a significant numbers of shareholders reside,¹⁵³ as long as the address is specified in the AGM notification.

Best Practices: AGM materials should be posted on the internet, preferably on the company's website. Electronic dissemination is a simple and cost-effective method of allowing broad public access.

Each shareholder of record has the right to receive copies of AGM materials. The company may recoup the actual cost of making copies from shareholders.¹⁵⁴ Copies must be provided within five days of the request, unless the charter or by-laws specify a shorter period.¹⁵⁵

e) When and How Voting Ballots Are Sent to Shareholders

The Company Law dictates when the company is required to use voting ballots and when to distribute these in advance.

¹⁵¹ FCSM Code, Chapter 2, Section 1.3.3.

¹⁵² LJSC, Article 52, Clause 3, Paragraph 3.

¹⁵³ FCSM Code, Chapter 2, Section 1.3.5.

¹⁵⁴ LJSC, Article 52, Clause 3, Paragraph 4.

¹⁵⁵ FCSM Regulation No. 17/ps, Section 3.8.

Chapter 8. The General Meeting of Shareholders

Companies with more than 100 shareholders with voting rights must always use voting ballots.¹⁵⁶ Companies with fewer shareholders may use voting ballots if required by the charter.

The company is required to distribute voting ballots if it has more than 1,000 shareholders with voting rights or the charter requires so.¹⁵⁷

Voting ballots must be distributed to all shareholders of record:¹⁵⁸

- No later than 20 days prior to the AGM; and
- By registered mail, if the charter does not provide otherwise; or
- By hand with a delivery receipt.

For companies with more than 500,000 shareholders with voting rights, the charter may allow for the publication of voting ballots in the print media.¹⁵⁹

f) Information on Voting Ballots

Voting ballots must include the information summarized in Table 3.¹⁶⁰

Required Information	The Company Law	The FCSM Code
The full name and location of the company	✓	✓
The form of the AGM (either in the presence of shareholders or by written consent)	✓	✓
The date, place, and time of the AGM	✓	✓
Deadline prior to which completed ballots must be sent to the company	✓	✓
The mailing address to which completed ballots must be sent	✓	✓

¹⁵⁶ LJSC, Article 60, Clause 1.

¹⁵⁷ LJSC, Article 60, Clause 2, Paragraph 2.

¹⁵⁸ LJSC, Article 60, Clause 2, Paragraphs 2 and 3.

¹⁵⁹ LJSC, Article 60, Clause 2, Paragraph 4.

¹⁶⁰ LJSC, Article 60, Clause 4. FCSM Letter on Information that is Contained in the Voting Ballot for the General Meeting of Shareholders, 16 June 2000, Section 4; FCSM Regulation No. 17/ps, Sections 2.13. and 2.14.

The Russia Corporate Governance Manual

Table 3: Information That Must Be Included on the Voting Ballot		
Required Information	The Company Law	The FCSM Code
The wording of decisions on each issue and the names of candidates	✓	✓
The instruction that the ballot must be signed by the shareholder	✓	✓
The exact wording “for,” “against,” or “abstain” alongside each decision	✓	✓
An explanation of cumulative voting with the following text: “When Supervisory Board members are elected with cumulative voting, the shareholder may cast all his votes for one candidate or for several candidates”		✓
The ballot must have a designated area where shareholders must insert the number of votes they cast for each candidate		✓
The ballot must contain an explanation that fractions of a vote may only be cast for one candidate		✓
The ballot must show the number of votes each shareholder may cast to decide on each decision based on information from the shareholder list		✓
Instructions on how to complete the ballot → See also Section C.11 in this Chapter.		✓
The instruction that a shareholder who is a physical person must write his last name when he signs the ballot		✓
The instruction that an individual who completes the ballot on behalf of a shareholder that is a legal entity must indicate his name and position, and the full name of the legal entity which he represents		✓
The instruction that a copy of the power of attorney must be attached to the ballot, and that the representative of the shareholder must sign the voting ballot (if the voting is by proxy)		✓

g) Nominal Shareholders and Shareholder Notification

The AGM notification must be sent to nominal shareholders if the mailing address of the beneficial owner is unknown.

If notice is sent to a nominal shareholder, the nominal shareholder must inform the beneficial owner of the AGM. The nominal shareholder must give notice in

Chapter 8. The General Meeting of Shareholders

accordance with the procedure and time specified by legislation, or by agreement with the beneficial owner.¹⁶¹

5. Preliminarily Approving the Annual Report

The last step in preparing for the AGM is for the Supervisory Board to preliminarily approve the annual report, which must occur no later than 30 days prior to the AGM.¹⁶² Before it does so, the Revision Commission must verify the annual report.¹⁶³ The AGM then approves the final version of the annual report.

C. Conducting the Annual General Meeting of Shareholders

The company may conduct the AGM once all the preparatory steps have been completed. The AGM is a key corporate governance event, and its proper implementation thus takes on added importance.

Best Practices: The AGM should be used to inform shareholders about company activities, achievements, and plans, and to involve shareholders in important decisions. For a minority shareholder, the AGM is often the only chance to obtain detailed information about the company's operations, and to meet management and directors.¹⁶⁴

Convening and conducting the AGM is a complex task and a number of steps must be followed to ensure that the AGM meets legal requirements and the FCSM Code's recommendations.

Best Practices: The AGM should not start prior to 09.00 and should end not later than 22.00.¹⁶⁵ Clearly, one should steer away from a marathon AGM in order to avoid exhausting participants. This may pose considerable organizational challenges when the issues to be decided are either complex, contentious, and/or numerous.

¹⁶¹ LJSC, Article 52, Clause 4.

¹⁶² LJSC, Article 88, Clause 4.

¹⁶³ LJSC, Article 88, Clause 3, Paragraph 1.

¹⁶⁴ FCSM Code, Introduction to Chapter 2.

¹⁶⁵ FCSM Code, Chapter 2, Section 1.6.3.

The overriding principle for organizing the AGM is that it should be conducted in such a manner so as to facilitate effective shareholder participation and decision-making.

An overview of the steps necessary to organize the AGM is provided in Figure 10.

1. Shareholder Participation Options

Shareholders may attend the AGM in person or grant a power of attorney to a representative (proxy) who attends the AGM on the shareholder's behalf.¹⁶⁶ Shareholders may also participate in the GMS by sending completed voting ballots to the company (if voting ballots are distributed in advance). If participation is by proxy, the power of attorney must be drafted in compliance with legislation or notarized to become valid.¹⁶⁷ It may be revoked and/or transferred to another person at any time by the shareholder. In addition, the shareholder may change the terms of the proxy and give his representative different instructions at any time.

→ See Part VI, Annexes 22 and 23 for a model proxy from an individual and a legal entity, respectively.

In case of joint ownership of shares, proxy voting may be by:¹⁶⁸

- One of the owners, acting on behalf of all owners on the basis of a valid proxy; or
- A joint representative, acting on the basis of a valid proxy.

If an individual shareholder dies or a legal entity shareholder reorganizes after the record date, the legal heir or the new shareholder may attend.¹⁶⁹

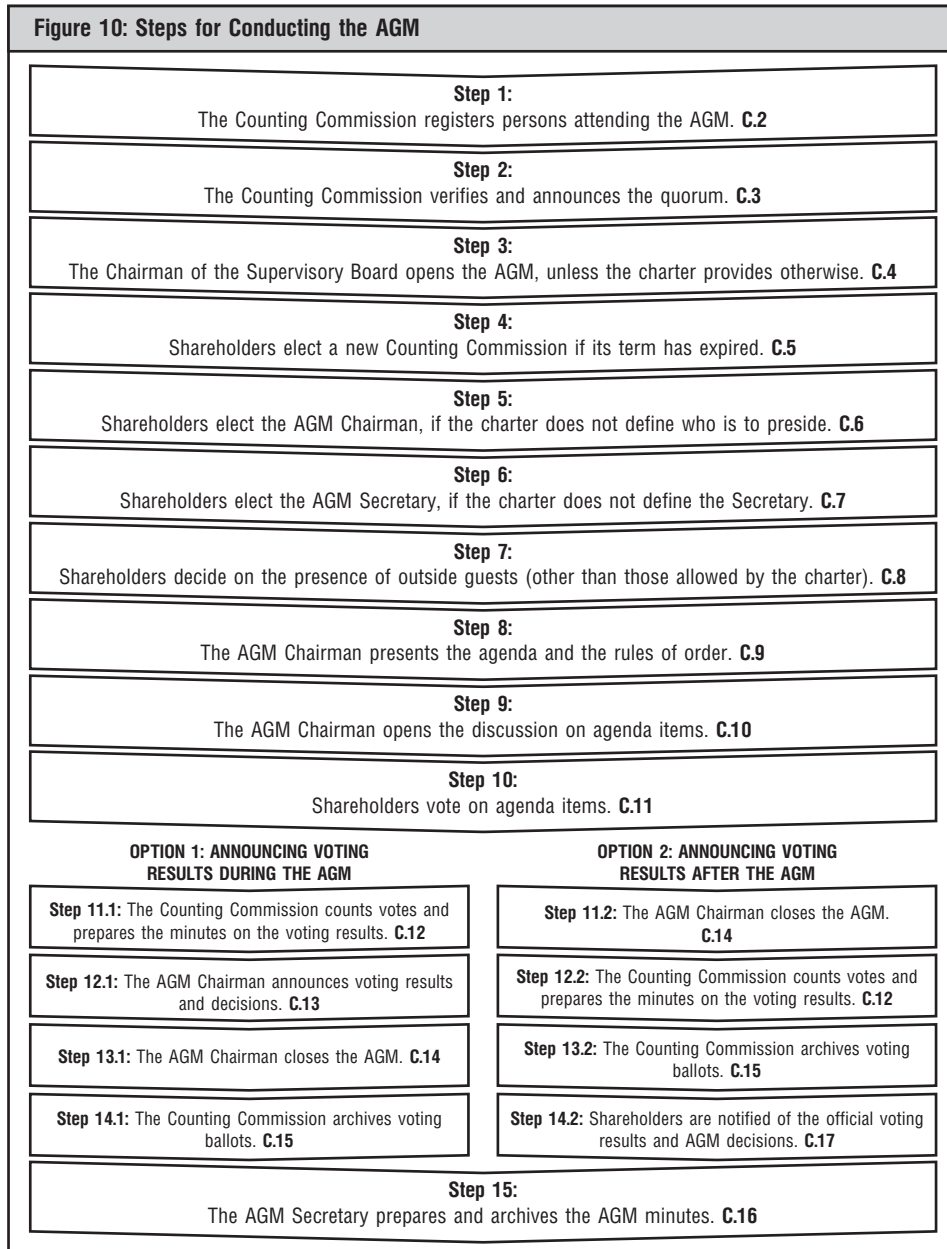
¹⁶⁶ LJSC, Article 57, Clause 1, Paragraph 1.

¹⁶⁷ LJSC, Article 57, Clause 1, Paragraph 3.

¹⁶⁸ LJSC, Article 57, Clause 3.

¹⁶⁹ FCSM Regulation No. 17/ps, Section 4.1.

Chapter 8. The General Meeting of Shareholders



Source: IFC, March 2004

2. Shareholder Registration

The previous year's Counting Commission registers shareholders or shareholder representatives before the AGM may begin.¹⁷⁰ Participants must be registered to verify the quorum. In the absence of a quorum, the AGM must be rescheduled. It should be noted that shareholders whose voting ballots were received at least two days prior to the AGM are automatically registered.¹⁷¹

Best Practices: To avoid company officials preventing shareholders from participating in the AGM, e.g. by blocking registration, the registration procedure should be described in detail in the internal documents of the company, and in the GMS notification.¹⁷²

a) Who Registers Shareholders

Registration of participants must be done by:

- The body specified by the charter when the company has 100 or fewer shareholders with voting rights, or by the External Registrar;¹⁷³ or
- The Counting Commission¹⁷⁴ when the company has more than 100 shareholders with voting rights;¹⁷⁵ or
- The External Registrar if it is assigned to perform such functions;¹⁷⁶ or
- The External Registrar when the company has more than 500 shareholders with voting rights.

b) Who Must Be Registered

The following persons must be registered before they may participate in the AGM:¹⁷⁷

¹⁷⁰ LJSC, Article 56, Clause 4.

¹⁷¹ FCSM Regulation No. 17/ps, Section 4.6.

¹⁷² FCSM Code, Chapter 2, Section 2.2.1.

¹⁷³ FCSM Regulation No. 17/ps, Section 4.4.

¹⁷⁴ Hereinafter, any references to the Counting Commission include other bodies fulfilling the function of the Counting Commission, as specified by the Company Law and/or the charter.

¹⁷⁵ LJSC, Article 56, Clause 1, Paragraph 1.

¹⁷⁶ LJSC, Article 56, Clause 1, Paragraph 2.

¹⁷⁷ FCSM Regulation No. 17/ps, Section 4.6.

Chapter 8. The General Meeting of Shareholders

- Shareholders, or shareholder representatives who did not return voting ballots; and
- Shareholders, or shareholder representatives who acquired shareholder rights due to the reorganization of the company or death of a shareholder.

c) What Documents Must Be Verified for the Registration

To register participants of the AGM, the registering body must verify:¹⁷⁸

- The identity of the participants;
- That participants are on the shareholder list; and
- That shareholder representatives, or proxies, have a valid power of attorney.

d) Registration of Participants and Voting Ballots

The registering body must provide voting ballots to participants after registration is complete, unless voting ballots were sent prior to the AGM.

e) The Time for the Registration of Participants

The registration of participants of the AGM officially starts at the time stated in the notice of the AGM and ends after the discussion of the last agenda item.¹⁷⁹

Best Practices: The registration of participants should be carried out on the same day just prior to conducting of the AGM.¹⁸⁰ Poorly organized registration may result in shareholders having to wait in line while the AGM starts. Accordingly, companies should make every effort to ensure that the registration process is quick and efficient, and that participants are not prevented from participating in the AGM due to administrative delays. This means that the registration desk needs to be adequately staffed, and open well in advance of the AGM.

¹⁷⁸ FCSM Regulation No. 17/ps, Section 4.8.

¹⁷⁹ FCSM Regulation No. 17/ps, Section 4.9, Paragraph 1.

¹⁸⁰ FCSM Code, Chapter 2, Section 2.2.2.

f) Where Participants Must Be Registered

Registration must take place where the AGM is held.¹⁸¹

3. Verifying and Announcing the Quorum

The Counting Commission must verify and announce that a quorum is present for the AGM after registration is complete and before shareholders may vote.¹⁸²

Owners of more than 50% of voting shares must participate in the AGM for it to commence and its decisions to be valid.¹⁸³ The shareholders participating in the AGM are those who:

- Are registered (in person or by proxy); or
- Have returned voting ballots no later than two days prior to the AGM.¹⁸⁴

If the agenda of the AGM includes items with different voting requirements for common shareholders and preferred shareholders, a quorum must be determined separately for each item. The absence of a quorum for any one agenda item does not prevent shareholders from voting on other agenda items for which a quorum exists.¹⁸⁵ A quorum must be re-verified for each agenda item.¹⁸⁶

A quorum is verified by counting the number of registered shares. Fractional shares must be counted for a quorum, and may not be rounded off.¹⁸⁷

The Chairman opens the AGM when there is a quorum for at least one agenda item. If there is no quorum, the AGM must be postponed in accordance with the charter or by-laws. The AGM may not be postponed for more than two hours.¹⁸⁸ If the charter or by-laws do not specify how long the AGM may be postponed, it must be postponed for only one hour. The AGM may be postponed only once.

¹⁸¹ FCSM Regulation No. 17/ps, Section 4.5.

¹⁸² LJSC, Article 56, Clause 4.

¹⁸³ LJSC, Article 58, Clause 1, Paragraph 1.

¹⁸⁴ LJSC, Article 58, Clause 1, Paragraphs 1 and 2.

¹⁸⁵ LJSC, Article 58, Clause 2.

¹⁸⁶ FCSM Regulation No. 17/ps, Section 4.11.

¹⁸⁷ FCSM Regulation No. 17/ps, Section 4.15.

¹⁸⁸ FCSM Regulation No. 17/ps, Section 4.9, Paragraphs 2 and 3.

Chapter 8. The General Meeting of Shareholders

In the absence of a quorum for at least one agenda item, the AGM must be rescheduled. The rescheduled AGM must be conducted with the same agenda.¹⁸⁹

The rescheduled AGM may be conducted and will be deemed valid if the owners of not less than 30% of voting shares participate in the rescheduled AGM.¹⁹⁰ The charter of a company with more than 500,000 shareholders with voting rights may set a lower quorum requirement for any rescheduled AGM.

Best Practices: Charters of companies with more than 500,000 shareholders (with voting rights) should require the registration of no less than 20% of voting shares for a rescheduled AGM.¹⁹¹

If the rescheduled AGM is held within 40 days of the original AGM, it is not necessary to prepare a new shareholder list.¹⁹² The rescheduled AGM may only be held if persons included on the shareholder list are notified in a timely manner according to procedures for the original AGM.¹⁹³

4. Opening the Annual General Meeting of Shareholders

The AGM may be opened if a quorum exists on at least one agenda item. The person who opens the AGM, typically the Chairman of the Supervisory Board, must invite shareholders to vote on:

- The Counting Commission members if their terms have expired;
- The AGM Chairman (unless the charter defines who presides over the GMS);¹⁹⁴ and
- The AGM Secretary (unless the charter defines who the Secretary is).

¹⁸⁹ LJSC, Article 58, Clause 3, Paragraph 1.

¹⁹⁰ LJSC, Article 58, Clause 3, Paragraphs 1 and 2.

¹⁹¹ FCSM Code, Chapter 2, Section 2.3.

¹⁹² LJSC, Article 58, Clause 4.

¹⁹³ LJSC, Article 58, Clause 3, Paragraph 3.

¹⁹⁴ LJSC, Article 67, Clause 2.

5. Electing the Counting Commission

The AGM must elect Counting Commission members when the company has more than 100 shareholders with voting rights and the term of the previous Counting Commission has expired.¹⁹⁵

If the company has more than 500 shareholders with voting rights, an External Registrar must perform the functions of the Counting Commission.¹⁹⁶ A company with 500 or fewer shareholders with voting rights may voluntarily retain an External Registrar to perform the functions of the Counting Commission.¹⁹⁷

The functions of the Counting Commission may also be assigned to an External Registrar when:¹⁹⁸

- The terms of Counting Commission members have expired; or
- The number of its members is less than three; or
- Fewer than three Counting Commission members are present at the AGM.

There are no term-limits for Counting Commission members.

Figure 11 depicts the various responsibilities of the Counting Commission.¹⁹⁹

The Counting Commission must have at least three members.²⁰⁰ To ensure that it performs its functions independently of the General Director, the Executive Board, and the Supervisory Board, the following individuals may not be members:²⁰¹

- Supervisory Board members, and candidates for the Supervisory Board;
- Revision Commission members, and candidates for the Revision Commission;
- The General Director, and candidates for the position of General Director;
- Executive Board members and candidates for the Executive Board; and
- The External Manager, and candidates for the External Manager.

¹⁹⁵ LJSC, Article 56, Clause 1.

¹⁹⁶ LJSC, Article 56, Clause 1.

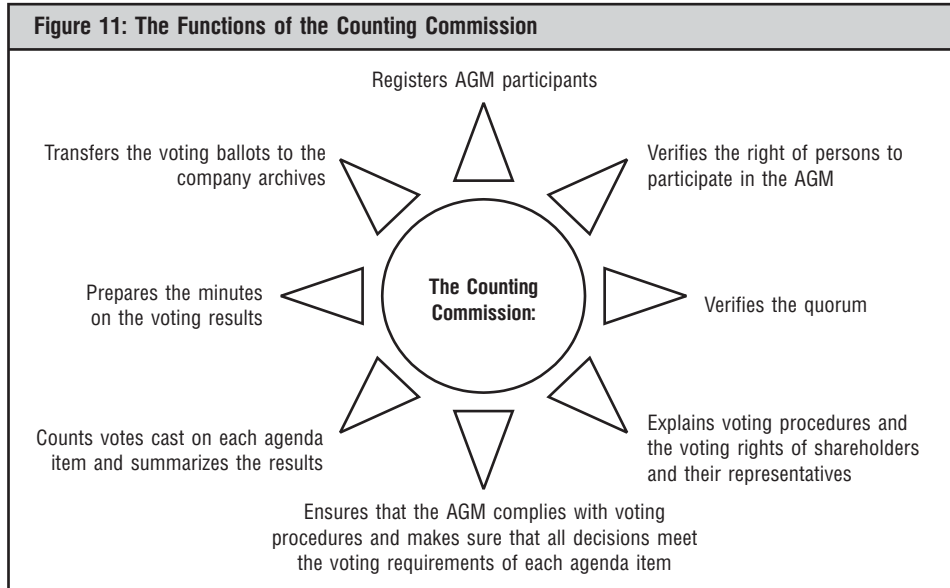
¹⁹⁷ LJSC, Article 56, Clause 1, Paragraph 2.

¹⁹⁸ LJSC, Article 56, Clause 3.

¹⁹⁹ LJSC, Article 56, Clause 4.

²⁰⁰ LJSC, Article 56, Clause 2.

²⁰¹ LJSC, Article 56, Clause 2.



Source: IFC, March 2004

6. Electing the Chairman of the Annual General Meeting of Shareholders

The Chairman of the Supervisory Board presides over the AGM if the charter does not provide otherwise.²⁰² In all other cases, shareholders must elect the AGM Chairman.

7. Electing the Secretary of the Annual General Meeting of Shareholders

The AGM must have a Secretary.²⁰³ The AGM Secretary ensures that discussions and decisions are duly recorded in the AGM minutes. Shareholders elect the AGM Secretary if the charter does not define who the Secretary is or when his term expires.

Best Practices: A qualified Corporate Secretary is an excellent candidate to serve as the AGM Secretary.²⁰⁴

²⁰² LJSC, Article 67, Clause 2.

²⁰³ LJSC, Article 63, Clause 1.

²⁰⁴ FCSM Code, Chapter 5, Section 1.1.7.

8. Inviting Outside Guests as Observers

As a practical matter, the company may invite creditors, potential investors, employees, government officials, journalists, experts, and other individuals and organizations that do not own company shares to the AGM. The charter and by-laws may specify procedures on inviting guests to the AGM.

9. Presenting the Agenda and the Rules of Order

The Chairman of the AGM presents the agenda to the AGM participants. In addition, the AGM Chairman explains the rules of order as specified either in the charter, by-laws or a decision of the GMS. Per request of the AGM Chairman, the Counting Commission explains the voting procedures.

10. Discussing Agenda Items

The AGM Chairman may invite Supervisory Board members, the General Director, and Executive Board members to comment on agenda items before the shareholders vote. He may also ask invited experts to explain agenda items to shareholders.

Best Practices: It is good practice that:²⁰⁵

- Shareholders have the opportunity to question Revision Commission members and the External Auditor;
- Shareholders receive clear answers to questions;
- Questions from shareholders are answered immediately. If a question cannot be answered immediately, a written response should be given as soon as possible after the AGM;
- The AGM be conducted so that all shareholders have an opportunity to make balanced and informed decisions on all agenda items;
- The External Auditor, the General Director, and members of the Supervisory Board, the Revision Commission, and the Executive Board are present at the AGM. If they are not, the AGM Chairman should explain their absence;
- Key officers of the company, including the chairmen of Supervisory Board committees, speak at the AGM;
- The agenda set aside some time for presentations by shareholders; and
- The Chairman of the AGM interrupt speakers only to maintain order or comply with procedural requirements.

²⁰⁵ FCSM Code, Chapter 2, Section 2.1.

11. Voting

After one or several agenda items have been thoroughly discussed, the Chairman of the AGM invites shareholders to vote. Voting is based upon the principle of “one voting share — one vote,” except for cumulative voting when directors are elected²⁰⁶ or when the charter includes voting limitations.²⁰⁷

Shareholders have the right to vote on all agenda items from the moment the AGM is opened until the moment it is closed when voting results are not announced during the AGM.²⁰⁸

When the charter, by-laws, or a decision of the AGM requires voting results to be announced during the AMG, all shareholders have the right to vote on all agenda items from the moment the AGM is opened until the counting of votes begins.²⁰⁹

The format of a ballot depends on the voting procedures. Ballots document how shareholders voted on agenda items. Further, they may help shareholders to prove how they voted in the event that there are subsequent legal actions. The ballot is typically a document that:

- Contains all agenda items on which shareholders may vote. In this case, the Counting Commission presents voting results to the Chairman of the AGM after shareholders have voted on all agenda items; or
- Consists of separate pages, each containing one or several items on which shareholders may vote. In this case, the Counting Commission presents the voting results to the Chairman of the AGM every time that shareholders vote on the items listed on one page.

➔ *For more information on voting ballots, see Section B.4.f of this Chapter.*

A ballot is valid if a shareholder marks only one of the possible options for a particular item.²¹⁰ A failure to do so invalidates the ballot with regard to that item.

²⁰⁶ LJSC, Article 59.

²⁰⁷ LJSC, Article 11, Clause 3.

²⁰⁸ FCSM Regulation No. 17/ps, Section 4.10.

²⁰⁹ FCSM Regulation No. 17/ps, Section 4.10.

²¹⁰ LJSC, Article 61.

Improperly completed voting ballots with respect to one or more items do not cause the voting ballot to be invalid for other agenda items.

Best Practices: The procedure for counting votes should be transparent. To avoid any (perception) that the voting results have been manipulated, the Counting Commission should be independently monitored when counting votes. The charter and other internal regulations should provide for such monitoring and, additionally, define the authority of those persons appointed to monitor the counting process.²¹¹

12. Counting and Documenting Votes

The Counting Commission must count the number of votes cast during the AGM and summarize voting results in its minutes. The Counting Commission presents the voting results to the Chairman of the AGM, who then announces the results (if the company decides to announce results immediately).

The FCSM requires that the Counting Commission minutes contain specific information.²¹²

→ See Section C.18 of this Chapter.

All Counting Commission members must sign the minutes on the voting results.²¹³ If the External Registrar performs the functions of the Counting Commission, the person(s) authorized by the Registrar must sign the minutes.²¹⁴

13. Announcing the Voting Results and Decisions

The Chairman of the AGM announces the voting results by reading the Counting Commission minutes and the AGM decisions.²¹⁵

²¹¹ FCSM Code, Chapter 2, Section 2.4.2.

²¹² FCSM Regulation No. 17/ps, Section 5.3.

²¹³ LJSC, Article 62, Clause 1.

²¹⁴ FCSM Regulation No. 17/ps, Section 5.4.

²¹⁵ LJSC, Article 62, Clause 4.

Best Practices: The voting results should be counted and announced prior to the closing of the AGM.²¹⁶

14. Closing the Annual General Meeting of Shareholders

The Chairman of the AGM closes the AGM when:

- All agenda items have been discussed and voted upon; and
- The voting results have been announced (if the company decides to announce results immediately).

An AGM may not be closed if a quorum does not exist on outstanding agenda items by the end of the registration.²¹⁷

Best Practices: The company should close the AGM on the same day to avoid unnecessary (extra) expenses for shareholders. If the AGM cannot be completed within one day, the company should continue the Meeting on the next day.²¹⁸

15. Archiving Voting Ballots

After the AGM, the Counting Commission must ensure that the voting ballots are sealed and transferred to the archives.²¹⁹

16. Preparing the Annual General Meeting of Shareholders Minutes

The company must prepare the AGM minutes within 15 days of its closure.²²⁰ The AGM Chairman and Secretary must each sign two original copies of the minutes.

²¹⁶ FCSM Code, Chapter 2, Section 2.4.3.

²¹⁷ FCSM Regulation No. 17/ps, Section 4.11.

²¹⁸ FCSM Code, Chapter 2, Section 2.4.1.

²¹⁹ LJSC, Article 62, Clause 2.

²²⁰ LJSC, Article 63, Clause 1.

The AGM minutes must include specific information.²²¹

→ *For more information on the information that must be contained in the AGM minutes, see Section C.18 of this Chapter.*

The AGM minutes are inserted in the minute book. The company must provide a copy of the AGM minutes to shareholders upon request.²²² Shareholders may be asked to reimburse the company for reasonable copying costs.²²³

The following documents must be attached to the AGM minutes:²²⁴

- The Counting Commission minutes on the voting results; and
- Documents approved by the AGM.

17. Notifying Shareholders of Voting Results and Decisions (After the Annual General Meeting of Shareholder)

If the voting results are not announced during the AGM, shareholders should receive a report detailing the results no later than 10 days after the minutes on the voting results are drafted.²²⁵ The report on the voting results should contain the information specified in Section C.18 below, and should be signed by the Chairman and Secretary of the AGM.²²⁶ The company should follow the same procedure as required for notifying shareholders of the AGM.

18. Documents of the Annual General Meeting of Shareholder

Table 4 presents a summary of information that must be included in the Counting Commission minutes on the voting results, as well as the AGM minutes (regardless of whether the results are announced during or after the AGM). It also covers the information required in the report on the voting results that must be furnished to shareholders in the event that decisions are not announced during the AGM.

²²¹ LJSC, Article 63, Clause 2; FCSM Regulation No. 17/ps, Section 5.1.

²²² LJSC, Article 91, Clause 1.

²²³ LJSC, Article 52, Clause 3, Article 91, Clause 2.

²²⁴ LJSC, Article 62, Clause 3; FCSM Regulation No. 17/ps, Section 5.2.

²²⁵ LJSC, Article 62, Clause 4.

²²⁶ FCSM Regulation No. 17/ps, Section 5.6.

Chapter 8. The General Meeting of Shareholders

Table 4: Information Related to the Results of the AGM			
Information	Must Be Included in:		
	The Minutes on the Voting Results	The AGM Minutes	The Report on the Voting Results
Full name and location of the company	✓	✓	✓
AGM address, i.e. location where it was held	✓	✓	✓
Date of the AGM	✓	✓	✓
Number of votes cast on each agenda item	✓	✓	✓
Number of votes on each agenda item and the required quorum	✓	✓	✓
Agenda	✓	✓	✓
Voting results (number of votes “for,” “against,” and “abstained” on each agenda item with a quorum)	✓	✓	✓
Type of GMS (AGM or EGM)	✓	✓	✓
Form of AGM (by physical attendance or written consent)	✓	✓	✓
Time when registration of participants started and ended	✓	✓	
Number of votes on each agenda item that were not counted because they were invalid	✓		
Names of Counting Commission members	✓		✓
Full name and location of the External Registrar or of persons authorized by the Registrar to act as the Counting Commission	✓	✓	✓
Date of writing the Counting Commission minutes on the voting results of the AGM	✓		
Name of the AGM Chairman and Secretary		✓	✓

Table 4: Information Related to the Results of the AGM			
Information	Must Be Included in:		
	The Minutes on the Voting Results	The AGM Minutes	The Report on the Voting Results
Text of approved decisions		✓	✓
Summary of speeches and discussions		✓	
Time when the AGM was opened and closed		✓	
Time when the calculation of votes started, if the decisions approved by the AGM and the voting results were announced during the Meeting		✓	
Mailing address of the company to which the completed voting ballots were submitted by shareholders, if the company distributed ballots prior to the AGM		✓	
Date when the AGM minutes were prepared		✓	

D. An Overview of the Extraordinary General Meeting of Shareholders

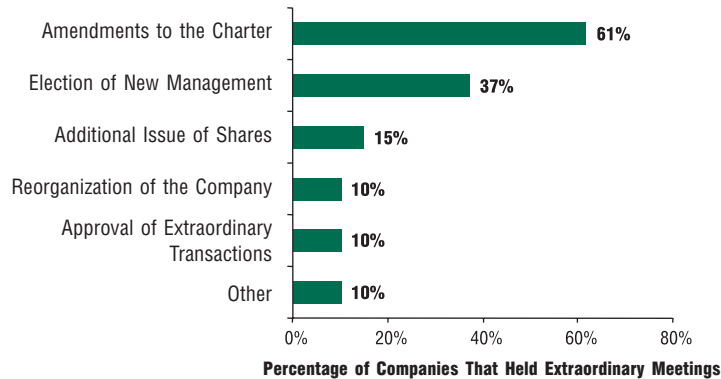
An EGM may be convened for the company to make important decisions between two AGM. The organization of an EGM resembles that of the AGM. The particularities of the organization of an EGM are the focus of this section.

Company Practices in Russia: 38% of companies in Russia's regions conducted an EGM during 2001 and 2002.²²⁷ As depicted in Figure 12, the two most frequent reasons for calling an EGM are: (1) changes to the company charter (61%) and (2) the election of new management (37%). In 70% of the

²²⁷ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.3.1, page 34, August 2003 (see www.ifc.org/rcgp).

companies holding an EGM, the Supervisory Board called the Meeting. Shareholders called an EGM in only 6% of companies. In only one case did a Revision Commission initiate an EGM.

Figure 12: Reasons for Calling an EGM



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003.

1. When to Conduct an Extraordinary General Meeting of Shareholders

An EGM may be called under a number of different circumstances:

a) When Required by Law

The Supervisory Board is required by law to conduct an EGM when:

- The Supervisory Board is unable to perform its duties due to the lack of a quorum, i.e. when the number of serving members becomes less than the quorum as specified by the charter;²²⁸ or
- The executive bodies are suspended or unable to perform their duties as shown in Table 5.

²²⁸ LJSC, Article 68, Clause 2.

Table 5: When the Supervisory Board is Required to Conduct an EGM²²⁹	
Circumstances	Agenda Items
The Supervisory Board suspends the authority of the General Director and appoints an interim General Director ²³⁰	The election of a new General Director
The Supervisory Board appoints an interim General Director because he cannot perform his duties due to illness, death, resignation, etc. ²³¹	The election of a new General Director
The Supervisory Board suspends the authority of the External Manager and appoints an interim General Director ²³²	The approval of the External Manager/General Director
The Supervisory Board appoints an interim General Director because the External Manager cannot perform the duties of the General Director due to illness, death, resignation, or the liquidation and bankruptcy of the Managing Organization	The approval of the External Manager/General Director
The number of serving Executive Board members becomes less than the quorum as specified by the charter ²³³	The election of a new Executive Board

b) Who May Request an Extraordinary General Meeting of Shareholders

A number of parties have the right to request an EGM, including:²³⁴

- The Revision Commission;
- The External Auditor; and

²²⁹ LJSC, Article 69, Clause 4, Paragraphs 3 and 4; Article 70, Clause 2, Paragraph 1.

²³⁰ The Supervisory Board has this authority when the establishment of executive bodies falls within the authority of the GMS, and the charter provides that the Supervisory Board has the authority to suspend the powers of the General Director and to appoint an interim General Director.

²³¹ The Supervisory Board has this authority when the establishment of executive bodies falls within the authority of the GMS.

²³² The Supervisory Board has this authority when the charter provides that the Supervisory Board has the right to suspend the powers of the external manager and to appoint an interim General Director.

²³³ The Supervisory Board has this authority when the establishment of the Executive Board falls within the authority of the GMS.

²³⁴ LJSC, Article 55, Clause 1, Paragraph 1.

Chapter 8. The General Meeting of Shareholders

- A shareholder (or a group of shareholders) owning at least 10% of voting shares.

The power to request an EGM is an important shareholder right. Though rarely exercised in practice, it allows the controlling bodies of the company to convene an EGM when they deem it necessary and appropriate.

2. Preparatory Procedures

An EGM and AGM have some procedural differences. These differences relate to the drafting of the agenda, timing requirements for notifying shareholders, and providing access to documents (information).

a) Initiating Preparation

The Supervisory Board initiates preparations if required by the Company Law or at its own discretion. When the request to convene an EGM comes from another party, the Company Law prescribes the following procedure:

- The Supervisory Board must review the request within five days;²³⁵
- The Supervisory Board decides to hold the EGM. The decision of when to hold the EGM will differ, in part, according to whether or not the agenda involves cumulative voting for directors;²³⁶ and
- The Supervisory Board must notify the requesting party within three days of the decision.²³⁷

The Supervisory Board has the right to reject the request when:²³⁸

- The request to conduct the EGM is inconsistent with the requirements of the Company Law;
- A shareholder (or a group of shareholders) does not own at least 10% of voting shares; or
- The proposed agenda items do not fall within the authority of the EGM and/or the proposal is inconsistent with legal requirements.

Rejection may be appealed to the courts.²³⁹

²³⁵ LJSC, Article 55, Clause 6, Paragraph 1.

²³⁶ LJSC, Article 55, Clause 2, Paragraphs 1 and 2.

²³⁷ LJSC, Article 55, Clause 7, Paragraph 1.

²³⁸ LJSC, Article 55, Clause 6, Paragraph 2.

²³⁹ LJSC, Article 55, Clause 7, Paragraph 2.

When the Supervisory Board makes no decision or decides to reject conducting an EGM, the requesting party has the right to conduct the EGM without the Supervisory Board's consent. In this case, the requesting party has the same rights and obligations as the Supervisory Board with respect to preparing and conducting the EGM.²⁴⁰ The company may be required to reimburse the expenses of the requesting party by a decision of the EGM.²⁴¹

b) Drafting the Agenda

The initiating party, i.e. the Supervisory Board or the requesting party, drafts the agenda of the EGM.

The agenda may include different items, including the election of directors. However, in the event that the number of directors becomes less than the quorum as specified by the charter, the agenda of the EGM may only include a single item, that to elect the new Supervisory Board. For another mandatory EGM, the agenda may include additional items.

c) Specific Requirements Depending on the Agenda Item

Different time periods exist for different procedural steps, depending on whether the election of Supervisory Board members, which must be conducted by cumulative voting, is on the agenda. These differences are summarized in Table 6.

	Cumulative Voting	Standard Voting or Other Agenda Items
Maximum period between the decision to conduct a mandatory EGM and the Meeting	70 days	40 days
Maximum period between the request to conduct a voluntary EGM and the Meeting	70 days	40 days
The record date is not earlier than (and no later than)	65 days (45 days)	50 days (45 days)
The notification of shareholders is not later than	50 days	20 days (30 days in case of reorganization)

²⁴⁰ LJSC, Article 55, Clause 8, Paragraph 1.

²⁴¹ LJSC, Article 55, Clause 8, Paragraph 2.

3. Conducting the Extraordinary General Meeting of Shareholders by Written Consent

The EGM may be held by written consent.²⁴² The EGM is held by written consent when shareholders do not have the opportunity to attend the EGM, and discuss and vote on agenda items. This is mainly useful when the EGM must make decisions on administrative matters, for example, increasing the number of Counting Commission members.

The section below describes the specific Company Law requirements in relation to an EGM conducted by written consent.

a) Decision-Making Powers of an Extraordinary General Meeting of Shareholders Held by Written Consent

An EGM held by written consent may decide all issues that fall within the GMS authority except for:²⁴³

- The election of Supervisory Board members (mandatory and voluntary);
- The election of Revision Commission members;
- The approval of the External Auditor; and
- The approval of the annual report, financial statements, the distribution of profits, and the payment of dividends.

An EGM by written consent may not be held in place of an AGM that is rescheduled because of the lack of a quorum.

b) Additional Information

Certain information, in addition to that available at an AGM, must be provided to shareholders in the notification, the voting ballot, and the EGM minutes, such as the deadline for accepting voting ballots and the mailing address to which completed ballots should be sent.²⁴⁴

²⁴² LJSC, Article 50, Clause 1.

²⁴³ LJSC, Article 50, Clause 2.

²⁴⁴ LJSC, Article 52, Clause 2; Article 60, Clause 4, Paragraph 1; FCSM Regulation No. 17/ps, Section 5.1.

c) The Date and Quorum of an Extraordinary General Meeting of Shareholders Held by Written Consent

The date on which an EGM is held by written consent is also the deadline for accepting voting ballots.²⁴⁵

An EGM by written consent is valid if the owners of more than 50% of voting shares participate. The shareholders who participate are those whose completed ballots have been received by the deadline.²⁴⁶

E. Decisions of the General Meeting of Shareholders

It is important to follow procedures for preparing and conducting the GMS to ensure the validity and lawfulness of decisions reached by this governing body.

1. Decisions Requiring a Simple Majority Vote

Most decisions of the GMS can be approved by a simple majority vote of participating shareholders, as depicted in Table 7.²⁴⁷

Table 7: Decisions that Require a Simple Majority Vote	
Decisions Related to the Governance of the Company	Reference
Approve the by-laws for the company's Supervisory Board, and executive bodies	LJSC, Article 48, Clause 1, Section 19
Approve the by-law for the Revision Commission	LJSC, Article 85, Clause 2, Paragraph 2
Determine the list of additional documents that must be kept by the company	LJSC, Article 89.
Related to the Supervisory Board, General Director, and Executive Board	
Approve the remuneration of Supervisory Board members	LJSC, Article 64, Clause 2
Appoint and dismiss the General Director and Executive Board members	LJSC, Article 48, Clause 1, Section 8

²⁴⁵ FCSM Regulation No. 17/ps, Section 4.19.

²⁴⁶ LJSC, Article 58, Clause 1, Paragraph 2.

²⁴⁷ LJSC, Article 49, Clause 2, Paragraph 1.

Chapter 8. The General Meeting of Shareholders

Table 7: Decisions that Require a Simple Majority Vote	
Transfer (and terminate the transfer) of the General Director's authority to the External Manager	LJSC, Article 69, Clause 1, Paragraph 3
Related to the Audit Function	
Request an extraordinary inspection of the financial and economic activities of the company by the Revision Commission	LJSC, Article 85, Clause 3, Paragraph 1
Elect and dismiss Revision Commission members or the individual performing the functions of the Revision Commission	LJSC, Article 48, Clause 1, Section 9
Approve the terms of compensation and reimbursement of Revision Commission members	LJSC, Article 85, Clause 1, Paragraph 2
Appoint the External Auditor	LJSC, Article 48, Clause 1, Section 10
Approve annual reports, annual financial statements, including profit and loss statements, the distribution of profits and losses, and the payment of dividends	LJSC, Article 48, Clause 1, Section 11
Related to Shareholder Rights	
Declare and pay dividends	LJSC, Article 48, Clause 1, Section 10.1
Establish procedures for the organization of the GMS if this is provided by the charter or by-laws	LJSC, Article 48, Clause 1, Section 12
Elect and dismiss Counting Commission members	LJSC, Article 48, Clause 1, Section 13
Determine the number of Counting Commission members	LJSC, Article 56, Clause 1
Approve the reimbursement of expenses if the EGM is conducted by parties other than the Supervisory Board	LJSC, Article 55, Clause 8
Increase the charter capital by increasing the nominal value of issued shares	LJSC, Article 48, Clause 1, Section 6
Increase the charter capital by issuing additional shares (if this power has not been delegated to the Supervisory Board by the charter)	LJSC, Article 48, Clause 1, Section 6; Article 39, Clause 4

The Russia Corporate Governance Manual

Table 7: Decisions that Require a Simple Majority Vote	
Reduce the charter capital by decreasing the nominal value of placed shares or by reducing the number of placed shares by retiring treasury shares	LJSC, Article 48, Clause 1, Section 7
Decrease or increase the nominal value of shares (split or consolidate shares)	LJSC, Article 48, Clause 1, Section 14
Approve related party transactions in cases specified by the Company Law (only by shareholders who are not interested parties in a transaction)	LJSC, Article 48, Clause 1, Section 15
Approve extraordinary transactions involving 50% or less of the book value of company assets	LJSC, Article 48, Clause 1, Section 16
Waive the obligation of the controlling shareholders to make a mandatory bid in case of control transactions	LJSC, Article 80, Clause 2, Paragraph 2
Issue bonds or other convertible securities through open subscription if these bonds and other securities may be converted into 25% or less of already issued common shares (if this power has not been delegated to the Supervisory Board by the charter)	LJSC, Article 33, Clause 2, Paragraph 2
Participate in holding companies, financial industrial groups, associations, or other groupings of commercial entities	LJSC, Article 48, Clause 1, Section 18

2. Decisions Requiring a Supermajority Vote

a) Per the Company Law

Table 8 summarizes decisions that must be approved by a $\frac{3}{4}$ -majority vote of participating shareholders.²⁴⁸

Table 8: Decisions Requiring a $\frac{3}{4}$-Majority Vote	
Decisions	References
Amend the charter or approve a new version of the charter	LJSC, Article 48, Clause 1, Section 1
Reorganize the company	LJSC, Article 48, Clause 1, Section 2

²⁴⁸ LJSC, Article 49, Clause 4.

Chapter 8. The General Meeting of Shareholders

Decisions	References
Liquidate the company and appoint Liquidation Committee members	LJSC, Article 48, Clause 1, Section 3
Approve the interim and final liquidation balance sheets	LJSC, Article 48, Clause 1, Section 3
Determine the number, nominal value, types, and classes of authorized shares	LJSC, Article 48, Clause 1, Section 5
Approve extraordinary transactions involving more than 50% of the book value of company assets	LJSC, Article 79, Clause 3
Approve the buy-back by the company of its issued shares	LJSC, Article 48, Clause 1, Section 17

b) Per the Charter

Some GMS decisions must be approved by a supermajority vote if specified in the charter, as depicted in Table 9.

Decision	Percentage of Votes	Reference
Amend the charter that limit the rights of preferred shareholders	<ul style="list-style-type: none"> A $\frac{3}{4}$-majority vote of preferred shareholders of a specified class whose rights will be affected as a result of charter amendments (if the charter does not require a higher percentage of votes); and A separate $\frac{3}{4}$-majority vote of all other shareholders with voting rights participating in the GMS (if the charter does not require a higher percentage of votes). 	LJSC, Article 32, Clause 4
Issue additional shares through closed subscription	A $\frac{3}{4}$ -majority vote of shareholders participating in the GMS (if the charter does not require a higher percentage of votes).	LJSC, Article 39, Clause 3

Table 9: Decisions Requiring a Supermajority Vote as Per the Charter		
Decision	Percentage of Votes	Reference
Issue convertible securities through closed subscription	A $\frac{3}{4}$ -majority vote of shareholders participating in the GMS (if the charter does not require a higher percentage of votes).	LJSC, Article 39, Clause 3
Issue additional shares through an open subscription that are more than 25% of the outstanding common shares	A $\frac{3}{4}$ -majority vote of shareholders participating in the GMS (if the charter does not require a higher percentage of votes).	LJSC, Article 39, Clause 4
Issue bonds or other convertible securities through open subscription if such bonds and other securities may be converted into more than 25% of the outstanding common shares	A $\frac{3}{4}$ -majority vote of shareholders participating in the GMS (if the charter does not require a higher percentage of votes).	LJSC, Article 39, Clause 4

3. Decisions Requiring a Unanimous Vote

The decision to reorganize the company into a non-commercial partnership must be approved by a unanimous vote of all shareholders.²⁴⁹

4. Appealing Decisions

Under certain circumstances, GMS decisions may be appealed to (and potentially invalidated by) the courts. Decisions may be appealed when legal and/or charter requirements have not been met.²⁵⁰ GMS decisions may be appealed by:

- A shareholder (or a group of shareholders) who did not participate in the GMS that approved the decision that is being appealed; or
- A shareholder (or a group of shareholders) who voted against the approval of the decision that is being appealed; if
- The decision violates his rights and lawful interests.

A decision of the GMS may be appealed within six months from the date the shareholder knew (or should have known) about the decision.

²⁴⁹ LJSC, Article 20, Clause 1, Paragraph 2.

²⁵⁰ LJSC, Article 49, Clause 7.

The court may leave the contested decision intact when the:

- Vote of the claimant would not have changed the outcome; and
- Violation of the legal and/or the charter requirements are not significant; and
- Decision caused no losses to the claimant.

The following violations are significant enough to revoke a decision taken by the GMS:²⁵¹

- Failure to provide timely notice of the GMS to all shareholders;
- Depriving the shareholder of the opportunity to familiarize himself with the materials for the GMS; or
- Failure to distribute voting ballots on a timely basis.

Even if a shareholder did not file a claim, the court can still invalidate a decision of the GMS, under the following conditions:²⁵²

- Parties in another court proceeding base their arguments on a particular decisions of the GMS; and
- The court learns that the decision has been approved in violation of the GMS' authority; or
- The GMS lacked a quorum; or
- The issue in question was not included in the agenda.

F. The General Meeting of Shareholders in Companies with a Single Shareholder

When the company has only one shareholder who possesses all of the voting rights, this shareholder may make all decisions that fall within the authority of the GMS. All decisions must be approved in writing by the single shareholder.²⁵³ The procedures established by the Company Law for preparing and conducting the GMS do not apply to a company with a single shareholder, except for the requirement that the AGM must be held no earlier than two months and no later than six months after the end of the fiscal year.

²⁵¹ Resolution No. 19 of the Plenum of the Supreme Arbitration Court, on Certain Issues of Application of the Law on Joint Stock Companies (Resolution No. 19), 18 November 2003, Section 24.

²⁵² Resolution No. 19, Section 26.

²⁵³ LJSC, Article 47, Clause 3.



Chapter 9

Corporate Governance **Implications** of the **Charter Capital**



Table of Contents

A. GENERAL PROVISIONS RELATED TO THE CHARTER CAPITAL	94
1. <i>The Definition of Charter Capital</i>	94
2. <i>Minimum Charter Capital</i>	95
3. <i>Charter Capital and Authorized Shares</i>	95
4. <i>Full Payment for Shares</i>	96
5. <i>Contributions to the Charter Capital</i>	96
B. INCREASING THE CHARTER CAPITAL	98
1. <i>Methods of Increasing the Charter Capital</i>	98
2. <i>Methods of Placement</i>	99
3. <i>Internal Sources for Increasing the Charter Capital</i>	99
4. <i>Ownership Rights Protection When Increasing the Charter Capital</i> ..	100
5. <i>Procedural Guarantees for Increasing the Charter Capital</i>	101
C. PROTECTING THE CHARTER CAPITAL	105
1. <i>Overview of Decreasing the Charter Capital</i>	107
2. <i>Share Buybacks</i>	110
3. <i>Redemption of Shares</i>	114
4. <i>Reciprocal Shareholdings</i>	115
D. STATUTORY RESERVES	116
1. <i>The Reserve Fund</i>	116
2. <i>Other Funds</i>	117
3. <i>Additional Paid-In Capital</i>	118

The Chairman's Checklist

- ✓ Has the Supervisory Board ensured that the company's founders have paid their initial contributions and that in-kind contributions have been properly valued?
- ✓ Does the Supervisory Board understand the financial needs of the company and the different techniques of corporate finance? Is the Supervisory Board authorized to increase the charter capital? Is the Supervisory Board careful not to dilute the ownership of shareholders?
- ✓ Are capital increases justified?
- ✓ Does the Supervisory Board ensure that the charter capital and consequently the creditors are adequately protected in cases of charter capital decreases? In such cases, does the Supervisory Board make decisions regarding the buyback of company shares? Has the Supervisory Board ensured that all shareholders who submit their shares are treated equitably?
- ✓ How does the Supervisory Board ensure that the reserve fund is utilized in the best interests of the company? What other funds has the company established?

The concept of charter capital is still largely embedded in continental European law. The same holds true for Russia. The Company Law in particular attaches certain protective functions to charter capital, protecting shareholders from dilution and providing a minimum guarantee that obligations toward company creditors will be fulfilled. Although the charter capital per se cannot fulfill that role, it is still considered one of the elements guaranteeing the interests of creditors. Regarding shareholders, the charter capital plays an important role since many shareholder rights are directly linked to the size of their investment in the charter capital.

Charter capital has a legal, rather than economic meaning. It only exists in accounting terms, as fixed in the balance sheet. For this reason, its protective function is often criticized as a formality. Regardless, it is a legal requirement when establishing and operating a company. Legislation provides for certain rules

that govern both increases and decreases in the charter capital. In addition, there are other procedural guarantees of shareholder and creditor rights, such as the buyback by the company of its own shares, the redemption of shares, reciprocal shareholdings, and the maintenance of statutory reserves, all of which are discussed in this chapter.

A. General Provisions Related to the Charter Capital

The charter capital is an important element of the legal definition of a joint stock company, which is defined as a commercial entity, whose charter capital is divided into a specified number of shares, certifying the company participants' (shareholders') rights in relation to the company.²⁵⁴ The charter capital has important legal implications for:

- Determining the minimum amount of a shareholder's liability;²⁵⁵
- Determining shareholder rights in relation to their proportionate share in the charter capital; and
- Offering support to protect creditor rights by setting the minimum amount of assets a company must have; this is one of the legal instruments upon which creditors can rely when seeking to ensure that the company will fulfill its contractual obligations.²⁵⁶

1. The Definition of Charter Capital

The charter capital is defined as the par value of the company's shares that are issued and outstanding.²⁵⁷ Only shares that have been issued comprise the charter capital. This includes treasury shares, i.e. shares repurchased by the company for re-sale or for retirement that are issued but not outstanding. Bonds and other credit instruments are not part of the charter capital.

²⁵⁴ Civil Code (CC), Article 96, Clause 1; Law on Joint Stock Companies (LJSC), Article 2, Clause 1, Paragraph 1.

²⁵⁵ LJSC, Article 2, Clause 1, Paragraph 2.

²⁵⁶ LJSC, Article 25, Clause 1, Paragraph 3.

²⁵⁷ LJSC, Article 25, Clause 1.

Chapter 9. Corporate Governance Implications of the Charter Capital

The total amount of the charter capital cannot exceed a maximum of 25% preferred shares and must contain a minimum of 75% common shares.²⁵⁸

2. Minimum Charter Capital

Legislation requires that every company have minimum charter capital of at least 1,000 times the minimum monthly wage (effective on the date of the company's state registration).²⁵⁹ This amount is intended to dissuade smaller undertakings from registering as joint stock companies, and provide start-up capital to newly established companies that cannot be distributed to shareholders.

3. Charter Capital and Authorized Shares

The Company Law provides that the charter may specify the number and nominal value of authorized shares of each type and class, as well as the rights attached to them.²⁶⁰ Authorized shares are the maximum number of shares of any class that a company may create under the terms of its charter, in addition to already issued shares.

The company is not required to issue all shares it has authorized. If the company chooses not to issue authorized shares, these shares are referred to as authorized but not issued. Only those shares that are issued constitute the charter capital.

A shareholder vote is required to increase the number of authorized shares. In order to avoid costly and time-consuming GMS organization procedures every time the company seeks additional capital, a company may issue some of its authorized but previously un-issued shares by a Supervisory Board decision.

The total authorized capital that a company sets forth in its charter is based upon the amount of money that the company requires at its establishment and the percentage of dilution its founders are willing to accept in the future.

²⁵⁸ LJSC, Article 25, Clause 2.

²⁵⁹ LJSC, Article 26; The Law on the Minimum Amount of Payment for Labor, Article 4. Currently, the minimum monthly wage is set at RUR 100.

²⁶⁰ LJSC, Article 27, Clause 1, Paragraph 2.

Best Practices: Good corporate governance practice stipulates that the charter should authorize the Supervisory Board to increase the charter capital by issuing authorized shares. When doing so, the charter should include the following information:

- Maximum number of authorized shares. In general, the maximum amount must not exceed 100% of the charter capital at the moment of the authorization for the Supervisory Board to issue authorized shares;
- Types and classes of authorized shares; and
- Form of payment for additionally issued shares.

4. Full Payment for Shares

Shares issued and placed during the establishment of the company must be paid in full within one year from the moment of the company's state registration, unless the founders' contract provides for a shorter period.²⁶¹ Full payment should guarantee that shareholders contribute the minimum amount of assets and that the charter capital is duly formed. If shares have not been fully paid upon expiration of a specified period, the unpaid shares must be returned to the company. The founders' contract may also provide penalties in cases of non-payment or failure to pay in full. At least 50% of the shares placed to the founders at the establishment of the company must be paid within three months after the company's state registration.²⁶² The company is prohibited from engaging in any activity, other than those related to the establishment of the company, before receiving payment for 50% of the shares.²⁶³

5. Contributions to the Charter Capital

The form of payment for shares during the establishment of the company must be specified by the founders' contract.²⁶⁴ In general, the shares issued during the estab-

²⁶¹ LJSC, Article 34, Clause 1.

²⁶² LJSC, Article 34, Clause 1, Paragraph 2.

²⁶³ LJSC, Article 2, Clause 2, Paragraph 2. This provision is unclear as to whether these shares have to be paid in full and who is responsible for verifying that full payment has been made.

²⁶⁴ LJSC, Article 34, Clause 2.

Chapter 9. Corporate Governance Implications of the Charter Capital

ishment of the company can be paid with money or contributions in-kind, including shares and securities of other companies, tangible or intangible assets, property rights, and/or other rights that have monetary value.²⁶⁵ In-kind contributions are, however, subject to certain rules. The valuation of in-kind contributions must be agreed upon by the founders²⁶⁶ and supported by the valuation of an Independent Appraiser. Founders are prohibited from setting the value of assets, property rights, and other rights at a value higher than that determined by an Independent Appraiser.²⁶⁷ An Independent Appraiser cannot be a founder, an owner, a shareholder, an employee, a contractor, or any other person affiliated with the company.²⁶⁸ Any individual (or a legal entity) needs a license to be an Independent Appraiser. An Independent Appraiser must be insured against civil liability.²⁶⁹

In addition to the valuation of initial in-kind contributions to the charter capital, an independent appraisal is required when the company:

- Redeems shares;²⁷⁰
- Is engaged in a transaction that involves state property;²⁷¹
- Is engaged in mortgage operations;²⁷² or
- Is engaged in the sale of its assets during bankruptcy.

Best Practices: A company should use a licensed Independent Appraiser to determine the market value of property,²⁷³ value debts, and assess liabilities.²⁷⁴ An Independent Appraiser can also play an important role in assisting management and shareholders during the company reorganization.

²⁶⁵ LJSC, Article 34, Clause 2.

²⁶⁶ LJSC, Article 34, Clause 3, Paragraph 1.

²⁶⁷ LJSC, Article 34, Clause 3, Paragraph 3.

²⁶⁸ Law on Appraisal Activity, Article 16.

²⁶⁹ Law on Appraisal Activity, Article 17.

²⁷⁰ LJSC, Article 75, Clause 3.

²⁷¹ Law on Appraisal Activity, Article 8.

²⁷² Law on Appraisal Activity, Article 8; Law on Mortgage of Property, Article 14, Clause 1.

²⁷³ LJSC, Article 77, Clause 2, Paragraph 1.

²⁷⁴ Law on Appraisal Activity, Article 5.

B. Increasing the Charter Capital

A number of different factors, such as market conditions, reorganizations, and growth, may necessitate an increase of charter capital. There are two methods of increasing the charter capital:

- Utilizing external sources, such as when the company attracts financial resources from existing shareholders or third parties; and
- From internal sources when the company uses its own funds to capitalize its internal reserves.

1. Methods of Increasing the Charter Capital

Methods to increase the charter capital are summarized in Table 1.²⁷⁵

Table 1: Increasing the Charter Capital			
	Issuing additional shares for consideration	Issuing additional shares without consideration	Increasing the nominal value of shares
Source	External	Internal	Internal
Contributors	Shareholders and third parties	The company (using funds available from internal sources as defined by legislation)	The company (using funds available from internal sources as defined by legislation)
Purpose	To attract additional funding. It will, however, dilute the holdings of existing shareholders if they are unwilling/unable to make use of their pre-emptive rights	To pay stock dividends, increase the company's equity, etc.	To pay stock dividends, increase the company's equity, etc.
Recipients of new shares	Existing shareholders and third parties	Only existing shareholders	Only existing shareholders

²⁷⁵ LJSC, Article 28, Clause 1.

Chapter 9. Corporate Governance Implications of the Charter Capital

Table 1: Increasing the Charter Capital			
	Issuing additional shares for consideration	Issuing additional shares without consideration	Increasing the nominal value of shares
Changing the company's ownership structure	Possibly	No	No
Method of share issue	Issue of additional (authorized) shares	Issue of additional (authorized) shares	Issue of shares with a higher nominal value
Method of placement	Subscription (open or closed)	Distribution	Conversion
Approving governing body	The General Meeting of Shareholders (GMS), unless delegated by the charter to the Supervisory Board	The GMS, unless delegated by the charter to the Supervisory Board	The GMS
Pre-emptive rights	Yes	No	No

2. Methods of Placement

There are three methods of placing shares:

- 1) Distribution of shares among shareholders;
- 2) Conversion, for example when the company increases the charter capital by increasing the nominal value of issued shares; and
- 3) Subscription, that is when the company floats shares for consideration.

3. Internal Sources for Increasing the Charter Capital

Depending on the method chosen to increase the charter capital, the company can use the funds of shareholders and/or third parties; it can also choose to capitalize using its internal resources. The company may use the following internal resources for capitalization purposes:²⁷⁶

- Additional paid-in capital;
- Special purpose funds of the company that were not used during the previous

²⁷⁶ FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses (FCSM Regulation No. 03-30/ps), 18 June 2003, Section 4.3.2.

year (the reserve fund and the employees' fund cannot however be used for this purpose); and

- Retained earnings/undistributed profits.

When increasing the charter capital from internal sources, the amount of the increase cannot exceed the difference between the amount of the net assets, on the one hand, and, on the other, the sum of the charter capital and the reserve fund as of the date the decision to increase the charter capital is approved.²⁷⁷

There are two types of subscription available, as shown in Table 2:²⁷⁸

Open	Closed
<ul style="list-style-type: none"> • The offer is made to an unlimited number of subscribers; • The charter or legislation cannot limit the subscription. 	<ul style="list-style-type: none"> • The offer is made to a limited number or a pre-determined group of subscribers; • The charter or legislation can limit the subscription.

4. Ownership Rights Protection When Increasing the Charter Capital

The company's ownership structure will likely change if the charter capital is increased from external sources. Issuing additional shares results in the dilution of the ownership rights of existing shareholders. Under certain circumstances, however, existing shareholders may have pre-emptive rights to protect them from dilution.²⁷⁹

→ *For a more detailed discussion on pre-emptive rights, see Chapter 7, Section B.5.*

When increasing the charter capital from internal sources, additional shares must be distributed to all owners of shares of each type and class.²⁸⁰ In addition, the number of new shares of each type and class that are distributed to each shareholder must be pro rated to the number of shares already held by him.

²⁷⁷ LJSC, Article 28, Clause 5, Paragraph 2.

²⁷⁸ LJSC, Article 39, Clause 2, Paragraph 1.

²⁷⁹ LJSC, Article 40, Clause 1, Paragraphs 1 and 2.

²⁸⁰ LJSC, Article 28, Clause 5, Paragraph 3; FCSM Regulation No. 03-30/ps, Section 4.3.4.

Chapter 9. Corporate Governance Implications of the Charter Capital

Consequently, each shareholder who owns fractional shares must receive a proportionate fraction of a full share of the same type and class.²⁸¹ However, Russian legislation forbids an increase in the charter capital from internal sources if fractional shares will occur as a result.²⁸²

5. Procedural Guarantees for Increasing the Charter Capital

Company Law and securities legislation provide detailed procedures that companies must follow in order to increase the charter capital. These procedures are aimed at guaranteeing that shareholder rights are protected. The Federal Commission for the Securities Market (FCSM), by registering share issues, plays an important role in overseeing the legality of the increase, thus enforcing proper corporate governance practices in such cases.

The GMS or the Supervisory Board plays the leading role in increasing the charter capital, depending on the method chosen.

a) The GMS Makes the Decision to Place Shares

The decision to increase the charter capital by increasing the nominal value of issued shares must be approved by the GMS.²⁸³ The GMS also decides to increase the charter capital by issuing additional shares (with or without consideration), unless the charter has delegated this right to the Supervisory Board.²⁸⁴

First, if the decision to increase the charter capital by issuing additional shares (with or without consideration) falls within the authority of the GMS, legislation requires that the Supervisory Board place the proposal (or motion) to increase the charter capital on the GMS agenda. Unless the charter provides otherwise, only the Supervisory Board has the right to propose the item for the agenda.²⁸⁵ A simple majority vote of directors participating in the Supervisory Board meeting must approve the proposal unless the charter or by-laws require a higher percentage of votes.²⁸⁶

²⁸¹ FCSM Regulation No. 03-30/ps, Section 4.3.6.

²⁸² FCSM Regulation No. 03-30/ps, Section 4.3.5.

²⁸³ LJSC, Article 28, Clause 2, Paragraph 1.

²⁸⁴ LJSC, Article 28, Clause 2, Paragraph 2.

²⁸⁵ LJSC, Article 49, Clause 3.

Second, the company cannot issue shares unless it has sufficient authorized shares for this purpose.²⁸⁷ The GMS can simultaneously take the decision to increase the charter capital and the decision to either amend the charter to provide for the respective number of authorized shares or amend the charter provision concerning the number of authorized shares.²⁸⁸ The GMS decision to increase the charter capital is also called the decision to place shares. The different majority votes required for these decisions are summarized in Table 3.

3/4-Majority in the Case of:²⁸⁹	Simple Majority in the Case of:²⁹⁰
<ul style="list-style-type: none"> • An issuance of additional common shares representing more than 25% of the total issued common shares through open subscription • An issuance of additional preferred shares which can be converted into common shares representing more than 25% of the total issued common shares through open subscription • Closed subscription 	<ul style="list-style-type: none"> • All other instances

b) The Supervisory Board Decides to Place Shares

In general, the purpose of authorized shares is to enable the company to attract additional capital in an uncomplicated manner. Procedural requirements for increasing the charter capital by the decision of the GMS are cumbersome, time-consuming, and costly. This may make it harder for the company to attract financing quickly in a rapidly changing business environment. For this very purpose, the Company Law permits companies to empower the Supervisory Board to issue authorized shares (with or without consideration). In this case, a unanimous approval of all serving Supervisory Board members is, however, required.²⁹¹

²⁸⁶ LJSC, Article 68, Clause 3.

²⁸⁷ LJSC, Article 27, Clause 1, Paragraph 2.

²⁸⁸ LJSC, Article 28, Clause 3, Paragraph 2.

²⁸⁹ LJSC, Article 49, Clause 4; Article 39, Clause 4; Article 32, Clause 4, Paragraph 2. The charter may provide for a higher percentage of votes required for a decision.

²⁹⁰ LJSC, Article 28, Clause 2; Article 49, Clause 2.

²⁹¹ LJSC, Article 28, Clause 2, Paragraph 3.

Chapter 9. Corporate Governance Implications of the Charter Capital

Best Practices: The Supervisory Board should conduct a meeting where directors are physically present to approve the decision to place shares.²⁹²

The Supervisory Board may only approve the decision to place shares if the number of additional shares of each type and class to be issued does not exceed the total number of authorized shares of each type and class as set forth in the charter.²⁹³

c) Information that Must Be Included in the Decision to Place Shares

Depending on the method of placement, the decision to place shares must include the information presented in Table 4.²⁹⁴

Table 4: Information that Must Be Included in the Decision to Place Shares			
Required Information	Method of Placement		
	Conversion	Distribution	Subscription (Open or Closed)
The types and classes of shares, the nominal value of which will be increased	✓		
The nominal value of shares of each type and class after the increase	✓		
Information that the increase of the charter capital is from retained earnings (if it is so provided)	✓		
The method of placement	✓	✓	✓
The number of shares of each type and class that will be issued within the limits of authorized shares		✓	✓

²⁹² Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 3, Section 4.4.

²⁹³ LJSC, Article 28, Clause 3, Paragraph 1.

²⁹⁴ LJSC, Article 28, Clause 4; FCSM Regulation No. 03-30/ps, Sections 4.1.3, 5.1.1, 6.1.1 and 6.1.10.

The Russia Corporate Governance Manual

Table 4: Information that Must Be Included in the Decision to Place Shares			
Required Information	Method of Placement		
	Conversion	Distribution	Subscription (Open or Closed)
The price of additional shares, or the procedure to determine the price, of additional shares → <i>For more information on the placement price, see Chapter 11, Section C.</i>			✓
The price of additional shares, or the procedure to determine the price, for shareholders who exercise pre-emptive rights			✓
The form of payment for additionally issued shares (if required)			✓
The list of persons (names and/or categories of persons such as the company's employees, shareholders, credit institutions, etc.) to whom the company intends to issue additional shares if the issue takes place through closed subscription			✓

Depending on the method of placement, the decision to place shares can include optional information, as presented in Table 5.²⁹⁵

Table 5: Optional Information Included in the Decision to Place Shares			
Optional Information	Method of Placement		
	Conversion	Distribution	Subscription (Open or Close)
The date, or the procedure to determine the date, of placement (the dates of the beginning and end of the period of placement)	✓	✓	✓
The sources from which the increase in charter capital will be paid	✓	✓	

²⁹⁵ FCSM Regulation No. 03-30/ps, Sections 4.1.3, 5.1.1 and 6.1.1.

Chapter 9. Corporate Governance Implications of the Charter Capital

Optional Information	Method of Placement		
	Conversion	Distribution	Subscription (Open or Close)
The procedure and the period for making the payment for additional shares			✓
The procedure for concluding contracts during the placement of additional shares			✓
The number of additionally issued shares that is necessary for the issue to be recognized as completed, and the procedure for returning payments that have been made for additionally issued shares ²⁹⁶			✓

d) Issue of Shares for In-Kind Contributions

If the decision to place shares allows shareholders to pay for additional shares with other securities, or with other assets having monetary value, such a decision must also include the:²⁹⁷

- List of assets that can be used to pay for shares; and
- Name of the Independent Appraiser(s) who will be used to determine the market value of the assets.

C. Protecting the Charter Capital

One of the purposes of the charter capital is to provide a minimum guarantee that the company will fulfill its obligations toward creditors. However, this function will only exist in theory if it is not linked to preserving a minimum level of company assets. The Company Law provides that the value of a company's net assets at the end of the second and any subsequent year cannot be lower than the stated

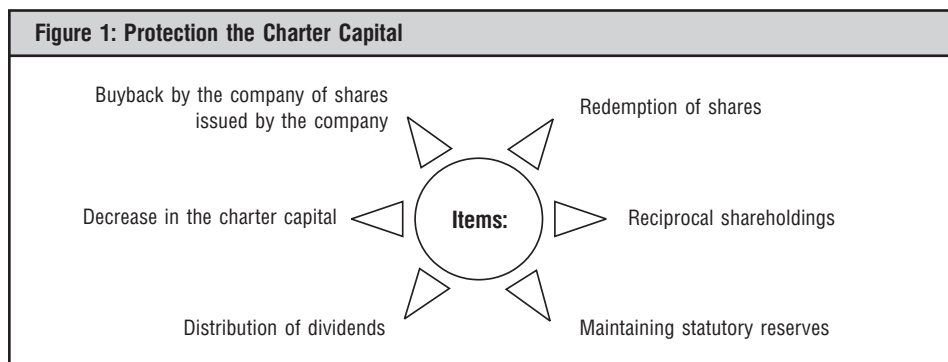
²⁹⁶ FCSM Regulation No. 03-30/ps, Section 6.1.11. The volume of additionally issued shares that is necessary for the issue to be recognized as having taken place cannot be less than 75% of the additionally issued shares.

²⁹⁷ FCSM Regulation No. 03-30/ps, Section 6.1.12.

The Russia Corporate Governance Manual

charter capital of the company.²⁹⁸ Should this occur, the company must decrease its charter capital, but not to a level lower than the minimum amount set forth in legislation.²⁹⁹ Moreover, the company must liquidate if the value of its net assets at the end of the second year, or any subsequent year thereafter, falls below the minimum amount of the charter capital.³⁰⁰ This is yet another safeguard for providing protection for creditors. If the company does not make the decision to either decrease the charter capital or liquidate within a reasonable period of time, creditors may request either the early performance, or the early termination of obligations toward them. In both cases, creditors can also request compensation for losses. Finally, state oversight bodies have the right to ask the court to liquidate the company.³⁰¹

There are other actions that may, in one way or another, affect the charter capital and net assets. Such actions and mechanisms, which protect against the distribution of the company's assets to shareholders or other parties to the detriment of creditors, are listed in Figure 1.



Source: IFC, August 2003

²⁹⁸ LJSC, Article 35, Clause 4.

²⁹⁹ LJSC, Article 29, Clause 1, Paragraph 4. The company cannot decrease its charter capital below the minimum specified by legislation, which is currently set at RUR 100,000 as of 1 January 2004. The minimum charter capital is determined as of the date of submission of the documents for the state registration of charter amendments related to the decrease of the charter capital. However, when the decrease is required by the Company Law, the minimum charter capital must be determined as of the date of the company's state registration.

³⁰⁰ LJSC, Article 35, Clause 5.

³⁰¹ LJSC, Article 35, Clause 6. The Constitutional Court of Russia has recently upheld the legality of these rules (Decision No. 14-P, the Constitutional Court of the Russian Federation, 18 July 2003).

1. Overview of Decreasing the Charter Capital

A decrease in the company's charter capital is generally used as a tool to create returns for shareholders without paying dividends. Decreases in charter capital — more specifically, share buybacks — do however have the potential for abuse. A decrease in the charter capital can favor some shareholders at the expense of others. If a decrease in the charter capital involves a share buyback, it is essential to ensure the equitable treatment of all shareholders. This holds particularly true if the company has several classes of shareholders with different rights or holders of other securities. At the same time, a decrease in the charter capital reduces the level of shareholders' liability and the minimum amount of assets intended to serve as a guarantee that the company will fulfill its obligations toward creditors.

Thus, any decrease in the charter capital can be:

- **Real** when it involves a share buyback from shareholders; or
- **Nominal** when the charter capital is decreased by writing off losses, intended to either reorganize the company's financial position or create reserves that can be used for future distribution.

a) Methods of Decreasing the Charter Capital

The charter capital can be decreased in three different ways as summarized in Table 6.³⁰²

Table 6: Methods of Decreasing the Charter Capital			
	Decrease the Nominal Value of Issued Shares	Retire Treasury Shares	Buyback Outstanding Shares and Retire These
Type of Decrease	Nominal	Nominal	Real
Legal Stipulation	Mandatory and/or voluntary	Mandatory and/or voluntary	Voluntary
Charter Stipulation	Always permitted	Always permitted	Only if permitted by the charter

³⁰² LJSC, Article 29, Clause 1, Paragraph 2.

Table 6: Methods of Decreasing the Charter Capital			
	Decrease the Nominal Value of Issued Shares	Retire Treasury Shares	Buyback Outstanding Shares and Retire These
Who Can Propose the Decrease	Shareholders or the Supervisory Board	Shareholders or the Supervisory Board	The Supervisory Board, unless the charter provides otherwise
Approving Governing Body	The GMS	The GMS	The GMS
Class by Class Voting	Yes, if the rights of preferred shareholders can be limited as a result of decreasing the charter capital	No	No
Implementation of the Decrease	Conversion of shares with a higher nominal value into shares with a lower nominal value	Retiring treasury shares	Purchasing and retiring shares

b) Mandatory and Voluntary Decreases of the Charter Capital

A decrease in the charter capital is required by legislation, if:³⁰³

- At the end of the second and every subsequent financial year the value of the net assets of the company is less than the charter capital; and
- Treasury shares are not replaced within one year after the company has purchased them.

Decreasing the charter capital by retiring treasury shares is only possible if permitted by the charter.³⁰⁴

c) Procedures for Decreasing the Charter Capital

Regardless of which method is chosen, the decision to decrease the charter capital must be taken by a simple majority vote of shareholders participating in the GMS.³⁰⁵

³⁰³ LJSJ, Article 35, Clause 4; Article 34, Clause 1, Paragraph 5; Article 72, Clause 3, Paragraph 2; Article 76, Clause 6, Paragraph 2.

³⁰⁴ LJSJ, Article 29, Clause 1, Paragraph 3.

³⁰⁵ LJSJ, Article 29, Clause 2; Article 49, Clause 2.

Chapter 9. Corporate Governance Implications of the Charter Capital

The proposal to decrease the charter capital by decreasing the nominal value of issued shares, or by retiring treasury shares, can be placed on the agenda of the GMS either by shareholder proposal or at the initiative of the Supervisory Board. If shares are repurchased for retirement, the right to put this resolution on the agenda of the GMS rests exclusively with the Supervisory Board, unless the charter provides otherwise.³⁰⁶

If the proposal to decrease the charter capital is submitted by the Supervisory Board, a simple majority vote of its members participating in the Supervisory Board meeting is required, unless the charter or by-laws require a higher percentage of votes.³⁰⁷

Best Practices: The quorum for the Supervisory Board meeting proposing to decrease the charter capital should be defined as $\frac{2}{3}$ of all directors.³⁰⁸

d) Information Included in the Decision to Place Shares

To decrease the charter capital by reducing the nominal value of issued shares, new shares with a lower nominal value must be issued, and the existing shares have to be converted into these newly issued shares. In this case, the decision to decrease the charter capital is also called the decision to place shares and must include information on:³⁰⁹

- The types and classes of shares, the nominal value of which will be decreased;
- The nominal value of shares for each type and class after the decrease has taken place; and
- The method of placing shares (in this case, the conversion of shares with a higher nominal value into shares with a lower nominal value).

The decision to place shares can also include information on the date, or the procedure to determine such date, when shares must be converted.³¹⁰

³⁰⁶ LJSC, Article 49, Clause 3.

³⁰⁷ LJSC, Article 68, Clause 3.

³⁰⁸ FCSM Code, Chapter 3, Section 4.15.

³⁰⁹ FCSM Regulation No. 03-30/ps, Section 5.1.2.

³¹⁰ FCSM Regulation No. 03-30/ps, Section 5.1.2.

e) Decreases in the Charter Capital and Creditor Protection

The decrease of the charter capital typically affects creditor rights since it decreases the minimum amount of the company's assets serving as a guarantee that the company can meet its obligations toward creditors. The company must then notify creditors in writing of a reduction in the charter capital. It must further publish an announcement in the print media that publishes information on the state registration of legal entities regarding the decrease in its charter capital within 30 days after the decision is taken.³¹¹ This falls under the authority of the General Director who will commonly assign this task to the Corporate Secretary or another person.

The company is required to present evidence to the state registration authority of the timely notification of all creditors regarding the decrease in the charter capital before the respective charter amendments can be registered.³¹²

Within 30 days after the submission of the notification to creditors, or after the publication of the announcement, a creditor has the right to demand in writing:³¹³

- Early termination of the company's obligations and the reimbursement of losses caused by early termination; or
- Early fulfillment of obligations by the company and the reimbursement of losses related to early fulfillment.

2. Share Buybacks

Under certain circumstances and conditions, companies have the right to repurchase their own shares. This is called a share buyback. Share buybacks may have a number of corporate governance implications. First, there may be a financial planning concern: since cash is used to purchase shares, fewer funds may be available for further business development. Second, shareholder rights can be abused if the company does not provide equal opportunity to all shareholders to sell their shares back to the company. Third, the company distributes cash directly to selling shareholders and may therefore diminish the company's ability to service its debts or otherwise meet its obligations to creditors.

³¹¹ LJSC, Article 30, Clause 1.

³¹² LJSC, Article 30, Clause 2.

³¹³ LJSC, Article 30, Clause 1.

Chapter 9. Corporate Governance Implications of the Charter Capital

Certain rules specify how to conduct a share buyback and are summarized in Table 7. They differ depending on whether the buyback is to decrease the charter capital (specific buyback) or for any other reason (general buyback).

Specific³¹⁴	General³¹⁵
The shares issued by the company are repurchased and retired to decrease the charter capital	The shares issued by the company are repurchased for any reason
The repurchase is carried out by decision of the GMS to decrease the charter capital	The purchase is carried out by decision of the GMS, unless the charter delegates this right to the Supervisory Board
The share buyback is only permitted if allowed by the charter	The share buyback is only permitted if allowed by the charter
Shares must be retired upon buyback	Purchased shares must be re-placed or retired within one year

a) Buyback Procedures

To repurchase its own shares, a company must follow steps, as summarized in Table 8.

	Specific	General
Initiation	On the basis of the decision to decrease the charter capital	At the discretion of the Supervisory Board or a shareholder proposal
Decision-making	The GMS	The GMS, unless delegated to the Supervisory Board
Purchase price	Market value	Market value
Limitations	The charter capital may not become less than the legal minimum	The nominal value of the outstanding shares must not be less than 90% of the charter capital after the shares have been repurchased ³¹⁶

³¹⁴ LJSC, Article 72, Clause 1, Paragraph 1.

³¹⁵ LJSC, Article 72, Clause 2, Paragraph 1.

³¹⁶ LJSC, Article 72, Clause 2, Paragraph 2.

Table 8: Buyback Procedures		
	Specific	General
Share retiring	Must be retired upon purchase	Must be retired within one year or re-placed

The decision to buyback shares issued by the company must be approved by either:³¹⁷

- A $\frac{3}{4}$ -supermajority of shareholders participating in the GMS, upon the proposal of the Supervisory Board, unless the charter provides otherwise; or
- A simple majority vote of directors participating in the Supervisory Board meeting, if the charter delegates this authority to the Supervisory Board.

The Supervisory Board must set the purchase price of shares for each type and class, which is always the market value of shares.³¹⁸

The Supervisory Board must also define the form of payment for the shares. As a rule, a company must pay in cash unless the charter provides otherwise.³¹⁹

In addition, the Supervisory Board must set the period within which the share buyback must take place. This period cannot be less than 30 days.³²⁰

b) Information Included in the Buyback Decision

The decision to buyback shares must include information on:³²¹

- The type and class of shares to be repurchased;
- The number of shares of each type and class;
- The purchase price;
- The form of payment;
- The period for making payments to shareholders; and
- The period within which the buyback will take place.

³¹⁷ LJSC, Article 49, Clause 3; Article 49, Clause 4; Article 68, Clause 3.

³¹⁸ LJSC, Article 72, Clause 4, Paragraph 2; Article 77.

³¹⁹ LJSC, Article 72, Clause 4, Paragraph 2.

³²⁰ LJSC, Article 72, Clause 4, Paragraph 2.

³²¹ LJSC, Article 72, Clause 4, Paragraph 1.

Chapter 9. Corporate Governance Implications of the Charter Capital

c) Limitations on Share Buybacks

Several limitations are placed on the repurchase of shares as summarized in Table 9.

The Company Cannot Repurchase if:	Common Shares³²²	Preferred Shares³²³
The nominal value of the outstanding shares will be reduced to less than 90% of the charter capital after repurchase ³²⁴	✓	✓
The charter capital is not fully paid	✓	✓
The company is bankrupt	✓	✓
The company would be bankrupt as the result of a buyback	✓	✓
The company had not redeemed the shares upon the demand of shareholders ³²⁵	✓	✓
The value of the company's net assets is less than the sum of the charter capital, the reserve fund, and the positive difference between the liquidation value of preferred shares of all classes and their nominal value	✓	
The value of the company's net assets will become less than the sum of the charter capital, the reserve fund, and the positive difference between the liquidation value of preferred shares of all classes and their nominal value specified by the charter as a result of the repurchase by the company of common shares	✓	
The value of the company's net assets is less than the sum of the charter capital, the reserve fund, and the positive difference between the liquidation value of preferred shares of a specified class, the owners of which have priority in receiving the liquidation value of their shares in relation to the preferred shares of the specified class that must be purchased by the company, and their nominal value		✓

³²² LJSC, Article 73, Clause 1.

³²³ LJSC, Article 73, Clause 2.

³²⁴ LJSC, Article 72, Clause 2, Paragraph 2.

³²⁵ LJSC, Article 73, Clause 3.

The Company Cannot Repurchase if:	Common Shares³²²	Preferred Shares³²³
The value of the company's net assets will become less than the sum of the charter capital, the reserve fund, and the positive difference between the liquidation value of preferred shares of a specified class, the owners of which have priority in receiving the liquidation value of their shares in relation to the preferred shares of the specified class that shall be purchased by the company, and their nominal value specified by the charter as the result of the repurchase by the company of preferred shares		✓

d) Implementing a Share Buyback

A company must notify shareholders 30 days before the beginning of the period during which a buyback will take place. The shareholder notification must contain the same information as required for the decision on the buyback.³²⁶

Any shareholder who owns shares of the type and class that shall be repurchased by the company has the right to sell shares to the company within the specified period. The company must pay for these shares within the period that has been specified in the decision and communicated to shareholders in the notice.³²⁷

If shareholders offer more shares for sale than the company intends to buy according to the decision on the repurchase, the company must purchase shares from all shareholders in a number that is proportionate to the number of shares that have been offered by shareholders for sale (see Mini-Case 1).³²⁸

3. Redemption of Shares

The redemption of issued shares is another transaction that may affect the charter capital, and consequently, the rights of shareholders and creditors. Shares redeemed by a company are commonly retired so as to reduce the charter capital. During a reorganization, repurchased shares must be retired upon re-

³²⁶ LJSC, Article 72, Clause 5.

³²⁷ LJSC provides no statutory period for such payment.

³²⁸ LJSC, Article 72, Clause 4, Paragraph 3.

Chapter 9. Corporate Governance Implications of the Charter Capital

Mini-Case 1		
Charter capital = RUR 300,000 (10,000 common shares with a nominal value of RUR 30 each).		
The company has decided to purchase 1,000 of its own shares.		
Five shareholders offer to sell 2,000 shares.		
The company must purchase shares in proportion to the shares offered by shareholders for sale.		
Shareholders	Number of shares offered to the company:	Number of shares the company must purchase:
Shareholder 1	400	200
Shareholder 2	200	100
Shareholder 3	600	300
Shareholder 4	300	150
Shareholder 5	500	250
Total:	2.000	1.000

Source: IFC, March 2004

demption.³²⁹ The Company Law provides for certain procedures to protect the rights of creditors; in particular, a company cannot use more than 10% of its net assets to redeem shares.³³⁰ If shareholders request the redemption of shares with a total value of more than 10% of the company's net assets, the company must redeem shares from all shareholders pro rata to the number of shares offered for redemption.

→ For more information on redemption rights, see Chapter 7, Section B.6.

4. Reciprocal Shareholdings

Reciprocal or cross-shareholdings are quite common between different companies and may be set up to establish mutual influence or diversify portfolios. Such shareholding structures between two or more companies often cause governance problems. For example:

- If companies increase their charter capital by means of reciprocal subscriptions to shares, the same initial contribution serves to cause two capital increases;

³²⁹ LJSC, Article 76, Clause 6, Paragraph 1.

³³⁰ LJSC, Article 76, Clause 5.

- When two companies create a reciprocal shareholding by acquiring issued shares of each other, they are causing, at least partially, an indirect distribution or repayment to shareholders whose shares are purchased; or
- Reciprocal shareholdings can decrease the normal influence of independent directors in both companies, and replace the normal control exercised by the shareholders over directors and officers, with a self-controlling system.

Russian legislation, however, does not provide any specific rules regarding reciprocal shareholdings, unless the relationship of dominance and subordination in groups of companies appears.

→ *For more information on groups of companies, see Part V, Chapter 15.*

D. Statutory Reserves

Protecting the charter capital to safeguard creditor rights is further extended by the requirement and possibility of creating certain additional reserves. As with the charter capital, such reserves only exist in accounting terms.

1. The Reserve Fund

Every company must have a reserve fund.³³¹ This fund is used to cover (a portion of) the company's losses, and covers the costs of redeeming shares and bonds when company profits are insufficient for such payment. A company may also establish other funds and additional paid-in capital. The decision as to whether and when to use the reserve fund and the additional paid-in capital is made by the Supervisory Board.

The amount of the reserve fund must be specified by the charter, and cannot be less than 5% of the charter capital. Its main purpose is to protect creditors by ensuring that part of the company's assets, in addition to the charter capital, cannot be distributed among shareholders.

The reserve fund must be funded by annual deductions from the company's net profits. The amount of such annual deductions must be specified in the charter, and cannot be less than 5% of its net profits.³³²

³³¹ LJSC, Article 35, Clause 1, Paragraph 1.

³³² LJSC, Article 35, Clause 1, Paragraph 2

Chapter 9. Corporate Governance Implications of the Charter Capital

Only if, and to the extent that the company does not have other resources, the reserve fund may be used to:³³³

- Write off/cover losses of the company;
- Redeem bonds; and/or
- Redeem shares from shareholders.

The reserve fund may only be used upon a decision by the Supervisory Board.³³⁴ The GMS has no authority in this regard.

2. Other Funds

a) Employees' Fund

The GMS can establish a special fund from its net profits for company employees.³³⁵ The Company Law does not require or define specific requirements for such a fund. Its establishment is therefore optional, and all provisions governing such a fund must be specified in the charter.

This fund can only be used for acquiring shares, provided that such shares are to be transferred to the company's employees. Accordingly, the Company Law provides for one specific source for replenishing the employees' fund: if a company has transferred shares purchased by using the employees' fund to its employees, the funds collected must be re-directed to the employees' fund.³³⁶

b) Other Funds of a Company

The charter or a decision of the GMS may establish other internal funds, such as for stock option plans or dividend payments. Such internal funds are financed through a deduction from the company's net profits. An example of such funds is the special fund for the payment of dividends on preferred shares.³³⁷ Such funds can only be used upon a decision of the Supervisory Board.³³⁸

³³³ LJSC, Article 35, Clause 1, Paragraph 3.

³³⁴ LJSC, Article 65, Clause 1, Paragraph 3, Section 12.

³³⁵ LJSC, Article 35, Clause 2, Paragraph 1.

³³⁶ LJSC, Article 35, Clause 2, Paragraph 2.

³³⁷ LJSC, Article 42, Clause 2.

³³⁸ LJSC, Article 65, Clause 1, Paragraph 3, Section 12.

3. Additional Paid-In Capital

Additional paid-in capital is part of the company's equity and is typically composed of the following sources:

- Any increase resulting from the re-valuation of non-current assets; and
- The positive difference between the nominal value and the placement value of the company's shares.

Additional paid-in capital has an accounting meaning only, and there is no actual accumulation of funds. Additional paid-in capital can be used, for example, to:

- Offset the losses as the result of re-valuating non-current assets; and
- Increase the charter capital from internal resources of the company.



Chapter 10

Dividends

Table of Contents

A. GENERAL PROVISIONS ON DIVIDENDS.....	122
1. <i>The Definition of Dividends</i>	122
2. <i>Distributable Profit</i>	122
3. <i>Dividend Rights</i>	122
4. <i>Types of Dividends</i>	123
5. <i>Forms of Dividend Payments</i>	124
6. <i>Decision-Making Authority Regarding Dividends</i>	124
7. <i>The Amount of Dividends</i>	125
8. <i>The Importance of Receiving Stable Dividends</i>	126
B. PROCEDURES FOR DECLARING AND PAYING DIVIDENDS.....	127
1. <i>How Dividends Are Declared</i>	127
2. <i>The Shareholder List for Dividends</i>	129
3. <i>When Declared Dividends Are Paid</i>	130
4. <i>When the Company Cannot Declare Dividends</i>	131
5. <i>When the Company Cannot Pay Declared Dividends</i>	132
C. THE DISCLOSURE OF INFORMATION ON DIVIDENDS	133
D. DIVIDEND POLICY	134

The Chairman's Checklist

- ✓ Has the Supervisory Board developed a dividend policy? What are the primary issues addressed in this policy?
- ✓ Does the Supervisory Board properly weigh using net profits for the payment of dividends versus re-investing these profits?
- ✓ Does the Supervisory Board properly communicate its dividend policy to shareholders and potential investors, and, if it deviates from this policy, the reasons for doing so?
- ✓ Does the company properly disclose information about its dividend policy and dividend history in a timely manner?
- ✓ Does the Supervisory Board propose intermediary dividends? How does the Supervisory Board ensure that this is done in the best interests of the company?
- ✓ How does the company calculate its dividends? Does the Supervisory Board ensure that preferred and common shareholders are treated equitably when distributing dividends?
- ✓ Does the Supervisory Board ensure that creditor rights are protected when it declares and pays dividends to shareholders?

Successful companies produce profits that can either be retained in the company or distributed to shareholders as dividends. In Russia, there is an expectation, in particular among minority shareholders with small holdings, for companies to make (a reasonable amount of) dividend payments, and not exclusively retain its earnings. The vast majority of Russian companies need additional capital, for which there is no immediately alternate source other than company earnings. Since internally generated financing is one of the few viable sources of funding, the decision to pay dividends is often difficult for Russian companies.

This chapter discusses dividends from both the shareholder and creditor protection perspectives, the procedure for declaring and paying dividends, as well as a company's dividend policy.

A. General Provisions on Dividends

1. The Definition of Dividends

Shareholders have a right to share in the profits of the company. They may do so by enjoying capital gains (an increase in the market value of shares they hold in the company) and/or through receiving dividend payments. From this perspective, dividends are an important shareholder right.

In addition, the payment of dividends means paying out cash to shareholders, which may decrease the company's cash and assets needed to service debt on a timely basis. From this vantage point, dividends are also viewed in light of preserving creditor rights by following certain rules. To protect creditor rights, legislation imposes certain limitations on the types and payment of dividends.

2. Distributable Profit

The accounting treatment of dividend payments is determined both by the Company Law and accounting standards. Dividends can only be paid out of the net profits of the company.³³⁹ Dividends on preferred shares can, however, be paid out of funds that are specifically established for that purpose. Under no circumstances can dividends be paid out of the charter capital.

3. Dividend Rights

Owners of common and preferred shares have different dividend rights. Distributing dividends on common shares is solely at the discretion of the company.³⁴⁰ On the other hand, owners of preferred shares have a right to dividend payments.

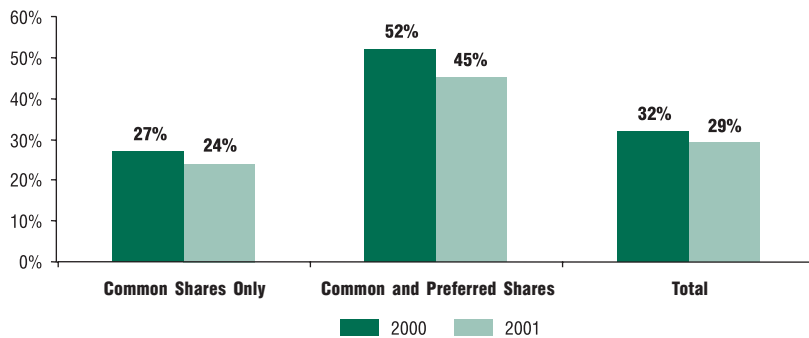
³³⁹ Law on Joint Stock Companies (LJSC), Article 42, Clause 2.

³⁴⁰ LJSC, Article 31, Clause 2.

If the company does not declare dividends, or declares only a partial payment of dividends to owners of preferred shares, these shares are automatically granted voting rights.

Company Practices in Russia: Figure 1 indicates that companies experience considerable difficulties in making dividend payments on both common and preferred shares in Russia's regions.³⁴¹ Only 45% of companies with preferred shareholders paid dividends in 2001, a decrease of more than 7% in comparison with 2000. The percentage of companies with common shares only that paid dividends decreased slightly from 27% in 2000 to 24% in 2001.

Figure 1: Percentage of Companies that Paid Dividends



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

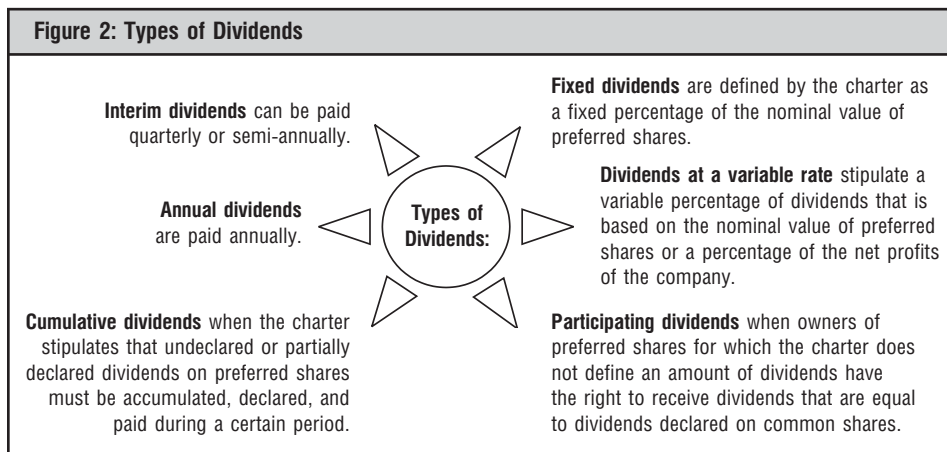
4. Types of Dividends

A company may declare dividends for common and preferred shares as shown in Figure 2.³⁴²

³⁴¹ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.3.2, page 36, August 2003 (see www.ifc.org/rcgp).

³⁴² LJSC, Article 32, Clause 2, Paragraphs 1 and 3.

Figure 2: Types of Dividends



Source: IFC, March 2004

5. Forms of Dividend Payments

As a rule, dividends are paid in cash, though the charter may allow other forms of payment.³⁴³

Best Practices: Companies should pay dividends in cash, since non-cash transactions are generally unsuited for dividend payments.³⁴⁴

6. Decision-Making Authority Regarding Dividends

The Supervisory Board has the authority to recommend the amount of dividends to pay out to the General Meeting of Shareholders (GMS). The authority to approve dividends, however, rests with the GMS. The GMS approves or disapproves the Supervisory Board's recommendation by a simple majority vote of participating shareholders.³⁴⁵ The amount of dividends declared by the GMS may not exceed that recommended by the Supervisory Board.³⁴⁶

³⁴³ LJSC, Article 42, Clause 1, Paragraph 2.

³⁴⁴ Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 9, Section 2.1.1.

³⁴⁵ LJSC, Article 42, Clause 3; Article 49, Clause 2.

³⁴⁶ LJSC, Article 42, Clause 3.

The following rules apply to the payment of dividends on preferred shares:

- If the amount of dividends on preferred shares is less than that required by the charter, the owners of preferred shares receive voting rights;
- Dividends on preferred shares may not exceed the amount specified in the charter; and
- If the amount of dividends on preferred shares is not specified in the charter, the amount of dividends is the same as that paid on common shares.

7. The Amount of Dividends

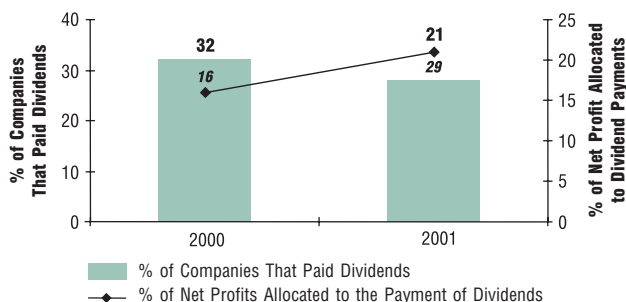
The Supervisory Board should seek to maximize shareholder value when formulating its recommendation on the amount of dividends to be distributed. The target payout ratio — defined as the percentage of net income to be paid out as cash dividends — should be based on shareholder preferences. More specifically, the Supervisory Board will want to determine shareholder preferences for capital gains (for example, using excess cash to buyback shares or re-invest in the company) *versus* receiving dividends. The Supervisory Board will then need to define its optimal dividend policy, which ideally should strike a balance between current dividends and future growth. For any given company, the optimal payout ratio is determined by four factors:

1. Investor preference for capital gains *versus* dividends;
2. The company's investment opportunities (for example, companies with excess cash but limited investment opportunities would typically distribute a large percentage of their income to shareholders via dividends, while companies in high-growth sectors typically reinvest their earnings in the business);
3. The company's target capital structure; and
4. The availability and cost of external capital.

Company Practices in Russia: The results of a 2003 IFC Survey³⁴⁷ show a slight decline in dividend payments among companies in Russia's regions between 2000 and 2001. This decrease occurred mainly among companies with over 300 employees. In contrast, the percentage of companies paying dividends with less than 300 employees has remained stable. Although fewer companies paid dividends, the percentage of net profits allocated to dividend payment increased from an average of 16% in 2000, to 21% in 2001 (see Figure 3).

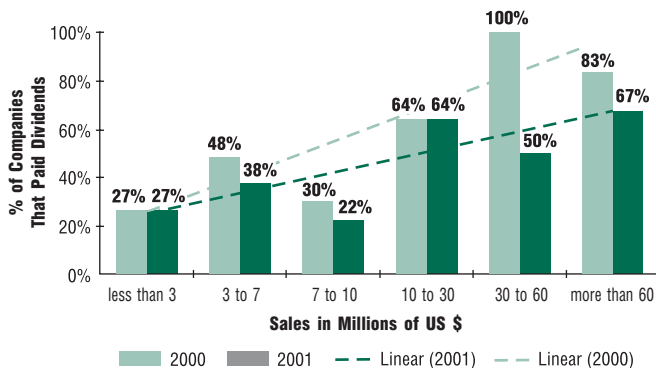
³⁴⁷ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.3.2, page 36, August 2003 (see www.ifc.org/rcgp).

Figure 3: Percentage of Companies that Paid Dividends and an Average Percentage of Net Profits Allocated to Dividend Payments



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

Figure 4: Correlation Between the Percentage of Companies in Russia's Regions that Paid Dividends and Company Sales



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

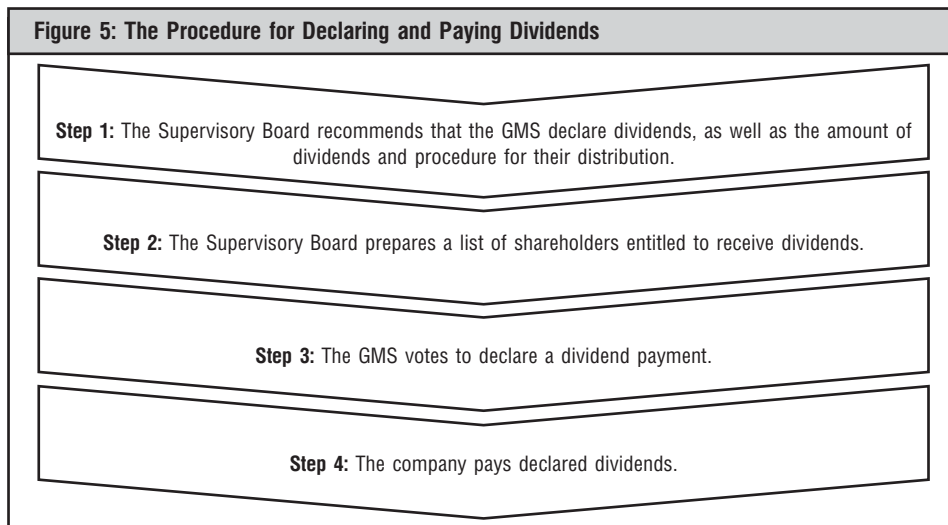
8. The Importance of Receiving Stable Dividends

The stability of dividends is important to shareholders. Dividend payments tend to vary over time, since company cash flows may fluctuate. Many shareholders rely on dividends to meet expenses, however, and would consequently suffer from unstable dividend streams. A company needs to carefully balance between the stability and dependability of its dividend policy.

Best Practices: Ideally, the company should formulate and communicate a dividend policy to its shareholders, for example to “pay approximately 30% of its current year’s earnings as dividends, which will permit the company to retain sufficient capital to provide for future growth.”

B. Procedures for Declaring and Paying Dividends

To declare and pay dividends, the company must follow specific steps, summarized in Figure 5.



Source: IFC, March 2004

1. How Dividends Are Declared

A company may declare dividends annually, or more frequently if stipulated in its charter.³⁴⁸ The decision to declare interim dividends, based on quarterly results,

³⁴⁸ LJSC, Article 42, Clause 1, Paragraph 1. The text of this provision contains the phrase “unless the law provides otherwise” which refers to circumstances when the company cannot declare dividends that are specified by LJSC, Article 43.

must be made within three months of the end of the dividend period.³⁴⁹ The decision to declare annual dividends is based on the decision regarding the distribution of profits (losses) of the company and can be taken by a simple majority vote of shareholders participating in the GMS.³⁵⁰

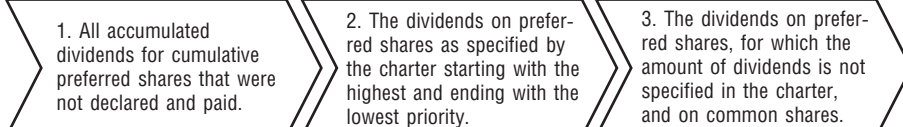
Best Practices: In order to help shareholders properly assess a company's capacity to make dividend payments, companies are advised to:³⁵¹

- Establish a transparent and shareholder-friendly mechanism for evaluating the payment of dividends;
- Provide sufficient information to shareholders to enable them to understand the conditions that must be met before the company will pay dividends;
- Provide sufficient information to shareholders to enable them to understand the procedures for the payment of dividends;
- Prevent the dissemination of any misleading information on the company that might influence shareholders' assessment of policies governing dividend payments;
- Provide simple dividend payment procedures; and
- Impose (financial) sanctions on the General Director and Executive Board members for incomplete or delayed payments of declared dividends.

Dividend reports are a useful tool for assessing a company's dividend policy and its dividend payment record. Dividend reports are published by commercial firms that track the dividend performance of companies. These reports are usually available for a fee.

The Company Law also stipulates a certain sequence for declaring dividends when the company has issued shares of different types and classes as illustrated in Figure 6.

Figure 6: Order of Declaring and Paying Dividends



Source: IFC, March 2004

³⁴⁹ LJSC, Article 42, Clause 1, Paragraph 1.

³⁵⁰ LJSC, Article 48, Clause 1, Section 11; Article 49, Clause 2.

³⁵¹ FCSM Code, Chapter 1, Section 1.3.

In other words, until the company has declared and paid all dividends (including accumulated dividends) for preferred shares in full, as specified by the charter, it cannot declare and pay dividends for other preferred or common shares.³⁵² Further, the company cannot declare dividends if the claims of a higher priority shareholder are not satisfied in full.³⁵³

Company Practices in Russia: The Company Law is not clear as to whether the distribution of annual dividends must be a separate agenda item of the Annual General Meeting of Shareholders (AGM) or a part of the decision on the distribution of profits (and losses). Russian companies commonly treat these decisions separately. However, there is a risk of making conflicting decisions on the amount of dividends as part of the decision on dividend payments and the decision on the distribution of profits. As long as shareholders agree with the recommendation of the Supervisory Board on the amount of dividends, there should be no conflict. However, voting on the dividend payment as part of the more general decision on the distribution of profits appears to be a safer solution. Interim dividends do not present a problem as there is no requirement for approving the distribution of interim profits.

2. The Shareholder List for Dividends

The list of shareholders entitled to receive dividends for a specific period includes shareholders of record entitled to participate in the GMS.³⁵⁴ This date upon which such record is to be compiled is called the “ex-dividend date”. Shareholders included on this list as of the ex-dividend date are entitled to receive any dividends that the company pays out to shareholders. Consequently, shareholders who own shares on the ex-dividend date, and who sell them after that date, retain the right to receive dividends; shareholders who purchased shares after the ex-dividend date are not entitled to receive dividends until the next declaration of dividends. However, the contract of sale for the shares may provide that the right to receive declared dividends shall be transferred to the new owner of shares.

³⁵² LJC, Article 43, Clause 2.

³⁵³ LJC, Article 43, Clause 3.

³⁵⁴ LJC, Article 42, Clause 4, Paragraph 2.

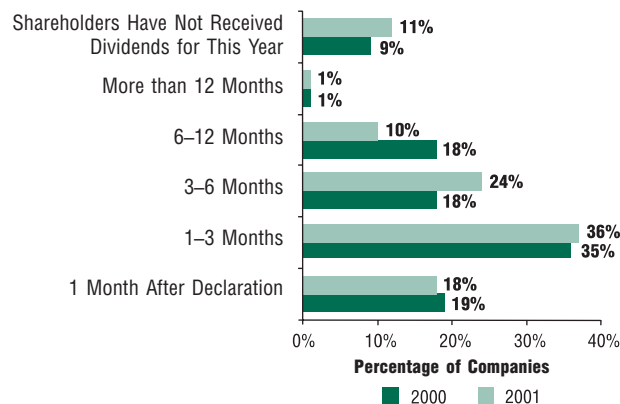
In the event that dividends on shares of a specified type and class are declared, each shareholder must receive dividends in accordance with the number of shares of the type and class he owns.

3. When Declared Dividends Are Paid

A company is obliged to pay dividends once they have been declared.³⁵⁵ The period for paying dividends is established either in the charter or by decision of the GMS. If not specified, companies must pay dividends no later than 60 days after they are declared.³⁵⁶

Company Practices in Russia: The results of a 2003 IFC survey show that arrears on dividend payments are an enormous problem among Russian companies (see Figure 7). According to the Company Law, and as recommended by the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), companies are required to pay declared dividends within 60 days. However, in 2001, only 18% of companies paid dividends within one month after their declaration, and only 36% paid within three months.³⁵⁷

Figure 7: Timeliness of Dividend Payments



Source: IFC, Regional Survey on Corporate Governance Practices, August 2003

³⁵⁵ LJSC, Article 42, Clause 1.

³⁵⁶ LJSC, Article 42, Clause 4, Paragraph 1.

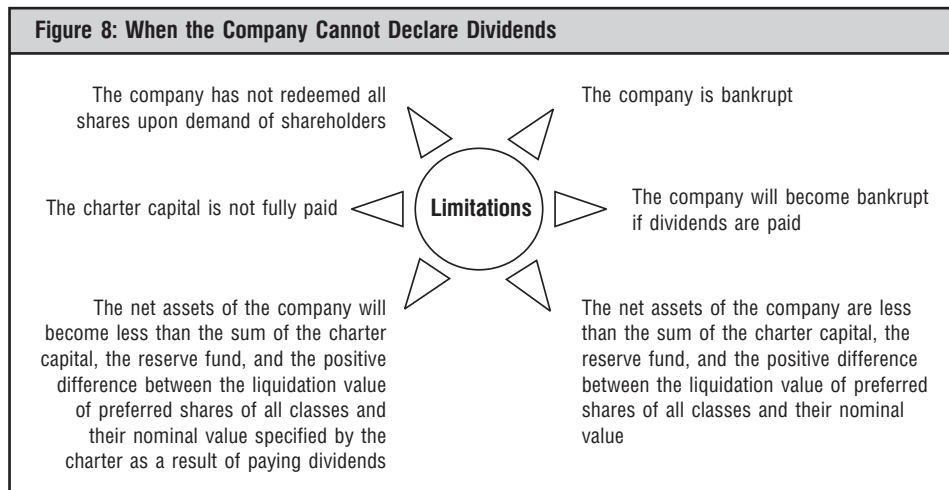
³⁵⁷ IFC Survey on Corporate Governance Practices in Russia's Regions, Section 2.3.2, page 36, August 2003 (see www.ifc.org/rcgp).

The accumulation of declared but unpaid dividends gives shareholders the right to file a claim in court against the company demanding payment.

Best Practices: The FCSM Code recommends that companies penalize the General Director, Executive Board members, or the External Manager when dividend payments are incomplete or in arrears. In particular, it is recommended that the Supervisory Board have the authority to reduce the remuneration of the General Director, Executive Board members, and/or the External Manager, or to terminate their authorities, when the company fails to pay declared dividends in full and/or on time.³⁵⁸

4. When the Company Cannot Declare Dividends

The company is prohibited from declaring dividends under the circumstances illustrated in Figure 8.³⁵⁹



Source: IFC, March 2004

³⁵⁸ FCSM Code, Chapter 9, Section 3.

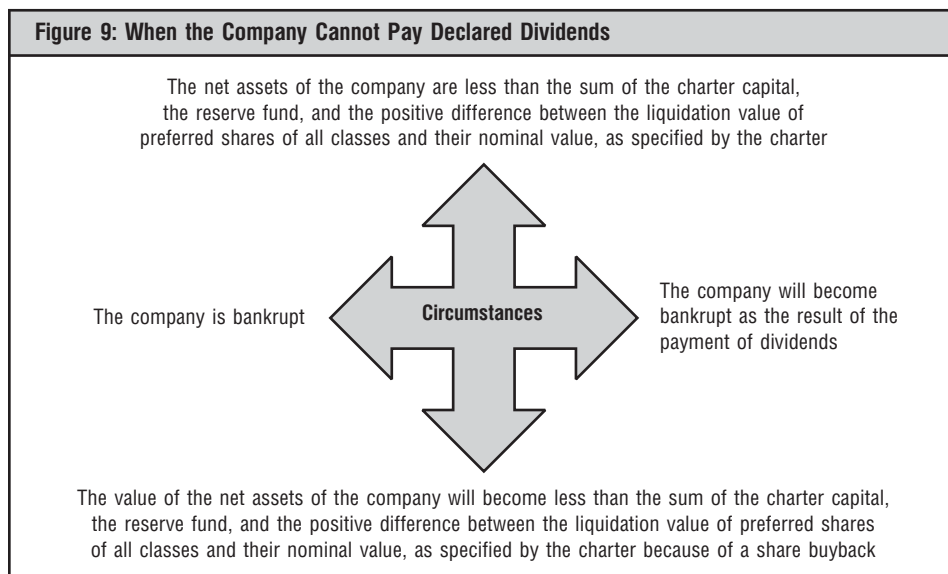
³⁵⁹ LJSC, Article 43, Clause 1.

The Russia Corporate Governance Manual

This list of circumstances is not exhaustive. The Company Law stipulates that legislation may specify further circumstances under which the company cannot declare dividends. In addition, both the charter and the company's debt instruments can specify circumstances under which the company is prohibited from declaring dividends.

5. When the Company Cannot Pay Declared Dividends

As some time may pass between the decision to declare dividends and the actual payment, the company may find itself in contravention of some of the requirements for the declaration of dividends noted above. The company may not pay declared dividends under the circumstances illustrated in Figure 9.³⁶⁰



Source: IFC, March 2004

³⁶⁰ LJSC, Article 43, Clause 4, Paragraph 1. Note that a court decision declaring the company bankrupt is not required; the factual features of the company's bankruptcy suffices to prohibit the payment of dividends.

This list of circumstances is not exhaustive. As mentioned above, legislation may specify further grounds, as can the charter and corporate debt instruments. As soon as the specified conditions cease to exist, the company is obliged to pay declared dividends.³⁶¹

C. The Disclosure of Information on Dividends

Securities legislation regulates the information disclosure as pertaining to dividends. A company must make available to all its shareholders the recommendations of the Supervisory Board regarding the distribution of profits, including the amount of proposed dividends on all types of shares, and the procedure for the payment of such dividends.³⁶²

A company needs to address two basic issues in deciding to declare dividends:

- 1) The percentage of profits to be distributed; and
- 2) The frequency of payments, i.e. should the dividends vary from year to year, or remain stable over time.

A company is also required to provide a report on its dividend payment record in its annual report.³⁶³

Best Practices: The FCSM Code recommends that the company adopt a by-law on information disclosure, and that this by-law include a list of information, documents, and materials that must be submitted to shareholders to enable them to make decisions regarding dividends. The information should refer to agenda items for the GMS, such as:³⁶⁴

- Recommendations of the Supervisory Board regarding the distribution of profits;
- Recommendations of the Supervisory Board on the payment of dividends; and

³⁶¹ LJSC, Article 43, Clause 4, Paragraph 2.

³⁶² FCSM Regulation No. 17/ps on Additional Requirements for the Procedure of Preparing, Calling and Conducting the General Meeting of Shareholders (FCSM Regulation No 17/ps), 31 May 2002, Section 3.2.

³⁶³ FCSM Regulation No. 17/ps, Section 3.6.

³⁶⁴ FCSM Code, Chapter 7, Section 3.2.1.

- Reasons for each recommendation.

Companies should also disclose information on dividend payments, or when dividends have not been paid, the reasons for dividend non-payment.³⁶⁵

Companies are required to include the following information on dividends in the prospectus and quarterly reports:³⁶⁶

- The amount of dividends declared within the last five years or, if the company has been in operation for less than five years, during each year of operation; and
- The procedure for dividend payment.

D. Dividend Policy

Companies are best served by adopting a clearly stated and rational dividend policy, in-line with shareholder preferences.

Best Practices: Companies should inform the markets of their dividend policy, for example, through the print media. This disclosure should be in the same publication specified by the charter for publishing notice for the GMS. The company should also consider using the internet for this purpose.³⁶⁷

It is essential that shareholders receive information — at a very minimum — on the following issues:³⁶⁸

- The method the company uses in determining the portion of profits that may be paid as dividends;
- The conditions under which dividends may be paid;
- The minimum amount of dividends payable for shares of each type and class;

³⁶⁵ FCSM Code, Chapter 7, Section 3.3.2.

³⁶⁶ FCSM Regulation No. 03-32/ps on the Disclosure of Information by Security Issuers, 2 July 2003, Annexes 4 and 11.

³⁶⁷ FCSM Code, Chapter 9, Section 1.1.3.

³⁶⁸ FCSM Code, Chapter 7, Section 2.1.3.

- The criteria the Supervisory Board uses in deciding on the recommendation to declare dividends; and
- The procedure for dividend payment, including the time, place, and form of payment.

Companies should further implement a transparent and easy-to-understand mechanism for determining dividends. To do so, the company should approve a by-law on dividends that includes information on:³⁶⁹

- The percentage of net profits for dividend payments;
- The terms and conditions for dividend payments;
- The amount of dividends payable for shares of a specific type and class if this amount is not specified by the charter;
- The minimum amount of dividends payable for shares of each type and class;
- The procedure for the payment of dividends, including the schedule, place, and methods; and
- Circumstances when dividends will not be declared, or when dividends may be partially declared on preferred shares.

Companies are free to change their dividend policies at any time; however, corporate officers should be aware that this may cause inconveniences for their shareholders and send adverse, if unintended, signals to the markets.

³⁶⁹ FCSM Code, Chapter 9, Section 1.1.2.



Chapter 11

Corporate Governance **Implications** of **Corporate Securities**



Table of Contents

A. AN OVERVIEW OF CORPORATE SECURITIES	140
1. <i>Equities and Bonds</i>	140
2. <i>Primary and Derivative Instruments</i>	143
3. <i>Securities in Paper and Paperless Forms</i>	144
4. <i>Domestic and International Markets</i>	144
B. TYPES OF SECURITIES	145
1. <i>Shares</i>	145
2. <i>Bonds</i>	147
C. ISSUING SECURITIES	151
1. <i>Making the Decision to Place Securities</i>	153
2. <i>Adopting the Decision to Issue Securities</i>	154
3. <i>Approving the Prospectus</i>	155
4. <i>The Control over Securities Issue</i>	158
5. <i>The Sale of Securities</i>	160
D. THE CONVERSION OF SECURITIES.....	162
E. SHARE SPLITS AND CONSOLIDATIONS	163
1. <i>Agenda Proposal to Split or Consolidate Shares</i>	165
2. <i>Decision to Split or Consolidate Shares</i>	165
3. <i>Charter Amendments</i>	166
4. <i>Registration of Charter Amendments</i>	166
F. STOCK OPTIONS.....	167
G. RAISING CAPITAL IN THE INTERNATIONAL MARKETS	168

The Chairman's Checklist

- ✓ When was the last time the company rigorously examined its financial needs?
- ✓ If the company is in need of external financing, what are the alternative sources? What are the advantages and disadvantages of debt *versus* equity financing? What are the costs? What is the company's optimal debt-to-equity ratio? What are the corporate governance implications of each of the alternatives?
- ✓ What is the most appropriate financing method for the company, and why?
- ✓ Has the company explored international financing options?
- ✓ What are the advantages and disadvantages of accessing capital in foreign markets? What are the corporate governance implications of listing on foreign exchanges?
- ✓ What are the disadvantages and advantages of stock options?

Companies have a number of financing options. They may fund their investment needs from internally generated capital or seek external financing. Among external sources of funding, they may borrow from banks or issue securities.

Financing decisions are usually quite complex. The method(s) that a company chooses to finance its operations will depend upon a large number of internal and external factors. Some of the company specific factors include the intended use of the funds (whether for short-term working capital needs or long-term capital investment), the capacity to service interest payments and repay principal, and the nature (and the degree of risk) of the business. Important external factors include the level of a country's economic development, political stability, its banking system, and financial markets.

Each financing option (whether bank lending or the sale of equities or bonds) has different financial and legal characteristics and will have different corporate governance implications. In addition, each form of capital has a different cost. Equity finance has some important differences and advantages for companies. Although it is not the cheapest source of funding, equity finance has the advantage of permitting companies to access large amounts of capital that do not need to be paid back in the same manner as debt financing.

However, access to the enormous potential of securities markets — with its millions of potential investors — comes at a price. Securities markets are traditionally tightly regulated to limit the manifest potential for abuse. Regulators therefore make significant demands on companies. They require that investors receive complete information on the risks of investment; and they also go to great lengths to protect investor rights. While market regulators are often criticized for the burdens they impose on companies, real and potential abuses are, ultimately, the reason for the imposition of regulation and of corporate governance standards.

This chapter discusses the different types of securities that companies may issue and their corporate governance implications.

A. An Overview of Corporate Securities

1. Equities and Bonds

There are two basic types of securities that companies use to raise capital: 1) equities (also referred to as stocks or shares); and 2) corporate bonds. Equities represent an ownership position in the company and come with certain ownership rights. Bonds, on the other hand, represent a creditor relationship with the company. Unlike shareholders, bondholders have no corporate ownership rights, although they may be accorded a significant degree of control over (certain) corporate activities during the life of the creditor/debtor relationship.

Chapter 11. Corporate Governance Implications of Corporate Securities

Bonds envisage the repayment of the principal as well as periodic interest payment until the bond reaches maturity and the obligation of the borrower (the company) to make any further payments of principal/interest is terminated. Corporate bonds come in many different forms and may be structured in a number of ways. For example, there is no provision for interest payments on “zero coupon” bonds. The bondholder in such a case is compensated by a discounted purchase price and the gradual appreciation in the price of the bond, which is then redeemed at its face value on its maturity date. Despite the many differences, bonds have one element in common in that they come with a predictable and contractually fixed repayment.

Equities function differently. Companies can use equity capital for an unlimited period and are under no immediate obligation to repay investors. Investors are compensated for their investment either through the possibility of receiving capital gains (an increase in the value of their shares) and/or the possibility of receiving dividend payments in addition to governance rights. From an investor point of view, equities — as an investment class — are normally riskier than bonds. Capital gains are never guaranteed (share prices go up and down) and companies are not obligated to make any dividend payments to holders of common shares.

An important implication of the difference in risk is that equity capital is often more expensive than bonds or bank lending. One of the most fundamental rules of finance is: the higher the level of risk, the greater the level of return that investors will expect (demand) for taking such risk. Given — as mentioned — that the risk of receiving a return on one’s investment is higher for equities than for bonds or other types of loan transactions, investors will demand a higher price for the use of their capital by the company and will charge what is referred to as a “risk premium.”

One of the methods to manage equity risk is by granting shareholders governance rights (a full set of rights in the case of common shares and a limited set of rights in the case of preferred shares). Another method of managing risk — and, by extension, of reducing the cost of capital — is to ensure that these rights are uniformly respected and adequately protected. This, from a financial perspective, is what helps to define good corporate governance.

Equities and bonds offer different advantages and disadvantages for investors and companies as outlined in Table 1.

The Russia Corporate Governance Manual

Table 1: Comparison of Equities and Bonds		
	Equities	Bonds
Duration of investment	Unlimited. The company does not repay the investment. The company is not restricted in how it may invest funds.	Bonds have a maturity date. While bonds differ, the principal is generally repaid with interest. Repayment is predictable and regular, which reduces bondholder risks.
Obligations in return for the investment	Investors may expect dividend payments when the company generates sufficient cash flow. However, dividend payments are made at the discretion of the company.	The company must repay the principal and generally makes coupon payments.
Governance rights	If common shares are issued, the investor is granted governance rights. If preferred shares are issued, the investor holds governance rights only in specific circumstances. Governance rights and their enforcement reduce the equity investment risk.	No governance rights are granted to bondholders.
Ease of securing the investment	<p>The ease of securing equity investment depends on numerous external and internal factors. Ultimately, the attractiveness of a share offering depends on the company's future prospects and its ability to assure investors that good governance and, in particular, investor rights to the company's free cash flow, will be observed.</p> <p>In addition, the company's health, including compliance with good corporate governance practices, influences the price it pays for equity capital.</p>	Bonds are attractive to investors interested in predictable, secure returns. The company's health, including compliance with good corporate governance practices, is important for the credit rating of the company and will influence the price at which it may borrow.
Cost	From the company's perspective, equities can be more expensive than bonds. Investors charge a risk premium for the higher risk associated with equities.	Bonds are less risky, and investors charge a lower risk premium. Bonds are, consequently, less expensive for the company than equities.

Chapter 11. Corporate Governance Implications of Corporate Securities

Table 1: Comparison of Equities and Bonds		
	Equities	Bonds
Advantages	<p>Most investors are compensated through capital gains (the increase in share prices on the equities markets). If the company generates sufficient free cash flow, the shareholder may receive a dividend.</p> <p>The potential long-term returns on equities as an investment class are higher than bonds.</p>	<p>The bondholder receives his principal back with some compensation for the investment, usually in the form of interest. Generally, interest payments are fixed in advance and predictable.</p> <p>If the company defaults, the bond may, under certain circumstances, still be sold on the market at a discount, meaning that the bondholder may not lose the full amount of his investment.</p>
Risks	<p>The higher returns on equities are in exchange for a higher level of risk. Share prices go up and down, at times quite dramatically. Capital gains on shares are uncertain and dividend payments are not guaranteed.</p> <p>If the company becomes insolvent, shareholders are typically last in line to receive compensation. In practice, shareholders may lose the full value of their investment in case of bankruptcy or liquidation.</p>	<p>Once the company has the cash, it may use the money for riskier activities than those foreseen by the bondholder. In this case, the bondholder may have little recourse.</p> <p>In case of default, the bondholder is granted a set of legal mechanisms to enforce his contractual rights, including seeking the insolvency of the company. However, seeking insolvency is not generally in the interest of the bondholder. If the bond is secured, the risk of the bondholder may be minimized.</p>

2. Primary and Derivative Instruments

Shares and bonds can be described as primary securities, i.e. such which directly certify a specified set of rights. Companies can also issue derivative instruments that embody rights dependent on the performance of underlying or primary securities, assets, or other property. Such instruments can, in international practice, relate to both equities and debt securities.

Best Practices: The issuance of derivatives is associated with the existence of mature capital markets. Derivatives are used by companies mainly as a risk-reduction instrument. At the same time, their existence necessitates special regulation to ensure accounting and information transparency.

According to Russian law, options are recognized as the main form of derivatives. Stock options can play an important role in the context of executive remuneration programs and, consequently, may have important corporate governance implications.

→ *For more information on stock options and executive remuneration, see Part II, Chapter 5, Section G, as well as Section F of this Chapter.*

3. Securities in Paper and Paperless Forms

Securities must be issued in certain forms and comply with legal requirements.³⁷⁰ Securities may take two main forms: tangible securities issued in paper form and intangible securities (also known as “paperless” or “dematerialized securities”).³⁷¹ The rights of the holders of tangible securities are embodied in a certificate. The rights of the holders of dematerialized securities are based upon an entry into a bond or shareholder register (similar to an entry in a bank account reflecting the depositor’s rights to funds). In Russia, shares may only be issued in paperless form, unless a law provides otherwise,³⁷² while bonds can take both forms.

4. Domestic and International Markets

Companies may choose to raise capital in domestic as well as international capital markets. In doing so, they may issue shares and bonds directly on foreign exchanges; they may also issue shares indirectly through depositary receipts. Depositary receipts require the registration of the original security in the name of a foreign trust company or, more commonly, a bank. The bank holds the share in

³⁷⁰ Civil Code (CC), Article 142.

³⁷¹ Law on Securities Markets, Article 2. Tangible and intangible securities may be referred to in translations of Russian documents as “documentary” and “non-documentary” securities.

³⁷² Law on the Securities Market, Article 16, Paragraph 1.

Chapter 11. Corporate Governance Implications of Corporate Securities

safekeeping and issues receipts against shares. These receipts are referred to as “depository receipts.” This system was developed because investors in the world’s largest capital markets discovered it could take several months to have their foreign share purchases registered in their name. The system is also attractive for companies, since it allows them to establish a presence in foreign markets without having to go through the process of a complete issue. The corporate governance implications of this system are that Russian issuers of depository receipts must comply, to varying degrees, with foreign standards of corporate governance, as well as with those applicable specifically to the Russian market.

→ *Raising capital in foreign markets is discussed at slightly greater length in Section G of this Chapter.*

B. Types of Securities

1. Shares

Shares (stock or equities) entitle their holder to a set of property and governance rights, and have several fundamental characteristics:

- **Name of the holder:** Shares in Russia can only be issued as registered securities.³⁷³ This means that the identification of their holder is mandatory to exercise shareholder rights, and the shareholder identity is entered in a shareholder register.³⁷⁴ Registered securities help to make the company’s ownership structure more transparent and assist in protecting shareholder rights.
 - *For a discussion on transparent ownership structures, see Part IV, Chapter 13, Section B.3.*
- **Rights of the holder:** Shares may be common or preferred. Rights pertaining to particular shares are specified in the charter³⁷⁵ and certified by decision of the Supervisory Board.³⁷⁶

³⁷³ Law on Joint Stock Companies (LJSC), Article 25, Clause 2; Law on the Securities Market, Article 2.

³⁷⁴ Law on the Securities Market, Article 2.

³⁷⁵ LJSC, Article 27, Clause 1.

³⁷⁶ Law on the Securities Market, Article 18.

- **Nominal value:** Each share has a nominal value (also referred to as “par value” or “face value”).³⁷⁷ The nominal value of shares is established in the charter and is used to calculate the charter capital.³⁷⁸ Russian law does not require minimum or maximum nominal values of shares. The nominal value of all common shares issued by the company must be the same.³⁷⁹

At the time of its formation, the company must issue shares at a price no lower than their nominal value.³⁸⁰ The company issues shares after its formation to attract new investors at a price equal to their market value, as long as this value is not lower than their nominal value.³⁸¹ Changing the nominal value of shares for the purposes of increasing, decreasing, or restructuring the company’s capital must comply with a special procedure.

→ *For more on shareholder rights in this respect, see Chapter 7, Section B; for more on procedures for increasing, decreasing, or restructuring the charter capital, see Chapter 9.*

The nominal value of shares rarely reflects the true value of the company. The differences between the nominal value of shares and the price at which they trade on the market can be enormous. In addition, market prices constantly fluctuate.

The value of shares may be determined by the discounted free cash flow that a company generates. The assessment of such cash flow is, in turn, determined by a great number of factors, including the current performance and future prospects of the company, its dividend policy, the reputation of the company and its management, the macroeconomic situation, and government support for (or interference in) business development. The level of demand also affects share prices.

Not least of these factors is the quality of the company’s governance. Ultimately, the free cash flow of a company has little value to shareholders unless they can assert their rights.

³⁷⁷ LJSJ, Article 25, Clause 1.

³⁷⁸ LJSJ, Article 11, Clause 3.

³⁷⁹ LJSJ, Article 25, Clause 1.

³⁸⁰ LJSJ, Article 36, Clause 1.

³⁸¹ LJSJ, Article 36, Clause 1.

2. Bonds

Bonds are securities through which companies raise debt capital. A bond has the following legal characteristics:

a) Registered and Bearer Bonds

As with shares, bonds can be issued as registered securities.³⁸² In such cases, the bondholder is identified in a bondholder register, which the company is required to maintain. If the number of bondholders exceeds 500, the register must be maintained by an external organization, which is registered as a professional participant in the securities market.³⁸³

Unlike shares, however, bonds can also be issued as bearer securities.³⁸⁴ Bearer bonds have the advantage of privacy for the bondholder. Bearer bonds are issued with certificates, which contain certain legal requirements.³⁸⁵ If a bearer bond is lost, the rights of its holder can only be affirmed by a court through special procedures.³⁸⁶ Bearer bonds may facilitate the transfer of bonds and reduce the administrative costs for the company of maintaining a bond register.

Best Practices: Despite these advantages, the use of bearer bonds may result in violations of securities and tax laws. Because they are easy to transfer, owners of bearer bonds may not be as precise about adhering to the laws when they sell bearer bonds to another person as they would need to be in the event of registered bonds. Thus, for example, bearer instruments have the great disadvantage that they may conceal assets from creditors or the tax authorities.

b) Nominal Value

Bonds are issued at a certain nominal value.³⁸⁷ The nominal value of bonds is most often referred to as their “face value”. In the interest of bondholders (and, one could argue, of shareholders as well), the face value of all bonds issued by

³⁸² LJSC, Article 33, Clause 3, Paragraph 8.

³⁸³ Law on Securities Markets, Article 8, Clause 1.

³⁸⁴ LJSC, Article 33, Clause 3, Paragraph 8.

³⁸⁵ Law on Securities Markets, Article 16; Article 18, Article 27.2, Clauses 2 and 3.

³⁸⁶ LJSC, Article 33, Clause 3, Paragraph 8.

³⁸⁷ LJSC, Article 33, Clause 3, Paragraph 3.

the company must not exceed: 1) the value of the charter capital, or 2) the value of a guarantee submitted to the company by a third party for the purposes of the bond issue.³⁸⁸ In any event, bonds may not be issued before the charter capital has been paid in full.

c) Rights of Bondholders

The bondholder has the rights of a creditor, and is entitled to:

- **Redeem the bond at maturity for its face value.**³⁸⁹ A company can issue bonds with different redemption alternatives. It can issue bonds that have the same payment period or a series of bonds with different payment periods. The company can also envisage the possibility of early payment at the request of the holder;
- **Receive interest payable on the bond.**³⁹⁰ Interest payments on bonds are generally referred to as coupons. (Historically, bonds were issued with detachable coupons that were submitted in exchange for payment.)

Since bonds are freely transferable, the bondholder can sell his bond to another investor. As with equities, bonds are subject to a market pricing mechanism. This means that bond prices are constantly fluctuating, and that bondholders can both make and lose money from buying and selling bonds.

d) Secured and Unsecured Bonds

Companies may issue both unsecured and secured bonds,³⁹¹ although they may not issue unsecured bonds during the first three years of their existence.³⁹² This rule is intended to protect bondholders from the risks associated with a new business.

Secured bonds provide additional protections to bondholders in case the company defaults on its obligations. The law provides the following guarantees:

- **Pledges of property.** Only securities or “immovable property” can be the subject of the pledge (security).³⁹³ Immovable property includes land, or a building together with any machinery, plant, furniture, or fittings that are

³⁸⁸ LJSC, Article 33, Clause 3, Paragraph 3.

³⁸⁹ LJSC, Article 33, Clause 3, Paragraph 4; Law on the Securities Market, Article 2.

³⁹⁰ LJSC, Article 33, Clause 3, Paragraph 1; Law on the Securities Market, Article 2.

³⁹¹ LJSC, Article 33, Clause 3, Paragraph 6.

³⁹² CC, Article 102, Clause 2; LJSC, Article 33, Clause 3.

³⁹³ Law on the Securities Market, Article 27.3, Clause 1.

Chapter 11. Corporate Governance Implications of Corporate Securities

fixed to the property. It may also include rights with respect to land or a building. Immovable property is subject to a valuation of an Independent Appraiser. All secured bondholders of the same issue have equal rights with regard to the pledged property.

- **A third party guarantee** can be submitted to the company for the purposes of the bond issue. This can be a bank guarantee or a corporate (for example, submitted by a parent company for bonds issued by a subsidiary) or personal guarantee. The guarantor is jointly and severally liable for the redemption of the bond. In case of a bank guarantee, the law prohibits the revocation of the guarantee.³⁹⁴ It requires that the period of validity of the guarantee be at least six months longer than the bond redemption date.

The issue of secured bonds means that guarantee requirements must be fulfilled (pledges, mortgages, or bank guarantees, as well as the notarization and the state registration of a mortgage) in addition to the normal requirements associated with a bond issue.³⁹⁵

In principle, the redemption of bonds is protected by the requirement in the Company Law for the company to maintain a reserve fund that can be used, among other things, for the redemption of bonds.³⁹⁶

→ *For more information on reserve funds, see Chapter 9, Section D.1.*

e) Convertible Bonds

Companies can also issue bonds that can be converted into shares.³⁹⁷ In international practice, convertible bonds may: 1) grant bondholders the right to subscribe for shares at a later date and specified price (also referred to as “subscription warrants”, or “warrants” for short); 2) be directly convertible into shares; or 3) be reimbursable by shares.

In any case, the Company Law requires that the conversion of bonds be authorized by the charter. A company cannot issue bonds if the amount of the authorized shares is insufficient to allow for the conversion of bonds.³⁹⁸

³⁹⁴ Law on the Securities Market, Article 27.5.

³⁹⁵ Law on the Securities Market, Article 27.3.

³⁹⁶ LJSC, Article 35, Clause 1.

³⁹⁷ LJSC, Article 33, Clause 2, Paragraph 2.

³⁹⁸ LJSC, Article 33, Clause 4.

f) Differences Between Bondholder and Shareholder Interests

Both shareholders and bondholders are interested in the profitability and health of the company. For shareholders, a healthy company generates free cash flows that generally lead to a higher market valuation. Healthy companies are also more likely to pay dividends than unhealthy ones. For bondholders, a healthy company reduces the risk of default on its obligation to repay the bond principal and interest. In short, for both, a successful and profitable company can lead to an increase in the market value of their respective securities.

There are, however, some important differences between the interests of these two types of investors.

- **Interests diverge most distinctly during insolvency.** During insolvency proceedings, different priorities are assigned to different types of claimants. In general, creditor claims (including those of bondholders) are always satisfied before those of shareholders.
- **Another difference is in the conversion of bonds.** Shareholders are always interested in minimizing the dilution of their holdings. It is, in part, for this reason that they enjoy certain governance rights, and that decisions that would result in the dilution of share ownership are always subject to the approval of the company's governing bodies.³⁹⁹ Similarly, holders of convertible bonds are interested in preventing the reduction of capital or the redemption of shares when this conflicts with the exercise of their conversion rights.
- **The interests of shareholders and bondholders also diverge with respect to risk.** Shareholders generally accept a higher level of risk than bondholders in exchange for potentially higher returns. If a company successfully takes higher risks, returns to shareholders will be higher. If a company fails in its risk-taking, the losses will be greater. Bondholders will, on the other hand, always receive the same contractually stipulated return regardless of the level of risk of the projects that the company undertakes; bondholders only stand to lose if the level of risk to the enterprise ultimately results in corporate insolvency. This holds particularly true for holders of unsecured bonds. Bondholders always hope to see a predictable, stable cash flow, and, if possible, a reduction in the company's risk profile.

³⁹⁹ Shareholders are not necessarily always opposed to dilution. They may accept some level of dilution as a necessary cost to achieving the goals of the enterprise. A common example is the issue of stock options as part of incentive compensation programs. The cost of share dilution is, arguably, less than the benefits achieved by a highly motivated workforce.

Best Practices: In some countries, company laws incorporate special measures for balancing the conflicting interests of shareholders and bondholders by:

- **Granting bondholders consultation rights.** In France, for example, the meeting of bondholders must be consulted in a number of circumstances, such as the reorganization or issuance of bonds that are secured by significant company assets.
- **Allowing bondholders to inspect documents** during the General Meeting of Shareholders (GMS), as is the case in Germany.
- **Prohibiting the redemption of shares** or reduction of capital while bonds are open for conversion or subscription, for example in France.

Russian law does not provide bondholders with special rights, although nothing prohibits Russian companies from inviting bondholders to the GMS or even to Supervisory Board meetings. As in France, information can also be sent to bondholders on issues that may be of special concern to them. Companies may wish to develop specific policies with respect to bondholders and are encouraged to integrate them into their overall programs on corporate governance.

C. Issuing Securities

Issuing securities is a complex process involving a transfer of funds in exchange for specific control and cash flow rights, all subject to different levels of assurance and guarantee. Efficient capital markets help companies raise capital for productive uses. They also allow investors to reap returns on their capital (that might otherwise lie dormant) and to select investments that correspond to their desired level of risk and return.

Capital markets cannot bring users and providers of capital together efficiently if the markets are subject to misuse. Unfortunately, the history of financial markets both in Russia and throughout the world is rife with such examples. Securities legislation has developed largely in response to abuse and market failure. Its purpose is to protect the interests of companies and investors, and to enhance the function and efficiency of capital markets.⁴⁰⁰ Accordingly, the issuance process of all securities in Russia is subject to state registration, during which the Federal

⁴⁰⁰ At the same time, market regulators must make sure that they do not strangle entrepreneurial drive or company growth. Companies are wealth generators in every economy, and elaborate regulation usually entails costs. The challenge for regulators is to develop intelligent regulations that meet its goals while imposing the minimum level of costs upon the economy and society.

The Russia Corporate Governance Manual

Commission for the Securities Market (FCSM)⁴⁰¹ uses its powers to ensure the transparency and legality of the issuance.

Legal requirements for issuing equities differ according to the method of placement and, more specifically, according to the type and number of investors involved. These differences are summarized in Table 2.⁴⁰²

Method of Placement	Legal Requirements
Closed subscription, if the number of potential investors is less than 500	<ul style="list-style-type: none"> • The decision to issue securities, and the report on the results thereof, are subject to state registration; and • A prospectus may be registered on a voluntary basis.
Closed subscription, if the number of potential investors is more than 500	<ul style="list-style-type: none"> • The decision to issue securities, and the report on the results thereof, are subject to state registration; • It is mandatory to prepare and register a prospectus with contents prescribed by law; • A securities market financial consultant may be invited to certify the prospectus;⁴⁰³ and • Specific information must be disclosed at every step of the issue process.
Open subscription ⁴⁰⁴	<ul style="list-style-type: none"> • The decision to issue securities, and the report on the results thereof are subject to state registration; • It is mandatory to prepare and register a prospectus with contents prescribed by law; • The prospectus must be certified by a securities market financial consultant;⁴⁰⁵ and • Specific information must be disclosed at every step of the issue process.

⁴⁰¹ In late March 2004 under government reorganization, the FCSM was replaced by the Federal Service for Financial Markets (FSFM). Its authorities are expected to be widened, with additional supervisory authority from the Antimonopoly and Finance Ministries. At the time of publishing this Manual, the authority of the new FSFM had not been finalized.

⁴⁰² Law on the Securities Market, Article 19, Clause 2.

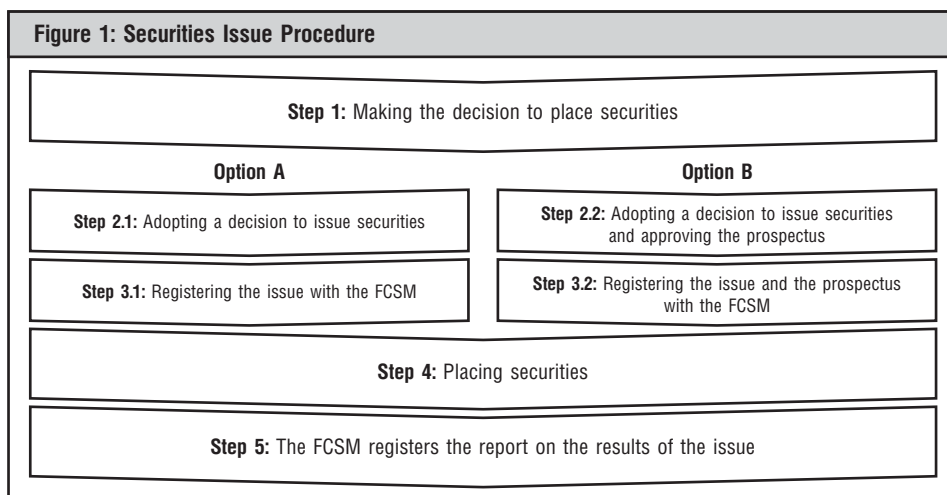
⁴⁰³ According to Article 2 of the Law on the Securities Market, a securities market financial consultant is a legal entity licensed to carry out broker's and/or dealer's activity in the securities market and/or perform services in relation to preparing the securities prospectus of an issuing company. Common usage in English would be "securities market professional."

⁴⁰⁴ Article 2 of the Law on the Securities Market refers to open subscriptions as "public subscriptions."

⁴⁰⁵ Law on the Securities Market, Article 22.1, Clause 2.

Chapter 11. Corporate Governance Implications of Corporate Securities

The process of issuing securities involves a number of steps, as illustrated in Figure 1.⁴⁰⁶ Option A illustrates the procedure when a prospectus is not required and Option B when it is required.



Source: IFC, March 2004

The following section discusses the above-mentioned steps in greater detail and highlights the differences between equities and bonds.

1. Making the Decision to Place Securities

The decision to place securities is made by different governing bodies, depending on the type of issue and the charter requirements, as summarized in Table 3.

⁴⁰⁶ Law on the Securities Market, Article 19, Clause 1; FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses (FCSM Regulation No. 03-30/ps), 18 June 2003, Section 2.1.1.

Table 3: The Decision to Place Different Types of Securities	
Shares	The GMS generally approves the decision. → <i>For more information on the decision to place shares, see Chapter 9, Section B.2.</i>
Convertible bonds (or options)	The GMS (or the Supervisory Board, if specified in the charter) approves the decision. ⁴⁰⁷
Bonds	The Supervisory Board approves the decision, unless otherwise provided for by the charter. ⁴⁰⁸ The decision-making procedure for issuing bonds may be simpler than for other securities, which may serve as an additional incentive for their use. However, the charter can provide for stricter approval requirements, for example, with regard to specific types of bonds.

2. Adopting the Decision to Issue Securities

The decision to issue securities is made by the Supervisory Board⁴⁰⁹ based on, and in compliance with, the decision to place them.⁴¹⁰ This decision must then be adopted within six months.⁴¹¹ This requirement is important, in as much as the decision to issue securities becomes the main document certifying the rights of the holders of securities and of the company.⁴¹²

Although the contents of the decision depend on the circumstances of each issue, it must generally include information on the:⁴¹³

- Issuing company, i.e. full name, place of business, and postal address;
- Decision to place securities, i.e. date and the decision-making body;
- Decision to issue securities, i.e. date and the decision-making body;

⁴⁰⁷ LJSC, Article 33, Clause 2; Article 65, Clause 1, Section 6.

⁴⁰⁸ LJSC, Article 33, Clause 2; Article 65, Clause 1, Section 6.

⁴⁰⁹ Law on the Securities Market, Article 17, Clause 2.

⁴¹⁰ FCSM Regulation No. 03-30/ps, Section 2.3.1.

⁴¹¹ FCSM Regulation No. 03-30/ps, Section 2.3.3.

⁴¹² Law on the Securities Market, Article 18.

⁴¹³ Law on the Securities Market, Article 17, Clause 1; FCSM Regulation No. 03-30/ps, Section 2.3.4.

Chapter 11. Corporate Governance Implications of Corporate Securities

- Securities to be issued, i.e. type and class, their nominal value, the rights of the holders of securities, and number to be issued; and
- Conditions of the placement.

In the case of bonds, the decision must include information on the:⁴¹⁴

- Form of bond redemption (monetary or in-kind);
- Maturity date (and details regarding early redemption, where applicable);
- Other terms of redemption, i.e. the value of the payment, if early redemption is possible;
- If convertible bonds are issued, the procedure for their conversion into shares;⁴¹⁵
- If secured bonds are issued, information on the security or the person submitting the guarantee and the conditions of the guarantee (in the latter case, the decision must also be signed by the guarantor);⁴¹⁶ and
- If registered bonds or bonds in paper form are issued with mandatory centralized storage, the date of record for compiling the bondholders list. This date may not be earlier than 14 days before the maturity date. Payments are made to the bondholders of record even if the bond has been transferred to another bearer after the record date.⁴¹⁷

Copies of the decision to issue securities are kept with the registration authority, the company, and, when the shareholder register is maintained externally, by the External Registrar.⁴¹⁸

3. Approving the Prospectus

The prospectus is a document through which investors obtain information about securities, including the risks and returns associated with the investment. For this reason, legislation requires that a prospectus be prepared in the case of: 1) any open subscription; and 2) a closed subscription to more than 500 investors.⁴¹⁹

⁴¹⁴ LJSC, Article 33, Clause 3.

⁴¹⁵ LJSC, Article 37, Clause 1.

⁴¹⁶ Law on the Securities Market, Article 17, Clause 2; Article 27.2, Clause 2.

⁴¹⁷ Law on the Securities Market, Article 17, Clause 2.

⁴¹⁸ Law on the Securities Market, Article 17, Clause 4; FCSM Regulation No. 03-30/ps, Section 2.3.5.

⁴¹⁹ Law on the Securities Market, Article 19, Clause 2.

Best Practices: Even if a registered prospectus is not required for the issue, companies can still register one voluntarily after filing the report on the results of the securities issue.⁴²⁰

There are costs attached to the preparation of a prospectus that some companies may wish to avoid. However, the short-term costs of preparing the prospectus are likely to be greatly outweighed by the long-term benefits (e.g. lower cost of capital) that can be achieved by clarifying the risks and returns of the company to investors.

Investor interests are protected by the information that must be included in the prospectus, the liability attached to those who have signed it, and the requirement for its state registration.

a) The Contents of the Prospectus

Securities legislation contains detailed provisions outlining what must be disclosed in the prospectus.⁴²¹ These provisions are summarized briefly below:

- 1) Information about members of the company's governing bodies, the bank accounts of the company, the bodies controlling its financial and economic activities, the External Auditor, the Independent Appraiser, and other persons signing the prospectus;
- 2) Information on the terms and procedures for the issue of securities, including information on the volume, terms, and procedures;
- 3) Essential information about the financial health of the company, including risk factors;
- 4) Detailed information on the issuing company;
- 5) Information on the financial and economic activities of the issuing company;
- 6) Detailed information about the members of the governing bodies of the issuing company, and the bodies controlling its financial and economic activities; and
- 7) Information on the company's shareholders, related parties, and related party transactions.

⁴²⁰ Law on the Securities Market, Article 19, Clause 3; FCSM Regulation No. 03-30/ps, Section 10.1.

⁴²¹ Law on the Securities Market, Article 22.

Chapter 11. Corporate Governance Implications of Corporate Securities

Additional information must be included in the prospectus when bonds are issued. For example, the prospectus must include information on the guarantor, and conditions of the guarantee, and be signed by the guarantor when secured bonds are issued.⁴²²

Best Practices: It is good practice to disclose all material information about the company in the prospectus.⁴²³ The company should seek to provide shareholders and potential investors with all information that may be important in valuing the company.

b) Prospectus Approval and Certification

The Supervisory Board must approve the prospectus.⁴²⁴ The following individuals must sign the prospectus to certify the truthfulness and completeness of the information included therein:⁴²⁵

- The General Director and the Chief Accountant (or the person fulfilling this function);
- The External Auditor;
- The Independent Appraiser in circumstances envisaged by the FCSM; and
- The (securities market) financial consultant in the case of a public offering, except with regard to information already certified by the External Auditor and/or the Independent Appraiser.

The most important feature of this requirement is the liability of those who have signed the prospectus. They are jointly and severally liable with the issuer for any damage caused to investors because of untruthful, incomplete, and/or misleading information.⁴²⁶ If investors believe that they have suffered damages, they can file claims with a court within three years after the issue. If there is no mandatory requirement for the registration of the prospectus, this period begins with the public trading of securities.

⁴²² Law on the Securities Market, Article 22.1, Clause 1; Article 27.2, Clauses 2 and 3.

⁴²³ FCSM Code, Chapter 7, Section 2.1.

⁴²⁴ Law on the Securities Market, Article 22.1, Clause 2.

⁴²⁵ Law on the Securities Market, Article 22, Clause 2.

⁴²⁶ Law on the Securities Market, Article 22.1, Clause 3.

c) Disclosure

When state registration of the issue includes the registration of a prospectus, every stage of the issue process is accompanied by public disclosure.⁴²⁷

→ For more on information disclosure and the prospectus, see Chapter 13, Section C.1.

4. The Control over Securities Issue

Registering of the issue and prospectus is an important investor protection mechanism. This is a form of state control over the securities issue process. Without proper registration, securities cannot be considered issued and sold to investors. The FCSM has the power to verify that the legal requirements of the issue have been satisfied (e.g. that the charter capital has been paid in full, or options are issued for no more than 5% of issued shares).⁴²⁸ It also is charged with verifying the completeness of the information disclosed and taking actions to guarantee its truthfulness. Securities legislation:

- Ensures the quality and availability of information to users;
- Encourages the timely registration of the issue, which is essential for business operations;
- Allows companies to remedy minor defects and thus postpone registration refusal; and
- Guarantees companies the right to appeal if there has been an arbitrary refusal.

For registration purposes, the company is required to submit certain documents required by securities legislation.⁴²⁹ The FCSM registers the issue and the prospectus and assigns a registration number to the issue.⁴³⁰ However, there are no provisions in the Law on the Securities Market that allow a claim to be made against the FCSM for the truthfulness of information, even if it conducted an investigation.⁴³¹

⁴²⁷ Law on the Securities Market, Article 19, Clause 2 and Article 30.

⁴²⁸ Such as the requirements provided in LJSC, Article 33, Clause 3; FCSM Regulation No. 03-30/ps, Sections 2.4.20 and 2.4.21.

⁴²⁹ FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses, 18 June 2003, Section 2.4.2.

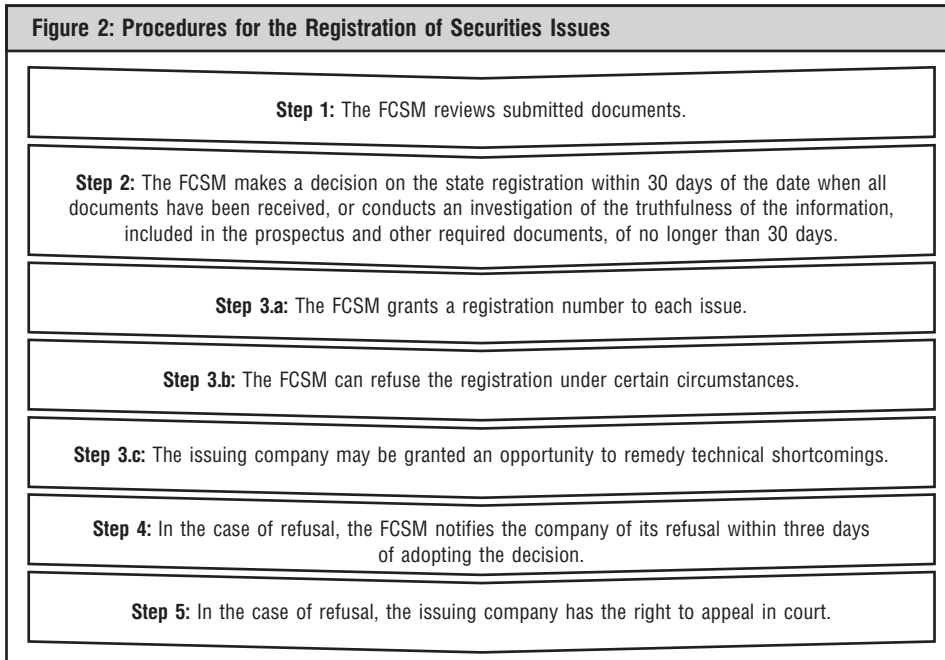
⁴³⁰ Law on the Securities Market, Article 20, Clause 4.

⁴³¹ Law on the Securities Market, Article 20, Clause 5.

Chapter 11. Corporate Governance Implications of Corporate Securities

FCSM control over securities issue procedures extends beyond the registration of the issue and prospectus. If it discovers legal violations after registration, it can request that a court invalidate the issue.⁴³² The FCSM can deem that the issue was not undertaken in good faith in the case of violation of legal requirements in the process of the issue or discovery of untruthful information in the documents that have served as the basis for the registration.⁴³³

In such cases, the FCSM can temporarily stay the procedure until defects are remedied. More importantly, the FCSM can invalidate the issue. This can be done within three months from the date of registration of the report on the results of the issue. If an issue is invalidated, securities must be returned to the company and issue proceeds refunded to investors. Figure 2 illustrates the steps required for the state registration of securities issues.



Source: IFC, March 2004

⁴³² FCSM Regulation No. 03-30/ps, Section 2.6.13.

⁴³³ Law on the Securities Markets, Article 26.

5. The Sale of Securities

The issuer can begin selling securities once the state registration of the issue has been completed, unless otherwise provided by law.⁴³⁴ The placement is the actual transaction between the company and the investor.⁴³⁵ This transaction is subject to a number of legal requirements and only takes effect upon the registration of its results, as discussed hereinafter.

a) Number of Securities Placed

The number of securities placed should be no more than indicated in the decision to issue securities.⁴³⁶ If a company places more than the number indicated in the prospectus, it is obliged to repurchase the surplus securities and cancel them within two months.⁴³⁷ If the company fails to do so, the FCSM can file a claim in court for the return of the issue proceeds.

The number of securities placed may, however, be less than the number indicated in the prospectus. In practice, the ability of a company to sell securities depends on investor demand. Whatever its stated goal, the actual number of securities placed must be disclosed in the report on the results of the issue.⁴³⁸

b) The Timing of the Placement

The placement of securities must occur within a legally defined period of time.⁴³⁹

- **Minimum:** When securities are placed by subscription requiring the registration of a prospectus, the subscription cannot start earlier than two weeks after the publication of the announcement of the state registration of the issue. This requirement aims to provide a minimum period for investors to effectively acquaint themselves with the conditions of the investment. The

⁴³⁴ Law on the Securities Market, Article 24.

⁴³⁵ Law on the Securities Market, Article 2.

⁴³⁶ Law on the Securities Market, Article 24.

⁴³⁷ Law on the Securities Market, Article 26.

⁴³⁸ Law on the Securities Market, Article 24.

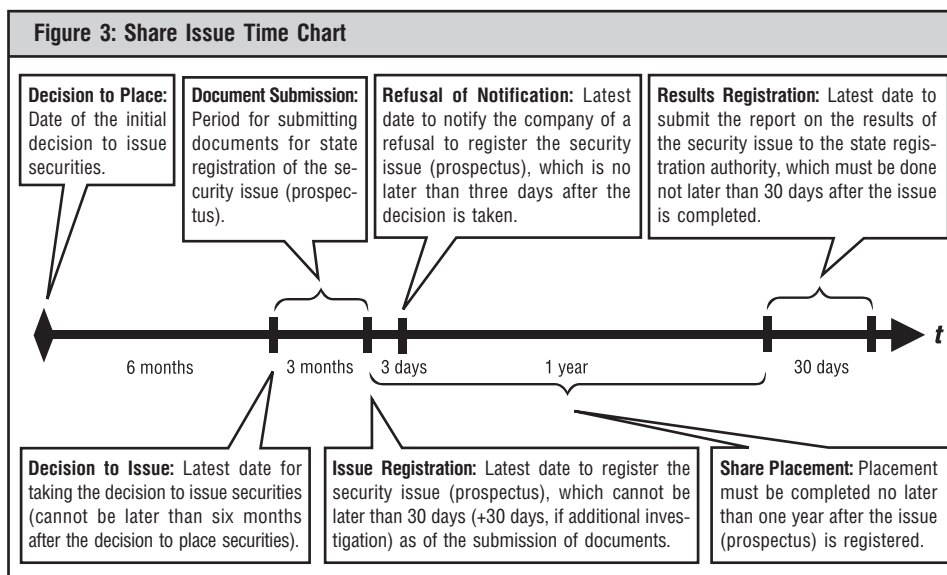
⁴³⁹ Law on the Securities Market, Article 24.

Chapter 11. Corporate Governance Implications of Corporate Securities

subscription price, however, can be disclosed on the day when the placement of securities begins.

- **Maximum:** The placement must be completed no later than one year after the date of the state registration.

To carry out a legally valid securities issuance several deadlines must be met, as illustrated in Figure 3.



Source: IFC, March 2004

c) Issue Price

The Supervisory Board has the right to determine the issue price of securities.⁴⁴⁰ The discretionary powers of the Supervisory Board are limited, however, to prevent directors or large shareholders from acquiring securities below market price when the issue is done by subscription (see Table 4).

⁴⁴⁰ LJSC, Article 36, Clause 1; Article 38, Clause 1.

Table 4: Issue Price	
Security	Price
Shares	<ul style="list-style-type: none"> The issue price must correspond to the market value.⁴⁴¹ An Independent Appraiser can determine the market value of shares. The use of an Appraiser is not mandatory when share prices are quoted; and The issue price cannot be lower than the nominal value. <p>When shareholders exercise pre-emptive rights, the price cannot be lower than 90% of the market value.⁴⁴²</p>
Convertible bonds (or options)	<ul style="list-style-type: none"> The issue price must correspond to the market value;⁴⁴³ and The issue price cannot be lower than the nominal value of the shares into which they are to be converted.⁴⁴⁴ <p>In this case, similar to shares, shareholders, when exercising their pre-emptive right, can acquire convertible bonds at a price no more than 10% lower than the price determined for other investors.⁴⁴⁵</p>
Bonds	<ul style="list-style-type: none"> The issue price must correspond to the market value.⁴⁴⁶

D. The Conversion of Securities

Companies not only issue securities when seeking to raise capital, but also when existing securities, or rights embodied in them, must be restructured. A conversion of securities occurs in the following circumstances:⁴⁴⁷

- Increasing the charter capital by increasing the nominal value of shares;
- Decreasing the charter capital by decreasing the nominal value of shares;
- Consolidating or splitting shares;
- Converting one type and class of shares into another type and class of shares;

⁴⁴¹ LJSC, Article 77.

⁴⁴² LJSC, Article 36, Clause 1; Article 38, Clause 2.

⁴⁴³ LJSC, Article 38, Clause 1; Article 77.

⁴⁴⁴ LJSC, Article 38, Clause 1.

⁴⁴⁵ LJSC, Article 38, Clause 2.

⁴⁴⁶ LJSC, Article 77.

⁴⁴⁷ FCSM Regulation No. 03-30/ps, Section 5.1.1.

Chapter 11. Corporate Governance Implications of Corporate Securities

- Converting bonds into shares; and
- Reorganizing the company.

In these cases, new investors are not involved. Shares are placed with existing shareholders or other investors holding securities that grant them a conversion right. The procedure for converting existing shares is simpler and quicker than for issuing additional shares: no prospectus needs to be prepared and registered and the conversion of shares must be completed no later than one month from the date of the state registration of the issue.⁴⁴⁸

E. Share Splits and Consolidations

Shares are issued in specific quantities and at a given nominal value. Yet, during the life of a company, the nominal value can be altered without changing the amount of the charter capital. This can occur either through share splits or consolidations:

- Shares are split when the company exchanges one share of the company for two or more shares of the same type and class.⁴⁴⁹ The result is an increase in the number of shares with a lower nominal value and lower market value per share. The most common share splits are 3-for-2, 2-for-1, and 3-for-1.
- Shares are consolidated when the company exchanges two or more shares for a lesser number of shares of the same type and class.⁴⁵⁰ The result is fewer shares with a higher nominal value and a higher market value per share.

There are three main reasons for a share split: affordability, message, and psychology. Since shares are generally traded in blocks, splitting the shares and price reduces the minimum investment required to purchase a block of shares. Share splits can then make shares more affordable for small investors, and the increase in the number of shares may improve liquidity. Moreover, splits are often used to send “a message” to the markets that management is confident in the future of their company and it expects the share price to increase. There also

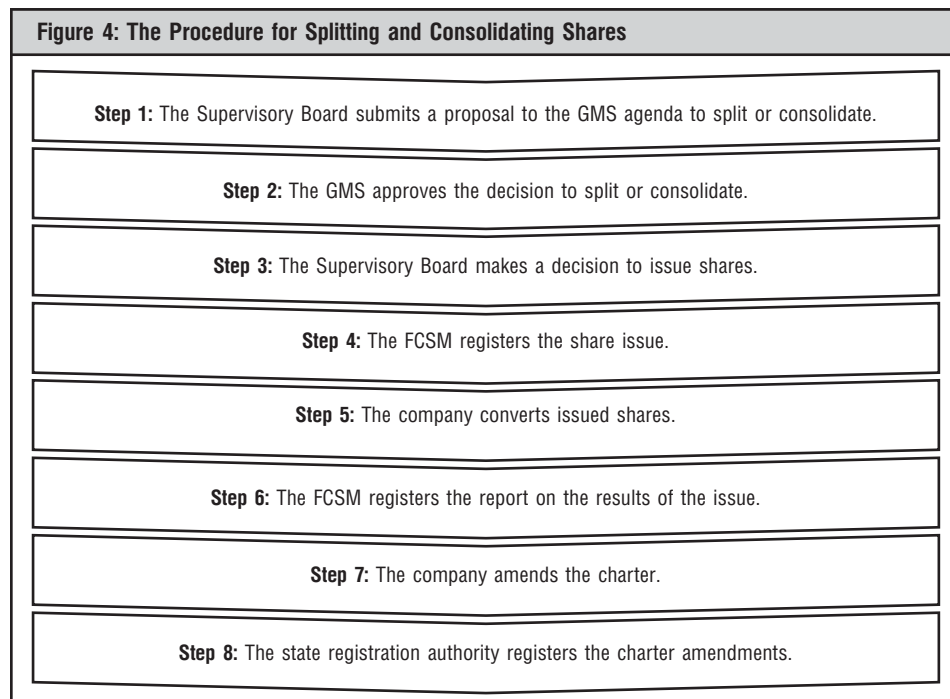
⁴⁴⁸ FCSM Regulation No. 03-30/ps, Section 5.3.1.

⁴⁴⁹ LJSC, Article 74, Clause 2.

⁴⁵⁰ LJSC, Article 74, Clause 1.

may be a psychological benefit in that shareholders own two (or more) shares for the price of one.⁴⁵¹

The decision to split or consolidate shares is subject to special procedures, as illustrated in Figure 4.



Source: IFC, March 2004

The discussion in the following section will focus on the steps related to the decision-making requirements within the company (steps 1 and 2) and the charter amendments (steps 7 and 8). Steps 3 to 6, which represent the process of converting shares with a higher or lower nominal value into shares with a respectively lower or higher nominal value, have already been addressed in Section C of this Chapter.

⁴⁵¹ None of these reasons are corroborated by financial theory. Finance theory argues that splits and consolidations are largely irrelevant. Nevertheless, many western companies continue to split and consolidate shares.

1. Agenda Proposal to Split or Consolidate Shares

The decision to split or consolidate shares must be approved by the GMS.⁴⁵² However, only the Supervisory Board has the authority to propose splits or consolidations to the agenda of the GMS, unless the charter provides otherwise.⁴⁵³ A simple majority vote of directors participating in the Supervisory Board meeting must approve the decision, unless the charter or by-laws require a greater percentage of votes.⁴⁵⁴

2. Decision to Split or Consolidate Shares

The GMS approves the decision to split or consolidate shares by a simple majority vote of participating shareholders.⁴⁵⁵

If the decision to split shares results in charter amendments that limit the rights of preferred shareholders, separate votes of the following groups of shareholders are required with the following majorities:

- A $\frac{3}{4}$ -majority vote of preferred shareholders whose rights are being limited, unless the charter requires a greater number of votes;⁴⁵⁶ and
- A $\frac{3}{4}$ -majority vote of all other shareholders participating in the GMS.

Information included in the decision to split or consolidate shares is summarized in Table 5.

⁴⁵² LJSC, Article 48, Clause 1, Section 14.

⁴⁵³ LJSC, Article 49, Clause 3.

⁴⁵⁴ LJSC, Article 68, Clause 3, Paragraph 1.

⁴⁵⁵ LJSC, Article 74, Clause 1; Article 49, Clause 2.

⁴⁵⁶ LJSC, Article 32, Clause 4, Paragraph 2.

	Required	Optional
Consolidation ⁴⁵⁷	<ul style="list-style-type: none"> Types and classes of shares to be consolidated; The number of shares of each type and class to be consolidated into one share of the same type and class (the consolidation ratio). The ratio must be a whole number. Fractions of a whole number are not allowed; and The form of placement of shares (in this case the conversion of placed shares into shares of the same type and class but with a higher nominal value). 	<ul style="list-style-type: none"> The date, or the procedure for determining the date, when shares must be converted; and Other significant terms and conditions of the consolidation.
Split ⁴⁵⁸	<ul style="list-style-type: none"> Types and classes of shares to be split; The number of shares of each type and class into which one issued share of the same type and class will be split (the split ratio). The ratio must be a whole number; and The form of placement of shares (in this case, the conversion of issued shares into shares of the same type and class but with a lower nominal value). 	<ul style="list-style-type: none"> The date, or the procedure for determining the date, when shares must be converted; and Other significant terms and conditions of the split.

3. Charter Amendments

Companies are required to make charter amendments related to:⁴⁵⁹

- The nominal value of issued and authorized shares;
- The number of issued shares; and
- The number of authorized shares.

4. Registration of Charter Amendments

Charter amendments for share consolidations or splits must be registered with the state registration authority.⁴⁶⁰

⁴⁵⁷ FCSM Regulation No. 03-30/ps, Section 5.1.4.

⁴⁵⁸ FCSM Regulation No. 03-30/ps, Section 5.1.5.

⁴⁵⁹ LJSC, Article 74.

⁴⁶⁰ LJSC, Article 14.

F. Stock Options

A company may also issue options on securities.⁴⁶¹ Options are complex and often extremely risky derivative instruments (see Mini-Case 1).

Mini-Case 1: A simple explanation of how an option functions is that it gives the holder the right to buy (or sell) an asset (generally share) at a pre-determined price. For example, an option may give the holder the right to buy company shares at today's price (e.g. RUR 1,000) in three months time. The holder of an option expects a change in the price of the underlying share from which he hopes to benefit. He may expect the price to rise to RUR 1,500. In this case, the option holder stands to gain RUR 500. On the other hand, if the price of shares falls, the option has no value. There are many different types of options that can be used to create complex tools for managing and trading risk.

In the corporate governance context, a relatively mundane form of option — the incentive stock option — is used to provide performance-enhancing incentives to management and employees. In some countries, options are the primary component of remuneration packages for top executives. They are popular because the returns to executives can be large, they ostensibly align the interests of management and shareholders, and because the true cost of options (the dilution of other shareholders) is not readily apparent under current accounting standards.

Best Practices: Stock option compensation is a complex and contentious remuneration technique that requires close examination by the governing bodies of the company.

The issue of stock options must normally be accompanied by the issue of new shares. For this reason, the decision to place options must be carried out in accordance with the rules on convertible securities.⁴⁶² More specifically, a company

⁴⁶¹ Law on the Securities Market, Article 2.

⁴⁶² Law on the Securities Market, Article 2.

can only sell options after the charter capital is fully paid and if the number of authorized shares is not less than the number of shares subject to the exercise of the options rights.⁴⁶³

The quantity of shares that can be obtained when the option is exercised cannot exceed 5% of the shares of this type and class issued on the date of the submission of the documents for state registration of the options issue. Treasury shares may also be used for the exercise of stock options.

Best Practices: The use of other derivative instruments is important from a risk management perspective. The power of derivatives and similar instruments, such as hedges and futures, lies in their capacity to adjust the company's circumstances to any particular situation that arises. Options can be speculative or conservative. This means that various goals can be pursued, ranging from protecting companies from changes in commodity prices to gambling on the movement of shares. However, derivative and related instruments are complex and can be extremely risky. Supervisory Boards, and indeed shareholders, need to be aware of the company's use of these tools since they could potentially expose companies to unexpected and significant risks.

G. Raising Capital in the International Markets

Russian companies are increasingly seeking capital in international markets. Listings on foreign exchanges often bring advantages including a lower cost of capital, higher liquidity, and, last but not least, greater prestige. The world's largest foreign markets tend to have higher standards of corporate governance than the Russian markets. The most popular markets are in the U.S., the U.K., and continental Europe, which arguably have some of the most rigorous governance standards in the world.

The Law on the Securities Market allows Russian companies to issue shares abroad, after receiving permission from the FCSM.⁴⁶⁴ Permission is generally granted subject to the following conditions:

⁴⁶³ Law on the Securities Market, Article 27.1.

⁴⁶⁴ Law on the Securities Market, Article 16.

Chapter 11. Corporate Governance Implications of Corporate Securities

- The state registration of the issue;
- The securities of the Russian issuer have been listed on at least one exchange in Russia;
- The quantity of securities placed abroad does not exceed a quota established by the FCSM; and
- The contract embodying the derivative rights to the company's shares cannot contain a clause that under a foreign law might grant a right to vote the securities without investor instructions.

The FCSM must decide on the foreign issue within 30 days of the submission of the required documentation.

There are two principal means for companies to establish a presence in the international securities markets. Companies can either: 1) issue securities directly; or 2) issue depositary receipts. Depositary receipts are contracts with foreign financial institutions, pursuant to which certificates are traded in lieu of shares. Depositary receipts are an increasingly popular form of accessing foreign capital. Depositary receipts are also used to give their holders the benefit of being able to have recourse to Russian law, with which they are familiar. Depositary receipts also contribute to increasing the liquidity of the issuing company's shares.

There are different types of depositary receipts, depending upon the market where they are traded. American Depositary Receipts (ADRs) circulate in U.S. stock markets, European Depositary Receipts (EDRs) circulate in European markets, and Global Depositary Receipts (GDRs) circulate in both.

The issue of depositary receipts is negotiated with individual banks as part of a contract that results in depositing the company's shares with the bank. Depositary receipts are popular with investors in foreign countries because of the added credibility given to them by the issuing banks, and because the investment is *de facto* a domestic investment. Depositary receipts offer a number of advantages over direct issues:

- Contracts are easier to satisfy than direct listings;
- Depositary receipts are less expensive than direct listings; and
- The placement of depositary receipts is often easier than the issue of shares on foreign stock exchanges, especially if the company is not well known on the foreign market.

Best Practices: Depository receipts have corporate governance implications for investors. Shares are typically voted by the bank within which they are deposited, rather than by the holders of the receipt. This could be an advantage. Banks are able to combine the votes of many shareholders and thus be more effective in exerting influence over companies. On the other hand, it may be a disadvantage since the investor is unable to assert his views. In addition, intermediaries often vote with management as a matter of practice. The services of depository banks are an extra tier of relationships between the company and the ultimate investor, and can lead to additional costs. Thus, depository receipts, like any other investment vehicle, require careful evaluation from the perspective of both the issuer and the investor.

Chapter 12

Material **Corporate Transactions**



Table of Contents

A. EXTRAORDINARY TRANSACTIONS	174
1. <i>Definition</i>	174
2. <i>Exempted Transactions</i>	177
3. <i>Valuing of Extraordinary Transactions</i>	177
4. <i>Approving of Extraordinary Transactions</i>	178
5. <i>How Shareholders Can Protest Extraordinary Transactions</i>	180
6. <i>Disclosure Requirements</i>	180
7. <i>Invalidating Extraordinary Transactions</i>	181
B. CONTROL TRANSACTIONS	182
1. <i>Affiliated Persons</i>	184
2. <i>Pre-Acquisition Requirements</i>	185
3. <i>Post-Acquisition Requirements</i>	186
4. <i>Anti-Takeover Measures</i>	189
5. <i>Consequences of Procedural Violations</i>	190
C. RELATED PARTY TRANSACTIONS	190
1. <i>Definition</i>	191
2. <i>Exempted Transactions</i>	195
3. <i>Approving of Related Party Transactions</i>	195
4. <i>Identifying Related Party Transactions</i>	199
5. <i>Disclosure Requirements</i>	200
6. <i>Invalidating of Related Party Transactions</i>	202
7. <i>Liability for the Violation of Procedural Requirements</i>	202

The Chairman's Checklist

Extraordinary Transactions:

- ✓ Do all directors understand the concept of extraordinary transactions? Does the company charter specify additional criteria for identifying transactions that are to be treated as extraordinary beyond the minimum criteria mandated by law? Does the Supervisory Board distinguish between extraordinary transactions and those entered into in the ordinary course of business?
- ✓ How does the Supervisory Board ensure that extraordinary transactions are properly evaluated and approved by the Supervisory Board or shareholders? Does the Supervisory Board ensure that an Independent Appraiser is engaged to ascertain the market value of assets involved in the transaction?
- ✓ What steps are taken to protect the rights of shareholders who do not approve of extraordinary transactions?
- ✓ Does the company properly disclose information on completed extraordinary transactions?

Control Transactions:

- ✓ Has the company ever been involved in control transactions? How does the Supervisory Board make sure that minority shareholder rights are properly protected in control transactions?
- ✓ Does the Supervisory Board take adequate measures to inform shareholders of the advantages and disadvantages of a change in control? Does the Supervisory Board allow unwarranted takeover defenses?
- ✓ Does the Supervisory Board ensure that any new controlling shareholder extends a mandatory bid at a fair price for outstanding common shares and convertible securities?

Related Party Transactions:

- ✓ Does the Supervisory Board ensure that related parties properly disclose their interest in transactions? Do related parties abstain from participating in discussing and voting on such transactions?
- ✓ Does the Supervisory Board ensure that all legal requirements for the approval of related party transactions are adhered to? What role do independent directors play in related party transactions?

- ✓ Does the Supervisory Board take adequate measures to disclose information on related party transactions and related parties?
- ✓ Do all directors understand their liability for violating procedures for approving related party transactions?

Shareholders are legally protected when the company is involved in extraordinary, control, and/or related party transactions. Such protection is essential because of the impact that these transactions can have on the value of the company, the price of its shares, and the property rights of shareholders. Nevertheless, corporate governance abuses in these types of transactions continue to take place. For example, beneficial ownership structures typically remain non-transparent, making it near impossible to identify related parties in a transaction. In the meantime, insiders continue to develop complex structures and sophisticated techniques that allow them to tunnel assets, profits, and corporate opportunities away from the company and its shareholders.

The protection of shareholders under these circumstances receives considerable attention in the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) and is described in detail in this chapter.

A. Extraordinary Transactions

1. Definition

The Company Law refers to and defines extraordinary transactions.⁴⁶⁵ The Supreme Arbitration Court has interpreted the legal definition and applied it to specific transactions.⁴⁶⁶ Furthermore, companies have the right to set additional criteria for defining extraordinary transactions, which is most commonly done in the company charter.

⁴⁶⁵ Law on Joint Stock Companies (LJSC), Article 78, Clause 1.

⁴⁶⁶ Information Letter No. 62, Overview of Practices of Resolving Disputes Related to the Conclusion by Commercial Companies of Extraordinary and Related Party Transactions, the Presidium of the Supreme Arbitration Court of the Russian Federation, 13 March 2001, Sections 1, 4 and 6.

A transaction (or several related transactions) is extraordinary when it meets all five of the following criteria:

a) The Nature of the Transaction

- The transaction directly or indirectly involves the acquisition, sale, or the possibility of sale of corporate assets;
- The transaction is a credit, pledge, or guarantee transaction; and
- The transaction is not related to the issue of additional common shares or securities convertible into common shares.

b) The Value of the Transaction

The assets involved have a value of 25% or more of the book value of the company's assets as determined by financial statements as of the most recent reporting date.

c) The Relation of the Transaction to the Business of the Company

The transaction is not being carried out in the “ordinary course of business” of the company.

The Company Law does not define the “ordinary course of business.” Whether a transaction qualifies as such will depend on company-specific factors. For example, the purchase of real estate may be an extraordinary transaction if the company is generally engaged in the trade of consumer goods. However, the same transaction would not be extraordinary if the core business is trading in real estate. In other words, the same transaction that could be in the ordinary course of business for one company may not be for another. The Supreme Arbitration Court lists some transactions that could fall under the “ordinary course of business.”⁴⁶⁷ In particular, they are:

- Transactions to acquire raw materials and materials necessary for company's business activities;
- Sale of produced goods; and
- Obtaining loans to fund its ordinary operations.

⁴⁶⁷ Resolution No. 19, the Plenum of the Supreme Arbitration Court, on Certain Issues of Application of the Law on Joint Stock Companies (Resolution No. 19), 18 November 2003, Section 30.

d) Related Transactions

Two or more related transactions involving company's assets totaling 25% or more of the book value of the company's assets are considered a single extraordinary transaction.⁴⁶⁸ Factors that determine whether several transactions must be considered as a single transaction extraordinary include:

- The purpose of the transactions;
- The market conditions under which the transactions have been concluded;
- The sphere of activities of the company; and
- The duration of relationships between the company and its transactional counterpart.

e) Additional Charter Criteria

The charter may define additional transactions that should be treated as extraordinary transactions.⁴⁶⁹ For example, the charter may specify that transactions involving assets with a lower percentage of the book value be considered an extraordinary transaction. The charter can also provide that certain types of contracts (e.g. all loan agreements or all pledges of company shares) must be treated as extraordinary transactions, regardless of their nature. However, the company has no right to change the legal definition of an extraordinary transaction to limit cases of extraordinary transactions. For example, the company cannot provide that only transactions involving assets with a value in excess of 30% of the book value of the company's assets will be considered as extraordinary transactions.

Best Practices: There are many cases when transactions should be subject to special procedures for extraordinary transactions, even though they fall well below the legislated threshold of 25%. For example, the sale of a subsidiary of a large petroleum company that holds significant oil drilling rights may be of such size and strategic importance that it should be considered an extraordinary transaction regardless of the percentage of asset value it represents.

Legislation establishes a minimum standard of behavior, and there is some room for various interpretations regarding what is extraordinary and what is not. For this reason, it is good practice for charters to include provisions that “transac-

⁴⁶⁸ LJSC, Article 78, Clause 1, Paragraph 1.

⁴⁶⁹ LJSC, Article 78, Clause 1.

tions that may have a significant effect on the company” be treated as extraordinary (except for transactions that are concluded in the ordinary course of business).⁴⁷⁰

It is also recommended that the sale of shares of a subsidiary where the company would lose its majority stake be considered extraordinary transactions.

When two companies are engaged in a transaction, each company must separately apply the criteria for extraordinary transactions. This means that the same transaction may conceivably be an extraordinary transaction for one company but not for the other.

2. Exempted Transactions

Under certain circumstances, companies are not required to follow all the approval procedures for concluding an extraordinary transaction. Exceptions are granted when the extraordinary transaction is:

- Executed by a company owned by a single shareholder who is also the General Director;⁴⁷¹ or
- Simultaneously a related party transaction.⁴⁷² In this case, the company follows the procedures for related party transactions.

→ *For more information on related party transactions, see Section C of this Chapter.*

3. Valuing Extraordinary Transactions

An important aspect in determining whether a transaction is an extraordinary transaction is to value the assets involved in the transaction. The value of these assets must be determined to ascertain which governing body approves the transaction before the company can conclude the transaction. The Supervisory Board

⁴⁷⁰ Federal Commission for the Securities Market’s Code of Corporate Conduct (FCSM Code), Chapter 6, Section 1.1.

⁴⁷¹ LJSC, Article 79, Clause 7.

⁴⁷² LJSC, Article 79, Clause 5.

⁴⁷³ LJSC, Article 77; 78, Clause 2.

has the authority to determine the value of assets or services.⁴⁷³ In doing so, the Supervisory Board must compare the book value of the assets involved in the transaction with the book value of the company's assets as a whole. This comparison depends on the nature of the transaction whether it is an acquisition or a sale, as illustrated in Table 1.⁴⁷⁴

Type of Transaction	Basis of Valuation
Sale, or the possibility of a sale, of assets	The value of assets involved in the transaction as determined by reference to the company's financial statements as of the most recent reporting date before the transaction.
Acquisition of assets	The acquisition price of assets involved in the transaction.

Best Practices: An Independent Appraiser should assist the Supervisory Board in determining the value of assets.⁴⁷⁵

If the state or a municipal entity owns more than 2% of voting shares, the Supervisory Board is required to involve the state financial control agency in the valuation of the assets in extraordinary transactions.⁴⁷⁶ This can be a control agency of the Ministry of Finance (such as the Department of State Financial Control and the regional Control and Revision Departments), the Chief Control Department of the President of the Russian Federation, or a local state financial body.

4. Approving Extraordinary Transactions

A transaction must be approved by different governing bodies depending on the value of assets as illustrated in Table 2.

⁴⁷⁴ LJC, Article 78, Clause 1, Paragraph 2.

⁴⁷⁵ LJC, Article 77, Clause 2. See also: FCSM Code, Chapter 6, Section 1.3.

⁴⁷⁶ LJC, Article 77, Clause 3.

Table 2: The Approval of Extraordinary Transaction	
Value of Assets	Approving Governing Body
Between 25% and 50% of the book value of the company's assets	The Supervisory Board ⁴⁷⁷
More than 50% of the book value of the company's assets	The General Meeting of Shareholders (GMS) ⁴⁷⁸

The Supervisory Board has the authority to approve those extraordinary transactions that are defined as such by the charter.⁴⁷⁹

a) Transactions Involving Between 25% and 50% of the Book Value of Company Assets

Unanimous approval of all serving Supervisory Board members is required to approve an extraordinary transaction involving assets with a value between 25% and 50% of the book value of the company's assets.

If the Supervisory Board is not able to reach a unanimous decision, it can request that the GMS approve the transaction. The Supervisory Board can do this by a simple majority vote of directors participating in the Board meeting, unless the charter or by-laws require a higher percentage of votes. The GMS can then approve the transaction with a simple majority vote of participating shareholders.⁴⁸⁰

b) Transactions Involving More than 50% of the Book Value of Company Assets

The GMS must decide on whether to approve transactions involving more than 50% of the book value of company assets by a $\frac{3}{4}$ -majority vote of participating shareholders.⁴⁸¹

⁴⁷⁷ LJSC, Article 79, Clause 2, Paragraph 1.

⁴⁷⁸ LJSC, Article 79, Clause 3.

⁴⁷⁹ This decision cannot be approved by the GMS because the company charter cannot delegate additional powers to the GMS beyond those defined by law.

⁴⁸⁰ LJSC, Article 79, Clause 2, Paragraph 2; Resolution No. 19, Section 32.

⁴⁸¹ LJSC, Article 79, Clause 3.

c) Required Information for the Decision to Approve an Extraordinary Transaction

The decisions of the Supervisory Board or the GMS must include information on:⁴⁸²

- The parties that are involved in the transaction;
- Other beneficiaries of the transaction (if any);
- The price of the transaction;
- The object of the transaction; and
- Any other significant terms and conditions related to the extraordinary transaction.

5. How Shareholders Can Protest Extraordinary Transactions

If a shareholder does not agree with an extraordinary transaction conducted in full compliance with procedural requirements and the law, he may:

- **Sell his shares.** Practically, this is only possible if the company's shares are liquid, i.e. there are interested buyers and shareholders are able to sell their shares at a fair price; or
- **Demand redemption of shares in part or whole:** Shareholders have the right to have their shares redeemed by the company.⁴⁸³

6. Disclosure Requirements

Companies are required to include the following information on extraordinary transactions in their annual reports:⁴⁸⁴

- A list of all extraordinary transactions concluded by the company during the reporting year;

⁴⁸² LJSC, Article 79, Clause 4.

⁴⁸³ LJSC, Article 75, Clause 1 provides that redemption rights only arise when the extraordinary transaction involves assets or services, the value of which is 50% or less of the book value of company assets. However, the Plenum of the Supreme Arbitration Court has interpreted this provision to include extraordinary transactions involving assets with a value of more than 50% of the book value of company's assets (see also: Resolution No. 19, the Plenum of the Supreme Arbitration Court, on Certain Issues of Application of the Law on Joint Stock Companies, 18 November 2003, Section 29).

⁴⁸⁴ FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparation, Calling, and Conducting of the General Meeting of Shareholders, 31 May 2002, Section 3.6.

- A list of transactions that are considered extraordinary based on the definition in the charter;
- Key terms of each extraordinary transaction; and
- The governing body that approved each transaction.

Companies must also disclose information on extraordinary transactions in their prospectus and quarterly reports.⁴⁸⁵ For the registration of the secured bond issue and the report on the results of issue, the company must submit the meeting minutes of the approving body with information on the quorum and the voting results to the registration agency.⁴⁸⁶

Companies are required to provide information on extraordinary transactions in the “disclosure appendix” or notes to financial statements related to the acquisition or the disposition of fixed assets and investments.⁴⁸⁷

Audit standards provide that the External Auditor must review extraordinary transactions with related parties to identify the true conditions under which such transactions took place.⁴⁸⁸

7. Invalidating of Extraordinary Transactions

The company and its shareholders have the right to request the court to invalidate an extraordinary transaction if the decision-making body of the company failed to follow appropriate procedures.⁴⁸⁹

However, according to the Supreme Court and the Supreme Arbitration Court, an extraordinary transaction that was invalidated due to procedural violations may

⁴⁸⁵ Annex 4 of FCSM Regulation No. 03-32/ps on the Disclosure of Information by Issuers of Securities, 2 June 2003, Section 10.1.6; Annex 11 of FCSM Regulation No. 03-32/ps, Section 8.1.6.

⁴⁸⁶ FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses, 18 June 2003, Sections 2.4.7, 6.5.1; Annex 9 of the Standards, Section 11.

⁴⁸⁷ Decree No. 56n, the Ministry of Finance, on the Approval of Rules on Accounting Events After the Reporting Date, Section 2. It is, however, unclear whether the term “extraordinary transaction” in this act has the same meaning as in the Company Law.

⁴⁸⁸ Audit Standard on Accounting Operations With Related Parties During an Audit, Section 4.2, a). It is not clear whether the term “major transactions” in this act has the same meaning as in the Company Law.

⁴⁸⁹ LJSC, Article 79, Clause 6.

be re-validated if approved after the fact by the GMS (or the Supervisory Board, where applicable).

Best Practices: Russian legislation appears inadequate in protecting the interests of the company's counterparts in extraordinary transactions. If the company can seek to invalidate a transaction that was not concluded in accordance with the company's internal approval procedures then this may create undue problems for the counterpart. It is recommended to follow the example of some western jurisdictions where the company needs to prove that the counterpart in the transaction knew or must have known of the irregularity of its approval.

B. Control Transactions

Control transactions are transactions in which a person (or a group of affiliated persons) acquires a controlling block of shares, defined in the Company Law as 30% or more of the company's common shares.⁴⁹⁰ Control transactions are also referred to as takeovers.

Best Practices: The market for corporate control, together with the product, labor, and capital markets, is a distinct feature of a market economy. Generally, markets for corporate control represent the historical development of a distinct fourth type of market, in which the trading of corporate equity occurs on a very large scale and bestows the power to control these corporations. Takeovers are a key mechanism in the dynamic allocation of corporate control; they allow the removal of inefficient managers (against their will) and exploitation of synergies between firms. Moreover, the mere threat of a takeover affects the behavior of those entrusted with control, i.e. disciplines them. Consequently, a functioning takeover market is widely considered an important component of — if not a prerequisite for — an effective governance system.

Over the last several decades, the issue of regulating takeovers has become increasingly important. In the EU, for example, the Thirteenth Company Law

⁴⁹⁰ LJSC, Article 80, Clause 1.

Directive on Takeover Bids was recently adopted. In contrast to Russian law, it attempts to apply takeover rules to listed companies and specifically deals with voluntary bids, which are not regulated by Russian legislation. Voluntary bids, which are also called tender offers, are a means of public offer to acquire shares of the company leading to a change of control. There are specific rules that deal with the disclosure and terms of such bids.⁴⁹¹

Takeovers result in changes to company control, strategy, decision-making, and, generally, lead to the replacement of the acquired company's directors and senior managers. One of the economic benefits of takeovers is that they may result in improved utilization of company assets. This, in turn, should benefit all shareholders. On the other hand, takeovers have considerable potential for abusing minority shareholder rights.

Best Practices: Changes of control may occur on a voluntary basis by consolidation or merger, as agreed upon by shareholders and managers of participating companies. Control can, however, also pass hands in a hostile manner, i.e. when directors and managers of the target company resist the takeover attempt. The negative implications of change of control situations not only relate to pre-change possibilities of abuse (for example, two-step tender offers, during which the acquiring company offers different prices to different groups of shareholders), but also to post-change challenges that non-controlling shareholders might face (for example, changes to the dividend policy or increases in executive remuneration, to the detriment of minorities).

In case of voluntary change of control, shareholders have a say in the results and expressly agree with all consequences. In case of hostile takeovers, directors and managers typically have more opportunities to resist the value-increasing changes of control in their own interests. At the same time, if a hostile takeover attempt succeeds, minority shareholders who did not agree with the change of control risk being in the situation where the new controlling shareholder may abuse its position and retaliate for such behavior of shareholders.

⁴⁹¹ For more information on EU Thirteenth Directive and voluntary bids, see http://europa.eu.int/eur-lex/en/archive/2004/1_14220040430en.html.

In Russia, companies with more than 1,000 shareholders with common shares must follow special procedures both before and after the acquisition of 30% or more of common shares.⁴⁹² Companies are also required to follow procedures for control transactions each time the controlling shareholder(s) acquires an additional 5% or more of common shares (e.g. 35%, 40%, 45%, and 50%).⁴⁹³

Company Practices in Russia: Control transactions are of particular concern to many Russian companies today, given the current consolidation wave taking place in many sectors. More specifically, smaller, successful companies and their (minority) shareholders often become subjects of abuse by large companies through hostile takeovers. In many instances, however, takeovers are not carried out through the typical market mechanisms (e.g. by extending a tender offer to shareholders) but rather through block sales. Moreover, certain illegal methods to overrule privatization results are used to circumvent proper control transactions, e.g. dubious lawsuits that paralyze the company and often bring it to the verge of bankruptcy. Under these circumstances, the role of the judiciary, the FCSM, and other enforcement bodies becomes particularly important in protecting companies and shareholders.

1. Affiliated Persons

The concept of affiliated persons is important in the context of control transactions because shares acquired by affiliated persons are added up when determining whether a transaction is a control transaction. An affiliated person is defined as an individual or a legal entity that can influence the activity of legal entities, and/or individual engaged in entrepreneurial activity.⁴⁹⁴ Consequently, the following are considered affiliated persons of a legal entity:

- A Supervisory Board member;
- The General Director or an Executive Board member;
- The External Manager;

⁴⁹² LJC, Article 80, Clause 1.

⁴⁹³ LJC, Article 80, Clause 7.

⁴⁹⁴ Law on Competition and Limitation of Monopolistic Activities in Commodities Markets (Antimonopoly Law), Article 4.

Chapter 12. Material Corporate Transactions

- Any legal entity that is part of the same group of companies⁴⁹⁵ to which the company belongs;
- Any individual who possesses more than 20% of votes in the company;
- Any legal entity, in which the company possesses 20% of votes; and
- A member of the Supervisory Board or the Executive Board, the General Director, and the External Manager of other members of the company's Financial and Industrial Group (FIG).

→ For more information on FIGs, see Part V, Chapter 15, Section B.4.

The following persons are considered affiliated persons of an individual, e.g. Individual (B) who carries out entrepreneurial activity:

- Any individual or legal entity belonging to the same group to which Individual (B) belongs; and
- Any legal entity in which Individual (B) has more than 20% of voting shares (participatory shares, units).

→ For more information on disclosure requirements of affiliated persons, see Part IV, Chapter 13, Section B.3.

2. Pre-Acquisition Requirements

An individual, legal entity, or group of affiliated persons must notify the company in writing when they intend to acquire:

- 30% or more of the company's common shares; or
- Shares that will lead to the ownership of 30% or more of common shares.⁴⁹⁶

This notification must be sent to the company no earlier than 90 days before the shares will be acquired, and no later than 30 days before the acquisition.⁴⁹⁷

⁴⁹⁵ Antimonopoly Law, Article 4.

→ For more on groups of companies, see Chapter 15.

⁴⁹⁶ LJSC, Article 80. Note that the Company Law refers only to common shares and does not include voting preferred shares and convertible securities. Since control transactions are aimed at acquiring control of the target company, buyers seek to acquire voting shares.

⁴⁹⁷ LJSC, Article 80, Clause 1. Russian legislation does not specify what information must be included in the notice of the intention to acquire 30% or more of common shares.

Best Practices: If notice of an intent to acquire control is received by the company, the Supervisory Board should:⁴⁹⁸

- Have an Independent Appraiser determine the market value of common shares; and
- Inform shareholders of the possible consequences of the acquisition of shares.

This should enable shareholders to make an informed decision regarding whether to sell their shares to the person who intends to acquire a controlling block.

3. Post-Acquisition Requirements

A far more important procedural requirement found in the Company Law arises after the acquisition of a controlling block of shares.

a) Mandatory Bid

The controlling shareholder (or group of affiliated persons) is obliged to make an offer to purchase or buyout the remaining common shares (and other securities convertible into common shares) within 30 days after the acquisition of a controlling block. This is referred to as a “mandatory bid” or a “fair price requirement.”

The mandatory bid must be sent to all common shareholders in writing and must include:⁴⁹⁹

- The name and address of the acquirer of the controlling block of shares;
- The number of acquired common shares;
- The price offered by the acquirer to shareholders (the buyout price);
- The period for accepting the mandatory bid; and
- The period for making the payment for shares and convertible securities.

Best Practices: It is good practice to submit the mandatory bid to shareholders not directly but through the company. The Corporate Secretary can assist in

⁴⁹⁸ FCSM Code, Chapter 6, Section 2.1.1.

⁴⁹⁹ LJSC, Article 80, Clauses 3 and 5.

forwarding the mandatory bid to shareholders in accordance with the notification procedures for the GMS.⁵⁰⁰

→ See also Chapter 8, Section B.4 on notification procedures for the GMS.

Non-controlling shareholders have the right to accept the mandatory bid in no later than 30 days after they receive it. If accepted, the controlling shareholder is obliged to purchase the shares and/or convertible securities within 15 days of the non-controlling shareholder's acceptance of the mandatory bid at the buyout price.⁵⁰¹

b) The Buyout Price

The buyout price for common shares and convertible securities must be at market value. At the same time, the price for common shares may not be below their average weighted market price over the six months preceding the acquisition.⁵⁰²

Best Practices: Control transactions usually include a so-called control premium, which is paid by the acquirer of control to selling shareholders. Some commentators argue that equal treatment of shareholders should also lead to sharing the control premium. Hence, the City Code on Takeovers and Mergers of the U.K. and EU Thirteenth Directive require that the mandatory bid equal the highest price that was paid for buying the control.⁵⁰³

c) Waiver of the Mandatory Bid Requirement

The acquirer of a controlling block of shares can be released from the obligation to make the mandatory bid in the following two situations:⁵⁰⁴

- **Charter exemption.** The charter may exempt the acquirer from the obligation to make a mandatory bid in relation to control transactions; or

⁵⁰⁰ FCSM Code, Chapter 6, Section 2.4.

⁵⁰¹ LJSC, Article 80, Clause 4.

⁵⁰² LJSC, Article 80, Clause 2, Paragraph 1. Note that this article does not specify the date on which the market value of shares must be determined.

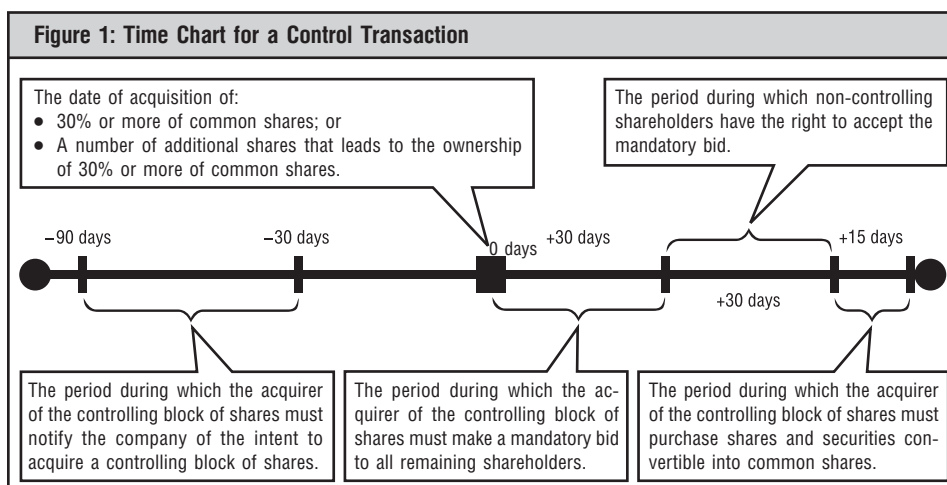
⁵⁰³ For more information on mandatory bids, see the EU Thirteenth Directive at http://europa.eu.int/eur-lex/en/archive/2004/1_14220040430en.html.

⁵⁰⁴ LJSC, Article 80, Clause 2, Paragraph 2.

- **Transaction-specific exemption.** The GMS can exempt the acquirer from the obligation to make a mandatory bid. A simple majority vote of participating shareholders (excluding the votes of the acquirer of the controlling block of shares) is sufficient.

Best Practices: Neither the charter nor GMS should release the controlling shareholder(s) from the responsibility to buyout the shares of non-controlling shareholders.⁵⁰⁵

The timelines for carrying out control transactions are summarised in Figure 1.



Source: IFC, March 2004

Best Practices: In addition to the mandatory bid rule, legislation in western jurisdictions provides for an additional shareholder protection mechanism, the sell-out right.⁵⁰⁶ The sell-out right allows minority shareholders to force the controlling shareholders (typically those with 90–95% of the charter capital) to purchase all their shares. The sell-out right is usually mirrored by a correspond-

⁵⁰⁵ FCSM Code, Chapter 6, Section 2.3.

⁵⁰⁶ For more information on sell-out and squeeze-out rights, see the EU Thirteenth Directive at http://europa.eu.int/eur-lex/en/archive/2004/1_14220040430en.html.

ing right of the controlling shareholder to force the exit of minority shareholders, the so-called squeeze-out right, if he owns 90–95% of the company’s charter capital.

Companies wishing to follow good corporate governance practices will include both the sell-out and squeeze-out rights in their charter.

4. Anti-Takeover Measures

There are many legitimate reasons for opposing takeovers. Potential acquirers may not have credible business plans, or the price offered for the company may be too low. However, managers and directors often oppose takeovers simply because they will likely lose their jobs.

Best Practices: A guiding principle for Supervisory Boards to follow is for companies to never employ anti-takeover measures at the expense of shareholder rights and interests. There are different takeover defenses available under various legal systems. In any given jurisdiction, the application of various defenses depends on the national legal and regulatory framework, and judicial practice. Anti-takeover measures range from pre-takeover to post-takeover mechanisms. Some of the more famous measures include poison pills, crown jewels, golden parachutes, and white knights.⁵⁰⁷

The Supervisory Board should not issue additional shares, convertible securities, or securities that entitle holders to purchase shares of the company during the acquisition period of a controlling block of shares (even if an issue is authorized by the charter).⁵⁰⁸

⁵⁰⁷ Poison pills are designed to make a hostile takeover prohibitively expensive. For instance, a company may issue a new series of preferred shares that grant its shareholders the right to redeem shares at a premium price after a takeover or allow all existing shareholders of the target company to buy additional shares at a bargain price, thereby deterring a takeover bid by raising the acquisition cost and causing dilution. White knight provisions include the issuance of preferred shares that the Supervisory Board may issue at any time to a “white knight” investor, i.e. a friendly investor sought out by the target firm. For more information on these and other anti-takeover provisions and their corporate governance implications, see the Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, 10 January 2002, Annex 4, Overview of the Most Important Barriers to Takeover Bids, p. 74. See also: <http://europa.eu.int/comm/internal-market/en/company/company/news/hlg01-2002.pdf>.

⁵⁰⁸ FCSM Code, Chapter 6, Section 2.2.

5. Consequences of Procedural Violations

The acquirer of a controlling block may not vote shares acquired in violation of the legal procedures for control transactions.⁵⁰⁹ Thus, the acquirer may only exercise rights attached to shares that were lawfully acquired below the 30% threshold.

If a controlling shareholder (who already owns at least 30% of common shares) acquires an additional 5% or more of common shares without advance notification or without offering to buy out the remaining common shares, he may only exercise the rights attached to the shares that were lawfully acquired.⁵¹⁰

C. Related Party Transactions

Related party transactions involve insiders, such as directors, managers, large shareholders, or parties related to them. Some related party transactions have legitimate purposes and can be conducted fairly. Others do not. Regardless, they are easily abused and warrant particular attention since they may reduce the value of the company and expropriate shareholder rights. Legislation contains detailed procedures to discourage insiders from entering into related party transactions, and to help ensure fairness when a related party transaction does take place.

Related party transactions not only occur between the company and its directors, managers, and large shareholders, but more importantly, within groups of companies (holding structures), where transactions between the parent and subsidiary companies frequently occur.

⁵⁰⁹ LJSC, Article 80, Clause 6.

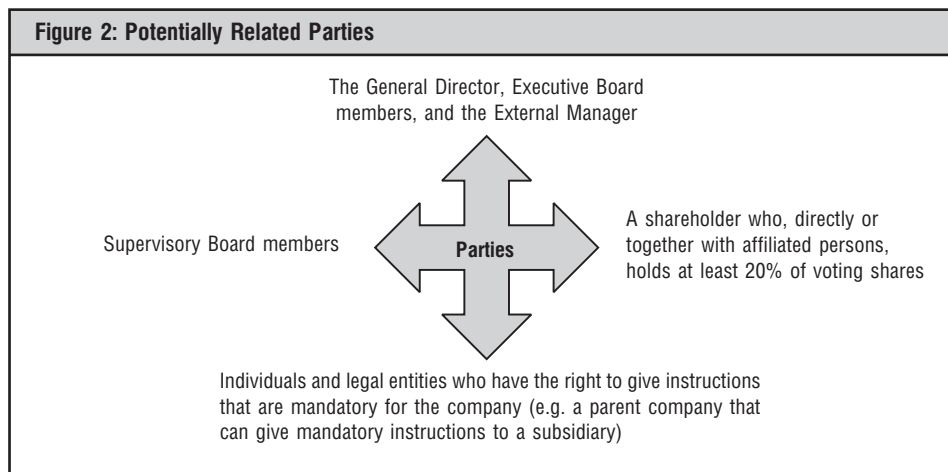
⁵¹⁰ Note that the Company Law refers to the limitation of voting rights attached to the controlling block of shares that were acquired in violation of procedures for control transactions. This means that all other rights, including the right to receive dividends, can be exercised. To enforce the buyout requirement, the law could require that shares acquired while violating the procedures for control transactions lose all rights and that they must be disposed of within a specified period.

1. Definition

For a transaction to be considered a related party transaction, each company involved in the transaction must check whether two conditions are met.

a) Potentially Related Parties

A number of parties can be defined as related if they play a role in a transaction. Such parties are presented in Figure 2.⁵¹¹



Source: IFC, March 2004

Best Practices: The list of parties defined by the Company Law as related fails to cover key company officers in positions of control. For example, Deputy General Directors, Chief Accountants, and directors of representative offices and branches are not covered by the legal definition, unless they happen to also sit on the Executive Board. Companies wishing to follow good corporate governance practices may consequently wish to expand the list of potentially related parties in their charter.

The OECD Principles of Corporate Governance provide a general definition of related parties, including entities under common control, significant shareholders

⁵¹¹ LJSC, Article 81, Clause 1.

including members of their families and business associates, and key management personnel.⁵¹²

International Accounting Standard (IAS) Number 24.9 provides a more detailed definition, and thus parties are considered to be related if one party has the ability to control the other party or to exercise significant influence or joint control over the other party in making financial and operating decisions.⁵¹³ A party is related to an entity if:

1. Directly, or indirectly through one or more intermediaries, the party:
 - Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries, and fellow subsidiaries);
 - Has an interest in the entity that gives it significant influence over the entity; or
 - Has joint control over the entity;
2. The party is an associate (as defined in IAS 28 Investments in Associates) of the entity;
3. The party is a joint venture in which the entity is a venturer (see IAS 31 Interests in Joint Ventures);
4. The party is a member of the key management personnel of the entity or its parent;
5. The party is a close member of the family of any individual referred to in (1) or (4);
6. The party is an entity that is controlled, jointly controlled, or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (4) or (5); or
7. The party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

At the same time, IAS 24.11 specifies which parties are not deemed related:

- Two enterprises simply because they have a director or key manager in common;
- Two venturers who share joint control over a joint venture;
- Providers of finance, trade unions, public utilities, government departments, and agencies in the course of their normal dealings with an enterprise; and
- A single customer, supplier, franchiser, distributor, or general agent with whom an enterprise transacts a significant volume of business merely by virtue of the resulting economic dependence.

⁵¹² See 2004 OECD Principles of Corporate Governance on www.oecd.org/dataoecd/32/18/31557724.pdf.

⁵¹³ See also: the International Accounting Standard Board's website under www.iasb.co.uk.

The Financial Accounting Standards Board's (FASB) Statement No. 57 finally defines a related party as affiliates of an enterprise, trusts for benefits of employees, owners and their family members, investment entities accounted for by the equity method by the firm, management, and other large shareholders or parties that influence firm policy.

b) Related Parties Are Involved in the Transaction

For the purposes of defining related party transactions, the parties specified in the previous section as well as spouses, parents, children, sisters and brothers, adopted children, and adoptive parents of other potentially related parties listed in this Figure must be involved in the transaction in one of the following capacities:⁵¹⁴

- Act as a transacting party, a beneficiary, an intermediary, or an agent in the transaction;
- Own at least 20% of voting shares (participatory shares, units)⁵¹⁵ in a legal entity which is a party, beneficiary, intermediary, or agent in the transaction;
- Hold a position in a governing body of a legal entity which is a party, beneficiary, intermediary, or agent in the transaction; or
- Other instances specified in the charter.

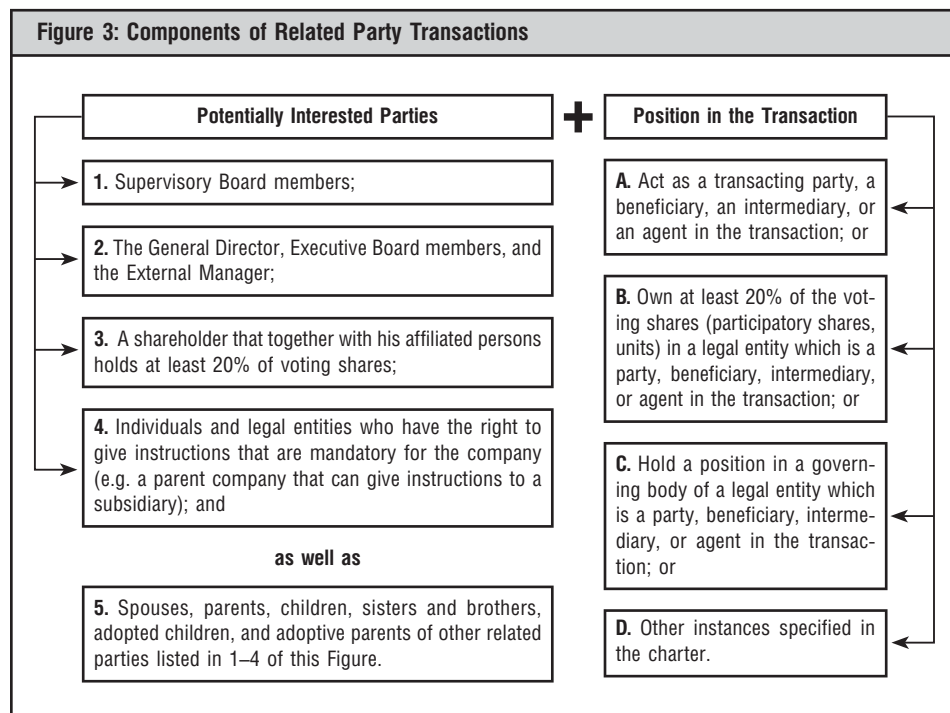
Mini-Case 1: Company (X) concludes a contract with Company (Y) that Company (Y) will sell products of Company (X) on-line. Mr. (A) is a Supervisory Board member of Company (X) and is also the General Director of Company (Z), which will receive a special discount on products of Company (Y) sold to Company (Z) if the transaction between Company (X) and Company (Y) is concluded. In such a transaction between Company (X) and Company (Y), Mr. (A) is considered a related party who is a beneficiary of the transaction. The transaction will be a related party transaction for Company (X) and will require approval. At the same time, it is not a related party transaction for Company (Y).

As illustrated in Mini-Case 1, it is important to note that the same transaction can be a related party transaction for one company but not for another. In this case, only one company needs to approve the transaction as a related party transaction.

⁵¹⁴ LJSC, Article 81, Clause 1.

⁵¹⁵ Participatory shares refer to limited liability companies, while units refer to production cooperatives.

Figure 3 depicts components of related party transactions, which must be present in a transaction.



Source: IFC, March 2004

To determine whether a transaction is a related party transaction, it is necessary for an interested party from the left column of Figure 3, be involved in the transaction as indicated in the right column of Figure 3. In practice, this means that a company must create a list of potentially interested parties and always check whether any of these parties (1–4 of the left column) or their affiliated persons (5 of the left column) is involved in each and every transaction carried out by the company, as mentioned in A — D of the right column.

Best Practices: Related party transactions are common in the context of groups of companies, e.g. in parent-subsidary relations. If one company dominates another, there is a risk that the parent will utilize the subsidiary for its own busi-

ness objectives, without care for the subsidiary's long-term financial viability. In these cases, the creditors and shareholders of both the subsidiary and parent may be put at risk — often unknowingly.

- The risk for creditors at the subsidiary level is obvious. But the risk is present at the parent level as well, as the subsidiary's insolvency can greatly damage the surviving parent.
- Shareholders are also put at risk, although the position of shareholders at the subsidiary level is weaker. On the one hand, shareholders at the subsidiary level often benefit from being part of the parent's business. On the other, they may have to contribute to the parent's welfare to their own detriment.

→ *For more information on intra-group transactions, and the important role the Supervisory Board plays, see Part V, Chapter 15, Sections B and C.*

2. Exempted Transactions

Companies are not required to comply with approval procedures if:⁵¹⁶

- The transaction is executed by a company consisting of a single shareholder who is simultaneously the General Director;
- All shareholders are related parties in the transaction;
- The transaction is the exercise of pre-emptive rights by shareholders;
- The transaction is the buyback or the redemption of shares; or
- The transaction is a reorganization through merger (consolidation), and the other entity that participates in the merger (consolidation) owns more than 75% of voting shares of the company being reorganized.

3. Approving Related Party Transactions

Best Practices: There are different means of regulating related party transactions. Prohibitions of specific types of transactions are found in the U.K., where the U.K. Companies' Act prohibits directors from entering into certain transac-

⁵¹⁶ LJSC, Article 81, Clause 2.

tions that are deemed detrimental to the company.⁵¹⁷ The advantage of this first approach is clear: all practitioners know where the boundaries are. There will be no fine analysis as to the possibilities to circumvent the prohibition. The disadvantage is the rule's lack of flexibility: even economically useful transactions may not come into being when the law contains a flat prohibition. Additionally, parties may also make great efforts to circumvent the rule.

In some jurisdictions there have been calls to change the approach and foster more substantive criteria of fairness: transactions with conflicting interests should always be open to challenge on the basis of unfairness, at least gross unfairness. This second approach is frequently found in U.S. law, and in the U.K.⁵¹⁸

Russia seems to have chosen a third option, also present in developed jurisdictions — to require specific approval procedures for related party transactions.

Related party transactions have to be approved by the GMS or the Supervisory Board, respectively, as illustrated in Table 3.

Nature of the Transaction	Approving Body
<ul style="list-style-type: none"> • Value of assets involved in the sale (or the offer price) is 2% or more of the book value of the company's assets according to its financial statements for the last reporting period; or • Transaction relates to the placement by subscription or a sale of shares that are more than 2% of issued common shares and convertible securities; or • Transaction relates to the placement by subscription or a sale of convertible securities that are more than 2% of issued common shares and convertible securities. 	The GMS ⁵¹⁹
<ul style="list-style-type: none"> • All other related party transactions. 	The Supervisory Board ⁵²⁰

⁵¹⁷ Section 330 (2), U.K. Companies Act.

⁵¹⁸ See in the U.K., the Law Commission, *Company directors: Regulating conflicts of interest and formulating a statement of duty*, September 1999, p. 282, document Law Com No. 261.

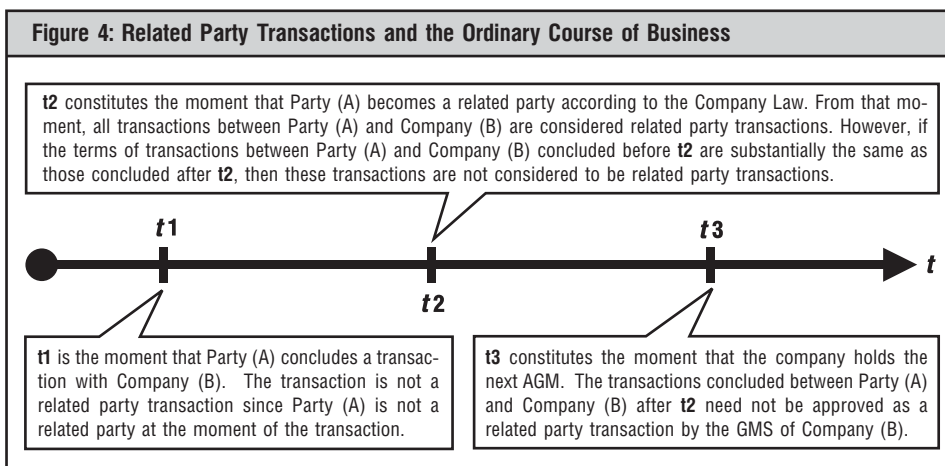
⁵¹⁹ LJSC, Article 83, Clause 4.

⁵²⁰ LJSC, Article 83, Clause 2; Article 83, Clause 3, Paragraph 1.

a) Approval by the GMS

A simple majority vote of shareholders participating in the GMS (excluding votes of related parties) is required to approve a related party transaction. The GMS may adopt a decision to approve a future transaction between the company and a related party, as long as it is concluded in the course of the company's ordinary business activities. In this case, the decision of the GMS must specify the maximum amount of the transaction. The decision remains in force until the next Annual General Meeting of Shareholders (AGM).⁵²¹

The GMS is not required to approve a related party transaction if the terms of the transaction are substantially similar to past transactions with a person before such person became a related party.⁵²² This exception applies to related party transactions until the next AGM, as illustrated in Figure 4.



Source: IFC, March 2004

b) Approval by the Supervisory Board

The Supervisory Board has the authority to approve related party transactions if they do not fall under the authority of the GMS. The legal requirements for decision-making thresholds differ depending upon the number of shareholders in the company:

⁵²¹ LJSC, Article 83, Clause 6, Paragraph 2.

⁵²² LJSC, Article 83, Clause 5.

- **In companies with 1,000 and fewer shareholders with voting rights**, the decision to conclude a related party transaction must be made by a majority of directors participating in the Supervisory Board meeting and who are not related parties.⁵²³ This means that directors who are related parties:⁵²⁴
 - Must inform the Supervisory Board about their interest in the transaction; and
 - Must abstain from participating in the decision of the Supervisory Board on the transaction.

“Interested” members are not counted for the quorum. The decision to approve a related party transaction must be adopted by the GMS if the number of disinterested directors is insufficient to meet the quorum.⁵²⁵

- **In companies with more than 1,000 shareholders with voting rights**, the decision to conclude related party transactions must be made by a majority of independent directors who are not related parties.⁵²⁶ Again, this means that directors must inform the Supervisory Board of their interest in the transaction and must abstain from voting. Furthermore, directors who are not independent must abstain from participating in the discussion and from voting on the issue. These members are not counted for the quorum. If all directors are either interested or non-independent, the decision to approve the related party transaction must be adopted by the GMS.

Mini-Cases 2 and 3:

2. The only shareholder of Company (B) is the brother of the Chairman of the Supervisory Board of Company (A). Company (A) sold its shares to Company (B) at a price that is below market. This is a related party transaction for Company (A). The Chairman of Company (A) is a related party and should not take part in decision-making on the approval of this transaction.

⁵²³ LJSC, Article 83, Clause 2.

⁵²⁴ FCSM Code, Chapter 3, Section 3.1.4.

⁵²⁵ LJSC, Article 83, Clause 2.

⁵²⁶ LJSC, Article 83, Clause 3. The independence of directors during a related party transaction is not to be confused with independent directors as such. See Part II, Chapter 4, Section C.4 for a definition and discussion on independent directors.

3. Company (A) transferred a significant amount of assets to Company (C), in which companies (A) and (B) both receive shares: Company (A) receives 55% and Company (B) receives 45% without any consideration. The managers of Company (A) own Company (B).

One year later, Company (A) sold 38% of its shares in Company (C) to Company (B) for the total price of U.S. \$ 2,000. In reality, these shares were worth about U.S. \$ 600 million.

The sale of a 38% stake in Company (C) by Company (A) to Company (B) is a related party transaction and managers of Company (A) should not participate in decision-making on the approval of this transaction.

c) Required Information for the Decision to Approve Related Party Transactions

Depending on the nature of a related party transaction, either the GMS or the Supervisory Board must adopt a decision on the transaction. Regardless of which body approves, the decision must include information on:⁵²⁷

- The parties that are involved in the transaction;
- Other beneficiaries of the transaction (if any);
- The value of the transaction;
- The assets and services involved in the transaction; and
- Any other significant terms and conditions related to the transaction.

4. Identifying Related Party Transactions

Any related party transaction should be properly approved before it can be concluded. However, in practice not all transactions follow such procedures. There are different reasons for this, including the fact that the Supervisory Board and shareholders may not always know whether the transaction involves related parties, in particular when insiders concealed their affiliation and personal interest. In such cases, non-executive and independent directors will need to play the lead role in identifying and disclosing related party transactions. Creating the list of related parties and their position in the transaction is but one aspect, made difficult

⁵²⁷ LJSC, Article 83, Clause 6.

by the fact that most ownership structures remain opaque. The materiality of these transactions is another important issue. Indeed, while the nature of some related party transactions is easily identifiable, others are structured in an elaborate manner, involving complicated off-shore schemes.

Best Practices: The Supervisory Board's composition and experience will largely determine the success in identifying such related party transactions. Non-executive, independent directors who enjoy an arms-length relationship with managers will certainly play a key role in this respect. The External Auditor also plays a key supporting role, and the Supervisory Board and its Audit Committee will want to ensure that the company's External Auditor uses the full range of audit procedures to evaluate managerial self-dealings. For example, the American Institute of Certified Public Accountants' (AICPA) Statement of Auditing Standard No. 45, AU Sec. 334 (2001) sets forth criteria for identifying material transactions, such as interest free borrowing, asset sales that diverge from appraisal value, in-kind transactions, and loans made without scheduled terms.

5. Disclosure Requirements

The Company Law requires persons who are potential related parties to disclose information to the Supervisory Board, the Revision Commission, and the External Auditor regarding:⁵²⁸

- Legal entities in which they, either independently or together with affiliated persons, own 20% or more of voting shares (participatory shares, units);
- Legal entities in which they hold managerial positions; and
- Pending or planned transactions in which they may be considered a related party.

Moreover, the disclosure of beneficial ownership is an important aspect in detecting related party transactions. If the identity of the company's true owners is hidden, then it is difficult, if not impossible, to establish whether the parties in the transaction are related (as mentioned in Section C.1.a of this Chapter).

⁵²⁸ LJSC, Article 82.

Best Practices: To protect shareholder interests, the Supervisory Board members (especially independent directors) should demand that all owners of 5% and more of common shares comply with the relevant disclosure requirements.

→ *For more information on the disclosure of beneficial ownership, see Part IV, Chapter 13, Section B.3.*

The FCSM addresses the issue of related party transactions and requires that companies include the following information regarding related party transactions in their annual report:⁵²⁹

- A list of related party transactions concluded by the company during the reporting year;
- Significant terms and conditions of each related party transaction; and
- The governing body that approved related party transactions.

In addition, securities legislation requires that companies disclose the following information on related party transactions:⁵³⁰

- Copies of the minutes of the meeting of the approving body, including information on the quorum and the voting results, for the registration of secured bond issue and the report on the results of issue;
- The list of persons, with whom transactions may be qualified as related party transactions, and the list of those persons with whom transactions have already been approved by the company, in case of an open subscription to securities;
- Information on related parties before the placement starts, in case of an open subscription through intermediaries; and
- The prospectus and quarterly reports must provide information on related party transactions.⁵³¹

⁵²⁹ FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparation, Calling, and Conducting of the General Meeting of Shareholders, 31 May 2002, Section 3.6.

⁵³⁰ FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses, 18 June 2003, Sections 2.4.7, 2.5.3, 6.4.7, 6.5.1; Annex 9 of the Standards, Section 11.

⁵³¹ Annex 4 of FCSM Regulation No. 03-32/ps on the Disclosure of Information by Issuers of Securities, 2 June 2003, Section VII; Annex 11 of FCSM Regulation No. 03-32/ps, Section VI.

Finally, accounting legislation requires companies to disclose information on operations with related parties in their accounting documents.⁵³²

6. Invalidation of Related Party Transactions

A court may nullify a related party transaction in a legal action filed by the company or a shareholder if procedural requirements were violated.⁵³³

Best Practices: Russian legislation seems to fall short in protecting the interests of the company's counterparts in related party transactions. If the company can seek to invalidate a transaction that was not concluded in accordance with its internal approval procedures then this may create undue problems for the counterpart. It is recommended to follow the example of some western jurisdictions where the company needs to prove that the counterpart in the transaction knew or must have known of the irregularity of its approval.

7. Liability for the Violation of Procedural Requirements

Related parties can be held liable for losses caused to the company because of a transaction that was concluded in violation of procedural requirements. If several persons are held responsible for losses, they are jointly and severally liable.⁵³⁴

Best Practices: A company may wish to codify its policy regarding related party transactions in its company-level corporate governance code, charter, or by-laws. More importantly, the company may codify a director's duty of care to properly handle related party transactions, i.e. not to authorize, procure, or permit the company to enter into a transaction if he has an interest in the transaction and has not disclosed this interest.

⁵³² Ministry of Finance Decree No. 5n, on the Approval of Rules on Accounting, "Information on Affiliated Persons," Rules on Accounting 11/2000, Section 5.

⁵³³ LJSC, Article 84, Clause 1.

⁵³⁴ LJSC, Article 84, Clause 2.



INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group



Good corporate governance contributes to a company's competitiveness and reputation, facilitates access to capital markets, and thus helps develop financial markets and spur economic growth. With this in mind, the International Finance Corporation and the U.S. Department of Commerce have combined their efforts to provide Russian managers, directors, and shareholders with a practical tool to implement good corporate governance practices – the Russia Corporate Governance Manual. This Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. It follows the recommendations of the FCSM's Code of Corporate Conduct and refers to internationally accepted principles of good corporate governance.

“Corporate governance is vital to the interests of every economy, and government has a role to play in establishing the framework for reform - but it is companies that have the tough job of putting governance reform into practice. This is where the Corporate Governance Manual can provide excellent help. It offers a comprehensive workbook for company directors, officers, and advisers in taking up the challenge of corporate governance improvement. Shareholders and stakeholders alike should applaud IFC for bringing practical, and professional advice within reach of every boardroom.”

Anne Simpson, Manager,
Global Corporate Governance Forum

“Corporate governance reform in Russia is the continuation of the more general processes of change affecting the country as a whole. Taken together, these developments have created a new environment, new rules regulating the relationships between the market and regulators, between shareholders, shareholders and managers, etc. In the business community there is a growing awareness of the benefits of corporate governance reform, and companies are now working on improving the quality of their corporate governance ...”

Ruben K. Vardanian, President of Troika Dialogue; Chairman of the Board,
OJSC Rosgosstrakh; and Chairman of the RSPP Corporate Governance Committee

“Good corporate governance is a key driver of financial transparency and managerial accountability, essential ingredients for national prosperity in a global economy. We congratulate the U.S. Department of Commerce and the International Financial Corporation of the World Bank for their initiative in bringing about the publication of the Russia Corporate Governance Manual.”

Andrew B. Somers, President,
American Chamber of Commerce in Russia

Questions on corporate governance should be addressed to the IFC Russia Corporate Governance Project, via CGPRussia@ifc.org

An electronic version of the Manual is available on the website of the International Finance Corporation under www.ifc.org/rcgp and the U.S. Department of Commerce under www.mac.doc.gov/ggp

The Russia Corporate Governance Manual

IV Part IV Information Disclosure and Transparency

Prepared and Published by the International Finance Corporation and the U.S. Department of Commerce

In Partnership with the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs and the Swiss State Secretariat for Economic Affairs



The Russia **Corporate Governance** Manual

Part IV

Information Disclosure and Transparency

Prepared and Published by the International Finance Corporation
and the U.S. Department of Commerce

In Partnership with the Agency for International Business
and Cooperation of the Dutch Ministry of Economic Affairs
and the Swiss State Secretariat for Economic Affairs

First edition: 10,000 copies in Russian, 1,500 copies in English.

Published in 6 Parts

Printed in Moscow, Russia.

ISBN 5-9614-0085-9

Copyright © 2004 International Finance Corporation
2121 Pennsylvania Ave. NW, Washington, DC 20433, United States of America
A Member of the World Bank Group

Design copyright © 2004 Alpina Business Books

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, for commercial purposes without the prior permission of the International Finance Corporation.

Chapter 13

Information

Disclosure

Table of Contents

A. AN INTRODUCTION TO INFORMATION DISCLOSURE.....	5
1. <i>Definition and Rationale</i>	5
2. <i>Principles of Disclosure</i>	6
3. <i>Confidential Information</i>	6
4. <i>Insider Information and Insider Dealing</i>	7
5. <i>Disclosure in Listed Versus Closely Held Companies</i>	9
6. <i>Disclosure Versus Transparency</i>	10
7. <i>Personal Liability for Non-Disclosure</i>	10
B. DISCLOSURE ITEMS	11
1. <i>Financial and Operating Results</i>	13
2. <i>Company Objectives</i>	19
3. <i>Major Share Ownership and Voting Rights</i>	20
4. <i>Information on Directors and Executives</i>	28
5. <i>Material Foreseeable Risk Factors</i>	31
6. <i>Employees and Other Stakeholders</i>	31
7. <i>Corporate Governance Structures and Policies</i>	32
C. MANDATORY DISCLOSURE	35
1. <i>Disclosure During the Placement of Securities</i>	36
2. <i>Quarterly Reports</i>	37
3. <i>The Material Events Report</i>	38
4. <i>Information for Shareholders Through the Annual Report</i>	39
5. <i>The List of Related Parties</i>	40
6. <i>Notification to Regulators</i>	41
7. <i>Notification to Creditors</i>	42
8. <i>Providing Information to Company Employees</i>	42
D. VOLUNTARY DISCLOSURE.....	43
1. <i>Corporate Websites</i>	43
2. <i>SKRIN “Emitent”</i>	44
3. <i>Mass Media</i>	45
E. SUMMARY OF MANDATORY DISCLOSURES.....	45

The Chairman's Checklist

- ✓ Does the company have a written disclosure policy? Does the policy fully express the company's commitment to transparency? Is the disclosure policy easily available to market participants and other interested parties?
- ✓ Does the company fully comply with its legal disclosure obligations? What systems are in place to ensure that full and timely disclosure of material information occurs?
- ✓ Are executives and directors fully aware of the personal and corporate repercussions of false or incomplete disclosure? Do executives and directors act accordingly to ensure good disclosure?
- ✓ Is the company's ownership structure transparent?
- ✓ What steps are being taken to ensure that the company's financial position is communicated clearly to the markets?
- ✓ Is the disclosure fair? For example, does the company ensure that all investors receive information at the same time, not giving special access to a privileged few individual or institutional investors?
- ✓ Does the company have a policy on insider trading and does it enforce this policy? What systems are in place to manage the flow of insider and other sensitive information?
- ✓ Does the company appreciate that it is in its own interest to make voluntary disclosures to the market? If so, how does it ensure the veracity of this information, and that its disclosure is not merely for marketing or public relations purposes?
- ✓ Does the company truly understand the definition of commercially sensitive information? Or, does the company hide behind protections provided for sensitive information in order to withhold important material facts from the markets?
- ✓ How does the company's disclosure compare to international disclosure requirements, for example, the OECD Principles of Corporate Governance?

There are two basic forms of market regulation: 1) substantive rules-based regulation, and 2) disclosure-based regulation. Both regulatory approaches seek to protect shareholders and provide for fair and stable financial markets. Rules-based regulation sets down what companies can and cannot do, and seeks to establish a wide-reaching set of regulations that cover a number of potential circumstances. Disclosure-based regulation relies more heavily upon market mechanisms to punish and reward certain types of corporate behavior, and shifts part of the responsibility for protecting investors to market participants, according to the motto *caveat emptor* or buyer beware. Disclosure-based regulation is partly predicated upon the faith that markets are better at policing corporate misconduct than regulatory agencies, and that disclosure is an effective and inexpensive substitute for substantive regulation. In practice, the two approaches are almost always used in combination with one another, though, some countries rely more heavily on disclosure than others.

The effectiveness of disclosure-based regulation must be considered with caution, especially in the Russian context. In the absence of substantive checks upon managers or owners, its value may, in fact, be quite limited. The early years of Russia's financial markets have an unfortunate history of insiders, controlling shareholders, and related parties freely tunneling company assets under the glare of the Russian and international press.

For disclosure-based regulation to work effectively, a number of elements and incentives need to work together. These include a proper legal and regulatory environment, combined with effective enforcement mechanisms such as regulators that screen financial information for misstatements and courts that provide effective redress. Independent External Auditors also play an important role, providing assurance to the markets, as does an active and interested media that questions company strategies and communications. Finally, a competent and vigilant Supervisory Board is crucial. It is broadly accepted that even the best disclosure system cannot thwart individuals who are intent upon defrauding a company and its shareholders. Without a Supervisory Board that is uniformly intolerant of obfuscation, disclosure cannot be fully effective.

While disclosure based-regulation may function imperfectly in an emerging financial market such as in Russia, disclosure is nevertheless important and is only likely to grow in importance as Russia's financial markets mature. Among the broad palette of disclosures, particular importance must be attached to financial and operating results, related party transactions, and ownership structures.

A. An Introduction to Information Disclosure

1. Definition and Rationale

Disclosure is ensuring access to information by all interested parties, regardless of the purpose of obtaining the information, through a transparent procedure that guarantees information is easily found and obtained.¹

Timely and accurate disclosure is essential for shareholders, potential investors, regulatory authorities, and other stakeholders. Access to material information helps shareholders protect their rights and improves the market participants' ability to make sound economic decisions. Disclosure makes it possible to assess and oversee management, as well as to keep management accountable to the company and shareholders. Disclosure benefits companies since it allows them to demonstrate accountability towards shareholders, act transparently towards the markets, and maintain public confidence and trust.² Good disclosure policies should also reduce the cost of capital. Finally, information is also useful for creditors, suppliers, customers, and employees to assess their position, respond to changes, and shape their relations with companies.

The power of a sound disclosure regime is expressed clearly and eloquently in the following quote:

“Requiring disclosure of information can be a powerful regulatory tool in company law. It enhances the accountability for and the transparency of the company’s governance and its affairs. The mere fact that, for example, governance structures or particular actions or facts have to be disclosed, and therefore will have to be explained, creates an incentive to renounce structures outside what is considered to be best practice, and to avoid actions that are in breach of fiduciary duties or regulatory requirements, or could be criticized as being outside best practice. For those who participate in or do business with companies, information is a necessary element in order to be able to assess their position and respond to changes that are relevant to them.”³

¹ Law on the Securities Market, Article 30, Clause 1.

² Federal Commission for the Securities Market’s Code of Corporate Conduct (FCSM Code), Chapter 7, Introduction.

³ Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002. (See also: http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf)

2. Principles of Disclosure

A more everyday and practical expression of what constitutes good disclosure follows in these four basic principles:

Best Practices: Good disclosure should be:

1. Provided on a regular and timely basis;
2. Easily and broadly available;
3. Correct and complete; and
4. Consistent, relevant, and documented.

3. Confidential Information

Securities legislation require publicly held companies to disclose a broad range of financial and non-financial information. At times, information disclosure required by regulations can adversely affect a company's business and financial condition because of the competitive harm that could result from the disclosure. Despite the fact that many Russian companies often consider the most mundane information commercially sensitive, in reality, competitive harm only arises under a limited number of circumstances. Some examples of truly sensitive information include pricing terms, technical specifications, and milestone payments. To address potential disclosure hardship, legislators and regulators develop systems for allowing companies to request confidential treatment of information.

In Russia, information is deemed commercially sensitive if:⁴

- It has real or potential commercial value due to its uncertainty to third parties;
- There is no free access to it on legal grounds; and
- The owner of the information undertakes steps to keep it confidential.

However, if left to the interpretation of the company, this definition could yield a never-ending number of exceptions. Fortunately, legislation defines what information can and cannot be treated as confidential.⁵ For example, the law

⁴ Civil Code (CC), Article 139, Clause 1.

⁵ Decree of the RF President No. 188 on the Approval of the List of Information of Confidential Nature.

considers personal data confidential information, and forbids the collection, storage, usage, and dissemination of private information without the person's consent, unless otherwise provided by a court decision.⁶ Accessibility to confidential information is limited, its public disclosure is prohibited, and persons who act in breach of rules may be held liable.⁷ This provision can be re-enforced by concluding confidentiality agreements with such persons.

→ *For more information on how to implement confidentiality agreements, see the model contracts with a non-executive director and the General Director in Part VI, Annexes 13 and 14, respectively.*

Best Practices: Today's corporate governance problems are related less to excessive transparency and over-disclosure than under-disclosure and lack of transparency.

Companies should be clear on what truly constitutes confidential information and should not interpret the broad definitions provided for by law so widely as to withhold relevant information from investors. To guide practices with respect to commercially sensitive information, companies are well advised to develop written policies and procedures, and define what should be considered confidential in internal documents or by-laws.⁸ These policies must be consistent with the list of confidential information approved by Presidential Decree on the one hand,⁹ and the list of information that may not be deemed commercial secrets under Governmental Resolution, on the other.¹⁰

4. Insider Information and Insider Dealing

Insider trading encompasses both legal and prohibited activity. Insider trading takes place legally, every day, when corporate insiders (officers, directors, or em-

⁶ Law on Information and Protection of Information, Article 11, Clause 1.

⁷ CC, Article 67, Clause 2; Article 139, Clause 2; Labor Code, Article 81, Clause 5, Section c; Article 243; Law on Joint Stock Companies (LJSC), Article 71, Clause 2, Paragraph 1.

⁸ FCSM Code, Chapter 7, Section 4.1.1, Paragraph 3.

⁹ Decree of the RF President No. 188 on the Approval of the List of Information of Confidential Nature.

¹⁰ Resolution of the RSFSR Government No. 35 on the List of Information which Cannot be Deemed as Containing a Commercial Secret. [Note: A draft law on Commercial Secrets was being considered, but had not yet been passed by the State Duma as of this Manual's completion.]

ployees) buy or sell shares in their own companies within the confines of company policy, law, and regulation.

There is also an illegal variety of insider dealing. It is the dealing that takes place when those with access to privileged and confidential information use their knowledge to reap profits or avoid losses on the stock market. Investors lacking access to privileged information often pay the costs of insider dealing.

Another, and far greater, cost of insider dealing is the damage done to the credibility of securities markets. One of the main reasons that capital is easily available in the world's most successful stock markets is that investors largely trust them to be fair. The common belief in some countries that privileged investors should be allowed to profit from their access to confidential information may explain, in part, relatively low public share ownership in these countries. Governments cannot afford to ignore insider dealing if they hope to promote an active securities market and attract international investment. The same holds true for Supervisory Boards that wish to protect shareholders and attract investment.

In Russia, insider information is defined as any information about a company and its securities, which is not easily accessible and which provides privileges to those who have access to it due to their official position, contractual obligation vis-à-vis (or agreement with) the company in comparison to other participants of the securities market.¹¹ Individuals with access to insider information include:¹²

- Members of the company's governing bodies or securities market professionals with a contractual agreement with the company;
- The External Auditor of the company or securities market professionals having a contractual agreement with the Auditor; and
- Officials of regulatory agencies having legal rights to control or monitor the company.

Best Practices: Disclosure of insider information may substantially affect the market value of shares and other securities of a company. Therefore, per-

¹¹ Law on the Securities Market, Article 31. [Note: A draft law on Insider Information was being considered, but had not yet been passed by the State Duma as of this Manual's completion.]

¹² Law on the Securities Market, Article 32.

sons who have access to insider information may not use it to execute transactions, nor may they transfer insider information to a third party.¹³ Illegal use of insider information can damage shareholder interests and adversely affect the financial position and reputation of the company as well as securities markets overall. The company should have a written insider dealing policy in place, and vigorously enforce it. The Internal Auditor should monitor whether directors, managers, and other officers comply with the law, regulation, and internal rules on insider dealing.¹⁴

5. Disclosure in Listed *Versus* Closely Held Companies

Disclosure requirements are different for publicly listed companies, open and closed joint stock companies, and private companies. Private and closed joint stock companies usually need only to comply with minimal disclosure requirements. More stringent rules apply to listed open joint stock companies. Tight regulation of disclosure among listed companies is needed because of the greater impact of potential fraud when a company may have many thousands of shareholders. Given the importance of capital markets in a modern economy, governments are, understandably, keen on ensuring the integrity of the financial system. The increased number of disclosure obligations for listed companies is the price to be paid to access the large funds available on the capital markets.

Russia's two leading stock exchanges, the Russian Trading System (RTS) and Moscow Interbank Currency Exchange (MICEX) have specific listing rules. For example, companies listed on Tier-A, Level 1 on any of these exchanges must provide documents confirming their full compliance with the FCSM Code (or, if listed on MICEX, with their internal company-level code of corporate governance that is based on the FCSM Code). Companies listed on RTS' Tier-A, Level 1 are further required to disclose their financial statements according to both Russian and International Financial Reporting Standards. On the other hand, companies listed on Tier-A, Level 2 must simply provide documents confirming their compliance with Chapter 7 of the FCSM Code on information disclosure. RTS requires that companies additionally report on specific material events, for example, on issuing, splitting, consolidating, or retiring securities; on transferring the register to

¹³ Law on the Securities Market, Article 33, Clause 1.

¹⁴ FCSM Code, Chapter 4, Section 4.2.

another External Registrar; on the date of the General Meeting of Shareholders (GMS); on the record date; and on the total number of shareholders.¹⁵

→ *For more general information on the differences between forms of joint stock companies, see Part I, Chapter 2, Section A.2.*

6. Disclosure *Versus* Transparency

Disclosure is sometimes confused with transparency. Unfortunately, these two terms are frequently and erroneously used interchangeably. While disclosure and transparency would, at first glance, appear to be the same, they are not. Companies may disclose an enormous amount of information that is of no particular value to the users of such information. Important pieces can be withheld. Disclosure can be irrelevant or, worse, appear to be manipulated in such a way as to conceal the true picture of the state of the enterprise.

Company Practices in Russia: The disclosure of ownership in Russian companies highlights how disclosure and transparency may diverge. While most companies properly disclose their ownership, the true owners and the extent of their control often remains hidden behind complex legal structures such as Special Purpose Entities (or Vehicles), off-shore holding companies, and trusts. For example, most companies in Russia's regions comply with general disclosure requirements. However, 91% fail to provide information on a variety of issues, including major shareholders.¹⁶ Few companies thus have transparent ownership structures.

7. Personal Liability for Non-Disclosure

As a rule, companies are liable for damages caused to shareholders denied legitimate access to information. Companies are also liable when they cause damages to third parties by providing false, incomplete, or distorted information.¹⁷ Members

¹⁵ To view the complete set of listing rules, visit RTS's and MICEX's websites under: www.rts.ru and www.micex.ru.

¹⁶ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.1, page 25, August 2003 (see www.ifc.org/rcgp).

¹⁷ CC, Article 1068.

of the company's governing bodies, in particular the executive bodies, are personally liable for losses caused to the company through their fault.¹⁸ The company (or a shareholder owning 1% or more of common shares) may seek compensation for losses.

The failure to disclose information to the securities markets, provide reliable information, and/or follow disclosure procedures is also subject to liability.¹⁹ Persistent non-disclosure of information or provision of false information causing material damage to individuals, legal entities, or the state is subject to criminal prosecution.²⁰

Executive bodies, typically the General Director, are legally responsible for proper disclosure.²¹ Some documents, such as the prospectus and quarterly report, must be signed by more than one person, e.g. by the General Director and the Chief Accountant, financial consultant, and the External Auditor. These persons are jointly and severally liable for the reliability and completeness of the disclosed information. They also bear subsidiary (secondary) liability with the company for any damages caused to shareholders due to incorrect, incomplete, and/or false information in such documents.

B. Disclosure Items

The OECD Principles of Corporate Governance (OECD Principles) suggest that

“...timely and accurate disclosure be made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.”²²

The key concept that underlies the OECD's recommendation is the concept of materiality. Material information is information, the omission or misstatement of which could affect economic decisions taken by the users of information. Materiality may also be defined as a characteristic of information or an event that makes it sufficiently important to have an impact on a company's share price.

¹⁸ LJSC, Article 71, Clause 2.

¹⁹ Law on the Securities Market, Articles 22.1, Clause 3; Article 30, Paragraph 11.

²⁰ Criminal Code, Articles 185 and 185.1.

²¹ LJSC, Article 88, Clause 2.

²² OECD Principles, Principle IV on Disclosure and transparency. See also: www.oecd.org/dataoecd/32/18/557724.pdf.

The Russia Corporate Governance Manual

The application of the materiality concept allows companies to avoid overly detailed disclosure that is ultimately irrelevant to shareholders. For example, damage to RUR 150,000 (approximately U.S. \$ 5,000) worth of paper in a large, publicly traded company is, clearly, of little importance to the investor. It may, on the other hand, be material to a small family-owned print shop. Materiality is, consequently, a relative concept that depends on the context. It is often difficult to define with great precision in practice. Companies and auditors may sometimes apply certain numerical thresholds (such as, for example, 5% of earnings) to simplify its application. However, these thresholds can only serve as a starting point for a more rigorous application of the concept of materiality.

Best practices: The OECD Principles call for disclosure of all material information in the following areas:

- Financial and operating results of the company;
- Company objectives;
- Shareholdings and ownership structure;
- Directors and key executives, as well as their remuneration;
- Material foreseeable risk factors;
- Material issues regarding employees and other stakeholders; and
- Governance structure and policies.

This list is comprehensive, if general. The Technical Committee of the International Organization of Securities Commissions (IOSCO) has developed more detailed, high-level principles for ongoing disclosure and material development reporting for listed entities. These principles are:²³

- Materiality of information for an investor's investment decision;
- Disclosure on a timely basis — immediate or periodic;
- Simultaneous and identical disclosure in all jurisdictions where the entity is listed;
- Dissemination of information by using efficient, effective, and timely means;
- Disclosure criteria fairness, without misleading or deceptive content and containing no material omission;
- Equal treatment of disclosure — no selective disclosure to investors and others before public disclosure; and
- Compliance with disclosure obligations.

²³ Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities, OICU-IOSCO, October, 2002. See also: www.iosco.org.

Russian legislation covers these essentials in considerable detail. The following sub-sections discuss Russian requirements and disclosure practices with respect to the above-mentioned OECD disclosure items.

1. Financial and Operating Results

a) Presenting Financial Information

Information about financial results, performance, and situation, as well as operations of the company, is of utmost importance for shareholders, potential investors, creditors, and other stakeholders. The following list constitutes the most typical forms of, and additions to, financial reporting:

- *The balance sheet* provides a snapshot of the company's assets, capital, and liabilities on a particular date. To skilled analysts, it provides important information on, *inter alia*, the degree of risk an investment in the company carries or the company's ability to pay creditors.
- *The income statement* provides information on the company's performance over a specified period of time. Income statements may be organized in a number of different ways. According to internationally recognized practice, income statements must show: 1) revenues or sales; 2) the results of operating activities; 3) financing costs; 4) income from associates and joint ventures; 5) taxes; 6) profit or loss from ordinary activities; and 7) net profit or loss. The income statement demonstrates business sustainability.
- *The statement of changes in owners' equity* shows all changes in the charter, additional paid-in, and reserve capital, as well as retained earnings. In addition, it provides information on changes in statutory and additional funds, and briefs on net assets.
- *The cash flow statement* illustrates a company's sources and uses of cash. It lists all changes affecting cash in three areas: 1) operations; 2) investments; and 3) financing. For example: net operating income increases cash; the purchase of a plant is an investment that decreases cash; and the issuance of shares or bonds is a financing activity that increases cash.
- *The notes to the financial statements* help explain the company's financial statements by providing important details and insight into how the company prepared its accounts.
- *Explanations to financial statements* briefly describe features of the company's activities, its main performance indicators and factors that affected the

company's financial results, as well as decisions of the review of financial statements and distribution of net profits. This refers to any relevant information that would enable users to receive a complete and objective picture of the company's financial condition, financial results for the reporting period, and any changes in its financial position.

Best Practices: International practice also calls for the Management's Discussion and Analysis (MD&A), which provides management's view of the performance and future prospects of the company. The MD&A, which is typically disclosed in the company's annual report, should: 1) complement as well as supplement financial statements; 2) have a forward-looking orientation; 3) focus on long-term value creation; 4) integrate long- and short-term perspectives; 5) present information that is significant to the decision-making needs of users; and 6) embody the qualities of reliability, comparability, consistency, relevance, and understandability. The MD&A presents a more analytical and qualitative view than the rest of the financial statements.

Finally, *the External Auditor's report with conclusions* enables an independent External Auditor to express an opinion on whether or not the company's financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they are reliable. This provides shareholders, managers, employees, and market participants with an independent opinion about the company's financial position and — if performed properly — should attest to the accuracy of the statements. Russian companies are further required to publish the Revision Commission's report.

→ *For more information on the role of the External Auditor and Revision Commission, see Part IV, Chapter 14, Section B and A, respectively.*

b) Preparing Financial Information

Russian legislation regulating financial reporting recognizes the following basic concepts and principles:²⁴

- **Accrual based accounting**, according to which revenues and expenses are booked over time and not at the point of payment or receipt of funds. This requires that sales and expenses relating or pertaining to a particular period

²⁴ Russian Accounting Standard 1/98, Accounting Policy of the Company, Section 6.

- be recorded in the period of occurrence irrespective of when the amount was received or paid;
- **Going concern assumption**, i.e. that financial statements are prepared on the assumption that the company is operating and will continue to operate for the foreseeable future, and that it has neither the intention nor the necessity of liquidation or of materially curtailing the scale of its operations. The going concern assumption is a fundamental principle in the preparation of financial statements. For this reason, it is recognized that management has a responsibility to assess the entity's ability to continue as a going concern. However, management's assessment may not always involve detailed analysis, particularly when there is a history of profitable operations and ready access to financial resources.

Company Practices in Russia: Not all companies in Russia follow the going concern principle when preparing financial statements. Some are on the verge of bankruptcy, while others cannot guarantee the stability of company's operation in the future. Additionally, a poor financial picture is often presented to minimize tax payments.

- **Consistency**, which states that the presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new accounting standard; and
- **Separation of assets and liabilities**, meaning that the assets and liabilities of the company shall be separated from those of its owners and other organizations.

In addition, company accounting policies should ensure:²⁵

- **Completeness of information disclosure**, meaning that information contained in the company's financial statements should disclose all material business facts and results (actually and potentially) influencing economic decision-making by the users of these financial statements both from the standpoint of materiality of such information and from the standpoint of the cost of its preparation (an omission can cause information to be false

²⁵ Russian Accounting Standard 1/98, Accounting Policy of the Company, Section 7. Russian Accounting Standard 4/99, Financial Statements of the Company, Section 33.

or misleading and thus unreliable and imperfect from the standpoint of its relevance);

- **Timeliness**, i.e. the company needs to publish reports quickly, as up-to-date information is of much more value to users than older information that may have been superseded by events;
- **Conservatism**, requiring a company to make prudent accounting choices and estimate when future events would have negative effects on its financial conditions;
- **Substance over form**, meaning that for the faithful presentation of information in the financial statements it is necessary that transactions and events are accounted for and presented in accordance with their substance and economic reality (which should prevail) and not merely their legal form;
- **Analytical**. The sum of analytical accounts should be equal to the synthetic account;
- **Balance between benefit and cost**, which, given the complexity and breadth of certain reporting requirements, allows smaller companies to tailor their financial information to be cost-effective. This concept, however, should not be used to deny information to users. The presumption must be that information required by law and accounting standards should be provided to users unless there is a clear indication that the cost outweighs the benefit; and
- **Matching**. Expenses are matched to related revenues in determining earnings for the period.

Legislation, accounting, and other standards will determine the specific content and format of financial statements. Taken together and compared over time, the financial statements and the MD&A should provide a well-rounded picture of the company's operations and financial position.

Best Practices: If companies plan to access international capital markets or, simply, to improve upon the quality of financial reporting, they will need to prepare financial statements according to an internationally accepted body of accounting standards. The two most recognized standards are the International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (U.S. GAAP).²⁶

²⁶ U.S. GAAP are available on the Financial Accounting Standard Board's website under: <http://www.fasb.org>. A summary of IFRS is available on the International Accounting Standard Board's website under: <http://www.iasb.org>.

In addition to standard financial reporting according to the Russian Accounting Standards (RAS), a company should consider reporting in accordance with IFRS for the following reasons:

- IFRS have clear economic logic and provide better information to the company's management than the current RAS do, allowing for a better comparison with a peer group of international companies;
- There is global convergence of national standards towards IFRS;
- Russian companies will likely need to report using IFRS in the future due to the convergence of Russian standards with IFRS;²⁷ (The Russian Ministry of Finance has issued statements regarding its intent to adapt RAS to IFRS.)
- All listed companies in Europe with consolidated accounts will be required to present their consolidated financial statements using IFRS as of 2005;²⁸
- Unification of standards will allow users of financial statements to “read” financial statements under common rules; and
- Implementing IFRS could help Russian companies decrease expenses in attracting investment.

Applying IFRS typically has the following impact on the balance sheet of a standard Russian company:

- The need to prepare consolidated financial statements (IAS 27.7/11);
- Inventories can no longer be generally carried at cost, but at the lower of cost or net realizable value (IAS 2.6);
- A significant change in the value of fixed assets;
- Use of fair market valuation rather than the historical cost approach for many assets and liabilities;
- The appearance of new financial instruments, derivatives in particular; and
- Recognition of assets and liabilities, the control over which does not stem directly from participation in equity.

Additional items are included in the income statement, such as fair value adjustment for financial instruments, and recognition or recovery of asset impairment, among others. Disclosures also become more informative and user-oriented.

Depending on where the company intends to list, statements will likely need to be prepared according to one of these two standards.

²⁷ Research released by the world's six largest accountancy firms shows that an overwhelming majority of countries — over 90% of a total 59 countries surveyed — intend to converge with IFRS; see GAAP Convergence 2002 from <http://www.ifad.net>.

²⁸ Regulation (EC) 1606/2002 of the European Parliament of the Council of 19.7.2002 on the Application of International Accounting Standards. See also: http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/1_243/1_24320020911en00010004.pdf.

c) Disclosing Financial Information

Financial information will typically be presented in different forms and at different times throughout the financial year. Financial and operating results will appear in the prospectus, and annual and quarterly reports. The Law on the Securities Market requires that the following information on the last five operating years and the last reporting period be disclosed in these documents:²⁹

- Major areas of company activity;
- Results of the financial and business activity, as well as any major factors affecting revenues;
- Financial and economic ratios of the company;
- Market capitalization, liquidity, and its obligations;
- Capital structure, including working capital;
- Composition, structure, and value of fixed assets;
- Total amount of export; and
- Inventory of the company's property.

Best Practices: Companies should disclose all material information, and do so on a timely basis and in such a manner as to make the information as clear and understandable to users as possible. Companies should adhere to the spirit of the law, not just the letter, and should not limit themselves to the minimum standards of statutory disclosure. Some examples of additional disclosures that are encouraged by the FCSM Code:

- The quarterly report for the fourth quarter should include additional financial information, in particular data about the company's operations over the entire previous reporting year rather than for the fourth quarter only;³⁰
- The annual report should also disclose information that will enable shareholders to understand the results of the company's activities during the reporting year;³¹ and
- Any of the material events defined by the FCSM Code.³²

²⁹ Law on the Securities Market, Article 22, Clauses 4 and 6.

³⁰ FCSM Code, Chapter 7, Section 2.2.

³¹ FCSM Code, Chapter 7, Section 3.3.

³² FCSM Code, Chapter 7, Section 2.3, Paragraph 6.

d) Financial Information in Groups of Companies

Complete disclosure of intra-group relations, transactions, and their financial terms, and consolidated accounts is a crucial pre-requisite to make the group's functioning transparent.

Best Practices: When preparing consolidated accounts, companies should follow uniform accounting policies for the parent and its subsidiaries or, if this is not practicable, the company must disclose that fact and the proportion of items in the consolidated financial statements to which different policies have been applied. In the parent's separate financial statements, subsidiaries may be shown at cost, at revalued amounts, or using the equity method. According to IFRS, a company's consolidated accounts should include, *inter alia*:³³

- The name, ownership, and voting percentages for each significant subsidiary;
- The reason for not consolidating a subsidiary;
- The nature of the relationship if the parent does not own more than 50% of the voting power of a consolidated subsidiary;
- The nature of the relationship if the parent does own more than 50% of the voting power of a subsidiary excluded from consolidation;
- The effect of acquisitions and disposals of subsidiaries during the period; and
- In the parent's separate financial statements, a description of the method used to account for subsidiaries;

→ For more information on the importance of disclosing financial information in groups of companies, see Part V, Chapter 15, Section B.2.

2. Company Objectives

It is important for markets, shareholders, and other stakeholders to be aware of the company's objectives. The communication of company objectives can be either in response to legal requirements or it can be voluntary.

Legislation requires that company objectives (such as the issuance of securities, acquisition plans, replacement and sales of assets, or research and development) be disclosed in the prospectus.³⁴ In addition, quarterly reports must contain forward-

³³ Excerpt from International Accounting Standard No. 27. See also: <http://www.iasb.co.uk>.

³⁴ Law on the Securities Market, Article 22, Clauses 4, 6 and 9.

looking information including sources of revenue, plans for new production procedures, expansion or reduction of production, new product development, substitution of old products, modernization or repair of fixed assets, and modification of the types of company activities.³⁵ In addition, the annual report must outline the company position in the industry, priority areas of activity, and development trends.³⁶

Voluntary disclosure may cover issues such as a company's policies concerning corporate governance, business ethics, environmental issues, and other public policy commitments. This information can help to properly evaluate the prospective performance of the company, its relationship with various stakeholders and communities in which it operates, and the steps that the company has taken to implement its objectives. As with other types of disclosure, the quality of information provided to the public is greatly enhanced by adhering to a widely accepted standard.³⁷

Best Practices: Companies may choose to voluntarily disclose their objectives in the charter, company-level corporate governance code, and/or ethics code, as well as annual report. Regardless of the form, companies should ensure that this information is readily accessible to the public, for example, on their websites.

3. Major Share Ownership and Voting Rights

a) Major Share Ownership

It is important that shareholders are informed about company ownership structures to understand their rights, role and authority in governing the company, and influence its policy. Depending on the size of ownership, shareholders have varying degrees of influence over decision-making in a company. Legislation provides greater rights to shareholders with larger holdings.

→ *For more information on the rights of shareholders according to their ownership percentage, see Part III, Chapter 7.*

³⁵ FCSM Regulation No. 03-32/ps on the Disclosure of Information by Security Issuers (FCSM Regulation No. 03-32/ps), Annex 11, Section 3.4.

³⁶ FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparation, Calling, and Conducting the General Meeting of Shareholders (FCSM Regulation No. 17/ps), 31 May 2002, Section 3.6.

³⁷ For a general discussion of non-financial disclosure, see the OECD's Guidelines for Multinational Enterprises. See the OECD website at www.oecd.org or consult the Guidelines directly under: www.oecd.org/dataoecd/62/58/2438852.pdf.

Clearly, it is vital to know who is in a position to make (or influence) decisions within a company. For this reason, full information on the amount of the issued capital, its increases and decreases, the rights attached to shares of different types and classes, and the number of shareholders is crucial.

Shareholders with large stakes have the opportunity to exercise control over decision-making in a company. These opportunities are summarized in Table 1.

Ownership	Influence on decision-making
25% plus 1 vote	The shareholder can block major decisions that require $\frac{3}{4}$ -majority, e.g. to amend the charter or reorganize the company.
50% plus 1 vote	The shareholder can unilaterally take decisions that require a simple majority, e.g. to declare dividends and approve the External Auditor.
75% plus 1 vote	The shareholder can unilaterally decide all issues.

In practice, lower thresholds may suffice to exercise control over a company. In particular, in companies with dispersed ownership it is not necessary for a shareholder to hold the percentages of votes outlined in Table 1 above since the quorum for decisions of the GMS is counted based on votes cast. Since it is rare for all shareholders to vote at the GMS, a lesser percentage of shares usually provides the same degree of influence. In any event, the larger the ownership stake, the greater the ease with which shareholders can control the company.

Legislation requires disclosure of ownership once its size reaches or exceeds specific thresholds. What, where, when, and to whom disclosure needs to be made depends upon ownership thresholds. These thresholds are summarized in Table 2.

Threshold	Who Should Disclose	What Should be Disclosed	To Whom and Where to Disclose
One share	Nominal holders	Beneficial owners	Notification to the Registrar of the company. ³⁸

³⁸ Law on the Securities Market, Article 8, Clause 2.

The Russia Corporate Governance Manual

Table 2: Ownership Disclosure Thresholds			
Threshold	Who Should Disclose	What Should be Disclosed	To Whom and Where to Disclose
5% of the charter capital or 5% of common shares ³⁹	The company	Personal data, the size of the stake in the charter capital, and the amount of common shares, the dynamics of changes in the list of owners of 5% and the size of holdings	To the FCSM. In the prospectus and quarterly reports, and on the company website.
5% of the charter capital or 5% of common shares if shareholders are legal entities	The company	Information on the owners of 20% of the charter capital or common shares in the company-shareholder, as well as the size of the stake in the charter capital and the amount of common shares (chain shareholding)	To the FCSM. In the prospectus and quarterly report, and on the company website.
20% of voting shares	The company	Information on the owners of 20% of voting shares	To the FCSM. In the List of Related Parties and on the company website.
20% and more of securities other than non-convertible bonds ⁴⁰	The owner	The holding of securities/the acquisition of securities	To the FCSM, not later than five days after the thresholds are reached; ⁴¹ as well as to the antimonopoly body. ⁴²
20% of voting shares	The legal entity — owner	On legal entities that own 20% of voting shares in the company	To the Supervisory Board, Revision Commission, and External Auditor.
The acquisition of any 5% of securities above 20% as well as the sale of 5% if the remaining stake is higher than 20%	The owner	On the acquisition and/or sale	To the FCSM not later than five days after the thresholds are reached. A special notification form is used for this purpose.
Owning 25% of securities of any type ⁴³	The company	The holding of securities	To the FCSM. In the material events reports.

³⁹ Law on the Securities Market, Article 22, Clause 8; Article 30, Clause 5.

⁴⁰ Law on the Securities Market, Article 30, Paragraph 14.

⁴¹ Law on the Securities Market, Article 30, Paragraph 15.

⁴² Law on Competition, Article 18, Clause 1.

⁴³ Law on the Securities Market, Article 30, Paragraph 12.

Information about the identity of “formal” shareholders is a prerequisite since they can exercise voting and dividend rights related to the shares they hold. But it may not be sufficient to work out the actual ownership and control structure because, if the “formal” shareholder is controlled by another person (the beneficial owner), it is the beneficial owner who can influence the behavior of “formal” shareholders and eventually control voting rights. Even more important, several “formal” shareholders can be controlled by the same beneficial owner. In such case, the real voting power of the beneficial owner consists of the sum of voting rights held by several “formal” shareholders. It is therefore necessary to know the identity of the beneficial owner and then attribute all the stakes held by the “formal” shareholders to him.

Best Practices: Companies seeking to disclose their ownership structure may wish to follow examples under U.S. and EU regulations.

U.S. regulations define a beneficial owner as any person who, directly or indirectly, through any contract arrangement, understanding, relationship, or otherwise has or shares:⁴⁴

- Voting power, which includes the power to vote, or to direct the voting of, such a security; and/or
- Investment power that includes the power to dispose, or direct the disposition of, such security.

U.S. securities law states that any person who is directly or indirectly the beneficial owner of more than 5% of any equity security of a class, shall notify the issuer and each exchange where the security is traded of such acquisition within 10 days, as well as of any increase or decrease by 1% of more.⁴⁵ If the beneficial owner acts in concert with other institutions or persons, their names and the relationship with the beneficial owner must be disclosed.

The EU Transparency Directive of 2001 provides a framework for disclosure.⁴⁶ In summary:

1. Article 9 stipulates that investors must disclose the acquisition or disposal of major shareholdings in listed companies, based on thresholds starting at 5% continuing at intervals of 5% until 30% of voting rights, or charter capital or both.

⁴⁴ 17 Code of Federal Regulations (CFR), 240/ 13d-3(a).

⁴⁵ U.S. Securities and Exchange Act 1934, Sec. 13d-1,2; 17 CFR 240, 13d-2.

⁴⁶ See also: http://europa.eu.int/eur-lex/en/consleg/pdf/2001/en_2001L0034_do_001.pdf.

2. Article 11(2) shortens the reporting obligation of the acquirer to the company and the competent regulatory authority from seven calendar days to five business days on the one hand and, on the other, of the company to the public from nine calendar days to three business days.
3. Article 2 extends the definition of “security holder” to include custodians and those holding securities for clearing and settlement purposes.
4. Finally, Article 11(5) extends notification requirements to various classes of shares, such as warrants and convertible bonds if the holdings reach or fall below the thresholds defined in Article 9.

Six Member States have already introduced this Directive by law or regulation. In addition, the EU Takeover Bids Directive’s Article 10 regulates transparency issues, including the disclosure of beneficial ownership structures, and listed companies in the EU are thus required to disclose information in their annual report on, *inter alia*:

1. The structure of their capital;
2. Any restrictions on the free transferability of securities;
3. Significant direct and indirect shareholdings (including pyramid schemes and cross-shareholdings);
4. The holders of any securities with special control rights;
5. The system of control of any employee share scheme where the control rights are not exercised directly by employees;
6. Restrictions on voting rights;
7. Shareholder agreements that are known to the company;
8. The rules governing the appointment and replacement of Supervisory Board members;
9. Significant agreements made by the company that take effect upon a change of control; and
10. Compensation agreements between the company and its directors in the case of a successful takeover bid.

Russian legislation requires timely disclosure of information regarding beneficial owners. In particular, the Company Law requires the nominal shareholder to disclose information to the company on persons on whose behalf he holds shares for the purposes of compiling the shareholder list for the GMS and distributing dividends.⁴⁷

⁴⁷ LJSJ, Article 51, Clause 2; Article 42, Clause 4, Paragraph 2.

Best Practices: Opaque ownership structures continue to preoccupy the corporate governance debate since a considerable percentage of shares of Russian companies remain offshore with their true — or beneficial — owners hidden.

Offshore structures can have legitimate uses. However, they are often used to conceal the identity of the owners of interests in underlying pools of assets and related parties, and tend to be associated with perceptions of tax-fraud, self-dealing, money laundering, illicit capital export, and other generally recognized unsavory business practices. International accords are making it increasingly difficult to use such structures for illegitimate purposes.

Russian companies wishing to comply with good corporate governance practices should disclose their ownership structure, including beneficial owners, in a transparent manner.

b) Indirect Control

Shareholders owning less than the majority of shares can exercise indirect control over the company through pyramid structures and/or cross shareholdings. Relationships with related parties may also alter the control structure of the company. For these reasons, information on indirect ownership, related parties, and related party transactions should be fully disclosed, specifically in the annual report,⁴⁸ quarterly reports,⁴⁹ material events report,⁵⁰ and other notifications to regulators or creditors.⁵¹ Legal requirements are summarized in Figure 1.

⁴⁸ FCSM Regulation No. 17/ps, Section 3.6.

⁴⁹ Law on the Securities Market, Article 22, Clauses 8 and 11; FCSM Regulation No. 03-32/ps, Annex 13.

⁵⁰ Law on the Securities Market, Article 30, Paragraph 12; FCSM Regulation No. 03-32/ps, Section 11.4.

⁵¹ LJSC, Article 15, Clause 6, Paragraph 1; Law on Competition, Article 18, Clause 1.

The Russia Corporate Governance Manual

Figure 1: Disclosure of Indirect Ownership, Related Parties, and Related Party Transactions

	Quarterly Report	Material Events Report	Annual Report	Notification of Regulators and Creditors
Interest of Supervisory Board and executive body members in the charter capital	✓	Acquisition of securities (see Table 2)	✓	Buyback of securities (see Table 2)
Dependent companies with 5% or more participation	✓	Not applicable (n/a)	n/a	n/a
Owners of 20% + of shares in a company – shareholder who, in turn, own 5% + of the company's charter capital or common shares (chain shareholding)	✓	n/a	n/a	n/a
Reorganization of the company, its subsidiaries, or dependent companies	n/a	✓	n/a	To creditors: reorganization of the company
Related party transactions	✓	n/a	✓	n/a
Related parties	Only if related parties are debtors of the company	n/a	n/a	n/a
Acquisition of the company's assets or rights to determine the conditions of the company's business activities	Transactions that impose obligations covering 10% or more of the company's assets	<ul style="list-style-type: none"> • Acquisition of assets entailing a one-time increase/decrease in the value of the company's assets by 10% and more; • A one-time transaction involving 10% and more of the company's assets 	List of extraordinary and similar transactions	<ul style="list-style-type: none"> • Acquisition of assets if their book value exceeds 10% of the book value of the selling company's fixed and/or intangible assets; • Acquisition of rights providing the possibility to determine the conditions of the company's business activity or to act as its executive body

Source: IFC, March 2004

Best Practices: In addition to the above-mentioned statutory requirements, companies should disclose the following material events related to beneficial shareholdings:⁵²

- Transactions involving company property, the value of which is equal to, or in excess of, 2% of the non-current assets and/or which can materially influence the market price of the company's shares;
- Buyback by the company of its shares (unless connected with the reduction of the charter capital); and
- Other transactions that can materially affect shareholder interests.

Companies should further disclose information regarding the buyback of company shares and the most important transactions in the annual report.⁵³

Finally, a list of the company's related parties should be submitted by the company to the FCSM on a quarterly basis.⁵⁴

→ *For more information on the procedure to disclose the company's related parties, see Section C.5 of this Chapter.*

c) Shareholder Agreements and Voting Caps

Shareholder agreements, voting caps, and caps of shareholdings can also affect control. Shareholder agreements typically oblige parties to vote as a block and may give first-refusal rights for the purchase of shares to another shareholder. Shareholder agreements can cover many issues including which candidates to nominate for the Supervisory Board or the selection of the Chairman.

Best Practices: Russian legislation does not provide for the disclosure of shareholder agreements. Shareholder agreements, however, are clearly of material interest to shareholders. While difficult to detect, companies should make reasonable efforts to obtain information about the existence of shareholder agreements and to disclose such information to all shareholders.⁵⁵ In principle, parties to shareholder agreements should voluntarily disclose this information themselves.

⁵² FCSM Code, Chapter 7, Section 2.3.

⁵³ FCSM Code, Chapter 7, Section 3.3.2 and 3.3.4.

⁵⁴ LJSC, Article 93, Clause 4; FCSM Regulation No. 03-19/ps on the Disclosure of Information about Affiliated Persons of Open Joint Stock Companies (FCSM Regulation No. 03-19/ps), Section 4.

⁵⁵ FCSM Code, Chapter 7, Article 2.1.4

Voting caps limit the number of votes that a shareholder may cast regardless of the number of shares he actually possesses. As such, caps go against the principle of one share — one vote and control that is proportional to ownership. Voting caps are often used to either entrench the position of existing controlling shareholders or management, and are rarely supported by good faith investors.

Russian law allows voting caps and caps of shareholdings to be established, however, requires the company to disclose such caps in its charter.⁵⁶ Caps should also be disclosed in the prospectus and quarterly reports.⁵⁷

4. Information on Directors and Executives

a) Personal Data

Investors and shareholders should have access to relevant information about Supervisory Board members and key executives to evaluate their experience and qualifications. Educational background, current occupation, and professional experience of directors and senior executives should be disclosed and readily accessible to interested parties. It is also important that shareholders and investors have information about any (existing or potential) conflicts of interest that may affect the independence and decision-making capacity of the Supervisory Board and Executive Board.

Shareholders should also be able to assess whether or not Supervisory Board and Executive Board members dedicate sufficient time to their duties and properly carry out their responsibilities. Accordingly, companies should disclose all other Board positions held by Supervisory or Executive Board members in other companies (domestic and foreign), and the meeting attendance records.

Table 3 summarizes the legal disclosure requirements for members of the Supervisory and Executive Boards in the quarterly report,⁵⁸ annual report,⁵⁹ the list of related parties,⁶⁰ and in notifications to regulators.⁶¹

⁵⁶ LJSJ, Article 11, Clause 3.

⁵⁷ Law on the Securities Market, Article 22, Clause 8.

⁵⁸ Law on the Securities Market, Article 22, Clause 7; Article 30, Paragraph 5; FCSM Regulation No. 03-32/ps, Annex 11, Section V.

⁵⁹ FCSM Regulation No. 17/ps, Section 3.6.

⁶⁰ FCSM Regulation No. 03-19/ps, Section 4.

⁶¹ Law on Competition, Article 18, Clause 6.

Table 3: Disclosures on Supervisory and Executive Board members				
	Quarterly Report	Annual Report	List of Related Parties	Notification of Regulators
Full name of all individuals	✓	✓	✓	n/a
Current positions	✓	n/a	n/a	Election of an individual into executive bodies and Supervisory Board of two or more companies
Positions for the last five years	✓	n/a	n/a	n/a
Brief biographical data	n/a	✓	n/a	n/a
Kinship of Supervisory and Executive Board members and the Internal Auditor	✓	n/a	n/a	n/a

Best Practices: Legal disclosure requirements clearly fall short of best practices. According to the FCSM Code, companies should also disclose the following information in its annual report:⁶²

- Other key officials of the company, including their curriculum vitae;
- Information about all transactions between these other key officials and the company;
- Age, profession, employment, and citizenship of each Supervisory Board member, as well as all other positions, the date of initial appointment, and the current term of appointment; and
- Information on all claims filed in Russian or foreign courts (or arbitration tribunals) against Supervisory and Executive Board members and/or the General Director.

b) Remuneration

Incentive remuneration schemes are common in many countries and come in many varieties. Few companies have such arrangements that are identical to one another.

Executive remuneration plans are usually put in place in an effort to motivate executives, and better align their interests with the interests of shareholders. They

⁶² FCSM Code, Chapter 7, Article 3.3.3.

normally include performance based bonuses. Incentive remuneration schemes may not be the most effective way of alleviating inherent conflicts of interests and, in any event, should always be subject to careful legal and financial examination and the approval of both the Supervisory Board and the GMS.⁶³ Remuneration plans for non-executive directors will differ considerably.

In Russia, companies must disclose aggregate data on the amount of remuneration for each governing body during the last completed fiscal year in the prospectus and quarterly report, as well as existing agreements regarding such payments in the current fiscal year.⁶⁴

Best Practices: The remuneration of Supervisory Board members and key executives is disclosed on an individual basis in some countries, putting shareholders in a better position to assess the extent to which an individual's remuneration is justified in view of his responsibility and/or performance. It also allows shareholders to hold executives and Supervisory Board members fully accountable for the performance of their duties.

- With respect to executive remuneration plans, shareholders and investors should have sufficient information to properly assess their costs and benefits to the company, and the relation between the performance of the company, on the one hand, and the level of executive remuneration, on the other.
- At some point, the independence of non-executive directors may be compromised if they earn a significant amount of their total income from their Board activities. Some countries have monetary thresholds that serve as convenient “rules of thumb” or warning signals. While numerical thresholds may be a reasonable starting point, judgments on independence will, of course, require a much more sophisticated analysis. The disclosure of a non-executive director's remuneration remains critical in order to judge the extent to which their independence may be compromised.

Companies should not only be transparent with respect to the levels of remuneration but also the methods for determining remuneration. The criteria for determining the amount of remuneration for Supervisory Board members, the General Director and/or Executive Board members — as well as the total amount

⁶³ FCSM Code, Chapter 4, Section 5.1.2.

⁶⁴ Law on the Securities Market, Article 22, Clause 7; FCSM Regulation No. 03-32/ps, Annex 11, Section V.

of remuneration paid or to be paid depending on the results of the reporting year — must be disclosed in the annual report.⁶⁵

Best Practices: To adhere to the spirit of full disclosure of remuneration, companies may find it necessary to disclose information regarding the remuneration of other company officials who are not part of the Executive or Supervisory Boards.⁶⁶

→ *For more information on non-executive and executive remuneration practices, see Part II, Chapter 4, Section H and Chapter 5, Section G, respectively.*

5. Material Foreseeable Risk Factors

Risk (along with return) is one of the most important considerations for any investor. Risks may include particular industry risks as well as political, commodities, derivatives, environmental, market, and interest and currency fluctuation risks. In short, risk is an omnipresent feature of business activity.

Risk is, by its very nature, forward looking and extremely difficult to quantify. Nevertheless, companies are required to describe material risks in their annual reports.⁶⁷ Specific industry, country and regional risks, as well as financial and legal risks all need to be disclosed in prospectuses and quarterly reports.⁶⁸

→ *For more information on how to manage risk, see the model by-law on risk management in Part VI, Annex 27.*

6. Employees and Other Stakeholders

Russian law requires the prospectus and quarterly reports to contain information on the following issues regarding employees, creditors, and other company stakeholders:⁶⁹

⁶⁵ FCSM Regulation No. 17/ps, Section 3.6.

⁶⁶ FCSM Code, Chapter 7, Section 3.3.3.

⁶⁷ FCSM Regulation No. 17/ps, Section 3.6.

⁶⁸ Law on the Securities Market, Article 22, Clause 4; FCSM Regulation No. 03-32/ps, Annex 11, Article 2.5.

⁶⁹ Law on the Securities Market, Article 22, Clauses 7–8; FCSM Regulation No. 03-32/ps, Annex 11, Sections 5.7, 5.8, 2.1, 2.3.

- Number of employees, and any material changes in that number;
- General or aggregated data on educational background, composition of personnel, salaries and wages paid, and social insurance;
- Employee share ownership and stock option plans;
- List of debtors whose debts exceed 10% of accounts receivable; and
- Amount and structure of accounts payable.

Company employees and creditors are further entitled to access information on reorganization, bankruptcy, and liquidation issues.⁷⁰

Strictly speaking, most of the information on employees and other stakeholders may not be “material” according to the accounting or financial definitions of the term. On the other hand, information about the company’s employees, creditors, and suppliers, as well as the company’s relationship with local communities, can be “material” to other constituencies. Employees are also users of information, and disclosure helps them to make better employment decisions, protect themselves in the workplace, and participate in other aspects of company life. Stakeholder disclosure is becoming increasingly common as an issue of interest and attention worldwide.

Best Practices: While some forms of stakeholder disclosure are required by law, it is good practice to provide stakeholders with other relevant information. For example, stakeholder disclosure might include the health protection of employees, safety conditions in the workplace, and environmental or community impact statements.⁷¹

→ *For more information on the importance of stakeholder issues, see Part I, Chapter 1, Section A.2. See also Part VI, Annex 5 for a model company code of ethics.*

7. Corporate Governance Structures and Policies

When assessing a company’s governance structure, market participants may want to obtain information on the company’s governing bodies, including the division of authority between shareholders, directors, and executives, as well as on the

⁷⁰ On information disclosure to employees, see Labor Code, Article 53.

⁷¹ FCSM Code, Chapter 7, Section 3.3.5.

company's corporate governance policy, its commitment to corporate governance principles, and compliance mechanisms.

The charter is the document that sets the rules and procedures of the company's governance system. It is a fundamental document of the company that is to be made publicly available. Company-level corporate governance codes also serve to highlight general corporate governance concepts and structures. By-laws finally provide more detailed guidance on processes.

→ *For more information on the charter, see Part I, Chapter 3, Section A. See also Part VI, Annex 2 for a model company charter.*

Most recently, Russian companies are required to disclose whether they follow FCSM Code provisions in their annual reports on a “comply or explain” basis.⁷² Comply or explain means that while compliance is not mandatory, the reasons for non-compliance with the FCSM Code should be explained.

Best Practices: It is necessary to disclose information about corporate conflicts resulting from improper implementation by the company of those FCSM Code recommendations that the company declared binding upon itself in one form or another.⁷³

a) Commitment to Corporate Governance

Markets are keenly interested in understanding the level of a company's commitment to good governance practices. They wish to determine whether a company sees governance as a public relations, “box-ticking,” or “window-dressing” exercise, or whether the company is in fact willing “to do right” by shareholders, and to institute and implement real change as necessary and appropriate. While good disclosure, in and of itself, is not sufficient to consistently and uniformly ensure good corporate governance, it is clearly one way of demonstrating the commitment a company is willing and able to make to its shareholders and to its other stakeholders.

⁷² FCSM Regulation No. 17/ps, Section 3.6; FCSM Instruction No. 03-849/r on Methodological recommendations on the content and the form of disclosure of information on the compliance with the Code of Corporate Conduct in Annual Reports of joint Stock Companies, 30 May 2003, Section 5; FCSM Code, Chapter 7, Section 3.3.6.

⁷³ FCSM Code, Chapter 7, Section 3.3.6.

→ For more information on how a company can properly express its commitment to corporate governance, see the IFC corporate governance progression matrix in Part VI, Annex 1.

b) Corporate Governance Structures

Companies must describe their governance structures, including the authority of each governing body and internal control mechanisms, in their prospectus and quarterly reports.⁷⁴ Companies must also describe the procedures for calling and conducting their GMS in these documents,⁷⁵ and disclose GMS decisions in material events reports.⁷⁶

Best Practices: Companies should disclose information about changes in the identity of (or contractual arrangements with) the company's External Auditor, Registrar, or depository in their material events reports.⁷⁷

c) Corporate Governance Policies

Companies should disclose their corporate governance policies, and provide interested users with easy and inexpensive access to this information.

Best Practices: The FCSM Code recommends companies to develop disclosure policies that should be approved by the Supervisory Board and be binding upon the company.⁷⁸ Some of the provisions suggested by the FCSM Code for inclusion in company policies include:⁷⁹

- List of information the company intends to disclose;
- Rules for communicating with the mass-media, as well as the sources and regularity of communications;
- Media contacts, including press conferences, publications, brochures, and booklets;

⁷⁴ Law on the Securities Market, Article 22, Clause 7; FCSM Regulation No. 03-32/ps, Annex 11, Section 5.4.

⁷⁵ FCSM Regulation No. 03-32/ps, Annex 11, Section 8.1.4.

⁷⁶ Law on the Securities Market, Article 30, Paragraph 12; FCSM Regulation No. 03-32/ps, Section 6.2.1.

⁷⁷ FCSM Code, Chapter 7, Section 2.3.

⁷⁸ FCSM Code, Chapter 7, Section 1.1.1.

⁷⁹ FCSM Code, Chapter 7.

- The requirement for executive bodies to conduct meetings for shareholders and analysts;
- Procedures for answering questions from all shareholders;
- List of information, documents, and materials to be provided to all shareholders for the GMS;
- List of confidential information; and
- Procedures for the identification and treatment of insider information.

In addition, companies should consider disclosing other internal policies or by-laws such as a code of ethics, environmental policies, and the by-laws for the Supervisory Board and its committees among others.

→ *For more information on company policies and by-laws, see Part I, Chapter 3. For a model code of ethics, see Part VI, Annex 5. For a set of model by-laws for the Supervisory Board, as well as its committees, see Part VI, Annexes 6 through 10.*

C. Mandatory Disclosure

Russian legislation provides different forms and procedures for mandatory disclosure. Companies will, at various times, have to report to regulatory authorities, respond to information requests from shareholders or other stakeholders, or disclose the occurrence of specific events. This section describes the procedural requirements for the following forms of mandatory disclosure:

- Disclosure during securities placement, specifically the prospectus;
- Quarterly reports;
- Material events reports;
- Providing documents and information to shareholders through the annual report;
- List of related parties;
- Notification of regulators;
- Notification of creditors; and
- Providing information to the company's employees.

1. Disclosure During the Placement of Securities

a) The Prospectus

Companies must prepare and register prospectuses under certain circumstances.⁸⁰ A prospectus provides material information on the company so that investors can make informed decisions on the merits of potential investments. Prospectuses set forth the nature and object of shares, debentures, or other securities, and the investment and risk characteristics of the issue. Investors must be furnished with a prospectus before purchasing securities.

→ *For more detailed information on the prospectus, see Part III, Chapter 11, Section C.*

b) Decisions and Events to Be Disclosed

Russian legislation and regulations impose certain disclosure requirements on companies when issuing securities. The FCSM requires a number of events to be disclosed in the mass media:⁸¹

- The decision to place securities;
- The decision to issue securities;
- State registration of the issue;
- Start and completion of the placement; and
- State registration of the report on the results of the issue.

Figure 2 summarizes events that the company must disclose on its corporate website,⁸² website ticker,⁸³ in the mass media,⁸⁴ and to interested parties.⁸⁵ Similar requirements apply to the disclosure of amendments or suspension of issues.⁸⁶

⁸⁰ Law on the Securities Markets, Article 19, Clause 2.

⁸¹ FCSM Regulation No. 03-32/ps, Section II.

⁸² FCSM Regulation No. 03-32/ps, Sections 1.6, 2.2.2, 2.3.2, 2.4.2, and 2.5.2.

⁸³ FCSM Regulation No. 03-32/ps, Section 1.4. The FCSM has authorized the Interfax and AK&M agencies whose website tickers must be used for disclosure.

⁸⁴ FCSM Regulation No. 03-32/ps, Section 1.7. In the case of an open subscription, the company must publish an announcement in a journal with a circulation of not less than 10,000 copies. In the case of closed subscription, in a publication with a print run of not less than 1,000 copies. Additionally, the announcement must be published in the Supplement to the Vestnik of the FCSM.

⁸⁵ FCSM Regulation No. 03-32/ps, Section 1.9.

⁸⁶ FCSM Regulation No. 03-32/ps, Section 2.5.

Figure 2: Disclosure During Security Placements

Events	Website Ticker	Mass Media	Corporate Website	Access to Copies
Decision to place securities	One day after the date of the minutes	Not later than five days after the date of the minutes	Not later than three days after the date of the minutes	Within seven days of the request
Decision to issue securities	One day after the date of the minutes	Not later than five days after the date of the minutes	Not later than three days after the date of the minutes	Within seven days of the request
State registration of securities issue	One day after the date of state registration	Not later than five days after the date of state registration	Not later than three days after the date of state registration, incl. prospectus	Within seven days of the request
Start of the placement	Not later than five days before the date of placement	Not applicable (n/a)	Not later than four days before the date of placement	n/a
Completion of the placement	Next day from the date of placement of the last security or the last day of placement	Not later than five days after the date of placement of the last security or the last day of placement	Not later than three days from the date of placement of the last security or the last day of placement	n/a
State registration of the report on the results of the issue	One day after the date of the report's registration	Not later than five days after the date of the report's registration	Not later than three days from the date of the report's registration	Within seven days of the request

Source: IFC, March 2004

2. Quarterly Reports

Companies that have registered a prospectus must file quarterly reports.⁸⁷ The content and amount of information in the quarterly report must be consistent with the requirements established for prospectuses. The law does not require the quarterly report to include information regarding the procedure and the terms of placement of securities, as such information is included in the prospectus itself.⁸⁸

⁸⁷ Law on the Securities Market, Article 30, Paragraph 4.

⁸⁸ Law on the Securities Market, Article 30, Paragraph 5.

a) Signatories of the Quarterly Report

Both the General Director and Chief Accountant must sign quarterly reports to attest to their reliability and completeness.⁸⁹

b) Filing Quarterly Reports

Quarterly reports must be submitted to the FCSM or its regional agencies no later than 45 days after the last day of the reporting quarter.⁹⁰ The company must also provide access to a copy of the quarterly report at the location of its executive bodies. Copies of quarterly reports must further be provided to the owners of the company's securities at their request, within seven days from the day of the request, for a charge not exceeding the costs of copying.⁹¹ Finally, the company must also publish the quarterly report on the company's website no later than 45 days after the last day of the reporting quarter.⁹²

3. The Material Events Report

Companies that register a prospectus must file material events reports when significant incidents, circumstances, or events affect their activities.⁹³

a) Signatories of the Material Events Report

The General Director must sign the material events report. The Chief Accountant should also sign reports on material market transactions, changes in net profits; or changes in company assets.⁹⁴

⁸⁹ Law on the Securities Market, Article 30, Paragraph 11; FCSM Regulation No. 03-32/ps, Section 5.4.

⁹⁰ Law on the Securities Market, Article 30, Paragraph 10; FCSM Regulation No. 03-32/ps, Section 5.6.

⁹¹ Law on the Securities Market, Article 30, Paragraph 11; FCSM Regulation No. 03-32/ps, Section 1.9.

⁹² FCSM Regulation No. 03-32/ps, Section 5.7.

⁹³ Law on the Securities Market, Article 30, Paragraph 4; FCSM Regulation No. 03-32/ps, Section 6.

⁹⁴ FCSM Regulation No. 03-32/ps, Section 6.1.4.

b) Codification of Material Events

Each material event should be reported separately.⁹⁵ For statistical purposes, the FCSM codifies material events reports and requires that every report be marked with a relevant code.⁹⁶

c) Filing Material Events Reports

Companies must file the material events report with the FCSM within five days of the event's occurrence. The report must also be disclosed on the website ticker the day after the event, on the corporate website no later than three days after, and in the mass media no later than five days after the day of its occurrence.⁹⁷

Companies must provide access to a copy of material events reports at the location of its executive bodies. Copies of reports must be provided to the owners of the company's securities at their request within seven days from the day of the request, for a charge not exceeding copying costs.⁹⁸

4. Information for Shareholders Through the Annual Report

Companies are obliged to provide shareholders with access to corporate documents, regardless of the number of shares owned.⁹⁹

Arguably, the most important document to be provided to shareholders is the company's annual report. It is a formal record of a company's financial condition that must be distributed to shareholders under the Company Law and FCSM regulations. Included in the report is a description of company operations as well as a balance sheet, income statement, and the other items listed above (in this Chapter's Section B.1 on Financial and Operating Results).

⁹⁵ FCSM Regulation No. 03-32/ps, Section 6.1.6.

⁹⁶ FCSM Regulation No. 03-32/ps, Section 6.2.

⁹⁷ Law on the Securities Market, Article 30, Paragraph 13; FCSM Regulation No. 03-32/ps, Sections 6.3.1 and 6.3.2. Additionally, the report must be published in the Supplement to the Vestnik of the FCSM. (FCSM Regulation No. 03-32/ps, Section 1.7).

⁹⁸ Law on the Securities Market, Article 30, Paragraph 11; FCSM Regulation No. 03-32/ps, Section 1.9.

⁹⁹ LJSC, Article 91.

The annual report is a shorter and more easily digestible version of more detailed financial information filed with the FCSM. Annual reports increasingly include forward-looking and qualitative information that is important to readers. They must be signed by the company's General Director and the Chief Accountant, and must receive the preliminary approval of the Supervisory Board before being submitted to the GMS for final approval.¹⁰⁰

→ *For more information on shareholder rights and the GMS, see Part III, Chapters 7 and 8 respectively. For more information on the annual report, see Part VI, Annex 29.*

5. The List of Related Parties

All companies must disclose information on related parties on a quarterly basis, including personal data, grounds, and duration of affiliation.¹⁰¹

a) Signatories to the List of Related Parties

The General Director must attest to the reliability and completeness of the information included in the list of related parties by signing this list.¹⁰²

b) Disclosure of the List of Related Parties

Companies must submit the list of related parties to the FCSM or its regional agencies no later than 45 days after the last day of the reporting quarter. The FCSM is, in turn, required to disclose these lists by posting them on its website.¹⁰³

c) The List of Related Companies

Companies which have securities listed on either RTS or MICEX are additionally obliged to disclose the list of related parties (as well as any changes to the list for at least the last three years) on their corporate website with subsequent notification to the FCSM.¹⁰⁴

¹⁰⁰ FCSM Regulation No. 17/ps, Section 3.7.

¹⁰¹ LJSC, Article 93, Clause 4; FCSM Regulation No. 03-19/ps, Section 4.

¹⁰² FCSM Regulation No. 03-19/ps, Section 7.

¹⁰³ See www.fcsm.ru. FCSM Regulation No. 03-19/ps, Section 5.

¹⁰⁴ FCSM Regulation No. 03-19/ps, Sections 3 and 8.

→ For more detailed discussion on the importance of disclosing related party transaction, see Section B.3 in this Chapter, as well as Part III, Chapter 12, Section C.

6. Notification to Regulators

Companies must notify regulatory bodies such as the FCSM and the Ministry of Antimonopoly Policy and Support of Entrepreneurial Activities (MAP).¹⁰⁵

a) Notification to the FCSM

The owner of securities must notify the FCSM about changes in his shareholdings beyond 20% of voting shares within five days from the date of the change. The notification should include general information about the owner and securities under consideration.¹⁰⁶

b) Notification to the MAP

Notification is required if the total book value of the assets of the acquirer and acquired company exceeds 100 thousand times the minimum monthly wage. The MAP must be notified within 45 days from the date of purchasing 20% and more of voting shares.

The company is also required to notify the MAP within 45 days of the election of an individual to the executive bodies or Supervisory Board of two or more companies with a total book value of assets exceeding 100 thousand times the minimum monthly wage. The same holds true for companies included in the register of companies having more than 35% of the market share of certain goods.¹⁰⁷

In practice, the book value thresholds are so low that virtually any combination of publicly traded companies, or election to the Supervisory Board, triggers notification requirements.

Notification must include the formal application of the interested person. The notification must also include information about the company's main activities, its production volumes and the distribution of its products in corresponding goods markets, as well as other information required by the MAP.¹⁰⁸

¹⁰⁵ Law on the Securities Market, Article 30; Law on Competition, Article 18.

¹⁰⁶ Law on the Securities Market, Article 30, Paragraph 15.

¹⁰⁷ Law on Competition, Article 18, Clause 6.

¹⁰⁸ Order of MAP No. 276 on the Adoption of the Regulation about the Procedure of Submitting Notifications and Petitions to Antimonopoly Bodies in accordance with Articles 17 and 18.

7. Notification to Creditors

Creditors are notified through personal notification and publication of announcements in the press. Figure 3 summarizes the requirements for the notification of creditors when the company decreases its charter capital,¹⁰⁹ reorganizes,¹¹⁰ liquidates,¹¹¹ or enters into bankruptcy proceedings.¹¹²

Figure 3: Notification to Creditors

		Decrease in Charter Capital	Reorganization	Liquidation	Bankruptcy
Form of Notification	Individually	✓	✓	✓	✓
	Via Press	✓	✓	✓	✓
Deadlines		30 days	30 days	not defined	Three days
Responsible Body		General Director	General Director	Liquidation Commission	Bankruptcy Administrator

Source: IFC, March 2004

8. Providing Information to Company Employees

Employees represent a specific class of information users. One of their rights is to receive information affecting their interests. The representatives of the company's employees, usually members of the local trade union (but other representatives may be elected by employees) have the right to receive information from their employer regarding the following issues:¹¹³

- Reorganization and liquidation of the company;
- Introduction of technological changes leading to changes in labor conditions;
- Continuous professional education (CPE) to advance professional skills; and

¹⁰⁹ LJSC, Article 30, Clause 1.

¹¹⁰ LJSC, Article 15, Clause 6, Paragraph 1.

¹¹¹ LJSC, Article 22, Clauses 1 and 3.

¹¹² Law on Insolvency, Article 54.

¹¹³ Labor Code, Article 53, Clause 2.

- Other issues stipulated by Russian legislation, internal corporate documents, and collective bargaining agreements.

Employee representatives are entitled to make suggestions on these issues to the governing bodies and participate in their meetings when these issues are considered.¹¹⁴ Finally, the company is required to provide employee representatives with full and reliable information needed for the conclusion of collective bargaining agreements and the supervision of their fulfillment.¹¹⁵

D. Voluntary Disclosure

It is good practice for companies to voluntarily disclose material information beyond formal legal requirements. This holds particularly true for companies operating in emerging markets that are often marred by weak legal and regulatory environments, and, moreover, poor enforcement mechanisms. To the extent possible, companies are encouraged to use existing forms of disclosure (e.g., prospectuses, and quarterly, annual, and material events reports) and adhere to the same quality standards that are demanded for these forms of reporting. They are also encouraged to use existing channels of communication, such as the internet and the print media. This section describes disclosure practices of Russian companies in the mass media and the internet.

1. Corporate Websites

Corporate websites are easily accessible to the public at low cost, and can be an exceptionally powerful means of communication. At present, the internet is beginning to be accepted as an official disclosure channel. Web-based disclosure is being studied closely by securities commissions worldwide.

Best Practices: The following information should be placed on the company's website:¹¹⁶

- The company's charter and amendments thereto;
- Information on the company's development strategy;
- Quarterly reports;

¹¹⁴ Labor Code, Article 53, Clause 3.

¹¹⁵ Labor Code, Article 22, Clause 2.

¹¹⁶ FCSM Code, Chapter 7, Article 1.1.2.

- Prospectuses;
- External Auditor's reports;
- Information on material events;
- Information regarding the GMS; and
- Important Supervisory Board decisions.

The company should also place the annual report on its website.

The internet is an effective tool for rapid and cost-effective communications and is increasingly used by Russian companies for voluntary disclosure.

Company Practices in Russia: Some Russian companies place their annual and financial reports, and governance information (such as information on Supervisory Board members and key executives) on their websites. The better websites have special sections devoted to corporate governance and include contact addresses and telephone numbers for inquiries.

Some Russian companies are already following best practices and disclose additional information on their websites, including:¹¹⁷

- Financial statements for the last three years;
- Financial ratios for the last three years;
- Internal corporate documents;
- Structure, authorities, and composition of the governing bodies;
- List of affiliated persons for the last year;
- Annual and quarterly reports for the last three years;
- Materials and results of the GMS for the last three years;
- Information on corporate securities; and
- Corporate news ticker.

2. SKRIN "Emitent"

Company Practices in Russia: Russian companies are increasingly disclosing information through the Internet using SKRIN ("System of Complex Disclosure of News Information"). SKRIN was founded by the National Association of Stock Market Participants (NAUFOR), which is now part of the RTS Group.

¹¹⁷ Based on the results of the 6th all-Russia competition on annual reports and corporate websites. See also: www.rts.ru/?tid=394&mtid=10000.

The heart of SKRIN is a database called SKRIN “Emitent” (“Issuer”).¹¹⁸ Companies contract for SKRIN’s services and furnish it with corporate information. SKRIN subscribers are then granted access to the following company-specific information:

- Company charters;
- Quarterly reports;
- Accounting reports, drawn up in accordance with RAS and IFRS; and
- Material events reports.

Some companies pay SKRIN for the expenses related to the dissemination of information and in this way allow users to access their information free of charge.

3. Mass Media

The print media are an additional channel for disclosure. Although publication may entail additional costs, it is a recognized legal channel for disclosure and (unlike the internet, which is passive) ensures the active dissemination of information among the public.

Most companies disclose information about new products, major contracts, acquisitions, financial results, production plans, and securities issues in the print media.

Best Practices: The FCSM Code considers financial statements to be the most important document for shareholders and potential investors to understand the financial position of the company. In this respect, companies with 10,000 or more shareholders should publish their financial statements in at least two newspapers with a circulation of not less than 50,000 each. In principle, these newspapers should be accessible to the majority of the company’s shareholders.¹¹⁹

E. Summary of Mandatory Disclosures

Table 4 summarizes mandatory disclosure requirements for Russian companies.

¹¹⁸ See also: www.skrin.ru.

¹¹⁹ FCSM Code, Chapter 7, Clause 1.1.2.

Table 4: Mandatory Disclosure									
Details/Forms	Disclosure during placement	Quarterly report	Material events reports	List of related parties	Annual report	Notification to regulators	Notification to creditors	Info to employees	
Responsible person	General Director (GD)	GD after signing by Chief Accountant	GD, and Chief Accountant in particular cases	GD	GD, Corporate Secretary, or specially appointed executives	GD	GD/ Liquidation Commission/ Bankruptcy Administrator	GD or specially appointed executives	
Recipients	Any interested person	Any interested person	Any interested person	Any interested person through the FCSM	Shareholders	Interested persons through the FCSM, MAP	Stakeholders/ creditors	Employees	
Deadline/frequency	Next day/within three and five days depending where disclosed	Not later than 45 days after the last day of the reporting quarter	Next day/ within three and five days depending where disclosed	Every quarter	Within seven days upon request/ 20 days prior to GSM	Five days — the FCSM; and 45 days — MAP	30 days, liquidation — not defined	Not applicable (n/a)	
Place of disclosure	Website ticker, corporate Website, mass-media	Submission to the FCSM, company's office, corporate website	Submission to the FCSM website ticker, corporate website, mass-media	Submission to the FCSM	Office of the company executive body	Notification of the FCSM and/ or MAP	Publication in mass media and personal notification	Place of employment	
Financial and operating results	n/a	Financial statements, ratios, composition of assets/capital	10% and more increase/ decrease of the assets value, large-scale transactions	n/a	Not defined: results of the development	n/a	n/a	n/a	

Table 4: Mandatory Disclosure								
Details/ Forms	Disclosure during Placement	Quarterly report	Material events reports	List of related parties	Annual report	Notification to regulators	Notification to creditors	Info to employees
Company objectives	n/a	Commercial objectives only	n/a	n/a	Commercial objectives and priority activities	n/a	n/a	n/a
Major share ownership and voting rights	n/a	Owners of over 5%, chain shareholding, related party transactions	Owners of more than 25% of the company's securities	List of related parties	Related party transactions	Owners/acquirers of 20% and more of any type of securities (FCSM+MAP)	n/a	n/a
Supervisory Board and key executives, remuneration	n/a	Info about each member, remuneration in aggregate, size of interest	n/a	Included in the list	Biographical data, share ownership, amount of remuneration in aggregate	Directors and executives holding more than one appointment (MAP)	n/a	n/a
Risk factors	n/a	Risks of industry, region, currency rate fluctuation, other potential risks	n/a	n/a	Major risks affecting activity of the company	n/a	n/a	n/a

Table 4: Mandatory Disclosure								
Details/ Forms	Disclosure during Placement	Quarterly report	Material events reports	List of related parties	Annual report	Notification to regulators	Notification to creditors	Info to employees
Issues regarding employees and other stakehold- ers	n/a	General information regarding employees, suppliers, debtors, and creditors	n/a	n/a	n/a	n/a	Decrease in the charter capital, reorganization, liquidation	Reorganiza- tion, liqui- dation, tech- nological changes, CPE, foundation documents, collective bargaining agreements
Governance structures and policies	n/a	Authority of each governing body	n/a	n/a	Compliance with recom- mendations of the FCSM Code	n/a	n/a	n/a



Chapter 14

Control **and Audit Procedures**

Table of Contents

A. THE REVISION COMMISSION.....	54
1. <i>The Composition and Requirements for Members</i>	54
2. <i>Authorities</i>	55
3. <i>The Nomination of Members</i>	56
4. <i>The Election and Dismissal of Members</i>	57
5. <i>Contracts with Members</i>	58
6. <i>The Remuneration of Members</i>	58
7. <i>Operating Procedures</i>	58
8. <i>Reporting</i>	60
B. THE INDEPENDENT EXTERNAL AUDITOR.....	61
1. <i>When an Annual Audit Is Required</i>	61
2. <i>The Rights and Duties of the External Auditor</i>	63
3. <i>The Rights and Duties of the Company</i>	64
4. <i>The Appointment of the External Auditor</i>	65
5. <i>Compensation</i>	68
6. <i>Reporting</i>	68
7. <i>The External Auditor's Liability</i>	69
C. THE AUDIT COMMITTEE.....	70
1. <i>Functions</i>	72
2. <i>Composition</i>	73
3. <i>Meetings</i>	74
4. <i>Access to Information and Resources</i>	75
D. INTERNAL CONTROL FUNCTION.....	76
1. <i>Internal Control Principles</i>	76
2. <i>Elements of the Internal Control System</i>	77
3. <i>Bodies and Persons Responsible for Internal Control</i>	79
4. <i>Internal Auditing</i>	80
5. <i>The Control and Revision Service</i>	82
6. <i>Management's Report on Internal Control over Financial Reporting</i> ...85	
E. SUMMARY.....	85

The Chairman's Checklist

- ✓ What is the relationship between the Revision Commission, Supervisory Board's Audit Committee, Internal Auditor, and/or Control and Revision Service? Have their roles and responsibilities been properly defined to avoid overlap and conflict?

The Revision Commission:

- ✓ Is the Revision Commission fulfilling its function and duties? Has the Revision Commission ever found, and reported on, possible misstatements or other violations to the General Meeting of Shareholders?
- ✓ Who are the members of the Revision Commission? Are any employees members? Are the members fully independent from management?
- ✓ Does the Revision Commission meet regularly and respond to all shareholder requests and inquiries?

The External Audit:

- ✓ Does the company have an independent External Auditor? Does the External Auditor provide other, non-audit services to the company that could compromise his independence? Are audit partners rotated?
- ✓ How is the External Auditor selected? Does an open tender process take place? If so, who organizes this tender process?
- ✓ To whom does the External Auditor report?
- ✓ Does the External Auditor participate in the Annual General Meeting of Shareholders and answer all questions posed by shareholders?

The Audit Committee:

- ✓ Should the company's Supervisory Board have an Audit Committee? What are the costs and benefits?
- ✓ If the company has an Audit Committee, is it staffed with individuals who are independent, able, and willing to do the job properly and effectively?
- ✓ Does the Chairman of the Audit Committee have the requisite professional and human relations skills? Are Audit Committee members publicly recognized financial experts?
- ✓ Does the Audit Committee meet often enough to perform its duties effectively? Does it place the necessary and appropriate issues on the agenda?

- ✓ Does the Audit Committee add value to the Supervisory Board's discussion of audit, risk, internal control, and financial reporting?
- ✓ Does the Audit Committee receive the necessary information to perform its duties effectively? Does it have resources to hire outside accounting or legal advice?
- ✓ Does the Audit Committee perform self-evaluations on a regular basis?

Internal Control:

- ✓ Does the company have a system of internal control in place? Does the company have a formal document that regulates the internal control system and procedures? Is this document periodically reviewed?
- ✓ Does the company have a risk management system in place? Does this system cover risk at the subsidiary level as well? How are business, operational, and financial risks identified?
- ✓ Does the Internal Auditor report to management or the Supervisory Board? To whom should the Internal Auditor report? Are there barriers that could discourage the Internal Auditor from reporting problems to the company?

A system for internal and external audit is an important tool both in the management and oversight of a company, and also contributes to transparent and sound financial reporting. There are a number of internal structures and external agents involved in the management and oversight of company finances and operations. These bodies are diverse in their nature, functions, and reporting lines. Some are mandatory, while others are optional.

The *Revision Commission* focuses on controlling financial and business activities of the company and monitoring compliance with laws and regulations. The mission, scope, and duties of the Revision Commission are narrower than that of the Audit Committee. The Revision Commission may: monitor compliance with regulations governing the company's business operations; express an opinion on whether reports and financial statements provide a true and accurate picture; and ascertain whether business and financial transactions are recorded properly. The Revision Commission reports to shareholders.

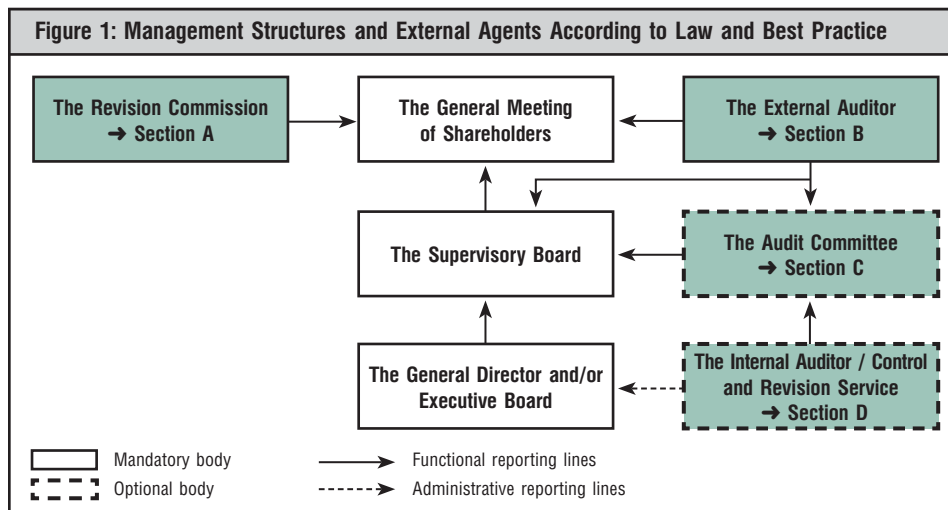
The *independent External Auditor* examines a company's financial and accounting records, as well as supporting documents, in all material respects. Shareholders depend upon the External Auditor to express an independent opinion that the financial statements of an enterprise are reliable.

The *Supervisory Board's Audit Committee* safeguards the company by questioning executive bodies regarding the way in which financial reporting responsibilities are handled, as well as by ensuring that corrective actions are being taken. The Audit Committee oversees the Internal Auditor and the company's relations with the External Auditor. It may consider the appointment of an External Auditor, review the internal audit plan, review the effectiveness of internal control systems, consider major findings of internal audit investigations and management responses to these, and promote co-ordination between the Internal and External Auditors. Finally, the Audit Committee may consider the draft annual accounts and review the External Auditor's conclusions on annual financial statements. The Audit Committee is part of the Supervisory Board, and as such, develops recommendations for the Board's consideration; the Audit Committee consequently has no independent decision-making authority.

The *Internal Auditor* (or *the Control and Revision Service*) is responsible for the ongoing daily appraisal of the financial health of a company's operations. Company employees carry out this function. During an internal audit, Internal Auditors evaluate and monitor a company's risk management, reporting, and control practices, and make suggestions for improvement. Internal auditing not only covers the finance function, but also the company's operations and systems. The Internal Auditor reports to the Supervisory Board, ideally to its Audit Committee, on a functional basis, and to the General Director on an administrative basis.

Best Practices: Audit committees have only recently been introduced in Russia, where there is more experience with Revision Commissions. Questions may arise over the extent to which the responsibilities of these two bodies overlap, and which is best able to oversee the preparation of financial information and assess the systems of internal controls. At present, it appears that given the differences in their mandate, they could fulfill complementary functions. However, many experts will argue that the function of the Revision Commission does indeed overlap with the External Auditor and the Audit Committee; most countries throughout the world have chosen to strengthen the latter two, and many have chosen to abolish the Revision Commission.

This chapter discusses the role, authority, and duties of these various bodies in detail, and how they specifically contribute to company transparency and information disclosure. For an overview of these agents and their reporting lines, see Figure 1.



Source: IFC, March 2004

A. The Revision Commission

The Revision Commission controls the operations and financial activities of the company.¹²⁰ Any company, regardless of its legal form (open or closed), must have a Revision Commission. Its primary function is to provide an independent opinion on the reliability of the company's financial information to the company's shareholders, as well as the company's compliance with laws and regulations during business operations.

1. The Composition and Requirements for Members

Revision Commissions may take a number of forms. They may be composed of a single individual or a number of individuals.¹²¹

Best Practices: Because Company Law does not determine the number of Revision Commission members, companies should specify the number in the charter.

¹²⁰ Law on Joint Stock Companies (LJSC), Article 85, Clause 1, Paragraph 1.

¹²¹ When this Manual makes reference to the Revision Commission, this also includes any individual who is performing the function of a Revision Commission.

Revision Commission members should be independent of the company's management, and may not be:¹²²

- A Supervisory Board member;
- The General Director;
- An Executive Board member; or
- A Counting Commission member.¹²³

Best Practices: Revision Commission members should be neither company officials nor Supervisory Board members, the General Director, or an Executive Board member of a competing legal entity.¹²⁴

Generally, Revision Commission members should be chosen based on their financial background and expertise. The Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code) advises that only persons with impeccable reputations be elected to the Revision Commission.¹²⁵ The charter and by-laws can provide additional requirements for Revision Commission members such as proficiency in accounting and financial reporting.¹²⁶

2. Authorities

The Revision Commission has the authority to:

- Conduct an annual inspection of the company's finances and operations before the Annual General Meeting of Shareholders (AGM);¹²⁷
- Undertake extraordinary inspections of the company's finances and operations;¹²⁸
- Review the accuracy of the company's annual report and annual financial statements;¹²⁹

¹²² LJSC, Article 85, Clause 6, Paragraph 1.

¹²³ LJSC, Article 56, Clause 2.

¹²⁴ FCSM Code, Chapter 8, Section 1.3.4.

¹²⁵ FCSM Code, Chapter 8, Section 1.3.3.

¹²⁶ FCSM Code, Chapter 8, Section 1.3.2.

¹²⁷ LJSC, Article 85, Clause 3.

¹²⁸ LJSC, Article 85, Clause 3.

¹²⁹ LJSC, Article 88, Clause 3, Paragraph 1.

- Demand an Extraordinary General Meeting of Shareholders (EGM);¹³⁰
- Demand a Supervisory Board meeting to discuss items under its authority;¹³¹
- Request and receive minutes of Executive Board meetings;¹³²
- Request and receive documents regarding the company's finances and operations from the executive bodies;¹³³ and
- Request and receive information concerning related parties and related party transactions.¹³⁴

In addition, shareholders are provided with great flexibility in defining additional authorities of the Revision Commission in the charter.¹³⁵

Best Practices: Additional authorities and duties of the Revision Commission should include the authority to:

- Investigate cases of using insider information;
- Check the timeliness of payments to contractors and mandatory budget payments;
- Check the timeliness of the accrual and payment of dividends, as well as the timely meeting of the company's other financial obligations;
- Check the appropriateness of using the company's reserve and other funds;
- Check the timeliness of payment for the company's issued shares;
- Review the financial condition of the company, specifically its solvency, the liquidity of its assets, and creditworthiness; and
- Oversee the timeliness of the valuation of the company's net assets.

3. The Nomination of Members

The procedure for nominating candidates to the Revision Commission is identical to the procedure for nominating candidates to the Supervisory Board, the

¹³⁰ LJSC, Article 55, Clause 1, Paragraph 1; LJSC, Article 85, Clause 5.

¹³¹ LJSC, Article 68, Clause 1.

¹³² LJSC, Article 70, Clause 2, Paragraph 2.

¹³³ LJSC, Article 85, Clause 4.

¹³⁴ LJSC, Article 82.

¹³⁵ LJSC, Article 85, Clause 2, Paragraph 1.

Executive Board, the Counting Commission, and for nominating the General Director.¹³⁶

→ *For more information on the nomination process, see Part III, Chapter 8, Section B.1.*

The charter can require that additional information about candidates be included in the proposal for their nomination.

4. The Election and Dismissal of Members

The agenda of the AGM must include the election of the Revision Commission.¹³⁷ This means that Revision Commission members are elected for a one year term and serve until the next AGM. The GMS cannot elect the Revision Commission by written consent.¹³⁸

Revision Commission members are elected by a simple majority vote of participating shareholders.¹³⁹ It is important to note that Supervisory Board members, the General Director, and Executive Board members are not entitled to vote on the election of the Revision Commission.¹⁴⁰

The authority of individual members of the Revision Commission can be terminated at any time by a simple majority vote of participating shareholders.¹⁴¹

Best Practices: Although the Company Law does not prohibit Supervisory Board members, the General Director, or Executive Board members from voting on the early termination of the Revision Commission, such a prohibition would be consistent with the prohibition on their election in the first place. Accordingly, it is good practice for company officials not to vote in such cases.

¹³⁶ LJSC, Article 53.

¹³⁷ LJSC, Article 47, Clause 1, Paragraph 3; Letter from the FCSM No. IK-07/883, 28 February 2000.

¹³⁸ LJSC, Article 50, Clause 2.

¹³⁹ LJSC, Article 49, Clause 2, Paragraph 1.

¹⁴⁰ LJSC, Article 85, Clause 6, Paragraph 2.

¹⁴¹ LJSC, Article 48, Clause 1, Section 9; Article 49, Clause 2, Paragraph 1.

5. Contracts with Members

Companies may conclude an employment contract¹⁴² or a civil law contract¹⁴³ with Revision Commission members.

Best Practices: Employment contracts are typically entered into with company employees who report directly to management. A company should thus conclude civil law contracts with Revision Commission members, underlining their independence from management.

The charter or by-laws should specify who signs the contract on behalf of the company. In principle, the Chairman of the General Meeting of Shareholders (GMS) or the Supervisory Board (who are often one and the same person) should do this. If, on the other hand, the General Director or another executive signs the contract, this would likely affect the independence of the Revision Commission, either in appearance or in fact. Of course, the authority to sign the contract does not imply the authority to negotiate or alter contract terms. Key elements and terms of the contract, for example, remuneration, are subject to the GMS' approval.

6. The Remuneration of Members

The GMS decides whether Revision Commission members are compensated for their work and reimbursed for expenses.¹⁴⁴ The Supervisory Board, ideally through a Remuneration Committee, if established, should recommend the amount of remuneration for GMS approval. A shareholder (or a group of shareholders) owning at least 2% of voting shares has the right to propose such agenda item.¹⁴⁵

7. Operating Procedures

A Revision Commission's operating procedures can be specified in the charter or, preferably, in the company's by-laws for the Revision Commission, approved by

¹⁴² Labor Code, Article 59.

¹⁴³ Civil Code (CC), Articles 779–783.

¹⁴⁴ LJSC, Article 85, Clause 1, Paragraph 2.

¹⁴⁵ LJSC, Article 53, Clause 1.

Chapter 14. Control and Audit Procedures

the GMS.¹⁴⁶ Revision Commission members usually elect their Chairman during their first meeting. The charter or by-laws may provide the Chairman of the Revision Commission with the responsibility to:

- Call, organize, and preside over Revision Commission meetings;
- Prepare and sign the minutes of meetings and other decisions;
- Represent the Revision Commission in meetings with third parties; and
- Cast a deciding vote at meetings in case of a tie-vote.

The charter or by-laws must specify what constitutes a quorum and define the voting procedures.¹⁴⁷

Best Practices: The quorum should not be less than half of the Revision Commission members, and decisions should be approved by a simple majority vote.¹⁴⁸

In addition to annual inspections of finances and operations, the Revision Commission may carry out extraordinary inspections at its own discretion, or be required to do so upon:¹⁴⁹

- A decision of the GMS;
- A request of the Supervisory Board; or
- A request of a shareholder (or a group of shareholders) owning at least 10% of voting shares.

Best Practices: Extraordinary inspections should start no later than 30 days, either after the Revision Commission receives a shareholder request, or after the respective minutes of the GMS or the Supervisory Board meeting containing a request to carry out an extraordinary inspection have been signed. These inspections should take no more than 90 days to complete.¹⁵⁰

¹⁴⁶ LJSC, Article 85, Clause 2, Paragraph 2.

¹⁴⁷ LJSC, Article 85, Clause 2, Paragraph 2.

¹⁴⁸ FCSM Code, Chapter 8, Section 3.1.2.

¹⁴⁹ LJSC, Article 85, Clause 3.

¹⁵⁰ FCSM Code, Chapter 8, Section 3.1.3.

The Revision Commission must prepare a written report on the findings of each inspection.¹⁵¹

Best Practices: The Revision Commission should present the results of the extraordinary inspection to the Audit Committee (if established) and the initiator of the extraordinary inspection with the assistance of the company's Corporate Secretary not later than three days after finalizing the inspection.¹⁵²

8. Reporting

a) Inspection Report

The Revision Commission must prepare a report on the results of each annual inspection and present:¹⁵³

- Its conclusions on the accuracy of the company's operations, financial reports, and other documents; and
- Information regarding any violations of accounting and financial reporting procedures, disclosure rules, and relevant laws and regulations.

Best Practices: All Revision Commission members should sign the report and:¹⁵⁴

- Those who have not signed the report explain why they have not done so; or
- Indicate that a member refused to sign and was unwilling to provide an explanation for such refusal.

Revision Commission members who attend the GMS should provide shareholders the opportunity to ask questions and discuss inspection results.¹⁵⁵

b) Presenting the Inspection Report

The Revision Commission's conclusions should be attached to the company's annual report. Because the Supervisory Board must preliminarily approve the

¹⁵¹ LJSC, Article 87.

¹⁵² FCSM Code, Chapter 8, Section 3.1.5.

¹⁵³ LJSC, Article 87.

¹⁵⁴ FCSM Code, Chapter 8, Section 3.1.4.

¹⁵⁵ FCSM Code, Chapter 2, Section 2.1.2.

annual report no less than 30 days before the AGM,¹⁵⁶ it is good practice for the Revision Commission to give the Supervisory Board at least ten days to review and discuss the inspection report. Thus, the Revision Commission should submit their inspection report to the Supervisory Board at least 40 days before the AGM. The annual inspection report must also be distributed to shareholders as a separate document before the AGM.¹⁵⁷

B. The Independent External Auditor

An independent audit conducted by an External Auditor is an important element of the company's control framework. The objective of an audit is to enable the External Auditor to express an opinion on whether or not the financial statements of the company are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they are reliable. It gives shareholders, managers, employees, and market participants an independent opinion about the company's financial position and, if performed properly, should attest to the accuracy of the statements. An independent audit conducted by a publicly recognized accounting firm normally enhances the company's credibility, and accordingly, its prospects for attracting investment.

Three key points about the independent audit are:

1. Management remains responsible for preparing and presenting the company's financial statements;
2. The External Auditor is responsible for forming and expressing an opinion on the financial statements prepared by management; and
3. The audit of the financial statements does not relieve management of any of its responsibilities.

1. When an Annual Audit Is Required

The Law on Auditing provides that companies must have an annual, independent audit conducted by a certified independent External Auditor (or a licensed audit company), when the company:¹⁵⁸

¹⁵⁶ LJSC, Article 88, Clause 4.

¹⁵⁷ LJSC, Article 52, Clause 3, Paragraph 1.

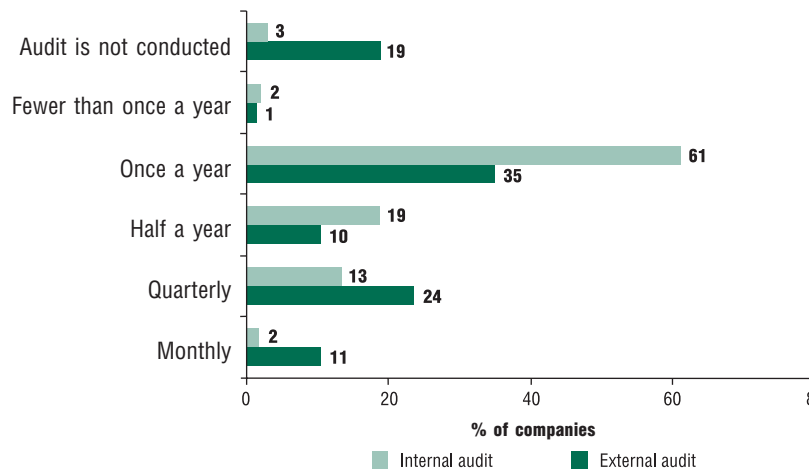
¹⁵⁸ Law on Auditing, Article 7, Clause 1, Paragraph 2.

The Russia Corporate Governance Manual

- Is incorporated as an open joint stock company; or
- Has revenues for the reporting year greater than 500 thousand times the minimum wage;¹⁵⁹ or
- Has a book value of assets that, as of the end of the year, exceeds 200 thousand times the minimum wage.

Company Practices in Russia: Figure 2 shows that 61% of regional companies are audited by an External Auditor at least once every year.¹⁶⁰ 34% have external audits conducted more frequently. However, more than one-third violate the procedures set out for the election of the External Auditor in the Company Law in that they are not elected by the GMS. There is also serious concern regarding the independence of the External Auditor (and, by extension, the quality of the assurances provided) in at least one-third of Russian companies.

Figure 2: Frequency of Internal and External Audits



Source: IFC Survey on Corporate Governance Practices in Russia's regions, August 2003

¹⁵⁹ The Law on the Minimum Amount of Payment for Labor, Article 4. Currently, the minimum monthly wage is set at RUR 100.

¹⁶⁰ IFC Survey on Corporate Governance Practices in Russia's regions, Section 2.2.2, page 29, August 2003 (see www.ifc.org/rcgp).

2. The Rights and Duties of the External Auditor

The External Auditor has the authority to:¹⁶¹

- Determine the method of conducting the audit;
- Examine the documentation, as well as uncover and confirm assets of the company;
- Receive oral and written explanations on any issues that arise during the audit;
- Refuse to carry out the audit or provide an opinion about the reliability of financial statements if the company does not provide all required documents or when circumstances arise that have an effect on the Auditor's opinion;
- Have access to the charter, including amendments and any restated charter;¹⁶²
- Request an EGM;¹⁶³
- Request a Supervisory Board or an Executive Board meeting;¹⁶⁴
- Receive minutes of Executive Board meetings;¹⁶⁵
- Receive information from interested parties on related parties and related party transactions;¹⁶⁶ and
- Provide other services as specified by legislation.¹⁶⁷

→ See Section B.4 in this Chapter for a discussion on conflicts of interests when External Auditors provide non-audit services to their audit clients.

The External Auditor must:¹⁶⁸

- Carry out the audit in conformity with Russian (and any applicable foreign) laws;
- Provide the company with relevant information on the legal requirements for conducting the audit, as well as any legal acts on which the comments and conclusions of the External Auditor are based;

¹⁶¹ Law on Auditing, Article 5, Clause 1.

¹⁶² LJSC, Article 11, Clause 4.

¹⁶³ LJSC, Article 55, Clause 1, Paragraph 1.

¹⁶⁴ LJSC, Article 68, Clause 1.

¹⁶⁵ LJSC, Article 70, Clause 2, Paragraph 2.

¹⁶⁶ LJSC, Article 82.

¹⁶⁷ Law on Auditing, Article 1, Clause 5.

¹⁶⁸ Law on Auditing, Article 5, Clause 2.

- Provide the audited company with the audit report within the time specified by the contract between the External Auditor and the company;
- Ensure the safekeeping of documents received or developed during the audit, and not permit the disclosure of the contents of these documents to any unauthorized persons without the consent of the company, except when such disclosure is required by law; and
- Carry out other duties that derive from the nature of the legal relationship specified by the contract between the External Auditor and the company, as long as such duties do not contradict Russian (and any applicable foreign) laws.

Best Practices: The External Auditor will often submit, and companies seeking to implement good corporate governance should demand, what is referred to as a ‘management letter’ in addition to the audit report. This management letter typically covers all material weaknesses in the company’s internal control, accounting, and operating procedures. The purpose of the letter is to provide constructive suggestions to management concerning improvements for such procedures.

The findings contained in the management letter are considered to be “non-reportable” to third parties, yet require corrective action by management. Companies wishing to attract external finance should be aware that investors will typically request a copy of the management letter.

3. The Rights and Duties of the Company

The company has the right to:¹⁶⁹

- Receive from the External Auditor relevant information on the legal requirements related to the audit, as well as any legal acts on which the comments and conclusions of the External Auditor are based;
- Receive the audit report within the time specified by the contract between the External Auditor and the company; and
- Exercise other rights that derive from the nature of the legal relationship specified by the contract between the External Auditor and the company,

¹⁶⁹ Law on Auditing, Article 6, Clause 1.

as long as the existence of such rights does not contradict Russian (and any applicable foreign) laws.

The audited company is obligated to:¹⁷⁰

- Conclude a contract with the External Auditor for carrying out the statutory audit within the time specified by Russian law;
- Assist the External Auditor in every way in successfully completing the audit, including: providing all necessary information and documentation, furnishing full explanations and confirmations, and, when necessary, securing information from third parties;
- Not hinder the successful completion of the audit in any way;
- Pay for the External Auditor's services, even when the conclusions of the audit report conflict with the opinions of the company's officials; and
- Carry out other duties that derive from the nature of the legal relationship specified in the contract between the External Auditor and the company, as long as such duties do not contradict Russian (and any applicable foreign) laws.

4. The Appointment of the External Auditor

The External Auditor is approved by a simple majority vote of shareholders participating in the GMS.¹⁷¹

Best Practices: The Supervisory Board should propose candidates for the External Auditor and provide its recommendation to the GMS.¹⁷² However, it is widely considered an even better practice for the Supervisory Board to conduct an open tender for the provision of audit services on a regular basis. The Audit Committee of the Supervisory Board should oversee the selection process, and assess the qualification, expertise, resources, effectiveness, and independence of the External Auditor.¹⁷³

¹⁷⁰ Law on Auditing, Article 6, Clause 2.

¹⁷¹ LJSC, Article 48, Clause 1, Section 10; Article 49, Clause 2, Paragraph 1.

¹⁷² FCSM Code, Chapter 8, Section 4.1.7.

¹⁷³ Audit Committees, Combined Code Guidance, Sir Robert Smith group. Paragraph 5.17. See also: www.ecgi.org/codes/country_pages/codes_uk.htm.

A shareholder (or a group of shareholders) owning 2% or more of voting shares can propose items related to the approval of the External Auditor for inclusion on the AGM agenda.¹⁷⁴

The AGM agenda must always include the appointment of an External Auditor.¹⁷⁵ Therefore, an External Auditor must be approved for one year until the next AGM. The GMS cannot approve the External Auditor by written consent.¹⁷⁶

a) Who Can Be an External Auditor

Any individual certified as an individual auditor, or a legal entity with a license to perform auditing services, can be an External Auditor.¹⁷⁷ The External Auditor must be independent of the company and its management. In particular, an audit cannot be conducted by an audit organization if:¹⁷⁸

- The External Auditor is the founder, the General Director, the accountant, or other official of a firm responsible for the bookkeeping or accounting of the company;
- The External Auditor is a relative of the founders of the company, its officials, accountants, and other persons responsible for the bookkeeping or accounting of the company;
- The General Director and other officials of the audit firm are the founders of the audited company or its accountants, or are responsible for the bookkeeping and/or accounting of the audited company;
- The General Director or other officials of the audit firm are relatives of the founders of the company, its officials, accountants, or other persons responsible for the bookkeeping or accounting of the audited company;
- The audit firm has been established by the audited company or is its founder (this also applies to subsidiaries, branches, or representative offices of the audited company);
- The audit firm and the audited company have common founders or shareholders; or

¹⁷⁴ LJSC, Article 53, Clause 1, Paragraph 1.

¹⁷⁵ LJSC, Article 54, Clause 2.

¹⁷⁶ LJSC, Article 50, Clause 2.

¹⁷⁷ Law on Auditing, Article 3, Clause 1; Article 4, Clause 1.

¹⁷⁸ Law on Auditing, Article 12, Clause 1.

- The audit firm provided other services related to the restoration of the bookkeeping and the preparation of financial statements to the audited company during the last three years.

The External Auditor may not have any proprietary interest in the company or its shareholders.¹⁷⁹ All large international accounting firms normally have strict rules that preclude their staff from having a proprietary interest in any of their audit clients.

Best Practices: In the U.S., the 2002 Sarbanes-Oxley Act prohibits public accounting firms from providing non-audit service to their audit clients including: (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) financial information systems design and implementation; (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (4) actuarial services; (5) internal audit outsourcing services; (6) management functions or human resources; (7) broker or dealer, investment adviser, or investment banking services; (8) legal services and expert services unrelated to the audit; and (9) any other service that the Board of Directors determines, by regulation, is impermissible.¹⁸⁰

An exception to this rule is made should non-audit services that are not listed above be pre-approved by the Supervisory Board's Audit Committee. The Audit Committee should, however, disclose these services to investors in periodic reports. Another exception is made when the non-audit services constitute less than 5% of the total amount of revenues paid to its auditor, these services were not recognized to be non-audit services at the time of engagement, and the Audit Committee promptly approves these services prior to the completion of the audit.

b) The Contract with the External Auditor

The company must enter into a contract with the External Auditor once he has been approved by the GMS. The Company Law does not specify who must sign the contract on behalf of the company. In practice, this is often the General Director. The contract with the External Auditor stipulates the rights and duties of the External Auditor and the company, and may include any additional terms that the parties agree upon.

¹⁷⁹ LJSC, Article 88, Clause 3.

¹⁸⁰ The Sarbanes-Oxley Act of 2002, Section 201(a). See also: www.sarbanes-oxley.com.

5. Compensation

The company pays for the External Auditor's services. The Supervisory Board has the authority to determine the amount of the External Auditor's compensation.¹⁸¹ Clearly, the procedure for the payment of compensation and the amount of compensation must not be made dependent upon audit results.¹⁸²

Best Practices: The amount of compensation for the services of the External Auditor should be disclosed to shareholders.

6. Reporting

The External Auditor presents conclusions on the reliability of the company's financial statements and compliance with accounting procedures.¹⁸³ The opinion paragraph of the auditor's report should state the auditor's opinion as to whether the financial statements give a true and fair view (in all material respects) in accordance with the financial reporting framework used by the company and, where appropriate, whether the financial statements comply with statutory requirements.¹⁸⁴ The External Auditor must prepare a report on the annual audit that includes:¹⁸⁵

- Conclusions on the accuracy of the company's reports and other financial documents; and
- Information on violations of accounting or financial reporting procedures, disclosure rules, and relevant laws and regulations.

Best Practices: The External Auditor should divulge (potential) errors, misconduct, and violations of legislation or the company's internal rules during audits, and report them immediately to the Supervisory Board or its Audit Committee.¹⁸⁶ The External Auditor should make the company aware, as soon as practical

¹⁸¹ LJSC, Article 65, Clause 1, Paragraph 2, Section 10; Article 86, Clause 2.

¹⁸² Law on Auditing, Article 12, Clause 2.

¹⁸³ Law on Auditing, Article 10, Clause 1.

¹⁸⁴ The International Federation of Accountants' International Standards on Auditing (ISA) 700, The Auditor's Report on Financial Statements.

¹⁸⁵ LJSC, Article 87.

¹⁸⁶ FCSM Code, Chapter 8, Section 4.1.3.

and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to the Auditor's attention.¹⁸⁷ The Supervisory Board or Audit Committee should take appropriate steps to remedy these problems.

The format and contents of and procedures for submitting the audit report to shareholders and the GMS are specified by the Federal Standards of Auditing.¹⁸⁸

Best Practices: The External Auditor should participate in the AGM and answer shareholder questions with respect to the audit report.¹⁸⁹ Moreover, the Audit Committee should evaluate:¹⁹⁰

- Whether the audit was made in accordance with the established procedures and whether the External Auditor omitted any matters in carrying out the audit; and
- The opinion of the External Auditor before it is presented at the GMS.

If the company plans to seek access to international capital markets, the External Auditor should prepare the report in accordance with the International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC).¹⁹¹

7. The External Auditor's Liability

Since the External Auditor is liable for civil, administrative, and criminal infractions,¹⁹² he should be adequately insured by a reputable (domestic or international) insurance provider with appropriate coverage.¹⁹³

¹⁸⁷ ISA 400, Risk Assessment & Internal Control.

¹⁸⁸ Law on Auditing, Article 10, Clause 2; LJSC, Article 52, Clause 3, Paragraph 1.

¹⁸⁹ FCSM Code, Chapter 8, Section 4.1.2.

¹⁹⁰ FCSM Code, Chapter 8, Section 4.1.5.

¹⁹¹ International Standards on Auditing are available on the International Federation of Accountants' website under: www.ifac.org.

¹⁹² Law on Auditing, Article 21, Clause 1.

¹⁹³ Law on Auditing, Article 13.

a) Civil Liability

The grounds and terms of civil liability are usually specified in the contract between the External Auditor and the company. The External Auditor must keep information confidential about company operations.¹⁹⁴ If the External Auditor divulges confidential information, the company may seek compensation for the resulting losses.¹⁹⁵

b) Administrative Liability

The Law on Auditing states that the External Auditor bears administrative liability if he provides the company with an obviously false opinion.¹⁹⁶ In such cases, the Auditor's license may be revoked.

c) Criminal Liability

The Criminal Code stipulates that when the External Auditor uses his authority for his own purposes and violates the rights of a company or related parties, the External Auditor may be prosecuted.¹⁹⁷

C. The Audit Committee

The Supervisory Board is not legally required to establish an Audit Committee, though it is increasingly seen as an essential element of the corporate governance structure in some countries. While still optional in Russia, the FCSM Code and this Manual recommend that companies establish an Audit Committee.

Key Practices: The Audit Committee typically focuses on three main areas: financial reporting, risk management, and internal and external auditing (see Figure 3).

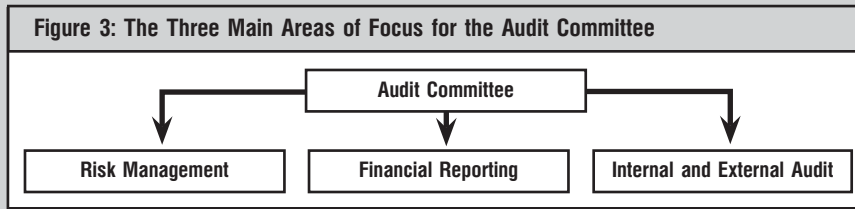
International best practices suggest that the Audit Committee develop and maintain an internal document, for example a by-law for the Audit Committee,

¹⁹⁴ Law on Auditing, Article 8, Clause 1.

¹⁹⁵ Law on Auditing, Article 8, Clause 4.

¹⁹⁶ Law on Auditing, Article 11, Clause 2. The Article defines an “obviously false report” as a report on an audit that was: 1) drawn up without actually carrying out the audit; or 2) based on conclusions that are clearly inconsistent with the audited documents. The report can be deemed “obviously false” only by a court. A false report can also give rise to criminal liability.

¹⁹⁷ The Criminal FCSM Code, Article 202.



Source: IFC, March 2004

that addresses its purpose, duties, and responsibilities. The following are suggested by the New York Stock Exchange (NYSE):¹⁹⁸

- The purpose of the Audit Committee is to assist the Supervisory Board to oversee the integrity of the company's financial statements, the company's compliance with legal and regulatory requirements, the independent Auditor's qualifications and independence, and the performance of the company's internal audit function and independent Auditors, on the one hand; and, on the other, to prepare the report that Securities Commission rules require be included in the company's annual proxy statement.
- The duties and responsibilities of the Audit Committee are to, *inter alia*:
 - At least annually, obtain and review the report by an independent Auditor;
 - Discuss the annual audited and quarterly financial statements with management and the independent Auditor;
 - Discuss earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies;
 - As appropriate, obtain advice and assistance from outside legal, accounting, or other advisors;
 - Discuss policies with respect to risk assessment and risk management;
 - Meet separately, at least quarterly, with management, with Internal Auditors, and with independent Auditors;
 - Review with the External Auditor any audit problems or difficulties and management's response;
 - Set clear hiring policies for employees or former employees of the independent Auditors; and
 - Report regularly to the Board of Directors.
- Conduct an annual performance evaluation of the Audit Committee.

¹⁹⁸ New York Stock Exchange Corporate Accountability and Listing Standards Committee, 6 June 2002 (see also: www.nyse.com).

1. Functions

The Audit Committee should:

- Develop recommendations for the Supervisory Board on selecting an External Auditor;¹⁹⁹
- Interact with the company's External Auditor and Revision Commission;²⁰⁰
- Control financial and business operations, and oversee the implementation of the financial and business plan of the company;²⁰¹
- Monitor the Control and Revision Service;²⁰²
- Evaluate the efficiency of internal control procedures;²⁰³
- Develop internal control and risk management procedures in cooperation with management;²⁰⁴ and
- Develop recommendations for the Supervisory Board's approval of non-standard operations.²⁰⁵

Best Practices: The National Association of Corporate Directors' (NACD) Blue Ribbon Commission on Audit Committees has identified the following indicators of risk that the Audit Committee should monitor and closely examine:²⁰⁶

- Complex business arrangements appearing to serve little practical purpose;
- Large last-minute transactions that resulted in significant revenues in quarterly or annual reports;
- Changes in Auditors over accounting or auditing disagreements;
- Overly optimistic news releases in which the CEO (General Director) seeks to cajole investors into believing in future growth;

¹⁹⁹ FCSM Code, Chapter 3, Section 4.9.

²⁰⁰ FCSM Code, Chapter 3, Section 4.9.

²⁰¹ FCSM Code, Chapter 8, Section 1.1.2, Paragraph 2; Chapter 8, Sections 2.2 and 2.3.

²⁰² FCSM Code, Chapter 8, Section 1.1.2, Paragraph 3.

²⁰³ FCSM Code, Chapter 8, Section 1.2.

²⁰⁴ FCSM Code, Chapter 8, Section 1.2, Paragraph 1.

²⁰⁵ FCSM Code, Chapter 8, Section 1.4.

²⁰⁶ The Report of the NACD Blue Ribbon Commission on Audit Committees. See also: www.nacdonline.org. Reprinted with permission of the NACD, 1133 21-st Street, NW, Suite 700, Washington, DC 20031, www.nacdonline.org.

- Widely dispersed business locations with decentralized management and a poor internal reporting system;
- Inconsistencies between Management's Discussion and Analysis (MD&A), the President's letter, and the underlying financial statements;
- Insistence by the General Director or Chief Financial Officer (CFO) that he be present at all meetings of the Audit Committee and Internal or External Auditors;
- A consistently close or exact match between planned results and reported results, and managers who always achieve 100% of their bonus opportunities;
- Hesitancy, evasiveness, and/or lack of specifics from management or Auditors regarding questions about the financial statements;
- Frequent differences of views between management and External Auditors;
- A pattern of shipping most of the month's or quarter's sales in the last week or last day;
- Internal audit operating under scope restrictions, such as the Internal Auditor not having a direct line of communication to the Audit Committee;
- Unusual balance sheet changes, or changes in trends or important financial statement relationships such as, for example, receivables growing faster than revenues, or accounts payable that are continually delayed;
- Unusual accounting policies, particularly for revenue recognition and cost deferrals such as, for example, recognizing revenues before products have been shipped ("bill and hold"), or deferring cost items that are normally expensed as incurred;
- Accounting methods that appear to favor form over substance;
- Accounting principles/practices at variance with industry norms; and
- Numerous and/or recurring unrecorded or "waived" adjustments raised in connection with the annual audit.

2. Composition

The charter should set forth special professional qualifications for Audit Committee members. Of particular importance is that members have relevant and real expertise in accounting and financial reporting.²⁰⁷ As a guideline, the qualifications

²⁰⁷ FCSM Code, Chapter 8, Section 1.3.2.

of Audit Committee members should inspire confidence that they are able and willing to detect accounting irregularities, and act in the best interests of the company and its shareholders. It is, therefore, recommended that only persons of an impeccable reputation be elected to the Supervisory Board and appointed to the Audit Committee.²⁰⁸

Because the Audit Committee is an internal structure of the Supervisory Board, it consists solely of Supervisory Board members. The Audit Committee should have at least three members, though this may be difficult for small Supervisory Boards. Other individuals will likely participate in Audit Committee meetings (such as the External Auditor or Revision Commission members). They may not, however, be Committee members.

Best Practices: An experienced individual should chair the Audit Committee. The independence, aptitude, and leadership skills of the Chairman are crucial for the Committee's success.

The Audit Committee should further be composed entirely of independent directors as recommended by the FCSM Code.²⁰⁹ If this is not practically possible, it is recommended that an independent director chair the Audit Committee, and that the Committee be composed solely of non-executive directors.

→ *For more information on independent and non-executive Supervisory Board members, see Part II, Chapter 4, Sections C.4 and D.2.*

3. Meetings

If a Supervisory Board meeting considers matters pertaining to Audit Committee activities, a meeting of the Audit Committee should take place before the Supervisory Board meets. This meeting should occur sufficiently in advance of the Supervisory Board meeting to allow the Audit Committee to communicate its conclusions and allow the Supervisory Board to thoroughly consider them.

²⁰⁸ FCSM Code, Chapter 8, Section 1.3.3.

²⁰⁹ FCSM Code, Chapter 8, Section 1.3.1.

The Audit Committee should also:²¹⁰

- Regularly inform the Supervisory Board about violations of procedures and legislation by the company's officers;
- Inform the Supervisory Board about individuals who are responsible for irregularities, the circumstances under which they took place, and how errors can be prevented in the future; and
- Analyze and give recommendations to the Supervisory Board regarding risks associated with transactions and operations of the company.

The Audit Committee should conduct meetings at least once a month to prepare recommendations for the Supervisory Board.²¹¹

Best Practices: However, meeting once a month may be regarded as onerous and burdensome, as well as costly. The new U.K. Combined Code suggests that Audit Committee meetings be held to coincide with key dates in the financial reporting and audit cycle, with no fewer than three formal meetings per year.²¹² The Audit Committee's Chairman will likely call additional meetings to establish an ongoing and informal contact with the Supervisory Board Chairman and General Director.

4. Access to Information and Resources

The Supervisory Board should be provided with information on the financial and operating results of the company.²¹³ In addition, Audit Committee members will need to have unfettered access to documents and corporate information to allow them to fulfill their functions. The Corporate Secretary often plays a crucial role in this respect, facilitating a free flow of information.

It is further recommended that the Audit Committee be authorized, and be provided with resources to hire outside audit, financial, legal, and other professional advisors without seeking permission from the Supervisory Board or executives.

²¹⁰ FCSM Code, Chapter 8, Section 2.3.2.

²¹¹ FCSM Code, Chapter 8, Section 1.4.

²¹² The U.K. Combined Code on Corporate Governance, Section 2.7. See also: www.frc.org.uk/combined.cfm.

²¹³ FCSM Code, Chapter 8, Section 2.3.1.

D. Internal Control Function

Internal control is a process conducted jointly by the Supervisory Board, management and the company's employees, the aim of which is to provide a reasonable guarantee that the following company objectives are attained: financial reporting is reliable and accurate, operations are efficient and effective, and the company complies with legislation, and its own internal rules and guidelines.

In fact, an effective internal control structure can help the company:²¹⁴

- Make better business decisions with higher quality and more timely information;
- Gain (or regain) the trust of investors;
- Prevent loss of resources;
- Provide security over its assets;
- Prevent fraud;
- Comply with applicable laws and regulations; and
- Gain a competitive advantage through streamlined operations.

The FCSM Code defines the internal control system as control over the conduct of the company's financial and business operations (including the implementation of its financial and business plan) by the company's divisions and bodies.²¹⁵

1. Internal Control Principles

A company's internal control system should be based on the following principles:

- The internal control system should function at all times and without interruption. A system that functions on a permanent basis allows the company to identify deviations on a timely basis, and helps predict deviations in the future;
- Each person involved in the internal control process should be held accountable. The performance of each person carrying out control functions should consequently be managed by yet another person in the internal control system;
- The internal control system should segregate duties. Companies should prohibit duplication of control functions, and should distribute functions

²¹⁴ Moving Forward — A Guide to Improving Corporate Governance Through Effective Internal Control: A Response to Sarbanes-Oxley, Deloitte & Touche, January 2003.

²¹⁵ FCSM Code, Chapter 8, Section 1.1.1.

- among the employees so that one and the same person would not combine functions relating to the authorization of operations with certain assets, recording of such operations, ensuring and safe-keeping of assets, and inventory of these same assets;
- Proper authorization and approval of operations. Companies should establish procedures for approving financial and business operations by authorized persons, within the scope of their authority;
 - Companies should ensure the organizational separation of its subdivision responsible for internal control, and moreover, ensure that this subdivision is accountable directly to the Supervisory Board (commonly through its Audit Committee). This organizational separation ensures that internal controls are verified by an independent authority, in this case the Supervisory Board, which is not involved in the implementation or maintenance of internal controls;
 - All units and departments of the company should integrate and cooperate to allow the internal control system to be properly implemented;
 - A culture of continuous development and improvement needs to be put in place. A company's internal control system should be structured to allow it to flexibly address new issues, and easily be expanded and upgraded; and
 - A system for timely reporting on any deviations should be put in place. Ensuring the timeliness of reporting on deviations with the shortest possible deadlines allows authorized persons to act swiftly to correct problems.

2. Elements of the Internal Control System

The internal control system includes the following inter-related elements:²¹⁶

1. **Control environment:** The control environment sets the tone of an organization, and influences the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values, and competence of the company's employees and officers; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its staff; and the attention and direction provided by the Supervisory Board.

²¹⁶ Internal Control — Integrated Framework, COSO. See also: http://www.coso.org/publications/executive_summary_integrated_framework.htm.

Best Practices: An essential element of an effective internal control system is a strong control culture.²¹⁷ It is the responsibility of the Supervisory Board and senior management to emphasize the importance of internal control through their words and actions. This includes the ethical values that management displays in their business dealings, both inside and outside the organization. The words, attitudes, and actions of the Supervisory Board and senior management affect the integrity, ethics, and other aspects of the company's control culture.

2. **Risk assessment:** Every entity faces a variety of risks from external and internal sources. A precondition to risk assessment is setting the company's objectives. Risk assessment is the identification and analysis of relevant risks to achieve company objectives, forming a basis for determining how risks should be managed.
3. **Control activities:** Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks to achieve the entity's objectives. Control activities occur throughout the organization, at all levels, and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties.

Best Practices: Control activities should be as strict on the top as on the bottom of the company's operations, lending credibility to the control environment and the tone at the top.

4. **Information and communication:** Pertinent information must be identified and communicated in a form and within a timeframe that enables employees to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the business. They not only deal with internally generated data, but also information about external events, activities, and conditions necessary to informed business decision-making and external reporting. Effective communication also must occur in a broader sense — flowing up, down, and

²¹⁷ Framework for Internal Control Systems in Banking Organizations, Basel Committee Publications No. 40, September 1998, <http://www.bis.org/publ/bcbs40.pdf>. Note that this document is for banking organizations. However, some of its provisions are equally applicable to companies in the real sector.

across the organization. All personnel must receive a clear message from senior management that control responsibilities must be taken seriously. Further, they must understand their own role in the internal control system, as well as how individual activities relate to the work of others. Of particular importance is that management not limit itself to communicating on a control measure in and of itself, but properly emphasize the meaning and purpose of the particular control element. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators, and shareholders.

5. **Monitoring the efficiency of the internal control system:** Internal control systems need to be monitored over time in order to assess the quality of the system's performance. This is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs during the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations depend primarily on an assessment of the risks and effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with the most serious matters reported directly to senior management and the Supervisory Board. Senior management and the Supervisory Board need to clearly formulate sanctions to be imposed as a result of control violations on an *ex ante* basis.

3. Bodies and Persons Responsible for Internal Control

Internal control is, to some degree, the responsibility of everyone in an organization and should be an explicit or implicit part of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operations, noncompliance with an internal code of conduct or company-level corporate governance code, should such documents exist, or other policy violations or illegal actions.

Best Practices: The company's department responsible for corporate training programs should ensure that all employees and executives receive training on the company's control culture and system.

Further, although each company has its own specific internal control system and bodies, there are some general rules that a company should follow. Internal control

always starts at the top of the company, at the level of the Supervisory Board and executive bodies. In particular, the Supervisory Board and executive bodies are responsible for establishing the proper internal control environment and maintaining high ethical standards at all levels of the company's operations. Further, the approval of internal control procedures falls within the competence of the company's Supervisory Board, commonly through the Audit Committee. The Supervisory Board's Audit Committee is also assigned to review and evaluate the efficiency of the internal control system as a whole, and prepare proposals on how to improve it. Finally, the implementation of internal control procedures is the responsibility of the executive bodies.

Best Practices: The General Director is ultimately responsible for and should assume ownership of the system.²¹⁸ More than any other individual, he sets the 'tone at the top' that affects the integrity and ethics of a positive control environment. In a large company, the General Director fulfills this duty by providing leadership and direction to senior managers and reviewing the way they are controlling the business. Senior managers, in turn, assign responsibility for establishing more specific internal control policies and procedures to personnel responsible for the unit's functions. For example, controls for the company's IT system should fall under the responsibility of the Chief Information Officer or manager responsible for IT. Of particular significance are financial officers and their staff, whose control activities cut across, as well as up and down, the operational and other units of a company.

The executive bodies, in particular the General Director or the Finance Director would further create structures (services or departments), or assign persons to be responsible for carrying out specific control activities on a daily basis. The Control and Revision Service, as recommended by the FCSM Code, or the Internal Auditor are two such structures.

4. Internal Auditing

Internal auditing is an integral part of a company's internal control system. While internal control is wider in scope, the internal audit can be defined as an independent, objective assurance and consulting activity designed to add value and improve

²¹⁸ Internal Control — Integrated Framework, COSO. See also: www.coso.org/publications/executive_summary_integrated_framework.htm.

an organization's operations.²¹⁹ It helps an organization accomplish its objectives by introducing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and corporate governance processes.

More specifically, internal auditing reviews and ensures the reliability and integrity of information, compliance with policies and regulations, safeguarding of assets, economical and efficient use of resources, and attainment of established operational goals and objectives. Internal audits encompass financial activities and operations including systems, production, engineering, marketing, and human resources.

Company Practices in Russia: A recent survey of internal audit practices in the Commonwealth of Independent States (CIS) lists typical internal audit tasks:²²⁰

- Appraise compliance of business activities with internal policies and procedures;
- Provide advice in setting up internal policies and procedures;
- Appraise controls over the safeguarding of assets;
- Appraise compliance with laws and regulations;
- Appraise internal controls over financial information;
- Appraise internal controls over business processes;
- Appraise the process for identifying, evaluating, and managing business risks;
- Appraise operational efficiency;
- Appraise compliance with contractual obligations;
- Conduct audits of information technologies;
- Investigate fraud; and
- Audit of subsidiary companies.

Similar tasks have been identified in research conducted by the Russian chapter of the Institute of Internal Auditors and the Russian Institute of Directors in 2003:²²¹

- Conduct traditional internal audits;
- Help safeguard the company's assets;
- Assist management in setting up and maintaining internal controls;
- Consulting services; and
- Fraud investigation.

²¹⁹ The Institute of Internal Auditors. See also: www.theiia.org.

²²⁰ 2002 Internal Audit Survey — Russia and the CIS, Ernst & Young, 2002, pages 9 and 11.

²²¹ Internal Audit in Russian Enterprises, the Institute of Internal Auditors — Moscow, and the Russian Institute of Directors; 2003.

According to a recent survey on internal audit in Russian companies, over 2/3 of respondents indicated that their internal audit function reports to executive bodies,²²² raising concerns over the organizational independence of the internal audit function. Moreover, the survey found that professionals carrying out the internal audit function often lacked necessary knowledge and skills.

In order to function properly, the Internal Auditor should enjoy a reasonable degree of independence. This can be attained by making him accountable to the Supervisory Board (through the Audit Committee) rather than an executive of the company (the General Director or Finance Director).

Best Practices: In reality, it is difficult for the internal audit function to be entirely independent of management. Indeed, the internal control function is a key management tool. It would lose a great deal of its utility if it did not report to management. Cognizant of the need to maintain independence while working closely with management, the Institute of Internal Auditors suggests that the Internal Auditor report administratively to the executive bodies and functionally to the Supervisory Board's Audit Committee.²²³

5. The Control and Revision Service

The internal control function can be implemented by different structures within the company, such as the Internal Auditor or Internal Audit Department. In Russia, the FCSM Code recommends the establishment of a Control and Revision Service.²²⁴ The Control and Revision Service is responsible for the daily internal control of the company's finances and operations, and may also carry out the functions of the Internal Auditor.

Company Practice: In most Western companies, the internal control function is typically carried out by a control department on a daily basis, while the internal

²²² Internal Audit in Russian Enterprises, the Institute of Internal Auditors — Moscow and the Russian Institute of Directors; 2003.

²²³ The Institute of Internal Auditors, Standards for the Professional Practice of Internal Auditing. See also: www.theiia.org.

²²⁴ FCSM Code, Chapter 8, Section 1.1.1.

audit function is carried out by an Internal Auditor on a periodic basis. Internal control and audit are separate, both in terms of authority and organization. In Russia, it appears that the Control and Revision Service is to play a hybrid function, taking on some of the duties typically carried out by the Internal Auditor, but functioning on a daily basis as if it were a Control Department. In practice however, the Control and Revision Service only sporadically carries out the functions of the Internal Auditor as defined by the Institute of Internal Auditors, at least in the few Russian companies that have created this control body.

a) Authorities

The Control and Revision Service should fulfill the following tasks:²²⁵

- Develop policies and procedures for internal control in cooperation with the executive bodies and Audit Committee;
- Attend those meetings of the Audit Committee in which implementation of the finance and business plan, compliance with internal control and risk management procedures, and the approval of non-standard operations are discussed;
- Examine documents and materials regarding their compliance with internal control procedures, including the existence of required approvals of relevant department heads, as well as the existence of funds in the financial and business plan sufficient for fulfilling certain operations;
- Exercise daily control over the financial and business activities of the company;
- Analyze and evaluate non-standard operations and prepare recommendations for the Supervisory Board; and
- Help the Audit Committee to obtain information.

The FCSM Code introduces the concept of “non-standard operations”, not defined by legislation.²²⁶ Non-standard operations are operations that go beyond the scope of the financial and economic plan of the company. Non-standard operations should receive Supervisory Board approval. Procedures for approving non-standard operations should be set forth in the charter and internal documents.

²²⁵ FCSM Code, Chapter 8, Sections 1.2–1.4; 2.1–2.3.

²²⁶ FCSM Code, Chapter 8, Sections 2.2.1 and 2.2.2.

The Control and Revision Service should evaluate the need for and feasibility of non-standard operations before they are conducted, and report its conclusions to the Supervisory Board.

To fulfill its tasks, the Control and Revision Service should have the authority to:²²⁷

- Receive all documents and materials that are necessary to reasonably and unequivocally monitor whether the financial and business operations undertaken by the management are consistent with the financial and business plans, and the procedures set forth by the company for such operations;
- Check whether all financial documents and materials comply with the company's internal control procedures, such as the approval by department heads of certain documents; and
- Collect all information on (possible) errors and violations that have occurred during company operations, and report all such errors and violations to the Audit Committee.

b) Reporting

To be effective, the Control and Revision Service should report directly to the Audit Committee.²²⁸ It is recommended that the Control and Revision Service hold regular meetings with the Audit Committee to report on the performance of the financial and business plan, and deviations from it.

c) Composition

The head of the Control and Revision Service and not less than $\frac{2}{3}$ of his staff should hold a higher degree in the fields of finance, accounting, business, law, or economics. The head of the Control and Revision Service should also have at least five years of experience in a similar function.

The contract with the head of the Control and Revision Service should be signed by the Chairman of the Supervisory Board to protect the independence of the Control and Revision Service.²²⁹ Contracts with employees of the Service should also be signed by the Chairman of the Supervisory Board and not by a member of the executive bodies.²³⁰ The FCSM Code recommends that the com-

²²⁷ FCSM Code, Chapter 8, Section 2.1.

²²⁸ FCSM Code, Chapter 8, Section 1.1.2.

²²⁹ FCSM Code, Chapter 8, Section 1.3.5.

²³⁰ FCSM Code, Chapter 8, Section 1.3.5.

pany outline the organization and staffing of the Control and Revision Service in its by-laws.²³¹

6. Management's Report on Internal Control over Financial Reporting

Best Practices: In May 2003, the U.S. Securities and Exchange Commission (SEC) approved a rule to implement requirements of Section 404 of the Sarbanes-Oxley Act of 2002.²³² Section 404 of the Act directs the SEC to adopt rules requiring each annual report of a company to contain (1) a statement of management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) management's assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting. Section 404 also requires the company's External Auditor to attest to, and report on management's assessment of the effectiveness of the company's internal controls and procedures for financial reporting in accordance with standards established by the Public Company Accounting Oversight Board.

Under the final rules, management's annual internal control report will have to contain:

- A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- A statement identifying the framework used by management to evaluate the effectiveness of this internal control;
- Management's assessment of the effectiveness of this internal control as of the end of the company's most recent fiscal year; and
- A statement that its auditor has issued an attestation report on management's assessment.

Russian companies wishing to follow best corporate governance practices should report on these items in their annual report.

E. Summary

Table 1 summarizes the main features of bodies involved in the internal and external audit of the company.

²³¹ FCSM Code, Chapter 8, Section 1.3.2.

²³² The Sarbanes-Oxley Act of 2002, Section 404. See also: www.sarbanes-oxley.com.

Table 1: Summary of Audit Functions				
	Revision Commission	External Auditor	The Supervisory Board's Audit Committee	Internal Auditor (Control and Revision Service)
Status	A controlling body of the company, independent from management	A certified auditor, typically an audit firm, that is independent from management and major shareholders	A committee of the Supervisory Board	Typically, an employee or a subdivision of the company
Main Functions:	<ul style="list-style-type: none"> Conducts annual inspections of financial and business activities; Conducts extraordinary inspections; and Reviews the annual report and financial statements. 	<ul style="list-style-type: none"> Audits the financial statements prepared and presented by the company; and Conducts extraordinary audits. 	<ul style="list-style-type: none"> Develops recommendations for the Supervisory Board on the selection of the External Auditor; Interacts with the External Auditor and Revision Commission; Oversees financial and business operations of the company; Oversees the budget process; Works with the Internal Auditor and/or Control and Revision Service; Supervises the development of the internal control and risk management procedures; Develops recommendations for the Supervisory Board's approval of "non-standard operations;" and Liaises between all auditing functions, both internal and external. 	<ul style="list-style-type: none"> Develops policies and procedures for internal control; Ensures compliance with policies and procedures, as well as with local laws and regulations; Designs and operates controls to safeguard assets, and over financial and business data; and Assists in enhancing the efficiency of operations.
Reports to:	Shareholders	Shareholders via the Supervisory Board or its Audit Committee	The Supervisory Board	The General Director and/or the Financial Director administratively and the Supervisory Board's Audit Committee functionally

Table 1: Summary of Audit Functions				
	Revision Commission	External Auditor	The Supervisory Board's Audit Committee	Internal Auditor (Control and Revision Service)
Regulated by:	The Company Law	Accounting and audit legislation, the Company Law, and the contract with the company	The charter, by-laws, internal documents, and employment contracts	The charter, by-laws, internal documents, and employment contracts
Liabilities:	Civil and labor legislation, employment contracts	Civil and audit legislation, civil contracts	Civil and labor legislation, employment contracts	Internal documents, labor legislation, employment contracts
Composition:	Supervisory Board members and executive bodies cannot be members. Members may be employees or shareholders of the company	The External Auditor must be independent from the company in all respects	Audit Committee members should be independent directors	Staffed by company employees



INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group



Good corporate governance contributes to a company's competitiveness and reputation, facilitates access to capital markets, and thus helps develop financial markets and spur economic growth. With this in mind, the International Finance Corporation and the U.S. Department of Commerce have combined their efforts to provide Russian managers, directors, and shareholders with a practical tool to implement good corporate governance practices – the Russia Corporate Governance Manual. This Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. It follows the recommendations of the FCSM's Code of Corporate Conduct and refers to internationally accepted principles of good corporate governance.

“Corporate governance is vital to the interests of every economy, and government has a role to play in establishing the framework for reform - but it is companies that have the tough job of putting governance reform into practice. This is where the Corporate Governance Manual can provide excellent help. It offers a comprehensive workbook for company directors, officers, and advisers in taking up the challenge of corporate governance improvement. Shareholders and stakeholders alike should applaud IFC for bringing practical, and professional advice within reach of every boardroom.”

Anne Simpson, Manager,
Global Corporate Governance Forum

“Corporate governance reform in Russia is the continuation of the more general processes of change affecting the country as a whole. Taken together, these developments have created a new environment, new rules regulating the relationships between the market and regulators, between shareholders, shareholders and managers, etc. In the business community there is a growing awareness of the benefits of corporate governance reform, and companies are now working on improving the quality of their corporate governance ...”

Ruben K. Vardanian, President of Troika Dialogue; Chairman of the Board,
OJSC Rosgosstrakh; and Chairman of the RSPP Corporate Governance Committee

“Good corporate governance is a key driver of financial transparency and managerial accountability, essential ingredients for national prosperity in a global economy. We congratulate the U.S. Department of Commerce and the International Financial Corporation of the World Bank for their initiative in bringing about the publication of the Russia Corporate Governance Manual.”

Andrew B. Somers, President,
American Chamber of Commerce in Russia

Questions on corporate governance should be addressed to the IFC Russia Corporate Governance Project, via CGPRussia@ifc.org

An electronic version of the Manual is available on the website of the International Finance Corporation under www.ifc.org/rcgp and the U.S. Department of Commerce under www.mac.doc.gov/ggp

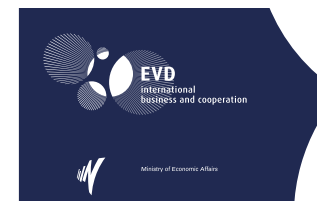
The Russia Corporate Governance Manual

V Part V Special Focus Section



Prepared and Published by the International Finance Corporation and the U.S. Department of Commerce

In Partnership with the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs and the Swiss State Secretariat for Economic Affairs



The Russia **Corporate Governance** Manual

Part V

Special Focus Section

Prepared and Published by the International Finance Corporation
and the U.S. Department of Commerce

In Partnership with the Agency for International Business
and Cooperation of the Dutch Ministry of Economic Affairs
and the Swiss State Secretariat for Economic Affairs

First edition: 10,000 copies in Russian, 1,500 copies in English.

Published in 6 Parts

Printed in Moscow, Russia.

ISBN 5-9614-0085-9

Copyright © 2004 International Finance Corporation
2121 Pennsylvania Ave. NW, Washington, DC 20433, United States of America
A Member of the World Bank Group

Design copyright © 2004 Alpina Business Books

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, for commercial purposes without the prior permission of the International Finance Corporation.

Chapter 15

Corporate Governance in **Groups** of **Companies**



Table of Contents

A. GENERAL PROVISIONS ON GROUPS OF COMPANIES.....	4
1. Relationships Between Companies in Groups.....	4
2. Corporate Governance Issues in Groups of Companies	6
3. Groups of Companies in the Company Law	9
4. Groups of Companies in Other Areas of Legislation	10
B. SPECIFIC GROUP STRUCTURES	13
1. Parent-Subsidiary Company Structures.....	13
2. Dominant-Dependent Company Structures	20
3. Holding Companies.....	21
4. Financial and Industrial Groups	21
C. SUMMARY TABLE.....	23

The Chairman's Checklist

- ✓ Is the company part of a parent-subsidary structure? Is the parent company's Supervisory Board aware of its role and, in particular, of its responsibilities in such structures?
- ✓ Is there economic justification for establishing subsidiaries and dependent companies?
- ✓ If the company is a parent company, how does the Supervisory Board ensure that it oversees the management of subsidiaries? Are binding instructions of the parent to the subsidiary legally and economically justified?
- ✓ How does the Supervisory Board of the parent company make sure that minority shareholders of subsidiaries are treated fairly?
- ✓ How does the Supervisory Board of the subsidiary ensure that the rights of its minority shareholders are not violated by the parent company through related party transactions and other mechanisms?
- ✓ Do all directors fully understand the legal and economic implications of holding structures and Financial and Industrial Groups?

Companies often adopt complex structures in response to legitimate business needs. Some companies create identifiable sub-divisions, i.e. representative offices or branches.¹ Others establish or acquire participation in yet other companies, creating

¹ Civil Code (CC), Article 55, Law on Joint Stock Companies (LJSC), Article 5, Clause 1. The decision to establish representative offices/branches is a strategic decision, taken by the Supervisory Board. Representative offices represent and protect the company's interests, while branches may fulfill additional business functions. Representative offices/branches have no independent legal personality. This has a number of implications. For one, the manager of the representative office/branch is a part of the management structure of the company, and should be appointed by the company's Executive Board. The manager's authority is defined in special by-laws, the power of attorney issued by the company, and the employment contract with the manager. In addition, the representative office/branch is subject to the same internal control procedures as the company, which is of particular importance since the company is liable for the actions of branches/representative offices.

subsidiaries or dependent companies with a separate legal existence. In doing so, they create a group of companies. Either way, the decision to diversify the company's structure has important governance implications.

While complex business structures may serve legitimate purposes, cross-shareholdings, pyramid structures, and other arrangements can make the company difficult to understand for shareholders and other investors. Special vigilance on the part of the Supervisory Board is called for since such structures have been used extensively to expropriate and circumvent the rights of (some) shareholders.

This chapter draws attention to the corporate governance and legal implications of groups of companies, including parent-subsidiary relations, holdings, and Financial and Industrial Groups (FIGs).

A. General Provisions on Groups of Companies

1. Relationships Between Companies

Companies set up or acquire control in other companies for a variety of legal and economic reasons. These include diversifying business operations, complying with legal and administrative requirements, enjoying the limited liability available to shareholders (of the parent), or identifying assets in separate legal entities for the purposes of secured borrowing. In such cases, companies remain independent legal personalities, with their own charter, governing bodies, and charter capital. Relationships between companies can vary in terms of:

- **The extent of share participation.** A Company can hold small or large blocks of shares in the charter capital of another company. Companies can further have reciprocal holdings in each other. Alternatively, companies may not have any share participation whatsoever, but base their relationships on contracts granting certain control rights.
- **The degree to which companies integrate or cooperate in their businesses.** Companies can be economically dependent on each other with varying degrees of intensity. This holds particularly true for different areas of

Chapter 15. Corporate Governance in Groups of Companies

decision-making, such as strategic development, marketing, production, asset management, management of financial flows, human resources, or research and development.

- **Whether the group of companies includes both financial and non-financial institutions.** Groups of companies that include financial institutions may be registered as FIGs. Other groups may take the form of holdings.
- **Whether the companies are a part of a wider network of legal entities and the degree of complexity of this network.** Companies can be organized “vertically,” that is with one parent company at the top. Such groups are often referred to as “holding companies.” When there are several layers of holding companies, they are referred to as “pyramids.” Companies can also be organized “horizontally,” that is with several parent companies.

Best Practices: The EU defines groups of companies in its Seventh Company Law Directive on Consolidated Accounts.² Two basic types of relationships exist: vertical and horizontal.

Vertical control relationships exist when:

1. Company (A) controls the majority of the voting rights in Company (B);
2. Company (A) is a shareholder in Company (B), and has the right to appoint and dismiss the majority of the Supervisory Board members of Company (B);
3. Company (A) exercises “dominant influence” over Company (B) by means of a contract;
4. Company (A) exercises “dominant influence” over Company (B), by virtue of a provision in the company’s charter;
5. Company (A) controls the majority of shares as a result of an agreement with other shareholders of Company (B);
6. Company (A) exerts “dominant influence” over Company (B) by means not mentioned above; or
7. Company (A) manages Company (B) on a unified basis.

² See <http://europa.eu.int/scadplus/leg/en/lvb/l26010.htm>.

The Directive identifies two types of associative links that tie together horizontal groups:

1. Companies that are managed on a unified basis; or
2. Companies that are tied together through interlocking directorates.

Cash-flow links and cross-shareholdings are not specifically mentioned in this Directive, although they typically feature in horizontal groups as well.

2. Corporate Governance Issues in Groups of Companies

Relationships between companies serve modern commercial realities; yet they also give rise to some particular corporate governance issues that require management's and, in particular, the Supervisory Board's attention:

- **Lack of transparency of control and economic interdependence of a group of companies.** Complex ownership structures are often used to obscure control relationships between companies, making it virtually impossible to determine when transactions are being conducted in good faith, or when self-dealing, transfer pricing, and similar abuses occur. Just as important are situations in which such structures obscure liabilities or potential risks associated with other companies in the group.

Best Practices: Transparent ownership structures are important prerequisites in both the U.S. and EU. The same should hold true for Russian companies, and the following are some of the best practices for implementing this principle.

- Significant attention is given internationally to the disclosure of holdings and voting power in listed companies. For example, in the U.S., the disclosure of voting blocks in excess of 5% in listed companies is required; in the EU, this requirement is established at the level of voting power in excess of 10%.
- It is extremely important to provide adequate financial information on the economic interdependence of the group of companies. In the EU, for example, the consolidation of group accounts is a legal requirement since the adoption of the Seventh Company Law Directive in 1978. The EU system was recently updated and all listed companies in the EU will need to consolidate their financial reports according to International Financial Reporting Standards as of 2005.

- The EU deems coherent and accurate disclosure of group structure and intra-group relations as a crucial precondition for protecting the rights of shareholders and creditors. Thus, the parent company of each group is to be made responsible for appropriate disclosure practices.
 - In addition to the above, the EU is particularly concerned about pyramidal groups that include listed companies, especially those placed on lower levels of the chain of control. In those cases, for example, the recommendation is made for securities markets not to accept for trading shares of holding companies whose sole or main assets are shareholdings in another listed company.
-
- **Ability of the dominant company to control the decision-making of its subsidiary, contrary to the interest of the subsidiary.** There is a real danger that a dependent company or subsidiary can be made to operate in the interests of the dominant or parent company, to its detriment.

Best Practices: German law, which contains comprehensive regulation on groups, envisages the possibility for a controlling company to issue mandatory instructions to the directors of the controlled company.

- In the case of contract-based groups, the instructions issued can even be to the detriment of the subsidiary as long as the interests of the group as a whole are served.
- The latter condition does not apply in the case of so-called integrated groups, whereby the participation in the subsidiary's capital exceeds 95%.
- With regard to the third category of groups recognized by German law, the *de facto* groups, the parent company cannot issue instructions disadvantageous to the subsidiary without providing compensation. Under this particular group structure, directors of the dependent company are required to prepare a "dependence report," listing the circumstances of its transactions, and disclose this report to the company's External Auditor.

French law accepts the notion of the group's predominance over its members' interests. When making decisions, the parent is thus entitled to take the group's interests into account and is not required to indemnify the subsidiary. However, two exceptions exist. First, the subsidiary may not enter into transactions with other group entities that would jeopardize its solvency. Second, that a certain "*quid pro quo*" between the parent and subsidiary exists, i.e. that a just balance be struck between the burden imposed on the subsidiary and the advantages it receives from its participation in the group.

Similarly, the 2004 OECD Principles of Corporate Governance (OECD Principles) mention that some countries are now moving toward controlling the negative effects [of groups of companies] by specifying that a transaction in favor of another group company must be offset by receiving a corresponding benefit from other companies of the group.³

- **The need to protect minority shareholders of dependent companies or subsidiaries against abuse by the controlling powers of the dominant company.** Minority shareholders in subsidiaries or dependent companies may be particularly vulnerable to abuses by controlling shareholders. Subsidiary or dependent companies are not generally publicly quoted, so minority shareholders may not receive full information or have the ability to sell their shares in the market.

Best Practices: Some important areas of concern for companies wishing to follow good corporate governance in terms of minority shareholder protection in groups include:

- Providing minority shareholders with reliable information on the company's management and the actual relations between companies.
- Providing security for the profit interests of the subsidiary's shareholders. Under German law for example, minority shareholders can be offered security in the form of a guaranteed dividend, the amount of which is determined in relation to past or future profits.
- Minority shareholders have the right to withdraw from the company against an appropriate compensation, when the dominant company has acquired 90% (for example, in the U.K.) or 95% (in France) of the company.

- **The need to protect creditors of the dependent company or the subsidiary against fraud or under-capitalization of the subsidiary.** Creditors may also find themselves in a weaker position with respect to their ability to receive

³ OECD Principles of Corporate Governance, Annotations to Principle II on the Equitable Treatment of Shareholders, Section A.2. See also: www.oecd.org.

Chapter 15. Corporate Governance in Groups of Companies

the payments that they are due. Some potential responses are mentioned below:

Best Practices: Creditors of the subsidiary could be protected by a variety of means, such as:

- The obligation of the dominant company to compensate creditors for any annual deficits of the subsidiary (as is the case, for example, in Germany); or
- Extending the liability of the parent for the debt of the subsidiary under specific circumstances (France, Spain, and the Netherlands).

3. Groups of Companies in the Company Law

The Company Law does not recognize groups of companies as a single legal entity. It does, however, regulate the relationships between parent companies and their dependent or subsidiary companies for the purposes of protecting shareholder and creditor interests.⁴

Best Practices: Legal systems the world over are confronted with issues of groups of companies. Some have developed formal rules; others have left developments to case law. Formal regulation has mainly been developed in Germany, Portugal, and in some Eastern European countries. Brazil and Senegal are examples where group law has formally been introduced in company law, although it is unclear how the law is actually applied. Other jurisdictions, such as the U.S., have extensive rulings on groups of companies, developed by the courts, but no laws on groups.

In the absence of regulation on groups, Russian companies — wishing to follow good corporate governance practices — should regulate their group structure in the company charter, in particular, the main governance rights and responsibilities between the parent and its subsidiaries. The charter provisions may further be complemented with a specific by-law on the group.

⁴ LJSC, Article 6.

4. Groups of Companies in Other Areas of Legislation

Tax and Antimonopoly laws both have significant implications for a company's decision to use group mechanisms. These laws place important constraints on companies, limiting their ability to create and/or expand their group structure.

Moreover these laws have their own definition as to whether a group of companies may be characterized as interdependent (apart from the corporate parent-subsidiary relationship).

a) Interdependent Companies under Tax Legislation

The Tax Code provides for a special definition of interdependent companies for tax purposes.⁵ The main legal consequences which it envisages with regard to interdependent companies, relate to the tax regime of transactions concluded between these companies.⁶ The regime aims to regulate a company's ability to trade commodities or transfer assets at prices below market rates.

Mutual dependence exists when a relationship between companies is capable of affecting the terms or economic results of their activities or the activities of persons represented by them. More specifically, the Tax Code identifies the following cases of interdependent companies:

- A company has direct and/or indirect participation in another company exceeding in total 20% of its capital.

Mini-Cases 1–3:

1. **Direct ownership:** Company (A) owns 21% of shares of Company (B).
2. **Indirect ownership:** Company (A) owns 50% of shares of Company (B). Company (B) owns 50% of shares of Company (C). The participation of Company (A) in Company (C) is calculated as the multiple of the direct participation by Company (A) in Company (B), and Company (B) in Company (C), hence 25%.

⁵ Tax Code, Article 20.

⁶ Tax Code, Article 40.

3. **Combination of direct and indirect ownership:** Company (A) owns 16% of shares of Company (C) directly, and 50% of shares of (B), which in turn holds 10% of shares of Company (C). Company (A) thus indirectly holds 5% of shares in Company (C) through its ownership in Company (B). Thus, the total direct and indirect ownership of Company (A) in Company (C) amounts to 21% of shares of Company (C).

- Courts have recognized two companies as being interdependent based on criteria other than those described in the examples above, e.g. when the relations between them can influence the results of transactions in providing goods, labor, or services.

b) Groups of Persons and Affiliated Persons under Antimonopoly Law

The Law on Competition and Restricting Monopoly Activities on the Commodities Markets (Antimonopoly Law) has its own definition of groups of persons and affiliated persons for the purposes of antimonopoly control. The emergence of groups or affiliation relationships requires notification or preliminary approval by the Ministry of Antimonopoly Policy and Entrepreneurship Support (MAP).⁷ The question of whether such groups or affiliations exist under Antimonopoly Law must be examined independently of the question as to whether such companies form a dominant-dependent or parent-subsidiary relationship under the Company Law and/or an interdependent relationship under the Tax Code.

Under Antimonopoly Law, a group of companies exists in the following situations, as presented in Table 1:⁸

⁷ Law on Competition and Restricting Monopoly Activities on the Commodities Markets (Antimonopoly Law), Article 18. Table 1 only covers those relationships mentioned in Article 18 that relate to companies.

⁸ Antimonopoly Law, Article 4.

Table 1: Company Relations under Antimonopoly Law	
Direct Relationships	Indirect Relationships
<ul style="list-style-type: none"> • Based on an agreement, Company (A) has the right of disposal of more than 50% of voting shares of another Company (B). This right of disposal can take a direct or indirect form, including on the basis of a contract. The Antimonopoly Law specifies that indirect participation means the possibility for <i>de facto</i> control through a third person with regard to which Company (A) has the same rights. • Company (A) has the right to determine the decisions of Company (B), including the conditions for its entrepreneurial activity, on the basis of a contract or other form, or to fulfill the functions of the executive bodies of Company (B) by virtue of a contract. • Company (A) has the right to appoint the General Director and/or more than 50% of Executive Board members of Company (B), or, on the basis of its proposal more than 50% of members of the Supervisory Board or collective body have been elected. 	<ul style="list-style-type: none"> • The same individuals (or their relatives) or persons proposed by one of the companies represent more than 50% of Executive Board or Supervisory Board membership of Companies (A) and (B), or upon the proposal of one of the companies, more than 50% of members of the Supervisory Board or collective executive body of Companies (A) and (B) have been elected. • Employees of Company (A) are the General Director or more than 50% of members of the Supervisory Board or a collective executive body of Company (B). • The same individuals (or their relatives) have the right of disposal with more than 50% of voting shares in both Companies (A) and (B). • The individuals or legal entities who have the right of disposal over more than 50% of voting shares of Company (A) are at the same time the persons constituting more than 50% of members of the Supervisory Board or collective executive body of Company (B). • Companies (A) and (B) are members of the same FIG.

For the purposes of antimonopoly control, companies are considered to be affiliated persons when:⁹

- Companies (A) and (B) belong to the same group of companies;
- Company (A) has the right to dispose of more than 20% of voting shares of Company (B); or
- The members of the executive bodies and the Supervisory Board of Company (A) are affiliated persons to Company (B), when both companies are members of the same FIG.

→ For more on affiliated parties, see Part III, Chapter 12, Section B.1.

⁹ Antimonopoly Law, Article 4. The list includes only those relationships listed in Article 4 that relate to companies.

B. Specific Group Structures

Specific group structures or regimes are differentiated from one another, depending on the legal regulation and their economic features. In many cases, these structures may overlap or exist simultaneously. Such structures will refer to:

- Parent-subsiary;
- Dominant-dependent;
- Holding structures; and
- FIGs.

1. Parent-Subsidiary Company Structures

a) Definition of Parent and Subsidiary Companies

Companies (A) and (B) are defined as parent and subsidiary companies when Company (A) can control decisions adopted by Company (B) by virtue of:¹⁰

- Predominant participation in the capital of Company (B); or
- A contract to that effect executed between the two companies; or
- Other forms of control.

Thus, there are no strict formal criteria for the definition of parent-subsiary relationships. It requires the examination of the degree and nature of the influence of the parent company over subsidiary decision-making. This approach allows for a greater degree of flexibility in reflecting the different relations between companies. At the same time, a clear definition of a parent-subsiary relationship is imperative under the Company Law, which attaches important consequences to situations in which shareholder or creditor interests are put at risk.

The following types of parent-subsiary relationships exist under the Company Law:

1) *Parent Company as a Predominant Shareholder of the Subsidiary*

The Company Law does not contain an exact percentage of share participation needed to qualify as a parent company. The requirement for “predominance” must be satisfied in specific cases in conjunction with the possibility to determine the decisions of the subsidiary company. Two factors in particular must be taken into account:

¹⁰ CC, Article 105, Clause 1; LJSC, Article 6, Clause 2.

The Russia Corporate Governance Manual

- The actual share ownership in the capital of a company; and
 - The type of quorum and voting majority required by the charter for the decision-making of the company.
- For more information on the quorum and voting majorities of the General Meeting of Shareholders (GMS), Part III, see Chapter 8, Sections C.3 and E.

Table 2 illustrates the level of control in a company based upon the percentage of share ownership.

Participation in the Capital of Another Company	Control Implications
100%	The parent company (A) has full control over the decision-making of its subsidiary Company (B).
75% to 100%	Company (A) controls all decisions of the subsidiary's GMS, which — according to the Company Law or the charter — require 3/4-majority of voting shares or more.
50% to 75%	Company (A) controls all decisions of the subsidiary's GMS, which require a simple majority.

2) *Contractual Relationship*

A contract between two companies can provide that Company (A) is able to control decisions of Company (B). This means that even if Company (A) does not have a predominant participation in the charter capital of Company (B), a contract can provide for certain control rights. Such control rights include the right to appoint and dismiss directors and/or managers, approve or veto certain transactions, or instruct the company to act in a specific manner.

Russian law does not provide specific regulation with regard to the contents or the form of a contract that will influence the decision-making of a subsidiary. Some level of control can result from different types of contracts, such as joint ventures, bank credits, pledges of securities, or asset management contracts.

In these cases, specific rules applicable to individual contracts need to be observed. It is important to note that the provisions of the contract must be consistent with relevant legislation.

3) *Other Relationships*

The Company Law does not exhaust the cases in which a company has the potential to control the decisions of another company, thus qualifying as a parent-subsidiary relationship. In concrete circumstances, specific tests will be needed to identify such relationships (see examples in Mini-cases 4 and 5).

Mini-Cases 4 and 5.

4. **Pyramidal structures:** Company (A) has majority control of Company (B), and Company (B) has majority control of Company (C). As a result, Company (A) only controls Company (C) indirectly, but its control can be as effective as that of direct control. (A) is thus considered a parent company of (C).
5. **Control of affiliated companies:** Neither Company (A) nor Company (B) have majority control of Company (C). Yet, together companies (A) and (B) can have sufficient control to determine the decisions of Company (C). Both (A) and (B) are considered parent companies when they exercise control over (C).

b) Parent-Subsidiary Relations and the Decision-Making of the Subsidiary

A parent company and its subsidiary are separate legal entities that are legally independent from each other. The decision-making of the subsidiary, however, is by definition subject to the influence of the parent company. This section describes the mechanisms through which this influence occurs. Such mechanisms frequently exist in combination.

A parent company is able to influence decisions of a subsidiary through standard governance mechanisms available to controlling shareholders (shareholders with a predominant participation in the charter capital of the subsidiary), including the ability to:

- Directly control the outcome of issues that fall under the decision-making authority of the subsidiary's GMS;
- Nominate and elect representatives to the Supervisory Board of the subsidiary; and
- Nominate and elect representatives to the executive bodies of the subsidiary.

Best Practices: It is good practice to authorize the Executive Board of the parent company to complete certain tasks related to subsidiaries, such as to:¹¹

- Set agenda for the GMS of wholly-owned subsidiaries, except when this authority is vested in the Supervisory Board of the parent;
- Appoint representatives of the parent company to the GMS of wholly-owned subsidiaries and issue voting instructions to them; and
- Nominate candidates for the Supervisory Board, the executive bodies, or other bodies in companies in which it participates.

Executive Board members or the General Director of the parent company frequently sit on the Supervisory Board or the executive bodies of the subsidiary. For this, the prior consent of the parent company's Supervisory Board is needed.¹²

Best Practices: It is important in such cases to ensure that the General Director of the parent has enough time to fulfill his tasks in both legal entities, but most importantly at the parent level.¹³ Establishing an Executive Board at the parent level to spread managerial responsibilities or prohibiting side activities per contract are means of achieving this end.

Russian law allows parent companies to issue mandatory instructions to their subsidiaries. This right is, however, only allowed if predetermined in the contract between the two companies or charter of the subsidiary company.¹⁴

c) Protecting Shareholders of the Subsidiary

When a subsidiary is not 100% owned by the parent company, there are, by definition, other shareholders. Depending on the amount and type of their holdings, such shareholders may affect the decision-making of the subsidiary and exercise minority shareholder rights.

¹¹ FCSM Code, Chapter 4, Section 1.1.4.

¹² LJSC, Article 69, Clause 3.

¹³ FCSM Code, Chapter 4 Section 2.1.4.

¹⁴ CC, Article 105, Clause 2; LJSC, Article 6, Clause 3.

Chapter 15. Corporate Governance in Groups of Companies

In addition to the general rules protecting minority shareholders, the parent company is directly liable when it deliberately damages the interests of the subsidiary.¹⁵ Such liability emerges when:

- The parent company has exercised its rights to influence the actions of the subsidiary; and
- As a result of this, the subsidiary has incurred losses; and
- The parent company has acted knowing that, by such act, the subsidiary will likely suffer losses.

The Company Law does not vest this right with the subsidiary itself, but instead with its shareholders. Accordingly, shareholders must file their claim on behalf of, and in the interest of, the subsidiary and against the parent company.

d) Protecting Creditors of the Subsidiary

A parent company can endanger the interests of the subsidiary's creditors in a variety of ways, ranging from obfuscating risks involved in contracts between the subsidiary and its creditors, to transferring assets between parent and subsidiary companies. Creditors of the subsidiary enjoy the general protection granted to creditors of commercial companies by Russian law.

Additional guarantees to creditors of a subsidiary exist. For example, the subsidiary is not liable for any debts of its parent company.¹⁶ Further, the parent company — at least in principle — also enjoys limited liability with respect to the debts of its subsidiary. There are, however, a number of important exceptions to this rule.

1) *The Parent Company Has the Right to Give Mandatory Instructions*¹⁷

A parent company is liable for the debts of its subsidiary, when:

- The parent company has the right to issue mandatory instructions to the subsidiary; and
- This right has been envisaged in a contract between the parent company and the subsidiary, or in the charter of the subsidiary; and

¹⁵ CC, Article 105, Clause 3; LJSC, Article 6, Clause 3.

¹⁶ CC, Article 105, Clause 2; LJSC, Article 6, Clause 3.

¹⁷ CC, Article 105, Clause 2; LJSC, Article 6, Clause 3.

- The debt of the subsidiary was incurred as a part of a transaction fulfilling such mandatory instructions.

In such circumstances, joint and several liability of the parent company for the debts of the subsidiary exists. This means that a creditor can choose to direct its claim, or a part of it, to the subsidiary or to the parent, or to both.¹⁸ If the claim is directed to the subsidiary but no satisfaction of the claim, or only a partial satisfaction, is received, the creditor can direct the claim (in full or the outstanding part of the claim) to the parent company. Thus, the parent company remains liable until the full amount of the debt has been satisfied.

2) *The Subsidiary's Insolvency Has Been Caused by the Parent Company*

A parent company can also be held liable for the debts of its subsidiary, when:¹⁹

- The subsidiary has become insolvent (bankrupt); and
- The insolvency of the subsidiary has been caused by the parent company, by exercising its rights and/or influence; and
- The parent company acted knowing that such action would result in the insolvency of the subsidiary.

The purpose of this exemption from the limited liability rule is to prevent parent companies from deliberately causing the bankruptcy of the subsidiary and thereby defrauding its creditors. (A great number of insolvencies in Russia during the mid- to late 1990s were in fact deliberately and fraudulently caused by parent companies and went un-punished due to poor enforcement mechanisms.) In such cases, the Company Law provides for the liability of the parent in addition to that of the insolvent subsidiary. This means that the subsidiary remains the main debtor, to which the creditor directs all claims first.²⁰ Only if the subsidiary is unable to satisfy the claim or fails to react to the claim within a reasonable time can the parent company be held liable.

e) **Establishing Subsidiaries**

Subsidiaries can be established by founding a new company, through the reorganization of an existing company or by acquiring shares of an existing company.

¹⁸ CC, Article 323.

¹⁹ CC, Article 105, Clause 2; LJSC, Article 6, Clause 3. See also: Insolvency Law, Article 10, Clause 4.

²⁰ CC, Article 399.

Chapter 15. Corporate Governance in Groups of Companies

A subsidiary can be created by founding a new company. The parent company can:

- Invest the entire amount of the initial charter capital, thus becoming the only shareholder of a fully-owned subsidiary; or
- Contribute to the initial charter capital and become the majority shareholder of the subsidiary, along with other companies or individual shareholders.

In this case, the parent company needs to comply with all legal requirements regulating the founding of a new company in the respective legal form, for example a joint stock company or limited liability company.²¹

Accordingly, the parent company is subject to the duties and liabilities of the founders of a company, as specified in Table 3.

Legal Source	Duties and Liabilities
The Company Law	<ul style="list-style-type: none">• Joint and several liability for debts incurred in the process of forming the new company;²² and• To take all steps and actions necessary for the state registration of the company.²³
Securities Legislation	→ <i>For the requirements as to founders, see Part III, Chapter 11.</i>
Antimonopoly Legislation	<ul style="list-style-type: none">• Founders need to notify the MAP within 45 days of the state registration if the sum of the founders' assets, according to the last balance sheet, exceeds 200 thousand times the minimum wage.²⁴
Tax Legislation	<ul style="list-style-type: none">• The company needs to notify the tax authorities at its location about its participation in the new company within 30 days.²⁵

A subsidiary can also be created through the reorganization of a company in the form of split-up or spin-off.

→ *For more on company reorganization, see Part V, Chapter 16.*

²¹ CC, Article 51.

²² LJSC, Article 10, Clause 3.

²³ LJSC, Articles 11 and 13, Law on State Registration of Legal Persons, Articles 12 and 13.

²⁴ Antimonopoly Law, Article 17, Clause 5.

²⁵ Tax Code, Article 23, Clause 2.

A company can finally acquire shares in an already existing company. In such cases, the following requirements apply:

- The acquiring company must notify and disclose the acquisition of 20% of voting shares of the acquired company, and any subsequent 5% increases thereof, to the Federal Commission for the Securities Market (FCSM) within a month of the acquisition or increase.²⁶
- When the acquiring company has the right of disposal of more than 20% of voting shares of the acquired company, the company must:
 - Seek the consent of the antimonopoly body *ex ante*, when the sum of the assets of the founders according to the last balancesheet exceeds 200 thousand times the minimum wage or when one of the founding companies (or the persons who have a predominant participation in the capital of such a company) has a market share of more than 35%;²⁷ and
 - Notify the MAP, when the sum of the founders' assets according to the last balance sheet exceeds 100 thousand times the minimum wage.²⁸

2. Dominant-Dependent Company Structures

Another type of regime in a group of companies is that between dominant and dependent companies, which is regulated by the Company Law. The legal regime regulating dominant-dependent companies is quite similar to that of the parent-subsidiary regime, though, differences exist. The main difference between dependent companies and subsidiaries relates to the degree of control exercised by the parent/dominant company, and the legal obligations toward minority shareholders and creditors of subsidiary/dependent companies.

Thus, Company (B) is considered dependent on Company (A) when Company (A) holds more than 20% of the voting shares in Company (B).²⁹ Dependency consequently occurs on the satisfaction of a formal criterion (the acquisition of a percentage of voting shares) and not the nature of the relationship between the companies.

²⁶ CC, Article 106, Clause 2; LJSC, Article 6, Clause 4.

²⁷ Antimonopoly Law, Article 18, Clauses 1 and 2.

²⁸ Antimonopoly Law, Article 18, Clause 6.

²⁹ CC, Article 106, Clause 1; LJSC, Article 6, Clause 4.

Chapter 15. Corporate Governance in Groups of Companies

When dependent company structures exist, the following should be kept in mind:

- **Disclosure Obligation:** Company (B) is obliged to disclose its 20% stake in (A), as determined by the FCSM;³⁰ and
 - *For more information on such disclosure requirements, see Part IV, Chapter 13, Section B.3.*
- **Rules on Related Party Transactions:** The acquisition of more than 20% of shares in another company triggers special provisions of the Company Law when these two companies engage in certain transactions.³¹
 - *For more on related party transactions, see Part III, Chapter 12, Section C.*

Other than these two rules, the Company Law does not regulate relations between the dominant and dependent companies.

3. Holding Companies

The holding company concept was introduced by Presidential Decree in relation to groups of companies created in the process of transforming state-owned enterprises (SOEs) into joint stock companies for privatization.³² A holding company is defined as a company whose assets include control shares of another company or a group of companies.³³ Control shares are defined as any form of share participation that ensures the unconditional right of approving or rejecting specific decisions of the GMS and its executive bodies.

4. Financial and Industrial Groups

Russian law recognizes the existence of FIGs. FIGs are created for the purposes of technological or economic integration based on:³⁴

³⁰ LJSC, Article 6, Clause 4.

³¹ LJSC, Article 81, Clause 1.

³² Decree No. 1392, the President of the Russian Federation, Temporary Statute of Holding Companies Established in the Process of Transforming State Companies Into Joint Stock Companies (Decree No. 1392), 16 November 1992. Note that following this decree, a draft law on holdings has been discussed by the State Duma, but has yet to be adopted.

³³ Decree No. 1392, Clause 1.1.

³⁴ Law on Financial and Industrial Groups, Article 2.

- Legal entities acting as parent and subsidiary companies. In this case, both the parent company and the subsidiary form the FIG;³⁵ or
- Legal entities that have fully or partially unified their tangible or intangible assets on the basis of a contract for the establishment of a FIG.

Central to the FIG is a legal entity established by a contract between all parties, or a parent company authorized by law or contract to act as one.³⁶

The most important legal requirements applicable to FIGs are:

- The establishment of the FIG is subject to state registration;³⁷
- In the cases set forth by tax legislation, the contract for the establishment of a FIG can provide for tax consolidation of the members of the FIG.³⁸ Similarly, the contract can provide for accounting consolidation;³⁹
- The participants in the FIG bear joint and several liability for the debts incurred by the central company in realizing the activities of the group. The specific aspects of this liability are regulated by the contract for the establishment of the FIG;⁴⁰
- The FIG is required to prepare an annual report within 90 days of the end of the fiscal year.⁴¹ The report must reflect the results of the inspection of an independent External Auditor. This report is submitted to all participants of the group and to the authorized state body; and
- The FIG is subject to annual state control, including the possibility of an audit.⁴²

³⁵ Law on Financial and Industrial Groups, Article 3, Clause 5.

³⁶ Law on Financial and Industrial Groups, Article 11, Clause 1.

³⁷ Law on Financial and Industrial Groups, Article 5.

³⁸ Such provisions have not been made to date.

³⁹ Law on Financial and Industrial Groups, Article 13. Also, see Regulation No. 24, the Council of Ministers, on the Procedure for Keeping Consolidated Accounts, Reports, and Books of Financial and Industrial Groups, 9 January 1997.

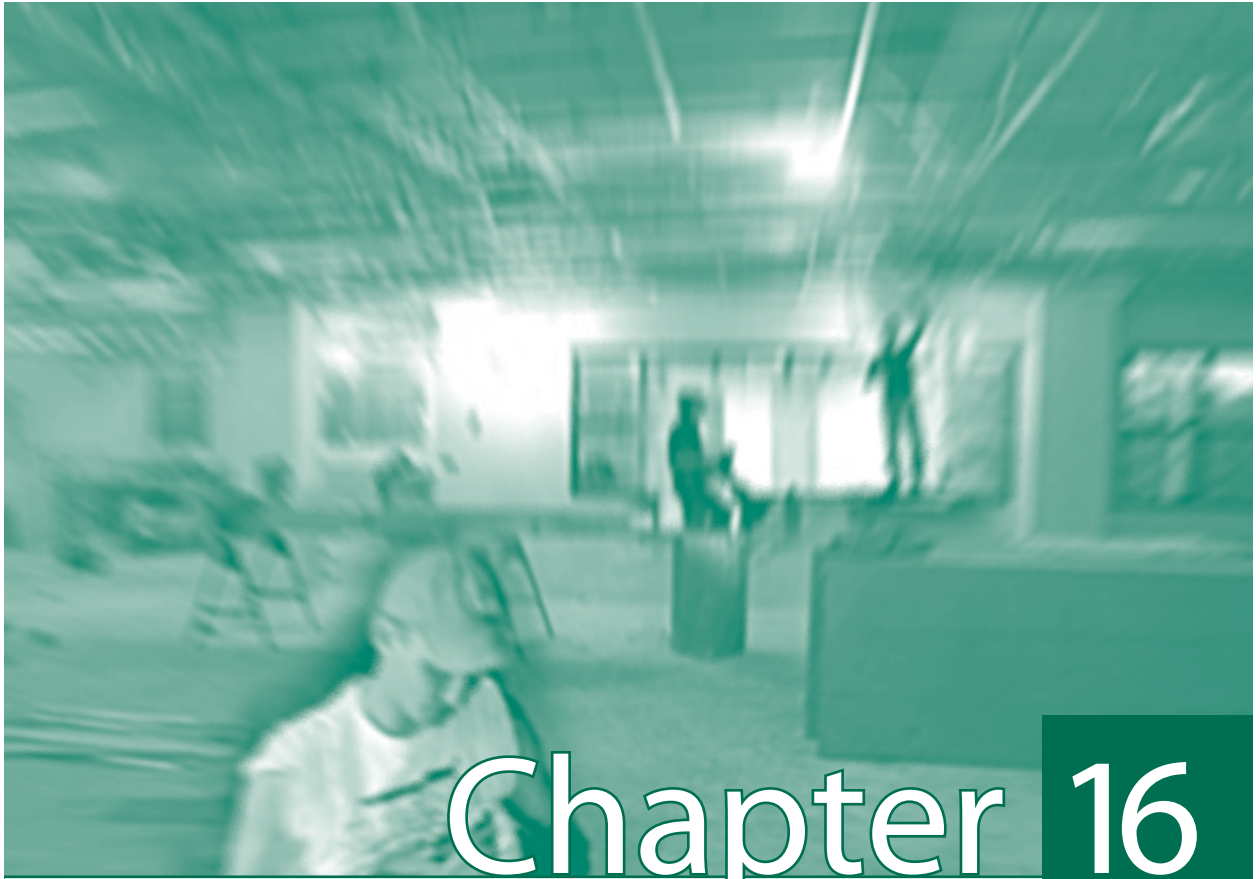
⁴⁰ Law on Financial and Industrial Groups, Article 14.

⁴¹ Law on Financial and Industrial Groups, Article 16.

⁴² Law on Financial and Industrial Groups, Article 17.

C. Summary Table

Table 4: Summary of Corporate Governance in Groups of Companies		
	Legal relationship in another company recognized	Legal consequences
Dependent companies (the Company Law)	Holding 20% or more of voting shares	Disclosure obligation
		Applicability of provisions regarding related party transaction
Parent-subsidiary (the Company Law)	Possibility to control decisions by virtue of: <ul style="list-style-type: none"> • Predominant share participation (typically, more than 50%), • Contract, or • Other. 	The parent can issue mandatory instructions regarding the business of the subsidiary if provided in the subsidiary's charter or the contract between parent and subsidiary.
		Extended liability of the parent for debts of the subsidiary if: <ul style="list-style-type: none"> • The debts are incurred in exercise of the parent's right to issue mandatory instructions (and parent <i>mala fide</i>), or • The insolvency of the subsidiary has been brought about by the parent (and parent <i>mala fide</i>).
		The parent is liable to the subsidiary's shareholders for losses caused deliberately.
Interdependent companies (Tax Code)	<ul style="list-style-type: none"> • Direct or indirect participation exceeding 20% • Other relationship with effect on the results of the transactions in realizing goods or providing labor or services, when recognized by a court. 	Notification obligation and tax liability.
Groups of persons (Antimonopoly Law)	Direct or indirect relationships. → See Section A.4.b in this Chapter	Requirements for notification or <i>ex ante</i> approval.
Affiliated persons (Antimonopoly Law)	→ See section A.4.b in this Chapter	Requirements for notification or <i>ex ante</i> approval.
Financial and Industrial Group (Law on Financial and Industrial Groups)	Group of companies based on: <ul style="list-style-type: none"> • A parent-subsidiary relationship; • A special contract for the establishment of the FIG. 	Requirements for state registration and enhanced state regulation.



Chapter 16

Corporate Governance **Implications** of **Reorganizations**

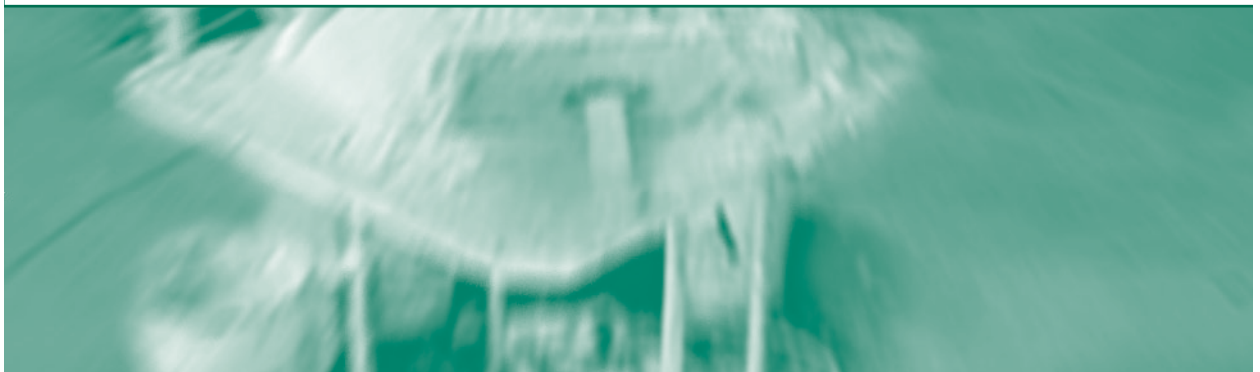


Table of Contents

A. GENERAL OVERVIEW.....	29
1. <i>Types of Reorganizations</i>	29
2. <i>Voluntary and Mandatory Reorganization</i>	29
B. SHAREHOLDER PROTECTION DURING A REORGANIZATION.....	30
C. CREDITOR PROTECTION DURING A REORGANIZATION	31
D. REORGANIZATION PROCEDURES.....	33
1. <i>The Proposal for a Reorganization</i>	33
2. <i>The Preliminary Approval</i>	33
3. <i>Approval</i>	35
4. <i>Transactions with Shares During a Reorganization</i>	36
5. <i>State Registration</i>	37
E. CONSOLIDATIONS	38
1. <i>Documents and Decisions Required for a Consolidation</i>	39
2. <i>Specific Aspects of the Decision-Making Procedure</i>	40
3. <i>Retiring Shares</i>	41
4. <i>Approval by the Competition Authorities</i>	41
5. <i>State Registration</i>	42
F. MERGERS.....	43
1. <i>Documents and Decisions Required for a Merger</i>	44
2. <i>Specific Aspects of the Decision-Making Procedure</i>	44
3. <i>Retiring Shares</i>	44
4. <i>State Registration</i>	45
G. SPLIT-UPS.....	45
1. <i>Documents and Decisions Required for a Split-Up</i>	45
2. <i>Specific Aspects of the Decision-Making Procedure</i>	46
3. <i>State Registration</i>	46

H. SPIN-OFFS OR DIVESTITURES.....	47
1. <i>Documents and Decisions Required for a Divestiture</i>	48
2. <i>Specific Aspects of the Decision-Making Procedure</i>	48
3. <i>Converting, Distributing, or Acquiring Shares</i>	48
4. <i>State Registration</i>	49
I. TRANSFORMATIONS	49
1. <i>Documents and Decisions Required for a Transformation</i>	50
2. <i>Decisions of Participants in the New Legal Entity</i>	50
3. <i>State Registration</i>	50

The Chairman's Checklist

- ✓ Is management's reorganization proposal economically justifiable and legally feasible? Have negotiations with other companies participating in the reorganization been conducted with due diligence and in good faith?
- ✓ Has the Supervisory Board considered the company's reorganization as part of the company's long-term development strategy? If so, has the Supervisory Board carefully deliberated financial, legal, and social implications?
- ✓ Have all documents needed for the approval of the reorganization by the General Meeting of Shareholders been prepared and submitted to shareholders on a timely basis? Are these documents sufficient for shareholders to make an informed decision?
- ✓ Have creditors been duly notified of the planned reorganization? Has the legal succession of all debt been ensured? Has the potential cost of early repayment of debts been properly estimated?
- ✓ Have all the requirements of state registration (including of charter amendments) been met? Have the appropriate state bodies been notified of the reorganization or, if applicable, has their preliminary approval been obtained? Are there any aspects of the proposed reorganization that involve international or foreign rules and regulations?

Companies often respond to a dynamic and changing business environment by reorganizing their operations, for example by recasting their legal structure. They may decide to restructure on a relatively small scale by streamlining, for example, a division or function, or by changing reporting structures.

There are other times when companies will restructure or reorganize themselves on a larger scale. They may acquire or merge with other companies in order to take better advantage of markets or assets, or to achieve greater economies of scope or scale. The joining of existing businesses is generally referred to as a "consolidation" or a "merger". There are other situations when the isolation of business operations, assets, or liabilities is needed. These are generally

Chapter 16. Corporate Governance Implication of Reorganizations

referred to as “spin-offs, sales, or divestitures”. A change to another legal form of company such as, for example, a limited liability company, is referred to as a “transformation”.

Whatever the justification may be for a corporate reorganization, it is typically a complex process that involves the interaction of the company’s governing bodies; it will also typically have corporate governance implications for the rights of shareholders and creditors, as well as other stakeholders, such as employees.

A. General Overview

1. Types of Reorganization

Russian law envisages five different types of company reorganization.⁴³ Figure 1 describes the simplest cases of each type.

2. Voluntary and Mandatory Reorganization

A reorganization is generally voluntary. In specific circumstances, however, legislation may require a company to reorganize.⁴⁴ Such reorganization can take the form of a split-up or divestiture, and is carried out pursuant to the decision of an authorized state body or court ruling.⁴⁵ For example, the Ministry of Antimonopoly Policy and Entrepreneurship Support (MAP) can force the split-up or divestiture of companies if they:⁴⁶

- Have a dominant market position; or
- Have committed two or more violations of antimonopoly legislation.

Companies may also be forced to restructure themselves in the context of bankruptcy proceedings. This chapter refers to reorganizations in the

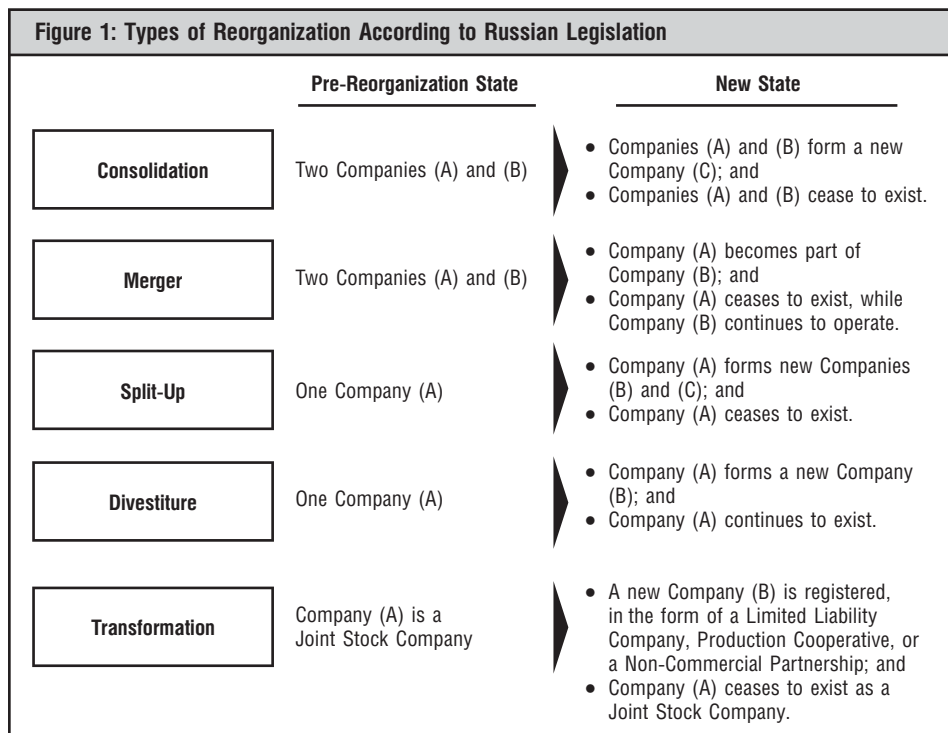
⁴³ Civil Code (CC), Article 57, Clause 1; Law on Joint Stock Companies (LJSC), Article 15, Clause 2.

⁴⁴ CC, Article 57, Clause 2; LJSC, Article 15, Clause 1.

⁴⁵ CC, Article 57, Clause 2.

⁴⁶ Law on Competition and Restricting the Monopoly Activities on the Commodities Markets (Antimonopoly Law), Article 19.

broader sense and focuses only on large-scale voluntary reorganization of companies.



Source: IFC, March 2004

B. Shareholder Protection During a Reorganization

Reorganization is a significant event in the life of a company with potentially far-ranging implications for shareholders. Legislation provides rules that guarantee shareholders access to information about the reorganization, participation in the decision-making process and, in certain circumstances, the right to exit from the company. Some requirements in case of reorganisation include:

Chapter 16. Corporate Governance Implication of Reorganizations

- **Longer notification periods for the General Meeting of Shareholders (GMS):** Notice of the GMS must be given no later than 30 days in advance of the GMS, if the decision to reorganize is placed on the agenda.⁴⁷
- **Longer access periods for information:** Information must be made available 30 days before the GMS.⁴⁸
- **Additional information must be made available to shareholders.**⁴⁹
- **Preferred shareholders have the right to vote on agenda items related to the reorganization.**⁵⁰
- **A supermajority (3/4-majority) of votes is required for the approval of the reorganization.**⁵¹
- **Redemption rights:** Holders of voting shares can demand the redemption of all or part of their shares if they voted against the reorganization or did not participate in the voting during the GMS.⁵²
- **The right to receive the same type of shares in cases of split-up or divestiture:** Shareholders of a company being reorganized either through split-up or divestiture who did not vote on the decision or voted against it are entitled to receive a proportional number of shares in the newly established company(ies) granting them the same rights as before.⁵³

C. Creditor Protection During a Reorganization

Reorganizations may also have important implications for creditors. Changes may be made to the company's assets and/or liabilities that could have an impact on the degree of risk affecting the repayment of debt, or on the terms of the debt agreements themselves. Thus, legislation guarantees the following rights to creditors during a reorganization:⁵⁴

⁴⁷ LJSC, Article 52, Clause 1.

⁴⁸ LJSC, Article 52, Clause 3.

⁴⁹ Federal Commission for the Securities Market (FCSM) Regulation No. 17/ps on Additional Requirements to the Procedure of Preparing, Calling, and Conducting the General Meeting of Shareholders (FCSM Regulation No. 17/ps), 31 May 2002, Section 3.5.

⁵⁰ LJSC, Article 32, Clause 4.

⁵¹ LJSC, Article 49, Clause 4.

⁵² LJSC, Article 75, Clause 1.

⁵³ LJSC, Article 18, Clause 3; Article 19, Clause 3.

⁵⁴ It is also important to keep in mind that contractual agreements with creditors may provide additional guarantees that benefit lenders in the event of the company's reorganization.

a) Notification Requirement

The governing body of the company must notify creditors about the reorganization.⁵⁵ This must be done within 30 days of the day of:

- The decision on the reorganization if this involves a split-up or divestiture; or
- The decision on the reorganization adopted by the last company involved in the reorganization if it involves a consolidation or merger.

Further, the company must notify creditors by:

- Written notification; and
- Publication of the decision in the print media where information on the state registration of companies is published.

b) Options of Creditor Actions

Creditors have the right to request the termination or early performance of the company's obligations, as well as compensation for losses.⁵⁶ Creditors are granted 30 days from the notification day to file a written claim against the debtor.⁵⁷

c) Rules on the Succession of Company Liabilities

Legislation guarantees that liabilities are assumed by the new entities resulting from reorganization. Thus:

- The transfer act and the divided balance sheet required for the reorganization must allocate the rights and obligations of the reorganized entity(ies) to the new entity(ies), thus ensuring legal succession.⁵⁸ If no such provision is made, the state registration authority must refuse the registration of the reorganization.⁵⁹
- If the transfer act or the divided balance sheet makes it impossible to determine the precise legal successor of the reorganized company, all newly established companies will be jointly and severally liable for the debts of the defunct entity(ies).⁶⁰

⁵⁵ CC, Article 60, Clause 1; LJSC, Article 15, Clause 6.

⁵⁶ CC, Article 60, Clause 2.

⁵⁷ LJSC, Article 15, Clause 6.

⁵⁸ CC, Article 59, Clause 1.

⁵⁹ CC, Article 59, Clause 2.

⁶⁰ CC, Article 60, Clause 3; LJSC, Article 15, Clause 6.

D. Reorganization Procedures⁶¹

1. The Proposal for a Reorganization

The executive bodies of a company typically decide how to reorganize, based on the company's goals, and act to initiate and implement the reorganization. The initiation of the reorganization should be consistent with the company's overall strategy as developed and approved by the Supervisory Board and shareholders.

Best Practices: A corporate reorganization is a complex and resource intensive undertaking. Most reorganizations in fact destroy rather than create shareholders value. Some of the preparatory steps that management will thus want to carefully consider include:

- Conducting a full analysis of the commercial and legal (as well as social and political) implications of the reorganization. The analysis should include an assessment of the role of, and the impact upon, shareholders and other stakeholders during and after the reorganization;
- Negotiating the (preliminary) terms and conditions of the reorganization with the executive bodies of other companies participating in the reorganization;
- Preparing documents that will enable the Supervisory Board and the shareholders to make an informed decision on the reorganization; and
- Preparing drafts of the main documents required by the Company Law for the reorganization. These documents are then submitted to the Supervisory Board and the GMS for approval (as well as regulatory bodies where applicable).

2. The Preliminary Approval

A preliminary approval of the Supervisory Board is usually required for a reorganization. The Supervisory Board should consider whether the proposed reorganization is in the best interests of the company and its shareholders. It will

⁶¹ This section summarizes procedural steps common to all types of reorganization. The specific aspects of different types of reorganizations are discussed in this Chapter's Sections E through I.

also need to consider other issues, such as the fate of the reorganizing company's employees. The Supervisory Board must then submit a proposal on reorganizing the company to the GMS for shareholder approval.⁶²

Best Practices: The decision to submit a reorganization for approval to the GMS should only be made after the Supervisory Board has concluded that the reorganization is necessary, and after determining that the negotiated terms are acceptable to the company. The Supervisory Board must be provided with all information necessary to make an informed decision. In addition to the draft documents required for the reorganization, the Supervisory Board should be provided with:⁶³

- Annual reports and balance sheets for the last three reporting years of all companies participating in the reorganization in the case of a consolidation or merger;
- Quarterly reports compiled no later than six months prior to the date of the GMS which will consider the issue of reorganization, if more than six months have passed since the end of the reporting year; and
- The rationale for the reorganization.

In addition, the Supervisory Board should participate actively in finalizing the terms of the company's reorganization.⁶⁴ The Supervisory Board may be involved in the reorganization in a number of ways:

- Individual directors may participate in negotiations conducted by executive bodies; and
- A special, or *ad hoc* Supervisory Board committee, task force, or working group can work with the executive bodies before, during, and/or after the negotiations regarding the reorganization.

Reorganization is of such importance to a company that close oversight by the Supervisory Board during the final stages of the negotiation process is indispensable.

The Supervisory Board should approve the final drafts of the documents by a simple majority vote, unless the charter or by-laws require a supermajority.⁶⁵

⁶² LJSC, Article 16, Clause 2; Article 49, Clause 3.

⁶³ FCSM's Code of Corporate Conduct (FCSM Code), Chapter 6, Section 3.1.2.

⁶⁴ FCSM Code, Chapter 6, Section 3.1.

⁶⁵ LJSC, Article 68, Clause 3.

Chapter 16. Corporate Governance Implication of Reorganizations

Best Practices: Supervisory Board members should be physically present at the Board meeting to recommend the approval of the reorganization by the GMS.⁶⁶ In addition, a higher quorum of $2/3$ of all directors is recommended.⁶⁷

The Supervisory Board should express its position (with minority dissenting views clearly appended to any Board opinion that is not unanimous) regarding the merits and disadvantages of the reorganization along with the other documents that are submitted to the GMS.⁶⁸

3. Approval

a) Preparing for the General Meeting of Shareholders

The preparation for the GMS, which will either approve or reject the corporate reorganization, should not be a last-minute exercise. First, there is a longer legally stipulated notification period (30 instead of 20 days); furthermore, there are also legally-mandated additional disclosure requirements.⁶⁹

A detailed list of information that must be made available to shareholders is set out in the Company Law and securities legislation; additional disclosure requirements may be mandated by the company's charter.⁷⁰

Best Practices: The company's charter should define the materials to be provided to shareholders, including the:⁷¹

- Rationale for the reorganization;
- Annual reports and annual balance sheets for the last three reporting years of all organizations participating in the reorganization;
- Conclusion of a professional securities markets expert;

⁶⁶ FCSM Code, Chapter 3, Section 4.4.

⁶⁷ FCSM Code, Chapter 3, Section 4.15.

⁶⁸ FCSM Code, Chapter 6, Section 3.1.1.

⁶⁹ LJSC, Article 52, Clause 1 and 3.

⁷⁰ LJSC, Article 52.

⁷¹ FCSM Code, Chapter 2, Section 1.3.1; Chapter 7, Section 3.2.1; FCSM Regulation No. 17/ps, Section 3.5.

- Quarterly reports if more than six months have passed since the end of the last reporting year; and
- Any additional information that might be relevant in influencing the decision to approve a reorganization.

Another aspect of GMS preparation relates to the agenda. Voting on the reorganization may involve adopting a number of separate but related resolutions (e.g., on the terms and conditions of the reorganization, on the conversion of shares, or on the election of new governing bodies).

Best Practices: For this reason it is recommended that companies group together, or combine, resolutions on related issues.⁷²

b) Conducting the GMS

The resolution on reorganization must be approved by a $\frac{3}{4}$ -majority vote of shareholders participating in the GMS.⁷³ Both common and preferred shares are allowed to vote on the reorganization of a company.⁷⁴

4. Transactions with Shares During a Reorganization

Different transactions with shares, namely retiring, placing, converting, distributing, or acquiring shares during the reorganization process are regulated by the Company Law, securities legislation, and the terms of the reorganization agreement.⁷⁵ The processes and methods of placing new shares are specified by the Company Law and securities legislation for each type of reorganization.

Best Practices: It is good practice for an Independent Appraiser to determine the conversion ratio of shares in order to ensure a fair transaction.⁷⁶

⁷² FCSM Code, Chapter 2, Section 1.4.3.

⁷³ LJSC, Article 49, Clause 4.

⁷⁴ LJSC, Article 32, Clause 4.

⁷⁵ LJSC, Article 37, Clause 2.

⁷⁶ FCSM Code, Chapter 6, Section 3.2.

Chapter 16. Corporate Governance Implication of Reorganizations

This appraisal should be communicated to the executive bodies, Supervisory Board and shareholders on a timely basis. Confidentiality restrictions should be limited in number and scope to only those that are strictly necessary in the legitimate business interests of the parties involved.

5. State Registration

The state registration of a reorganization is mandatory. Table 1 depicts the different registrations mandated, depending on the type of reorganization.

	Charter Amendments	Striking the Company Off the Register	Registration of Each New Company
Consolidation		✓	✓
Merger	✓	✓	
Split-up		✓	✓
Divestiture	✓		✓
Transformation		✓	✓

→ For more information on how to amend the charter of the reorganizing company, see Part I, Chapter 3, Section A.

a) Registering a New Legal Entity

When reorganization results in a new legal entity, it will need to be registered by the state registration authority at its location. When the new legal entity is located at a place different from that of the reorganized company, the registration requires the cooperation of different regional divisions of the state registration authority.⁷⁷

The following documents need to be submitted to the registration authorities:⁷⁸

⁷⁷ The procedure for this is provided by Regulation No. 440, the Government of the RF, 19 June 2002.

⁷⁸ Law on State Registration of Legal Entities, Article 14; LJSC, Article 15, Clause 6. Some of the documents are specifically mentioned in the CC, Article 59, Clause 2.

- A statement regarding each newly created company confirming that:
 - The founding documents of the newly created legal entity comply with legal requirements,
 - The information included in the founding documents and the statement is true,
 - The transfer act or the divided balance sheet includes provisions regarding the legal succession of all obligations with respect to all creditors,
 - All creditors of the reorganized company have been notified in writing about the reorganization, and
 - The reorganization has been approved by the appropriate state and/or municipal authorities if legally required;
- The founding documents of the newly established entity;
- The reorganization agreement and decision to reorganize;
- The transfer act or the divided balance sheet; and
- Proof of payment of the registration fee.

b) Striking the Reorganized Companies from the Register

The state registration authority makes a record that the reorganized companies cease to exist. It then strikes the reorganized companies from the register of commercial legal entities after receiving information from the registration division registering the newly established legal entities.⁷⁹

E. Consolidations

A consolidation is the combination of separate companies into a single one. It differs from a merger in that a new entity is created.⁸⁰ The newly created company assumes all rights and obligations of the companies participating in the consolidation according to the transfer act.⁸¹ Consolidations allow companies to:

- Achieve economies of scale or scope and operate more efficiently;
- Realize strategic benefits, such as entry into new markets in the case of cross-border consolidations;

⁷⁹ Law on State Registration of Legal Entities, Article 15, Clause 2.

⁸⁰ CC, Article 58, Clause 1; LJSC, Article 16, Clause 1.

⁸¹ LJSC, Article 16, Clause 5.

Chapter 16. Corporate Governance Implication of Reorganizations

- Increase the company's charter capital;
- Improve its capacity to borrow; and
- Raise revenues by the aggregation of sales, through increased market power and more efficient marketing efforts.

1. Documents and Decisions Required for a Consolidation

Each of the companies participating in a consolidation must adopt the documents and decisions as presented in Table 2.

Document	Information Contained in the Document
Consolidation agreement	<p>The consolidation agreement should include the terms and procedures necessary for implementing the consolidation, including:⁸²</p> <ul style="list-style-type: none">• The procedure for converting the shares of each of the consolidating companies into the shares of the new company;• The conditions for conducting the joint GMS of the new company (e.g. voting procedures); and• Other terms and conditions, such as the date of the consolidation, allocation of costs, management (executive) functions, and the liability for breach of agreement.
Transfer act	<p>The transfer act is the main document that deals with the succession of the company's obligations, including any contested obligations.⁸³ Certain documents should be attached to the transfer act.⁸⁴</p>

⁸² LJSC, Article 16, Clauses 2 and 3; FCSM Regulation No. 03-30/ps on the Standards of Security Issue and Registration of Security Prospectuses, 18 June 2003, Section 8.4 also provides for other methods of converting shares of the reorganized companies into the shares of the new company which, however, do not apply to the consolidation of Joint Stock Companies (it applies to Limited Liability Companies, Production Cooperatives, or Non-commercial Partnerships).

⁸³ CC, Article 59, Clause 1; LJSC, Article 16, Clause 5.

⁸⁴ Ministry of Finance Order No. 44n, on the Approval of Methodological Instructions on Formation of Accounting Statements in the Process of Reorganization of Organizations, 20 May 2003, Annex, Section 4.

Table 2: Documents Required for Consolidation	
Document	Information Contained in the Document
Charter of the newly created company	→ For more on charter requirements, see Part I, Chapter 3, Section A, as well as the model company charter in Part VI, Annex 2.
Decision on the reorganization	The decision adopted by the GMS of each consolidating company. ⁸⁵

2. Specific Aspects of the Decision-Making Procedure

a) Exemption from Provisions on Related Party Transactions

When one of the consolidating companies holds more than $\frac{3}{4}$ of voting shares of the other, then the legal provisions on related party transactions do not apply.⁸⁶

→ For more information on related party transactions, see Part III, Chapter 12, Section C.

b) Conducting a GMS of the New Company

A joint GMS of all consolidating companies shall be held after the decision of the companies to consolidate.⁸⁷

Best Practices: The notice of the joint GMS should be given by each consolidating company in accordance with the procedures established for that company by legislation and its charter.⁸⁸

The joint GMS adopts decisions on:

- Electing the governing bodies of the new company;⁸⁹ and
- Other issues related to the founding of the new company, such as adopting a new charter and by-laws.

⁸⁵ LJSC, Article 48, Clause 1, Section 2.

⁸⁶ LJSC, Article 81, Clause 2.

⁸⁷ LJSC, Article 16, Clause 3.

⁸⁸ FCSM Code, Chapter 6, Section 3.3.

⁸⁹ LJSC, Article 16, Clause 3. The Company Law does not describe the procedures for conducting the joint Supervisory Board meeting or joint GMS. It does, however, provide the possibility of specifying voting procedures in the consolidation agreement.

Best Practices: The GMS of the newly created entity should follow all of the regular voting procedures established by law, and its charter and by-laws.⁹⁰ In addition, the consolidation agreement should specify who will perform certain functions at the GMS, including its chairmanship. It is recommended to select individuals who perform these functions from the companies that are a party to the consolidation or from among outside persons who possess relevant special skills or experience. Finally, the agreement should specify individuals who will count the voting results.

3. Retiring Shares

Any shares that a consolidating company holds in another consolidating company, as well as any treasury shares, must be retired.⁹¹

→ For more on retiring treasury shares, see Part III, Chapter 9, Section C.1.

4. Approval by the Competition Authorities

The MAP exercises two forms of control over consolidations: 1) notification; and 2) preliminary approval.⁹²

a) Notification Requirement

Consolidating companies are obliged to notify the MAP within 45 days of state registration, if its assets exceed 100 thousand times the minimum monthly wage.⁹³

If the resulting entity potentially restricts competition, the MAP may prescribe corrective actions.⁹⁴

b) Preliminary Approval

For the consolidation of companies with assets of more than 200 thousand times the minimum monthly wage, preliminary approval of the MAP is required.⁹⁵

⁹⁰ FCSM Code, Chapter 6, Clause 3.4.

⁹¹ LJSC, Article 16, Clause 4.

⁹² This control is based on the general provisions of the CC, Article 57, Clause 3.

⁹³ Antimonopoly Law, Article 17, Clause 5.

⁹⁴ Antimonopoly Law, Article 17, Clause 6.

⁹⁵ Antimonopoly Law, Article 17, Clause 1.

To obtain the MAP's preliminary approval, consolidating companies must submit:⁹⁶

- An application;
- The same documents that need to be submitted to the state registration authority;
- Information on the economic activities and production (or service) volumes of the company; and
- Other information as may be required by the MAP.⁹⁷

The MAP must respond within 30 days of the written application (50 days with an extension).⁹⁸ The MAP may reject the application if:⁹⁹

- The information submitted in the application is untrue; or
- The approval of the consolidation would restrict competition.

Even if competition could be restricted as a result of consolidation, the MAP may grant the approval if:¹⁰⁰

- The applicant proves that negative effects will be offset by the positive effect of the consolidation; or
- The consolidating companies agree to carry out actions to safeguard competition.

The preliminary approval of the MAP is a pre-condition for state registration.¹⁰¹

5. State Registration

Companies are consolidated as of the date when state registration of the newly established company is completed,¹⁰² and the reorganizing companies are stricken from the register.¹⁰³

⁹⁶ Antimonopoly Law, Article 17, Clause 2.

⁹⁷ This list of possible additional information was introduced by the MAP Order No. 276, 13 August 1999.

⁹⁸ Antimonopoly Law, Article 17, Clause 2.

⁹⁹ Antimonopoly Law, Article 17, Clause 3.

¹⁰⁰ Antimonopoly Law, Article 17, Clause 4.

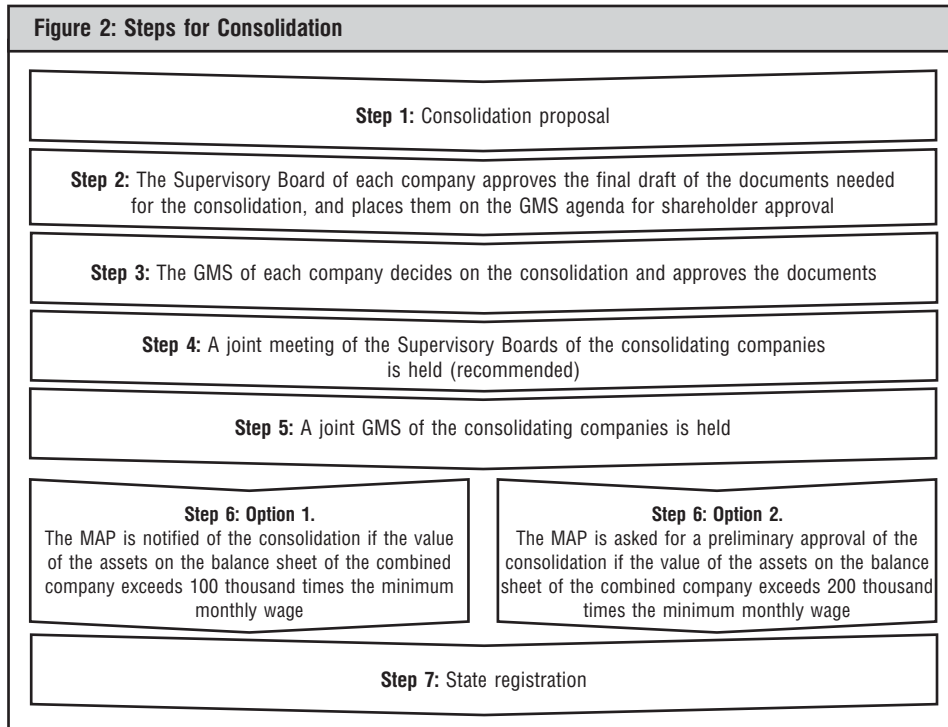
¹⁰¹ Antimonopoly Law, Article 17, Clause 8.

¹⁰² CC, Article 57, Clause 4.

¹⁰³ Law on State Registration of Legal Entities, Article 16, Clause 2.

Chapter 16. Corporate Governance Implication of Reorganizations

Figure 2 summarizes the steps involved in a consolidation.



Source: IFC, March 2004

F. Mergers

A merger is the combination of two or more entities into one, through a purchase or a pooling of interests. A merger differs from a consolidation in that no new entity is created from a merger. Mergers involve the transfer of rights and obligations of one or more companies to another company. One company survives and the other(s) is (are) stricken from the register.¹⁰⁴ The surviving company assumes all of the rights and liabilities of the merging company(ies) according to the transfer act.¹⁰⁵

¹⁰⁴ CC, Article 58, Clause 2; LJSC, Article 17, Clause 1.

¹⁰⁵ LJSC, Article 17, Clause 5.

The advantages of a merger are generally the same as for consolidations. The steps required to carry out a merger closely resemble those of a consolidation. This section focuses on the differences.

1. Documents and Decisions Required for a Merger

In a merger, the following documents need to be submitted to the GMS for shareholder approval by each of the merging companies:¹⁰⁶

- The merger agreement, which sets forth merger terms and conditions, the procedure for converting the shares of the merging companies into surviving company shares, the voting procedure for conducting the joint GMS of the surviving company, and other conditions;
- The transfer act; and
- The decision on reorganization through merger.

2. Specific Aspects of the Decision-Making Procedure

The joint GMS of the merging companies must make decisions on:¹⁰⁷

- Amendments and additions to the charter of the surviving company; and
- Other issues related to the merger, e.g. the adoption of new by-laws.

The decision-making procedure for the joint GMS is specified in the merger agreement.

3. Retiring Shares

Any shares in the merging company that are owned by the surviving company, as well as any treasury shares, must be retired.¹⁰⁸

¹⁰⁶ LJSC, Article 17, Clause 2.

¹⁰⁷ LJSC, Article 17, Clause 3.

¹⁰⁸ LJSC, Article 17, Clause 4.

4. State Registration

The merger is concluded with the registration of the merging company(ies) termination in the state register.¹⁰⁹

Figure 2 above also refers to the steps involved in a merger.

G. Split-Ups

A split-up of companies is the transfer of all rights and obligations of one company to a number of newly created companies, and the termination of the original company.¹¹⁰ The newly created companies assume all the rights and liabilities of the original company according to the divided balance sheet.¹¹¹ A split-up typically allows a company to:

- Rid itself of units (divisions) that are either underperforming, no longer important to the achievement of its strategic goals, or potentially worth more as separate units than as part of a whole;
- Grant legal personality to previously existing sub-divisions (e.g. in order for these to benefit from an Initial Public Offering (IPO));
- Comply with specific legal requirements in different jurisdictions in which the company now (or in the future) operates;
- Comply with the requirements of competition authorities or to reorganize in the context of bankruptcy proceedings; and
- Better resolve corporate conflicts with shareholders.

1. Documents and Decisions Required for a Split-Up

Figure 3 illustrates the decisions and documents needed to split a company:¹¹²

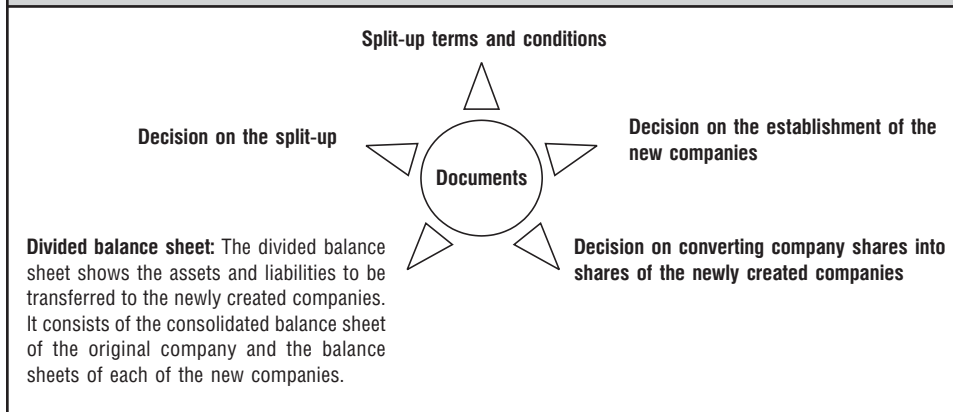
¹⁰⁹ Law on State Registration of Legal Entities, Article 16, Clause 5.

¹¹⁰ CC, Article 58, Clause 3; LJSC, Article 18, Clause 1.

¹¹¹ LJSC, Article 18, Clause 4.

¹¹² LJSC, Article 18, Clauses 2 — 4; Ministry of Finance Order No. 44n on the Approval of Methodological Instructions on Formation of Accounting Statements in the Process of Reorganization of Organizations, 20 May 2003, Annex, Section 4.

Figure 3: Documents Required for a Split-Up



Source: IFC, March 2004

2. Specific Aspects of the Decision-Making Procedure

The GMS of the original company is followed by separate GMS of the new companies created by split-up, each of which must:¹¹³

- Adopt a new company charter;
- Form governing bodies; and
- Decide on other issues related to the governance of the new company, such as adopting new by-laws.

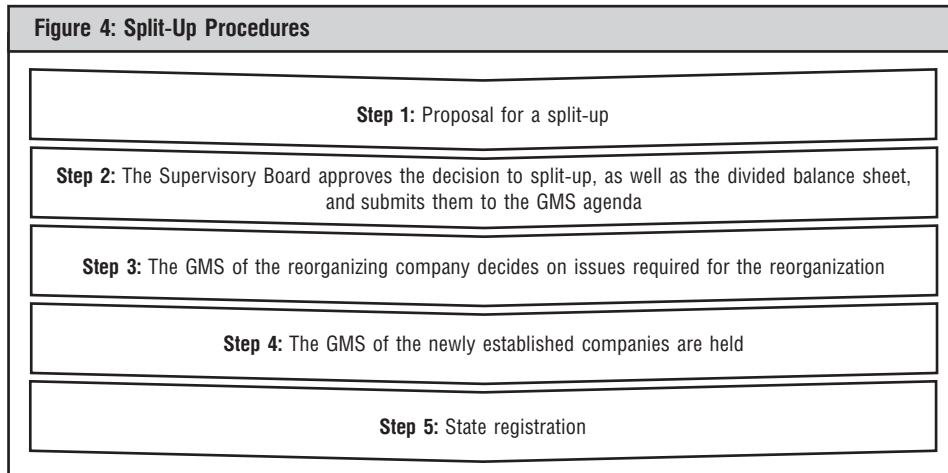
3. State Registration

The split-up is legally recognized as of the state registration of the last of the newly established companies.¹¹⁴

Figure 4 summarizes steps involved in carrying out a split-up.

¹¹³ LJSC, Article 18, Clause 3.

¹¹⁴ Civil Code, Article 57, Clause 4; Law on State Registration of Legal Entities, Article 16, Clause 3.



Source: IFC, March 2004

H. Spin-Offs or Divestitures

Spin-offs or divestitures are the establishment of one (or more) new company(ies) with the transfer thereto of a portion of the rights and obligations of the company being reorganized without its termination.¹¹⁵ Companies often choose to divest assets that are:

- Underperforming;
- Not part of the company's core business; or
- Worth more as separate entities than as part of the company.

A spin-off or divestiture may also be used to remedy mismatches between acquired companies and parent companies or to comply with the requirements of competition authorities. The newly created company(ies) assume(s) part of the assets and liabilities of the original company according to a divided balance sheet.¹¹⁶ Unlike in a split-up, the original company continues to exist.¹¹⁷

The steps for carrying out a divestiture closely resemble those of a split-up, and, therefore, the following text focuses only on differences.

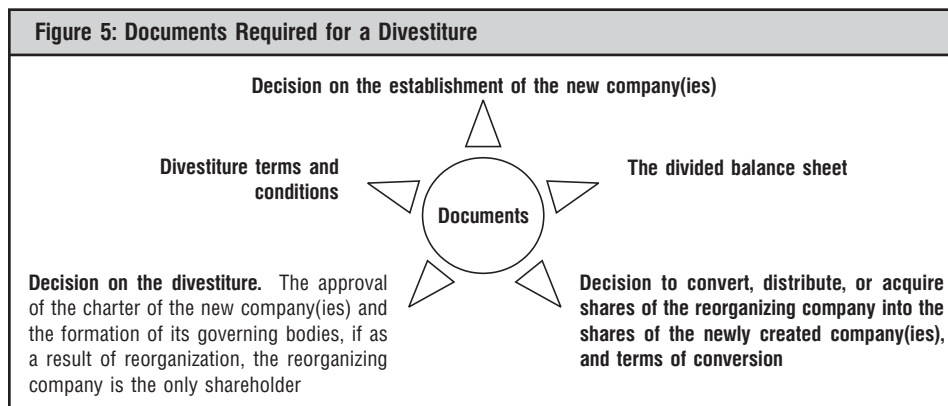
¹¹⁵ LJSC, Article 19, Clause 1.

¹¹⁶ LJSC, Article 19, Clause 4.

¹¹⁷ CC, Article 58, Clause 4; LJSC, Article 19, Clause 1.

1. Documents and Decisions Required for a Divestiture

Figure 5 shows the documents and decisions required to implement a divestiture.¹¹⁸



Source: IFC, March 2004

2. Specific Aspects of the Decision-Making Procedure

If the divesting company is not the sole shareholder in the spin-off, the GMS of each newly created company must:¹¹⁹

- Approve a new charter;
- Form governing bodies; and
- Decide on other issues, such as the adoption of new by-laws.

3. Converting, Distributing, or Acquiring Shares

The shares of the divesting company must be exchanged for the shares of the newly established company(ies). This can be done by:¹²⁰

- Conversion;
- Distribution of the new company's shares to the shareholders of the divesting company without consideration; or
- Acquisition of these shares by the divesting company.

¹¹⁸ LJSC, Article 19, Clause 2 and 3.

¹¹⁹ LJSC, Article 19, Clause 3.

¹²⁰ LJSC, Article 19, Clause 2.

4. State Registration

The divestiture is completed when the state registration of the last of the divested companies is completed.¹²¹

Figure 4 above also refers to the steps involved in carrying out a spin-off or divestiture.

I. Transformations

A joint stock company may transform itself into another type of legal entity. Transformation of a company involves the transfer of all rights and obligations to a newly formed legal entity based on a transfer act, whereby the joint stock company is terminated.¹²² The legal forms of entities include a:

- Limited liability Company (LLC);
- Production Co-operative; or
- Non-commercial Partnership.¹²³

Company Practices in Russia: Transformations frequently occur when minority shareholders are bought out by the company's controlling shareholder(s) who wish(es) to take the company private. Indeed, many companies involuntarily became joint stock companies through privatization, regardless of their size and ability to carry the costs of this legal form. A transformation, thus, continues to be a useful tool to make a company's economic identity consistent with its legal identity.

There are important differences between joint stock companies on the one hand, and LLCs, production cooperatives, and non-commercial partnerships, on the other. Mostly, these relate to the rights of shareholders (members), relationships between the governing and other internal bodies, and disclosure requirements.

→ *For a general discussion on the advantages (and disadvantages) of joint stock companies relative to LLCs, see Part I, Chapter 2, Section A.*

¹²¹ Law on State Registration of Legal Entities, Article 16, Clause 4.

¹²² CC, Article 58, Clause 5; LJSC, Article 20, Clause 4.

¹²³ Law on Non-Commercial Organizations, Article 8.

1. Documents and Decisions Required for a Transformation

The GMS must adopt the following decisions for the company transformation:¹²⁴

- Decision on the transformation;
- Decision on the terms and conditions of the transformation; and
- Decision on the conversion of shares into the stakes of members of a limited liability company or the contributions of the members of a production co-operative.

2. Decisions of Participants in the New Legal Entity

The participants in the new legal entity must decide on:¹²⁵

- The founding documents of the new legal entity; and
- The formation of the governing bodies of the new legal entity.

These decisions need to conform with applicable legislation for the particular legal form to be adopted.

3. State Registration

The company transformation is completed as of the moment of the state registration of the newly established legal entity, whereupon the original company ceases to exist.¹²⁶

¹²⁴ LJSC, Article 20, Clause 2.

¹²⁵ LJSC, Article 20, Clause 3.

¹²⁶ Law on the State Registration of Legal Persons, Article 16, Clause 1.

Chapter 17

Enforcement and Remedies



Table of Contents

A. GENERAL OVERVIEW.....	54
1. <i>Enforcement Structures</i>	54
2. <i>Available Remedies</i>	54
B. ENFORCEMENT BY JUDICIAL AUTHORITIES.....	55
1. <i>Court Jurisdiction</i>	55
2. <i>Provisional Remedies</i>	58
3. <i>Statute of Limitations</i>	66
4. <i>Types of Claims</i>	66
5. <i>Administrative Procedures in Arbitration Courts</i>	67
6. <i>Enforcement Authority of the Prosecutor's Office and Criminal Liability of Directors and Managers</i>	70
7. <i>Execution of Court Acts and the Role of Bailiffs</i>	73
C. ALTERNATIVE DISPUTE RESOLUTION	74
D. ENFORCEMENT BY REGULATORS AND ADMINISTRATIVE AUTHORITIES.....	76
1. <i>Enforcement by the Federal Commission for the Securities Markets</i>	76
2. <i>Enforcement by Other Regulatory Bodies</i>	79
E. STOCK EXCHANGES AND SELF-REGULATORY BODIES	80
1. <i>Listing Rules</i>	80
2. <i>Self-Regulatory Organizations</i>	82
F. PUBLIC PRESSURE	82
1. <i>Non-Governmental Organizations</i>	83
2. <i>Shareholder Activism</i>	84
G. SELF-ENFORCEMENT	85
1. <i>The Federal Commission for the Securities Market's Code of Corporate Conduct</i>	85
2. <i>Self-Enforcement Through Internally Established Procedures</i>	87
3. <i>Internal Dispute Resolution</i>	88

The Chairman's Checklist

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

Effective corporate governance involves the interplay of five key elements:

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

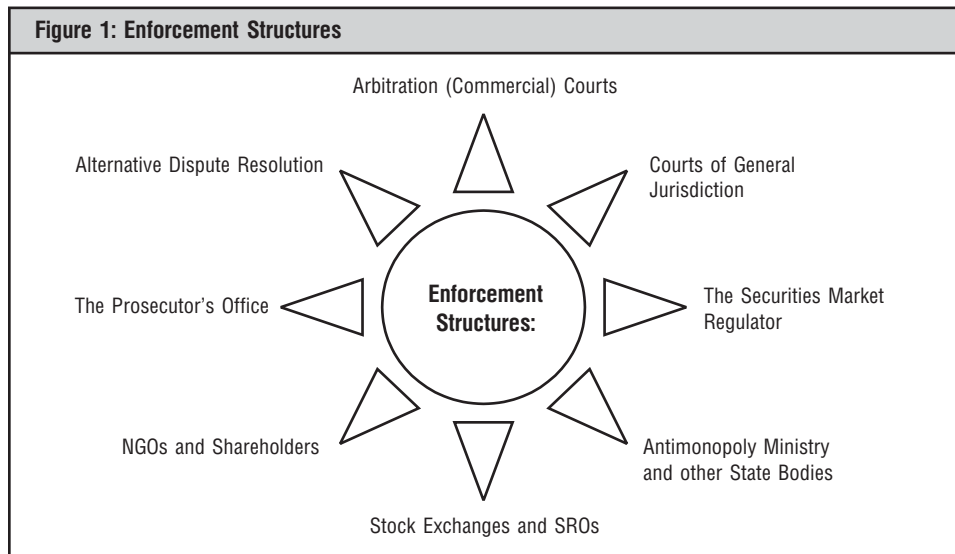
The Russia Corporate Governance Manual

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

A. General Overview

1. Enforcement Structures

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



Source: IFC, March 2004

2. Available Remedies

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

¹²⁷ Civil Code (CC), Article 12.

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

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

B. Enforcement by Judicial Authorities

1. Court Jurisdiction

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

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

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

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

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

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

¹³¹ Arbitration Procedure Code, Article 27, Clause 1.

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

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

b) Venue in Corporate Litigation

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

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

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

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

¹³³ Civil Procedure Code, Article 22, Clause 4.

¹³⁴ Arbitration Procedure Code, Article 35.

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

¹³⁶ Arbitration Procedure Code, Article 36.

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

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

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

- A bankruptcy notice may only be filed with an arbitration court at the location of the debtor;
- An “application for establishing circumstances of legal significance” or declaratory judgment¹³⁹ should be filed with an arbitration court at the location or place of residence of the plaintiff, except for applications relating to the legal status of immovable property, which are filed with a court at the location of the property;
- An application challenging a bailiff’s decisions or actions (omissions) should be filed with an arbitration court at the location of the bailiff;
- An application related to a dispute between Russian legal entities that have activities or property on the territory of a foreign country should be filed with an arbitration court at the place of state registration of the defendant on the territory of the Russian Federation; and
- A counterclaim may be filed only with the same court as the original action.¹⁴⁰

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

¹³⁷ Arbitration Procedure Code, Article 37.

¹³⁸ Arbitration Procedure Code, Article 38.

¹³⁹ The closest U.S. legal equivalent to “an application for establishing circumstances of legal significance” is “declaratory judgment”.

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

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

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

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

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

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

2. Provisional Remedies

a) General Provisions

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

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

¹⁴² Arbitration Procedure Code, Article 39, Clause 1.

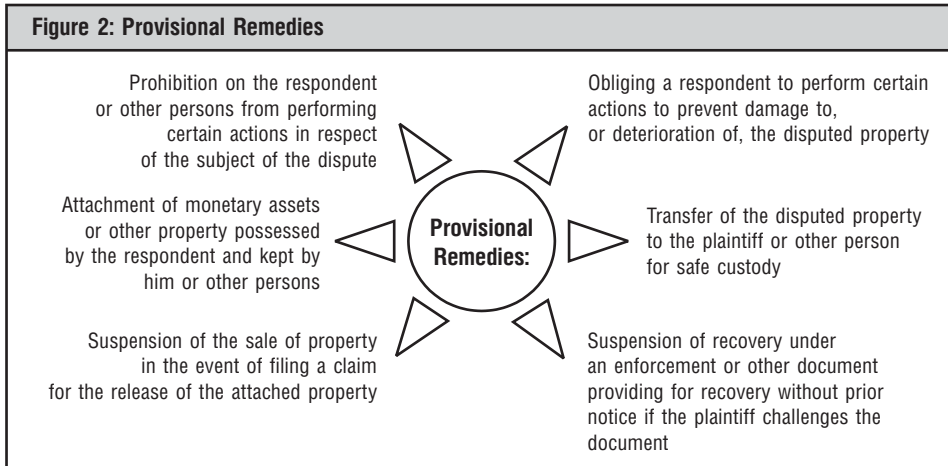
¹⁴³ Arbitration Procedure Code, Article 156, Clause 2.

¹⁴⁴ Arbitration Procedure Code, Articles 23 — 33.

¹⁴⁵ Arbitration Procedure Code, Article 90, Clause 2.

¹⁴⁶ Arbitration Procedure Code, Article 91, Clause 2.

by Chapter 8 of the Arbitration Procedure Code apply. However, the Supreme Arbitration Court has interpreted provisions regarding provisional remedies as discussed, which are shown in Figure 2.¹⁴⁷



Source: IFC, March 2004

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

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

¹⁴⁷ Arbitration Procedure Code, Article 91.

¹⁴⁸ Arbitration Procedure Code, Article 92, Clause 1.

¹⁴⁹ Arbitration Procedure Code, Article 93, Clause 1.

¹⁵⁰ Arbitration Procedure Code, Article 96, Clause 1.

¹⁵¹ Arbitration Procedure Code, Article 93, Clause 6.

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

b) Preliminary Provisional Remedies

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

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

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

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

c) Protection of Defendant Rights

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

¹⁵² Arbitration Procedure Code, Article 99.

¹⁵³ Arbitration Procedure Code, Article 99, Clause 5.

¹⁵⁴ Arbitration Procedure Code, Article 94.

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

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

d) Protection Against Abusive Use of Provisional Remedies

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

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

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

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

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

¹⁵⁵ Arbitration Procedure Code, Article 94, Clause 2.

¹⁵⁶ Arbitration Procedure Code, Article 98.

rendered¹⁵⁷ and, therefore, a defendant would not have the right to apply for reimbursement of losses.¹⁵⁸ As a result, plaintiffs often file frivolous claims to obtain a court order on provisional remedies. After a period, the plaintiff withdraws its claim and thus makes itself immune from liability for the defendant's losses. Since the arbitration court does not have to provide for the plaintiff's security bond, the plaintiff does not have to reimburse the losses borne by the defendant because of such provisional remedies. These losses may be significant enough to bankrupt even large companies.

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

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

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

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

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

¹⁶⁰ Resolution No. 11, Section 1.

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

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

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

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

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

¹⁶³ Resolution No. 11, Section 3.

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

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

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

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

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

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

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

e) Application of Provisional Remedies by Courts of General Jurisdiction

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

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

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

¹⁶⁷ Civil Procedure Code, Chapter 13.

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

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

3. Statute of Limitations

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

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

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

4. Types of Claims

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

¹⁶⁹ CC, Articles 196 and 200.

¹⁷⁰ CC, Article 181, Clause 2.

¹⁷¹ CC, Article 181, Clause 1.

¹⁷² LJSC, Article 49, Clause 7.

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

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

5. Administrative Procedures in Arbitration Courts

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

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

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

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

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

Challenges to normative legal acts¹⁷⁵ of the President, the Russian Government, and federal executive bodies fall under the exclusive jurisdiction of the Supreme

¹⁷³ See Section D of this Chapter.

¹⁷⁴ Arbitration Procedure Code, Article 189, Clause 1.

¹⁷⁵ Arbitration Procedure Code, Chapter 23.

Arbitration Court.¹⁷⁶ Since the FCSM is a federal executive body, its normative acts may be challenged only in the Supreme Arbitration Court, which, in this case, is the court of first instance. Non-normative (individual) acts¹⁷⁷ of the President, the Government, State Duma, and Federation Council also fall under the exclusive jurisdiction of the Supreme Arbitration Court.¹⁷⁸ However, non-normative legal acts of federal and local executive bodies (including non-normative rulings and orders of the FCSM) should be challenged in an arbitration court at the location of the body or official whose act is being challenged.

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

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

b) Arbitration Court Authority over Administrative Offences

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

An application shall be filed with the arbitration court at the offender's location or place of residence¹⁸³ by the regulatory body that has such authority.¹⁸⁴ The administrative hearing must (as a rule) be completed within 15 days after an application has been filed. If necessary, this term may be extended for one month.¹⁸⁵

¹⁷⁶ Arbitration Procedure Code, Article 34, Clause 2.

¹⁷⁷ Arbitration Procedure Code, Chapter 24.

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

¹⁷⁹ Arbitration Procedure Code, Article 193, Clause 3.

¹⁸⁰ Arbitration Procedure Code, Article 199, Clause 3.

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

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

¹⁸³ Arbitration Procedure Code, Article 203.

¹⁸⁴ Arbitration Procedure Code, Article 202, Clause 2.

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

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

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

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

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

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

¹⁸⁶ Arbitration Procedure Code, Article 208, Clause 1.

¹⁸⁷ Arbitration Procedure Code, Article 210, Clause 1.

¹⁸⁸ Code of Administrative Offences, Article 3.11.

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

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

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

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

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

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

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

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

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

a) The Prosecutor’s Office in Civil Litigation

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

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

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

¹⁹⁵ Arbitration Procedure Code, Article 52.

¹⁹⁶ Civil Procedure Code, Article 45.

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

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

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

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

b) Prosecutor's Office in Criminal Litigation

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

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

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

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

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

secret,¹⁹⁸ and refusal to provide information when required to do so by legislation;¹⁹⁹

- Offences related to the issuance of securities;²⁰⁰
- Offences in the field of bankruptcy, such as illegal actions in the course of bankruptcy,²⁰¹ deliberate bankruptcy,²⁰² and fictitious bankruptcy;²⁰³ and
- Offences related to the abuse of authority by management²⁰⁴ and commercial bribery.²⁰⁵

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

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

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

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

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

¹⁹⁹ Criminal code, Article 185.1.

²⁰⁰ Criminal Code, Article 185.

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

²⁰² Criminal Code, Article 196.

²⁰³ Criminal Code, Article 197.

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

²⁰⁵ Criminal Code, Article 204.

²⁰⁶ Criminal Procedure Code, Article 20, Clause 4.

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

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

7. Execution of Court Acts and the Role of Bailiffs

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

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

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

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

²⁰⁷ Criminal Procedure Code, Article 221.

²⁰⁸ Criminal Procedure Code, Article 246.

²⁰⁹ Law on Bailiffs, Article 12.

²¹⁰ Law on Bailiffs, Article 14.

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

²¹² Law on Execution Procedure, Article 45.

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

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

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

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

C. Alternative Dispute Resolution

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

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

²¹³ Law on Execution Procedure, Article 11.

²¹⁴ Law on Bailiffs, Article 13.

²¹⁵ Law on Execution Procedure, Article 13.

²¹⁶ Law on Execution Procedure, Article 9.

Arbitration is not prohibited by law. However, arbitral decisions will be revoked if it is found that an arbitration tribunal lacks jurisdiction to try the case.²¹⁷ The Arbitration Procedure Code states that disputes between shareholders and companies fall under the “special jurisdiction” of arbitration courts.²¹⁸ Actually, the precise meaning of the phrase “special jurisdiction” is (as yet) unclear. Although Article 33 does not state that arbitration tribunals²¹⁹ may not resolve corporate disputes, the words “special jurisdiction” may be interpreted in this way.

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

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

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

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

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

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

²¹⁸ Arbitration Procedure Code, Article 33.

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

²²⁰ Law On Securities Market, Article 15.

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

D. Enforcement by Regulators and Administrative Authorities

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

1. Enforcement by the Federal Commission for the Securities Markets

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

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

a) Authority over Professional Participants of the Securities Market

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

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

²²¹ Law on the Securities Market, Chapter 2.

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

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

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

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

b) Right to Seek the Liquidation of a Company

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

c) Right to Assist Other Law-Enforcement Agencies

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

d) Right to Apply Administrative Liability

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

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

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

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

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

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

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

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

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

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

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

²²⁷ Code of Administrative Offences, Article 15.21.

²²⁸ Code of Administrative Offences, Article 15.20.

²²⁹ Code of Administrative Offences, Article 15.22.

²³⁰ Code of Administrative Offences, Article 15.23.

²³¹ Investor Protection Law, Article 14, Clause 1.

²³² Investor Protection Law, Article 14, Clause 2.

2. Enforcement by Other Regulatory Bodies

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

a) Antimonopoly Ministry

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

b) Other Regulatory Bodies

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

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

²³³ Antimonopoly Law, Articles 17 and 18.

²³⁴ Antimonopoly Law, Article 19, Clause 1.

²³⁵ Antimonopoly Law, Article 6, Clause 5.

²³⁶ Code of Administrative Offences, Article 14.21.

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

²³⁸ Code of Administrative Offences, Article 14.22.

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

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

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

E. Stock Exchanges and Self-Regulatory Bodies

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

1. Listing Rules

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

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

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

²⁴⁰ Code of Administrative Offences, Article 15.11.

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

²⁴² See Section B.6 of this Chapter.

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

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

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

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

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

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

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

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

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

2. Self-Regulatory Organizations

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

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

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

F. Public Pressure

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

²⁴⁴ RTS Listing Rules, section 3.

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

1. Non-Governmental Organizations

NGOs can help shareholders exercise their rights.

a) The Russian Investor Protection Association

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

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

b) The Russian Union of Industrialists and Entrepreneurs

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

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

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

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

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

2. Shareholder Activism

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

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

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

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

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

- To prohibit the Supervisory Board, Executive Board, and their respective chairmen from approving or carrying out any restructuring plan involving changes to the capital structure of RAO UES and its subsidiaries, as well as other entities without the approval of $\frac{3}{4}$ -majority of voting shares at the GMS;
- To lower the number of votes required to approve the early termination of the Chairman of the Executive Board;
- To require that most transactions with the assets of RAO UES and its subsidiaries (including subsidiaries of such subsidiaries), and the liquidation

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

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

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

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

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

G. Self-Enforcement

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

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

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

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

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

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

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

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

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

²⁴⁶ CC, Article 5.

2. Self-Enforcement Through Internally Established Procedures

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

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

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

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

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

3. Internal Dispute Resolution

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

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

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

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

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

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

²⁴⁸ FCSM Code, Chapter 10, Section 2.1.2.

²⁴⁹ FCSM Code, Chapter 10, Section 1.1.2.

²⁵⁰ FCSM Code, Chapter 10, Section 3.1.2.

Chapter 17. Enforcement and Remedies

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



INTERNATIONAL FINANCE CORPORATION
A Member of the World Bank Group



Good corporate governance contributes to a company's competitiveness and reputation, facilitates access to capital markets, and thus helps develop financial markets and spur economic growth. With this in mind, the International Finance Corporation and the U.S. Department of Commerce have combined their efforts to provide Russian managers, directors, and shareholders with a practical tool to implement good corporate governance practices – the Russia Corporate Governance Manual. This Manual refers to and is based on the principal laws and regulations that apply to open joint stock companies. It follows the recommendations of the FCSM's Code of Corporate Conduct and refers to internationally accepted principles of good corporate governance.

“Corporate governance is vital to the interests of every economy, and government has a role to play in establishing the framework for reform - but it is companies that have the tough job of putting governance reform into practice. This is where the Corporate Governance Manual can provide excellent help. It offers a comprehensive workbook for company directors, officers, and advisers in taking up the challenge of corporate governance improvement. Shareholders and stakeholders alike should applaud IFC for bringing practical, and professional advice within reach of every boardroom.”

Anne Simpson, Manager,
Global Corporate Governance Forum

“Corporate governance reform in Russia is the continuation of the more general processes of change affecting the country as a whole. Taken together, these developments have created a new environment, new rules regulating the relationships between the market and regulators, between shareholders, shareholders and managers, etc. In the business community there is a growing awareness of the benefits of corporate governance reform, and companies are now working on improving the quality of their corporate governance ...”

Ruben K. Vardanian, President of Troika Dialogue; Chairman of the Board,
OJSC Rosgosstrakh; and Chairman of the RSPP Corporate Governance Committee

“Good corporate governance is a key driver of financial transparency and managerial accountability, essential ingredients for national prosperity in a global economy. We congratulate the U.S. Department of Commerce and the International Financial Corporation of the World Bank for their initiative in bringing about the publication of the Russia Corporate Governance Manual.”

Andrew B. Somers, President,
American Chamber of Commerce in Russia

Questions on corporate governance should be addressed to the IFC Russia Corporate Governance Project, via CGPRussia@ifc.org

An electronic version of the Manual is available on the website of the International Finance Corporation under www.ifc.org/rcgp and the U.S. Department of Commerce under www.mac.doc.gov/ggp

The Russia Corporate Governance Manual

VI Part VI Annexes Model Corporate Governance Documents



Prepared and Published by the International Finance Corporation and the U.S. Department of Commerce

In Partnership with the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs and the Swiss State Secretariat for Economic Affairs



The Russia **Corporate Governance** Manual

Part VI

Annexes

Model Corporate Governance Documents

Prepared and Published by the International Finance Corporation
and the U.S. Department of Commerce

In Partnership with the Agency for International Business
and Cooperation of the Dutch Ministry of Economic Affairs
and the Swiss State Secretariat for Economic Affairs

First edition: 10,000 copies in Russian, 1,500 copies in English.

Published in 6 Parts

Printed in Moscow, Russia.

ISBN 5-9614-0085-9

Copyright © 2004 International Finance Corporation
2121 Pennsylvania Ave. NW, Washington, DC 20433, United States of America
A Member of the World Bank Group

Design copyright © 2004 Alpina Business Books

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, for commercial purposes without the prior permission of the International Finance Corporation.

Contents

<i>Important Notice</i>	1
PART I – CORPORATE GOVERNANCE INTRODUCED	3
<i>Annex 1. The IFC Corporate Governance Progression Matrix for Russian Companies</i>	4
<i>Annex 2. A Model Company Charter</i>	9
<i>Annex 3. A Table of Charter Provisions</i>	41
<i>Annex 4. A Model Company-Level Corporate Governance Code</i>	55
<i>Annex 5. A Model Code of Ethics</i>	73
PART II – GOOD BOARD PRACTICES	81
<i>Annex 6. A Model By-Law for the Supervisory Board</i>	83
<i>Annex 7. A Model By-Law for the Supervisory Board's Audit Committee</i>	109
<i>Annex 8. A Model By-Law for the Supervisory Board's Corporate Governance Committee</i>	119
<i>Annex 9. A Model By-Law for the Supervisory Board's Nominations and Remuneration Committee</i>	127
<i>Annex 10. A Model By-Law for the Supervisory Board's Strategic Planning and Finance Committee</i>	135
<i>Annex 11. A Model By-Law for the Executive Bodies</i>	143
<i>Annex 12. A Model By-Law for the Corporate Secretary</i>	155
<i>Annex 13. A Model Contract With the Non-Executive Director</i>	163
<i>Annex 14. A Model Employment Contract with the General Director</i>	171
<i>Annex 15. A Model Employment Contract with the Corporate Secretary</i>	183
<i>Annex 16. Model Minutes for a Supervisory Board Meeting</i>	191
<i>Annex 17. A Model Checklist for the Supervisory Board's Self-Evaluation</i>	195
<i>Annex 18. A Model Definition of an Independent Director</i>	199
PART III – SHAREHOLDER RIGHTS	201
<i>Annex 19. A Model By-Law for the General Meeting of Shareholders</i>	203
<i>Annex 20. A Model By-Law on Dividends</i>	229
<i>Annex 21. A Model Notice of the General Meeting of Shareholders</i>	235
<i>Annex 22. A Model Power of Attorney for an Individual</i>	237
<i>Annex 23. A Model Power of Attorney for a Legal Entity</i>	239
<i>Annex 24. Time Charts for the Preparation of the Extraordinary General Meeting of Shareholders</i>	241
PART IV – INFORMATION DISCLOSURE AND TRANSPARENCY	245
<i>Annex 25. A Model By-Law on Information Disclosure</i>	247
<i>Annex 26. A Model By-Law for the Revision Commission</i>	263
<i>Annex 27. A Model By-Law on Risk Management</i>	273
<i>Annex 28. A Model By-Law on Internal Control</i>	283
<i>Annex 29. Guidelines on the Annual Report</i>	303
<i>Annex 30. Glossary of English and Russian Corporate Governance Terminology</i>	315

IMPORTANT NOTICE

The model documents contained in the following Annexes are intended to guide a company in drafting and/or amending its internal documents to meet good corporate governance standards. These documents meet the requirements set forth in Russian law, recommendations proposed in the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), and internationally recognized best practices utilized by specific companies at the time of this Manual's publication.

These documents have been developed for companies with the following characteristics:

- The company is an open joint stock company;
- The company has subsidiaries;
- State ownership does not exceed 25% of the charter capital, and golden share arrangements do not exist;
- The company has more than 50 shareholders;
- The company has a Supervisory Board;
- The Supervisory Board has the right to increase the charter capital by issuing authorized shares;
- The company has a Revision Commission;
- The company has a General Director and an Executive Board;
- The External Registrar responsible for maintaining the shareholder register is a specialized organization, which is also responsible for carrying out the functions of the Counting Commission;
- Supervisory Board members are elected by cumulative voting;
- Shareholder(s) holding not less than 2% of voting shares may call a Supervisory Board meeting;
- The procedures for preparing and conducting the General Meeting of Shareholders (GMS) are regulated in the by-law for the GMS;
- The company has a Corporate Secretary; and
- The company has created Supervisory Board committees, specifically the Audit Committee, Corporate Governance Committee, Nominations and Remuneration Committee, and Strategic Planning and Finance Committee.

Other companies, irrespective of their legal form, size (in terms of turnover, assets, employees, and/or shareholders), ownership structure, and public listing, may

The Russia Corporate Governance Manual

benefit from making use of these model documents. However, they should carefully choose and/or adapt the documents to meet their specific needs, and are best advised to carefully consider the costs *versus* the benefits of implementing specific corporate governance structures. In any event, the model documents contained in these Annexes should not be adopted on a wholesale basis, but rather tailored to meet the specific characteristics of each company.

These model documents may be used separately and independently from one another, although many of the provisions contained in different documents are interrelated.

Developing the company's governance structure goes beyond words on paper. The company's management and/or Supervisory Board will be well served to assess the need for specific corporate governance structures and processes before drafting and/or amending specific internal documents. The authors recommend that these model documents be used in conjunction with the Manual that has been jointly prepared by the IFC Russia Corporate Governance Project and the U.S. Department of Commerce. Moreover, the company will benefit from corporate training sessions to ensure that the structures and processes contained in these Annexes are understood by the governing bodies and properly implemented in practice.

Finally, these model documents must not be used without, or viewed as a substitute for, professional legal or any other advice that one would normally use in preparing internal company documents.

Part 1

Corporate Governance Introduced

Annex 1

THE IFC CORPORATE GOVERNANCE PROGRESSION MATRIX FOR RUSSIAN COMPANIES

	Level 1: Compliance with legal and regulatory requirements	Level 2: Initial steps to improve corporate governance are made	Level 3: Advanced corporate governance system	Level 4: Corporate Governance leadership
Legal Compliance	<p>✓ The company has developed and follows a valid charter according to Russian legislation with provisions on the protection of shareholder rights and the equitable treatment of shareholders, distribution of authority between the General Meeting of Shareholders (GMS), the Supervisory Board and executive bodies, and information disclosure, and transparency of the company's activities.</p>	<p>✓ The company has developed and follows by-laws regulating the activities and working procedures of the corporate bodies approved by the GMS (the GMS, Supervisory Board, Executive Board, and Revision Commission).</p>	<p>✓ The company has developed and follows a comprehensive set of internal documents that are recommended by the Federal Commission of the Securities Market Code of Corporate Conduct (FCSM Code) and are approved by the Supervisory Board.</p>	<p>✓ The company has adopted a company level corporate governance code and code of ethics, and follows internationally recognized best practices of corporate governance.</p>
I. Commitment to CG	<p>✓ n/a</p>	<p>✓ The company has a person/officer responsible for the implementation of corporate governance policies in the company.</p> <p>✓ The company follows the main recommendations of the FCSM Code and discloses information to the FCSM on a "comply or explain" basis.</p>	<p>✓ The company has a designated officer(s) responsible only for ensuring the development of, compliance with, and periodic review of corporate governance policies and practices in the company (for example, the Corporate Secretary).</p> <p>✓ The company has an explicit and clearly stated plan in place to improve its governance practices and has taken initial steps to implement this plan.</p>	<p>✓ The company has formally established a committee of the Supervisory Board responsible for supervising the governance policies and practices of the company (e.g. Corporate Governance Committee).</p> <p>✓ The Company is publicly recognized as a national leader and among the global leaders in corporate governance.</p>
Meetings	<p>✓ The company has established the Supervisory Board in accordance with legal requirements.</p> <p>✓ The Supervisory Board meets at least once a year.</p>	<p>✓ Detailed procedures for calling and conducting Supervisory Board meetings are clearly defined in by-laws.</p> <p>✓ The Supervisory Board meets at least four times a year.</p> <p>✓ The Supervisory Board keeps minutes of its meetings that include voting results on an individual basis.</p>	<p>✓ The Supervisory Board meets regularly (at least once every six weeks as recommended by the FCSM Code).</p>	<p>✓ The non-executive directors meet separately from executive directors at least once a year.</p>

Annex 1. The IFC Corporate Governance Progression Matrix for Russian Companies

II. Supervisory Board and General Director/Executive Board	Composition/Independence	Comitees	Remuneration	Expertise	Executive Board
<p>✓ Executive Board members do not exceed 25% of the total number of Supervisory Board members.</p>	<p>✓ The charter or the by-laws require the proposing shareholder and other shareholders to provide additional information to the company on the proposed candidates to the Supervisory Board.</p> <p>✓ The number of Supervisory Board members is set in the charter and not by decision of the GMS.</p> <p>✓ The majority of Supervisory Board members are non-executive (outside) directors.</p>	<p>✓ The Supervisory Board has an Audit Committee.</p> <p>✓ Supervisory Board members receive an annual retainer in accordance with a contract signed with the company.</p>	<p>✓ The composition of the Supervisory Board (competencies/skill mix) is adequate for oversight duties and development of company direction and strategy.</p> <p>✓ The Supervisory Board has an independent director, who meets the definition of the FCSM Code.</p>	<p>✓ The company's Supervisory Board includes an experienced financial expert who is a non-executive director.</p> <p>✓ At least 25% or not less than three members of the Supervisory Board are independent directors.</p>	<p>✓ The company has properly appointed the General Director and Executive Board in accordance with Russian legislation.</p>
<p>✓ n/a</p>	<p>✓ The Supervisory Board has an Audit Committee that is chaired by an independent director and is entirely composed of non-executive directors.</p> <p>✓ The Supervisory Board has at least one other committee (e.g. on Nominations and Remuneration).</p>	<p>✓ The annual retainer of non-executives is linked to meeting attendance and additional responsibilities, such as chairmanship and/or work on committees.</p> <p>✓ The company publicly discloses the remuneration of each director on an aggregate basis.</p>	<p>✓ The company's Supervisory Board has other specialized committees as recommended by the FCSM Code or international best practice (e.g. on Strategic Planning, Conflict Resolution).</p> <p>✓ The Audit and Remuneration Committees are composed entirely of independent directors.</p>	<p>✓ The company publicly discloses the remuneration of each director on an individual basis.</p>	<p>✓ The Company has adopted an executive remuneration policy, consisting of a fixed and variable component, inline with internationally recognized principles and practices.</p>
<p>✓ n/a</p>	<p>✓ The company conducts regular training programs to its Supervisory Board and executive bodies.</p>	<p>✓ The company publicly discloses the remuneration of each director on an aggregate basis.</p>	<p>✓ The Supervisory Board conducts regular self-evaluations on a collective and individual basis.</p>	<p>✓ The Supervisory Board conducts regular self-evaluations on a collective and individual basis.</p>	<p>✓ The company has developed a procedure for periodic reports (information briefs) of the General Director and/or Executive Board to the Supervisory Board.</p> <p>✓ The company has a succession plan in place that outlines how it will deal with the loss of senior executives should this occur.</p>

		Level 1: Compliance with legal and regulatory requirements	Level 2: Initial steps to improve corporate governance are made	Level 3: Advanced corporate governance system	Level 4: Corporate Governance leadership
III. Disclosure and Transparency	General	<ul style="list-style-type: none"> ✓ The company meets the main requirements of legislation on issuer reporting by preparing and publishing regular quarterly reports, material information (facts), reports, etc. ✓ Shareholders are provided with information (actual documents) upon their request and as specified by legislation. 	<ul style="list-style-type: none"> ✓ The company discloses information on: <ul style="list-style-type: none"> — affiliated parties and the affiliation of Supervisory Board members; — extraordinary and related party transactions; — Supervisory Board meetings; and — the GMS. 	<ul style="list-style-type: none"> ✓ The company discloses information on the remuneration of the General Director and members of the Executive Board. ✓ The company publishes a comprehensive annual report that includes a corporate governance section. 	<ul style="list-style-type: none"> ✓ The company discloses its corporate governance practices and other material information on the Internet in a timely manner.
	Internal Control	<ul style="list-style-type: none"> ✓ The company has a Revision Commission that meets at least once a year. 	<ul style="list-style-type: none"> ✓ The Revision Commission's scope of work goes beyond legal requirements and is set forth in the by-laws. ✓ The Revision Commission meets regularly (at least four times a year). 	<ul style="list-style-type: none"> ✓ The Revision Commission consists of independent members and at least one member is an experienced financial expert. ✓ The company has a risk management and an internal control system that reports to the General Director and/or Executive Board. 	<ul style="list-style-type: none"> ✓ The results of the work of the Revision Commission are disclosed to shareholders. ✓ The company has a risk management and an internal control system that reports to the Supervisory Board. ✓ The company has an Internal Auditor that reports to the Supervisory Board.
	Financials	<ul style="list-style-type: none"> ✓ The company keeps records and prepares its financial statements in accordance with Russian Accounting Standards. 	<ul style="list-style-type: none"> ✓ The company discloses its financial statements to the public. 	<ul style="list-style-type: none"> ✓ The company keeps records and prepares its financial statements in accordance with IFRS or U.S. GAAP. 	<ul style="list-style-type: none"> ✓ The company's financial statements prepared in accordance with IFRS or U.S. GAAP are properly disclosed.
	External Audit	<ul style="list-style-type: none"> ✓ The company's financial statements are audited annually by an External Auditor. 	<ul style="list-style-type: none"> ✓ The company's External Auditor is independent of the management and major shareholders of the company 	<ul style="list-style-type: none"> ✓ The company's External Auditor is a publicly recognized independent auditing firm. 	<ul style="list-style-type: none"> ✓ The company periodically rotates its audit partner. ✓ The remuneration of the External Auditor is disclosed to shareholders.
	Ownership	<ul style="list-style-type: none"> ✓ n/a 	<ul style="list-style-type: none"> ✓ The beneficial controlling shareholder (50%+1 share) can be identified by the information disclosed by the company. 	<ul style="list-style-type: none"> ✓ The beneficial controlling and blocking shareholders can be identified by the information disclosed by the company. 	<ul style="list-style-type: none"> ✓ The beneficial owners of 5% of voting shares can be identified from the information disclosed by the company.

Annex 1. The IFC Corporate Governance Progression Matrix for Russian Companies

IV. Shareholders Rights	
Minority SH Rights	<p>✓ The company's charter provides for equal rights to all shareholders possessing shares of the same type and class with respect to voting, subscription, and transfer rights.</p> <p>✓ Minority shareholders have representatives on the Supervisory Board.</p> <p>✓ The company has a clearly articulated and enforceable policy in place that protects the rights of minority shareholders in special circumstances, such as change of control.</p> <p>✓ The company has a positive track record on minority shareholder protection. ✓ The company has a system of registering shareholder complaints and effectively regulating corporate disputes.</p>
The General Meeting of Shareholders	<p>✓ The agenda of the GMS is not changed after it is approved by the Supervisory Board.</p> <p>✓ The shareholders receive advance notice of the GMS in a timely manner along with material information; the location is accessible for the majority of shareholders.</p> <p>✓ The shareholders are informed of the decisions made by the GMS and the voting results in accordance with legal requirements.</p> <p>✓ The External Registrar of the company is independent from management and the company's major shareholders.</p> <p>✓ The shareholders have access to additional materials (information) other than what is required by law during the preparation for the GMS.</p> <p>✓ The shareholders have the opportunity to ask questions at the GMS.</p> <p>✓ The procedures for counting votes at the GMS are transparent and exclude the possibility of manipulating voting results.</p> <p>✓ The company charter has a special provision specifying the list of materials made available to the shareholders on specific items of the agenda of the GMS.</p> <p>✓ The company has effective shareholder voting mechanisms in place (e.g. supermajority voting) to protect minority shareholder against unfair actions.</p> <p>✓ Shareholders have the possibility to use electronic means of communication (including the internet) for voting.</p> <p>✓ The company posts materials for the GMS, as well as decisions of the most recent GMS, on its internet site.</p>
Dividends	<p>✓ n/a</p> <p>✓ The company has formally developed and follows a by-law on dividend policy.</p> <p>✓ The company pays declared dividends not later than 60 days after a decision to declare dividends is made.</p> <p>✓ The company's by-law on dividend policy is publicly disclosed.</p>



Annex 2

A MODEL COMPANY CHARTER

Approved
by the General Meeting of Shareholders
of the Open Joint Stock Company «_____»

Minutes of the [Annual or Extraordinary]
General Meeting of Shareholders

No. _____
of _____ 200_

dated this ___ day of _____, 200_
[The Company's Seal]

C H A R T E R

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	10
ARTICLE 2.	THE NAME AND LOCATION OF THE COMPANY	11
ARTICLE 3.	THE PURPOSE AND ACTIVITIES OF THE COMPANY	11
ARTICLE 4.	THE CHARTER CAPITAL, SECURITIES, AND FUNDS OF THE COMPANY	12
ARTICLE 5.	THE RIGHTS AND OBLIGATIONS OF SHAREHOLDERS AND DIVIDENDS	14
ARTICLE 6.	THE GOVERNING BODIES OF THE COMPANY	17
ARTICLE 7.	THE GENERAL MEETING OF SHAREHOLDERS	17
ARTICLE 8.	THE SUPERVISORY BOARD	24
ARTICLE 9.	THE EXECUTIVE BODIES	32
ARTICLE 10.	THE CORPORATE SECRETARY	36
ARTICLE 11.	THE REVISION COMMISSION AND EXTERNAL AUDITOR.....	37
ARTICLE 12.	THE ANNUAL REPORT OF THE COMPANY	38
ARTICLE 13.	MISCELLANEOUS PROVISIONS	39

Article 1. General Provisions

- 1.1. «_____», an Open Joint Stock Company (hereinafter the Company), was established pursuant to the decision of _____ [enter the name of the governing body that approved the decision] dated as of _____ [enter date].
- 1.2. The Company shall be governed by the present charter (hereinafter the Charter) and any applicable provisions of the Civil Code of the Russian Federation, the Federal Law on Joint Stock Companies, the Federal Law on the Securities Market, and other legislation of the Russian Federation, as well as any other legal acts and regulations adopted pursuant thereto (hereinafter the Law). The Charter also takes into account the recommendations of the Russian Code of Corporate Conduct as developed by the Federal Commission for the Securities Market (hereinafter the FCSM Code).
- 1.3. The duration of the Company shall be unlimited unless reorganized or liquidated pursuant to the Charter and the Law.

Article 2. The Name and Location of the Company

- 2.1. The full registered name of the Company is:
 - 2.1.1. Открытое акционерное общество «_____» (in Cyrillic letters);
 - 2.1.2. Open Joint Stock Company «_____» (in Latin letters).
- 2.2. The abbreviated registered name of the Company is:
 - 2.2.1. ОАО «_____» (in Cyrillic letters);
 - 2.2.2. OJSC «_____» (in Latin letters).
- 2.3. The Company's location and postal address is _____, the Russian Federation, being the location where the Company is registered and where the General Director is located. The Company shall notify the competent registration authorities of its postal address and any changes thereto in the established manner.
- 2.4. The Company has a branch [or a representative office] in the following location in the Russian Federation [and abroad]_____.¹

Article 3. The Purpose and Activities of the Company

- 3.1. The principal purpose of the Company shall be _____ in order to earn profits.
- 3.2. The Company may engage in the following activities with the aim of accomplishing its principal purposes as set forth in Article 3.1. above, while operating within the parameters set forth in the Law and subject to obtaining all necessary licenses or permits:
 - 3.2.1. Conduct all activities related to _____;
 - 3.2.2. _____;
 - 3.2.3. _____;
 - 3.2.4. _____; and

¹ Law on Joint Stock Companies (LJSC), Article 5, Clause 6, provides that information about a company's branches and representative offices must be included in the charter. If the Company does not have branches and/or representative offices, the charter may include a provision that no branches and representative offices have been established.

- 3.2.5. Carry out any and all other activities not prohibited by the Charter or the Law within the Russian Federation or beyond its borders for the accomplishment of the Company's purposes.

Article 4. Charter Capital, Securities, and Funds of the Company

- 4.1. The charter capital of the Company (hereinafter the Charter Capital) shall consist of the nominal value of all shares issued to shareholder(s) and amounts to _____ [in digits] (_____) [in words] Rubles, being the equivalent of _____ [in digits] (_____) [in words] U.S. dollars [alternatively, in Euros] at the official exchange rate of the Central Bank of the Russian Federation on the date of the state registration of the Company's Charter.²
- 4.2. All shares of the Company are registered shares. The Charter Capital is divided into _____ [in digits] (_____) [in words] shares of common stock, each share having a nominal value of _____ [in digits] (_____) [in words] Rubles, and _____ [in digits] (_____) [in words] shares of preferred stock of class A, each share having a nominal value of _____ [in digits] (_____) [in words] Rubles, and _____ [in digits] (_____) [in words] shares of preferred stock of class B, each share having a nominal value of _____ [in digits] (_____) [in words] Rubles, the total value of which comprises one hundred percent (100%) of the Charter Capital.
- 4.3. In addition to the aforementioned issued shares, the Company shall be authorized to issue _____ [in digits] (_____) [in words] additional shares of common stock having a nominal value of _____ [in digits] (_____) [in words] Rubles per share,³ _____ [in digits] (_____) [in words] shares of preferred stock of class A, each share having a nominal value of _____ [in digits] (_____) [in words] Rubles, and _____ [in digits] (_____) [in words] shares of

² This is recommended in cases where the company's charter includes assets denominated in foreign currency.

³ LJC, Article 27, Clause 1. This provision is optional. However, the company may wish to include such a provision in the charter to ease its ability to increase the charter capital, which is only possible within the limits of the authorized charter capital and authorized shares.

Annex 2. A Model Company Charter

preferred stock of class B, each share having a nominal value of _____ [in digits] (_____) [in words] Rubles (the “Authorized Common Shares” [and “Authorized Preferred Shares”, respectively]) granting the same rights as issued shares, by decision of the [General Meeting of Shareholders (hereinafter the GMS) < or > Supervisory Board].⁴

4.4. Once the initial Charter Capital has been paid in full:

4.4.1. The Company is authorized to issue options for the acquisition of shares of the Company.⁵ If the Company issues options to acquire shares, the number of authorized shares cannot be less than the number of shares that can be acquired if the options are exercised. The Company may issue options to acquire shares of a specific type and class if the number of shares included in such options does not exceed 5% of the placed shares of that type and class;

4.4.2. The Company shall be authorized to increase its Charter Capital by decision of the GMS⁶ or the Supervisory Board either by:

4.4.2.1. Increasing the nominal value of the Company’s issued shares; or

4.4.2.2. Issuing additional shares in one or more installments, however, subject to the limitations contained in the Charter regarding the total number of Authorized Shares [and Authorized Preferred Shares], and with a corresponding amendment of the Charter.⁷

⁴ LJSC, Article 27, Clause 1. This provision is optional. However, the company may wish to include such a provision in the charter to make it easier to increase the charter capital, which is only possible within the limits of the authorized charter capital and authorized shares.

⁵ Law on the Securities Market, Article 27.1. The regulation of stock options is a novelty in Russian practice. For this reason, the charter provides guidance on how it can be reflected in the Charter.

⁶ LJSC, Article 28, Clause 2; Article 48, Clause 1, Section 6. This provision is optional. The authority to increase the charter capital may be delegated to the Supervisory Board by the charter or by decision of the GMS (LJSC, Article 12, Clause 2; Article 28, Clause 2). The Supervisory Board may increase the charter capital only by issuing authorized shares.

⁷ LJSC, Article 27. Note the requirement of LJSC, Article 27, Clause 2 that, in the case of issuing convertible securities, the number of authorized shares of the specific type and class may not be less than the number of shares needed for conversion. The GMS may also increase the number of authorized shares and issue these shares at the same time. Note that there are anti-dilution rules where the state holds 25% of shares (LJSC, Article 28, Clause 6).

The Russia Corporate Governance Manual

- 4.5. The Charter Capital may be decreased by decision of the GMS either by decreasing the nominal value of shares or by purchasing a portion of shares for the purpose of reducing the total number of outstanding shares.
- 4.6. Payment for the shares so purchased may be made in cash, securities, assets or property rights, or other rights having monetary value.
- 4.7. The value of any subsequent contributions in-kind to the Charter Capital shall be determined by the Supervisory Board in accordance with the Law. In cases of in-kind contributions to the Charter Capital, their valuation shall be based on an appraisal by an Independent Appraiser.
- 4.8. The Company must establish a reserve fund in the amount of _____ [in digits] (_____) [in words] percent of the Charter Capital.⁸
- 4.9. Annual deductions from the net profits of the Company to be transferred to the reserve fund shall be _____ [in digits] (_____) [in words] percent of the net profits until the reserve fund reaches the amount stipulated by Article 4.8 hereof.⁹

Article 5. Rights and Obligations of Shareholders and Dividends

- 5.1. Each common share shall entitle its owner to equal rights. Each common share grants its owner one vote at the GMS on all matters,¹⁰ and the right to receive dividends and a portion of the Company's assets in the event of the Company's liquidation.
- 5.2. Preferred shares of the same class possess the same rights and have the same nominal value. Preferred shares have no voting rights at the GMS unless otherwise provided for by the Law.

⁸ LJSC, Article 35, Clause 1 provides that the reserve fund may not be less than 5% of the charter capital. In addition, the company may establish other funds that are not required by legislation.

⁹ LJSC, Article 35, Clause 1 provides that the annual deductions from the net profits of the company to the reserve fund may not be less than 5% of the net profits.

¹⁰ The exception to the principle of one share-one vote is cumulative voting.

Annex 2. A Model Company Charter

- 5.2.1. Class A preferred shares¹¹ entitle their owners, relative to the owners of common shares and other classes of preferred shares, with first priority for receiving dividends and receiving the liquidation value of shares belonging to them.¹²
- 5.2.2. The dividend on each preferred share of class A is ____ [in digits] (_____) [in words] Rubles per year, payable annually no later than ____ [in digits] (_____) [in words] days after the date of the GMS.¹³
- 5.2.3. Any unpaid dividends or dividends not fully paid on class A preferred shares shall accumulate and be paid once the decision to pay dividends on shares of class A is made.
- 5.2.4. The liquidation value of each class A preferred share is ____ [in digits] (_____) [in words] Rubles.¹⁴
- 5.2.5. Each class A preferred share entitles its owner to ____ [in digits] (_____) [in words] votes on all issues on which class A preferred shares provide the right to vote.
- 5.2.6. Class B preferred shares¹⁵ grant their owners second priority for receiving payments for dividends and receiving the liquidation value of shares belonging to them, that is, they receive such payments only after the payment of dividends on class A preferred

¹¹ Class A preferred shares in this case are cumulative preferred shares. LJSC, Article 32, Clause 3 provides that the charter may have a provision for the conversion of preferred shares of a specific class into common shares or preferred shares of another class. If this is provided, the charter must specify the procedure for conversion, in particular, the number, type, and class of the shares into which they are converted and other conversion terms. It is prohibited to amend the said provisions of the charter after the decision is made to float converted preferred shares.

¹² These are only some of the preferences that can be provided for preferred shares. The charter may provide other or additional preferences for preferred shares.

¹³ The charter may provide other ways of determining the amount of dividends to be paid on preferred shares of each class, for example, a percentage of net profits. The period between declaration and the actual payment of dividends shall not exceed 60 days as recommended by the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 9, Section 2.1.3.

¹⁴ The charter may provide other ways of determining the liquidation value to be paid on preferred shares of each class. For example, the percentage of assets left after the satisfaction of claims of creditors can be distributed equally between the owners of class A preferred shares.

¹⁵ Class B preferred shares in this case are non-cumulative preferred shares.

- shares and payment of the liquidation value of class A preferred shares has been completed.
- 5.2.7. The dividend on each preferred share of class B is ____ [in digits] (_____) [in words] Rubles per year, payable annually no later than ____ [in digits] (_____) [in words] days after the date of the GMS.¹⁶
- 5.2.8. The liquidation value of each class B preferred share is ____ [in digits] (_____) [in words] Rubles.
- 5.2.9. Each class B preferred shares entitles its owner to ____ [in digits] (_____) [in words] votes on all issues on which class B preferred shares provide the right to vote.
- 5.3. Shareholders shall have such other rights and obligations as established by the Charter and the Law.¹⁷
- 5.4. The Company has the right to declare and pay dividends on common shares based on the results of each quarter and/or the results of the fiscal year. The Company shall pay declared dividends within _____ [in digits] (_____) [in words] days after the decision to declare dividends has been approved.¹⁸
- 5.5. Dividends shall be paid in money.¹⁹
- 5.6. The failure to pay declared dividends or the incomplete payment of dividends may be a ground for the Supervisory Board to reduce the remuneration of the General Director.²⁰

¹⁶ LJSC, Article 32, Clause 2 provides that if the date for accumulating and paying dividends against preferred shares of a specified class is not specified by the charter, preferred shares of that class are not deemed to be cumulative.

¹⁷ Shareholders have obligations with regard to the rules on related party transactions (LJSC, Articles 81–84), the disclosure of their affiliation with the company (LJSC, Article 93), and confidentiality (Civil Code, Article 67, 139).

¹⁸ LJSC, Article 42, Clause 4. The charter may specify the period during which declared dividends shall be paid. If that period is not specified, the Company Law requires that declared dividends be paid no later than 60 days from the date of approval. FCSM Code, Chapter 9, Section 2.1.3 recommends that in no case should the period for payment of declared dividends exceed 60 days.

¹⁹ LJSC, Article 42, Clause 1 provides that the charter may specify circumstances when dividends are paid in kind. FCSM Code, Chapter 9, Section 2.1.4. recommends that dividends be paid in cash.

²⁰ FCSM Code, Chapter 9, Section 3.

Article 6. The Governing Bodies of the Company

- 6.1. The Company shall have the following governing bodies:
 - 6.1.1. The GMS;
 - 6.1.2. The Supervisory Board;
 - 6.1.3. The General Director; and
 - 6.1.4. The Executive Board.

Article 7. The General Meeting of Shareholders

- 7.1. The GMS is the highest governing body of the Company.
- 7.2. The Annual General Meeting of Shareholders (hereinafter the AGM) must be held annually on the following date: _____ [*insert a date between March 1 and June 30*].
- 7.3. All GMS other than the AGM shall be Extraordinary General Meetings of Shareholders (hereinafter the EGM).
- 7.4. The GMS shall be valid if a quorum is present.²¹
- 7.5. The detailed procedures for preparing and conducting the GMS are specified by the Law, the Charter, and by-laws of the Company.
- 7.6. The AGM shall be held in the Russian Federation in the place where the Company is located or at another location if so specified in the by-laws of the Company or by the Supervisory Board.
- 7.7. The following issues fall within the authority of the GMS and shall be decided upon by a simple majority vote of shareholders participating in the GMS:
 - 7.7.1. An increase in the Charter Capital by increasing the nominal value of placed shares;
 - 7.7.2. An increase in the Charter Capital by issuing additional common and preferred shares through open subscription;

²¹ LJSC, Article 58, Clause 1 defines a quorum for the original and any reconvened GMS. In companies with more than 500 thousand shareholders, the charter may specify a lower quorum for the reconvened GMS. FCSM Code, Chapter 2, Section 2.3 recommends that the quorum for any reconvened GMS in large companies be not less than 20% of voting shares.

- 7.7.3. A reduction of the Charter Capital by decreasing the nominal value of issued shares;
- 7.7.4. A reduction of the Charter Capital by reducing the number of issued shares by retiring purchased or redeemed shares;
- 7.7.5. Splitting and consolidating shares;
- 7.7.6. The election and dismissal of Supervisory Board members;²²
- 7.7.7. Setting the number of Supervisory Board members;²³
- 7.7.8. The approval of the remuneration for Supervisory Board members;
- 7.7.9. The delegation of the authority of the General Director to an External Manager;
- 7.7.10. The election and dismissal of Revision Commission members;
- 7.7.11. The approval of the terms of compensation and remuneration for Revision Commission members;
- 7.7.12. The approval of the annual reports, annual financial statements, including balance sheet, profit and loss statements, statement of cash-flows, and notes to the financial statements, as well as the distribution of profits and losses based on the results of the fiscal year;
- 7.7.13. The declaration and payment of dividends based on the results of each quarter and/or the results of the fiscal year;
- 7.7.14. The election of the External Auditor;
- 7.7.15. Establishing procedures for conducting the GMS;²⁴
- 7.7.16. The election and dismissal of Counting Commission members;²⁵

²² LJSC, Article 66, Clause 4, Paragraph 13, states that directors who are elected with cumulative voting do not necessarily require a simple majority of votes to be elected. The candidates who receive the most votes are elected, which can be fewer than a simple majority of votes.

²³ LJSC, Article 66, Clause 3, Paragraph 1. The number of directors can be determined either by the charter (see Article 8.2 of the Charter) or decision of the GMS.

²⁴ It is advisable to specify the procedures for conducting the GMS in the company's by-laws. LJSC, Article 49, Clause 5 provides that either the charter or by-laws of the company may establish the procedures for decision-making on the issue.

²⁵ LJSC, Article 56, Clause 1, Paragraph 2. If the company has more than 500 shareholders with voting rights, the functions of the Counting Commission shall be performed by the External Registrar of the company. In companies with fewer shareholders with voting rights, the External Registrar could be assigned the functions of the Counting Commission.

Annex 2. A Model Company Charter

- 7.7.17. Designating the number of Counting Commission members;
 - 7.7.18. The approval of internal documents that regulate the activities of the Company's governing bodies (the Supervisory Board, the General Director, and the Executive Board);
 - 7.7.19. The approval of the by-law for the Revision Commission;
 - 7.7.20. The approval of the reimbursement of expenses for preparing and conducting an EGM if convened by parties other than the Supervisory Board;
 - 7.7.21. The approval of extraordinary transactions that are subject to the approval of the Supervisory Board in cases where the Supervisory Board failed to unanimously approve the transaction and transferred the authority for its approval to the GMS;
 - 7.7.22. The approval of related party transactions in cases specified by the Law on Joint Stock Companies;
 - 7.7.23. A waiver of the obligation of the controlling shareholders to make a buy-out offer during control transactions;²⁶
 - 7.7.24. Determine the list of additional documents that must be kept by the Company;
 - 7.7.25. Authorization for the Company to participate in holding companies, financial and industrial groups, and any associations or other unions of commercial entities; and
 - 7.7.26. Requesting an extraordinary inspection of the financial and economic activities of the Company by the Revision Commission.
- 7.8. A decision of the GMS on the following issues shall be adopted if a three-fourths majority vote of shareholders participating in the GMS is reached:
- 7.8.1. Amending the Charter or approving a new version of the Charter;
 - 7.8.2. The reorganization of the Company;

²⁶ LJSC, Article 80 provides for a waiver of the right to acquire shares in a company with more than 1,000 shareholders in case of acquisition of 30% or more of the company's common shares.

- 7.8.3. The liquidation of the Company and the appointment of the Liquidation Commission;
 - 7.8.4. The approval of the interim and final liquidation balance sheets;
 - 7.8.5. The determination of the number, nominal value, types, and classes of authorized shares that can be issued and placed by the Company, as well as which rights attach to these shares;
 - 7.8.6. The approval of extraordinary transactions involving more than 50 percent of the book value of assets of the Company;
 - 7.8.7. A buyback of shares by the Company in cases specified by the Law on Joint Stock Companies;²⁷
 - 7.8.8. The issue of additional shares through closed subscription;²⁸
 - 7.8.9. The issue of convertible securities through closed subscription;²⁹
 - 7.8.10. The issue of additional shares through open subscription that are 25 or more percent of already placed common shares;³⁰ and
 - 7.8.11. The issue of convertible securities if such securities can be converted into 25 or more percent of already issued common shares.³¹
- 7.9. A decision of the GMS on amending the Charter that limits the rights of preferred shareholders shall be adopted if the decision is approved by:³²
- 7.9.1. A three-fourths majority vote of preferred shareholders of the class whose rights will be affected as a result of Charter amendments; and

²⁷ LJSC, Article 72, Clause 1 provides that the charter may delegate this authority to the Supervisory Board. To avoid potential abuses, the company may not wish to delegate this authority to the Supervisory Board.

²⁸ LJSC, Article 39, Clause 3. The charter may require a higher number of votes to adopt the specified decision.

²⁹ LJSC, Article 39, Clause 3. The charter may require a higher number of votes to adopt the specified decision.

³⁰ LJSC, Article 39, Clause 4, Paragraph 1. The charter may require a higher number of votes to adopt the specified decision.

³¹ LJSC, Article 39, Clause 4, Paragraph 2. The charter may require a higher number of votes to adopt the specified decision.

³² LJSC, Article 32, Clause 4, Paragraph 2. The charter may require a higher number of votes to adopt the specified decision.

Annex 2. A Model Company Charter

- 7.9.2. A separate three-fourths majority vote of all other shareholders with voting rights participating in the GMS.
- 7.10. A decision on those issues set forth in sections 7.7.9, 7.7.12–7.7.13, 7.8.2–7.8.4 can be taken only if submitted by the Supervisory Board.
- 7.11. [A decision on those issues set forth in sections 7.7.1–7.7.2, 7.7.11, 7.7.18–7.7.19, 7.7.21–7.7.22, 7.7.25, 7.8.6–7.8.8, 7.8.10 can be taken only if submitted by the Supervisory Board.³³]
- 7.12. Issues falling within the authority of the GMS may not be delegated to the executive bodies of the Company.
- 7.13. The notification of the GMS and the voting ballot together with a sample power of attorney³⁴ shall be sent _____ days prior to the GMS³⁵ to all shareholders included in the list of shareholders entitled to participate in the GMS by registered mail [*option*: and/or published in _____ [*name of the printed media*], _____ [*name of the printed media*], and _____ [*name of the printed media*].³⁶ The notification for the GMS may be sent by other means of communication.
- 7.14. The following information and documents shall be made available for shareholders _____ days prior to the GMS:³⁷

³³ Unless the charter provides otherwise.

³⁴ FCSM Code, Chapter 2, Section 1.7 recommends this in order to provide shareholders with the possibility to vote through an authorized representative.

³⁵ LJSC, Article 52, Clause 1 provides that shareholders be notified of the GMS at least 20 days prior to the GMS, at least 30 days prior to the GMS if the agenda covers the reorganization of the company, and 50 days in the event of an EGM if the agenda includes the election of directors by cumulative voting. FCSM Code, Chapter 2, Section 1.1.1 recommends a notification period of at least 30 days.

³⁶ LJSC, Article 52, Clause 1 provides that notification by registered mail is the default rule. The charter, however, may provide for other ways of notification in lieu of, or in addition to, registered mail such as publication in the print media, which requires the charter to specify the name of the print media, personal delivery, and possibly other means of notification. FCSM Code, Chapter 2, Section 1.1.4 also recommends that the company select several print media.

³⁷ LJSC, Article 52, Clause 3 provides a list of information (materials) that shall be submitted to the shareholders as part of the preparation for the GMS. FCSM Code, Chapter 2, Section 1.3.1 recommends additional materials and documents.

- 7.14.1. The annual financial statements, including the balance sheet, profit and loss statement, statement of cash flows, and notes to the financial statements;
 - 7.14.2. The minutes of the Revision Commission and report of the Revision Commission that verifies the data in the annual report;
 - 7.14.3. The report of the External Auditor;
 - 7.14.4. Information on proposed candidates for the position of the General Director, and members of the Executive Board, the Supervisory Board, the Revision Commission, and the Counting Commission;
 - 7.14.5. The draft of amendments to the Charter, if any;
 - 7.14.6. The draft of the new version of the Charter, if any;
 - 7.14.7. Drafts of any internal documents of the Company if same have been submitted for approval;
 - 7.14.8. Drafts of decisions for the AGM;
 - 7.14.9. The annual report;
 - 7.14.10. The recommendations of the Supervisory Board on the distribution of profits, including the amount of dividends and the procedure for their payment, and on the distribution of losses of the Company based on the results of the previous fiscal year;
 - 7.14.11. The report of the Supervisory Board to shareholders;³⁸
 - 7.14.12. Information regarding the position of the Supervisory Board and any dissenting opinions of directors on each agenda item;³⁹ and
 - 7.14.13. Any other information required by the Law and internal documents of the Company.
- 7.15. If the agenda of the GMS includes the election of the Supervisory Board, the General Director, the Revision Commission, the Counting Commission and the approval of the External Auditor, information as to the existence of the written consent of the candidates shall also be provided to shareholders.

³⁸ FCSM Code, Chapter 2, Section 1.3.1.

³⁹ FCSM Code, Chapter 2, Section 1.3.3.

Annex 2. A Model Company Charter

- 7.16. If the agenda of the GMS includes items that can trigger redemption rights, the following information and documents shall be made available for shareholders during the preparation for the GMS:
- 7.16.1. The report of the Independent Appraiser on the market value of shares of the Company, the redemption of which can be requested;
 - 7.16.2. Information regarding the value of the net assets of the Company based on the data contained in the financial statements for the last reporting period; and
 - 7.16.3. The minutes (or an excerpt from the minutes) of the Supervisory Board meeting that determined the redemption price for shares and indicated that redemption price.
- 7.17. If the agenda of the GMS includes the reorganization of the Company, the following information and documents shall be made available for shareholders during the preparation for the GMS:
- 7.17.1. The basis or grounds for the terms and procedures of the reorganization that is contained in the decision on the consolidation, merger, split-up, divestiture, or transformation, or in the contract on merger or consolidation that is approved by the relevant Supervisory Board;
 - 7.17.2. The annual reports and the financial statements of all companies involved in the reorganization for the last three fiscal years, or for all completed fiscal years if the Company was established less than three years ago; and
 - 7.17.3. The quarterly accounting documents for the quarter that precedes the date of the GMS.
- 7.18. Information and materials should be submitted to the persons entitled to participate in the GMS for the purpose of familiarization at the premises of the Company and other locations specified in the notification on the GMS.⁴⁰
- 7.19. If the agenda of the GMS includes the election of members to the Supervisory Board, the Revision Commission, or the proposed External Auditor of the Company, the candidates shall be present when the GMS discusses this issue.⁴¹

⁴⁰ FCSM Code, Chapter 2, Section 1.1.3 recommends providing additional access to such information through electronic means of communications, including the internet.

⁴¹ FCSM Code, Chapter 2, Section 2.1.4.

Article 8. The Supervisory Board

- 8.1. The Supervisory Board shall supervise the executive bodies and provide overall strategic oversight of the Company's activities, except for those issues within the authority of the GMS.
- 8.2. The Supervisory Board shall consist of _____ members who shall be knowledgeable and experienced in the areas of the Company's business activities.⁴²
- 8.3. The following issues fall within the authority of the Supervisory Board:
 - 8.3.1. Determining the priority goals and strategic direction of the Company;
 - 8.3.2. Approving the financial and business plan of the Company;⁴³
 - 8.3.3. Appointing and dismissing the General Director and, upon the recommendation of the General Director, Executive Board members;
 - 8.3.4. Suspending the powers of the External Manager, if the GMS has transferred the authority of the General Director, and appointing an interim General Director;⁴⁴
 - 8.3.5. Supervising the operations of the executive bodies of the Company;
 - 8.3.6. Requesting the minutes of Executive Board meetings;
 - 8.3.7. Authorizing the General Director or an Executive Board member to serve in a similar capacity in any governing body (Supervisory Board, General Director, Executive Board) of another legal entity;
 - 8.3.8. Authorizing other persons, other than the Chairman of the Supervisory Board, to sign contracts with the General Director, Executive Board members, or the External Manager;
 - 8.3.9. Designating the terms of contracts with the General Director, Executive Board members, and the Corporate Secretary, including the terms and conditions for remuneration;

⁴² FCSM Code, Chapter 3, Section 2.2.3 recommends that the Supervisory Board be composed of at least three independent directors, or that at least one-fourth of the total number of members should be independent directors.

⁴³ FCSM Code, Chapter 3, Section 1.1.

⁴⁴ FCSM Code, Chapter 3, Section 1.4.1.

Annex 2. A Model Company Charter

- 8.3.10. Initiating the steps for the reimbursement of losses caused to the Company by Supervisory Board members;
- 8.3.11. Taking steps to reimburse the Company for losses caused by the General Director and Executive Board members, including the incomplete and/or untimely payment of declared dividends, as well as the failure to provide documents and information to the Supervisory Board where required pursuant to this Charter or by-laws of the Company;
- 8.3.12. Appointing the Corporate Secretary;⁴⁵
- 8.3.13. Establishing permanent and/or *ad hoc* Supervisory Board committees;
- 8.3.14. Approving by-laws and internal documents other than those that require the approval of the GMS or the executive bodies of the Company;
- 8.3.15. Establishing and liquidating branches and/or representative offices of the Company, and making the corresponding amendments to the Charter;
- 8.3.16. Establishing and liquidating subsidiaries and/or dependent companies in the Russian Federation and outside of the Russian Federation;
- 8.3.17. Calling the GMS including both the AGM and any EGM;
- 8.3.18. Determining the form for conducting the GMS, e.g. with joint presence of shareholders or written consent;
- 8.3.19. Determining the date, place, and time of the GMS, the time for commencing and ending the registration of shareholders and their representatives, and the postal address to which completed voting ballots must be sent;
- 8.3.20. Determining the date for compiling the list of persons entitled to participate in the GMS;
- 8.3.21. Reviewing proposals of shareholders and including approved proposals in the agenda of the GMS or rejecting proposals for the agenda;
- 8.3.22. Approving the agenda of the GMS;
- 8.3.23. Submitting proposals to the agenda of the GMS for items that can only be put on the agenda by the Supervisory Board;

⁴⁵ FCSM Code, Chapter 5, Section 2.1.

- 8.3.24. Determining procedures for notifying shareholders of the GMS;
- 8.3.25. Compiling the list of information and materials to be made available for shareholders during the preparation for the GMS, and of the procedure for accessing this information;
- 8.3.26. Determining the form and the text of the voting ballot;
- 8.3.27. Determining the classes of preferred shares, the owners of which shall have voting rights on each agenda item;
- 8.3.28. Including additional items on the agenda of the GMS upon its own initiative;
- 8.3.29. Proposing candidates to the governing bodies on the agenda if shareholders nominated less than the minimum number of candidates;
- 8.3.30. Increasing the Charter Capital by issuing additional authorized shares;
- 8.3.31. Approving of the report on the results of any share buyback by the Company for the purpose of decreasing the Charter Capital;
- 8.3.32. Issuing non-convertible bonds;⁴⁶
- 8.3.33. Approving the decision to purchase bonds placed by the Company;
- 8.3.34. Determining the market value of assets, the placement price, and the redemption price of shares and other securities;
- 8.3.35. Approving the External Registrar of the Company and the terms and conditions of the contract with the Registrar;
- 8.3.36. Using the reserve fund of the Company and other funds, if applicable;
- 8.3.37. Approving recommendations for the GMS regarding the amount of dividends and the approval of the procedure for the payment of such dividends;
- 8.3.38. Approving any extraordinary transactions that involve not more than 50 percent of the book value of the Company's assets;⁴⁷

⁴⁶ Good practice suggests that the Supervisory Board have the authority only to issue non-convertible bonds.

⁴⁷ LJC, Article 78 provides that the charter may stipulate the same approval procedures for other transactions as extraordinary transactions (defined within 25–50% of the book value of the company's assets).

Annex 2. A Model Company Charter

- 8.3.39. Approving any transactions that involve ten percent of the book value of assets of the Company;⁴⁸
 - 8.3.40. Approving any related party transactions that fall within the authority of the Supervisory Board;
 - 8.3.41. Requesting the Revision Commission to conduct an extraordinary inspection;
 - 8.3.42. Approving recommendations for the GMS regarding the remuneration of Revision Commission members;
 - 8.3.43. Determining the fees of the External Auditor;
 - 8.3.44. Preliminarily approving the annual report of the Company;
 - 8.3.45. Preparing and approving the annual report of the Supervisory Board regarding the business priorities of the Company for inclusion in the annual report of the Company;
 - 8.3.46. Preparing and submitting the report on compliance with the FCSM Code;
 - 8.3.47. Requesting oral and written reports as well as any other documents and information from the General Director, Executive Board members and other officials of the Company that are necessary for fulfilling its functions as a Supervisory Board;
 - 8.3.48. Making decisions regarding operations that go beyond the financial and business plan of the Company (non-standard operations); and
 - 8.3.49. Determining the list of additional documents that shall be kept by the Company.
- 8.4. Issues falling under the authority of the Supervisory Board may not be delegated to the executive bodies of the Company.
 - 8.5. The procedures for preparing and conducting Supervisory Board meetings shall be regulated by this Charter and by-laws of the Company.
 - 8.6. Supervisory Board meetings are convened by the Chairman of the Supervisory Board upon:
 - 8.6.1. The initiative of the Chairman of the Supervisory Board; or
 - 8.6.2. The request of a Supervisory Board member; or
 - 8.6.3. The request of the Revision Commission; or
 - 8.6.4. The request of the External Auditor; or

⁴⁸ FCSM Code, Chapter 4, Section 1.1.3.

- 8.6.5. The request of the General Director; or
- 8.6.6. The request of the Executive Board; or
- 8.6.7. The request of those shareholders holding two percent or more of voting shares.⁴⁹
- 8.7. A quorum for the Supervisory Board meeting shall be _____ of the elected Supervisory Board members.⁵⁰
- 8.8. The Supervisory Board shall make its decisions by a ___ majority vote of the Supervisory Board members who participate in the Supervisory Board meeting.⁵¹
- 8.9. A Supervisory Board member is prohibited from transferring his vote to any other person, including other members of the Supervisory Board.
- 8.10. The Supervisory Board shall approve the following decisions by unanimous vote of all the acting members of the Supervisory Board:
 - 8.10.1. Increases in the Charter Capital by issuing additional shares; and
 - 8.10.2. Approval of an extraordinary transaction.
- 8.11. The following decisions of the Supervisory Board shall be approved by a three-fourths majority of Supervisory Board members participating in the Supervisory Board meeting:
 - 8.11.1. The suspension of the powers the External Manager for any reason;
 - 8.11.2. The approval of an interim General Director; and
 - 8.11.3. Conducting an EGM to approve the new General Director, or the External Manager.

⁴⁹ FCSM Code, Chapter 3, Section 4.13 recommends that the charter specify other parties who have the right to request a meeting of the Supervisory Board. As an option, the FCSM Code proposes to give this right to a shareholder (or a group of shareholders) possessing at least 2% of voting shares.

⁵⁰ LJSC, Article 68, Clause 2 provides that the quorum for a Supervisory Board meeting should not be less than a majority of the Supervisory Board members. However, the FCSM Code, Chapter 3, Section 4.14 recommends a higher number for a quorum which should be set at a level ensuring that without the presence of non-executive and independent Supervisory Board members, there can be no valid quorum.

⁵¹ LJSC, Article 68, Clause 3 provides for a simple majority vote of Supervisory Board members that are present at the meeting for the Board to adopt a decision, unless the charter or the by-laws require a higher number of votes. The charter may also grant a deciding vote to the Chairman of the Supervisory Board in the event of a tie vote.

Annex 2. A Model Company Charter

- 8.12. The Supervisory Board shall approve related party transactions by a simple majority vote of those directors who are not interested parties to the transaction.⁵²
- 8.13. The Supervisory Board shall elect the members of Supervisory Board committees by a simple majority vote of all Supervisory Board members.
- 8.14. The Supervisory Board may make its decisions by an absentee vote as specified in the by-laws of the Company.⁵³
- 8.15. The written opinions of absentee Supervisory Board members shall be considered when the Supervisory Board makes decisions.⁵⁴
- 8.16. For the election of Supervisory Board members, shareholders shall receive information on:⁵⁵
- 8.16.1. The identity of the shareholder or the group of shareholders who nominated the candidate;
 - 8.16.2. The age and educational background of the candidate;
 - 8.16.3. The positions held by the candidate during the last five years;
 - 8.16.4. The positions held by the candidate at the moment of his nomination;
 - 8.16.5. The nature of the relationship the candidate has with the Company;
 - 8.16.6. Any positions held by the candidate on the Supervisory Board, or any other official positions that are held by the candidate in other legal entities;
 - 8.16.7. Information on any nominations of the candidate for a position on the Supervisory Board, or any other official positions with other legal entities;
 - 8.16.8. The relationship of the candidate with any affiliated persons;

⁵² LJSC, Article 83, Clause 2 and 3. This applies to companies with 1,000 or fewer shareholders with voting rights. In companies with more than 1,000 shareholders with voting rights, it is only necessary to have a simple majority of independent directors who are not interested parties in the related party transaction.

⁵³ LJSC, Article 68, Clause 1 states that the charter may provide for the approval of decisions through the Supervisory Board by absentee vote when making critical decisions. This is recommended by the FCSM Code, Chapter 3, Section 4.3.2.

⁵⁴ FCSM Code, Chapter 3, Section 4.3.1.

⁵⁵ FCSM Code, Chapter 3, Section 2.3.1.

The Russia Corporate Governance Manual

- 8.16.9. The nature of the candidate's relationship with major business partners of the Company;
 - 8.16.10. Information related to the financial status of the candidate and other circumstances that may affect the duties of the candidate as a member of the Supervisory Board; and
 - 8.16.11. Any refusal by the candidate to disclose information that has been requested by the Company.
- 8.17. The candidates for the position of Supervisory Board members shall possess:⁵⁶
- 8.17.1. _____;
 - 8.17.2. _____; and
 - 8.17.3. _____.
- 8.18. The Supervisory Board members shall be elected by cumulative voting.
- 8.19. The Supervisory Board members shall:
- 8.19.1. Act in the best interests of the Company and its shareholders;
 - 8.19.2. Carry out their duties with an appropriate level of care and loyalty;
 - 8.19.3. Actively participate in Supervisory Board committees to which they are elected;
 - 8.19.4. Not disclose confidential information, or any other information they became aware of during the course of performing their duties, to persons that do not have access to such information, nor use such information for their own personal interests or for the interests of other persons;
 - 8.19.5. Notify the Supervisory Board in writing of any conflicts of interests and disclose information as to all concluded transactions in which the member was interested; and
 - 8.19.6. Provide the shareholders with complete and accurate information about the Company's activities, financial status, and corporate governance practices in a timely manner.

⁵⁶ FCSM Code, Chapter 3, Section 1.4.2. Insert the relevant qualifications of a candidate for the position of a Supervisory Board member, such as educational background, experience, relevant contacts, and personal characteristics.

Annex 2. A Model Company Charter

- 8.20. For the purposes of the Charter, Supervisory Board members are deemed independent if their only non-trivial professional, familial, or financial connection to the Company, Supervisory Board, General Director, or any other executive officer is their directorship, and:⁵⁷
- 8.20.1. Over the last three years has not been, and, at the time of his election to the Supervisory Board, is not an officer (manager) or employee of the Company, or an officer or employee of the External Manager of the Company;
 - 8.20.2. Over the last three years has not been, and, at the time of his election to the Supervisory Board, is not an officer of another company in which any of the officers of the Company is a member of the Nominations and Remuneration Committee of the Supervisory Board;
 - 8.20.3. Over the last three years has not been, and, at the time of his election to the Supervisory Board, is not an affiliated person of an officer (manager) of the Company (or officer of the Company's External Manager);
 - 8.20.4. Over the last three years has not been, and, at the time of his election to the Supervisory Board, is not an affiliated person of the Company or an affiliated person of such affiliated persons;
 - 8.20.5. Is not bound by contractual relations with the Company, whereby such member may acquire property or receive money with a value in excess of ten percent of such person's aggregate annual income, not including any remuneration received for participating in activities of the Supervisory Board;
 - 8.20.6. Over the last three years has not been, and, at the time of his election to the Supervisory Board, is not a major business partner of the Company. A major business partner is defined as a business partner whose annual transactions with the Company are valued in excess of ten percent of the book value of assets of the Company; and
 - 8.20.7. Over the last three years has not been, and, at the time of his election to the Supervisory Board, is not a representative of the Government of the Russian Federation.

⁵⁷ FCSM Code, Chapter 3, Section 2.2.2. For an alternative definition of independent directors see Annex 18.

The Russia Corporate Governance Manual

- 8.21. Independent directors should inform the Supervisory Board of any changes in their independence.
- 8.22. The Supervisory Board may establish committees for the provisional consideration of major issues and the development of proposals in accordance with the requirements specified in the by-laws of the Company.⁵⁸

Article 9. The Executive Bodies

- 9.1. The execution of the day-to-day operations of the Company shall be conducted by the following executive bodies:
 - 9.1.1. The General Director; and
 - 9.1.2. The Executive Board.
- 9.2. Neither the General Director nor Executive Board members shall serve on a governing body of any other Company without the prior approval of the Supervisory Board. The General Director and Executive Board members may not be a member of the governing bodies or an employee of a competing company.
- 9.3. In addition to the authority of the General Director and the Executive Board as defined in the Charter, by-laws, and any other applicable legal provisions, the rights and obligations of the General Director and of the Executive Board may be specified in the employment contract entered into between the Company and the General Director or Executive Board members. Such employment contract shall be signed on behalf of the Company by the Chairman of the Supervisory Board, except that such contracts for Executive Board members shall be signed by the General Director after the terms have been approved by the Supervisory Board.
- 9.4. The General Director presides over Executive Board meetings.
- 9.5. The Executive Board shall consist of _____ persons.
- 9.6. The authority of the executive bodies includes all issues related to the day-to-day management of the Company's activities, except for those is-

⁵⁸ The number, names, authority, and working procedures of Supervisory Board committees will be specified in the by-laws of the Company. See also: Annexes 7–10.

Annex 2. A Model Company Charter

sues that fall within the authority of the GMS and the Supervisory Board.

- 9.7. The General Director and Executive Board members are elected for _____ [years].⁵⁹
- 9.8. The General Director and Executive Board members may begin to perform their duties from the moment the minutes of the Supervisory Board meeting are signed by the Supervisory Board.
- 9.9. The General Director has the authority to:
 - 9.9.1. Act without a power of attorney on behalf of the Company;
 - 9.9.2. Represent the Company's interests in relations with third parties;
 - 9.9.3. Conclude transactions on behalf of the Company within the limitations set forth by the present Charter and the Law;
 - 9.9.4. Hire staff, sign labor contracts, and manage the performance of all employees of the Company;
 - 9.9.5. _____; and
 - 9.9.6. _____.
- 9.10. The Executive Board has the authority to adopt the following decisions:
 - 9.10.1. Provisional approval of transactions or a group of related transactions with property, the value of which exceeds five percent of the book value of the Company's assets according to the balance sheet prepared for the latest reporting period;
 - 9.10.2. Decisions regarding issues to be included on the agenda of the GMS of subsidiary companies in which the Company is the only shareholder;
 - 9.10.3. Development of the Company's financial and business plans;
 - 9.10.4. _____;
 - 9.10.5. _____; and
 - 9.10.6. Other issues specified by the Law, the Charter, and the by-laws of the Company.

⁵⁹ To ensure continuity in the Company's direction of development, the IFC's RCGP recommends electing the General Director and Executive Board members for a term of 3–5 years, following an initial one-year term.

The Russia Corporate Governance Manual

- 9.11. The General Director calls the Executive Board meetings either upon his own initiative or upon the request of the Supervisory Board or an Executive Board member.
- 9.12. The procedures for Executive Board meetings shall be regulated by the Law, the Charter, and the by-laws of the Company.
- 9.13. The following decisions are approved by the Executive Board by a three-fourths majority vote of Executive Board members participating in the meeting:⁶⁰
- 9.13.1. _____;
 - 9.13.2. _____; and
 - 9.13.3. _____.
- 9.14. The following decisions are approved by a unanimous vote of Executive Board members participating in the meeting:
- 9.14.1. _____;
 - 9.14.2. _____; and
 - 9.14.3. _____.
- 9.15. The candidates for the positions of General Director, Executive Board members, and the External Manager may not be officials or employees of another company that competes with the Company.
- 9.16. The General Director and Executive Board members shall:
- 9.16.1. Act honestly;
 - 9.16.2. Act in the best interests of the Company and its shareholders;
 - 9.16.3. Act with care and be loyal;
 - 9.16.4. Not disclose confidential information or any other information they became aware of during the performance of their duties to persons who do not have access to such information, nor use such information for their own personal interests or for the interests of other persons;
 - 9.16.5. Notify the Supervisory Board in writing of any conflicts of interests regarding transaction with the Company and disclose information as to all concluded transactions in which the member was an interested party; and

⁶⁰ Insert the list of decisions that require a three-fourths majority vote.

Annex 2. A Model Company Charter

- 9.16.6. Provide the Supervisory Board and shareholders with complete and accurate information about the Company's activities, financial status, and effective corporate governance practices in a timely manner.
- 9.17. An Executive Board member should:
 - 9.17.1. Regularly attend and actively participate in Executive Board meetings;
 - 9.17.2. Participate actively in the discussion of issues and vote on matters included on the agenda of Executive Board meetings;
 - 9.17.3. Place matters on the agenda of Executive Board meetings or demand that the General Director conduct an Executive Board meeting when this is necessary;
 - 9.17.4. Notify the General Director if the member is unable to attend an Executive Board meeting;
 - 9.17.5. Provide adequate information to the Supervisory Board so that its members are properly informed on corporate matters.⁶¹
- 9.18. The General Director and Executive Board members shall refrain from:
 - 9.18.1. Participating in a competing Company;⁶²
 - 9.18.2. Participating in transactions involving a potential conflict of interest with the Company, such as related party transactions;
 - 9.18.3. Using corporate property and facilities for personal reasons unless authorized by the Supervisory Board; and
 - 9.18.4. Using information or business opportunities for personal benefit.

Article 10. The Corporate Secretary

- 10.1. The Company shall appoint a Corporate Secretary.⁶³
- 10.2. The functions, rights, and duties of the Corporate Secretary shall be defined by the Charter and by-laws of the Company.

⁶¹ FCSM Code, Chapter 3, Section 3.1.2.

⁶² FCSM Code, Chapter 4, Section 2.1.3.

⁶³ FCSM Code, Chapter 5, Introduction.

The Russia Corporate Governance Manual

- 10.3. The Corporate Secretary shall ensure:⁶⁴
- 10.3.1. Compliance with the Law, the Charter and by-laws of the Company regarding the preparation and conducting of the GMS and Supervisory Board meetings;
 - 10.3.2. The disclosure of relevant information and storage of Company documents;
 - 10.3.3. The examination of shareholder requests;
 - 10.3.4. The resolution of disputes related to the violation of shareholder rights; and
 - 10.3.5. _____.
- 10.4. The candidates for Corporate Secretary shall have:⁶⁵
- 10.4.1. _____;
 - 10.4.2. _____; and
 - 10.4.3. _____.
- 10.5. The Corporate Secretary is entitled to receive any information from the Company's governing bodies and employees as required to perform his functions. The Supervisory Board, the General Director, the Executive Board, and other officials of the Company shall provide the Corporate Secretary with any information so requested.⁶⁶
- 10.6. The Corporate Secretary is appointed by the Supervisory Board and shall perform his duties pursuant to the provisions of the Charter, the by-laws of the Company, and provisions of the contract entered into between the Secretary and the Company.⁶⁷

Article 11. The Revision Commission and External Audits

- 11.1. The Revision Commission shall be elected at the AGM and remain in existence until the next AGM.
- 11.2. The Revision Commission shall consist of _____ members.

⁶⁴ FCSM Code, Chapter 5, Section 1.

⁶⁵ FCSM Code, Chapter 5, Section 2.2.1. Insert qualifications required for the candidate for the position of a corporate secretary, such as education background, experience, and personal characteristics.

⁶⁶ FCSM Code, Chapter 5, Section 1.6.1.

⁶⁷ FCSM Code, Chapter 5, Section 2.1.

Annex 2. A Model Company Charter

- 11.3. The Revision Commission shall perform its duties in conformity with the Law, the Charter, and the by-laws of the Company.
- 11.4. The Revision Commission shall:
 - 11.4.1. Inspect the Company's financial and business activities by performing regular and extraordinary inspections, and submit its reports to the GMS;
 - 11.4.2. Inspect specific aspects of the Company's financial and business activities upon the request of a shareholder or a group of shareholders owning at least ten percent of voting shares, or at the request of the Supervisory Board;
 - 11.4.3. Verify compliance of the activities of the Supervisory Board with the Law;
 - 11.4.4. Verify facts regarding the use of insider information;
 - 11.4.5. Verify the timeliness of payments to contractors, payments to the budget, calculations and payments of dividends, and the performance of other obligations by the Company;
 - 11.4.6. Examine the use of the Company's reserve fund and other funds;
 - 11.4.7. Verify the timeliness of payments for issued shares of the Company;
 - 11.4.8. Review the Company's financial status, its solvency, and creditworthiness;
 - 11.4.9. Confirm the accuracy of data contained in the Company's annual report and other annual financial statements;
 - 11.4.10. Oversee the valuation of the Company's net assets;
 - 11.4.11. Inform the GMS and the Supervisory Board of any problems or deficiencies revealed;
 - 11.4.12. _____;
 - 11.4.13. _____; and
 - 11.4.14. Perform any other duties as specified by the Law, the Charter, and the by-laws of the Company.
- 11.5. The Company shall have an External Auditor who shall be elected by the GMS.
- 11.6. The External Auditor shall act pursuant to the Law and the provisions of the contract entered into between the Company and the External Auditor.

Article 12. The Annual Report of the Company

- 12.1. The annual report shall include the following information:⁶⁸
- 12.1.1. The Company's position in its industry;
 - 12.1.2. Priority directions of the Company's activities;
 - 12.1.3. The report of the Supervisory Board on the Company's results in its principal areas of activity;
 - 12.1.4. Prospects for the Company's development;
 - 12.1.5. The report on the payment of declared dividends;
 - 12.1.6. The analysis of the principal risks associated with the Company's activities;
 - 12.1.7. A list of extraordinary transactions concluded by the Company during the reporting year, including the significant terms of those transactions and the governing body of the Company that approved these transactions;
 - 12.1.8. A list of related party transactions concluded by the Company during the reporting year including a list of related parties, the significant terms of such transactions and the governing the body of the Company that approved these transactions;
 - 12.1.9. The composition of the Supervisory Board, including information regarding changes in the composition of the Board that took place during the reporting year, as well as information on members of the Supervisory Board, including a brief summary of their personal data and information on their share ownership in the Company during the reporting year;
 - 12.1.10. Information on the General Director and Executive Board members including a brief summary of their personal data and information on their share ownership in the Company during the reporting year;
 - 12.1.11. Criteria for the determination of and the amount of remuneration and expenses for the General Director, each member of the Execu-

⁶⁸ This article lists only legal requirements for the annual report of the Company. It does not include annual financial statements. Other information can be included in the annual report based on best practices. For more details, see the Model Annual Report in Annex 29 and FCSM Regulation No. 17/ps on Additional Requirements to the Procedure of Preparing, Calling, and Conducting the General Meeting of Shareholders, 31 May 2002, Section 3.6.

Annex 2. A Model Company Charter

- tive Board, and each member of the Supervisory Board, and the aggregate amount of remuneration paid to all these persons and governing bodies during the reporting year;
- 12.1.12. Information regarding the Company's compliance with the recommendations of the FCSM Code;
 - 12.1.13. The Company's corporate governance policies and practices;
 - 12.1.14. _____;
 - 12.1.15. _____; and
 - 12.1.16. Any other information required to be included in the by-laws of the Company.
- 12.2. The annual report shall be signed by the General Director, Chief Accountant, and Supervisory Board members.⁶⁹

Article 13. Miscellaneous Provisions

- 13.1. The General Director shall ensure that the originals or, in lieu thereof, notarized copies of the following corporate records and documents be maintained by the Company as provided by the Law:
 - 13.1.1. The Charter and any amendments and additions thereto, which have been registered in the manner required by the Law, the decision on the establishment of the Company, and the certificate of state registration of the Company;
 - 13.1.2. Any documents confirming the Company's rights to property reflected on its balance sheet;
 - 13.1.3. Internal documents;
 - 13.1.4. Regulations of the Company's branch(es) or representative office(s);
 - 13.1.5. Corporate documents of subsidiaries and dependent companies, if any;
 - 13.1.6. Annual reports and financial statements;
 - 13.1.7. Share prospectuses;
 - 13.1.8. Accounting documents;
 - 13.1.9. Financial reporting documents presented to the appropriate governing bodies;

⁶⁹ FCSM Code, Chapter 7, Section 3.3.8.

The Russia Corporate Governance Manual

- 13.1.10. Minutes of the meeting of GMS, the Supervisory Board, the Revision Commission, and the Executive Board, as well as all documents approved by the General Director;
 - 13.1.11. A list of related parties of the Company indicating the number of shares of each type and class belonging to each such person;
 - 13.1.12. Reports of the Revision Commission, External Auditor, and state and municipal financial oversight bodies;
 - 13.1.13. Documents on the Company's employees; and
 - 13.1.14. Other documents as required by the Law.
- 13.2. The Charter shall become effective immediately upon registration with the relevant state agency.

A TABLE OF CHARTER PROVISIONS

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
1. General Provisions				
1.1.	The legal form of the company (open or closed). ⁷⁰	Mandatory Law on Joint Stock Companies (LJSC), Article 7, Clause 1; Article 11, Clause 3.	LJSC, Article 7, Clause 1 states that the legal form of the company shall be reflected in the company name.	1.1.
1.2.	The duration of the company's activities.	Optional LJSC, Article 2, Clause 5.	«The Company is established for the period of _____ years.»	
1.3.	In the event the company is a subsidiary of another legal entity, the charter of the subsidiary can provide for binding instructions from the parent company to the subsidiary.	Optional LJSC, Article 6, Clause 3.		
2. The Name and Location of the Company				
2.1.	The location of the company.	Mandatory LJSC, Article 4, Clause 2; Article 11, Clause 3.		2.3.
2.2.	The name and abbreviation of the name of the company.	Mandatory LJSC, Article 11, Clause 3.		2.1. and 2.2.
2.3.	Information on branches and representative offices of the company.	Conditional LJSC, Article 5, Clause 6; Article 11, Clause 3.	«1. The Company has the following branches: 1.1. _____ (name and location); 1.2. _____ (name and location). 2. The Company has the following representative offices: 2.1. _____ (name and location); 2.2. _____ (name and location).»	2.4.
2.4.	Information that a single shareholder owns all shares of the company.	Conditional CC, Article 98; Clause 6.	«A single shareholder owns all shares of the Company.»	
3. Charter Capital, Securities and Funds of the Company				
3.1.	The amount of the charter capital.	Mandatory LJSC, Article 11, Clause 3.		4.1.

⁷⁰ This overview does not include provisions stipulated by the Law on Joint Stock Companies for Closed Joint Stock Companies.

The Russia Corporate Governance Manual

No.	Provisions	Primary References	Other References/Comments	Model Charter (Clause)
3.2.	The amount of the reserve fund.	Mandatory LJSC, Article 35, Clause 1.	«The reserve fund may not be less than 5% of the charter capital of the Company.»	4.8.
3.3.	The amount of annual deductions to the reserve fund.	Mandatory LJSC, Article 35, Clause 1.	«The deductions may not be less than 5% of net profits until the attainment of the amount of the reserve fund as established by the charter of the Company.»	4.9.
3.4.	The number and nominal value of shares of each type and class issued by the company.	Mandatory LJSC, Article 11, Clause 3; Article 27, Clause 1.	The charter must provide information regarding preferred shares if it has issued them.	4.2.
3.5.	The opportunity to decrease the charter capital by purchasing and retiring a part of issued shares.	Optional LJSC, Article 29, Clause 1; Article 72, Clause 1.		4.5.
3.6.	The possibility for the company to buyback shares it has already issued.	Optional Article 72, Clause 2.	«The Company may buyback shares issued by the Company by the decision of the General Meeting of Shareholders [or, the Supervisory Board].»	
3.7.	The form of payment, other than cash, for the buyback by the company of shares issued by the company.	Optional LJSC, Article 72, Clause 4.		4.6.
3.8.	The formation of a special fund for employees from the net profits of the company.	Optional LJSC, Article 35, Clause 2.	This fund should be used to buy shares of the company and distribute them among employees free-of-charge.	
3.9.	The procedure for conversion, and the number of shares of each type and class into which the securities can be converted, as well as other terms of the conversion.	Conditional LJSC, Article 32, Clause 3.	The inclusion of this procedure is mandatory if the charter has a provision on the conversion of preferred shares of a specific class into common shares or preferred shares of another class.	
3.10.	The procedure for the conversion of securities other than shares into preferred shares.	Conditional LJSC, Article 37, Clause 1.	The inclusion of the procedure in the charter for the conversion of securities other than shares into preferred shares of the company is mandatory if the company has issued securities convertible into preferred shares.	
3.11.	The number and rights attached to authorized shares of each type and class.	Optional LJSC, Article 27, Clause 1.	The company cannot issue additional shares if the charter does not specify the number of authorized shares of each type and class.	4.3.
3.12.	The procedures and conditions for issuing authorized shares.	Optional LJSC, Article 27, Clause 1.		

Annex 3. A Table of Charter Provisions

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
3.13.	The possibility to issue bonds upon the decision of a governing body other than the Supervisory Board.	Optional LJSC, Article 33, Clause 2.		
3.14.	The possibility to confer voting rights to shares owned by a company founder before these shares are paid in full.	Optional LJSC, Article 34, Clause 1.		
3.15.	The possibility to set restrictions on the types of property for the payment of shares.	Optional LJSC, Article 34, Clause 2.		
3.16.	Limitations regarding conducting closed subscriptions of shares in an Open Joint Stock Company.	Optional LJSC, Article 7, Clause 2. Article 39, Clause 2.		
4. Rights and Obligations of Shareholders and Dividends				
4.1.	The rights of shareholders attached to each type and class of company shares.	Mandatory LJSC, Article 11, Clause 3; Article 27, Clause 1.	The charter has to provide information regarding the rights attached to preferred shares only if it has issued them.	5.1, 5.2.
4.2.	The special right of the Russian Federation, a Russian region or a municipal entity to participate in the management of the company (Golden Share).	Conditional LJSC, Article 11, Clause 3; Article 12, Clause 4.	The charter has to provide information regarding the Golden Share if it exists.	
4.3.	The limitations on the total number and the total nominal value of shares that can be owned by one shareholder or limitations on the maximum number of votes that can be cast by one shareholder.	Optional LJSC, Article 11, Clause 3.	«No shareholder may possess more than _____ percent of the charter capital of the Company. No shareholder may exercise more than _____ votes on any issue on which the shareholder may vote.»	
4.4.	The amount of dividends to be paid on preferred shares of each class.	Conditional LJSC, Article 32, Clause 2.	The amount of dividends on preferred shares of each class must be specified in the charter if the company issues preferred shares.	5.2.
4.5.	The priority of payment of dividends and/or of the liquidation value to be paid on preferred shares of each class.	Conditional LJSC, Article 32, Clause 2.	The priority for the payment of dividends and/or of the liquidation value is mandatory if the company issues preferred shares of two or more classes with a dividend rate being specified for each of them.	5.2.1.
4.6.	The possibility to accumulate and subsequently pay unpaid or not fully paid dividends on preferred shares of a specific class until the specified date.	Optional LJSC, Article 32, Clause 2.	If the dates for accumulation and payment of dividends on preferred shares of a specific class are not specified by the charter, preferred shares of the said class are not cumulative.	5.2.3.

No.	Provisions	Primary References	Other References/Comments	Model Charter (Clause)
4.7.	The definition of property or assets other than money in which dividends can be paid.	Optional LJSC, Article 42, Clause 2.	«The Company may pay declared dividends in kind. The following assets can be used to pay dividends: 1. _____; 2. _____; and 3. _____»	
4.8.	The period (date of disbursement) for the payment of annual dividends.	Optional and Recommended by the FCSM Code LJSC, Article 42, Clause 4, FCSM Code, Chapter 9, Section 2.1.3.	The company must pay declared dividends within 60 days of the approval of the decision to declare dividends.	5.4.
4.9.	The authority of the Supervisory Board to reduce the remuneration of the General Director and Executive Board members in case of incomplete or late payment of dividends.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 9, Section 3.		5.6.
5. The General Meeting of Shareholders				
5.1.	The competence of the General Meeting of Shareholders (GMS).	Mandatory LJSC, Article 11, Clause 3.		7.7, 7.8.
5.2.	The list of issues on which the GMS must vote by a qualified majority of votes.	Mandatory LJSC, Article 11, Clause 3.		7.8.
5.3.	The procedures that must be followed when the company prepares and conducts GMS.	Mandatory LJSC, Article 11, Clause 3.		7.5, 7.10–7.19
5.4.	The period when the company must hold the Annual General Meeting of Shareholders (AGM).	Mandatory LJSC, Article 47, Clause 1.	«The AGM must be held at least two months after, but not later than six months after the end of the fiscal year.»	7.2.
5.5.	Names of print media where the notification of the GMS must be published.	Conditional LJSC, Article 52, Clause 1.		7.13.
5.6.	The use of electronic means to notify shareholders of the GMS.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 1.1.3.		

Annex 3. A Table of Charter Provisions

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
5.7.	The use of several print media to notify shareholders of the GMS.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 1.1.4.		7.1.3.
5.8.	The list of decisions of the GMS upon the proposal of parties other than the Supervisory Board.	Optional LJSC, Article 49, Clause 3.	LJSC, Article 48, Clause 1, Paragraphs 2, 6, 14–19.	
5.9.	The procedure for approving procedural decisions during the GMS.	Optional LJSC, Article 49, Clause 5.	These procedures can also be specified in by-laws.	
5.10.	The possibility to set a number of votes greater than three-fourths majority vote of preferred shareholders of a specific class who participate in the GMS in order to approve a specific decision that affects the rights of preferred shareholders.	Optional LJSC, Article 32, Clause 4.		
5.11.	The possibility to set a number of votes greater than three-fourths majority vote of voting shares who participate in the GMS in order to approve a decision on the issuance of additional shares or securities convertible into shares by closed subscription, issuance of common shares being more than 25% of previously issued common shares, issuance of securities convertible into common shares and being more than 25% of previously issued common shares.	Optional LJSC, Article 39, Clauses 3 and 4.		
5.12.	The method for notifying persons who are entitled to participate in the GMS, including the media to be used, and the circulation of ballots for voting by means other than by registered mail.	Optional LJSC, Article 52, Clause 1.	See also LJSC, Article 60, Clause 2 for methods of distribution of voting ballots by means other than by registered mail as determined by the charter.	7.1.3.
5.13.	The list of documents, other than those specified by the Company Law, that must be made available to shareholders during the preparation for the GMS.	Optional and Recommended by the FCSM Code LJSC, Article 52, Clause 3; FCSM Code, Chapter 2, Section 1.3.1.		7.14–7.17.

The Russia Corporate Governance Manual

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
5.14.	The list of information (materials) that must be made available to shareholders during the preparation for the GMS with respect to a specific agenda item.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 1.3.1.		7.14–7.17
5.15.	The requirement to distribute the report of the Supervisory Board on financial performance of the company to shareholders before the GMS.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 1.3.1.		7.4.11.
5.16.	The period within which the company must make the information (materials) available for shareholders during the preparation for the GMS.	Optional Regulation 17/ps of the Federal Commission for Securities Market, Section 3.8.	«The Company must provide the shareholders with information (materials) that the shareholders have the right to request during the preparation for the GMS within [less than 5] days after the request has been received.»	
5.17.	The possibility for shareholders to have access to information (materials) related to the GMS through the internet or other means.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 1.3.5.		
5.18.	The definition of the location for holding GMS.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 1.6.1.		7.6.
5.19.	The period for submitting proposals for the AGM which is more than 30 days after the end of the financial year.	Optional LJSC, Article 53, Clause 1.	«A shareholder (or a group of shareholders) possessing at least 2% of voting shares of the Company may propose agenda items not later than _____ days after the end of the financial year.»	
5.20.	The period for proposing candidates to the Supervisory Board if the agenda of the Extraordinary General Meeting of Shareholders (EGM) includes elections with cumulative voting.	Optional LJSC, Article 53, Clause 2.	«A shareholder (or a group of shareholders) possessing at least 2% of voting shares may propose candidates for the Supervisory Board to be elected with cumulative voting during the EGM in _____ [less than 30] days before the EGM is held.»	

Annex 3. A Table of Charter Provisions

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
5.21.	The period for holding an EGM to elect the Supervisory Board with cumulative voting which is less than 70 days after the request to conduct an EGM is made.	Optional LJSC, Article 55, Clause 2.	«A shareholder (or a group of shareholders) owning at least 10% of voting shares may request to hold an EGM to elect the Supervisory Board with cumulative voting within _____ [less than 70] days after the request to conduct the EGM.»	
5.22.	The period for holding a mandatory EGM which is less than 40 days after the request to conduct an EGM is made.	Optional LJSC, Article 55, Clause 3.	«The mandatory EGM must be convened by the Supervisory Board _____ [less than 40] days after the decision to conduct the mandatory EGM is approved by the Supervisory Board.»	
5.23.	The period for conducting a mandatory EGM to elect the Supervisory Board with cumulative voting which is less than 70 days after the request to conduct an EGM is made.	Optional LJSC, Article 55, Clause 3.	«The mandatory EGM to elect the Supervisory Board with cumulative voting must be convened by the Supervisory Board _____ [less than 70] days after the decision to conduct the mandatory EGM is approved by the Supervisory Board.»	
5.24.	The period for which the GMS can be postponed if the quorum does not exist on any of agenda items at the moment when the GMS must be opened.	Optional Federal Commission for the Securities Market (FCSM) Regulation 17/ps, Section 3.8.	«If a quorum of the GMS does not exist on any of the agenda items at the moment when the GMS must be opened, the Meeting can be postponed for _____ [less than 2] hours. The GMS can be postponed only once.»	
5.25.	The possibility to set the quorum at less than 30% of voting shares that participate in the reconvened GMS in companies with more than 500,000 shareholders.	Optional LJSC, Article 58, Clause 3.	«The quorum for the reconvened GMS exists if the shareholders possessing at least _____ [less than 30] percent of voting shares participate in the GMS when the Company has more than 500,000 shareholders.»	
5.26.	The requirement that the company distribute voting ballots in advance in companies with fewer than 1,000 shareholders with voting rights.	Conditional LJSC, Article 60, Clause 2.	The company must distribute voting ballots in advance of the GMS even if the company has fewer than 1,000 shareholders with voting rights.	
5.27.	The possibility to distribute voting ballots in advance to shareholders by using methods other than registered mail.	Conditional LJSC, Article 60, Clause 2.	«The Company distributes voting ballots to shareholders in advance of the GMS by _____ [e.g. faxing the ballots].»	
5.28.	The possibility to publish voting ballots in the print media accessible to all shareholders if the company has more than 500,000 shareholders.	Conditional LJSC, Article 60, Clause 2.	«The Company can publish voting ballots in _____ [name of the print media] for the GMS when the Company has more than 500,000 shareholders.»	
5.29.	The possibility to set the quorum not less than 20% of voting shares that participate in the reconvened GMS in companies with more than 500,000 shareholders.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 2.3.		

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
5.30.	The requirement for candidates of the Supervisory Board, executive bodies, the Revision Commission, and the External Auditor to be present during the GMS when the agenda includes the election of these bodies.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 2.1.4.		7.19.
5.31.	The procedures for monitoring the counting process during the GMS and the authority of persons in charge of counting the votes during the GMS.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 2, Section 2.4.2.	These procedures can also be specified in by-laws.	
6. The Supervisory Board				
6.1.	The authority of the Supervisory Board.	Mandatory and recommended by the FCSM Code LJSC, Article 11, Clause 3; FCSM Code, Chapter 3, Section 1.5.		8.1, 8.3.
6.2.	The list of Supervisory Board decisions to be approved by a qualified majority of votes.	Mandatory LJSC, Article 11, Clause 3.		8.10, 8.11.
6.3.	The possibility to delegate the authority of the GMS to the Supervisory Board to increase the charter capital by issuing additional shares.	Optional LJSC, Article 28, Clause 2.	«The Supervisory Board has the authority to increase the charter capital by issuing and placing additional shares authorized by the Company.»	8.3.30.
6.4.	The possibility to delegate the authority of the GMS to the Supervisory Board to approve the issue of bonds convertible into shares and other types of securities convertible into shares.	Optional LJSC, Article 33, Clause 2.	«The Supervisory Board has the authority to approve the issue of convertible bonds and other securities convertible into shares.»	
6.5.	The possibility to delegate the authority of the Supervisory Board to issue bonds and other types of securities to others than the Supervisory Board.	Optional LJSC, Article 33, Clause 2.	«The GMS has the authority to issue non-convertible bonds and other securities.»	
6.6.	The list of additional information on candidates that can be elected during the GMS.	Optional LJSC, Article 53, Clause 4.	These procedures can also be specified in by-laws.	8.16.
6.7.	The possibility to delegate the authority to prepare and conduct the GMS if the company does not establish a Supervisory Board.	Optional LJSC, Article 64, Clause 1.	In companies with less than 50 share holders of voting shares, the charter may provide that no Supervisory Board will be established. In this case, the charter has to appoint a person or a body that is responsible for preparing and conducting the GMS.	

Annex 3. A Table of Charter Provisions

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
6.8.	The number of Supervisory Board members.	Optional LJSC, Article 66, Clause 3.	The number of Supervisory Board members can also be determined by the decision of the GMS.	8.2.
6.9.	The approval of the special procedure for carrying out non-standard operations falling outside the scope of the financial and business plans.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 8, Section 2.2.2.		
6.10.	The number of votes required to elect the Chairman of the Supervisory Board.	Optional LJSC, Article 67, Clause 1.	«The Chairman of the Supervisory Board must be elected by the _____ majority of Supervisory Board members [e.g., the GMS].»	
6.11.	The number of votes required to re-elect the Chairman of the Supervisory Board.	Optional LJSC, Article 67, Clause 1.	«The Chairman of the Supervisory Board must be re-elected by the _____ majority of Supervisory Board members [e.g., the GMS].»	
6.12.	The provision that a person other than the Chairman of the Supervisory Board should preside over the GMS.	Optional LJSC, Article 67, Clause 2.	The Chairman of Supervisory Board usually presides over the GMS unless the charter provides otherwise.	
6.13.	Quorum and independent directors.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 4.14.	The quorum of the Supervisory Board meeting should be set at a level so that the presence of non-executive and independent directors is required for a quorum to exist.	
6.14.	The quorum greater than the minimum set by the Company Law for Supervisory Board meetings.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 4.15.		8.7.
6.15.	The right of persons other than the Chairman of Supervisory Board, other Supervisory Board members, the Revision Commission, to convene a Supervisory Board meeting.	Optional LJSC, Article 68, Clause 1.		8.6.
6.16.	The procedure for preparing and conducting Supervisory Board meetings.	Optional LJSC, Article 68, Clause 1.	These procedures can also be specified in by-laws.	
6.17.	The possibility to approve decisions by the Supervisory Board by written consent.	Optional and Recommended by the FCSM Code LJSC, Article 68, Clause 1; FCSM Code, Chapter 3, Section 4.3.2.	These procedures can also be specified in by-laws.	8.1.4.

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
6.18.	The determination of the quorum for conducting valid Supervisory Board meetings, being not less than half the number of elected Supervisory Board members.	Optional LJSC, Article 68, Clause 2.	These procedures can also be specified in by-laws. See also LJSC, Article 83, Clause 2.	8.7.
6.19.	The right of a shareholder (or a group of shareholders) owning at least 2% of voting shares to request a Supervisory Board meeting.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 4.13.		8.6.
6.20.	The number of votes necessary to approve decisions of the Supervisory Board other than by a majority vote of participating directors.	Optional LJSC, Article 68, Clause 3.	These procedures can also be specified in by-laws.	8.10, 8.11.
6.21.	The right of the Chairman of the Supervisory Board to cast a decisive vote in case of tie vote.	Optional LJSC, Article 68, Clause 3.	«The Chairman of the Supervisory Board has a decisive vote in case of a tie vote.»	
6.22.	The possibility that written opinions of members not physically present during the Supervisory Board meeting be taken into consideration.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 4.3.1.		8.15.
6.23.	The possibility that written opinions of members not physically present during the Supervisory Board meeting be taken into consideration and considered for determining the quorum of the Board meeting.	Optional LJSC, Article 68, Clause 1.		
6.24.	The Supervisory Board's authority to approve procedures for internal control.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 1.2.1.		
6.25.	The Supervisory Board's authority to suspend the authority of the executive bodies.	Optional and Recommended by the FCSM Code LJSC, Article 69, Clause 4; FCSM Code, Chapter 3, Section 1.4.1.	The charter may provide that the authority of the Supervisory Board include the suspension of the General Director (external manager), as well as fixing the period of and reasons for such suspension.	

Annex 3. A Table of Charter Provisions

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
6.26.	The Supervisory Board's authority to determine the terms and conditions of the contract with the General Director, Executive Board members, and an External Manager.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 1.4.3.		8.3.9.
6.27.	The definition of specific criteria for Supervisory Board candidates.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 2.1.3.		8.17.
6.28.	The provision that the Supervisory Board should consist of at least one-fourth or not less than three independent directors.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 2.2.3.	For the definition of independent directors, see FCSM Code, Chapter 3, Section 2.2.2.	
6.29.	The procedures and grounds for the election of new Supervisory Board members in case of early termination of the previous Supervisory Board.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 2.2.4.		
6.30.	A list of information on Supervisory Board candidates that must be disclosed to shareholders.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 2.3.1.		8.16.
6.31.	Fiduciary duties of directors.	Optional and recommended by the FCSM Code FCSM Code, Chapter 3, Section 3.1.1.		8.1.9.
6.32.	The possibility to establish Supervisory Board committees.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 4.7.1.		8.2.2.

The Russia Corporate Governance Manual

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
7. The Executive Bodies				
7.1.	The list of issues on which the Executive Board members must vote by a qualified majority.	Mandatory LJSC, Article 11, Clause 3.		9.14, 9.15
7.2.	The provision that specifies the division of authority between the single member and collective executive bodies.	Conditional LJSC, Article 69, Clause 1.	If the company has both single member and collective executive organs, the charter has to specify the authority of each of these bodies separately.	9.2.
7.3.	The authority of the Supervisory Board to suspend the powers of the General Director elected by the GMS and appoint an interim General Director.	Conditional LJSC, Article 69, Clause 4.		
7.4.	The Supervisory Board's authority to suspend the powers of the External Manager and appoint an interim General Director.	Conditional LJSC, Article 69, Clause 4.		8.3.4.
7.5.	The restriction of the scope of authority of the interim General Director.	Optional LJSC, Article 69, Clause 4.		
7.6.	The authority "as defined in the most comprehensive manner possible" of the General Director and Executive Board members.	Recommended by the FCSM Code FCSM Code, Chapter 4, Section 1.1.1.		
7.7.	The definition of the quorum for a Executive Board meeting as not less than half the number of elected Executive Board members.	Optional LJSC, Article 70, Clause 2.	These procedures can also be specified in by-laws.	
7.8.	The definition of additional requirements for candidates to the positions of General Director, Executive Board members, heads of major divisions, the External Manager, and the remuneration of these parties.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 3, Section 1.4.2; FCSM Code, Chapter 4, Section 2.1.1; FCSM Code, Chapter 4, Section 2.1.8.		
7.9.	The provision that individuals who are members, officers, or employees of legal entities competing with the company should not be appointed or elected to the positions of General Director or Executive Board member.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 4, Section 2.1.3.		9.1.2.

Annex 3. A Table of Charter Provisions

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
7.10.	The provision that the General Director is not engaged in activities other than the discharge of his duties related to the management of the current affairs of the Company.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 4, Section 2.1.4.		
7.11.	The procedures for the appointment of new members of the Executive Board, in particular in the case of death or incapacity of existing members.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 4, Section 2.1.6.		
7.12.	Prior to approval of the delegation of the powers of the General Director to an external manager, the Supervisory Board should determine the procedures applicable for selection of the External Manager.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 4, Section 2.1.9.	These procedures can also be specified in by-laws.	
7.13.	Fiduciary duties of Executive Board members and the General Director.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 4, Section 3.1.1.		9.16–9.18.
8. The Corporate Secretary				
8.1.	The procedure for appointing the Corporate Secretary and the definition of his responsibilities.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 5, Section 2.1.1.		10.3, 10.6.
8.2.	The provision that all corporate bodies and officers must assist the Corporate Secretary in discharging his duties.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 5, Section 1.6.1.		10.5.
8.3.	The definition of requirements for candidates for the position of Corporate Secretary.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 4, Section 2.2.1.		10.4.

No.	Provisions	Status/ Primary References	Other References/Comments	Model Charter (Clause)
9. Extraordinary, Control and Related Party Transactions				
9.1.	The possibility to apply the procedures for extraordinary transactions to other transactions defined by the charter.	Optional and Recommended by the FCSM Code LJSC, Article 78, Clause 1; FCSM Code, Chapter 6, Section 1.1.		
9.2.	The possibility to develop criteria for the definition of related party transactions in addition to those established by the Company Law.	Optional LJSC, Article 81, Clause 1.		
9.3.	The notification of non-controlling shareholders about their right to sell their shares to a shareholder (or a group of shareholders) owning at least 30% of common shares.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 6, Section 2.4.		
9.4.	The waiver of the duty of a shareholder (or a group of shareholders) owning at least 30% of common shares to make a mandatory offer.	Optional LJSC, Article 80, Clause 2.		
10. The Revision Commission and External Audits				
10.1.	The procedure for electing the Revision Commission.	Mandatory LJSC, Article 85, Clause 1.		11.1.
10.2.	Additional authorities of the Revision Commission.	Optional LJSC, Article 85, Clause 2.		11.4.
10.3.	The procedures for appointing employees of the Control and Revision Service (Internal Auditor) as defined by the FCSM Code.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 8, Section 1.1.1.		
10.4.	The definition of requirements for employees of the Control and Revision Service (Internal Auditor), members of the Audit Committee and the Revision Commission.	Optional and Recommended by the FCSM Code FCSM Code, Chapter 8, Section 1.3.2.		



Annex 4

A MODEL COMPANY-LEVEL CORPORATE GOVERNANCE CODE

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

_____ dated this __ day of _____, 200_
[The Company's Seal]

CORPORATE GOVERNANCE CODE

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

PREAMBLE	56
BACKGROUND AND PROFILE.....	57
PART I. COMMITMENT TO CORPORATE GOVERNANCE	57
1. <i>Definition and Principles</i>	57
2. <i>Internal Corporate Documentation</i>	58
3. <i>General Governance Structure</i>	59
4. <i>Compliance with and Adherence to Corporate Governance</i>	60
PART II. GOOD BOARD PRACTICES	60
1. <i>At the Supervisory Board Level</i>	60
2. <i>At the Executive Body Level</i>	64
3. <i>Interaction Between the Supervisory Board and Executive Bodies and the Role of the Corporate Secretary [if established]</i>	66
PART III. SHAREHOLDER RIGHTS	67
1. <i>General Meetings of Shareholders</i>	67
2. <i>(Minority) Shareholder Rights Protection</i>	68
3. <i>Related Party Transactions</i>	69
4. <i>Dividend Policy</i>	69
PART IV. INFORMATION DISCLOSURE AND TRANSPARENCY	69
1. <i>Disclosure Policies and Practices</i>	69
2. <i>Financial Reporting</i>	70
3. <i>Internal Audit and Control</i>	70
4. <i>The External Audit</i>	71
5. <i>Ownership Structure</i>	71

Preamble

The purpose of this Company Code of Corporate Governance (hereinafter the Company Code) is to improve and systematize the governance of the Open Joint Stock Company «_____» (hereinafter the Company), make its governance more transparent, and demonstrate the Company's commitment to good corporate governance by developing and furthering:

- Responsible, accountable, and value-based performance management;
- Effective oversight, with executive bodies that act in the best interests of the Company and its shareholders, including minority shareholders, and seek to enhance shareholder value in a sustainable manner; and

Annex 4. A Model Company-Level Corporate Governance Code

- Appropriate information disclosure and transparency, as well as an effective system of risk management and internal control.

By adopting, following, and updating the Company Code, the Company's charter, and by-laws on a regular basis, the Company confirms its desire to demonstrably lead and promote good corporate governance. To foster the confidence of its shareholders, employees, investors, and the general public, the Company Code goes beyond the established legal and regulatory framework in Russia today, and embraces both national and internationally recognized corporate governance principles and practices.

The Company's governing bodies and employees understand this Company Code as their joint obligation, and accordingly, obligate themselves to ensure that its provisions and its spirit are adhered to and acted upon throughout the Company [and its subsidiaries and dependent companies].

Background and Profile

The Company's mission is to _____. Its objectives are to _____, _____, and _____.⁷¹

The Company operates in the following business sectors: _____. It operates in the following regions: _____, _____, and _____, as well as countries: _____, _____ and _____.

The Company is publicly listed on the _____ exchange.

Part I. Commitment to Corporate Governance

1. Definition and Principles

The Company defines corporate governance as a set of structures and processes for the direction and control of companies, which involves a set of relationships between the Company's shareholders, Supervisory Board, and executive bodies with the

⁷¹ This section is intended to provide an overview of the company's mission, objectives, and main areas of activity. It may also include other areas that may be of interest to the readers of the Company Code that will enable them to gain a broad understanding of the company, its business, geographical location, and rationale for drafting the Company Code.

The Russia Corporate Governance Manual

purpose of creating long-term shareholder value. It views corporate governance as a means to improve operational efficiency, attract financing at a lower cost, and build a better reputation. It also views a sound system of governance as an important contribution to the rule of law in the Russian Federation, and an important determinant of the role of the Company in a modern economy and society.

The Company Code sets out the Company's corporate governance framework and is based on Russian legislation, the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), as well as internationally recognized best practices and principles, such as the OECD Principles of Corporate Governance.

The Company's corporate governance framework is based on the following principles:

- **Accountability:** This Company Code establishes the Company's accountability to all shareholders and guides the Company's Supervisory Board in setting strategy, and guiding and monitoring the Company's management.
- **Fairness:** The Company obligates itself to protect shareholder rights and ensure the equitable treatment of all shareholders, including minority [and foreign] shareholders. All shareholders are to be granted effective redress for violation of their rights through the Supervisory Board [or a shareholder rights committee, if established].
- **Transparency:** The Company is to ensure that timely and accurate disclosure is made on all material matters regarding the Company, including the financial situation, performance, ownership, and governance of the Company, in a manner easily accessible to interested parties.
- **Responsibility:** The Company recognizes the rights of other stakeholders as established by laws and regulations, and encourages co-operation between the Company and stakeholders in creating sustainable and financially sound enterprises.

The Company, its key officers and all employees act in accordance with all applicable laws and regulations, and, furthermore, shall comply with ethical standards of business conduct as defined by this Company Code, the FCSM Code and _____ [name other source of ethical standards].

2. Internal Corporate Documentation

This Company Code is principle-based. More specific corporate governance structures, processes, and practices are regulated in the Company's charter and the by-laws for the:

Annex 4. A Model Company-Level Corporate Governance Code

- General Meeting of Shareholders (GMS);
- Supervisory Board;
- Executive bodies;
- The Audit Commission; and
- _____.⁷²

This set of internal corporate documents follows legal and regulatory requirements, and incorporates the main provisions of the FCSM Code and internationally recognized corporate governance practices. The above-mentioned corporate documents are published on the Company's website.

3. General Governance Structure

The Company has the following governing and other bodies:

- **The General Meeting of Shareholder.** The highest governing body of the Company allows the shareholders to participate in the governance of the Company;
- **The Supervisory Board** is responsible for the strategic direction of the Company, and the guidance and oversight of management; [the Company's Supervisory Board may also establish committees on audit, corporate governance, nominations and remuneration, strategic planning and finance];
- **The General Director and the Executive Board** carry out the day-to-day management of the Company and implement the strategy set by the Supervisory Board and shareholders;
- **The Revision Commission** oversees the financial and economic activities of the Company and reports directly to the GMS;
- **The Corporate Secretary** ensures that the governing bodies follow internal rules and external regulations to facilitate clear communications between the governing bodies, and acts as an adviser to directors and senior executives;
- **The Internal Auditor** develops and monitors internal control procedures for the business operations of the Company. The Internal Auditor reports di-

⁷² Best practice calls for additional by-laws for the Corporate Secretary; for all Supervisory Board committees established; on internal control; on the company's dividend policy; on risk management; on information disclosure and transparency; and on corporate governance policies in groups of companies. The company may also wish to draft a company code of ethics.

rectly to the Supervisory Board [through the Audit Committee], and reports administratively to the General Director.

4. Compliance with and Adherence to Corporate Governance Policies and Practices

The Company's _____ is responsible for ensuring the development of, compliance with, and periodic review of corporate governance policies and practices in the Company.⁷³

Part II. Good Board Practices

The Company views a vigilant, professional, and independent Supervisory Board as essential for good corporate governance. The Supervisory Board cannot substitute for talented professional managers, nor change the economic environment in which the Company operates. It can, however, influence the performance of the Company through its supervision, guidance, and control of management in the interests and for the benefit of the Company's shareholders. Executive bodies also play a crucial role in the governance process. The effective interaction between governing all bodies, and a clear separation of authorities is key to sound corporate governance.

1. At the Supervisory Board Level

a. Authority. The Supervisory Board's scope of authority is set forth in the Company's charter, in conformity with relevant legislation and the recommendations of the FCSM Code.

b. Size. The Supervisory Board [upon the recommendation of its corporate governance committee, if established] recommends the appropriate size of the Supervisory Board. The Supervisory Board's size is fixed in the Company's charter. Achieving the needed quality and mix-of-skills will be the primary consideration in arriving at the overall number.

⁷³ Good practice suggests that the Corporate Secretary develop and the Supervisory Board's Corporate Governance Committee approve these policies.

Annex 4. A Model Company-Level Corporate Governance Code

c. Election, Term, and Dismissal. Directors are elected for a one-year term. The Company uses cumulative voting to elect its directors.

The Supervisory Board does not believe it is in the best interests of the Company or its shareholders to introduce term limits. Experienced directors, familiar with the Company and the industry in which it operates, are key to providing proper guidance.

The GMS may only dismiss all directors. Grounds for dismissal are included in the Company's charter [or by-law for the Supervisory Board].

d. Composition and Independence. The composition of the Supervisory Board is determined in such a way that combines the representatives of various shareholder groups, including minority shareholders.

The Supervisory Board's composition, competencies, and mix-of-skills are adequate for oversight duties, and the development of the Company's direction and strategy. Each individual director has the experience, knowledge, qualifications, expertise, and integrity necessary to effectively discharge Supervisory Board duties and enhance the Board's ability to serve the long-term interests of the Company and its shareholders. The Supervisory Board has a broad range of expertise that covers the Company's main business, sector, and geographical areas, and includes at least _____ experienced financial experts who are non-executive, independent directors.⁷⁴ A full and complete set of information on the directors' qualifications is set forth and annually reviewed by the Supervisory Board [upon the recommendation of its corporate governance committee] and fixed in the Company's charter or by-laws.

The law prohibits the General Director from being the Chairman of the Supervisory Board. To enhance unbiased oversight, the Company believes that a non-executive director should chair the Supervisory Board.

The Company's Supervisory Board is composed of not more than 25% of executive directors who are employees of the Company.

To ensure the impartiality of decisions and to maintain the balance of interests among various groups of shareholders, __ [number or percentage] of the Supervisory Board's members are independent directors. The Company defines those

⁷⁴ Good practice suggests that the Supervisory Board consist of at least two such persons. Should this not be possible, then the Supervisory Board shall hire an outside, independent adviser.

The Russia Corporate Governance Manual

directors who have no material relationship with the Company beyond their directorship as independent. The Supervisory Board ascertains which members are to be deemed independent during the first Supervisory Board meeting. Criteria for determining director independence shall be based on the FCSM Code, complemented by other internationally recognized definitions, and specified in the Company's charter and annual report.

The Company recognizes that directors that have served for longer than seven years shall not be considered independent directors.

e. Structure and Committees. The Company has established the following Supervisory Board committees:

- The Audit Committee;
- _____;
- _____; and
- Other committees deemed necessary by the Supervisory Board.⁷⁵

All committees have by-laws containing provisions on the scope of authority, competencies, composition, working procedures, as well as the rights and responsibilities of the committee members.

Each committee is to provide provisional consideration of the most important issues that fall within the authority of the Supervisory Board. After each of its meetings, the committee shall report on the meeting to the Supervisory Board.

f. Working Procedures. The Supervisory Board meets according to a fixed schedule, set at the beginning of its term, which enables it to properly discharge its duties. As a rule, the Supervisory Board shall meet at least ___ times a year.⁷⁶

⁷⁵ Other Supervisory Board committees recommended by the FCSM Code and generally-accepted best practices cover areas in which there is an especially large potential for conflicts of interest and the need for independent thought, in particular, the nominations and remuneration committee. Companies may eventually wish to consider adding further committees on corporate governance, strategic planning and finance, shareholder rights, ethics, and/or corporate conflicts resolution. However, companies should be prudent in the establishment of committees. Excessive numbers of committees may be costly, difficult to manage, and may fragment Board deliberations.

⁷⁶ Good practice suggests that four to ten Supervisory Board meetings per year are sufficient to properly discharge the Board's duties.

Annex 4. A Model Company-Level Corporate Governance Code

Non-executive directors meet separately from executive members at least once a year.

Detailed procedures for calling and conducting Supervisory Board meetings are defined in the Supervisory Board's by-law. All directors are provided with a concise but comprehensive set of information [by the Corporate Secretary] in a timely manner, concurrently with the notice of the Board meeting, but no less than ____ days before each meeting.⁷⁷ This set of documents is to include: an agenda; minutes of the prior Board meeting; key performance indicators, including relevant financial information prepared by management; and clear recommendations for action.

The Supervisory Board keeps detailed minutes of its meetings that adequately reflect Board discussions, signed by the Chairman [and the Corporate Secretary], and include voting results on an individual basis. The Company keeps transcripts (verbatim reports) of important Board decisions, such as the approval of extraordinary transactions.

g. Self-Evaluation. The Supervisory Board conducts a yearly self-evaluation. This process is to be organized by _____ [e.g. the corporate governance committee] and the results are to be discussed by the full Supervisory Board. Independent consultants may also be invited to assist the Supervisory Board in this process.

h. Training and Access to Advisers. The Company offers an orientation program for new directors on the Company, its business, and other issues that will assist them in discharging their duties. The Company also provides general access to training courses to its directors as a matter of continuous professional education. The Supervisory Board and its committees shall also have the ability to retain independent legal counsel, accounting, or other consultants to advise the Supervisory Board when necessary.

i. Remuneration. The remuneration of non-executive directors is competitive and is comprised of an annual fee (part of which can be paid in the form of shares in lieu of cash), a meeting attendance fee, and an additional fee for the chairmanship of committees or the Supervisory Board itself. The remuneration package shall, however, not jeopardize a director's independence. Executive directors are not paid beyond their executive

⁷⁷ Good practice suggests around two weeks.

remuneration package. The Supervisory Board [nominations and remuneration committee] periodically reviews the remuneration paid to directors. All directors sign a contract with the Company. The Company publicly discloses the remuneration of each director on an individual basis.

The Company will not provide personal loans or credits to its directors.

Further, the Company shall not provide stock options to its directors unless approved by the GMS.

j. Duties and Responsibilities. Directors act in good faith, with due care and in the best interests of the Company and all its shareholders — and not in the interests of any particular shareholder — on the basis of all relevant information. Each director is expected to attend all Supervisory Board and applicable committee meetings.

The Supervisory Board must decide as to whether its directors can hold positions in the governing bodies of other companies. The Company shall not prohibit its directors from serving on other Supervisory Boards. Directors are expected to ensure that other commitments do not interfere in the discharge of their duties.

Directors shall not divulge or use confidential or insider information about the Company.

Directors shall abstain from actions that will or may lead to a conflict of interest with the Company. When such a conflict exists, directors shall disclose information about the conflict of interests to the other directors and shall abstain from voting on such issues.

2. At the Executive Body Level

The Company understands that the day-to-day management of the Company requires strong leadership from the General Director. It also recognizes the challenge and complexity of running a Company and believes in teamwork, a collective rather than individual approach. The Company has thus established an Executive Board, chaired by the General Director.

a. Authority. The General Director and the Executive Board carry out the Company's day-to-day management, implementing its goals and objectives, and carrying out its strategy.

Annex 4. A Model Company-Level Corporate Governance Code

b. Size. The General Director [in close cooperation with the nominations and remuneration committee, if established] proposes to the Supervisory Board an appropriate number of Executive Board members. The size of the Executive Board is fixed in the Company's charter upon the recommendation of the Supervisory Board. Achieving the needed quality and mix of executives will be the primary consideration in arriving at the overall number.

c. Election, Term, and Dismissal. The Supervisory Board [or the GMS] elects the General Director for a _____ year term.⁷⁸ The General Director in turn submits proposals for Executive Board membership to the Supervisory Board for approval. Other Executive Board members are appointed for a _____ year term.

The Supervisory Board may dismiss the General Director. The Supervisory Board may also dismiss Executive Board members, upon close coordination with the General Director. Grounds include, among other things, providing false information to the Supervisory Board, willful neglect of his duties and responsibilities, or conviction of a criminal act.

d. Composition. The Executive Board's composition, competencies, and mix-of-skills are suited to the effective and efficient running of the Company's day-to-day operations. Each Executive Board member, including the General Director, has the experience, knowledge, qualifications, and expertise necessary to effectively discharge his duties.

All Executive Board members have the:

- Trust of the Company's shareholders, directors, other managers, and employees;
- Ability to relate to the interests of all shareholders and to make well-reasoned decisions;
- Professional expertise and education to be an effective manager;
- Business experience, knowledge of national issues and trends, and knowledge of the market, products, and competitors; and
- Capacity to translate knowledge and experience into solutions that can be applied to the Company.

⁷⁸ Good practice suggests that the Supervisory Board elect the General Director and the other Executive Board members upon the recommendation of the General Director. The IFC's RCGP recommends a term ranging from three to five years, following an initial one-year term.

e. Working Procedures. The Executive Board meets regularly, and agenda issues are communicated in advance. The working procedures of the Executive Board are specified in the by-laws for the Executive Board.

f. Succession Planning. The Supervisory Board is to adopt a succession plan that outlines how it will effectively deal with the temporary or permanent loss of senior executives. To assist in this process, the General Director is to provide the Supervisory Board with a list of individuals best suited to replace the Company's key executives, including the position of the General Director.

g. Remuneration and Evaluation. The amount of remuneration of the General Director and members of the Executive Board is set by the Supervisory Board, and approved by the GMS. The remuneration shall have a fixed and variable component, and the latter is tied to key performance indicators, in-line with the input into the Company's long-term development and creation of shareholder value.

The Company will not provide personal loans or credits to its executive officers.

h. Duties and Responsibilities. The General Director and Executive Board members shall act in good faith and with due care in the best interests of the Company and all its shareholders — and not the interests of a particular shareholder — on the basis of all relevant information.

The General Director and Executive Board members shall abstain from actions that will or may lead to a conflict between their and the Company's interests. When such a conflict exists, members of the executive bodies shall disclose information about the conflict of interests to the Supervisory Board, and shall abstain from deliberating and voting on such issues.

3. Interaction Between the Supervisory Board and Executive Bodies and the Role of the Corporate Secretary

Good corporate governance provides for an open dialogue between the Company's Supervisory Board and executive bodies. The Company has thus developed a procedure for periodic reports (information briefs) of the General Director and Executive Board to the Supervisory Board, as specified in the Executive Board's by-law. The Supervisory Board shall further have unrestricted access to the Company's management and its employees. The Corporate Secretary plays a key, overall role in facilitating this process.

Annex 4. A Model Company-Level Corporate Governance Code

The Company's Corporate Secretary is employed on a full-time basis. The Corporate Secretary possesses the necessary qualifications and skills to ensure that the governing bodies follow internal rules and external regulations; facilitates clear communications between the governing bodies in-line with the Company's charter, by-laws, and other internal rules; and keeps the Company's key officers abreast of the latest corporate governance developments.

Part III. Shareholder Rights

All shareholders have the right to participate in the governance and the profits of the Company. All rights are regulated in the Company's charter and by-laws.

1. General Meetings of Shareholders

The Company has a by-law for the GMS that provides a detailed description of all the procedures for preparing, conducting, and making decisions at the GMS.

a. Preparation. Every shareholder that holds voting shares is entitled to participate and vote during the GMS, and receive advance notification, an agenda, as well as accurate, objective, and timely information sufficient for making an informed decision about the issues to be decided at the GMS. The Company's executive bodies will be responsible for this process, which is to be implemented by the Corporate Secretary.

The Company has a fair and effective procedure for submitting proposals to the agenda of the GMS, including proposals for the nomination of Supervisory Board members. The agenda of the GMS is not changed after the Supervisory Board approves it.

b. Conducting the GMS. The Company takes all the steps necessary to facilitate the participation of shareholders in the GMS and vote on the agenda items.

The venue of the GMS is easily accessible for the majority of shareholders. Registration procedures are convenient and allow for quick and easy admittance to the GMS.

The Company's executive bodies are to help shareholders exercise their voting rights in the event they are unable to physically attend the GMS. The executive bodies will do so by providing shareholders with a power of attorney form, based

upon which the shareholder will have an opportunity to instruct his proxy on how to vote on agenda items.

The Company ensures that members of the Supervisory Board, executive bodies, Revision Commission, and External Auditor are present during the GMS to answer questions. Each shareholder has the right to take the floor on matters on the agenda, and submit relevant proposals and questions. The chairman of the GMS conducts the meeting professionally, fairly, and expeditiously.

Voting is conducted by ballot. The Company has effective shareholder voting mechanisms in place (e.g. super-majority voting) to protect minority shareholders against unfair actions, as regulated in its charter and by-law for the GMS. The procedures for counting votes at the GMS are transparent and exclude the possibility of manipulating voting results. The External Registrar of the Company shall also fulfill the functions of the Counting Commission.

c. Results. The voting results and other relevant materials are distributed to shareholders, either at the end of the GMS or very soon after the GMS is held, as well as to the general public by posting them on the Company's internet site and publishing them in the mass media in a timely manner.

2. (Minority) Shareholder Rights Protection

The Company has a system of registering shareholder complaints and effectively regulating corporate disputes [through the Supervisory Board's shareholder relations committee].

a. Supervisory Board representation. Minority shareholders have ___ [*number*] identifiable representatives on the Supervisory Board.⁷⁹

b. External Registrar. The Company engages an independent External Registrar to maintain the shareholder register. The Company ensures a reliable and efficient ownership registration system of shares and other securities through the selection and appointment of an independent External Registrar that has proper technical equipment and an excellent reputation.

⁷⁹ Good practice suggests that the Supervisory Board's composition reflect the shareholding structure, but that the Supervisory Board have at least one identifiable minority shareholder representative.

Annex 4. A Model Company-Level Corporate Governance Code

c. Takeover policy. The Company has a clearly articulated and enforceable policy in place that protects the rights of minority shareholders in special circumstances, such as a change of control.

3. Related Party Transactions

The Company avoids related party transactions. When this is not possible, the Company discloses all relevant information on related party transactions including information on the affiliated parties and the affiliation of directors and members of other governing bodies.

4. Dividend Policy

The Company has formally developed and follows a written dividend policy. This dividend policy is publicly disclosed on the Company's website.

The procedure for determining the amount of dividends on preferred shares does not violate other shareholder rights. The Company's dividend policy:

- Establishes a transparent, understandable, and predictable mechanism for determining the amount of the dividends;
- Ensures that the dividend payment procedure is easy and efficient; and
- Provides for the complete and timely payment of declared dividends.

Part IV. Information Disclosure and Transparency

Transparency, and timely and accurate information disclosure is a key corporate governance principle for the Company.

1. Disclosure Policies and Practices

The Company discloses and provides easy access to all material information, including the financial situation, performance, ownership, and the governance structure of the Company to shareholders free of charge. The Supervisory Board prepares and approves a by-law on information disclosure and makes it publicly available on the Company's internet site. The Company publishes a comprehensive annual report that includes a corporate governance section, and prepares

other reports, such as the prospectus, quarterly reports, and material facts reports. The Company discloses its corporate governance practices, corporate events calendar, and other material information on its website in a timely manner.

The Company takes measures to protect confidential information as defined in its by-law on information disclosure. Any information obtained by the Company's employees and the members of the governing bodies may not be used for their personal benefit.

2. Financial Reporting

The Company keeps records and prepares a full set of financial statements in accordance with Russian Accounting Standards. [In addition, the Company prepares its accounts in accordance with International Financial Reporting Standards (IFRS) [or U.S. GAAP] and discloses these in its regulatory filings, including the annual report, and on the internet.]

Detailed notes accompany financial statements so that the users of the statements can properly interpret the Company's financial performance. A management discussion and analysis (MD&A), as well as the opinions of the External Auditor and Revision Commission, shall complement all financial information.

[The company produces consolidated accounts when required by accounting standards.]

3. Internal Audit and Control

a. The Revision Commission. The Company's Revision Commission is to meet at least ___ [*number*] times a year to carry out its duties as specified by law and its by-laws. The Revision Commission shall consist of independent members, of which at least ___ [*number*] members are experienced financial experts. Its scope of authority and activity goes beyond legislative requirements.⁸⁰

b. The Internal Auditor. The Company has an Internal Auditor [or office of the Internal Auditor] that is responsible for the daily internal control of the

⁸⁰ Supervisory Board audit committees are becoming increasingly common internationally. Good practice suggests that the Company strengthen the role of the Supervisory Board's Audit Committee and make sure that it complements the functions of the Revision Commission. Good practice suggests that the Revision Commission meet at least four times per year, and that it be composed of at least one financially literate member.

Annex 4. A Model Company-Level Corporate Governance Code

Company's finances and operations. The Internal Auditor is staffed by a highly respected and reputable person[s], and reports to the Supervisory Board [or Audit Committee] functionally and to the General Director administratively.⁸¹ The Internal Auditor's authority, composition, working procedures, and other relevant matters are regulated in its by-law.

c. The Supervisory Board's Audit Committee. The Audit Committee is to focus on three key areas: financial reporting, risk management, and internal and external audit. This committee is to be chaired by an independent director and composed of non-executive directors, each of which is recognized for his or her financial literacy. Its exact authority, composition, working procedures, and other relevant matters are regulated in its by-laws.

4. The External Audit

An External Auditor audits the Company's financial statements. The External Auditor is a publicly recognized independent auditing firm, where independent means independence from the Company, the Company's management, and major shareholders. The Company ensures that the Audit partner is periodically rotated. The remuneration of the auditor is disclosed to shareholders. The External Auditor is selected by the GMS following an open tender and upon the recommendation of the Supervisory Board.

5. Ownership Structure

The Company ensures that beneficial owners of five percent or more of the voting shares are disclosed. Any corporate relations in case of groups of companies are also clearly identifiable and disclosed to the public.

⁸¹ Good practice suggests that the Internal Auditor be a member of the Institute of Internal Auditors (see also: <http://www.iiar-ru.ru>).



Annex 5
A MODEL CODE OF ETHICS

APPROVED
By decision of the Supervisory Board
of the Open Joint Stock Company «_____»
Supervisory Board Minutes
No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __ day of _____, 200_
[The Company's Seal]

CORPORATE CODE OF ETHICS

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

PREAMBLE	74
PART I. THE COMPANY'S VALUES	75
PART II. THE COMPANY'S ETHICAL PRINCIPLES.....	75
PART III. ETHICAL STANDARDS FOR THE COMPANY'S RELATIONSHIP WITH ITS STAKEHOLDERS.....	76
1. <i>Employees and Officers</i>	76
2. <i>Customers</i>	77
3. <i>Business Partners</i>	78
4. <i>Government</i>	78
5. <i>Society and the Wider Community</i>	79
PART IV. IMPLEMENTATION.....	79
1. <i>Means to Obtain Advice</i>	79
2. <i>Processes and Responsibility</i>	80
3. <i>Training Program</i>	80

Preamble

The purpose of this Code of Ethics is to:

- Commit the Open Joint Stock Company «_____» (hereinafter the Company) to the highest standards of ethical behavior;
- Encourage ethical conduct and sanction misconduct within the Company; and
- Develop an ethical culture within the Company that is based on such standards and conduct, and that will be applied by directors, managers, and employees alike.

By adopting, following, and updating this Code of Ethics on a regular basis, together with the Company's corporate governance code, charter, and by-laws, the Company confirms its desire to demonstrably lead and promote good ethical behavior. Ethics is not simply a question of obeying the law. Consequently, and to foster the confidence of its shareholders, employees, investors, and the public, this Code of Ethics goes beyond the legal and regulatory framework prevalent in

Russia today. It embraces both national and internationally recognized principles and practices.⁸²

The Company's governing bodies and employees understand this Code of Ethics as their joint obligation, and obligate themselves to ensure that its spirit and provisions are respected and acted upon throughout the Company [and its subsidiaries and dependent companies].

This Code of Ethics is reviewed and updated on an annual basis and published internally via the Company's intranet site, as well as on the Company's internet site under www._____.ru.

Part I. The Company's Values

In all internal and external relationships, the Company demonstrates its commitment to [insert Company's values]:⁸³

- Obey the Law;
- _____; and
- _____.

Part II. The Company's Ethical Principles

The Company is committed to act ethically in all aspects of its business.

The Company's ethical standards are based on the following principles:

- Honesty;
- Integrity;
- Fairness; and
- Transparency.

⁸² This ethics code was prepared using the "Basic Guidelines for Codes of Business Conduct" as a resource guide. A copy of these guidelines can be obtained in "Business Ethics: A Manual for Managing a Responsible Business Enterprise in Emerging Market Economies" and found under www.mac.doc.gov/ggp. Internationally recognized principles include, among others, the Sullivan Principles (www.globalsullivanprinciples.org), UN Principles on Corporate Ethics (www.unglobalcompact.org), Coalition for Environmentally Responsible Economies (www.ceres.org), ILO standards on labor issues (www.ilo.org), the OECD Conventions on Bribery and Corruption, and OECD Guidelines for Multi-national Enterprises (www.oecd.org).

⁸³ Company values often focus on delivering quality products and services; leadership (in terms of innovation, and research and development); promoting shareholder value; protecting the environment; satisfying customers; acting with honesty, integrity, and respect for people; etc.

Similarly, the Company expects the same in its relationships with all those with whom it does business.

The Company's ethical standards focus on the following shareholders: employees, customers, business partners, government, society, and the community at large.⁸⁴ These ethical standards shall also apply to all business areas [for all subsidiaries and dependent companies both within and outside of Russia].

The Company's ethical standards are based on:

- Respecting the rule of law, and Russian laws and regulations;
- Respecting human rights;
- Conducting business with integrity and fairness, renouncing bribery and corruption or similar unacceptable business practices, and not giving or accepting gifts and entertainment unless they fall under business custom, and are immaterial and infrequent;
- Creating mutual advantage in all the Company's relationships;
- Building and fostering trust; and
- Demonstrating respect for the community the Company operates in, as well as for the environment.

The Company shall develop specific, measurable targets for improving ethical behavior.

Part III. Ethical Standards for the Company's Relationship with its Stakeholders⁸⁵

1. Employees and Officers

The Company values its employees as the keystone to success. The Company is thus committed to treating all employees with dignity, trust, and respect, and to

⁸⁴ A company's areas of focus will depend largely on the industry in which it operates and its business sector. Thus, a company in the banking sector may wish to focus on issues different than those of a company in the oil sector (e.g. financial control, insider trading, and/or money laundering vs. environmental protection). Areas of focus can be structured around topics and/or relationships. Topics include health, safety, and environmental concerns; bribery and corruption; legality; conflicts of interest; human rights; gifts and entertainment; control and finance; etc. Relationships can include relations with employees, customers, business partners, suppliers, joint-venture partners, etc.

⁸⁵ Among the company's stakeholders are its shareholders. Shareholders are not treated explicitly in this document since shareholder issues are addressed more fully in the context of corporate governance. Detailed guidance can be found in other Annexes of this Manual.

building a long-term relationship based on Russian labor law and the respect of human rights.

The Company will not employ child labor.

It is the Company's policy to provide for and regularly improve upon a healthy, safe, and secure working environment for its employees.

Conflicts of interests can actually, or at least can appear to, compromise the judgment or objectivity of the Company's employees and officers. Conflicts of interest are to be avoided. To the extent that they cannot be avoided, employees and officers should inform supervisors and take themselves out of the decision-making process with respect to the conflict of interests.

The Company is an equal opportunity employer. Its recruitment, promotion, and compensation policy is based on merit and is free of discrimination. Clear and transparent policies have been developed and put into practice.

Discrimination or harassment at the workplace will not be tolerated. Charges of discrimination or harassment will be thoroughly investigated and dealt with by the relevant officer within the Company [Company's ethics officer and/or the Supervisory Board's ethics committee].

Employees are recognized and rewarded for their performance, based on performance objectives, and constructive and regular feedback through face-to-face meetings.

The Company has in place a training program, accessible to all employees, which encourages individuals to formulate personal development plans and provides for coaching, mentoring, and formal skill-enhancing training.

The Company prohibits the use of confidential and insider information by all officers and employees, and has developed a detailed procedure to effectively deal with insider trading and insider information.

In the interests of transparency, the Company has regular communications and holds consultations with employees regarding such topics as employment conditions and other issues that may affect the interests of employees.

2. Customers

Customer satisfaction is an overriding concern of the Company. Safe, high quality products and services, fair pricing, and appropriate after-sales service define the Company's relations with its customers.

The Company always seeks to deliver on its promises.

3. Business Partners

The Company believes that a long-term relationship with its business partners (suppliers, contractors, participants in joint ventures, and _____) founded on respect, trust, honesty, and fairness is vital to its success.

The Company will encourage its business partners to share its ethical standards.

The Company will fulfill its contractual obligations and respect its business relations. Thus:

- Contractual negotiations shall be conducted based on mutual respect and benefit;
- Business relations shall be based on high performance standards, delivering in a timely and qualitative manner, prompt settlement of bills, and _____; and
- In case of a commercial dispute, the Company will negotiate in good faith to arrive at a consensus and a fair solution.

The Company is committed to complying fully with the Russian Law on Anti-money Laundering and only conducts business with reputable suppliers, business customers, and other partners who are involved in legitimate business activities and whose funds are derived from legitimate sources.

4. Government

The Company will pay its taxes in full and in a timely manner.

The Company abides by all federal and regional regulations, including voluntary codes and guidelines such as the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), and adheres to both the letter and the spirit of such codes and guidelines.

The Company has legally obtained the licenses required to do business.

The Company seeks to build and manage a sound relationship with governmental authorities on an arm's length basis. No attempts to improperly influence governmental decisions shall be made, and the Company will not offer, pay, solicit, or accept bribes in any form or shape, either directly or indirectly, in its dealings with the government, administration, or courts. Transparent procedures regarding transactions engaged in by the Company with any government agency or official, or in dealings with any company owned or controlled by a government agency or official, shall be established to this end.

5. Society and the Wider Community

The Company views itself as an integral part of the community in which it operates and is committed to a sound relationship built on respect, trust, honesty, and fairness.

The Company is committed to creating jobs and developing local talent when this is economically possible.

The preservation of the environment is of great importance to the Company. The Company strives to minimize the environmental impact from its activities by reducing waste, emissions, and discharges, and by using energy efficiently. All operations and activities will be carried out according to the highest standards of care and in line with internationally recognized principles.⁸⁶

The Company is committed to help the local community through a variety of charities and foundations, educational organizations, and similar institutions

Non-governmental Organizations (NGOs) are a key element to any society and the Company seeks to build constructive relationships with such organizations to build a better society, and maintain a cleaner and safer environment for all.

The Company promises to discuss and consider the specific developmental needs of the communities in which it operates, through a process of regular, open dialogue.

Part IV. Implementation

1. Means to Obtain Advice

Many business decisions are complex and may involve dilemmas that require judgment to make an ethical choice. In cases of uncertainty, all officers and employees are expected to act responsibly and raise the ethical dilemma with their managers. Should this not lead to a satisfactory solution, the ethical issue can be raised with an ethics officer to obtain clarification. All officers and employees have the right to consult directly with an ethics officer [and/or the Supervisory Board's ethics committee] who, in turn, shall advise and take action in accord with the values contained in this Ethics Code.

⁸⁶ For example, ISO 14000 on Environmental Management, as developed by the International Organization for Standardization (www.iso.ch).

The Russia Corporate Governance Manual

Questions or concerns can be addressed by e-mail to ethics@companyname.ru, or by phone, fax, or regular mail to the Company's ethics officer:

Last Name, First Name, Patronymic

Tel.: _____ (ext.)

Fax: _____

Address: _____

E-Mail: _____

2. Processes and Responsibility

Each individual is responsible for his or her ethical behavior. Adherence to the Code of Ethics is made obligatory for all employees, and is incorporated into all employee contracts by reference, and linked to all disciplinary procedures.

Department heads are accountable to the General Director and/or the Executive Board for implementing this Code of Ethics within their departments, ensuring that all officers and employees understand it, and for providing assurances that they are operating according to the standards set by this Ethics Code. The General Director and/or the Executive Board are to provide the same assurances to the Supervisory Board. The principles and provisions in this Code of Ethics have been integrated into the Company's internal control system. Rigorous and objective processes to measure performance, identify shortcomings and gaps, and implement measures to address such ethical shortcoming and gaps, are regularly reviewed and modified as necessary.

The Supervisory Board's Ethics Committee [if established] periodically reviews and updates these principles, reviews the extent to which its standards are applied in practice, and formulates proposals for the Supervisory Board's approval.

3. Training Program

The Company offers a training course in ethics for all new directors, managers, and employees. This course offers practical examples and applications of this Code of Ethics.

Periodic and specialized training courses are offered to officers and employees, as part of the Company's continuous professional education program.

Part 2

Good Board
Practices



Annex 6

A MODEL BY-LAW FOR THE SUPERVISORY BOARD

Approved
by the General Meeting of Shareholders
of the Open Joint Stock Company «_____»

Minutes of the [Annual or Extraordinary]
General Meeting of Shareholders

No. _____
of _____ 200_

dated this __day of _____, 200_
[The Company's Seal]

BY-LAW FOR THE SUPERVISORY BOARD

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1. GENERAL PROVISIONS	84
ARTICLE 2. AUTHORITY	85
ARTICLE 3. COMPOSITION	90
ARTICLE 4. TERM OF OFFICE.....	92
ARTICLE 5. NOMINATION.....	92
ARTICLE 6. ELECTION AND DISMISSAL	95
ARTICLE 7. THE CHAIRMAN	96
ARTICLE 8. MEETINGS	98
ARTICLE 9. MINUTES AND VERBATIM REPORTS	103
ARTICLE 10. COMMITTEES	104
ARTICLE 11. DUTIES AND LIABILITY	105
ARTICLE 12. REMUNERATION	106
ARTICLE 13. EVALUATION	108

Article 1. General Provisions

- 1.1. This By-law on the Supervisory Board (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed in accordance with the legislation of the Russian Federation (hereinafter the Law), the Company charter, and the recommendations of the Federal Commission for the Security Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall regulate the Supervisory Board's authority; the rights, duties, and responsibilities of the Supervisory Board and its members; Board composition; term of office of Supervisory Board members (hereinafter directors); procedures for the election of directors, including their nomination; the Supervisory Board's working procedures and its relationship with the other governing bodies of the Company; Board structure, including committees; director liability; remuneration; as well as procedures for the dismissal of directors prior to the expiration of their term of office.

Annex 6. A Model By-Law for the Supervisory Board

- 1.3. The Supervisory Board shall act in accordance with the Law, the Company charter, the By-law and other internal corporate documents.
- 1.4. The relationship between the Company and its directors is regulated by civil law contracts to be signed by the Chairman of the General Meeting of Shareholders (hereinafter the GMS) on behalf of the Company.⁸⁷

Article 2. Authority

- 2.1. The Supervisory Board is a governing body of the Company responsible for setting the Company's strategy and business priorities, as well as guiding and controlling managerial performance, and for making decisions on matters that do not fall under the authority of the GMS.
- 2.2. The authority of the Supervisory Board in the area of strategic governance shall include:
 - 2.2.1. Guiding, setting, and monitoring the Company's strategy and business priorities, including the annual financial and business plans of the Company upon the recommendation of the Executive Board;
 - 2.2.2. Appointing and managing the performance of the General Director [and, upon his recommendation, the Executive Board members of the Company];⁸⁸
 - 2.2.3. Establishing and liquidating branches and representative offices, [and approving the by-laws of branches and representative offices];
 - 2.2.4. Defining the list of additional documents that shall be kept by the Company;
 - 2.2.5. Preparing the report on compliance with the FCSM Code.
- 2.3. The authority of the Supervisory Board in the area of preparing and conducting the GMS shall include:
 - 2.3.1. Deciding on the form of the GMS (physical presence of shareholders or written consent);

⁸⁷ This could be the Chairman of the General Meeting of Shareholders, who is often the Chairman of the previous Supervisory Board.

⁸⁸ LJSC, Article 65, Clause. 9, Paragraph 2 provides that under the charter of a company the Supervisory Board may have the powers to establish executive bodies and dismiss its members prior to termination of their term of office.

- 2.3.2. Determining the date, place, and the starting time of the GMS, beginning and ending the registration of shareholders, and postal address to which completed voting ballots must be sent;
- 2.3.3. Determining the date for preparing the list of persons entitled to participate in the GMS;
- 2.3.4. Approving the agenda for the GMS;
- 2.3.5. Setting procedures for the notification of shareholders about the GMS;
- 2.3.6. Determining the list of information (materials) to be made available for shareholders during the preparation for the GMS and the procedures for providing access to such information;
- 2.3.7. Approving the form and the text of the voting ballot;
- 2.3.8. Determining the class(es) of preferred shares the owners of which have the right to vote on separate agenda items;
- 2.3.9. Calling the AGM;
- 2.3.10. Reviewing the shareholder proposals to the agenda of the GMS and the candidates to the elective positions in the Company;
- 2.3.11. Putting items to the agenda of the GMS irrespective of the items proposed by the shareholders;
- 2.3.12. Including candidates in the list of candidates for election to the Supervisory Board, the Revision Commission, and the Counting Commission in case of the absence or insufficient number of candidates proposed by shareholders;
- 2.3.13. Calling an Extraordinary General Meeting of Shareholders (EGM) at the request of the Revision Commission, External Auditor, as well as shareholders holding not less than 10% of voting shares;
- 2.3.14. Reviewing proposals on calling an EGM and making a decision on calling or refusing to call such EGM within five days after the receipt of the request;
- 2.3.15. Notifying the interested parties of the decision to call an EGM or of the motivated refusal not later than three days after making such decision;
- 2.3.16. Calling an EGM in case any one of the directors ceases to be independent as defined by clause 3.10 herein, in cases when, as a result of this, the number of independent directors on the Supervisory Board becomes less than is set forth by the charter;

Annex 6. A Model By-Law for the Supervisory Board

- 2.3.17. Providing shareholders with access to information to be made available for the GMS, including at the location of most major groups of shareholders;
- 2.3.18. Proposing the following issues for the GMS' consideration (based on the recommendation of the Supervisory Board):⁸⁹
 - 2.3.18.1. The reorganization of the Company, the form of such reorganization, and other issues related to the Company's reorganization;
 - 2.3.18.2. The liquidation of the Company, appointment of the Liquidation Commission and approval of the relevant documents;
 - 2.3.18.3. The delegation of the General Director's powers to an External Manager;
 - 2.3.18.4. The recommendation on the amount of dividends to be distributed to shareholders, as well as the procedures for their distribution;
 - 2.3.18.5. The approval of the annual report;
 - 2.3.18.6. The increase of the charter capital;
 - 2.3.18.7. Splitting and consolidating shares;
 - 2.3.18.8. The approval of extraordinary transactions involving assets the total value of which is in excess of 50% of the book value of the Company's assets, or transactions involving assets the total value of which ranges from 25 to 50% of the book value of the Company's assets, unless the Supervisory Board has reached a consensus on approving such a transaction;
 - 2.3.18.9. The approval of related party transactions in cases where the Supervisory Board may not approve such a transaction due to the fact that all members are related parties and/or are not independent directors, as well as in cases where the number of disinterested directors is less than the quorum for a Board meeting as specified in the charter;
 - 2.3.18.10. The buyback by the Company of its own shares;⁹⁰

⁸⁹ Articles 2.3.18.6–2.3.18.13 are only applicable if provided for in the company charter.

⁹⁰ If the charter provides that decisions on the purchase of the company's shares shall be made by the GMS.

The Russia Corporate Governance Manual

- 2.3.18.11. The participation in holding companies, financial and industrial groups, and other groupings of commercial organizations;
 - 2.3.18.12. The approval of by-laws for the Supervisory Board, GMS, Executive Bodies, Revision Commission, as well as by-laws regulating the Company's other bodies; and
 - 2.3.18.13. The remuneration of Revision Commission members and the External Auditor's fee.
- 2.3.19. Issuing a preliminary approval of the annual report of the Company; and
- 2.3.20. Drafting and approving the annual report of the Supervisory Board on the Company's business priorities to be included in the annual report.
- 2.4. The authority of the Supervisory Board in the area of securities and assets shall include:
- 2.4.1. Approving reports on the results of a share buyback by the Company for decreasing the charter capital by retiring such shares;
 - 2.4.2. Deciding on non-convertible bonds issue;
 - 2.4.3. Deciding on purchasing bonds issued by the Company in cases specified by the Charter;
 - 2.4.4. Determining the monetary value of assets, issue price, and redemption price of securities;
 - 2.4.5. Making available to shareholders the list of assets to be used as payment for shares and the report on valuation of such assets if the agenda of the AGM includes an item on placement of additional shares, payment for which is to be made in kind;
 - 2.4.6. Recommending to the GMS the amount and procedures for the payment of dividends;
 - 2.4.7. Deciding on the use of the reserve and other funds of the Company;
 - 2.4.8. Approving extraordinary transactions in cases specified by the Law and the charter of the Company;

Annex 6. A Model By-Law for the Supervisory Board

- 2.4.9. Approving transactions involving assets the total value of which exceeds ___% of the book value of the Company's assets;⁹¹
- 2.4.10. Approving related party transactions in cases specified by the Law and the charter of the Company.
- 2.5. The authority of the Supervisory Board in the area of its working procedures and supervision of executive bodies and the External Registrar of the Company shall include:
 - 2.5.1. Establishing permanent and/or interim Supervisory Board committees;
 - 2.5.2. Developing criteria for evaluating directors' performance.
 - 2.5.3. Authorizing directors or other persons to sign employment contracts with the General Director, Executive Board members, and the Corporate Secretary on behalf of the Company;
 - 2.5.4. Determining the terms of employment contracts, including the remuneration of the General Director and Executive Board members, as well as the Corporate Secretary of the Company;
 - 2.5.5. Suspending the powers of the External Manager;
 - 2.5.6. Calling an EGM to approve the decision on dismissal of the External Manager and the transfer of the General Director's powers to a new External Manager;
 - 2.5.7. Consenting the General Director and Executive Board members to hold positions in the governing bodies of other companies;
 - 2.5.8. Holding the General Director and Executive Board members liable, including for incomplete or delayed payment of dividends, as well as for refusing to provide documents and information to the Supervisory Board in cases specified by the By-law;
 - 2.5.9. Requesting minutes of Executive Board meetings;
 - 2.5.10. Recommending to the GMS the remuneration of Revision Commission members, as well as the External Auditor's fees;
 - 2.5.11. Requesting an extraordinary inspection of financial and business operations of the Company by the Revision Commission;

⁹¹ FCSM Code, Chapter 4, Section 1.1.3. Recommends that transactions, the total value of which is in excess of 10% of the book value of the company's assets, be approved by the Supervisory Board.

The Russia Corporate Governance Manual

- 2.5.12. Requesting oral or written reports, as well as any documents and information necessary for it to perform its functions, from the General Director and Executive Board members;
- 2.5.13. Approving the External Registrar of the Company and the terms of contract with the Registrar, and terminating such contract;
- 2.5.14. Appointing and dismissing the Corporate Secretary;
- 2.5.15. Approving the following internal corporate documents:
 - 2.5.15.1. By-law on Risk Management;
 - 2.5.15.2. By-law on Information Policy;
 - 2.5.15.3. By-law for the Corporate Secretary;
 - 2.5.15.4. By-law on Branches and Representative Offices;
 - 2.5.15.5. List of confidential and insider information;
 - 2.5.15.6. Procedures for internal control over financial and business operations of the Company;
 - 2.5.15.7. Other internal documents of the Company, other than those to be approved by the GMS or executive bodies in accordance with the requirements of the charter;
- 2.5.16. Making decisions on approval of transactions outside the financial and business plan (non-standard transactions).
- 2.6. Issues falling within the competence of the Supervisory Board may not be delegated to the General Director or the Executive Board.
- 2.7. Directors shall have the right to receive from the executive bodies and heads of the main structural units of the Company all information necessary for them to perform their duties.

Article 3. Composition

- 3.1. The Supervisory Board shall have __ members.⁹²
- 3.2. Only individuals may be eligible to be elected to the Supervisory Board. An individual who is not a shareholder may also be eligible.

⁹² LJSC, Article 66, Clause 3 provides that the number of directors may be specified by the charter or the decision of the GMS subject to the requirements of the Company Law. The Supervisory Board of companies with more than 1,000 holders of voting shares shall consist of at least seven members, and the Supervisory Board of companies with more than 10,000 holders of voting shares shall have at least nine members.

Annex 6. A Model By-Law for the Supervisory Board

- 3.3. Persons elected to the Supervisory Board may be re-elected an unlimited number of times.
- 3.4. Directors may not hold directorships in more than _____ other companies.⁹³
- 3.5. Supervisory Board member may not be a partner, General Director (External Manager), member of the governing body or employee of a legal entity competing with the Company.⁹⁴
- 3.6. A person that has been found guilty of committing an economic offence, or offence against governmental and/or local authorities, or a person on whom administrative penalties were imposed for offences related to business, finance, taxes, and duties, or securities market operations, may not be elected to the Supervisory Board.
- 3.7. Members of the Revision Commission and the Corporate Secretary may not at the same time be directors.
- 3.8. The Chairman of the Supervisory Board shall head the Supervisory Board.
- 3.9. Executive Board members and any other executives may not account for more than one quarter of directors.
- 3.10. Not less than one third of the total number of directors shall be independent directors. Under the definition set forth in the Charter, the following persons shall be considered independent:⁹⁵
 - 3.10.1. Who were not over the past three years, and are not, the officers (managers) or the employees of the Company, or officers or employees of the External Manager;
 - 3.10.2. Who were not over the past three years, and are not, officers of another company in which any of the officers of the Company is a member of the Supervisory Board's Nominations and Remuneration Committee;
 - 3.10.3. Who were not over the past three years, and are not, affiliated persons of an officer (manager) of the Company (officer of the External Manager);⁹⁶

⁹³ Not more than five directorships may be considered as best practice.

⁹⁴ The "competing company" can be defined by analogy with Civil Code, Article 73, Clause 3.

⁹⁵ The definition of the term "independent director" is included in accordance with the recommendations of the FCSM Code, Chapter 3, Section 2.2.2. See also: Annex 18.

⁹⁶ See the definition of affiliated persons in the Law on Competition and Restriction of Monopolistic Operations in the Commodity Markets, Article 4.

- 3.10.4. Who were not over the past three years, and are not, affiliated persons of the Company, or affiliated persons of such affiliated persons;
 - 3.10.5. Who are not bound by contractual relations with the Company, whereby they may acquire property (receive cash funds) having value in excess of 10% of such persons' aggregate annual income, other than through receipt of remuneration for their work on the Supervisory Board;
 - 3.10.6. Who were not over the past three years, and are not, major business partners of the Company (the annual total value of transactions with which is in excess of 10% of the total book value of the Company's assets); and
 - 3.10.7. Who were not over the past three years, and are not, representatives of the government.
- 3.11. An independent director who has served on the Supervisory Board of the Company for a period of over seven years may not be considered independent.

Article 4. Term of Office

- 4.1. The Supervisory Board shall be elected for the period until the next AGM.
- 4.2. The newly elected Supervisory Board shall enter into office, and the previous Board shall resign, from the date of signing by the Counting Commission of the voting results minutes.
- 4.3. If the Annual General Meeting of Shareholders (AGM) was not held within the timeframe established by the charter, the powers of the Supervisory Board shall be terminated with the exception of the powers to prepare, call, and conduct the GMS.

Article 5. Nomination

- 5.1. Only shareholders owning at least 2% of voting shares on the date of the proposal shall have the right to make nominations to the Supervisory Board.
- 5.2. The Company shall receive proposals from the shareholders within ___ calendar days of the end of the fiscal year.⁹⁷

⁹⁷ The company shall receive such proposals within 30 days upon completion of the fiscal year unless the company's charter provides for a longer period (LJSC, Article 53, Clause 1).

Annex 6. A Model By-Law for the Supervisory Board

- 5.3. The Supervisory Board shall have the right to add candidates to the list of potential Supervisory Board members if an insufficient number of candidates have been nominated by shareholders.
- 5.4. The proposal nominating candidates to the Supervisory Board shall not include candidates in excess of the number of directors set forth in the Company's charter.
- 5.5. The candidates can be nominated by:
 - 5.5.1. Registered mail sent to _____(address) and the attention of: _____ [*position of person in charge of receiving proposals*];
or
 - 5.5.2. Hand delivery against receipt to _____ [*the Secretary of the Supervisory Board or the Corporate Secretary, if any, or other person authorized to receive written correspondence*].
- 5.6. The nomination date shall be established pursuant to the requirements for preparing, calling, and conducting the GMS set forth by the FCSM.
- 5.7. The nomination proposal shall be made in writing and shall include:
 - 5.7.1. Last, first, and middle name of each proposed candidate, and the date of birth;
 - 5.7.2. Name of the body for which candidates are nominated (the Supervisory Board);
 - 5.7.3. Name(s) of the shareholder(s) submitting the proposal;
 - 5.7.4. Number, types, and classes of shares held by the submitting shareholder(s);
 - 5.7.5. Education received, including continuing professional education (name of educational establishment, date of completion, education received);
 - 5.7.6. Professional experience, including positions held for the past ___ years, management positions occupied by the candidate in the governing bodies of other legal entities for the recent ___ years;⁹⁸

⁹⁸ FCSM Code, Chapter 3, Section 2.3.1 recommends a five-year period.

The Russia Corporate Governance Manual

- 5.7.7. List of legal entities in which the candidate participates or has an interest, including the number of shares or units held in the charter capital of such legal entity;
 - 5.7.8. List of persons with whom the candidate is affiliated, and the basis for such affiliation;
 - 5.7.9. Relation of the candidate to the affiliated persons and major counter-parties of the Company, and the statement of candidate's affiliation with the Company;
 - 5.7.10. Statement of any previous convictions and administrative disqualifications;
 - 5.7.11. _____; and
 - 5.7.12. _____.
- 5.8. Such proposal shall also contain the agreement of the candidate to be elected.
 - 5.9. The proposal shall be signed by the shareholder or by proxy. If the proxy signs the proposal, the power of attorney shall be attached.
 - 5.10. The Supervisory Board shall review the submitted proposals and decide whether the nominees are to be included into the list of candidates for election to the Supervisory Board within five days upon expiration of the period set forth in Clause 5.2 hereof.
 - 5.11. A grounded decision of the Company's Supervisory Board to refuse a nominee in the list of candidates shall be sent to the nominating shareholder(s) within three days following the relevant decision.
 - 5.12. The nominees shall be included in the list of candidates except when:
 - 5.12.1. The shareholder(s) failed to observe the timeline set forth in Clause 5.2 hereof;
 - 5.12.2. The shareholder(s) does not hold the requisite number of Company's voting shares set forth in Clause 5.1 hereof;
 - 5.12.3. The proposal does not meet the requirements of Clause 5.7 hereof; and
 - 5.12.4. The matter proposed for inclusion in the agenda of the GMS is not in the jurisdiction of the GMS and/or does not meet the requirements of the law.
 - 5.13. A candidate to the Supervisory Board shall have the right to withdraw before he is included in the list of candidates.

Annex 6. A Model By-Law for the Supervisory Board

Article 6. Election and Dismissal

- 6.1. Directors shall be elected by cumulative voting. Each voting share shall grant to the holder thereof the number of votes equal to the number of Supervisory Board members set forth in the charter. A shareholder may cast all his votes for one candidate or distribute the votes among several candidates at his own discretion.
- 6.2. The candidates for whom the largest number of votes is cast shall be deemed elected to the Supervisory Board.
- 6.3. In connection with the elections to the Supervisory Board the shareholders shall be provided with information on:⁹⁹
 - 6.3.1. The shareholder/group of shareholders proposing such candidate;
 - 6.3.2. The candidate's age and education;
 - 6.3.3. Professional experience, including positions held during the past five years;
 - 6.3.4. The position held as of the moment of nomination;
 - 6.3.5. The nature of the candidate's relations with the Company;
 - 6.3.6. The candidate's directorships and other positions held by the candidate in other legal entities;
 - 6.3.7. Nominations to the Supervisory Board or to positions in governing bodies of other legal entities;
 - 6.3.8. The candidate's relations with the Company's affiliates;
 - 6.3.9. The candidate's relations with the Company's major contractors;
 - 6.3.10. The candidate's status and other circumstances which may affect his ability to perform his duties as a director; and
 - 6.3.11. The candidate's refusal to provide information requested by the Company.
- 6.4. The GMS may dismiss the Supervisory Board prior to the expiration of its term of office. The GMS may make such decision only with regard to all directors.

⁹⁹ FCSM Code, Chapter 3, Section 2.3.1.

- 6.5. In case of dismissing the Supervisory Board prior to the expiration of its term of office, the newly elected directors shall be in office until the election of the new Supervisory Board at the next AGM.
- 6.6. In case of resignation of any directors, such director shall remain liable under the laws of the Russian Federation. Such director shall inform the Supervisory Board of his intention to resign in writing at least __ month(s) in advance.¹⁰⁰
- 6.7. In case the number of directors becomes less than the number required to constitute a quorum under the provisions of Clause 8.11 hereof, the Supervisory Board shall make a decision to call an EGM to elect a new Supervisory Board. The remaining directors shall not have the right to make any decisions other than calling such EGM.

Article 7. The Chairman

- 7.1. The Chairman of the Supervisory Board (hereinafter the Chairman) shall be elected by the directors from among themselves by a majority vote of all elected directors.
- 7.2. The person acting as the General Director [or another executive] of the Company may not be elected the Chairman.
- 7.3. The Supervisory Board shall have the right to dismiss and re-elect its Chairman at any time by a majority vote of all the elected directors.
- 7.4. The Chairman shall:
 - 7.4.1. Organize the work of the Supervisory Board, ensuring conditions for the free exchange of opinions by all directors, and open discussion of agenda items;
 - 7.4.2. Arrange for a fixed schedule and call Supervisory Board meetings, prepare the agenda for and preside over the meetings, as well as organize voting by written consent of the directors in accordance with the provisions of the charter;
 - 7.4.3. Organize meeting minutes [and transcripts] and sign the minutes;

¹⁰⁰ This rule applies only when a civil agreement is made with the member of the Supervisory Board.

Annex 6. A Model By-Law for the Supervisory Board

- 7.4.4. Not later than ____ days after the receipt of a proposal on the nomination of candidates for the position of General Director and Executive Board members, request information about the existence of any criminal offense or administrative penalties imposed on such candidates;
 - 7.4.5. Sign the employment contracts with the General Director and Executive Board members on behalf of the Company, unless this right has been delegated to other person(s) by the Supervisory Board, not later than ____ days after the Counting Commission signs the minutes on the voting results;
 - 7.4.6. Ensure for efficient decision-making on all agenda items, including sufficient background materials, proper discussions, and voting;
 - 7.4.7. Provide all directors with the information necessary for the meetings in a timely manner, but not less than __ week(s) before the meeting;¹⁰¹
 - 7.4.8. Establish Supervisory Board committees, nominate directors to such committees, and coordinate the relations between the committees and the officers and executives of the Company;
 - 7.4.9. Maintain regular contact with the other bodies and officers of the Company, namely, the General Director and other key executives;
 - 7.4.10. Receive written proposals of shareholders on calling an EGM and nominating candidates to the governing bodies of the Company;
 - 7.4.11. Preside over the GMS except when, under the law, persons and bodies calling the GMS have the right to appoint the Chairman of the GMS; and
 - 7.4.12. Prepare reports on the activities of the Supervisory Board for the year to be included in the annual report of the Company.
- 7.5. In case of the absence of the Chairman, another director shall perform his functions by the Supervisory Board's decision, made by a majority vote of directors participating in the meeting.

¹⁰¹ Good practice indicates between ten and 15 days.

Article 8. Meetings

- 8.1. Supervisory Board meetings shall be convened by the Chairman on his own initiative as required, but at least once every _____ [*number of weeks or months*],¹⁰² as well as upon request of:
 - 8.1.1. A director;
 - 8.1.2. The Revision Commission;
 - 8.1.3. The External Auditor;
 - 8.1.4. The General Director;
 - 8.1.5. An Executive Board member;
 - 8.1.6. Shareholder(s) — owner(s) of at least 2% of voting shares. Shareholders shall have the right to demand that a meeting be convened only to discuss issues that may be proposed for consideration by the GMS on the recommendation of the Supervisory Board, calling the AGM and EGM, as well as approval of transactions that require approval by the Supervisory Board.¹⁰³
- 8.2. The request of the person initiating the meeting of the Supervisory Board shall be made in writing by registered mail to the address of the Company or handed to the Corporate Secretary.
- 8.3. The date of the request to call a Supervisory Board meeting shall be determined by the cancellation stamp, or the date of receipt of the request by the Corporate Secretary.
- 8.4. The request shall be signed by the director who requests the calling of the meeting, or by the General Director, the Chairman of the Revision Commission, the External Auditor, or the person representing the shareholder(s) requesting such meeting.
- 8.5. The request shall contain:
 - 8.5.1. The name of the person requesting the meeting;
 - 8.5.2. Wording of the agenda items; and
 - 8.5.3. Form of the meeting.

¹⁰² FCSM Code, Chapter 3, Section 4.2.1 recommends holding Supervisory Board meetings at least once every six weeks.

¹⁰³ FCSM Code, Chapter 3, Section 4.13.

Annex 6. A Model By-Law for the Supervisory Board

- 8.6. Within ____ days after the receipt of the request, the Chairman shall call the Supervisory Board meeting.
- 8.7. In case of unjustified refusal or inability of the Chairman to call the Supervisory Board meeting, any other director may call such meeting.
- 8.8. Notice on the date, place, and time of the Supervisory Board meeting, together with the agenda of the meeting and the information on procedures for reviewing materials and information required to prepare for the meeting, shall be sent by registered mail or delivered to every director and the person who requested the meeting in cases when the meeting is called at the request of persons listed in Clause 8.1. hereof not later than ____ [10] days before the date of the meeting. The date of the notice shall be the date of the cancellation stamp or the date of delivery of the notice.
- 8.9. The first Supervisory Board meeting shall be held not later than ____ month(s) after the election of the Supervisory Board.¹⁰⁴
- 8.10. The agenda of the first meeting shall include the following items:
 - 8.10.1. Election of the Chairman;
 - 8.10.2. Determining business priorities of the Company;
 - 8.10.3. Establishing committees of the Supervisory Board;
 - 8.10.4. Determining independent directors.
 - 8.10.5. _____; and
 - 8.10.6. _____.
- 8.11. Supervisory Board meetings shall include a full set of relevant materials to be prepared by the Corporate Secretary and relevant executives.
 - 8.11.1. The Supervisory Board materials shall include an executive summary highlighting the main issues, including risks and consequences of inaction, and offer practical solutions. Detailed information shall be included in the Annexes.
 - 8.11.2. Materials for Supervisory Board meetings shall include:
 - 8.11.2.1. The company's financial and non-financial key performance indicators, as set by the Supervisory Board and prepared by the General Director;
 - 8.11.2.2. A full set of financial information;

¹⁰⁴ Good practices suggests one month. This meeting is often held right after the AGM.

The Russia Corporate Governance Manual

- 8.11.2.3. Minutes and recommendations from the last Supervisory Board meeting;
 - 8.11.2.4. Marketing and sales figures;
 - 8.11.2.5. Production data;
 - 8.11.2.6. The report of the Internal Auditor; and
 - 8.11.2.7. _____.
- 8.12. The quorum for the Supervisory Board meetings shall be _____ [not less than half] of all directors. This number shall include at least two directors none of whom is the General Director or an Executive Board member.
- 8.13. For the purposes of voting at the meetings, each director shall have one vote.
- 8.14. The transfer of votes from one director to another, as well as transfer of votes to any other person by the power of attorney shall not be permitted.
- 8.15. The Chairman shall have the right to cast a decisive vote in case of a tie vote.
- 8.16. Decisions of the Supervisory Board shall be made by a simple majority vote of directors who participated in the meeting, including absentee voting, unless otherwise provided herein and in the Company's charter.
- 8.17. The Supervisory Board shall make decisions on the following issues by a three-fourths majority vote of directors who participated in the meeting:
- 8.17.1. _____;
 - 8.17.2. _____; and
 - 8.17.3. _____;
- 8.18. Decisions on the placement of bonds by the Company, with the exception of convertible bonds, as well as approval of major transactions involving assets the total value of which ranges from 25 to 50% of the book value of the Company's assets, shall be made by unanimous decision of all the directors without taking into account the votes of retired Board members.
- 8.19. Decisions on the approval of other transactions made by the Company, as set forth by the charter, with the exception of the transactions made in the ordinary course of business, shall be made by the unanimous decision of

Annex 6. A Model By-Law for the Supervisory Board

all the directors without taking into account the votes of retired Board members.

- 8.20. Decisions on approval of related party transactions shall be made by a majority vote of independent directors who are not interested parties in such transactions as defined in the law. When all directors are interested parties and/or are not independent, the decision on approving such transactions shall be made by the GMS.
- 8.21. Decisions on the approval of the contractual terms with the General Director and/or Executive Board members shall be made by the majority vote of directors participating in the meeting. The General Director and Executive Board members shall not vote on such issues.
- 8.22. The Supervisory Board may make decisions at the meetings held in the form of joint attendance, or joint attendance taking into account written opinions of the absent directors, for the purposes of establishing quorum of the meeting and the results of the voting, as well as by absentee voting.
- 8.23. Notice about the meeting shall be made in accordance with the provisions of Clause 8.8 hereof.
- 8.24. The notice shall consist of two parts.
- 8.25. The first part of the notice shall contain the following information:
 - 8.25.1. Full legal name and location of the Company;
 - 8.25.2. Date, place, and time of the meeting;
 - 8.25.3. Agenda of the meeting;
 - 8.25.4. Information about the procedures for review, the materials and information required for preparing the meeting, or the list of the attached materials.
- 8.26. The second part of the notice (written opinion) shall contain the following:
 - 8.26.1. Postal address to which the written opinion should be mailed;
 - 8.26.2. Deadline for the acceptance of written opinions;
 - 8.26.3. Wording of decisions on each item of the agenda;
 - 8.26.4. Voting options on each item: “for”, “against”, “abstained”;
 - 8.26.5. Space for formulating the written opinion of the director on each item of the agenda;
 - 8.26.6. Space for signature of the director with the reminder that the signature is mandatory.

The Russia Corporate Governance Manual

- 8.27. The second part of the notice may be sent to the Supervisory Board by registered mail, courier, or delivered to the Corporate Secretary personally by the director or his representative.
- 8.28. Decisions on conducting the Supervisory Board meeting by absentee vote shall be made by the Chairman or the person requesting the extraordinary meeting.
- 8.29. The following decisions may not be made by absentee vote:
- 8.29.1. Approval of business priorities and the financial and business plan of the Company;
 - 8.29.2. Calling of the AGM and decisions necessary for its calling and conducting;
 - 8.29.3. Preliminary approval of the annual report of the Company;
 - 8.29.4. Calling or refusal to call an EGM;
 - 8.29.5. Election, dismissal, and re-election of the Chairman;
 - 8.29.6. Election and dismissal of the executive bodies of the Company [if these decisions fall within the authority of the Supervisory Board under the charter];
 - 8.29.7. Recommendations to the GMS on the reorganization or the liquidation of the Company.
 - 8.29.8. _____; and
 - 8.29.9. _____;
- 8.30. The ballot for absentee voting signed by the Chairman and materials required for preparing the meeting shall be sent by registered mail or delivered personally to directors with his confirmation of receipt at least ten days prior to the date of the meeting.
- 8.31. The date of receipt of the voting ballot by the director shall be the date of the cancellation stamp or the date of delivery of the document.
- 8.32. The voting ballot shall contain the following information:
- 8.32.1. Full legal name and location of the Company;
 - 8.32.2. Wording of the issues offered for voting, and decisions on each item of the agenda;
 - 8.32.3. Voting options on each item: “for”, “against” “abstained”;
 - 8.32.4. Information about the procedures for review, the materials and information necessary for preparing the meeting, or the list of the attached materials;

Annex 6. A Model By-Law for the Supervisory Board

- 8.32.5. Postal address to which the mail-in ballots shall be sent; and
- 8.32.6. Deadline for accepting the ballots.
- 8.33. The date of receipt of the voting ballot by the director shall be the date of the cancellation stamp or the date of delivery of the document.
- 8.34. Directors whose voting ballots were received on or before the established deadline shall be considered to have participated in the voting.
- 8.35. The Corporate Secretary shall draft the minutes on the absentee voting results.
- 8.36. A report on the voting results shall be sent to the directors by registered mail or delivered personally to directors with confirmation of receipt within ___ days after the date of the minutes on voting results.
- 8.37. Written opinions shall not be taken into account for the purposes of establishing a quorum and the voting results when making decisions on the approval of extraordinary and related party transactions.

Article 9. Minutes and Verbatim Reports

- 9.1. The Corporate Secretary shall prepare minutes of the Supervisory Board's meetings.
- 9.2. The minutes shall be made within three days after the meeting. The minutes shall contain the following information:
 - 9.2.1. Full legal name and location of the Company;
 - 9.2.2. Place (address) and time of the meeting;
 - 9.2.3. Agenda of the meeting;
 - 9.2.4. Persons attending the meeting and quorum;
 - 9.2.5. Directors who did not attend the meeting but submitted their written opinions;
 - 9.2.6. Issues put to vote and the voting results on an individual basis;
 - 9.2.7. Decisions made;
 - 9.2.8. _____; and
 - 9.2.9. _____.
- 9.3. The minutes of the Supervisory Board meeting shall be signed by the Chairman who shall be responsible for their accuracy, all directors who participated in the meeting, and the Corporate Secretary.

The Russia Corporate Governance Manual

- 9.4. Written opinions of the directors shall be appended to the minutes.
- 9.5. The minutes on the results of absentee voting shall be made within three days after the final date for acceptance of the ballots and shall be signed by the Chairman and the Corporate Secretary. The minutes shall include the following information:
 - 9.5.1. Issues put to absentee vote;
 - 9.5.2. Wording of decisions on each issue; and
 - 9.5.3. Voting results on each issue.
- 9.6. The Company shall provide the Supervisory Board's minutes to the Revision Commission, the External Auditor upon request, as well as provide copies of such documents at the request of shareholders for a fee that shall not exceed the cost of making and mailing of such copies.
- 9.7. The Company shall keep minutes of the Supervisory Board meetings at the location of the executive body of the Company.
- 9.8. The Corporate Secretary organizes verbatim reports of Supervisory Board meetings.

Article 10. Committees

- 10.1. The Supervisory Board may establish *ad hoc* or permanent committees for preliminary review and consideration of the most important issues within the authority of the Supervisory Board.
- 10.2. The Company shall establish the following Supervisory Board committees¹⁰⁵:
 - 10.2.1. _____;
 - 10.2.2. _____; and
 - 10.2.3. _____.
- 10.3. Only directors may become committee members.

¹⁰⁵ FCSM Code, Chapter 4 recommends establishing Strategic Planning, Nominations and Remuneration, Corporate Conflicts, and Audit Committees. Other committees recognized internationally include the Corporate Governance Committee and Ethics Committee.

Annex 6. A Model By-Law for the Supervisory Board

- 10.4. The same director may not serve on more than ___ committees.¹⁰⁶
- 10.5. The committees may employ the services of experts and specialists. The Supervisory Board shall determine the fees for the services of such experts and specialists.
- 10.6. Committee meetings shall be convened by the chairman of the committee, any committee member, or the Supervisory Board decision.
- 10.7. The results of the committee's work shall be reflected in a written decision signed by all members of the committee attending the meeting and submitted to the Chairman.
- 10.8. Opinions of the committee shall be treated as recommendations only.
- 10.9. Further details are regulated in separate by-laws on committees.

Article 11. Duties and Liability

- 11.1. Directors, while exercising their rights and performing their duties, shall:
 - 11.1.1. In all their decisions act reasonably, and in good faith, and in the best interests of the Company and its shareholders. This means careful consideration of all available information, and making careful and balanced decisions that may be expected of a good director in similar circumstances;
 - 11.1.2. Actively take part in the meetings and work of the Supervisory Board and the committees to which they have been elected;
 - 11.1.3. Seek clarifications and ask questions on issues that are unclear or not understandable;
 - 11.1.4. Notify the Supervisory Board in advance of their inability to attend the Supervisory Board meetings stating the reasons for such absence;
 - 11.1.5. Act in accordance with the following conflicts of interests rules and regulations:
 - 11.1.5.1. Immediately inform the Chairman in writing about any personal commercial or other interest (direct or indirect) in the transactions, contracts, or projects involving the Company, including intentions to enter into transactions

¹⁰⁶ Best practice suggests to prohibit permitting any director to sit on more than three Supervisory Board committees.

- with the securities of the Company in which they are directors, or subsidiary (dependent) companies thereof, as well as disclose information on any transactions made by them with such securities in accordance with the procedures set forth in the Company's by-laws;
- 11.1.5.2. Not accept from individuals or legal entities any gifts, services, or benefits, which are, or may be, considered as compensation for decisions or actions made by the director in his official capacity, with the exception of symbolic tokens of goodwill in accordance with the generally accepted norms of politeness or exchange of souvenirs during official events;
- 11.1.5.3. Not disclose confidential, insider, and other official information that became known to him in the course of performing his duties as a director, to persons who do not have access to such information, nor use such information in their own personal interests or in the interest of third parties both during the term of their office and for the period of ____ years after they leave the Company;
- 11.1.5.4. Act in compliance with all the rules and procedures set forth by by-laws of the Company on ensuring security and protection of the confidential information about the Company;
- 11.1.6. Provide complete and accurate information on the business and financial performance of the Company to the Supervisory Board; and
- 11.1.7. Independent directors shall refrain from actions as a result of which they would cease to be independent. If, as a result of a change in circumstances, an independent director ceases to be independent, he shall inform the Supervisory Board thereof in writing within ____ [*period of time*].
- 11.2. Directors shall be liable to the Company for losses incurred by the Company through their fault (omission) unless the law provides for other grounds and scope of liability.

Annex 6. A Model By-Law for the Supervisory Board

- 11.3. Directors who voted against the decision that resulted in losses to the Company, or did not participate in the voting shall not be liable for such losses.
- 11.4. In determining the grounds for, and the amount of, director liability ordinary business practices and other relevant circumstances shall be taken into account.
- 11.5. If several directors are liable under Clause 11.2. hereof, they shall be jointly and severally liable to the Company.
- 11.6. In case the Company becomes insolvent (bankrupt) through fault of the directors they may, in case of insufficiency of the Company's assets, bear subsidiary liability under the Company's obligations.
- 11.7. Insolvency of the Company shall be deemed to have resulted from the actions of directors only if such persons exercised their right to give mandatory instructions or their power to direct the actions of the Company being fully aware that such actions would result in the insolvency of the Company.

Article 12. Remuneration

- 12.1. Subject to the decision of the GMS, directors during the term of their office shall receive compensation of expenses incurred by them in connection with the performance of their duties as directors or Supervisory Board committee members, and remuneration.
- 12.2. Remuneration of the directors shall consist of:
 - 12.2.1. A fixed annual remuneration;
 - 12.2.2. A fixed fee upon meeting attendance;
 - 12.2.3. Fees for additional work such as for work on Supervisory Board committees; and
 - 12.2.4. Additional fees for additional responsibilities such as for serving as the Chairman of the Supervisory Board or one of its committees.
- 12.3. Executive directors do not receive additional fixed remuneration for their directorship.

The Russia Corporate Governance Manual

- 12.4. Non-executive directors receive equal fixed remuneration.
- 12.5. Fixed remuneration shall be payable once a _____, provided the director attended at least _____% of the Supervisory Board meetings.

Article 13. Evaluation

- 13.1. Performance of the Supervisory Board and each of its directors shall be evaluated in accordance with the criteria developed by the Supervisory Board [Nominations and Remuneration Committee].



Annex 7

**A MODEL BY-LAW FOR THE SUPERVISORY BOARD'S
AUDIT COMMITTEE**

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __ day of _____, 200_
[The Company's Seal]

BY-LAW FOR THE SUPERVISORY BOARD'S AUDIT COMMITTEE

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	110
ARTICLE 2.	AUTHORITY	111
ARTICLE 3.	RIGHTS AND RESPONSIBILITIES	114
ARTICLE 4.	ELECTION, COMPOSITION, AND DISMISSAL.....	115
ARTICLE 5.	MEETING PROCEDURES.....	116
ARTICLE 6.	REMUNERATION	117

Article 1. General Provisions

- 1.1. This By-law for the Audit Committee (hereinafter the By-law) of the Supervisory Board of the Open Joint Stock Company «_____» (hereinafter the Company) has been drafted in accordance with the laws of the Russian Federation (hereinafter the Law), the charter of the Company and other internal corporate documents, and relevant recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall define the authority of the Supervisory Board's Audit Committee (hereinafter the Committee) and its members, and further, shall define the rights and responsibilities of the Committee's members, election, composition, and dismissal of Committee members, meeting procedures, as well as the remuneration of Committee members.
- 1.3. The Committee has been established to assist the Supervisory Board in performing its guidance and oversight functions effectively and efficiently, and is specifically charged with ensuring the integrity of the Company's financial statements, internal control policies and procedures, interacting with the External Auditor, and internal audit policies and procedures.
- 1.4. All proposals developed by the Committee are recommendations only and thus non-binding to the Supervisory Board.

Annex 7. A Model By-Law for the Supervisory Board's Audit Committee

Article 2. Authority

- 2.1. The following issues shall fall within the authority of the Committee:
 - 2.1.1. As to financial accounting and reporting, to:
 - 2.1.1.1. Provide assistance during the organization and preparation of the Company's financial statements and accounts, and to ensure the veracity, transparency, and completeness of the financial information disclosed by the Company;
 - 2.1.1.2. Ensure compliance with the Company's accounting policies and practices as applied in the Company's financial reports, and evaluate and rate such practices as either aggressive, balanced and appropriate, or conservative;
 - 2.1.1.3. Identify and review significant accounting and reporting issues, including any recent professional and regulatory provisions from oversight authorities, and assess and understand their impact on the financial reports of the Company;
 - 2.1.1.4. Oversee the periodic financial reporting process implemented by management, and review the interim and annual financial statements of the Company as well as review preliminary announcements prior to their release or publication;
 - 2.1.1.5. Develop and make recommendations to the Revision Commission regarding the Company's overall accounting policy, and specifically, develop recommendations for an analysis of the Company's financial reports and assessments, and the results of any audits conducted; and
 - 2.1.1.6. Develop and make recommendations to the Revision Commission for the annual report prior to its approval by the Supervisory Board of the Company, including the full set of financial statements, including notes, and management's discussion and analysis.
 - 2.1.2. As to internal control and risk management, to:
 - 2.1.2.1. Develop and review the major risks faced by the Company, including financial, operational, and legal risk, and

- the guidelines and policies which management has implemented to govern the process of identifying, assessing, treating, and periodically reviewing such exposures;
- 2.1.2.2. Develop recommendations regarding the development, improvement, refinement, and expansion of a control environment within the Company;
 - 2.1.2.3. Conduct assessments of the general efficiency of internal control and risk management systems, including budgeting and staffing matters, as well as exercise control over management's compliance with the recommendations of the Internal and External Auditors; and
 - 2.1.2.4. Coordinate management's efforts to ensure the security of computer systems and applications, and develop and coordinate contingency plans for processing financial information in the event of a complete systems breakdown or failure with the help of the Company's IT staff.
- 2.1.3. As to working and interacting with the External Auditor, to:
- 2.1.3.1. Develop recommendations on the selection of an External Auditor, including a review of that Auditor's professional qualifications and independence, the potential risk of conflicts of interests, as well as the Auditor's fees;
 - 2.1.3.2. Conduct an annual review of the performance of the External Auditors, and make recommendations to the Supervisory Board on the appointment, reappointment, or termination of the External Auditor's contract;
 - 2.1.3.3. Work with the External Auditor to coordinate the scope, plan, and procedures to be followed for the current year's audit taking into consideration both the Company's present circumstances and any applicable changes in legislation and other regulatory requirements;
 - 2.1.3.4. Work to resolve any problems encountered in the normal course of the External Auditor's work, including any restrictions on the scope of the audit or access to information;
 - 2.1.3.5. Discuss any significant findings or recommendations made by the External Auditor and management's proposed

Annex 7. A Model By-Law for the Supervisory Board's Audit Committee

- response thereto, as well as any other appropriate actions to be taken based on such recommendations;
- 2.1.3.6. Conduct separate meetings with the External Auditor to discuss any matters that the Committee or the Auditor believes should be discussed privately, and ensure that the Auditors have access to the Chairman of the Committee when required;
 - 2.1.3.7. Develop recommendations on the Company's policy for the assignment of non-audit tasks and services to be provided by the External Auditor and, as need be, develop a framework for the pre-approval of both audit and non-audit services;
 - 2.1.3.8. Review and discuss with the External Auditor any transaction involving the Company and a related party;
 - 2.1.3.9. Develop recommendations regarding a policy for hiring personnel from audit firms for senior positions in the Company after they have left the audit firm; and
 - 2.1.3.10. Consider whether it is appropriate to adopt a policy of insisting upon the rotation of the External Auditor's lead audit partner or rotating the External Auditor on a periodic basis.
- 2.1.4. As to the internal audits, to:
- 2.1.4.1. Conduct separate meetings with Revision Commission members, and develop joint recommendations regarding the significant issues and matters concerning the Company's financial and economic activities, and ensure that the chairman of the Revision Commission has access to the Chairman of the Committee when required;
 - 2.1.4.2. Develop recommendations for the establishment and staffing, as well as the budget and independence of an Internal Auditor;
 - 2.1.4.3. Conduct assessments of the Internal Auditor's performance, including the objectivity and authority of its reporting obligations, the proposed audit plans for the coming year, and the results of internal audits, and

- develop recommendations for improving its efficiency;
and
- 2.1.4.4. Review the internal audit reports and develop recommendations for the Company's internal audit plans, and further, initiate and carry out both extraordinary and specifically targeted audits.
- 2.1.5. As to the legal framework and compliance, to:
 - 2.1.5.1. Establish procedures for reviewing and handling complaints or concerns received by the Company regarding the internal control process, financial accounting and reporting, or the external audit; and
 - 2.1.5.2. Enable employees to submit concerns confidentially and anonymously, and review the disclosure of any frauds that involve management or other employees with significant roles in internal control.

Article 3. Rights and Responsibilities

- 3.1. The Committee shall have the following rights:
 - 3.1.1. Request documents, reports, explanations, and other relevant information from the officers, executives, and employees of the Company [including the Company's strategy advisors];
 - 3.1.2. Invite the Company's officers, executives, and employees, as well as the Company's strategy advisors, to its meetings as observers to question them, and seek explanations and clarifications;
 - 3.1.3. Utilize the services of outside consultants, experts, and advisers;
 - 3.1.4. Perform special investigations as required, and utilize the services of independent experts in doing so; and
 - 3.1.5. Perform any other duties required by the Supervisory Board within the scope of the authority of the Committee as set forth herein.
- 3.2. The Committee shall conduct an annual review and assessment of the By-law in conformity with established requirements, and make recommendations to the Supervisory Board regarding any amendments hereto it deems appropriate.

Annex 7. A Model By-Law for the Supervisory Board's Audit Committee

- 3.3. The Committee shall report to the Supervisory Board on a regular basis, but not less than once every quarter. The Committee shall make such report to the Supervisory Board as soon as feasible after every meeting.
- 3.4. Further, Committee members shall:
 - 3.4.1. Participate in the activities and work of the Committee, and attend all its meetings;
 - 3.4.2. Treat all information that became known to them in the course of performing their official duties as confidential information;
 - 3.4.3. Inform the Supervisory Board of any changes in their independent status or any conflict of interest regarding decisions to be made by the Committee; and
 - 3.4.4. Conduct annual reviews and assessments of the Committee activities and its members, including a review of the Committee's compliance with the By-law.

Article 4. Election, Composition, and Dismissal

- 4.1. The Committee shall consist of ___ members and shall be elected by a majority vote of all Supervisory Board members.
- 4.2. The term of office of the Committee shall coincide with the term of office for the Supervisory Board.
- 4.3. Only Supervisory Board members may be elected members of the Committee.
- 4.4. Members of the Committee must possess the necessary knowledge and experience in the areas of financial accounting and reporting, and skills in interacting with the Company's senior executives, External Auditor, and other relevant parties.
- 4.5. The Supervisory Board shall, whenever possible, elect only independent directors to the Committee. If this is not feasible for whatever reason, the Committee shall be chaired by an independent director and have at least one other member who is an outside director.
- 4.6. The General Director, Executive Board members, and other executives may not be members of the Committee.
- 4.7. The Supervisory Board may, at any time, dismiss any member of the Committee, or re-elect the entire Committee.

Article 5. Meeting Procedures

- 5.1. The Committee shall be headed by a Chairman, who shall be elected by a simple majority vote of the Committee's members.
- 5.2. The Corporate Secretary of the Company shall act as the Secretary of the Committee unless and until one of the Committee members is so elected.
- 5.3. Meetings shall be the principal form utilized for carrying out the work and activities of the Committee.
- 5.4. Meetings may be conducted whenever and as often as necessary to properly carry out the Committee's functions and duties in a timely manner. However, at a minimum, the Committee should conduct not less than one meeting every three month(s). If a meeting of the Supervisory Board is to be conducted in which an issue within the Committee's authority is at issue, then a meeting of the Committee should be conducted no later than ____ days before such meeting of the Supervisory Board.
- 5.5. Meetings may be called by the Chairman of the Committee, any member of the Committee, or by decision of the Supervisory Board.
- 5.6. Additional meetings may be called at any time when necessary. The Secretary shall be responsible for calling such meetings when requested by either an Internal or External Auditor.
- 5.7. Meetings may be conducted when the members are physically present or by written consent of those members not physically able to attend and, further, may be conducted in the form of either video- or audio-conferences.
- 5.8. A quorum shall be deemed present at any meeting of the Committee if at least one-half of the Committee members are present.
- 5.9. The Secretary of the Committee shall be responsible for giving advance notice to all of the Committee members of the meeting and its agenda, and ensuring the availability of all necessary information regarding all of the items included on such agenda not less than ____ days prior to such meeting.¹⁰⁷ Additionally, the notice shall be given in any form deemed convenient and agreed upon by the Committee members, e.g. by telephone, fax, ordinary, or electronic mail.
- 5.10. The minutes of Committee meetings shall be signed by all members present.

¹⁰⁷ Good practice suggests two weeks.

Annex 7. A Model By-Law for the Supervisory Board's Audit Committee

- 5.11. Upon the conclusion of discussions regarding any particular issue, the Committee shall draft a written opinion to be signed by all members of the Committee, and such written opinion shall then be submitted to the Chairman of the Supervisory Board or the Corporate Secretary as required by the Company's internal documents. Any member of the Committee having a dissenting opinion should submit such opinion together with the majority opinion of the Committee.
- 5.12. The Committee shall make decisions by a majority vote of members participating in the meeting.

Article 6. Remuneration

- 6.1 The procedures for paying, and the amount of any such remuneration, shall be determined in accordance with the corresponding provisions of the By-laws for the Supervisory Board.



Annex 8

**A MODEL BY-LAW FOR THE SUPERVISORY BOARD'S
CORPORATE GOVERNANCE COMMITTEE**

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __day of _____, 200_
[The Company's Seal]



**BY-LAW FOR THE SUPERVISORY BOARD'S CORPORATE
GOVERNANCE COMMITTEE**

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	120
ARTICLE 2.	AUTHORITY	121
ARTICLE 3.	RIGHTS AND RESPONSIBILITIES	124
ARTICLE 4.	ELECTION, COMPOSITION AND DISMISSAL.....	125
ARTICLE 5.	MEETING PROCEDURES	125
ARTICLE 6.	REMUNERATION	126

Article 1. General Provisions

- 1.1. This By-law for the Corporate Governance Committee (hereinafter the By-law) of the Supervisory Board of the Open Joint Stock Company “_____” (hereinafter the Company) has been drafted in accordance with the laws of the Russian Federation (hereinafter the Law), the charter of the Company and other internal corporate documents, and relevant recommendations of the Federal Commission for the Securities Market’s Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-Law shall define the authority of the Supervisory Board’s Corporate Governance Committee (hereinafter the Committee) and its members, and further, shall define the rights and responsibilities of the Committee’s members, election, composition, and dismissal of Committee members, meeting procedures, as well as the remuneration of Committee members.
- 1.3. The Committee has been established to assist the Supervisory Board in performing its guidance and oversight functions effectively and efficiently, and is specifically charged with the development of, compliance with, and periodic review of the Company’s corporate governance policies and practices. The Committee further monitors and reviews policies concerning shareholder rights, conflict resolution, ethics, disclosure and transparency, evaluation, and the Company’s internal documents (organization and process).
- 1.4. All proposals developed by the Committee are recommendations and thus non-binding to the Supervisory Board.

Annex 8. A Model By-Law for the Corporate Governance Committee

Article 2. Authority

- 2.1. The following issues shall fall within the authority of the Committee:
 - 2.1.1. As to the Company's corporate governance framework, to:
 - 2.1.1.1. Develop and conduct periodic reviews of the Company's corporate governance documents, specifically, the Company's charter and by-laws, with the purpose of ensuring their compliance and conformity with the Law, as well as national and international best practices;
 - 2.1.1.2. Develop a specific and clearly stated plan for the improvement of corporate governance practices based on the leading and most progressive Russian and international practices, and further, conduct periodic reviews of the plan and its implementation;
 - 2.1.1.3. Develop the Company's corporate governance compliance program, including the corporate governance officer or department responsible for developing and conducting director induction and continuing education programs; and
 - 2.1.1.4. Ensure that the Company has an officer, e.g. the Corporate Secretary, who shall be responsible for implementing the Company's corporate governance policies and practices.
 - 2.1.2. As to the working procedures (organization and process) within the Company, to:
 - 2.1.2.1. Develop recommendations for the appropriate preparation and organization of the General Meeting of Shareholders (hereinafter GMS) working in close cooperation with the Company's Corporate Secretary;
 - 2.1.2.2. Ensure that the Supervisory Board is structured in such a way so as to allow it to effectively handle any number of complex issues. With this goal in mind, the Committee shall make recommendations for the establishment of other Supervisory Board committees as required, including the type, authority, and composition of such committees; and

- 2.1.2.3. Develop procedures for the Supervisory Board, including procedures for the preparation of meetings (including the notification period, types, and forms of notice, and information and documentation to be provided), their organization (e.g. the frequency of conducting meetings and the role of the Corporate Secretary), and their conclusion (e.g. minutes and verbatim reports).
- 2.1.3. As to shareholder rights and conflict resolution, to:
 - 2.1.3.1. Ensure that shareholder rights are appropriately and specifically defined in the Company's charter, by-laws, and company-level corporate governance code, and develop policies and procedures for the protection of these rights; and
 - 2.1.3.2. Develop and periodically conduct reviews of the Company's conflict resolution policy and procedures.
- 2.1.4. As to ethics and corporate conduct, to:
 - 2.1.4.1. Assist the Supervisory Board and management in drafting a code of ethics or company-level corporate governance code;
 - 2.1.4.2. Establish oversight and control procedures for detecting and preventing violations of the Law, the Company's code of ethics, and any other internal ethical standards; and
 - 2.1.4.3. Conduct an annual review and update of the code of ethics and policies concerning internal ethical standards.
- 2.1.5. As to the disclosure of financial information and issues of transparency, to:
 - 2.1.5.1. Work with the Supervisory Board's Audit Committee to develop policies and procedures for the disclosure of the Company's corporate governance practices, financial statements, ownership structure, and remuneration policy for directors, and other material information in the Company's annual and quarterly reports, corporate website, and other relevant sources of information.

Annex 8. A Model By-Law for the Corporate Governance Committee

- 2.1.6. As to the assessment of the Supervisory Board's activities, to:
 - 2.1.6.1. Develop procedures for conducting an annual evaluation of the Supervisory Board's activities;
 - 2.1.6.2. Conduct an annual evaluation of the Supervisory Board's performance utilizing an assessment of the Supervisory Board itself (self-evaluation) or, alternatively, utilizing third-party specialists to conduct such evaluation;
 - 2.1.6.3. Report on the results of the self-evaluation to the Supervisory Board, and facilitate a discussion of the findings by the Supervisory Board during an out-of-office retreat, a separate Board meeting or, at a minimum, as a separate agenda item;
 - 2.1.6.4. Develop recommendations for improving the Supervisory Board's performance based on the results of the self-evaluation and any ensuing Supervisory Board discussions thereon;
 - 2.1.6.5. If warranted, periodically organize professional training events for Supervisory Board members specifically addressing areas that need improvement; and
 - 2.1.6.6. Publish a summary of the findings and recommendations in the Company's annual report.
- 2.1.7. As to the individual evaluation of Supervisory Board members, to:
 - 2.1.7.1. Develop procedures and a set of criteria for conducting an annual evaluation of individual Supervisory Board members (directors) prior to any re-election of directors;
 - 2.1.7.2. Assess the findings, and develop recommendations for advising directors in areas that need improvement; and
 - 2.1.7.3. Present the findings and recommendations to the shareholders prior to the GMS.
- 2.1.8. As to director remuneration, to:
 - 2.1.8.1. Advise the Supervisory Board's Nominations and Remuneration Committee in the development of policies for the remuneration of directors, including the Chairman of the Supervisory Board, that are consistent with leading Russian and international practices.

Article 3. Rights and Responsibilities

- 3.1. The Committee shall have the following rights:
 - 3.1.1. Request documents, reports, explanations, and other relevant information from the officers, executives, and employees of the Company [including the Company's strategy advisors];
 - 3.1.2. Invite the Company's officers, executives, and employees, as well as the Company's strategy advisors, to its meetings as observers to question them, and seek explanations and clarifications;
 - 3.1.3. Utilize the services of outside consultants, experts, and advisers;
 - 3.1.4. Perform special investigations as required, and utilize the services of independent experts in doing so; and
 - 3.1.5. Perform any other duties as may be required by the Supervisory Board within the scope of authority of the Committee as set forth herein.
- 3.2. The Committee shall conduct an annual review and assessment of the adequacy of the By-law, and thereafter make such recommendations to the Supervisory Board regarding any changes to the By-law deemed advisable by the Committee.
- 3.3. The Committee shall report to the Supervisory Board on a regular basis, but not less than once every six months. The Committee shall make such report to the Supervisory Board as soon as feasible after every meeting.
- 3.4. Further, Committee members shall:
 - 3.4.1. Participate in the activities and work of the Committee, and attend all its meetings;
 - 3.4.2. Keep abreast of industry and market trends, advances in information technology, and other areas of strategic importance to the Company;
 - 3.4.3. Treat as confidential all information that becomes known to them in the course of performing their official duties;
 - 3.4.4. Inform the Supervisory Board of any changes in their independent status or any conflict of interest regarding decisions to be made by the Committee; and
 - 3.4.5. Annually review and evaluate the performance of the Committee and its members, including a review of the Committee's compliance with the By-law.

Annex 8. A Model By-Law for the Corporate Governance Committee

Article 4. Election, Composition, and Dismissal

- 4.1. The Committee shall consist of ___ members and shall be elected by a majority vote of all directors.
- 4.2. The term of office of the Committee shall coincide with the term of office for the Supervisory Board.
- 4.3. Only Supervisory Board members may be elected members of the Committee.
- 4.4. Members of the Committee must have the necessary knowledge and experience in matters concerning corporate governance.
- 4.5. The Supervisory Board shall, wherever possible, elect only independent directors to the Committee. If this is not feasible for whatever reason, the Committee shall be chaired by an independent director and have at least one other member who is an outside director.
- 4.6. The Supervisory Board may, at any time, dismiss any member of the Committee, or re-elect the entire Committee.

Article 5. Meeting Procedures

- 5.1. The Committee shall be headed by a Chairman, who shall be elected by a simple majority vote of the Committee's members.
- 5.2. The Corporate Secretary of the Company shall act as the Secretary of the Committee unless and until one of the Committee members is so elected.
- 5.3. Meetings shall be the principal form utilized for carrying out the work and activities of the Committee.
- 5.4. Meetings may be conducted whenever and as often as necessary to properly carry out the Committee's functions and duties in a timely manner. However, at a minimum, the committee should conduct not less than one meeting every six months. If a meeting of the Supervisory Board is to be conducted in which an issue within the Committee's authority is to be discussed, then a meeting of the Committee should be conducted no later than ___ days before such meeting of the Supervisory Board.
- 5.5. Meetings may be called by the Chairman of the Committee, any member of the Committee, or by decision of the Supervisory Board.
- 5.6. Meetings may be conducted when members are physically in attendance, or by written consent of those members not physically able to attend, and

The Russia Corporate Governance Manual

- further, may be conducted in the form of either video- or audio-conferences.
- 5.7. A quorum shall be deemed present at any meeting of the Committee if at least one-half of its members are present at such meeting.
 - 5.8. The Secretary of the Committee shall be responsible for giving advance notice to all of the Committee members of the meeting and its agenda at least ___ [number] days prior to the meeting, and ensuring the availability of all necessary information regarding all of the items included on the agenda. Additionally, the notice shall be given in any form deemed convenient and agreed upon by the Committee members, e.g. by telephone, fax, ordinary, or electronic mail.
 - 5.9. The minutes of Committee meetings shall be signed by all members present.
 - 5.10. Upon the conclusion of discussions regarding any particular issue, the Committee shall draft a written opinion to be signed by all members of the Committee, and such written opinion shall be submitted to the Chairman of the Supervisory Board or the Corporate Secretary in time for inclusion on the agenda of the next Supervisory Board meeting. Any member of the Committee having a dissenting opinion should submit such opinion with the majority opinion of the Committee.
 - 5.11. The Committee shall make decisions by a majority vote of members participating in the meeting.

Article 6. Remuneration

- 6.1. The remuneration of Committee members is determined in accordance with the requirements of the by-law on the Supervisory Board.

Annex 9

**A MODEL BY-LAW FOR THE SUPERVISORY BOARD'S
NOMINATIONS AND REMUNERATION COMMITTEE**

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __ day of _____, 200_
[The Company's Seal]

**BY-LAW FOR THE SUPERVISORY BOARD'S NOMINATIONS
AND REMUNERATION COMMITTEE**

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_

Table of Contents

ARTICLE 1. GENERAL PROVISIONS	128
ARTICLE 2. AUTHORITY	129
ARTICLE 3. RIGHTS AND RESPONSIBILITIES	131
ARTICLE 4. ELECTION COMPOSITION, AND DISMISSAL.....	132
ARTICLE 5. MEETING PROCEDURES	132
ARTICLE 6. REMUNERATION	133

Article 1. General Provisions

- 1.1. This By-law for the Supervisory Board's Nominations and Remuneration Committee (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been drafted in accordance with the laws of the Russian Federation (hereinafter the Law), the charter of the Company and other internal corporate documents, and relevant recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall define the authority of the Supervisory Board's Nominations and Remuneration Committee (hereinafter the Committee) and its members, and, further, shall define the rights and responsibilities of the Committee's members, election, composition, and dismissal of Committee members, meeting procedures, as well as the remuneration of Committee members.
- 1.3. The Committee has been established to assist the Supervisory Board in performing its guidance and oversight functions effectively and efficiently, and is specifically charged with identifying qualified senior executives and directors, and ensuring that the Company's remuneration policies and practices support the successful recruitment, development, and retention of managers and directors, and thus help the Company realize its business objectives and sustainable economic development.
- 1.4. All proposals developed by the Committee are recommendations only and thus non-binding to the Supervisory Board.

Annex 9. A Model By-Law for the Nominations and Remuneration Committee

Article 2. Authority

- 2.1. The following issues shall fall within the authority of the Committee:
 - 2.1.1. As to the nomination of directors and senior executives, to:
 - 2.1.1.1. Develop recommendations for the Supervisory Board on determining criteria for the selection of candidates for the positions of General Director, Executive Board member, and principal departmental head;
 - 2.1.1.2. Conduct preliminary evaluations of the candidates for the positions of General Director, Executive Board member, and departmental head of other principal subdivisions and units within the Company;
 - 2.1.1.3. Develop position descriptions, terms of reference, terms and conditions of employment contracts with the General Director, Executive Board members, and departmental heads of other principal subdivisions and units within the Company;
 - 2.1.1.4. Develop criteria and procedures for assessing the performance of the General Director, Executive Board members, and the departmental heads of other principal subdivisions and units of the Company;
 - 2.1.1.5. Develop criteria for determining a director's independence and the duty to keep shareholders informed as per the directors' independent status (or loss thereof);
 - 2.1.1.6. Conduct periodic performance assessments of the activities of the General Director, Executive Board members, and the departmental heads of the Company's principal subdivisions and units;
 - 2.1.1.7. Organize training programs for senior managers regarding issues of corporate governance and business ethics, [in cooperation with the Corporate Governance Committee];
 - 2.1.1.8. Develop instructions and an induction program for newly-elected independent or outside directors, which contain a detailed description of their duties as members of the Supervisory Board, [in cooperation with the Supervisory Board's Corporate Governance Committee]; and

2.1.1.9. Develop policies for planning and implementing the smooth succession of employees in top managerial positions.

2.1.2. As to the remuneration of directors and senior executives, to:

2.1.2.1. Develop a remuneration and incentive policy for the Company's directors and senior executives aimed at increasing the value of the Company and based on the principle of personal contribution of each director and senior executive in implementing the strategic goals of the Company, as well as on the Committee's evaluation of the individual's performance versus goals and objectives set by the Supervisory Board:

2.1.2.1.1. With respect to the remuneration of Supervisory Board members, including the Chairman, the Committee shall develop remuneration criteria that allow the Company to offer competitive terms without endangering the independent status of its members; and

2.1.2.1.2. With respect to the remuneration of the General Director, Executive Board members, and other senior executives, the Committee shall set and periodically review criteria for the (fixed) annual salary, the (variable) annual bonus system based on key financial and non-financial performance indicators, and a long-term incentive system to align the interests of the managers with those of the Company's shareholders, as well as benefits plans and other perquisites;

2.1.2.2. Continuously monitor the appropriateness of the Company's remuneration criteria, based on the Company's development strategy, financial position, and major trends in the labor market; and

2.1.2.3. Exercise control over the enforcement of the decisions of the General Meeting of Shareholders (GMS) as it concerns

Annex 9. A Model By-Law for the Nominations and Remuneration Committee

issues of remuneration of directors and senior executives. Further, exercise control over the disclosure of information on the remuneration of individual directors.

Article 3. Rights and Responsibilities

- 3.1. The Committee shall have the following rights:
 - 3.1.1. Request documents, reports, explanations, and other relevant information from the officers, executives, and employees of the Company [including the Company's strategy advisors];
 - 3.1.2. Invite the Company's officers, executives, and employees, as well as the Company's strategy advisors, to its meetings as observers to question them, and seek explanations and clarifications;
 - 3.1.3. Utilize the services of outside consultants, experts, and advisers; and
 - 3.1.4. Perform any other duties required by the Supervisory Board within the scope of the authority of the Committee as set forth herein.
- 3.2. The Committee shall conduct an annual review and assessment of the By-law in conformity with established requirements, and make recommendations to the Supervisory Board regarding any amendments hereto it deems appropriate.
- 3.3. The Committee shall report to the Supervisory Board on a regular basis, but not less than once every six months. The Committee shall make such report to the Supervisory Board as soon as feasible after every meeting.
- 3.4. Further, Committee members shall:
 - 3.4.1. Participate in the activities and work of the Committee, and attend all its meetings;
 - 3.4.2. Keep abreast of industry and market trends, advances in information technology, and other areas of strategic importance to the Company;
 - 3.4.3. Treat all information that became known to them in the course of performing their official duties as confidential information;
 - 3.4.4. Inform the Supervisory Board of any changes in their independent status or any conflict of interest regarding decisions to be made by the Committee;

- 3.4.5. Conduct annual reviews and assessments of the Committee activities and its members, including a review of the Committee's compliance with the By-law.

Article 4. Election, Composition, and Dismissal

- 4.1. The Committee shall consist of __ members and shall be elected by a majority vote of all directors.
- 4.2. The term of office of the Committee shall coincide with the term of office for the Supervisory Board.
- 4.3. Only members of the Supervisory Board may be elected members of the Committee.
- 4.4. The Supervisory Board shall, whenever possible, elect only independent directors to the Committee. If this is not feasible for whatever reason, the Committee shall be chaired by an independent director and have at least one other member who is an outside director.
- 4.5. The General Director and Executive Board members may not be members of the Committee.
- 4.6. Members of the Committee must possess the necessary knowledge, experience, and skills in interacting with the company's key executives and other relevant parties.
- 4.7. The Supervisory Board may, at any time, dismiss any member of the Committee, or re-elect the entire Committee.

Article 5. Meeting Procedures

- 5.1. The Committee shall be headed by a Chairman who shall be elected by a simple majority vote of the Committee's members.
- 5.2. The Corporate Secretary of the Company shall act as the Secretary of the Committee unless and until one of the members of the Committee is so elected.
- 5.3. Meetings shall be the principal form utilized for carrying out the work and activities of the Committee.
- 5.4. Meetings may be conducted whenever and as often as necessary to properly carry out the Committee's functions and duties in a timely manner. However, at a minimum, the committee should conduct one meeting every six months. If a meeting of the Supervisory Board is to be conducted in

Annex 9. A Model By-Law for the Nominations and Remuneration Committee

which the Committee's authority is at issue, then a meeting of the Committee should be conducted no later than ____ days before such meeting of the Board.

- 5.5. Meetings may be called by the Chairman of the Committee, any member of the Committee, or by decision of the Supervisory Board.
- 5.6. Meetings may be conducted when the members are physically present or by written consent of those members not physically able to attend and, further, may be conducted in the form of either video- or audio-conferences.
- 5.7. A quorum shall be deemed present at any meeting of the Committee if at least one-half of the Committee members are present.
- 5.8. The Secretary of the Committee shall be responsible for giving advance notice to all of the Committee members of the meeting and its agenda, and ensure the availability of all necessary information regarding all of the items included on such agenda not less than ____ days prior to such meeting. Such notice shall be given in any form deemed convenient and agreed upon by the Committee members, e.g. by telephone, fax, ordinary, or electronic mail.
- 5.9. The minutes of every Committee meeting shall be signed by all members present.
- 5.10. Upon the conclusion of discussions regarding any particular issue, the Committee shall draft a written opinion to be signed by all members of the Committee, and such written opinion shall then be submitted to the Chairman of the Supervisory Board or the Corporate Secretary as required by the Company's internal documents. Any member of the Committee having a dissenting opinion should submit such opinion together with the majority opinion of the Committee.
- 5.11. The Committee shall make decisions by a majority vote of those members participating in the meeting.

Article 6. Remuneration

- 6.1. The procedures for paying the Committee members and the amount of any such remuneration shall be determined in accordance with the corresponding provisions of the By-laws on the Supervisory Board.



Annex 10

**A MODEL BY-LAW FOR THE SUPERVISORY BOARD'S
STRATEGIC PLANNING AND FINANCE COMMITTEE**

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __day of _____, 200_
[The Company's Seal]

**BY-LAW FOR THE SUPERVISORY BOARD'S STRATEGIC PLANNING
AND FINANCE COMMITTEE**

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	136
ARTICLE 2.	AUTHORITY	137
ARTICLE 3.	RIGHTS AND RESPONSIBILITIES	139
ARTICLE 4.	ELECTION COMPOSITION, AND DISMISSAL.....	140
ARTICLE 5.	MEETING PROCEDURES	140
ARTICLE 6.	REMUNERATION	142

Article 1. General Provisions

- 1.1. This By-law for the Strategic Planning and Finance Committee (hereinafter the By-law) of the Supervisory Board of the Open Joint Stock Company «_____» (hereinafter the Company) has been drafted in accordance with the laws of the Russian Federation (hereinafter the Law), the charter of the Company and other internal corporate documents, and relevant recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall define the authority of the Supervisory Board's Strategic Planning and Finance Committee (hereinafter the Committee) and its members, and, further, shall define the rights and responsibilities of the Committee's members, election, composition, and dismissal of Committee members, meeting procedures, as well as the remuneration of Committee members.
- 1.3. The Committee has been established to assist the Supervisory Board in performing its oversight functions effectively and efficiently, and is specifically charged with defining the Company's strategic objectives, determining its financial and operational priorities, making recommendations regarding the Company's dividend policy, and evaluating the long-term productivity of the Company's operations.

Annex 10. A Model By-Law for the Strategic Planning Committee

- 1.4. All proposals developed by the Committee are recommendations only and thus non-binding to the Supervisory Board.

Article 2. Authority

- 2.1. The following issues shall fall within the authority of the Committee:
 - 2.1.1. As to the Company's strategy and objectives, to:
 - 2.1.1.1. Guide the Company's General Director [and the Executive Board] in setting the Company's mission, goals, and objectives;
 - 2.1.1.2. Guide the Company's General Director [and the Executive Board] in setting the Company's strategic plan and business objectives, conduct reviews of said strategic plan and business objectives, and make recommendations to the Supervisory Board as appropriate;
 - 2.1.1.3. Develop and conduct reviews of the Company's strategic planning processes and procedures in close cooperation with the Company's General Director [and the Executive Board], and develop a policy statement describing the Board's involvement in the strategic planning process;
 - 2.1.1.4. Ensure that the Company's strategic plans are transformed into concrete actions aimed at achieving the Company's objectives;
 - 2.1.1.5. Review the General Director's and the Executive Board's recommendations for the allocation of resources to verify their consistency with the Company's strategic plans and long-term business objectives; and
 - 2.1.1.6. Periodically review the Company's [and its subsidiaries'] strategic plan and business objectives to ensure alignment with the Company's mission, goals, and objectives.
 - 2.1.2. As to the Company's operational priorities, to:
 - 2.1.2.1. Review and make recommendations to the Supervisory Board as to certain strategic decisions regarding opera-

tional priorities, including expanding into new, or exiting from existing business markets or countries.

- 2.1.3. As to the Company's financial planning and dividend policy, to:
 - 2.1.3.1. Review and make recommendations to the Supervisory Board with respect to the Company's annual and long-term financial strategies and objectives, as well as any related performance goals and key performance indicators;
 - 2.1.3.2. Review significant financial matters of the Company and its subsidiaries, including matters relating to the Company's capitalization, its credit ratings, cash flows, borrowing activities, and investment of surplus funds, while working in close cooperation with the Company's management and, particularly, with the Supervisory Board's Audit Committee;
 - 2.1.3.3. Review and make recommendations to the Supervisory Board with respect to the Company's debt or securities offerings, the purchase or disposal of treasury shares, stock splits or share reclassifications, and any capital transactions or other project expenditures equal to or greater than RUR _____ million, and any other financial transactions, such as an investment in a subsidiary or other venture, or an asset disposal equal to or greater than RUR _____ million;
 - 2.1.3.4. Review and make recommendations to the Supervisory Board with respect to the Company's dividend policy and practices; and
 - 2.1.3.5. Periodically review actual capital expenditures and performance against previously approved budgeted amounts.
- 2.1.4. As to the evaluation of long-term productivity and operational efficiency, to:
 - 2.1.4.1. Review and make recommendations to the Supervisory Board as to certain strategic decisions regarding the expan-

Annex 10. A Model By-Law for the Strategic Planning Committee

sion into or exit from new technologies, and any other opportunities to improve the scope and scale, cost effectiveness, and quality of products and services provided by the Company when the amount involved is equal to or greater than RUR _____ million.

- 2.1.5. As to the oversight of the Company's reorganization plans, to:
 - 2.1.5.1. Review and make recommendations to the Supervisory Board as to certain strategic decisions regarding the consolidation, merger, split-up, transformation, or spin-off/divestiture of the Company.

Article 3. Rights and Responsibilities

- 3.1. The Committee shall have the following rights:
 - 3.1.1. Request documents, reports, explanations, and other relevant information from the officers, executives, and employees of the Company [including the Company's strategy advisors];
 - 3.1.2. Invite the Company's officers, executives, and employees, as well as the Company's strategy advisors, to its meetings as observers to question them, and seek explanations and clarifications;
 - 3.1.3. Utilize the services of outside consultants, experts, and advisers; and
 - 3.1.4. Perform any other duties as may be required by the Supervisory Board within the scope of authority of the Committee as set forth herein.
- 3.2. The Committee shall conduct an annual review and assessment of the adequacy of the By-law and thereafter make such recommendations to the Supervisory Board and its Corporate Governance Committee regarding any changes to the By-law deemed advisable by the Committee.
- 3.3. The Committee shall report to the Supervisory Board on a regular basis, but not less than once every six months. The Committee shall make such report to the Supervisory Board as soon as feasible after every meeting.

The Russia Corporate Governance Manual

- 3.4. Further, Committee members shall:
 - 3.4.1. Participate in the activities and work of the Committee, and attend all its meetings;
 - 3.4.2. Keep abreast of industry and market trends, advances in information technology, and other areas of strategic importance to the Company;
 - 3.4.3. Treat as confidential all information that becomes known to them in the course of performing their official duties;
 - 3.4.4. Inform the Supervisory Board of any changes in their independent status or any conflict of interest regarding decisions to be made by the Committee; and
 - 3.4.5. Annually review and evaluate the performance of the Committee and its members, including a review of the Committee's compliance with the By-law.

Article 4. Election, Composition and Dismissal

- 4.1. The Committee shall consist of ___ members and shall be elected by a majority vote of all directors.
- 4.2. The term of office of the Committee shall coincide with the term of office for the Supervisory Board.
- 4.3. Only Supervisory Board members may be elected members of the Committee.
- 4.4. Members of the Committee must have the necessary knowledge and experience in matters concerning the Company's industry, trends, and finance.
- 4.5. The Supervisory Board shall, wherever possible, elect an independent director to chair the Committee. If this is not feasible for whatever reason, the Committee shall be chaired by a non-executive director and have at least one independent member.
- 4.6. The Supervisory Board may, at any time, dismiss any member of the Committee, or re-elect the entire Committee.

Article 5. Meeting Procedures

- 5.1. The Committee shall be headed by a Chairman, who shall be elected by a simple majority vote of the Committee's members.

Annex 10. A Model By-Law for the Strategic Planning Committee

- 5.2. The Corporate Secretary of the Company shall act as the Secretary of the Committee unless and until one of the Committee members is so elected.
- 5.3. Meetings shall be the principal form utilized for carrying out the work and activities of the Committee.
- 5.4. Meetings may be conducted whenever and as often as necessary to properly carry out the Committee's functions and duties in a timely manner. However, at a minimum, the committee should conduct not less than one meeting every six months. If a meeting of the Supervisory Board is to be conducted in which the Committee's authority is at issue, then a meeting of the Committee should be conducted no later than __ days before such meeting of the Board.
- 5.5. Meetings may be called by the Chairman of the Committee, any member of the Committee, or by decision of the Supervisory Board.
- 5.6. Meetings may be conducted when members are physically in attendance, or by written consent of those members not physically able to attend and, further, may be conducted in the form of either video- or audio-conferences.
- 5.7. A quorum shall be deemed present at any meeting of the Committee if at least one-half of its members are present at such meeting.
- 5.8. The Secretary of the Committee shall be responsible for giving advance notice to all of the Committee members of the meeting and its agenda at least ____ (number) days prior to the meeting, and ensure the availability of all necessary information regarding all of the items included on the agenda. Additionally, the notice shall be given in any form deemed convenient and agreed upon by the Committee members, e.g. by telephone, fax, ordinary, or electronic mail.
- 5.9. The minutes of every Committee meeting shall be signed by all members present.
- 5.10. Upon the conclusion of discussions regarding any particular issue, the Committee shall draft a written opinion to be signed by all members of the Committee, and such written opinion shall be submitted to the Chairman of the Supervisory Board or the Corporate Secretary in time for inclusion on the agenda of the next Supervisory Board meeting. Any member of the Committee having a dissenting opinion should submit such opinion with the majority opinion of the Committee.

The Russia Corporate Governance Manual

5.11. The Committee shall make decisions by a majority vote of the members participating in the meeting.

Article 6. Remuneration

6.1. The procedures for paying and the amount of any such remuneration shall be determined in accordance with the corresponding provisions of the By-laws on the Supervisory Board.



Annex 11

A MODEL BY-LAW FOR THE EXECUTIVE BODIES

Approved
by the General Meeting of Shareholders
of the Open Joint Stock Company «_____»

Minutes of the [Annual or Extraordinary]
General Meeting of Shareholders

No. _____
of _____ 200_

dated this __day of _____, 200_
[The Company's Seal]

BY-LAW FOR THE EXECUTIVE BODIES

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	144
ARTICLE 2.	STATUS OF THE GENERAL DIRECTOR.....	145
ARTICLE 3.	THE AUTHORITY OF THE GENERAL DIRECTOR.....	145
ARTICLE 4.	APPOINTMENT AND TERMINATION PROCEDURES FOR THE GENERAL DIRECTOR.....	147
ARTICLE 5.	STATUS OF THE EXECUTIVE BOARD.....	148
ARTICLE 6.	THE AUTHORITY OF THE EXECUTIVE BOARD.....	149
ARTICLE 7.	APPOINTMENT AND TERMINATION PROCEDURES FOR EXECUTIVE BOARD MEMBERS	151
ARTICLE 8.	EXECUTIVE BOARD MEETINGS	152
ARTICLE 9.	DUTIES AND LIABILITY.....	153
ARTICLE 10.	REMUNERATION	154

Article 1. General Provisions

- 1.1. This By-law for the Executive Bodies (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed in accordance with the laws of the Russian Federation (hereinafter the Law), the Company charter, and the recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The Company shall establish the following executive bodies:
 - 1.2.1. The General Director; and
 - 1.2.2. The Executive Board.
- 1.3. The By-law shall determine the status and authority of the General Director and the Executive Board, as well as procedures for their election and dismissal, meeting procedures, duties and responsibilities, and remuneration.
- 1.4. The General Director and Executive Board members shall act in accordance with the Law, the Company charter, the By-law, and other internal documents of the Company.

Annex 11. A Model By-Law for the Executive Bodies

- 1.5. The executive bodies are accountable to the Supervisory Board and the General Meeting of Shareholders (hereinafter the GMS). The executive bodies shall be responsible for executing the decisions of the GMS and the Supervisory Board.
- 1.6. All decisions taken by the GMS and Supervisory Board shall be binding upon the General Director and the Executive Board.

Article 2. Status of the General Director

- 2.1. The General Director shall be a single-member executive body of the Company.
- 2.2. The General Director shall at the same time be the Chairman of the Executive Board.
- 2.3. The General Director may not at the same time be the Chairman of the Supervisory Board, a Revision Commission member, or the Corporate Secretary of the Company,¹⁰⁸ or a participant (shareholder), officer, or other employee of a legal entity competing with the Company.
- 2.4. The General Director may not be involved in any other commercial activity apart from managing the day-to-day operations of the Company, with the exception of membership in the Supervisory Board and, subject to the approval of the Supervisory Board, directorship in other legal entities provided this is required in the interests of the Company.
- 2.5. Upon the recommendation of the Supervisory Board, the GMS may delegate the powers of the General Director to an External Manager.
- 2.6. The relations between the General Director and the Company shall be regulated by an employment contract to be signed on behalf of the Company by the Chairman of the Supervisory Board.
- 2.7. The General Director shall refrain from actions that may result in a conflict of interest between himself and the Company, and, if a conflict of interest arises, the General Director shall immediately inform the Supervisory Board and the Corporate Secretary thereof.

Article 3. The Authority of the General Director

- 3.1. The General Director shall manage the day-to-day operations of the Company with the exception of issues that fall within the sole competence of the GMS or the Supervisory Board, and shall ensure the execution of decisions of the GMS and the Supervisory Board.

¹⁰⁸ If the Company has established a position of the Corporate Secretary.

The Russia Corporate Governance Manual

- 3.2. Beginning with his term of office, the General Director shall have the right to sign official documents, issue orders and instructions, effectuate transactions and sign contracts on behalf of the Company, subject to the Law and the Company Charter.
- 3.3. The General Director shall:
 - 3.3.1. Act on behalf of the Company without a power of attorney, including representing the interests of the Company;
 - 3.3.2. Open settlement accounts with banking and credit institutions;
 - 3.3.3. Dispose of the Company's assets to ensure its current operations, subject to the provisions of the charter;
 - 3.3.4. Guide, oversee, and manage the performance of the Company's employees, within the scope of his authority;
 - 3.3.5. Grant powers of attorney to perform actions on behalf of the Company;
 - 3.3.6. Make decisions on filing complaints and claims against legal entities and individuals on behalf of the Company;
 - 3.3.7. Approve staffing structures, enter into, and terminate employment contracts with the employees of the Company, and offer incentives to and sanction the employees of the Company;
 - 3.3.8. Sign employment contracts with the heads of representative offices and branches on the terms and conditions set forth by the Executive Board, not later than __ business days after their appointment;¹⁰⁹
 - 3.3.9. Supervise the work of the Executive Board, call its meetings, set its agenda, and preside over its meetings;
 - 3.3.10. Organize and implement the proper keeping of accounting records and financial reports of the Company;
 - 3.3.11. Implement risk management and internal control;
 - 3.3.12. Organize the timely filing of financial statements with the relevant authorities, as well as the disclosure of information about the Company to shareholders, creditors, and the markets;
 - 3.3.13. Sign the financial statements of the Company;
 - 3.3.14. Provide information on the Executive Board's agenda items, as well as on his own actions and decisions, to the Supervisory Board [and its committees], External Auditor, Revision Commission and, where necessary, the Corporate Secretary of the Company in a timely manner;

¹⁰⁹ Good practice suggests that this be five business days.

Annex 11. A Model By-Law for the Executive Bodies

- 3.3.15. Represent and explain the position of the executive bodies at the GMS and Supervisory Board meetings;
- 3.3.16. Provide reports on the work of the executive body to the Supervisory Board once every __ weeks, including on the Company's key performance indicators;¹¹⁰
- 3.3.17. Provide a report on the General Director's work to the GMS at least once a year;
- 3.3.18. Sign the securities prospectuses;
- 3.3.19. _____;
- 3.3.20. _____;
- 3.3.21. Perform other functions that may be necessary to ensure normal operations of the Company under the Law and subject to the provisions of the employment contract with the Company.

Article 4. Appointment and Termination Procedures for the General Director

- 4.1. Any person may be appointed as the General Director in accordance with procedures set forth by the Law and the By-law.¹¹¹
- 4.2. A candidate for the position of the General Director must possess the following qualifications:¹¹²
 - 4.2.1. _____;
 - 4.2.2. _____; and
 - 4.2.3. _____.

¹¹⁰ Good practice suggests that this be done for every Supervisory Board meeting.

¹¹¹ The FCSM Code, Chapter 4, Section 2.1.1 recommends that the specific requirements with respect to the General Director and Executive Board member be set forth in the charter or by-laws of the company.

¹¹² For example, __ years of professional experience in the sector or industry; higher education; special knowledge and skills, for example in finance and accounting, engineering, or law; personal qualities, such as integrity and team orientation; and useful contacts. More generally, Executive Board members and the General Director specifically should: (i) enjoy the trust of shareholders, directors, other managers and employees of the company; (ii) own the ability to relate to the interests of all stakeholders and to make well-reasoned decisions; (iii) possess the professional expertise and education to be an effective General Director and/or Executive Board member; (iv) possess (international) business experience, knowledge of national economic, political, legal, and social issues, as well as trends and knowledge of the market, products, and competitors (national as well as international); and (v) have the ability to translate knowledge and experience into practical solutions that can be applied to the company.

The Russia Corporate Governance Manual

- 4.3. The General Director shall be appointed by a $\frac{3}{4}$ -majority vote of the Supervisory Board for a term of ___ year(s).¹¹³
- 4.4. The terms of the employment contract with the General Director shall be determined by the Supervisory Board subject to the Law.
- 4.5. The employment contract with the appointed General Director shall be signed by the Chairman of the Supervisory Board within ___ days after the execution of the minutes of the Supervisory Board meeting.
- 4.6. The Supervisory Board may at any time terminate the powers of the General Director and appoint a new General Director by a $\frac{3}{4}$ -majority vote of all directors.

Article 5. Status of the Executive Board

- 5.1. The Executive Board shall be the collective executive body of the Company and shall, under the leadership of the General Director, manage the day-to-day operations of the Company and ensure practical implementation of the decisions of the GMS and the Supervisory Board.
- 5.2. The General Director shall be the Chairman of the Executive Board.
- 5.3. The Executive Board shall have the following members:¹¹⁴
 - 5.3.1. The Chairman of the Executive Board — the General Director;
 - 5.3.2. The Deputy General Director;
 - 5.3.3. _____;
 - 5.3.4. _____; and
 - 5.3.5. _____.

¹¹³ The term of office of the single member executive body is determined by the Company's charter in accordance with the law. Good practice suggests an initial term of one year, followed by three year terms.

¹¹⁴ A Russian company's Executive Board will typically consist of the General Director, and between five and seven other members, possibly the Chief Operating Officer; Chief Accountant, Chief Financial Officer; Chief Legal Counsel; Marketing Director; Head of Sales; Head of Purchasing; Head of Research and Development; Head of Information Technology; Head of Public/Investor Relations; Heads of Business/Product Lines; Human Resources Director; and the General Director of a dependent company or subsidiary. Executive Boards will however need to be adapted to the circumstances of the company and, consequently, should be composed differently.

Annex 11. A Model By-Law for the Executive Bodies

- 5.4. Relations between Executive Board members and the Company are regulated by employment contracts to be signed by the Chairman of the Supervisory Board on behalf of the Company.
- 5.5. Members of the Executive Board shall refrain from actions that may potentially give rise to conflicts of interests between themselves and the Company and, in case such conflicts of interests arise, immediately inform the Supervisory Board and the Corporate Secretary thereof.

Article 6. The Authority of the Executive Board

- 6.1. The Executive Board shall have the right to make decisions on the:
 - 6.1.1. Development of the preliminary strategic direction of the company, which it shall submit for Supervisory Board approval;
 - 6.1.2. Development of financial and business plans, based on the strategic direction of the company and the Supervisory Board's approval;
 - 6.1.3. Approval of the Executive Board's organizational structure (including committees), composition and status of departments, and functional divisions of the Company, upon the recommendation of the General Director;
 - 6.1.4. Approval of internal corporate documents on issues that fall within the competence of the Executive Board, including by-laws regulating incentive schemes and sanctions, as well as working schedules, and job descriptions or terms of references for all categories of the Company's employees;
 - 6.1.5. Approval of transactions, the total value of which is ___ or more percent of the total book value of the Company's assets, subject to immediate Supervisory Board notification;¹¹⁵
 - 6.1.6. Approval of any transactions with fixed assets and loans, unless such transactions fall under the ordinary course of business or fall under the competence of the Supervisory Board or GMS;

¹¹⁵ FCSM Code, Chapter 4, Section 1.1.3. recommends that transactions with the total value exceeding 5% of the book value of company assets be subject to Executive Board approval.

- 6.1.7. Approval of any transactions with fixed assets and receiving loans, unless such transactions fall under the ordinary course of business or fall under the competence of the Supervisory Board or GMS, and the total value of is ___ or more percent of the total book value of the Company's assets;¹¹⁶
- 6.1.8. Preliminary approval of mergers or consolidations in the course of reorganizing the Company;
- 6.1.9. Signing of collective bargaining agreements;
- 6.1.10. Remuneration, and principal terms and conditions of employment contracts concluded with middle management;¹¹⁷
- 6.1.11. Organizational, technical, and financial support for the GMS and the Company's other bodies, including the Supervisory Board and Revision Commission;
- 6.1.12. Appointment of the Company's heads of branches and representative offices;
- 6.1.13. Agenda items of the GMS of subsidiaries in which the Company is the sole shareholder;¹¹⁸
- 6.1.14. Appointment of persons to represent the Company at the GMS of subsidiaries in which the Company is the sole shareholder and provide them with voting instructions;
- 6.1.15. Nomination of candidates for the position of General Director, External Manager, Executive Board member, Supervisory Board member, as well as candidates to other governing bodies of organizations in which the Company has a stake;¹¹⁹
- 6.1.16. _____; and
- 6.1.17. _____.

¹¹⁶ Good practice suggests that the total value not exceed five or more percent of the total book value of the company's assets.

¹¹⁷ FCSM Code, Chapter 4, Section 1.1.5.

¹¹⁸ With the exception of cases in which such decisions fall within the competence of the Supervisory Board.

¹¹⁹ FCSM Code, Chapter 4, Section 1.1.4. recommends that decisions on these issues be made by the Executive Board.

Annex 11. A Model By-Law for the Executive Bodies

- 6.2. The Executive Board shall have the right to make decisions on other operational issues, with the exception of issues that under the Law and the charter fall within the exclusive authority of the Company's other governing bodies.

Article 7. Appointment and Termination Procedures for Executive Board Members

- 7.1. All members of the Executive Board shall be appointed by the Supervisory Board upon the recommendation of the General Director by a $\frac{3}{4}$ -majority vote of the Supervisory Board for a term of ___ year(s).¹²⁰
- 7.2. A candidate for the Executive Board must possess the following qualifications:¹²¹
- 7.2.1. _____;
 - 7.2.2. _____; and
 - 7.2.3. _____.
- 7.3. The contract with the newly appointed Executive Board members shall be signed by the Chairman of the Supervisory Board within ___ days following the signing of the relevant Supervisory Board meeting's minutes.
- 7.4. [Should the newly appointed Executive Board member be an employee of the Company with a regular open-ended employment contract, he shall sign an additional term contract with the Company in his capacity as an Executive Board member.]
- 7.5. The Supervisory Board may dismiss any Executive Board member at any time, and appoint a new Executive Board member prior to the expiry of the Executive Board's term of office by a $\frac{3}{4}$ -majority vote of all directors.

¹²⁰ Good practice suggests an initial term of one year, followed by three year terms.

¹²¹ For example, professional experience, education, special knowledge and skills, personal qualities, and useful contacts.

Article 8. Executive Board Meetings

- 8.1. The Executive Board shall meet as needed, but at least __ times a month.¹²²
- 8.2. Executive Board meetings shall be called by the General Director on his own initiative, as well as on the initiative of Executive Board members or the Supervisory Board.
- 8.3. The General Director shall set the agenda of Executive Board meetings,¹²³ send notice and relevant materials to its members, and preside over meetings.
- 8.4. Executive Board members shall have the right to propose items to the meeting agenda.
- 8.5. The quorum for Executive Board meetings shall be not less than __ of all Executive Board members.
- 8.6. Decisions made during Executive Board meetings shall be made by a majority of __ votes of the Executive Board members participating in the meeting.
- 8.7. The transfer of an Executive Board member's vote to another person, including another Executive Board member, shall not be allowed.
- 8.8. The Chairman of the Executive Board shall ensure that meeting minutes are prepared, and copies thereof sent to the Supervisory Board, the Revision Commission, and the External Auditor within __ days following the Executive Board meeting.
- 8.9. The minutes of the Executive Board meetings shall be signed by the General Director in his capacity as Chairman and Executive Board members attending the meeting. The minutes shall contain:
 - 8.9.1. The location and time of the meeting,
 - 8.9.2. The names of the persons present at the meeting;
 - 8.9.3. The agenda of the meeting;
 - 8.9.4. The results of voting on an individual basis;
 - 8.9.5. Decisions made by the Executive Board; and
 - 8.9.6. The rationale for the decisions.

¹²² FCSM Code, Chapter 4, Section 4.1.1 recommends to have scheduled Executive Board meetings not less than once a week.

¹²³ FCSM Code, Chapter 4, Section 4.1.3 recommends to send the agenda of the upcoming Executive Board meetings to every Executive Board member.

Annex 11. A Model By-Law for the Executive Bodies

Article 9. Duties and Liability

- 9.1. The General Director and Executive Board members shall act in good faith, with diligence and due care, and in the best interests of the Company and its shareholders.
- 9.2. The General Director and Executive Board members are prohibited from:
 - 9.2.1. Participating in a competing company;
 - 9.2.2. Entering into any transaction with the company without first disclosing the transaction and obtaining Supervisory Board or GMS approval;
 - 9.2.3. Entering into actions that may potentially result in a conflict between their own interests and the interests of the company;
 - 9.2.4. Using corporate property and facilities for personal needs;
 - 9.2.5. Disclosing non-public, confidential information for personal interests or the interests of third parties;
 - 9.2.6. Using company information or business opportunities for private advantage, i.e. personal profit or gain; and
 - 9.2.7. Accepting gifts from persons interested in decisions of the General Director and/or the Executive Board, or accept any other direct or indirect benefits, that exceed RUR _____, unless these gifts are symbolic, given as a common courtesy, or souvenirs that are given during official events.
- 9.3. The General Director and Executive Board members shall be liable to the Company for losses incurred through their fault (or omission), unless otherwise provided for by the Law.
- 9.4. Executive Board members who voted against, or abstained from voting on, the decision that resulted in losses to the Company shall not be liable for such losses.
- 9.5. In determining the grounds for and the amount of liability of the General Director and Executive Board members, normal business practices and other relevant circumstances shall be taken into account.
- 9.6. The terms of contracts with the General Director and Executive Board members may also include liability insurance.

Article 10. Remuneration

- 10.1. The remuneration of the General Director and Executive Board members shall be determined by the Supervisory Board [and its Nominations and Remuneration Committee].
- 10.2. The remuneration of the General Director shall be linked to the overall long-term performance of the Company and consist of a fixed and variable part.
- 10.3. The remuneration of the General Director and Executive Board members shall be fixed in separate employment contracts.¹²⁴

¹²⁴ The IFC's RCGP has developed a model employment contract for the General Director, which can also be adapted to other Executive Board members, see also: Annex 14.



Annex 12

A MODEL BY-LAW FOR THE CORPORATE SECRETARY

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __day of _____, 200_
[The Company's Seal]

BY-LAW FOR THE CORPORATE SECRETARY

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of contents

ARTICLE 1.	GENERAL PROVISIONS	156
ARTICLE 2.	ELECTION, TERM, AND DISMISSAL	157
ARTICLE 3.	FUNCTIONS, DUTIES, AND RESPONSIBILITIES	158
ARTICLE 4.	OFFICE OF THE CORPORATE SECRETARY.....	162

Article 1. General Provisions

- 1.1. This By-law for the Corporate Secretary (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) have been developed in accordance with the legislation of the Russian Federation (hereinafter the Law), the Company charter, other internal corporate documents, and recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall regulate the Corporate Secretary's authority to help with the development of, compliance with, and periodic review of the Company's corporate governance policies and practices, ensuring that the Company and its governing bodies follow and comply with the Law, as well as internal corporate rules and policies as determined by the Company charter, the By-law, and other by-laws and internal documents; the preparation and conducting of the General Meeting of Shareholders (hereinafter the GMS), Supervisory Board meetings [and Executive Board meetings]; the establishment and maintenance of clear and effective channels of communications between the various governing bodies of the Company; the disclosure of appropriate information about the Company; the keeping of corporate records; the review of shareholder requests; and the resolution of disputes involving the rights of shareholders.
- 1.3. The Corporate Secretary shall carry out his duties and responsibilities based on the Law, the Company charter, the By-law, and other relevant internal company documents, and the employment contract signed with the Company.
- 1.4. In case of negligence or failure to fulfill his responsibilities, the Corporate Secretary shall be held responsible under the Law.

Annex 12. A Model By-Law for the Corporate Secretary

Article 2. Election, Term, and Dismissal

- 2.1. The Corporate Secretary shall be appointed by the Supervisory Board by a majority vote of Supervisory Board members (directors) participating in the meeting.
- 2.2. Any director may nominate a candidate for the position of Corporate Secretary.
- 2.3. The Corporate Secretary must have the necessary qualifications to properly carry out his duties, including:¹²⁵
 - 2.3.1. _____;
 - 2.3.2. _____; and
 - 2.3.3. _____.
- 2.4. A candidate nominated for the position of Corporate Secretary must disclose to the Supervisory Board information on:
 - 2.4.1. Education and professional experience;
 - 2.4.2. Personal references;
 - 2.4.3. Share ownership in the Company;
 - 2.4.4. Positions held in other companies;
 - 2.4.5. Relationships with affiliated parties and business partners of the Company;
 - 2.4.6. _____;
 - 2.4.7. _____; and
 - 2.4.8. Other information that may affect his performance in carrying out the functions of the Corporate Secretary.
- 2.5. The Corporate Secretary shall be elected for the term of __ year(s).
- 2.6. The terms of the contract with the Corporate Secretary shall be approved by the Supervisory Board. The contract shall be signed by the Chairman of the Supervisory Board on behalf of the Company.
- 2.7. The Supervisory Board may dismiss the Corporate Secretary and appoint a new Corporate Secretary at any time.

¹²⁵ For example a legal and/or financial background (higher degree in law, finance, economics, or related field), relevant professional experience (practical work experience as an in-house lawyer), special skills (communication and interpersonal skills, as well as attention to detail), and specific knowledge (for example on corporate and securities law, and/or finance and accounting).

Article 3. Functions, Duties, and Responsibilities

- 3.1. The Corporate Secretary shall assist the Supervisory Board [and its Corporate Governance Committee] in the development of, compliance with, and periodic review of the Company's corporate governance policies and practices.
- 3.2. The Corporate Secretary shall help ensure that the Company and its governing bodies follow and comply with the Law. In doing so, the Corporate Secretary will keep abreast of the latest legal and regulatory developments, as well as internationally recognized best practices, as they relate to corporate governance, and provide periodic updates and briefs to the Company's directors and managers. The Corporate Secretary shall work and coordinate closely with the Company's legal department in this context.
- 3.3. The Corporate Secretary ensures that the governing bodies follow existing internal corporate rules and policies as determined by the Company charter, by-laws, and other internal documents, as well as to change such rules and policies, or institute new ones where appropriate. The Corporate Secretary is to inform the Chairman of the Supervisory Board of all violations of corporate procedures in a timely manner.
- 3.4. The Corporate Secretary shall properly prepare and conduct the GMS in accordance with the Law, the Company charter, and other relevant by-laws and internal documents of the Company following the decision on calling a GMS. In the course of preparing and conducting a GMS, the Corporate Secretary shall:
 - 3.4.1. Ensure that the list of the shareholders entitled to participate in the GMS is properly prepared;¹²⁶
 - 3.4.2. Ensure that the persons entitled to participate in the GMS are properly notified by preparing and sending (delivering) voting ballots to shareholders, as well as properly notifying all directors, the General Director [and Executive Board members, the External Manager], Revision Commission members, and the External Auditor of the Company;

¹²⁶ In the legally specified cases when the shareholder list is to be compiled by an independent External Registrar, the Corporate Secretary must have the authority to instruct the Registrar to create the list on the basis of instructions of the General Directors or by-laws (e.g. the By-law for the GMS).

Annex 12. A Model By-Law for the Corporate Secretary

- 3.4.3. Prepare and ensure unrestricted access to all materials that shall be made available for the GMS, and authenticate and provide copies of the materials upon the request of the persons entitled to participate in the GMS;
 - 3.4.4. Collect the completed voting ballots received by the Company and ensure their timely transfer to the Counting Commission;
 - 3.4.5. Organize the minutes of the GMS;
 - 3.4.6. Ensure that the persons entitled to participate in the GMS are informed of the voting results of the GMS in a timely manner; and
 - 3.4.7. Answer procedural questions during the GMS, and take measures to resolve conflicts arising when preparing and conducting the GMS.
- 3.5. The Corporate Secretary shall help the Chairman prepare and conduct the Company's Supervisory Board meetings in accordance with the Law, the Company charter, and other by-laws and internal documents of the Company.
- 3.5.1. The Corporate Secretary shall help prepare the annual schedule of Supervisory Board meetings and notify all directors of the upcoming meeting __ weeks in advance.¹²⁷
 - 3.5.2. If necessary, the Corporate Secretary shall send (or deliver) voting ballots to all directors, collect the completed ballots and written opinions of the directors who were not physically present at the meeting, and transfer these to the Supervisory Board Chairman.
 - 3.5.3. The Corporate Secretary shall ensure that Supervisory Board meetings are held in accordance with the procedures established in the By-law for the Supervisory Board;
 - 3.5.4. The Corporate Secretary shall assist the Chairman in keeping minutes of the Supervisory Board meetings that reflect the location and time of the meeting, the names of the persons who participated in the meeting, the agenda of the meeting, quorum and voting results, and a description of decisions made by the Supervisory Board;

¹²⁷ Good practice suggests two weeks.

- 3.5.5. The Corporate Secretary shall assist directors in obtaining the information necessary to take informed decisions. [In accordance with the information policy of the Company] the Corporate Secretary shall provide directors access to transcripts and minutes of Executive Board meetings, orders of the General Director, and other documents of the executive bodies of the Company, minutes of meetings and reports of the Revision Commission, and the opinion and management letter of the External Auditor, as well as the Company's primary accounting documents and financial information pursuant to a decision of the Supervisory Board's Chairman.
- 3.5.6. The Corporate Secretary shall help organize induction trainings for newly elected directors to brief these directors on their duties and responsibilities, the procedures that regulate the operations of the Supervisory Board and other working bodies of the Company, the Company's organizational structure and officers of the Company, internal documents of the Company, applicable decisions of the GMS and the Supervisory Board to their work as directors, and other information that may be required by directors for the appropriate discharge of their duties.
- 3.5.7. The Corporate Secretary shall inform and advise directors on legal requirements, charter provisions, and other internal corporate regulations that regulate their rights and responsibilities with respect to preparing and conducting the GMS and Supervisory Board meetings, and ensuring for information disclosure.
- 3.6. The Corporate Secretary shall assist in establishing and maintaining clear communication between the various governing bodies, in particular between the Supervisory and Executive Boards. To this extent, the General Director, Chief Accountant, and other relevant parties/bodies must provide timely and accurate information upon the Corporate Secretary's request.
- 3.7. The Corporate Secretary shall ensure for the proper disclosure of information about the Company. In particular, the Corporate Secretary shall:
 - 3.7.1. Ensure compliance with the requirements of the Law, the Company charter and by-laws, and other internal corporate documents on keeping and disclosing information about the Company;

Annex 12. A Model By-Law for the Corporate Secretary

- 3.7.2. Help ensure for the timely disclosure by the Company of information contained in the securities prospectuses, quarterly reports, annual report as well as information on all material facts that may affect the financial and business performance of the Company.
- 3.8. The Corporate Secretary acts as a liaison during a control transaction between the controlling shareholder (or group of shareholders) in a mandatory bid to buyout common shares (and securities convertible into common shares) and the other shareholders of the Company. In particular, the Corporate Secretary shall ensure that the offer is distributed to all shareholders in accordance with the requirements of the Law, the charter, and other internal documents of the Company.
- 3.9. The Corporate Secretary should notify the Chairman of the Supervisory Board of any potential or real conflicts of interests among the Company's shareholders, directors, or executives so that they can be dealt with appropriately, and act as a liaison in case of conflicts of interests among directors.
- 3.10. The Corporate Secretary shall keep the Company records and documents as specified under the Law, make these available to authorized parties, prevent un-authorized access, and make copies of such documents. The copies of the documents must be authenticated by the Corporate Secretary.
- 3.11. The Corporate Secretary shall ensure that all shareholder requests are properly processed by keeping records of all incoming shareholder requests, transferring the requests to the relevant governing bodies and departments, and monitoring the timely and full response to such requests by the governing bodies and departments.
- 3.12. The Corporate Secretary shall ensure that all conflicts arising from shareholder rights violations are properly examined and resolved by the Company [in accordance with the relevant by-laws]. The Corporate Secretary shall have the right to request explanations from the External Registrar in connection with shareholder complaints arising from the keeping of the shareholder register of the Company.¹²⁸

¹²⁸ It is recommended to include the provision on the responsibility of the Registrar to provide the relevant explanations to the Corporate Secretary in the company's contract with the Registrar.

The Russia Corporate Governance Manual

- 3.13. The Corporate Secretary shall have the right to obtain any information necessary for the proper discharge of his duties.
- 3.14. The Corporate Secretary shall act solely in the function of the Corporate Secretary and shall not perform any other duties in the Company.

Article 4. Office of the Corporate Secretary¹²⁹

- 4.1. To ensure the Corporate Secretary's performance of his duties, the Company shall establish the Office of the Corporate Secretary.
- 4.2. The staff of the Office of the Corporate Secretary (hereinafter staff) shall consist of ___ employees that report directly to the Corporate Secretary.
- 4.3. The staff shall be appointed by the General Director upon the recommendation of the Corporate Secretary.
- 4.4. The staff must have the necessary qualifications to properly carry out their duties and responsibilities.
- 4.5. The staff may not at the same time be directors, managers, or employees of another company, or Revision Commission members.

¹²⁹ Establishing an Office of the Corporate Secretary is only recommended for larger companies.



Annex 13

A MODEL CONTRACT WITH THE NON-EXECUTIVE DIRECTOR

CONTRACT

WITH A NON-EXECUTIVE DIRECTOR

of the Open Joint-Stock Company

«_____»

City of _____ this “___” day of _____, 200_.

The Open Joint Stock Company «_____» (hereinafter the Company), represented by _____ [*title, surname, name, patronymic of the authorized person*], acting on the basis of _____ [*decision of the General Meeting of Shareholders*], as one party, and Mr. _____ [*surname, name, patronymic*](hereinafter the Director) as the other party, elected as a member of the Supervisory Board of the Company by decision of the General Meeting of Shareholders of the Company (hereinafter the GMS) dated _____, Minutes No. ___ (hereinafter the Parties) have entered into the following Agreement:

Article 1. The Subject Matter of This Contract

- 1.1. This Contract is a civil law contract under which the non-executive Director agrees to render certain services to the Company as set forth in this Contract, and the Company agrees to remunerate the Director and reimburse the expenses incurred by the Director in connection with his performance hereof.
- 1.2. The contractual relationship set forth herein between the Company and the Director shall not be governed by any provisions or regulations of labor law, and the Director hereby represents and agrees that he is not among



those persons whose relations with the Company are governed by any provisions of labor or employment law.

- 1.3. The performance by the Parties of their obligations hereunder shall be governed by the provisions of this Contract and applicable laws of the Russian Federation (hereinafter the Law).

Article 2. The Rights of the Director

- 2.1. The Director shall have the following rights:
 - 2.1.1. Receive on time any relevant information required to enable him to properly perform his duties and responsibilities, from any source or person within the Company;
 - 2.1.2. Occupy and use office space, telecommunications facilities, and other property provided by the Company to attain the goals set forth herein;
 - 2.1.3. Participate in all Supervisory Board meetings and express his opinions on all matters under consideration in accordance with the procedures set forth in the Company's Charter and the By-law for the Supervisory Board;
 - 2.1.4. If necessary, but subject to the written consent of the Chairman of the Supervisory Board, he may hire specialists, experts, and advisors;
 - 2.1.5. Receive remuneration from the Company and reimbursement of expenses related to the performance of his functions as a member of the Supervisory Board in accordance with the procedures set forth in the charter, the By-law for the Supervisory Board, this Contract and any other applicable documents of the Company;
 - 2.1.6. Participate in training on the Company's account;
 - 2.1.7. _____;
 - 2.1.8. _____; and
 - 2.1.9. Enjoy such other rights as a member of the Supervisory Board of the Company pursuant to the Law, the charter, By-law for the Supervisory Board, and any other relevant internal documents of the Company.

Article 3. The Duties and Responsibilities of the Director

- 3.1. When performing his duties and responsibilities, the Director should act reasonably and in good faith, and in the best interests of the Company and its shareholders.
- 3.2. The Director shall have the following duties and responsibilities:
 - 3.2.1. Diligently and reasonably perform his duties subject to the requirements of the Law, the charter, and any other internal documents of the Company;
 - 3.2.2. Personally attend all meetings of the Supervisory Board, and in those cases specifically set forth in the By-law for the Supervisory Board, provide his written opinion to the Board as to the issues and matters considered at the meetings, or where applicable, provide such opinion on an absentee voting ballot;
 - 3.2.3. Personally and actively participate in the activities and work of any Board committees to which he is elected;
 - 3.2.4. Diligently perform any assignments of the Supervisory Board and its Chairman if delegated within the scope of their authority and competence;
 - 3.2.5. Analyze information and the current state of affairs in the Company in connection with those issues falling under the Director's scope of authority and competence, and prepare and present any necessary documentation concerning such issues in the form determined by the Chairman of the Supervisory Board;
 - 3.2.6. Properly prepare for Supervisory Board meetings, in particular, review the agenda and any materials for the meetings in advance, collect and analyze any necessary information, and prepare his opinions, conclusions, and recommendations;
 - 3.2.7. Upon expiration of the Director's term of office, including early termination thereof, he shall, within three days of such termination or expiration of term, vacate his office space and transfer the office keys, all Company documents, and any other Company property in his possession to the Corporate Secretary or any other person designated by the Company;
 - 3.2.8. Upon the request of the Chairman, provide any information except for the confidential and private;
 - 3.2.9. Comply with the following rules and requirements governing conflicts of interests:

- 3.2.9.1. Immediately inform the Chairman of the Supervisory Board of any personal profit or commercial interest, or any other personal interest, whether direct or indirect, in transactions, agreements, and projects of the Company, in accordance with the procedures set forth in any relevant internal documents of the Company;
 - 3.2.9.2. Should not receive any gifts, services, or any privileges from either individuals or legal entities, which are or may be viewed as a recognition for decisions or actions made or taken by the Director in his capacity as a member of the Supervisory Board;
 - 3.2.9.3. Should not disclose confidential, insider, or any other information which became known to the Director during the performance of his duties as a member of the Supervisory Board to any persons which have no access to such information, nor should he use such information for his own profit or in his own interests, or the interests of third parties, both during his term of office as a member of the Supervisory Board and for ____ years after the expiration of this Contract; and
 - 3.2.9.4. When working on the Company's premises, he should comply with the rules and procedures set forth by the internal documents of the Company governing the security and treatment of the Company's confidential information.
- 3.2.10. _____; and
- 3.2.11. _____.

Article 4. The Rights of the Company

- 4.1. The Company shall have the following rights:
 - 4.1.1. Require that the Director duly perform the duties of a member of the Supervisory Board as set forth in the Laws, the charter, By-law for the Supervisory Board, this Contract, and any other relevant internal documents of the Company;
 - 4.1.2. Terminate this Contract if and when the GMS takes a decision to dismiss the entire Supervisory Board;
 - 4.1.3. _____;
 - 4.1.4. _____; and

Annex 13. A Model Contract with the Non-Executive Director

- 4.1.5. Enjoy such other rights as set forth in the Law, the charter, and any other relevant internal documents of the Company, and the provisions of this Contract.

Article 5. The Duties and Obligations of the Company

- 5.1. The Company shall:
- 5.1.1. Remunerate the Director fully and on a timely basis as set forth herein, and reimburse any expenses appropriately incurred in connection with the performance of the Director's duties and responsibilities as a member of the Supervisory Board;
 - 5.1.2. Furnish information, materials, and any documents required by the Director to properly perform his duties in a timely manner;
 - 5.1.3. Provide technical support for the Director to perform his duties and obligations;
 - 5.1.4. _____; and
 - 5.1.5. _____.

Article 6. The Non-Executive Director's Remuneration¹³⁰

- 6.1. For the performance of his duties and responsibilities as a member of the Supervisory Board, the Director shall receive fixed remuneration in the amount RUR _____.
- 6.2. The Director may receive additional compensation in the following situations:
- 6.2.1. For the performance of his duties and responsibilities as Chairman of the Supervisory Board in the amount of RUR _____; and
 - 6.2.2. For the performance of his duties and responsibilities as the chairman of a Supervisory Board committee in the amount of RUR _____.
 - 6.2.3. For his work on a committee of the Supervisory Board in the amount of RUR _____ per attended meeting;
- 6.3. Fixed remuneration specified in Clause 6.1 hereof shall be paid once a quarter, and not later than the 15th day of the month following the period for which the remuneration is being paid.

¹³⁰ These rules relate only to non-executive directors. Executive directors typically do not receive any remuneration for sitting on the Supervisory Board.

The Russia Corporate Governance Manual

- 6.4. The Company shall reimburse the Director for all expenses incurred relative to the performance of the Director's duties, provided, however, that such expenses are stipulated and provided for in the work plans of the Supervisory Board, and the expenditure verified by receipts or other appropriate documentation, e.g. travel documents, invoices, etc.
- 6.5. The remuneration of the Director shall be paid in cash through the cash office of the Company, or alternatively, may be paid by way of a wire transfer to an account designated by the Director. Part of Director remuneration may be paid in shares.

Article 7. The Liability of the Parties

- 7.1. The Director shall be liable to the Company for any losses caused to the Company by the Director's conduct or failure to act, unless other grounds or the amount of such liability have been established by the Laws.
- 7.2. The Director shall not be liable if he voted against the decision that resulted in losses to the Company, or did not participate in such voting.
- 7.3. For purposes of determining the grounds or the scope and amount of the Director's liability, normal business practices and other relevant circumstances shall be taken into account.
- 7.4. If the Director's powers are terminated due to his initiative (fault), the Company may request the payment of compensation by the Directors of RUR _____.
- 7.5. If the Director's powers are terminated without cause as specified in Clause 8.4. hereof, the Director may request the payment of compensation by the Company of RUR _____.

Article 8. Duration and Termination

- 8.1. This Contract shall come into force immediately upon execution hereof by the Parties, and shall remain in effect until the new members of the Supervisory Board are elected by the GMS.
- 8.2. The date on which the Counting Commission signs the minutes of voting results shall be the date of election of the new directors.
- 8.3. The Company shall have the right to terminate this Contract with cause as specified in Clause 8.4. hereof or without any cause if and when the GMS

Annex 13. A Model Contract with the Non-Executive Director

approves a decision regarding the early termination of the entire Supervisory Board.

8.4. The Director may be dismissed on the following grounds:

8.4.1. The failure to fulfill his duties and obligations as specified in Article 3 hereof;

8.4.2. Causing losses to the Company;

8.4.3. _____; and

8.4.4. _____.

8.5. The termination date of this Contract shall be the date on which the Counting Commission signs the minutes of the voting results on the dismissal of the entire Supervisory Board.

Article 9. Final Provisions

9.1. This Contract is being executed in duplicate, one for each of the Parties, and each such duplicate shall serve as an original.

9.2. If the Director is re-elected as a member of the Supervisory Board, the Parties shall thereupon execute a new contract.

9.3. All matters not specifically addressed and provided for herein, shall be governed by the Law, the charter, and any other internal documents of the Company.

Article 10. Parties' Information and Signatures

Employer:

Name: _____

Address: _____

Banking information _____

(Title, name of the authorized person)

Director:

Surname, name, patronymic: _____

Passport: series _____ No. _____

Issued _____

Home address _____

(Signature)



Annex 14

**A MODEL EMPLOYMENT CONTRACT
WITH THE GENERAL DIRECTOR**

EMPLOYMENT CONTRACT

WITH THE GENERAL DIRECTOR

of the Open Joint Stock Company

« _____ »

City _____ this “ ____ ” day of _____, 200_.

The Open Joint Stock Company « _____ » (hereinafter the Company), represented by the Chairman of the Supervisory Board, _____, acting in accordance with the Company’s charter,

and

_____ [*full name*], (hereinafter the General Director),

collectively referred to hereinafter as “the Parties,” do hereby agree on the following:

Pursuant to the decision of the Supervisory Board as of _____ 200_ regarding the election of _____ [*full name*] for the position of General Director of the Company, and as confirmed by the minutes of meeting № _____ of _____ [*date*], _____ [*full name*] is appointed to the position of General Director [and Chairman of the Executive Board] according to the following terms and conditions:



Article 1. The Subject-Matter of This Contract

- 1.1. This Contract shall be an employment contract for a limited and fixed period of time, the term of which shall commence from the date of execution hereof for a term of _____ [number of months, years or other],¹³¹ and shall regulate and define all matters related to the General Director's employment, and any other matters between the Company and the General Director regarding the performance by the latter of his duties and responsibilities as General Director.
- 1.2. The General Director shall act as a single-member executive body on the basis of the legislation of the Russian Federation (hereinafter the Law), the charter, by-laws, and other internal documents of the Company, any applicable decisions of the General Meeting of Shareholders (hereinafter GMS) and the Supervisory Board, the provisions of this Contract, and the Company's terms of reference for the General Director.
- 1.3. The General Director shall be responsible for executing the decisions of the GMS and the Supervisory Board. Further, the General Director shall manage the day-to-day financial and business operations of the Company, and perform organizational and administrative functions. [Additionally, the General Director shall act as the Chairman of the Executive Board of the Company, ensuring that the Executive Board acts in accordance with its authorities as set forth by the Law, the charter, by-laws, and other internal documents of the Company].
- 1.4. The Company's premises shall be the principal workplace of the General Director.
- 1.5. The General Director's office shall be located within the Company's premises in _____ [city], the Russian Federation, and/or in any other location within the Russian Federation or abroad as so designated from time to time by the Company.

Article 2. The Rights of the General Director

- 2.1. The General Director shall have the following rights:
 - 2.1.1. Act on behalf of the Company without a power of attorney, including representing the interests of the Company both within the

¹³¹ The term of office of the General Director is determined by the company's charter in accordance with the Law. Good practice suggests an initial one year term, followed by three year term.

Annex 14. A Model Employment Contract with the General Director

- Russian Federation and abroad, and grant a power of attorney for performing legal actions on the Company's behalf;
- 2.1.2. Within the scope of his authority, manage and guide the performance of the Company's employees;
 - 2.1.3. [Direct the work and activities of the Executive Board, and convene, set the agenda for, and chair Executive Board meetings;]
 - 2.1.4. Represent the viewpoints and positions of the executive bodies of the Company at the GMS and meetings of the Supervisory Board;
 - 2.1.5. Make decisions regarding the filing of claims and suits against legal entities and individuals on behalf of the Company;
 - 2.1.6. Approve staffing structures, sign and terminate employment contracts with the employees of the Company, offer incentives to and take disciplinary actions against employees of the Company, and enforce the Company's right to compensation from employees if they are liable for losses pursuant to the Law;
 - 2.1.7. Use and dispose of the Company's assets, and enter into transactions and sign contracts if and as prescribed by the Law, the Company's charter and by-laws, and open bank accounts on behalf of the Company;
 - 2.1.8. Make requests and proposals to the governing bodies of the Company;
 - 2.1.9. Subject to the Law, define the nature and scope of information which constitutes a business or trade secret of the Company, and establish procedures for protecting such confidential information;
 - 2.1.10. Appoint a [member of the Executive Board as his] Deputy Director, to whom the General Director may delegate all or a portion of his authority while temporarily absent. Such appointment shall, however, be subject to the prior approval of the candidate by the Company's Supervisory Board;
 - 2.1.11. Receive a suitable office and place of work, which meets the conditions required of companies and organizations for safety in the workplace according to government standards, and receive full and accurate information regarding such working conditions and the requirements of the Company's security;
 - 2.1.12. Use of office space, telecommunications equipment, and facilities, the Company's vehicles, and any other property which may be

The Russia Corporate Governance Manual

- provided to him by the Company, to perform his functions as General Director;
- 2.1.13. Receive time off for official holidays, and in addition, receive paid annual vacations;
 - 2.1.14. Receive full and timely remuneration as specified in this Contract;
 - 2.1.15. _____;
 - 2.1.16. _____;
 - 2.1.17. Possess such other rights as may be provided for by the Law, the Company's charter, by-laws, and internal documents of the Company, as well as this Contract.
- 2.2. The General Director has the right to disclose information about the Company only in a manner consistent with the internal documents of the Company, and only to those persons who have the right to such information.

Article 3. The Duties and Responsibilities of the General Director

- 3.1. When performing his duties and responsibilities, the General Director should act reasonably and in good faith, and in the best interests of the Company and its shareholders.
- 3.2. The duties of the General Director shall be determined by the charter, the By-law for the Executive Bodies, as well as the Law.
- 3.3. The General Director shall:
 - 3.3.1. Manage the day-to-day business and financial operations of the Company with the purpose of increasing shareholder value;
 - 3.3.2. Ensure that the decisions of the GMS and the Supervisory Board of the Company are properly executed, and bear full responsibility for the consequences of his decisions;
 - 3.3.3. Protect and efficiently utilize the assets of the Company, including immovable property, for the purpose of achieving the business and commercial goals of the Company in accordance with the Law, the Company's charter, and internal documents;
 - 3.3.4. Manage the efficient operations of the Company, and coordinate effective interaction between the Company's various structural divisions and departments, ensuring for the proper development and improvement of their performance;

Annex 14. A Model Employment Contract with the General Director

- 3.3.5. Work to improve the Company's performance, growth of sales and profit, quality and competitiveness of the Company's products, product compliance with world standards, growth of domestic [and world] market share, and satisfying customer demands;
- 3.3.6. Be responsible for implementing the Company's information disclosure policy, specifically, for the organization, conditions, accuracy, and timeliness of the disclosure of information, and the Company's reporting to the appropriate state authorities, and additionally, be responsible for presenting accurate information about the Company to its shareholders, creditors, regulators, markets, the mass media, and any other interested parties;
- 3.3.7. Be responsible for the organization, procedures, and accuracy of keeping the accounting records of the Company, and certify that the financial statements and other financial documents of the Company are accurate and complete by signing these documents;
- 3.3.8. Provide all necessary documents and information about the Company's activities and operations to its executive bodies, the GMS, the Supervisory Board, the Revision Commission, the Internal Auditor, and the External Auditor of the Company within ___ working days after the receipt of a written request for such information or documents;
- 3.3.9. Ensure that the Company meets all its obligations to federal and regional governmental bodies, tax authorities, state non-budgetary social funds, suppliers, customers, and creditors, including banks, as well as meeting any obligations pursuant to commercial and labor contracts, and business plans;
- 3.3.10. Manage production and business operations utilizing state-of-the-art technology and progressive forms of management performance systems. Further, the General Director should manage financial, labor, and material costs, keep abreast of market research and the practices of leading domestic and foreign companies in order to achieve the highest possible improvement in the standards and quality of products and services, and achieve economic efficiency of operations, the rational use of production facilities, and the most efficient use of all types of resources;
- 3.3.11. Take measures to recruit and retain qualified staff, ensure the rational use and development of their professional skills and experience,

- ensure favorable and safe labor conditions, and ensure compliance with applicable labor, social and environmental regulations;
- 3.3.12. Ensure a balanced combination of an individualized and collective approach to decision-making, the use of pecuniary and moral incentives for improved performance, ensure proper motivation and responsibility at all levels of the Company, and ensure the timely payment of salaries;
 - 3.3.13. Together with the employees and trade union organizations, ensure the development and enforcement of collective bargaining agreements based on principles of social partnership,¹³² maintain labor and operations discipline, facilitate the motivation, initiative, and active participation of the employees in the development of the Company;
 - 3.3.14. Make financial, economic, and business decisions on behalf of the Company within the scope of his authority, as set forth in the Law, the Company charter, relevant by-laws, and this Contract;
 - 3.3.15. Act in compliance with the requirements of the Law, the Charter, and relevant by-laws and other internal documents of the Company;
 - 3.3.16. Ensure that the Company acts in compliance with the Law, and ensure that the Company utilizes legal methods of financial management and operation in the market economy, strengthens contractual and financial discipline, follows regulations regarding social and labor relations, and ensure the investment attractiveness of the Company in order to maintain and expand its business;
 - 3.3.17. Protect the interests of the Company in courts of law, arbitration proceedings, and in dealings with governmental authorities;
 - 3.3.18. Inform the Executive Board, the Supervisory Board, the Revision Commission, and the External Auditor of the Company in writing of any personal interest in any transaction, deal, contract, and project of the Company in those cases specifically provided for in the Law, and additionally, divulge any positions held in legal entities competing with the Company, or as to any participation in such legal entities, all on a timely basis;
 - 3.3.19. Not receive any gifts, services or other benefits from individuals given as compensation, or that may be regarded as compensation, for decisions or actions taken in his capacity as General Director;

¹³² In those cases where a collective labor agreement is required by the Law or by-laws of the company.

Annex 14. A Model Employment Contract with the General Director

- 3.3.20. Not disclose any confidential or insider information, or any information which constitutes a trade or commercial secret of the Company that became known to him in the course of performing his official duties during the term of this Contract and for the period of ____ years after its termination;
- 3.3.21. Sign a written confidentiality agreement;
- 3.3.22. Ensure that the next day following the termination of this Contract, all official affairs of the General Director can be transferred to the newly appointed General Director or such other person as may be appointed by the Company, including the transfer of all relevant documents, the Company's seal and stamps, staff ID card, keys to safes and offices, as well as any assets and equipment provided by the Company for official use. The transfer of documents, assets, and equipment shall be confirmed by executing an appropriate certificate referencing the Company's acceptance of such transfer;
- 3.3.23. _____; and
- 3.3.24. _____.

Article 4. The Rights of the Company

- 4.1. The Company shall have the following rights:
 - 4.1.1. Demand that the General Director act in compliance with the terms and conditions of this Contract, the charter, relevant by-laws, and other internal documents of the Company;
 - 4.1.2. Disclose information about the General Director as provided by the Law, the charter, relevant by-laws, and other internal documents of the Company both within the Company and to third parties, subject, however, to the requirements of Article 86 of the Labor Code of the Russian Federation, whose provisions guarantee protection of employees' personal information;
 - 4.1.3. _____;
 - 4.1.4. _____; and
 - 4.1.5. Possess such other rights as may be provided for by the Law, the Company's charter, by-laws, and other internal documents of the Company.

Article 5. The Obligations of the Company

- 5.1. The Company shall:
- 5.1.1. Pay the General Director's remuneration on a timely and full basis as set forth by the terms of this Contract, the Company's charter, by-laws, and other internal documents;
 - 5.1.2. Provide mandatory social security for the General Director in the manner set forth in the Law;
 - 5.1.3. Provide the General Director with liability, health, and life insurance;
 - 5.1.4. Provide working conditions for the General Director which are conducive and essential for the efficient performance of his duties and responsibilities, including:
 - 5.1.4.1. Separate, personal office space equipped with all the necessary means of communication such as a telephone, fax, and _____, office equipment such as a personal computer and printer, and _____, and the following items of furniture: _____;
 - 5.1.4.2. [Premises for holding Executive Board meetings;]
 - 5.1.4.3. A car (type _____, plate number _____); and
 - 5.1.4.4. Other assets/equipment _____.
 - 5.1.5. Inform the General Director on a timely basis of decisions made by the governing bodies of the Company;
 - 5.1.6. _____;
 - 5.1.7. _____; and
 - 5.1.8. Perform any other duties and responsibilities set forth in the Law, the Company's charter, by-laws, and other internal documents of the Company.

Article 6. Job Description and Remuneration

- 6.1. The General Director has, at the beginning of his term of office pursuant to this Contract, been duly informed of the scope of his official duties and relevant regulations established in the Company.
- 6.2. The General Director's normal work schedule shall be 40-hours per week. However, the specific number of work hours per day shall not be provided

Annex 14. A Model Employment Contract with the General Director

herein. All of the General Director's time and efforts during working hours shall be devoted to the Company's business and activities.

- 6.3. The General Director shall organize his schedule and workday at his own discretion.
- 6.4. Compensation for work performed in addition to a normal workday is included in the General Director's monthly amount of remuneration as provided herein.
- 6.5. The remuneration of the General Director shall be linked to the overall long-term performance of the Company and his personal input and shall consist of a:
 - 6.5.1. A fixed annual salary of RUR _____, which shall be paid out twice per month;¹³³
 - 6.5.2. A variable annual bonus, which shall cover a 12-month period coinciding with the financial year, and be based on:¹³⁴
 - 6.5.2.1. _____;
 - 6.5.2.2. _____; and
 - 6.5.2.3. _____.
 - 6.5.3. A long-term incentive system of _____ years, which shall consist of:¹³⁵
 - 6.5.3.1. _____;
 - 6.5.3.2. _____; and
 - 6.5.3.3. _____.

¹³³ The period for payment shall not be later than the [20–25th] of the current month (advances), and final payment, taking into account calculations for actual time worked, shall be paid no later than the [6th–10th] of the month following that month for which such payment is due.

¹³⁴ The variable part of the General Directors and Executive Board members' compensation shall be linked to key performance indicators that will vary by industry but should be linked to the company's long-term success. Commonly used key financial performance indicators include operating profit, return on capital employed, return on equity, and economic value added (EVA). Non-financial performance indicators can be organized around customers (for example customer satisfaction levels, retention rates and customer loyalty and acquisition), operational processes (quality measures, cycle time measures, cost measures, after sales service, etc.), and internal growth/knowledge management (training, employee satisfaction rates, employee absenteeism, employee turnover, etc.).

¹³⁵ Long-term incentive systems range from three to ten years and may include stock options, stock appreciation rights, restricted stock, and phantom stock.

- 6.5.4. Benefits plan, which shall consist of:¹³⁶
- 6.5.4.1. _____;
 - 6.5.4.2. _____; and
 - 6.5.4.3. _____.
- 6.5.5. Other perquisites, which shall consist of:¹³⁷
- 6.5.5.1. _____;
 - 6.5.5.2. _____; and
 - 6.5.5.3. _____.
- 6.6. The Company shall make any necessary deductions from the General Director's remuneration for social insurance, pension funds, and other funds of the Russian Federation as applicable, as well as those social deductions that the Company is required to deduct and pay pursuant to the Law. In addition, the Company shall also be responsible for deducting and transferring taxes to the appropriate tax authorities in accordance with the Law.
- 6.7. The Company shall grant the General Director a paid vacation for the period of _____ days annually.
- 6.8. If, during the term of this Contract, the General Director is temporarily unable to perform his duties and responsibilities due to illness, injury, or accident, the General Director shall provide a medical certificate confirming such temporary disability. Upon presentation of such certificate, the General Director shall be paid disability benefits in accordance with the Law and this Contract.
- 6.9. The General Director shall be reimbursed for any necessary and customary expenses incurred while traveling for and on behalf of the Company according to the rates set forth in the Law, internal documents of the Company, or decisions of the Supervisory Board.
- 6.10. Pursuant to a decision of the Supervisory Board, the General Director may be reimbursed for expenses incurred for medical treatment in a health resort or health center.

¹³⁶ The Company's benefits plan may include a pension plan, medical and dental plans, savings plans, life insurance plans, and a disability plan.

¹³⁷ Other perquisites may include club membership, use of a company car, chauffeurs, etc.

Annex 14. A Model Employment Contract with the General Director

- 6.11. In case of the General Director's death during the term of this Contract, his family shall be paid a one-time survivor's benefit in the amount of RUR _____.

¹³⁸

Article 7. The Term of the Contract and the Liability of the Parties

- 7.1. This Contract shall become effective from the date it is signed by the Parties and shall stay effective until the date of signing of the minutes of the Supervisory Board meeting dismissing the General Director or appointing a new General Director.
- 7.2. The Company may terminate this Contract at any time on the grounds specified by Clause 7.3. hereof, or without cause.
- 7.3. The Company may terminate this Contract on the following grounds:¹³⁹
- 7.3.1. The failure to perform or improper performance of the General Director's duties and obligations as specified in Article 3 hereof;
 - 7.3.2. Causing any real and direct damages to the Company;
 - 7.3.3. _____; and
 - 7.3.4. _____.
- 7.4. If the Director's powers are terminated without any cause as specified in Clause 7.3. hereof, the Director may request the payment of compensation by the Company of RUR _____.
- 7.5. This Contract may be unilaterally terminated by the General Director subject to a written notice to the Company not less than _____ month(s) prior to termination of the Contract.
- 7.6. The General Director shall bear civil liability to the Company for losses incurred through his willful neglect or failure to act.
- 7.7. In case of disclosure of confidential information that resulted in losses to the Company, the General Director shall reimburse the Company for such losses in accordance with the requirements of the Law.

¹³⁸ Or a percentage of the General Director's base salary.

¹³⁹ In addition to the general grounds for firing an employee by the employer according to the Labor Code, Articles 81, Clauses 4, 9, 10, 13, 14; Article 77; Article 278, Clause 2; Article 75.

Article 8. Final Provisions

- 8.1. This Contract is made in two originals, one for each of the Parties.
- 8.2. All disputes arising from this Contract shall be resolved in accordance with the Law.
- 8.3. All issues that are not covered by this Contract shall be regulated by the Law, the charter, by-laws, and other internal documents of the Company.
- 8.4. During the term of this Contract the Parties shall have the right to make changes and amendments thereto for the following reasons:
 - 8.4.1. Valid request of one of the Parties;
 - 8.4.2. Significant changes in the type of business of the Company;
 - 8.4.3. Changes in the charter and/or by-laws of the Company affecting the rights and interests of the General Director;
 - 8.4.4. Changes in the Law materially affecting and interests of the Parties; and
 - 8.4.5. Other reasons deemed by the Parties to be sufficient ground for making changes and amendments to this Contract.
- 8.5. All the aforementioned changes and amendments shall be made in writing and signed by the Parties and shall be an integral part of this Contract.

Article 9. Requisites and Signatures of the Parties

Company: Name: _____	General Director: Full name: _____
Location: _____ _____	Passport: number _____ Issued _____
Bank details _____	Home address _____

(Position, full name of the authorized person)

(Signature)



Annex 15

**A MODEL EMPLOYMENT CONTRACT
WITH THE CORPORATE SECRETARY**

EMPLOYMENT CONTRACT

WITH THE CORPORATE SECRETARY

of the Open Joint Stock Company
«_____»

City of _____ this “___” day of _____, 200_.

The Open Joint Stock Company «_____» (hereinafter the Employer or Company), represented by the Chairman of the Supervisory Board of the Company _____, and acting pursuant to and in accordance with the Company’s charter,

And _____, (hereinafter the Corporate Secretary),

Collectively referred to as “the Parties,” do hereby agree on the following:

Considering that the Supervisory Board has approved the appointment of _____ for the position of Corporate Secretary, and such appointment having been confirmed by the Minutes of the Supervisory Board’s meeting, №___ of _____ [date], _____ hereby commences his duties and responsibilities as Corporate Secretary subject to the following terms and conditions:



Article 1. The Subject Matter of this Contract

- 1.1. This Contract shall be an employment contract and shall constitute the terms and conditions of employment, and regulate the employment and labor relations between the Parties.
- 1.2. Pursuant to the terms of this Contract, the Corporate Secretary shall ensure the development of, compliance with, and periodic review of the Company's corporate governance policies and practices, ensuring that the Company and its governing bodies follow and comply with the legislation of the Russian Federation (hereinafter the Law), as well as internal corporate rules and policies as determined by the Company charter, the By-law for the Corporate Secretary, and other by-laws and internal documents; the preparation and conducting of the General Meeting of Shareholders (hereinafter the GMS), Supervisory Board meetings, and Executive Board meetings; the establishment and maintenance of clear and effective channels of communications between the various governing bodies of the Company; the disclosure of appropriate information about the Company; the keeping of corporate records; the review of shareholder requests; and the resolution of disputes involving the rights of shareholders.
- 1.3. The Employer shall pay remuneration for the services of the Corporate Secretary, and shall provide the necessary work premises and facilities in accordance with the law and provisions of this Contract.
- 1.4. The Company's premises shall be the principal workplace of the Corporate Secretary.
- 1.5. The Corporate Secretary's office shall be located within the Company's premises in _____ [city], the Russian Federation, and/or in any other location within the Russian Federation or abroad as so designated from time to time by the Employer.

Article 2. The Duties and Responsibilities of the Corporate Secretary

- 2.1. The Corporate Secretary shall:
 - 2.1.1. Perform the functions set forth in the charter and the By-law for the Corporate Secretary;
 - 2.1.2. Render services and perform duties assigned to the Corporate Secretary by the Supervisory Board within the scope of authority of the Corporate Secretary;

Annex 15. A Model Employment Contract with the Corporate Secretary

- 2.1.3. Inform the Chairman of the Supervisory Board of all facts hindering the preparation and conduct of the GMS, Supervisory Board meetings, disclosure of information about the Company, and other facts regarding non-compliance with procedures relating to the functions and duties of the Corporate Secretary;
- 2.1.4. Annually confirm to the Supervisory Board the accuracy of personal information previously disclosed to the Board, and if there are any changes in such information, immediately inform the Board of such changes;
- 2.1.5. Use the work premises, means of communication, transport, and any other assets and equipment provided by the Employer solely for performing the duties of the Corporate Secretary;
- 2.1.6. Not receive, from either individuals or organizations, any gifts, services, or other benefits that have been given as compensation for, or may be perceived as having been given as compensation for decisions or actions taken in the Corporate Secretary's official capacity;
- 2.1.7. Not disclose any information that is confidential, or disclose any trade or commercial secrets that became known to the Corporate Secretary during the course of performing his official duties for the duration of this Contract and for the period of ____ years after its termination;
- 2.1.8. Take all the necessary steps and measures to prevent the disclosure of confidential information and information which may constitute a trade or commercial secret of the Company;
- 2.1.9. _____;
- 2.1.10. _____; and
- 2.1.11. Ensure that all of the activities and affairs are transferred to the newly-appointed Corporate Secretary, or such other person as may be appointed by the Employer, the next day immediately following the day on which this Contract is terminated.

Article 3. The Rights of the Corporate Secretary

- 3.1. The Corporate Secretary shall have the right to:
 - 3.1.1. Receive full and relevant information necessary for the performance of his duties from the Supervisory Board, the General

The Russia Corporate Governance Manual

- Director, other executives, and employees of the Company upon request;
- 3.1.2. Receive an annual paid vacation;
 - 3.1.3. Receive remuneration on time, and in-full;
 - 3.1.4. _____;
 - 3.1.5. _____; and
 - 3.1.6. _____.

Article 4. The Rights of the Employer

- 4.1. The Employer shall have the right to:
 - 4.1.1. Demand that the Corporate Secretary act in compliance with the terms and conditions of this Contract, the charter, and by-laws of the Company;
 - 4.1.2. Hold the Corporate Secretary accountable in accordance with established procedures;
 - 4.1.3. _____;
 - 4.1.4. _____; and
 - 4.1.5. Have such other rights as set forth in the Law, this Contract, the charter, the By-law for the Corporate Secretary, and other relevant by-laws of the Company.

Article 5. The Duties of the Employer

- 5.1. The Employer shall:
 - 5.1.1. Pay the Corporate Secretary's remuneration on time and in-full as set forth by the terms and conditions of this Contract;
 - 5.1.2. Provide the Corporate Secretary with the necessary conditions and equipment for efficiently performing his duties. The Corporate Secretary shall be provided with his own separate office facilities and the following equipment, for which he shall bear personal responsibility:
 - 5.1.2.1. Communications equipment (telephone, fax, _____);
 - 5.1.2.2. Office equipment (personal computer, printer _____);

Annex 15. A Model Employment Contract with the Corporate Secretary

- 5.1.2.3. The following furniture (_____);
- 5.1.2.4. A car (type _____, plate number _____);
and
- 5.1.2.5. Other assets and equipment as follows: _____.
- 5.1.3. _____;
- 5.1.4. _____; and
- 5.1.5. _____.

Article 6. Remuneration, Work Hours and Vacations

- 6.1. The Corporate Secretary shall receive remuneration in the amount of RUR _____ per month, which shall be paid by the Company in accordance with the Law.
- 6.2. The time period for payment shall not be later than the [20–25th] of the current month (advances), and final payment, taking into account calculations for actual time worked, shall be paid no later than the [6th–10th] of the month following that month for which such payment is due.
- 6.3. The Company shall make any necessary deductions from the Corporate Secretary's remuneration for social security, pension fund, and other funds of the Russian Federation as applicable, as well as those social deductions that the Company is required to deduct and pay pursuant to the Law. In addition, the Company shall also be responsible for deducting and transferring taxes to the appropriate tax authorities in accordance with the Law.
- 6.4. The Corporate Secretary may be paid additional performance-based compensation or bonuses, the size of which shall be determined by the Supervisory Board. The amount of such bonus payments shall be determined based on the results of the quarter and/or year.
- 6.5. The Corporate Secretary's work hours shall be 40 hours, five working days per week, but the number of work hours per day shall not be regulated or fixed.
- 6.6. Compensation for work performed in addition to a normal workday is included in the Corporate Secretary's monthly amount of remuneration as provided hereinabove.
- 6.7. The Corporate Secretary shall be given an annual paid vacation of ____ days, which may be granted either in full or in parts, and an additional

The Russia Corporate Governance Manual

annual paid vacation of ____ days. The dates of vacations shall be agreed upon between the Corporate Secretary and the Chairman of the Supervisory Board.

- 6.8. After the termination of this Contract, the final payment for any outstanding amount of salary or any type of compensation owed to the Corporate Secretary shall be made only after the Corporate Secretary transfers all the affairs to the newly-appointed Corporate Secretary or such other person as may be appointed by the Employer.

Article 7. The Liability of the Parties

- 7.1. If either of the Parties fails to perform, or performs improperly or insufficiently any of their duties or responsibilities as set forth in this Contract, the breaching Party shall be held liable pursuant to the Law and this Contract.

Article 8. The Term of the Contract

- 8.1. The Contract shall become effective from the date it is signed by the Parties, and shall terminate on the date of signing of the minutes of the Supervisory Board meeting regarding the appointment of the new Corporate Secretary.
- 8.2. The Corporate Secretary may terminate the Contract. In such case, the Corporate Secretary shall give the Employer written notice of his intention to terminate at least two weeks prior to the effective date of such termination.
- 8.3. The Contract may be terminated on failure to perform or improper performance of the Corporate Secretary's duties and obligations as specified in Article 2 hereof, or other grounds as set forth by the Law.

Article 9. Final Provisions

- 9.1. The Contract is being executed in duplicate, with an original for each Party, and each such original having equal force and effect in law.
- 9.2. All disputes between the Parties shall be resolved in accordance with the Law.
- 9.3. All issues that are not specifically covered or provided for in this Contract shall be regulated by the Law, the charter, and by-laws of the Company.

⊕

Annex 15. A Model Employment Contract with the Corporate Secretary

Article 10. Requisites and Signatures of the Parties

Employer:

Name: _____

Location: _____

Bank details _____

Corporate Secretary:

Full name: _____

Passport: number _____

Issued _____

Home address _____

(Position of the authorized person)

(Signature)



Annex 16

MODEL MINUTES FOR A SUPERVISORY BOARD MEETING

MINUTES

FOR THE MEETING OF THE SUPERVISORY BOARD

OF THE OPEN JOINT STOCK COMPANY

« _____ »

Date of the meeting: « ____ » _____ 200__

Time of the meeting: From __: __ to __: ____

Place of the meeting: _____

Chairman of the meeting: _____

Supervisory Board members participating in the meeting as observers:

1. _____;
2. _____;
3. _____;
4. _____; and
5. _____.

The meeting has a quorum.¹⁴⁰

¹⁴⁰ The Federal Commission for the Security Market’s Code of Corporate Conduct (FCSM Code) Chapter 3, Section 4.3.1 recommends that the company charter have a provision which addresses the issue of taking into account the written opinions of directors who did not attend the Supervisory Board meeting. However, the votes of those directors who submitted their written opinion shall not be counted for the purposes of determining whether or not a quorum exists at the meeting.



The Russia Corporate Governance Manual

Persons and advisors invited to the meeting:

_____; and
_____.

Meeting Agenda

Item No. 1: _____

Item No. 2: _____

Item No. 3: _____

Item No. 1: _____

1. Discussed

Item No. 1 of the agenda of the Supervisory Board meeting on the _____
_____.

2. Presenters:

_____; and
_____.

3. Decision to approve the following _____ :

Voting results on this item:

№ p/p	Full name of the director	Voting options		
		«FOR»	«AGAINST»	«Abstained»
1.				
2.				
3.				
4.				
5.				

Annex 16. Model Minutes for a Supervisory Board Meeting

Item No. 2: _____

Item No. 3: _____

Date of the minutes «__» _____ 200__.

The Supervisory Board Chairman _____

Director 1 _____

Director 2 _____

Director 3 _____

Director 4 _____

Director 5 _____

The Corporate Secretary _____



Annex 17

A MODEL CHECKLIST FOR THE SUPERVISORY BOARD'S SELF-EVALUATION

Part I: Assessment Questionnaire for the Supervisory Board

To be completed by each director on a confidential basis. Note that:

- 1 = Needs significant improvement
- 2 = Needs improvement
- 3 = Adequate
- 4 = Consistently good
- 5 = Outstanding

<i>Section I: Authorities and General Information</i>					
1. Is the Supervisory Board's role in protecting the company's and shareholder's interests?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
2. How would you rate the Supervisory Board's consideration of shareholder value in its decision-making process?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
3. Do you feel that the Supervisory Board understands its role, authority, and priorities?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
4. To what degree is the Supervisory Boards' authority distinct from that of the General Director and the General Meeting of Shareholders (GMS) in practice?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
5. Does the Supervisory Board know and understand the company's values, mission, and strategic and business plans, and reflect this understanding on key issues throughout the year?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
6. How effective is the Supervisory Board in guiding and setting strategy?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
7. Does the Supervisory Board have the tools to properly oversee the operational and financial performance of the company?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
8. Is the Supervisory Board doing a good job in managing the performance and evaluating the General Director?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>

Comments:



The Russia Corporate Governance Manual

<i>Section II: Composition</i>					
9. Does the Supervisory Board have the right size, i.e. is the number of directors consistent with the needs of the company?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
10. How effective is the Chairman's leadership, both at the Supervisory Board and committee levels?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
11. Has the Supervisory Board designed, articulated, and implemented policies related to its composition (size, composition and mix-of-skills, breadth of experience, and other pertinent qualities)?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
12. Is the Supervisory Board's composition (in terms of competencies and mix of skills) suited to its oversight duties and the development of the company's strategy?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
13. How effectively does the Supervisory Board work together, for example is the Board effective as a team, or are directors encouraged to voice dissenting opinions while seeking constructive solutions?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
14. Do you feel that the Company's independent directors are truly independent?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>

Comments:

<i>Section III: Structure and Committees</i>					
15. Does the Supervisory Board have an appropriate number of committees?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
16. How effective do you believe the Supervisory Board's committees to be, that is do they provide useful recommendations allowing for better decision-making, and do they consequently make Supervisory Board meetings more efficient and effective?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
17. Do you feel that members of the _____ committee have sufficient expertise on _____ issues?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
18. How well informed are non-committee members about the committee's deliberations?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>

Comments:

Annex 17. A Model Checklist for the Supervisory Board's Self-Evaluation

<i>Section IV: Working Procedures</i>					
19. How well has the Supervisory Board identified, prioritized, and scheduled key issues that should be reviewed on a regular basis?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20. Is information on the various agenda items provided to you well in advance of Supervisory Board meetings, allowing you to properly prepare?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21. Are you as a director receiving proper information for good decision-making, i.e. is the information presented in a succinct manner, are key issues and risks properly highlighted, and do the materials also contain annexes with relevant detail for further study allowing you to understand and evaluate agenda items of the Supervisory Board's meeting and take effective decisions?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22. Are Board meetings conducted in a manner that ensures open communication, meaningful participation, and timely and constructive resolution of issues?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
23. Are the presentations given to you during the Supervisory Board meetings sufficiently clear to make good decisions?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
24. Is the Supervisory Board meeting time appropriately allocated between Board discussion and management presentations?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
25. Do you have sufficient access to senior executives outside of Supervisory Board meetings?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
26. Has the Supervisory Board identified the company's key performance indicators to monitor managerial performance?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
27. Does the financial information provided to you prior to Supervisory Board meetings give you the necessary information to understand the important issues and trends in the business?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
28. Is the financial information presented in such a way as to highlight these important issues and trends?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
29. Does the Supervisory Board, together with management, focus on risks that could have a significant impact on the Company?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
30. Does the Supervisory Board have a system for auditing the other, less significant risks that still have the potential under certain circumstances to influence significantly or negatively the Company's performance?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
31. Is the Company's orientation program for new directors providing helpful information about Supervisory Board processes and the Company?	1	2	3	4	5
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Comments:

The Russia Corporate Governance Manual

<i>Section V: Duties and Liabilities</i>					
32. Have your duties of loyalty, care, and business judgment been sufficiently communicated to you?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
33. Do Supervisory Board members spend sufficient time learning about the Company's business and understand it well enough to provide critical oversight?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
34. Do you generally believe that Supervisory Board members ask appropriate, yet challenging and critical questions of management?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
35. Do directors disclose personal interests in transactions and abstain from voting where appropriate?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>
36. Are you indemnified in any way?	1 <input type="checkbox"/>	2 <input type="checkbox"/>	3 <input type="checkbox"/>	4 <input type="checkbox"/>	5 <input type="checkbox"/>

Comments:

Part II: Assessment Questionnaire Directors

To be completed by each director on a confidential basis. Note that:

- 1 = Needs significant improvement
- 2 = Needs improvement
- 3 = Adequate
- 4 = Consistently good
- 5 = Outstanding

	Professional Experience	Industry Knowledge	Specific Competency	Business Judgment	Strategic Vision	Integrity	Attendance	Meeting Preparation	Team Player	Active Participation	Overall Contribution
Director 1											
Director 2											
Director 3											
Director 4											
Director 5											
Director 6											
Director 7											
Director 8											
Director 9											

Annex 18

A MODEL DEFINITION OF AN INDEPENDENT DIRECTOR

A Model Definition of an Independent Director

The purpose of identifying and electing independent directors is to ensure that the Supervisory Board includes directors who can effectively exercise their best judgment for the exclusive benefit of the company, judgment that is not clouded by either real or perceived conflicts of interests. The International Finance Corporation (IFC) expects that in each case where a director is identified as “independent,” the Supervisory Board will affirmatively determine that such director meets the requirements established by law and the company, and is otherwise free of any material relations with the company’s management, controllers, or others that might reasonably be expected to interfere with the independent exercise of his best judgment for the exclusive interest of the company and its shareholders. One suggested definition for “independent” follows hereinbelow. In each case, the company should consider making changes tailored to those particular types of relationships that would impair the director’s independence, while taking into account the specific circumstances and needs of their company.

An “independent director” is a director who has no material relationship with the company beyond his directorship (either directly or as a partner, shareholder, or officer of an organization that has a “material” relationship with the company). An independent director should be independent in character and judgment, and there should be no relationships or circumstances which could affect, or might appear to affect, the director’s independent judgment.

In particular, an independent director is a director who:

1. Is not, and has not been employed by the company or any of its related parties at any time during the past five years;
2. Is not, and has not been affiliated with a company that acts as an advisor or consultant to the company or its related parties, nor is not and has not himself acted in such capacity at any time during the past five years;
3. Is not, and has not been affiliated with any significant customer or supplier of the company or its related parties (i.e. a company that makes payments to, or receives

- payments from the company for property or services in an amount which, in any single fiscal year, exceeds the greater of US \$ _____, or 2% of such other company's consolidated gross revenues) at any time during the past five years;¹⁴¹
4. Does not currently have, nor has he had any personal service contracts with the company, its related parties, or its senior management at any time during the past five years;
 5. Is not affiliated with any non-profit organization that receives significant funding from the company or its related parties;
 6. Does not receive, and has not received any additional remuneration from the company apart from a director's remuneration, nor participates in the company's share option or performance-related payment plans, nor is a participant of the company's pension plan;
 7. His director's remuneration does not constitute a significant portion of his annual income;
 8. Is not employed as an executive officer of another company where any of the company's executives serve on that company's Supervisory Board;
 9. Is not a member of the immediate family of any individual who is, or has been at any time during the past five years, employed by the company or its related parties as an executive officer;
 10. Is not, nor has been at any time during the past five years, affiliated with or employed by a present or former External Auditor of the company or Auditor of any related party;
 11. Is not a controlling person of the company¹⁴² (or member of a group of individuals and/or entities that collectively exercise effective control over the company) or such person's brother, sister, parent, grandparent, child, cousin, aunt, uncle, nephew, or niece, or a spouse, widow, in-law, heir, legatee, and successor of any of the foregoing (or any trust or similar arrangement of which any such persons or a combination thereof are the sole beneficiaries), or the executor, administrator, or personal representative of any person described in this paragraph who is deceased or legally incompetent; and
 12. Has not served on the Supervisory Board for more than ten years.¹⁴³

¹⁴¹ Under the NYSE Listing Requirements, U.S. \$1 million is stipulated. Depending on the country specifics, the amount can be adjusted.

¹⁴² The definition of a controlling shareholder will vary from country to country, and even from company to company. However, in general, even a 5% ownership of the voting shares could be considered sufficient enough to vest significant powers of control in the shareholder.

¹⁴³ Depending on the availability of qualified independent directors in a given country, the term could be shortened to seven years.

Part 3

Shareholder Rights



Annex 19

A MODEL BY-LAW

FOR THE GENERAL MEETING OF SHAREHOLDERS

Approved
by the General Meeting of Shareholders
of the Open Joint Stock Company «_____»

Minutes of the [Annual or Extraordinary]
General Meeting of Shareholders

No. _____
of _____ 200_
dated this __day of _____, 200_
[The Company's Seal]

BY-LAW FOR THE GENERAL MEETING OF SHAREHOLDERS

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	204
ARTICLE 2.	THE AUTHORITY OF THE GENERAL MEETING OF SHAREHOLDERS	205
ARTICLE 3.	PROPOSALS TO THE AGENDA OF THE ANNUAL GENERAL MEETING OF SHAREHOLDERS.....	207
ARTICLE 4.	THE ANNUAL GENERAL MEETING OF SHAREHOLDERS	210
ARTICLE 5.	THE CALLING OF AND PREPARING FOR THE EXTRAORDINARY GENERAL MEETING OF SHAREHOLDERS.....	217
ARTICLE 6.	THE GENERAL MEETING OF SHAREHOLDERS CONDUCTED IN THE FORM OF JOINT ATTENDANCE.....	218
ARTICLE 7.	THE GENERAL MEETING OF SHAREHOLDERS CONDUCTED IN THE FORM OF ABSENTEE VOTING	222
ARTICLE 8.	PROCEDURES FOR MAKING DECISIONS AND KEEPING DOCUMENTS.....	223

Article 1. General Provisions

- 1.1. This By-law for the General Meeting of Shareholders (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed in accordance with the legislation of the Russian Federation (hereinafter the Law), the Company charter, and the recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law will become effective from the moment it is approved and shall apply to every General Meeting of Shareholders (hereinafter the GMS) following the GMS that approved the By-law.
- 1.3. The By-law shall regulate the authorities, procedures for calling, preparing, and conducting the GMS, procedures for electing its working bodies, as well as other related issues.
- 1.4. The GMS is the highest governing body of the Company.
- 1.5. Decisions of the GMS may be taken:

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 1.5.1. In the form of joint attendance of shareholders for discussing the agenda items and making decisions on issues put to vote with the circulation (delivery) of voting ballots prior to conducting the GMS; or
 - 1.5.2. By written consent (without the joint attendance of shareholders for discussing the agenda items and making decisions on issues put to vote).
- 1.6. The Company shall conduct an Annual General Meeting of Shareholders (hereinafter AGM). The AGM shall be held between _____ and _____ [the dates selected should be sometime between March 1-st and June 30-th].¹⁴⁴
- 1.7. The AGM may only be held in the form of joint attendance of shareholders.

Article 2. The Authority of the General Meeting of Shareholders

- 2.1. The following issues shall fall within the competence of the GMS:¹⁴⁵
- 2.1.1. Amending the charter of the Company and approving the new version of the charter;
 - 2.1.2. Reorganizing the Company;
 - 2.1.3. Liquidating the Company and appointing the Liquidation Commission;
 - 2.1.4. Approving the interim and final liquidation balance sheets;
 - 2.1.5. Determining the number of Supervisory Board members, and/or electing and terminating the powers of directors prior to the expiration of its term;
 - 2.1.6. Approving the remuneration and compensation payable to directors;
 - 2.1.7. Delegating the powers of the General Director to an External Manager and terminating their powers prior to the expiration of their term of office;
 - 2.1.8. Electing Revision Commission members and terminating their powers prior to the expiration of their term of office;

¹⁴⁴ The general timeframe for conducting the GMS is set by the Law on Joint Stock Companies (LJSC), Article 47, Clause 1. The Company may set other dates for conducting the AGM, but only within the timeframe provided by the Law.

¹⁴⁵ This article includes an exhaustive list of powers of the GMS.

- 2.1.9. Approving the remuneration of Revision Commission members;
- 2.1.10. Approving the annual report, the annual financial statements, including, but not limited to, the profit and loss statement (profit and loss accounts) of the Company,¹⁴⁶ as well as distributing the profits (including the declaration and payment of dividends, except as to the quarterly results) and losses of the Company in accordance with the results of the financial year;
- 2.1.11. Declaring and paying dividends according to the results of the first, second, and third quarter results of the financial year;
- 2.1.12. Approving the Company's External Auditor;
- 2.1.13. Electing Counting Commission members and terminating their powers prior to the expiration of their term of office;
- 2.1.14. Defining the number of Counting Commission members;
- 2.1.15. Delegating the functions of the Counting Commission to a specialized organization;
- 2.1.16. Approving by-laws for the GMS, the Supervisory Board, and the executive bodies;
- 2.1.17. Approving the internal regulation for the Revision Commission;
- 2.1.18. Increasing the charter capital by means of increasing the nominal value of shares, or by means of issuing additional shares;¹⁴⁷
- 2.1.19. Fixing the number, nominal value, category (class) of authorized shares, and the rights associated with such shares;
- 2.1.20. Decreasing the charter capital;
- 2.1.21. Splitting and consolidating shares;
- 2.1.22. Approving related party transactions, as set forth by the Law;
- 2.1.23. Approving extraordinary as set forth by the Law;
- 2.1.24. Approving the reimbursement of expenses to persons who conducted the GMS at their initiative when the Supervisory Board either failed or refused to call the Extraordinary General Meeting of Shareholders (EGM) at their request;
- 2.1.25. Buyback by the Company of its issued shares;

¹⁴⁶ Other financial statements include the balance sheet, the cash flow statement, the statement of changes in owners' equity, notes and explanations to the financial statements, and management's discussion and analysis.

¹⁴⁷ This power may be delegated to the Supervisory Board.

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 2.1.26. Waiving the obligation to make a mandatory bid during control transactions;
 - 2.1.27. Issuing and placing convertible bonds;¹⁴⁸
 - 2.1.28. Issuing and placing shares and other convertible securities by closed subscription;
 - 2.1.29. Approving the list of additional documents to be kept by the Company;
 - 2.1.30. Approving the participation in holding companies, financial and industrial groups, and other groupings of commercial organizations;
 - 2.1.31. Requesting an extraordinary audit of the financial and business operations of the Company by the Revision Commission.
- 2.2. Issues falling within the authority of the GMS may not be delegated to the executive bodies.

Article 3. Proposals to the Agenda of the Annual General Meeting of Shareholders

- 3.1. Shareholder proposals may be made by a shareholder (or group of shareholders) owning at least 2% of voting shares. The number of voting shares owned by the shareholder(s) making a proposal to the agenda of the GMS shall be determined at the date of such proposal. The date of the proposal shall be established in accordance with the requirements for preparing, calling, and conducting the GMS as established by the FCSM.
- 3.2. Shareholder proposals, including proposals on candidates for election to the Supervisory Board¹⁴⁹ and the Revision Commission, must be received by the Company within 30 days after the end of the financial year.¹⁵⁰
- 3.3. The number of candidates a shareholder (or groups of shareholders) can nominate to the respective governing bodies of the Company may not exceed the number of members to be elected.
- 3.4. Shareholder proposals must contain the exact wording of the issue as it will appear on the agenda. The proposal may also contain the text of the decision on the issue.

¹⁴⁸ This power may be delegated to the Supervisory Board.

¹⁴⁹ If, pursuant to the charter, the executive bodies are elected by the Supervisory Board.

¹⁵⁰ The Company Law allows setting a later date (see, LJSC, Article 53, Clause 1).

The Russia Corporate Governance Manual

- 3.5. Proposals on agenda items of the AGM may be made by:
- 3.5.1. Registered mail to the following address: _____
_____, to the attention of _____ [*specify name and title of the person responsible for receipt of proposals*];
 - 3.5.2. Personal delivery with confirmation of receipt to _____
____ [*the Secretary of the Supervisory Board or the Corporate Secretary, or such other person who has been authorized to receive written correspondence addressed to the Company.*]
- 3.6. Proposals on agenda items and the nomination of candidates shall be signed by the shareholder(s). If a proposal on any agenda item is signed by a proxy, a power of attorney (or a duly authenticated copy of the power of attorney) containing all the data required by law must be attached to the proposal.
- 3.7. Proposals on agenda items and the nomination of candidates shall be made in writing and shall state:
- 3.7.1. The name of the shareholder(s) submitting the proposal;
 - 3.7.2. The number and category (class) of shares owned;
 - 3.7.3. _____; and
 - 3.7.4. _____.
- 3.8. Proposals on the nomination of candidates to the governing bodies of the Company shall contain the following information:
- 3.8.1. The full name and date of birth of each candidate;
 - 3.8.2. Professional experience, current employment, positions held over the past ____ years, and positions held in the governing bodies of other legal entities over the past ____ years;¹⁵¹
 - 3.8.3. Educational background, including any continuous professional education (name of educational institution, date of graduation, qualification);
 - 3.8.4. List of legal entities of which the candidate is a shareholder, stating the number of shares (interest) in the charter capital of such legal entities;

¹⁵¹ The FCSM Code, Chapter 3, Section 2.3.1 recommends five years.

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 3.8.5. List of persons with whom the candidate is affiliated, specifying the nature of affiliation;¹⁵²
 - 3.8.6. Name of the body for which the candidate is being nominated;
 - 3.8.7. _____;
 - 3.8.8. _____; and
 - 3.8.9. Other information material to the election of the candidate as a member of such body.
- 3.9. Shareholder proposals shall also contain the written consent of the candidate to stand for election to the governing body, and information on whether the candidate is considered independent as defined by the Company charter.
 - 3.10. The Supervisory Board shall review the proposals and make a decision either accepting or rejecting them within five days after the end of the period set forth in Clause 2.2 hereof. The Supervisory Board may not change the proposed wording of the agenda items or the decision thereon.
 - 3.11. Any decision of the Supervisory Board to deny inclusion of the proposed items to the agenda, or to include the proposed candidate into the list of candidates for election to a governing body, shall be sent to the shareholder(s) who submitted the proposal within three days after the decision was made.
 - 3.12. The Supervisory Board is required to include the items proposed by the shareholder(s) to the agenda of the GMS, and include the proposed candidate in the list of candidates for election to a governing body, unless:
 - 3.12.1. The shareholder(s) failed to submit the proposal within the time-frame, as set forth in Clause 3.2 hereof;
 - 3.12.2. The shareholder(s) does not own a sufficient number of voting shares, as set forth in Clause 3.1 hereof;
 - 3.12.3. The proposal does not meet the requirements set forth in Clauses 3.6, 3.7, and 3.8 hereof;
 - 3.12.4. The issue proposed for the agenda does not fall within the scope of authority of the GMS and/or does not meet the requirements of the Law.
 - 3.13. In addition to agenda items proposed by the shareholders, or in the absence of such proposals, or if an insufficient number of candidates have been

¹⁵² See the definition of an affiliated party in the Law on Competition and Restriction of Monopolistic Operations in the Commodity Markets, Article 4.

nominated for election to the governing bodies of the Company, the Supervisory Board shall have the right to include items on the agenda or include candidates into the list of candidates at its own discretion.

- 3.14. The agenda shall include the following items:
 - 3.14.1. Election of the Supervisory Board;
 - 3.14.2. Election of the Revision Commission;
 - 3.14.3. Approval of the External Auditor; and
 - 3.14.4. Approval of the annual report, annual financial statements, including, but not limited to, the profit and loss statement (profit and loss account), as well as distribution of profit, including dividend payments, and losses of the Company based upon the results of the financial year.

Article 4. The Annual General Meeting of Shareholders

- 4.1. While preparing for the AGM, the Supervisory Board shall define:
 - 4.1.1. The form of the GMS (the AGM shall only be held in the form of joint attendance);
 - 4.1.2. The date, place, and time of the AGM, the time for the beginning and end of the registration of shareholders, and the mailing address to which completed voting ballots must be sent;
 - 4.1.3. The record date for the AGM;
 - 4.1.4. The agenda of the AGM;
 - 4.1.5. The procedures for notifying shareholders about the AGM;
 - 4.1.6. The list of information and materials to be made available to shareholders during the preparation for the AGM, and the procedures for providing access to such information;
 - 4.1.7. The form and the text of the voting ballot; and
 - 4.1.8. The class(es) of preferred shares, the owners of which have the right to vote on each agenda item.
- 4.2. The shareholder list shall be drafted based on the data contained in the shareholder register.¹⁵³

¹⁵³ The shareholder register of the company shall be kept by the External Registrar — a stock market professional. Information on the Registrar shall be published in accordance with the Law and by-laws of the company.

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 4.3. Each nominal holder of the Company's shares shall provide the External Registrar of the Company with information regarding persons in whose interests the shares are being held as of the record date.
- 4.4. The power of attorney authorizing such nominal holder or a third party to participate in the GMS may be submitted in advance.
- 4.5. The shareholder list shall include:
 - 4.5.1. Shareholders who are the owners of common shares;
 - 4.5.2. Shareholders who are the owners of preferred shares of a certain class, for which the amount of dividends is fixed by the charter, in cases where the previous AGM made a decision not to pay dividends on preferred shares of that class, regardless of the reason for such decision, or made a decision to pay only a portion of the dividends on preferred shares of that class;
 - 4.5.3. Shareholders who are the owners of preferred shares if the agenda of the AGM includes the reorganization or liquidation of the Company;
 - 4.5.4. Shareholders who are the owners of preferred shares of a certain class, if the agenda of the AGM includes the approval of changes or amendments to the charter (approval of a new version of the charter), restricting the rights of shareholders who are the owners of this particular class of preferred shares, as well as making decisions that, pursuant to the Law, would require changes or amendments to the charter that may restrict the rights of such shareholders; and
 - 4.5.5. Other persons as may be provided for by the Law.
- 4.6. If shares are owned by unit investment trusts, the shareholder list shall include the managing companies of such unit investment trusts.
- 4.7. If shares are managed on behalf of the Company by another entity, the shareholder list shall include the trustees of such entity, unless no trustee voting rights are associated with such shares.
- 4.8. The shareholder list shall include the following information:
 - 4.8.1. The full legal name of the person;
 - 4.8.2. The type, number, date, and place of issue of the personal identification document, the issuing body (number of state registration, name of the registration body, and date of registration);
 - 4.8.3. The place of residence or registration (location);

The Russia Corporate Governance Manual

- 4.8.4. The address to which correspondences may be sent (mailing address); and
- 4.8.5. The number, types, and classes of shares.
- 4.9. The record date shall be set by the Supervisory Board, and shall not be earlier than the date of making the decision to convene the AGM, and not later than 65 days prior to the date set for conducting the AGM.¹⁵⁴
- 4.10. Only persons included in the shareholder list shall have the right to participate in the AGM. Any other person may attend the GMS, subject to the permission of the Chairman of the GMS, but do not have the right to vote.
- 4.11. The shareholder list shall be made available at the Company's location by _____ [*person/body responsible for providing access to the list*] to persons requesting to review the list to determine if they are included in the list and own at least 1% of the votes. The details of the identification documents and the mailing addresses of individuals included in the list shall not be disclosed without their consent.
- 4.12. If shares are transferred after the record date and prior to the date of the GMS, the person transferring the shares and included in the list shall:
- 4.12.1. Issue a proxy to the new owner of the shares; or
- 4.12.2. Vote at the GMS in accordance with the instructions of the new owner.
- 4.13. The aforementioned rule shall apply to all subsequent transfers of the shares.
- 4.14. If the shares so transferred after the record date are transferred to two or more new owners, the person included in the list of shareholders of record shall:
- 4.14.1. Vote at the GMS in accordance with the instructions of each of the new owners; and/or
- 4.14.2. Issue a proxy to each of the new owners, stating in the proxy the number of votes associated with such shares.
- 4.15. In case the instructions of the new owners coincide, their votes may be added up. In case the instructions of the new owners in respect of voting on the same agenda item do not coincide, the person entitled to participate in the meeting shall vote on such an issue in accordance with the instruc-

¹⁵⁴ This period of time is required because the Supervisory Board is elected by cumulative voting (LJSC, Article 51, Clause 1, Paragraph 2).

Annex 19. A Model By-Law for the General Meeting of Shareholders

tions in proportion to the number of votes associated with the shares belonging to each new owner.

- 4.16. If a person entitled to participate in the GMS has issued proxies for shares transferred after the record date, the new owners of such shares shall be registered for and are entitled to receive voting ballots and participate in the GMS.
- 4.17. The Company shall, at the request of any interested person and within three days after the receipt of such request, provide an extract from the shareholder list, containing information about such person, or information that such person was not included in the shareholder list.
- 4.18. Any changes to the shareholder list may only be made in case of a restitution of rights of persons who were not included in the list at the date it was made, or to correct mistakes that have been made therein.
- 4.19. The notice for the AGM shall be made _____ days (and, if the agenda contains items on the reorganization of the Company, _____ days) before conducting the GMS.¹⁵⁵
- 4.20. The notice on the GMS shall be published in the following print media:
 - 4.20.1. “ _____ ”; and
 - 4.20.2. “ _____ ”.
- 4.21. In addition to such publication and pursuant to a decision of the Supervisory Board, the notice on the GMS, together with the voting ballots, may be sent to each of the shareholders included in the shareholder list, or delivered to such persons with confirmation of receipt. Additionally, the Company shall have the right to inform the shareholders of the GMS via other mass media (TV, radio), as well as the internet.
- 4.22. The GMS notice shall contain the following information:
 - 4.22.1. Full name and location of the Company;
 - 4.22.2. Form of the AGM (only joint attendance);
 - 4.22.3. Date, place, and time of the AGM, the time and place set for the registration of shareholders or, in case of an EGM by absentee vote, the final date for acceptance of the completed voting ballots;
 - 4.22.4. Mailing address to which the completed voting ballots must be sent;

¹⁵⁵ According to the LJSC, Article 52, Clause 1, the AGM notice must be made not later than 20 days, and if the agenda of the GMS contains items on the reorganization of the company, not later than 30 days prior to conducting the GMS.

- 4.22.5. Record date;
 - 4.22.6. Agenda; and
 - 4.22.7. Procedures for reviewing the information and materials to be made available in preparation for the AGM, and the address(es) where such information may be obtained.
- 4.23. Shareholders who are included in the list of persons having preemptive rights to purchase additional shares compiled from the data from the shareholder register on the date of the decision on the placement of additional shares, shall be notified of the possibility to exercise such preemptive rights by registered mail, as well as via publication of such information in “_____”.
- 4.24. The information and materials to be made available during the preparation for the GMS to persons entitled to participate in the GMS shall include the following:
- 4.24.1. The annual report and full set of financial statements, including the report of the Revision Commission and External Auditor;
 - 4.24.2. Information about the candidate(s) for election to the Supervisory Board, the Revision Commission, as well as information on the availability of any written consent of the candidates to stand for election to such bodies;
 - 4.24.3. The recommendations of the Supervisory Board on the distribution of profits, including the amount and procedures for payment of dividends on Company shares, and on the distribution of losses of the Company, based on the results of the financial year;
 - 4.24.4. Draft changes and amendments to the charter, or the draft of any new version of the charter, and draft by-laws of the Company; and
 - 4.24.5. Draft decisions of the GMS and other material information.
- 4.25. Additional information or materials to be made available during the preparation for the GMS to persons entitled to participate in the GMS, and the agenda of such GMS, if containing items which may trigger the right to demand redemption of the Company’s shares, shall include the following:
- 4.25.1. The report of an Independent Appraiser on the market price of those shares in which shareholders have a right of redemption;
 - 4.25.2. Calculation of the net asset value of the Company according to the Company’s books for the last complete reporting period;

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 4.25.3. Minutes (or an extract from the minutes) of the Supervisory Board meeting where a decision was made on the redemption price for shares, stating the price at which the shares were to be redeemed;
 - 4.25.4. _____; and
 - 4.25.5. _____.
- 4.26. If the agenda contains items on the reorganization of the Company, the persons entitled to participate in the GMS shall receive the following information and materials:
- 4.26.1. Explanation of the terms and conditions for reorganization in accordance with the decision of an authorized body;
 - 4.26.2. Annual reports and annual accounting statements of all of the companies participating in the reorganization for three completed financial years preceding the date of the GMS, or for each completed financial year as of the moment of the company's formation, if the company has been operating for less than three years;
 - 4.26.3. Quarterly financial statements for all of the companies participating in the reorganization, for the last completed quarter preceding the date of the GMS;
 - 4.26.4. Drafts of the founding documents for all of the companies which will be established as a result of the reorganization; and
 - 4.26.5. A copy of the consolidation (merger) agreement and a copy of the decision on the split-up (spin-off) or transformation.
- 4.27. During the preparation for the GMS, access to the information and materials to be made available to those persons entitled to participate in the GMS shall be given to them at least 20 days prior to the GMS, and if the agenda of the GMS contains items on the reorganization, at least 30 days prior to the GMS.
- 4.28. During the preparation for the GMS, access to the information and materials to be made available to persons entitled to participate in the GMS shall be given to such persons at the office of the General Director, or at another address(es) specified in the notice of the GMS. The said information (materials) shall be made available to persons participating in the GMS during the GMS.
- 4.29. The Company shall, at the request of a person entitled to participate in the GMS, provide copies of the said documents within five days after the

- Company's receipt of the request. The fees charged for providing copies of the documents may not exceed the actual copy costs.
- 4.30. Voting on the items of the agenda shall be done using voting ballots.
 - 4.31. The voting ballot shall be sent or delivered with confirmation of receipt to each person entitled to participate in the GMS, at least 20 days before the GMS.
 - 4.32. The voting ballot shall contain the following information:
 - 4.32.1. Full name and location of the Company;
 - 4.32.2. Form of the GMS (only joint attendance in case of the AGM);
 - 4.32.3. Date, place, and time of the AGM, and mailing address to which the completed voting ballots must be sent;
 - 4.32.4. Wording of decisions on each issue (or the name of each candidate), the voting on which shall be made using such voting ballot;
 - 4.32.5. Voting options ("for," "against," or "abstain") on each item of the agenda;
 - 4.32.6. In the case of cumulative voting, a relevant note and an explanation of the nature of cumulative voting;
 - 4.32.7. If the ballot is to be used for cumulative voting to elect members of the Company's Supervisory Board, the voting options on this issue ("against," or "abstain") shall be provided once for each of the candidates. Such voting ballots shall have a space opposite the name of each candidate for entering the number of votes cast for such candidate;
 - 4.32.8. In case of cumulative voting, an instruction that a fractional vote may only be cast for one candidate;
 - 4.32.9. If voting in accordance with the instructions of persons who acquired the shares after the record date, or in accordance with the instructions of the depository security holders, the voting ballot shall have a space to complete the number of votes cast for each voting option, and contain an explanatory note that the votes were cast under the instructions of the new owners of the shares or depository receipt holders, and any other information required under applicable law; and
 - 4.32.10. A note that the voting ballot must be signed by the shareholder.
 - 4.33. If voting is by proxy, with the completed voting ballot to be sent to the Company's address, the ballot shall be accompanied by the power of attorney pursuant to which the holder thereof is acting on behalf of the shareholder.
 - 4.34. A shareholder who intends to personally attend the GMS or have his representative attend the GMS shall have with him (or ensure that his/her repre-

Annex 19. A Model By-Law for the General Meeting of Shareholders

- sentative has) the voting ballot received from the Company. If the voting at the GMS may be held by submission of completed voting ballots, the completed voting ballots sent to the mailing address of the Company, as set forth in the uniform state register of legal entities, or to the address set forth in the Company's charter, shall be deemed sent to a proper mailing address, regardless of whether or not such address was specified in the GMS notice.
- 4.35. If the voting at the AGM will be held in the form of joint attendance and may be effected by completed voting ballots sent to the Company, the voting ballots issued at the request of persons being registered for participation in the AGM and whose voting ballots were not received by the Company at least two days before the date of the Meeting, must be marked as ballot duplicates.
- 4.36. The issue of invalidating the voting ballots shall be regulated by the Law.

Article 5. The Calling of and Preparing for the Extraordinary General Meeting of Shareholders

- 5.1. Any GMS, other than the AGM, shall be an EGM.
- 5.2. An EGM may be held in the form of joint attendance of shareholders for discussing the agenda items and making decisions on issues put to vote with the circulation (delivery) of the voting ballots in advance of such GMS, or by absentee vote (without joint attendance of shareholders for the discussion of agenda items and making decisions on issues put to vote).
- 5.3. An EGM shall be called by the Supervisory Board on its own initiative or if required by law. It may also be called pursuant to the request of those persons specified in Clause 5.4. hereof. If the Supervisory Board fails to call the EGM at the request of such persons, or refuses to call such EGM, the EGM may be called by the persons requesting such EMS, in which case such persons shall have all the necessary authority to call and conduct the EGM.
- 5.4. The following persons shall have the right to request an EGM:
- 5.4.1. Shareholder(s) owning at least 10% of voting shares;
 - 5.4.2. The Revision Commission; or
 - 5.4.3. The External Auditor of the Company.
- 5.5. The number of voting shares owned by the shareholder(s) proposing an issue for inclusion on the agenda of the EGM shall be determined as of or on the date of such a request.

The Russia Corporate Governance Manual

- 5.6. The request for conducting an EGM shall contain the wording of the agenda items. The text of the request may also contain the wording of decisions on each of the proposed agenda items, as well as the proposed form of the GMS. If the request contains a nomination proposal, the provisions of Article 3 hereof shall apply.
- 5.7. If a shareholder requests the calling of an EGM, such request shall state the name(s) of the shareholder(s) requesting the EGM, and the number, type, and class of shares owned.
- 5.8. The request for calling an EGM shall be signed by the person(s) requesting the EGM. If the request for conducting an EGM is signed by a representative of the shareholder, such request shall be accompanied by a duly certified copy of a proxy containing the information required by applicable laws.
- 5.9. The Supervisory Board shall not have the right to make changes to the wording of the agenda items and decisions thereon, or change the proposed form of the EGM if called at the request of the Revision Commission, the External Auditor or shareholder(s) owning at least 10% of voting shares. The Supervisory Board shall not have the right to refuse to convene an EGM for any reason other than those specified in the By-law and law.
- 5.10. An EGM called at the request of the Revision Commission, the External Auditor, or shareholder(s) owning at least 10% of the voting shares shall be held within 40 days after the request is submitted.
- 5.11. An EGM, the agenda of which contains items on the election of Supervisory Board members, shall be held within 70 days of submitting the request.
- 5.12. Unless otherwise provided for by law, or dictated by the specific circumstances of the EGM, the procedures for calling and preparing for an EGM shall be regulated by the provisions of Articles 3 and 4 hereof.

Article 6. The General Meeting of Shareholders Conducted in the Form of Joint Attendance

- 6.1. Only persons included in the shareholder list, the persons to whom the rights of said persons were transferred pursuant to inheritance rights as estate or because of reorganization, or their representatives acting under proxy or the Law can participate in the GMS.
- 6.2. The registration of persons entitled to participate in the GMS shall be made on the day of the GMS. The registration shall begin at least ____ hour(s) before the GMS.

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 6.3. Registration of persons participating in the GMS shall be made at the same address as the location for conducting the GMS.
- 6.4. Only persons included in the shareholder list may be registered for participation in the GMS upon presentation of their personal identification documents. Persons entitled to participate in the GMS whose voting ballots were received by the Company at least two days prior to the GMS (if voting on the agenda items can be effected by sending the completed voting ballots to the Company) do not need to be registered.
- 6.5. Registration of persons entitled to participate in the GMS shall be made subject to verification of their identity by means of comparing the data in the shareholder list with the data in the documents presented (submitted) by the said persons.
- 6.6. In the course of registration of persons entitled to participate in or attend the GMS, the Counting Commission shall keep the registration log.
- 6.7. The functions of the Counting Commission shall be performed by the External Registrar of the Company.
- 6.8. Shareholders (or their representatives) who have registered for participation in the GMS, and the shareholders (or their representatives) whose voting ballots were received by the Company at least two days prior to the GMS, shall be deemed to have participated in the GMS.
- 6.9. The following persons shall be entitled to attend the GMS:
 - 6.9.1. Persons included in the shareholder list and their authorized representatives;
 - 6.9.2. Executive Board members, the General Director, and the External Manager;
 - 6.9.3. Supervisory Board members;
 - 6.9.4. Members of the Revision Commission, the Counting Commission, and the External Auditor;
 - 6.9.5. Candidates for election to the governing bodies named in the voting ballots;
 - 6.9.6. _____; and
 - 6.9.7. Persons invited by the Chairman of the Supervisory Board or the General Director.¹⁵⁶

¹⁵⁶ Notably the company's stakeholders, for example, bondholders, company employees, or government officials.

The Russia Corporate Governance Manual

- 6.10. Persons listed in sections 6.9.6 and 6.9.7 shall be admitted to the GMS only with the permission of the Chairman of the GMS.
- 6.11. A shareholder shall have a right to replace his representative or participate in the GMS in person, subject to a written notice to the Counting Commission or the Company by revocation (or otherwise replacing) of such representative's proxy before the beginning of the GMS.
- 6.12. The registration of persons entitled to participate in the GMS shall not end before the GMS completes the discussion of the last item on the agenda for which a quorum is required.
- 6.13. The GMS shall be deemed valid (to have a quorum) provided the shareholders who aggregately own more than 50% of voting shares participate in such GMS.
- 6.14. If there is an insufficient quorum at the beginning of the GMS with respect to all agenda items, the opening of the GMS shall be postponed for ____ hours. No further postponements are allowed.¹⁵⁷
- 6.15. If the agenda of the GMS includes items to be voted on by different groups of shareholders, the quorum in respect of such agenda items shall be established separately prior to the beginning of discussions of each such item.
- 6.16. If a quorum does not exist for any AGM, such AGM shall be rescheduled with the same agenda. In case there is no quorum for an EGM, the EGM may be rescheduled with the same agenda.
- 6.17. The decision regarding the date for conducting the rescheduled GMS shall be made by the body or person who made the original decision on conducting the GMS.
- 6.18. The GMS shall be held at the location of the company, or another location easily accessible to the majority of shareholders in the territory of the Russian Federation, as determined by the Supervisory Board of the Company.¹⁵⁸
- 6.19. The GMS may not be held at nighttime.
- 6.20. If it is not possible to conduct the GMS within one day, the Chairman of the GMS shall adjourn the Meeting until the morning of the next day.
- 6.21. The Chairman of the GMS shall conduct the GMS in accordance with the agenda, determine the order of reports and presentations, and sign the minutes of the GMS.

¹⁵⁷ The GMS may be postponed for a maximum of two hours.

¹⁵⁸ FCSM Resolution No. 17/ps, Section 2.9 allows companies to specify the location of the GMS in the charter or the by-law for the GMS.

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 6.22. The Chairman of the Supervisory Board shall be the Chairman of the GMS, and in his absence, the GMS shall be chaired by one of the Supervisory Board members appointed by the Supervisory Board.¹⁵⁹
- 6.23. In case of the Supervisory Board's refusal to call and conduct an EGM, the persons who called the EGM shall have the right to appoint the Chairman of the EGM.
- 6.24. At the beginning of the GMS, the Head of the Counting Commission shall announce the results of the registration of persons participating in the GMS, the existence of a quorum for the GMS, and explain the voting procedures for the individual agenda items.
- 6.25. At the beginning of the GMS, its Chairman shall read the list of Supervisory Board members and members of the executive bodies present at the GMS, explain the procedures for participating in discussions and for making presentations, asking questions, and providing answers, and other material procedural details of conducting the GMS.
- 6.26. The Chairman of the GMS shall inform shareholders whether members of the current Supervisory Board and the candidates to the Supervisory Board meet independence criteria as set forth by the charter.
- 6.27. The GMS shall work continuously. Every ____ hours the Chairman of the GMS shall announce a break for not more than ____ minutes.
- 6.28. Every speaker on each separate issue put forth for voting shall be given ____ minutes [*sufficient time to present information necessary for making decisions on the issue*].
- 6.29. Every participant of the GMS shall be given _____ minutes to express his opinion on the agenda items to be voted upon.
- 6.30. The Chairman of the GMS shall ensure efficient discussion on agenda items, and prevent discussion of issues that are not to be voted on.
- 6.31. After completing the discussion of the last agenda item, the Chairman of the GMS shall explain the procedures for notifying shareholders about the decisions made and the voting results.
- 6.32. Voting at the GMS shall be made in accordance with the principle of one share — one vote, except for cumulative voting.
- 6.33. The persons who are officially registered for participation in the GMS shall have the right to vote on all agenda items from the moment the GMS is

¹⁵⁹ LJSC, Article 67, Clause 2 provides that other persons may act as the Chairman of the GMS if so provided under the charter.

opened until the moment it is officially adjourned, and if the voting results and decisions of the GMS are to be announced at the GMS, from the time the GMS is opened until the counting of votes cast on the agenda items begins. However, this rule does not apply to voting on procedural issues. After the completion of discussion of the last agenda item (the last item for which a quorum exists) and until the GMS is adjourned (beginning of counting of the votes), the persons who did not cast their votes until that moment shall be given time to cast their votes.

- 6.34. Only one voting option must be marked for each agenda item on the voting ballots. Those voting ballots completed in violation of this rule shall be considered null and void as to such agenda items.
- 6.35. Voting ballots considered void in respect of voting on one or several agenda items shall not be invalidated as a whole.
- 6.36. Unless otherwise provided for by the Law or mandated by the specific circumstances of conducting the EGM, the procedures for calling, preparing the EGM shall be regulated by provisions of Articles 5 and 6 hereof.

Article 7. The General Meeting of Shareholders Conducted in the Form of Absentee Voting

- 7.1. The GMS' decisions may be made without conducting a Meeting (joint attendance of shareholders for discussing items on the agenda and making decisions on such items) by means of absentee voting.
- 7.2. The Company shall have the right to conduct the GMS in the form of absentee voting on all items of the agenda with the exception of:
 - 7.2.1. Determining the number of Supervisory Board members, and/or electing and dismissing the Supervisory Board;
 - 7.2.2. Electing and dismissing Revision Commission members;
 - 7.2.3. Approving the External Auditor;
 - 7.2.4. Approving annual reports, annual financial statements, including, but not limited to, the profit and loss statement, as well as profit distribution (including declaration and payment of dividends, except for profits distributed as dividends upon the results of the first, second and third quarters of the fiscal year) and losses upon fiscal year results; and
 - 7.2.5. Paying (declaring) dividends upon the results of the first, second, and third quarters of the fiscal year.

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 7.3. The AGM, including any rescheduled AGM, may not be held in the form of absentee voting.
- 7.4. Shareholders whose completed voting ballots were received by the Company prior to the final date of acceptance of the voting ballots shall be deemed participants in the GMS.

Article 8. Procedures for Making Decisions and Keeping Documents

- 8.1. Decisions on the following agenda items of the GMS shall be made by a $\frac{3}{4}$ -majority vote of shareholders participating in the GMS:
 - 8.1.1. Making changes and amendments to the charter and approving a new version of the charter;
 - 8.1.2. Reorganizing the Company;
 - 8.1.3. Liquidating the Company and appointing the Liquidation Commission;
 - 8.1.4. Approving the interim and final liquidation balance sheets;
 - 8.1.5. Determining the number, nominal value, type of authorized shares, and the rights attached to such shares;
 - 8.1.6. Approving extraordinary transactions, as set forth by the Law;
 - 8.1.7. Purchasing by the Company of its shares;
 - 8.1.8. Placing additional shares through closed subscription;¹⁶⁰
 - 8.1.9. Placing convertible securities through closed subscription;¹⁶¹
 - 8.1.10. Placing additional shares if the number of shares offered exceeds 25% of common shares of the Company;¹⁶² and
 - 8.1.11. Placing convertible securities, if the number of securities offered exceeds 25% of common shares of the Company.¹⁶³

¹⁶⁰ LJSC, Article 39, Clause 3 provides that a greater number of votes may be required for making such decisions under the charter.

¹⁶¹ LJSC, Article 39, Clause 3 provides that a greater number of votes may be required for making such decisions under the charter.

¹⁶² LJSC, Article 39, Clause 4, Paragraph 1 provides that a greater number of votes may be required for making such decisions under the charter.

¹⁶³ LJSC, Article 39, Clause 4, Paragraph 2 provides that a greater number of votes may be required for making such decisions under the charter.

- 8.2. A decision on making changes and amendments to the Company's charter that may restrict the rights of preferred shareholders shall be deemed made when such decision was voted on by:
 - 8.2.1. Not less than a $\frac{3}{4}$ -majority vote of shareholders with voting rights participating in the GMS, with the exception of the votes of those preferred shareholders whose rights were to be restricted; and
 - 8.2.2. Not less than a $\frac{3}{4}$ -majority vote of all preferred shareholders of each type, the rights of which were to be restricted.
- 8.3. All other decisions of the GMS shall be made by a simple majority vote of holders of the voting shares participating in the GMS.
- 8.4. The minutes of the GMS and Counting Commission, as well as the report on the voting results, shall be prepared after the GMS.
- 8.5. The Counting Commission shall summarize the results of the voting and draft the minutes on the results within 15 days after the closing of the GMS or the final date for acceptance of the voting ballots in respect of the GMS held in the form of absentee voting. The Counting Commission minutes on the voting results shall be signed by the persons duly authorized by the External Registrar.
- 8.6. The minutes of the Counting Commission on the results of voting at the GMS shall contain the following information:
 - 8.6.1. Full legal name and address of the Company;
 - 8.6.2. Type of the GMS (AGM or EGM) and the form in which it was held;
 - 8.6.3. Date, location, and time of the GMS, and the postal address to which the completed ballots were sent, or, in the case of a GMS held in the form of absentee voting, the final date for acceptance of the voting ballots and the postal address to which the completed ballots were sent;
 - 8.6.4. Total number of votes belonging to holders of voting shares of the Company; in cases when different groups of shareholders voted on different items on the agenda — the number of votes in respect of each item on the agenda with a breakdown by types of shares and other criteria material for making decisions;
 - 8.6.5. Agenda of the GMS;
 - 8.6.6. Time of the beginning and end of registration of those persons entitled to participate in the GMS held in the form of joint atten-

Annex 19. A Model By-Law for the General Meeting of Shareholders

- dance, the time of opening and time of adjourning the GMS held in the form of joint attendance, and if the decisions of the GMS and the voting results thereon were announced at the GMS, the time when the counting of the votes began;
- 8.6.7. Total number of votes held by persons included in the shareholder list with respect to every agenda item;
 - 8.6.8. Number of votes belonging to the persons who actually participated in the GMS in respect to every agenda item, and information regarding the existence of a quorum for each item;
 - 8.6.9. Number of votes cast in each category of voting options, i.e. “for,” “against,” or “abstain” as to every item on the agenda for which a quorum was present;
 - 8.6.10. Number of votes cast for each agenda item of the GMS that were not counted by reason of declaring the ballots invalid (including the voting on relevant items);
 - 8.6.11. Full company name and address of the External Registrar, and the names of persons authorized by the Registrar who performed the functions of the Counting Commission; and
 - 8.6.12. Date of the Counting Commission minutes on the results of voting at the GMS.
- 8.7. The minutes of the GMS shall be prepared in duplicate by the secretary of the GMS within 15 days after its adjournment. Both copies shall be signed by the Chairman and the secretary of the GMS. The minutes on the voting results and the report on the voting results prepared by the Counting Commission shall be attached to the GMS minutes.
- 8.8. The GMS minutes shall contain the following information:
- 8.8.1. Full legal name and address of the Company;
 - 8.8.2. Type of GMS (AGM or EGM);
 - 8.8.3. Form of the GMS (joint attendance or absentee voting);
 - 8.8.4. Date and time of the GMS;
 - 8.8.5. Location of the GMS held in the form of joint attendance (address at which the GMS was held);
 - 8.8.6. Agenda of the GMS;
 - 8.8.7. Time of beginning and ending the registration of persons entitled to participate in the GMS held in the form of joint attendance;

- 8.8.8. Time of opening and time of adjournment of the GMS held in the form of joint attendance, and if the decisions of the GMS and the voting results were announced at the GMS, the time when the counting of the votes began;
 - 8.8.9. Postal address(es) to which the completed voting ballots were sent for the GMS held in the form of absentee voting, as well as for the GMS held in the form of joint attendance if voting on agenda items could also be made by mailing the completed voting ballots to the Company;
 - 8.8.10. Total number of votes belonging to persons included in the shareholder list as to every agenda item;
 - 8.8.11. Number of votes belonging to persons who actually participated in the GMS as to every agenda item and information regarding whether a quorum was present or absent for such items;
 - 8.8.12. Number of votes cast in each voting option (“for,” “against,” or “abstain”) on every agenda item for which a quorum was present;
 - 8.8.13. Wording of decisions made by the GMS on every item on the agenda;
 - 8.8.14. Summary of the discussions and the names of the speakers for every item on the agenda of the GMS held in the form of joint attendance;
 - 8.8.15. Names of the Chairman and Secretary of the GMS; and
 - 8.8.16. Date of the GMS minutes.
- 8.9. The wording of each decision in the GMS minutes must not differ from the wording of such decisions in the voting ballot.
 - 8.10. After the GMS minutes are signed, the voting ballots shall be sealed by the Counting Commission and kept in the archives of the Company.
 - 8.11. The report on results of the voting at the GMS shall contain the following information:
 - 8.11.1. Full company name and address of the Company;
 - 8.11.2. Type of the GMS (AGM or EGM);
 - 8.11.3. Form of the GMS (joint attendance or absentee voting);
 - 8.11.4. Date of the GMS;
 - 8.11.5. Location of the GMS held in the form of joint attendance (address at which the GMS was held);
 - 8.11.6. Agenda of the GMS;

Annex 19. A Model By-Law for the General Meeting of Shareholders

- 8.11.7. Total number of votes belonging to persons included in the shareholder list for every agenda item;
 - 8.11.8. Number of votes belonging to the persons who actually participated in the GMS for every agenda item, and information regarding whether a quorum was present for such items;
 - 8.11.9. Number of votes cast for each voting option (“for,” “against” or “abstain”) on every agenda item for which a quorum was present;
 - 8.11.10. Wording of decisions made by the meeting on every agenda item;
 - 8.11.11. Full company name and address of the External Registrar and the names of persons authorized by the Registrar; and
 - 8.11.12. Names of the Chairman and the secretary of the GMS.
- 8.12. The report on results of the voting at the GMS shall be signed by the Chairman and Secretary of the GMS.
- 8.13. If the agenda of the GMS includes items regarding the approval of related party transactions by the Company, the GMS minutes, the Counting Commission minutes, and the report on the voting results shall contain the following information as to such items:
- 8.13.1. Number of votes belonging to persons included in the shareholder list who are not interested parties in such transactions;
 - 8.13.2. Number of votes belonging to persons who are not interested parties in such transactions, and who actually participated in the GMS; and
 - 8.13.3. Number of votes cast for every voting option (“for,” “against,” or “abstain”).
- 8.14. If the agenda of the GMS includes items regarding the approval of changes or amendments to the charter (approval of the new version of the charter) which restrict the rights of the holders of a certain class of preferred shares, or on making a decision which under the Law may require amendments to the charter that may restrict the rights of holders of such class of preferred shares, the GMS minutes, the Counting Commission minutes, and the report on the voting results shall contain the following information regarding such items:
- 8.14.1. Number of votes belonging to persons included in the shareholder list excluding votes associated with the preferred shares, the rights of which may be restricted;

The Russia Corporate Governance Manual

- 8.14.2. Number of votes associated with the preferred shares of each class in which the rights may be restricted;
 - 8.14.3. Number of votes of shareholders who participated in the GMS, excluding votes of those preferred shareholders whose rights are being restricted, and separately the number of votes of such preferred shareholders; and
 - 8.14.4. Number of votes cast for every voting option (“for,” “against,” or “abstain”), excluding the votes of those preferred shareholders whose rights are being restricted, and separately the number of votes of such preferred shareholders cast in respect of such item for every voting option (“for,” “against,” or “abstain”).
- 8.15. Decisions of the GMS and the results of voting shall be announced at the GMS at which the voting was made, or communicated to persons included in the shareholder list within ten days after the date of the minutes on the voting results, in the form of a report on voting results, and sent by registered mail to the address of each shareholder of record, as well as published in “_____”.



Annex 20

A MODEL BY-LAW ON DIVIDENDS

APPROVED

By decision of the Supervisory Board
of the Open Joint-Stock Company

«_____»

Minutes No. _____

of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __day of _____, 200_

[The Company's Seal]



BY-LAW ON DIVIDENDS

of the Open Joint Stock Company

«_____»

The city of _____,
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	230
ARTICLE 2.	DECLARING DIVIDENDS.....	231
ARTICLE 3.	SOURCES FOR AND THE AMOUNT OF DIVIDENDS.....	232
ARTICLE 4.	PERSONS ENTITLED TO RECEIVE DIVIDENDS	232
ARTICLE 5.	PAYING DECLARED DIVIDENDS.....	233

Article 1. General Provisions

- 1.1. This By-law on Dividend Policy (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed in accordance with applicable provisions of the laws of the Russian Federation (hereinafter the Law), the Company charter, and other internal documents, as well as the recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall define the Company's policy and procedures regarding matters of calculating, declaring, setting the amount of, determining the form and the time periods for the payment of dividends.
- 1.3. The Company sets forth to declare and pay dividends based on its _____ results.¹⁶⁴
- 1.4. The Company sets forth to utilize ___% of its net profits as dividends, which will permit the company to retain sufficient capital to provide for future growth.
- 1.5. The Company seeks to provide for a stable and dependable dividend policy on a year-by-year basis, and sets forth to communicate any deviation.
- 1.6. The Company sets forth to pay its dividends in cash.

¹⁶⁴ The company may choose to have a policy of annual and/or interim dividends, which can be paid on a quarterly or semi-annual basis, and annual dividends that are paid annually.

Article 2. Declaring Dividends

- 2.1. The decision to declare and pay dividends, including the decision as to the amount and the procedure for making such payment regarding shares of each type and class, shall be made by the General Meeting of Shareholders (hereinafter GMS) upon the recommendation of the Supervisory Board.
- 2.2. The decision on whether to declare and pay dividends shall be a separate agenda item at the GMS.
- 2.3. The decision as to the amount of dividends and the procedure for their payment, shall be made by the Supervisory Board at a meeting where the preliminary distribution of the Company's net profit for the fiscal year is approved by directors, and recommended to the GMS.
- 2.4. Any declaration to pay dividends must provide the following:
 - 2.4.1. The type and class of shares on which the dividends have been declared;
 - 2.4.2. The amount of dividends per share of each type and class;
 - 2.4.3. The period for payment; and
 - 2.4.4. The form of payment.
- 2.5. The decision to declare dividends on common shares may be made only after a decision has been made to declare dividends on all classes of preferred shares and in the full amount as determined in the charter.
- 2.6. If the Company has several classes of outstanding preferred shares, then, regardless of the source of payment as set forth in Clauses 3.1 and 3.2 hereof, the decision to declare dividends on preferred shares shall be made in the order of priority set forth in the charter.
- 2.7. The Company must declare dividends on preferred shares in their order of priority set by the charter.
- 2.8. The Company does not have the right to declare dividends:
 - 2.8.1. Until the entire charter capital of the Company has been fully paid;
 - 2.8.2. Until a redemption of all those shares which must be redeemed pursuant to Article 76 of the Law on Joint Stock Companies has occurred;
 - 2.8.3. If, as of the date of such decision, the Company is insolvent or bankrupt pursuant to the provisions of the insolvency (bankruptcy) laws, or if, as a result of paying dividends, the Company would be rendered insolvent or bankrupt;

- 2.8.4. If, as of the date of such decision, the net asset value of the Company is less than its charter capital, reserve fund, and the excess of the liquidation value over the nominal value of the outstanding preferred shares as set forth in the charter, or if the net asset value will be less than such amount as a result of such decision; and
- 2.8.5. In any other case set forth by the Law.

Article 3. Sources for and the Amount of Dividends

- 3.1. Dividends shall be paid out of the Company's net profit, and shall be allocated among shareholders on a pro rata basis according to the number of shares of each type and class each shareholder owns.
- 3.2. Dividends on preferred shares may be paid out of the Company's funds specifically designated for this purpose.
- 3.3. The amount of dividends on common shares is determined upon recommendation of the Supervisory Board as provided in the By-law and may not exceed the amount so recommended.
- 3.4. The amount of dividends on one common share shall be equal to the total amount of dividends to be paid divided by the total number of the Company's common shares on which dividends may be payable pursuant to the Law.
- 3.5. The amount of dividends on preferred shares is determined pursuant to the Law and the Company charter.
- 3.6. The amount of dividends for one preferred share of a particular class shall be equal to the total amount of dividends divided by the total number of the preferred shares of this class on which dividends are paid.
- 3.7. Dividends shall be declared gross of the taxes payable by shareholders.

Article 4. Persons Entitled to Receive Dividends

- 4.1. The list of persons entitled to receive dividends shall be prepared by the Company's External Registrar according to the instructions of the Company.
- 4.2. The list of persons entitled to receive dividends shall be prepared as of the record date on which the list of persons entitled to participate in the GMS at which the decision to declare dividends is to be considered.
- 4.3. Such list shall include registered shareholders (except nominal shareholders), and the persons on behalf of whom the nominal holder owns the shares as of the record date.

Annex 20. A Model By-Law on Dividends

- 4.4. For the preparation of the list of persons entitled to receive dividends, nominal shareholders shall provide information on the persons for whom they hold shares.
- 4.5. Shares of the Company which underlie derivative securities and depositary receipts grant their holders the right to receive dividends in full as provided by the decision to issue those shares and the Company's charter.

Article 5. Paying Declared Dividends

- 5.1. The date on which annual dividends are paid shall be determined by the Company charter.¹⁶⁵
- 5.2. The Company shall continue making payments of declared dividends as to those shares for which the owners have not received the accrued dividends, or for which they have not claimed the dividends within the period defined pursuant to Clause 5.1 hereof.
- 5.3. No interest shall accrue on unclaimed dividends.
- 5.4. The Company is responsible for paying all declared dividends. Accordingly, the Company shall be liable to its shareholders for the failure to discharge this duty, pursuant to the Law.
- 5.5. The preparation, coordination, and all arrangements required from the Company in connection with the payment of dividends set forth herein shall be the responsibility of a department of the Company, _____, the functions of which include relations with shareholders.
- 5.6. The Company shall notify its shareholders of the time, form, place, and procedure for the payment of dividends by publication of such information in the print media specified in the Company charter for notification of shareholders of the GMS and/or by distribution of notices by mail to the addresses set forth in the shareholder register.
- 5.7. Any shareholder may submit a request to the Company to be included in the list of persons entitled to receive dividends and information regarding the procedure for the calculation of dividends, the procedure for taxation, and payment terms.

¹⁶⁵ If the company charter does not establish the date for the payment of dividends, then payment shall be made no later than 60 days following the date of the decision to pay annual dividends.

- 5.8. The Company shall provide the shareholder with a response to such request within ____ days after reception.
- 5.9. For the purposes of organizing and completing the payment of dividends, the Company shall have the right to engage an outside entity, a “Payment Agent,” on a contractual basis. However, such arrangement shall not release the Company from liability to shareholders for the payment of dividends.
- 5.10. The Company is obligated to inform shareholders of its use of a Payment Agent, including their replacement, if any, and the expiration of the term of their authority by way of publication of such information in the print media established in the Company charter for notification of shareholders of the GMS and/or by distribution of notices by mail to the addresses set forth in the list of persons entitled to receive dividends.
- 5.11. The Company shall be a tax agent for the purposes of payment of income to the shareholders for the shares owned by them. The Company shall perform the necessary calculations and deduct taxes on dividends in accordance with the procedures and within the period required by the Law.
- 5.12. The Company does not have the right to pay declared dividends on shares in the following cases:
 - 5.12.1. If, on the date of the decision, the Company is insolvent or bankrupt pursuant to the provisions of the insolvency or bankruptcy laws, or if, as a result of paying dividends, the Company would be rendered insolvent or bankrupt;
 - 5.12.2. If, as of the date of payment, the net asset value of the Company is less than its charter capital, reserve fund, and the excess of the liquidation value over the nominal value of the outstanding preferred shares as set forth in the charter, or if the net asset value will be less than such amount as a result of such decision; and
 - 5.12.3. In any other cases set forth by the Law.
- 5.13. Upon termination of those circumstances set forth in Clause 5.12 hereof which precluded the payment of dividends, the Company shall, within a reasonable period of time and according to the Law, pay to shareholders the dividends so declared.
- 5.14. Any matters relating to the payment of dividends and not governed by the Law, the Company’s charter, and the By-law, shall be resolved in a manner which takes into consideration and complies with the rights and legitimate shareholder interests.



Annex 21
**A MODEL NOTICE
 OF THE GENERAL MEETING OF SHAREHOLDERS**

**NOTICE OF THE GENERAL MEETING
 OF SHAREHOLDERS**

of the

Open Joint Stock Company

« _____ »

_____ [Enter address]

Dear Shareholder!

The Open Joint Stock Company « _____ » hereby notifies you that the General Meeting of Shareholders (hereinafter GMS) will be held with joint participation of shareholders on _____, 200_ , at __:__ local time at the following address: _____ [city, street (if applicable) location of holding the GMS].¹⁶⁶

The registration of shareholders shall start at __:__ local time on the day of the GMS at the address indicated above.¹⁶⁷

¹⁶⁶ An AGM should be held at a location and time that facilitates shareholder participation, and does not impose an undue hardship or expense upon them. Ideally, the AGM should be held where the company is located.

¹⁶⁷ The time of the beginning of the GMS minus the required minimum time for the registration as set forth by the charter or by-laws of the company. The Federal Commission for the Securities Market's Code of Corporate Conduct, Chapter 2, Section 2.2.3 recommends that the time set should allow sufficient time for registering all shareholders.



The Russia Corporate Governance Manual

The Agenda

1. _____
2. _____
3. _____

The list of persons entitled to participate in the GMS has been compiled on the basis of the data contained in the Company's shareholder register on _____, 200_.

Shareholders of record shall have access to the information and materials for the GMS from _____ to _____ [*date*] on weekdays, from 09.00 until 18.00 local time without interruption, at the following address: _____ [*address of the location of the executive body, including office number and the telephone number for inquiries*] or at the following address or addresses _____] [*if applicable*], as well as on the Company's website www._____.ru .

A shareholder (or shareholder's representative) has the right to vote on the agenda items indicated above by means of sending their completed voting ballots by registered mail to the attention of _____ [*name of office or person authorized to receive the voting ballots*] at the following address: _____ [*address*]. The deadline for the receipt of the voting ballots is _____, 200_ [*date*].

For additional information, please contact: _____ [*name of office or authorized person (Corporate Secretary)*] at _____ [*contact details*] .

Contact tel.: _____



Annex 22

A MODEL POWER OF ATTORNEY FOR AN INDIVIDUAL

MODEL POWER OF ATTORNEY

The city of _____ Date [*in words*]

With this Power of Attorney I, _____ [*full legal name*],
passport number _____, issued on _____
_____ «___» _____ 200__ by _____ [*issuing authority*], resid-
ing at [*full legal address*]: _____, owner of _____
[*number in words*] common shares of the Open Joint Stock Company «_____»
_____», state registration № _____, each having a nominal value of RUR _____,

hereby appoint _____ [*full legal name*], passport number _____
_____, issued on _____ «___» _____
_____ 200__ by _____ [*issuing authority*], residing at _____
_____ [*full legal address*],

as my Proxy for the next General Meeting of Shareholders (hereinafter the GMS)
to be held after the date of this Power of Attorney. My Proxy shall have the
power and authority to represent my interests and act on my behalf at said GMS,
including the power and authority to:¹⁶⁸

1. Participate in discussions of the agenda items;
2. Receive information and materials made available to shareholders of record;
3. Make statements and submit proposals to the governing bodies of the Company and the working bodies of the GMS;

¹⁶⁸ A power of attorney may also include detailed instructions regarding how to vote on each agenda item.



The Russia Corporate Governance Manual

4. Receive from _____ [*name of the authorized person of the company*] all documents relevant to conducting said GMS;
5. Vote all shares owned by me as to all issues on the agenda; and
6. Take any other actions that may be appropriate and consistent with representing my interests pursuant to the terms and conditions of this Power of Attorney.

This Power of Attorney is not transferable, and is being issued for a term of _____ months.

_____ (*Signature of the Principal*)

Verified by: _____ (*name of the notary*)

[Notary [city of] _____]¹⁶⁹

¹⁶⁹ LSJC, Article 57, Clause 1, Paragraph 3 provides that a power of attorney shall be verified, either in accordance with the requirements of the Civil Code, Article 185, Clauses 4 and 5, or notarized. Although the provisions of the Civil Code do not directly refer to using a power of attorney for voting purposes, its rules are also applicable to such documents. In particular, in addition to notarization, the power of attorney can be verified:

- In the organization where the principal works or studies;
- By the municipal authorities where the principal resides; and
- By the administration of the medical institution where the principal is located.



Annex 23

A MODEL POWER OF ATTORNEY FOR A LEGAL ENTITY

MODEL POWER OF ATTORNEY

The city of _____ Date [*in words*]

With this Power of Attorney I, _____ [full legal name], the General Director of of the Open Joint Stock Company «_____» (hereinafter the «Grantor»),¹⁷⁰ acting under the Charter and on behalf of the Grantor, owning _____ [*number in words*] common shares, state registration № _____, each having the nominal value of RUR _____,

hereby appoint _____ [full legal name], passport number _____, issued on _____ «____» _____200__ by _____ [*issuing authority*], residing at _____ [full legal address],

as Proxy with the power and authority to represent the interests of the Grantor at the next General Shareholders Meeting (hereinafter the GMS) of the Open Joint Stock Company “_____,” to be held after the date of execution of this Power of Attorney, including the power to:¹⁷¹

1. Participate in discussions regarding all of the agenda items;
2. Receive information and materials made available to shareholders of record;

¹⁷⁰ During the GMS, the representatives are frequently required to submit documents to verify their membership in the governing body of the company that has issued the power of attorney. However, in those cases when the person who signed the power of attorney is registered in the shareholders register, such requirement is illegal (see Resolution No. F09-126/02-GK, the Federal Court of Appeals of Urals District, 13 February 2002).

¹⁷¹ A power of attorney may also include detailed instructions regarding how to vote on each issue of the agenda.



3. Make statements and submit proposals to the governing bodies of the Company and the working bodies of the GMS;
4. Receive from _____ [*name of the authorized person of the company*] all documents relevant to conducting said GMS;
5. Vote all shares owned by the Grantor as to all issues on the agenda; and
6. Take any other actions as may be appropriate and consistent with representing the interests of the Grantor pursuant to the terms and conditions of this Power of Attorney.

This Power of Attorney is not transferable, and is being issued for the term of _____ months from its date of execution.

_____ (*Signature of the General Director*)

Appendix:¹⁷²

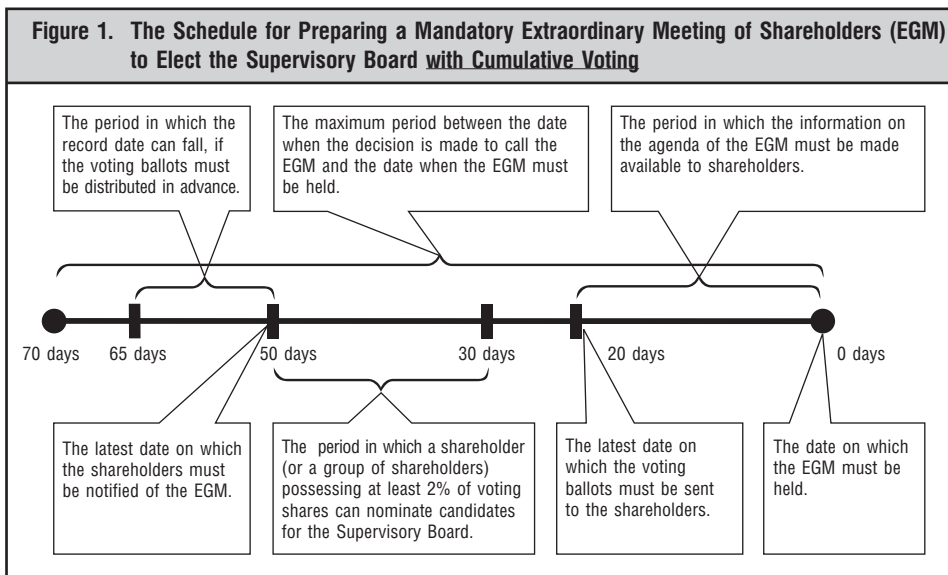
1. A copy of the charter of the Grantor.
2. A copy of the minutes of the _____ [*meeting of the relevant body*] on the election of _____ the General Director of the Grantor; and
3. An excerpt from the shareholder register on the ownership of company shares.

¹⁷² This is not required by the Company Law, however to avoid complications with gaining admittance to the GMS, it is recommended to have these documents available together with the power of attorney.



Annex 24

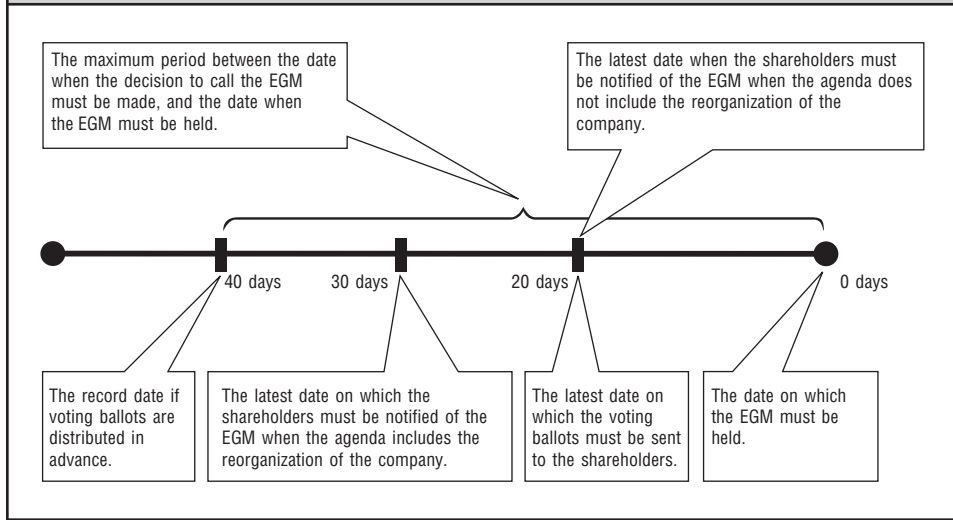
TIME CHARTS FOR THE PREPARATION OF THE EXTRAORDINARY GENERAL MEETING OF SHAREHOLDERS



Source: IFC, March 2004

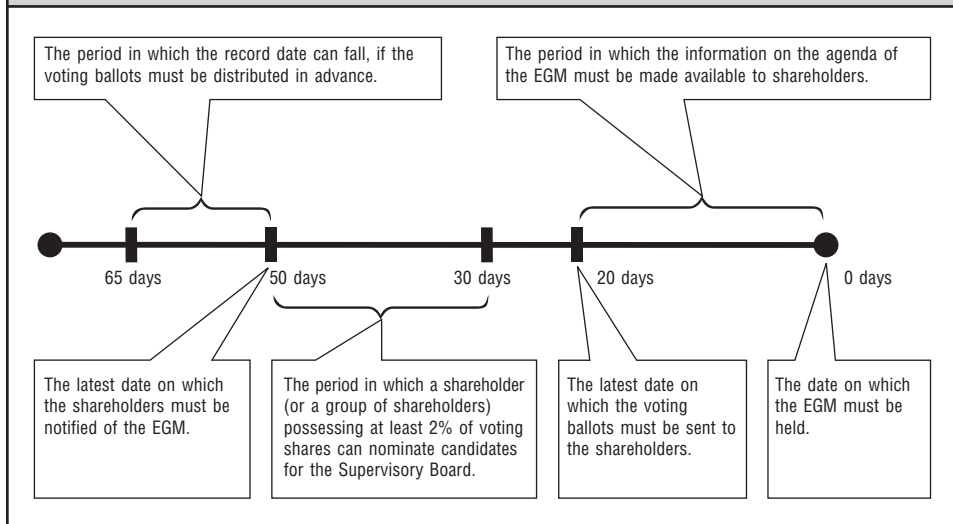


Figure 2: The Schedule for Preparing a Mandatory EGM to Decide on Agenda Items (Other Than the Election of the Supervisory Board with Cumulative Voting)



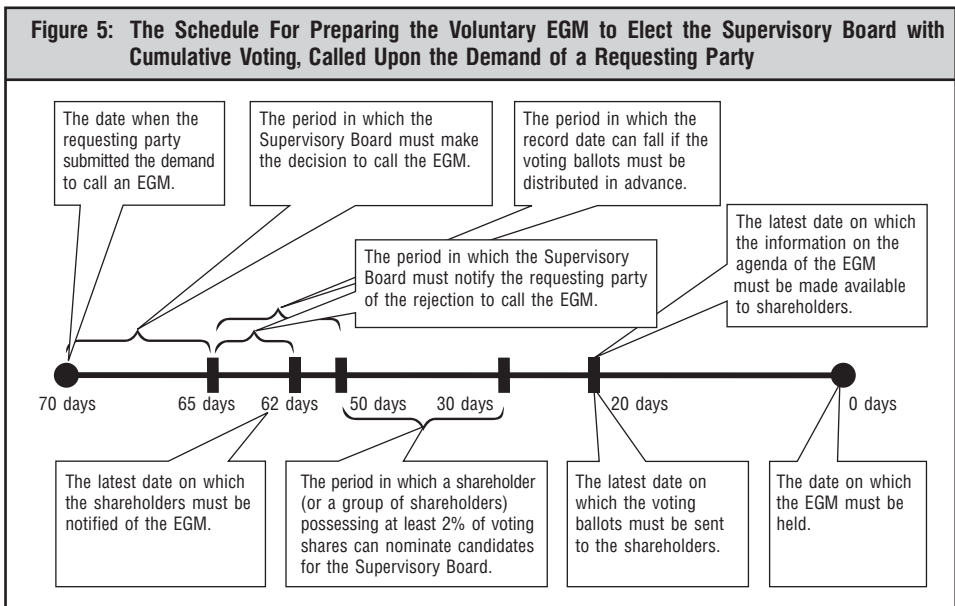
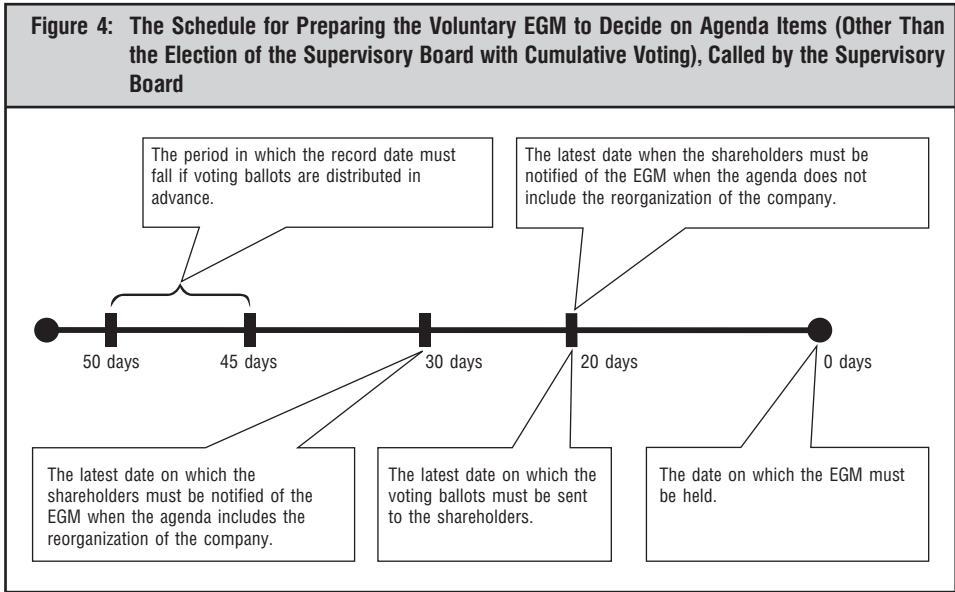
Source: IFC, March 2004

Figure 3: The Schedule for Preparing a Voluntary EGM to Elect the Supervisory Board with Cumulative Voting, Called by the Supervisory Board



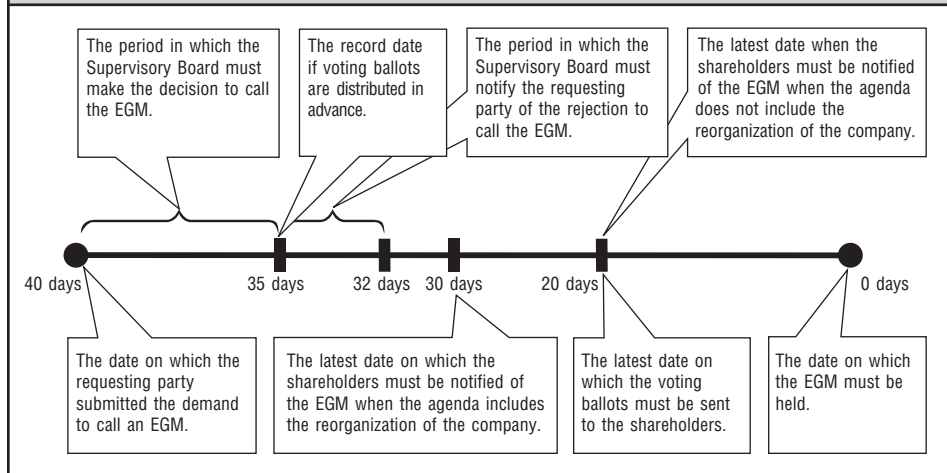
Source: IFC, March 2004

Annex 24. Time Charts for the Preparation of the EGM



The Russia Corporate Governance Manual

Figure 6: The Schedule for Preparing the Voluntary EGM to Decide on Agenda Items (Other Than the Election of the Supervisory Board with Cumulative Voting), Called Upon the Demand of a Requesting Party



Source: IFC, March 2004

Part 4

Information **Disclosure and Transparency**



Annex 25

A MODEL BY-LAW ON INFORMATION DISCLOSURE

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __day of _____, 200_
[The Company's Seal]

BY-LAW ON INFORMATION DISCLOSURE

of the Open Joint Stock Company
«_____»

The city of _____,
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	248
ARTICLE 2.	PERSONS AUTHORIZED TO MAKE DISCLOSURES ON BEHALF OF THE COMPANY.....	248
ARTICLE 3.	OBJECTIVES AND PRINCIPLES OF DISCLOSURE.....	249
ARTICLE 4.	RULES FOR THE DISCLOSURE OF INFORMATION.....	250
ARTICLE 5.	PUBLIC INFORMATION	252
ARTICLE 6.	INFORMATION PROVIDED TO SHAREHOLDERS	256
ARTICLE 7.	CONFIDENTIAL INFORMATION	257
ARTICLE 8.	INSIDER INFORMATION.....	259
ARTICLE 9.	INFORMATION PROVIDED TO THE COMPANY.....	261

Article 1. General Provisions

- 1.1. This By-law on Information Disclosure (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed in accordance with applicable provisions of the laws of the Russian Federation (hereinafter the Law), the Company charter, other internal documents, and the relevant recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law shall regulate information disclosure by the Company about the Company and its business activities.
- 1.3. For purposes of the By-law, the Company's disclosure policy shall be understood to mean the set of principles and procedures established by the Company for the proper information disclosure.
- 1.4. The General Director shall be responsible for ensuring the adherence to and compliance with the By-law.

Article 2. Objectives and Principles of Disclosure

- 2.1. The goal of disclosure is to provide information for shareholders and interested parties to assist such persons in making informed decisions or taking actions.

Annex 25. A Model By-Law on Information Disclosure

- 2.2. When disclosing information, the Company shall be guided by the principles of accuracy, accessibility, timeliness, completeness, and regularity, and additionally, will seek to maintain a reasonable balance between the transparency of the Company and the protection of its commercial interests while complying with relevant provisions of the Law, the charter, the By-law, and other internal documents of the Company.
- 2.3. The Company shall not avoid the disclosure of negative information about the Company if such information might be considered material or essential for shareholders or potential investors.
- 2.4. The preferential treatment of any one group of recipients of such information (selective disclosure) shall be prohibited unless otherwise provided for by the Law.

Article 3. Persons Authorized to Make Disclosures on Behalf of the Company

- 3.1. The following officers of the Company (hereinafter authorized persons) shall be authorized to disclose information to interested parties such as investors, the public, the mass media, and/or governmental authorities:
 - 3.1.1. The General Director;
 - 3.1.2. The Deputy General Director [or another person, e.g. the Head of the Investor Relations Department] responsible for information disclosure (hereinafter the Deputy General Director);
 - 3.1.3. The Chief Financial Officer;
 - 3.1.4. The Operations Manager;
 - 3.1.5. _____; and
 - 3.1.6. _____.
- 3.2. To ensure a uniform and consistent disclosure policy, authorized persons may also designate other persons to act on their behalf and respond to any inquiries, under extraordinary circumstances. However, no person other than the Company's authorized persons may comment upon or answer any questions, or respond to any inquiries regarding the Company's business activities, without special authorization or order of an authorized person.
- 3.3. Public statements that may have a significant impact on the Company's business activities and/or the value of its securities shall be coordinated with

_____ [e.g. the Deputy General Director or other person determined by the General Director].

- 3.4. If any employee of the Company participates in any public event, as part of his official or other duties, such employee shall ensure that any information disclosure regarding the Company is made in strict compliance with the Company's disclosure policy and with the prior approval of an authorized person.
- 3.5. Authorized persons shall be fully informed regarding the Company's business activities that might also be of interest to the business community. The communications of authorized persons shall be directed, coordinated, and controlled by the General Director.

Article 4. Parties and Rules for the Disclosure of Information

- 4.1. The Supervisory Board [or such other person or committee responsible for the Company's disclosure policy], in coordination with the General Director and any other authorized persons, shall develop, regularly review, and improve the Company's disclosure policy.
- 4.2. The General Director shall be responsible for the organization, accuracy, and timeliness of information disclosure, and for filing reports with the relevant governmental authorities. The General Director shall also be responsible for providing information about the Company to shareholders, creditors, and other interested parties.
- 4.3. The Corporate Secretary, in coordination with the General Director, shall ensure the:
 - 4.3.1. Timely disclosure of information contained in the securities prospectuses and quarterly reports of the Company, and information regarding material events affecting the Company's business and financial operations; and
 - 4.3.2. Safekeeping of the Company's documents that are subject to mandatory storage, control access thereto, and provide copies thereof. The Secretary shall certify copies.
- 4.4. The Company's disclosure policy shall be implemented in accordance with the Law, and in the best interests of the Company and its shareholders.

Annex 25. A Model By-Law on Information Disclosure

- 4.5. The General Director and other authorized persons shall always have complete information on all aspects of the Company's business activities for one or more of the following purposes:
- 4.5.1. Determining whether such information meets the disclosure requirements, whether it is material, and whether it may be disclosed at that particular time or should be treated as confidential;
 - 4.5.2. Ensuring the proper understanding of the current operations of the Company that may be of interest to investors; and
 - 4.5.3. Preventing situations where the Company might inadvertently deny the occurrence of any significant events, despite the fact that they actually occurred.
- 4.6. In addition to mandatory disclosure requirements, the Company shall prepare and disclose information regarding:
- 4.6.1. The Company's corporate governance policy;
 - 4.6.2. The Company's social and environmental policy;
 - 4.6.3. The activities of the Company's various governing bodies, and the corporate documents;
 - 4.6.4. Those shareholders who own 5% or more of the Company's shares, including information on indirect (beneficial) ownership;¹⁷³
 - 4.6.5. The following persons:¹⁷⁴
 - 4.6.5.1. Those persons specified in Clause 3.1 hereof;
 - 4.6.5.2. The Chief Accountant;
 - 4.6.5.3. Supervisory Board members;
 - 4.6.5.4. The Corporate Secretary;
 - 4.6.5.5. _____; and
 - 4.6.5.6. _____;
 - 4.6.6. _____; and
 - 4.6.7. _____.

¹⁷³ The Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 7, Section 2.1.4.

¹⁷⁴ FCSM Code, Chapter 7, Section 2.1.2.

The Russia Corporate Governance Manual

- 4.7. Those persons and channels responsible for information dissemination shall ensure unrestricted access thereto by interested parties. In addition to the means of disclosure required by the Law, the Company shall:
 - 4.7.1. Publish information about the Company, on planned presentations by the Company's officers and interviews with them in the mass media;
 - 4.7.2. Conduct regular meetings (information briefings¹⁷⁵ and/or press conferences) with shareholders, potential investors, and other market participants;
 - 4.7.3. In addition to the disclosures required by the Law, disclose additional information on the Company's website;
 - 4.7.4. Issue press-releases; and
 - 4.7.5. Conduct any other means of disclosure as established by the General Director and the Supervisory Board.
- 4.8. The Company shall publish on its website all significant announcements and materials, and may also publish brochures and booklets. The Company's website shall, at a minimum, include the following information:¹⁷⁶
 - 4.8.1. The charter and all amendments thereto;
 - 4.8.2. Annual reports, annual and quarterly financial statements (Russian Accounting Standards (RAS) and International Financial Reporting Standards (IFRS) when available);
 - 4.8.3. Securities prospectuses;
 - 4.8.4. Audit reports or opinions;
 - 4.8.5. Information on material facts; and
 - 4.8.6. Information on the General Meetings of Shareholders (hereinafter the GMS), material decisions of the Supervisory Board, and the development strategy of the Company.

Article 5. Public Information

- 5.1. Public information in the securities market shall mean information, access to which is not restricted in any way, and the disclosure of which is required by the Law on the Securities Market.

¹⁷⁵ FCSM Code, Chapter 7, Sections 1.1.1 and 1.1.2.

¹⁷⁶ Companies with 10,000 or more shareholders shall publish their financial statements in at least two printed media (with a circulation of not less than 50,000 copies) to which most shareholders have unrestricted access. FCSM Code, Charter 7, Section 1.1.2.

Annex 25. A Model By-Law on Information Disclosure

- 5.2. Public information shall include:
- 5.2.1. The charter, as amended;
 - 5.2.2. By-laws of the Company including, but not limited to, the by-laws for the governing bodies, audit and control bodies, disclosure policy, Supervisory Board's committees, etc.;
 - 5.2.3. The External Auditor's reports and opinions;
 - 5.2.4. Annual financial statements prepared in accordance with RAS;
 - 5.2.5. Annual financial statements prepared in accordance with IFRS;¹⁷⁷
 - 5.2.6. The annual report of the Company;
 - 5.2.7. An approved development strategy of the Company;¹⁷⁸
 - 5.2.8. Information about the securities, and the financial and business operations of the Company;
 - 5.2.9. _____; and
 - 5.2.10. _____.
- 5.3. The Company shall disclose information about its securities, and its financial and business operations in the form of:
- 5.3.1. Quarterly reports;
 - 5.3.2. Reports on material events affecting the financial and business operations of the Company;
 - 5.3.3. Decisions regarding the issuance of the Company's securities;
 - 5.3.4. Securities prospectuses; and
 - 5.3.5. Reports on results of securities issue.
- 5.4. The Company shall disclose information regarding material facts affecting its financial and business operations in accordance with the requirements of law.
- 5.5. The Company shall also disclose information on the following events and activities:¹⁷⁹
- 5.5.1. Changes in the name of the Company;
 - 5.5.2. Decisions regarding the increase or decrease of the charter capital;

¹⁷⁷ If the Company files accounting statements in accordance with international standards, e.g. US GAAP, IFRS.

¹⁷⁸ FCSM Code, Chapter 7, Section 3.3.1. recommends disclosure of the development strategy in the annual report to shareholders including the company's prospects regarding sales, efficiency, market share, income growth, profitability, and debt-equity ratio.

¹⁷⁹ If the company discloses information regarding said events and activities consistent with the recommendations of the FCSM Code in addition to that list required by statutory provisions.

- 5.5.3. A buyback by the Company of its own shares provided that such buyback is not related to a decrease in the charter capital, and a statement disclosing the source of funding for the acquisition, the purchase price, as well as the goals and reasons for such purchase;
 - 5.5.4. Price fluctuations of 5% or more of the Company's shares over a relatively short period of time;
 - 5.5.5. Transactions that may affect shareholder interests or the use of the Company's assets, including information regarding the use of shares and the other parties involved in such deals;
 - 5.5.6. Cessation of the production of goods or the provision of services, the sales of which accounted for at least 10% of the Company's total output based on the results of the previous fiscal year;
 - 5.5.7. Changes in the business priorities of the Company;
 - 5.5.8. Amendments to the charter relating to the issuance of preferred shares of classes other than those previously issued; and
 - 5.5.9. Changes of the External Auditor, External Registrar, or Depository of the Company;
 - 5.5.10. _____; and
 - 5.5.11. _____.
- 5.6. The Company shall disclose all material events affecting the financial and business operations of the Company even if not listed herein, but are nevertheless deemed material, and may affect the price of the Company's shares.
- 5.7. If securities are issued which require the registration of the securities prospectus, the Company shall provide access to information contained in the prospectus and shall publish a notice of the procedure of disclosure in _____¹⁸⁰.
- 5.8. The prospectus shall disclose all material information about:¹⁸¹
- 5.8.1. The motives for the issuance of such shares;
 - 5.8.2. The Company's dividend policy;
 - 5.8.3. The intention of any Supervisory Board member, the General Director, any Executive Board member, the General Director's depu-

¹⁸⁰ Name of the print media with a circulation of not less than 50,000 copies.

¹⁸¹ FCSM Code, Chapter 7, Section 2.1.

Annex 25. A Model By-Law on Information Disclosure

- ties, the Chief Accountant, and/or the Corporate Secretary to purchase and/or sell shares; and
- 5.8.4. Supervisory Board members, the General Director, Executive Board members, the General Director's deputies, the Corporate Secretary, and the Chief Accountant of the Company.
- 5.9. The Supervisory Board shall prepare the annual report of the Company for presentation at the Annual General Meeting of Shareholders (hereinafter AGM).
- 5.10. In addition to statutory information, the annual report of the Company shall contain the following:
- 5.10.1. An analysis of the competitive position of the Company;
- 5.10.2. An analysis of the Company's profitability;
- 5.10.3. A comparison of the planned and actual results of the Company for the year;
- 5.10.4. Net profit information, including total net profit, net profit from the Company's principal activities, and net earnings per share;
- 5.10.5. An assessment of changes in the asset structure over the past three years;
- 5.10.6. The percentage of export revenue over the year;
- 5.10.7. The Company's human resources and training policy;
- 5.10.8. The Company's corporate governance system and main corporate governance event during the reporting period;
- 5.10.9. _____; and
- 5.10.10. _____.
- 5.11. The annual report shall be signed by the General Director and the Chief Accountant, and be subject to prior approval by the Supervisory Board based on a review by the Revision Commission and External Auditor. The annual report shall be approved at least 30 days before the date of the AGM.
- 5.12. The Company shall publish its annual financial statements in _____¹⁸².
- 5.13. The Company shall publish annual financial statements not later than June 1 of the year following the reporting year.
- 5.14. The Company shall keep a record of its affiliated persons, and file reports on affiliated persons as required under law.

¹⁸² Name of the print media in which the annual accounting statements are published.

The Russia Corporate Governance Manual

- 5.15. The Company shall hold quarterly informational briefings.¹⁸³
- 5.16. Notice of informational briefings shall be published in _____¹⁸⁴ at least 10 days before the date of the briefing.
- 5.17. At the informational briefings, the shareholders and any other interested parties may receive information on the Company's business activities, and pose questions to representatives of the executive bodies and the Supervisory Board of the Company.
- 5.18. The Company shall disclose public information on its internet website located under: www._____.ru.

Article 6. Information Provided to Shareholders

- 6.1. The Company shall ensure that shareholders have access to the documents and information as set forth in the Law.
- 6.2. All shareholders shall have the right to review the documents listed in Clause 5.2 hereof, at the address of the executive body of the Company which is located at: _____.¹⁸⁵ The Company shall provide copies of any such documents upon request of any shareholder.
- 6.3. Requests to review or receive copies of documents shall be made in writing to the attention of _____,¹⁸⁶ and be sent to the following address: _____.¹⁸⁷ The request shall state the full name of the shareholder (for legal entities, their names and location), the number and type (class) of shares owned by the shareholder and the title of the document requested. The request is to be accompanied by an extract from the shareholder register.

¹⁸³ FCSM Code, Chapter 7, Section 3.1.1.

¹⁸⁴ Provide the name of the print media accessible to the majority of shareholders of the company. In accordance with the recommendations of the FCSM Code, Chapter 7, Section 1.1.2, it is possible to name an alternative print media.

¹⁸⁵ Name the location (physical address) of the executive body of the company. Name the contact telephone number of the Corporate Secretary, the Shareholder Relations Department, or others as applicable. It is also advisable to provide an alternative location, if available, where the shareholders may review the company's documents.

¹⁸⁶ Name the position of the relevant person: General Director, Corporate Secretary, or other person performing the functions of the Corporate Secretary.

¹⁸⁷ Name the location of the executive body.

Annex 25. A Model By-Law on Information Disclosure

- 6.4. The Corporate Secretary shall be required to verify the share ownership of the person requesting information.
- 6.5. The documents shall be made available for inspection free of charge within seven¹⁸⁸ calendar days after the date of the request.
- 6.6. Copies of the documents shall be made available within five business days after the relevant request and after receipt of payment from the shareholder for the copy and postage costs incurred by the Company. If copies of the documents are sent to the requesting party by mail, the date of dispatch shall be considered the date of providing the documents.
- 6.7. Payment for providing copies shall be made in the following manner: _____¹⁸⁹.
- 6.8. At the request of any shareholder, the Company or the External Registrar shall, within _____ days¹⁹⁰ after the receipt of such request, make available to the shareholder an extract from the list of persons entitled to participate in the GMS containing information about such persons, or a certificate that the person is not included in the list of persons entitled to participate in the GMS.

Article 7. Confidential Information

- 7.1. Trade secrets or confidential information shall mean any non-public information about the Company having actual or potential commercial value because of the fact that it is unknown to third parties. There is no legal right to free access to such information, and the possessor of such information shall be responsible for taking steps to protect its confidentiality.
- 7.2. The Company shall take all necessary steps and actions to protect its trade secrets and confidential information.
- 7.3. The following persons shall have access to confidential information:¹⁹¹
 - 7.3.1. Supervisory Board members;
 - 7.3.2. The General Director;

¹⁸⁸ FCSM Code, Chapter 7, Section 1.1.1. recommends a period of five business days.

¹⁸⁹ Specify how the payment for copies shall be made.

¹⁹⁰ Best practice suggests a period of 3–5 days.

¹⁹¹ List any other officers and employees of the company that shall have access to proprietary information, or make reference to any other company by-laws containing a list of employees having access to such information.

The Russia Corporate Governance Manual

- 7.3.3. Executive Board members;
 - 7.3.4. Deputy General Directors;
 - 7.3.5. The Chief Accountant;
 - 7.3.6. The Corporate Secretary; and
 - 7.3.7. _____.
- 7.4. These persons shall sign confidentiality agreements with the Company.
 - 7.5. The General Director shall have the right to make changes and amendments to the list of persons having access to confidential information.
 - 7.6. Any person having access to confidential information shall not use such information for entering into any business transactions, nor shall they disclose such information to third parties for commercial use.
 - 7.7. Persons who have illegally acquired the Company's trade secrets or confidential information shall reimburse the Company for any losses incurred. The same shall apply to the employees of the Company who have disclosed confidential information in violation of their employment contracts, and to any other contracting parties disclosing such information in violation of their contractual agreement.
 - 7.8. Confidential information shall include, but not be exclusively limited to, the following information:¹⁹²
 - 7.8.1. _____;
 - 7.8.2. _____; and
 - 7.8.3. _____.
 - 7.9. The following documents shall not constitute confidential information of the Company:
 - 7.9.1. The Company's founding documents;
 - 7.9.2. Documents providing evidence of certain legal rights, such as patents, or documents evincing the Company's legal right to engage in business operations, e.g. registration certificates, licenses, etc.;
 - 7.9.3. Mandatory reports on financial and business operations;
 - 7.9.4. Documents confirming the solvency of the Company;

¹⁹² FCSM Code, Chapter 7, Section 4.1.1. recommends including any information that shall be deemed confidential.

Annex 25. A Model By-Law on Information Disclosure

- 7.9.5. Documents containing information on the number and composition of the Company's employees, their salaries and labor conditions, as well as available vacancies;
 - 7.9.6. Documents regarding the payment of taxes and other mandatory payments;
 - 7.9.7. Documents containing information on environmental pollution;
 - 7.9.8. Documents concerning compliance with antitrust laws;
 - 7.9.9. Documents with information on noncompliance with labor safety regulations, the sale of products that may have a harmful effect on people's health, as well as any other violations of the Law, and the amount of damages caused by such noncompliance;
 - 7.9.10. Documents containing information about the participation in other organizations of any of the members of the Supervisory Board or Executive Board, the General Director or the General Director's deputies, or the Chief Accountant of the Company;
 - 7.9.11. Any documents containing confidential information which have been released by the Company and have become public information;
 - 7.9.12. _____; and
 - 7.9.13. _____.
- 7.10. The Company shall provide access to the documents and information listed in Clause 7.8 hereof when requested by those governmental and law enforcement authorities entitled to have access to such information pursuant to law, as well as when requested by employees of the Company.

Article 8. Insider Information

- 8.1. Insider information shall include any material non-public information about the business activities of the Company, its shares and any other securities, as well as any transactions with these securities, which, if disclosed, might materially affect the market value of these shares or other securities of the Company.¹⁹³

¹⁹³ It should be noted that the only document currently containing a definition of "insider information" is the FCSM Code, Chapter 7, Section 4.2. Russian legislation does not define those persons considered "insiders," nor does it establish liability for the improper or unauthorized use of insider information, nor does it regulate other issues related to control over the use of insider information. At present, a new law "On Insider Information" is under consideration by the State Duma, and it is advisable to incorporate appropriate changes and amendments to the by-law subsequent to the promulgation of such law.

The Russia Corporate Governance Manual

- 8.2. Information that meets the following criteria shall be considered insider information:
 - 8.2.1. Information that directly relates to the Company, its subsidiaries and their securities, as well as the business prospects of the Company and its subsidiaries;
 - 8.2.2. Information of a specific nature;
 - 8.2.3. Any non-public information; and
 - 8.2.4. Information that, if published, might significantly affect the price of any of the Company's securities.
- 8.3. Any individual or legal entity that has access to insider information pursuant to the Law, job description, or other internal regulation of the Company, shall be deemed an insider.
- 8.4. The following persons shall be considered insiders:
 - 8.4.1. Supervisory Board members, any corporate executive and members of control bodies of the Company, as well as its subsidiaries and affiliated companies;
 - 8.4.2. Persons employed by the Company or its subsidiaries and affiliated companies in any official or professional capacity pursuant to an employment contract, and having access to insider information pursuant to the terms of such contract; and
 - 8.4.3. The spouses and close relatives of the persons listed herein;
 - 8.4.4. Persons that own a _____% of voting shares or a _____% of votes of the issuer, its subsidiaries, or related companies;
 - 8.4.5. Officials of governmental authorities and agencies, or local authorities;
 - 8.4.6. Legal entities affiliated with any of the aforementioned persons or legal entities;
 - 8.4.7. _____; and
 - 8.4.8. _____.
- 8.5. Insiders shall be prohibited from disclosing insider information or from engaging in any transactions using insider information.
- 8.6. The procedures for the appropriate handling and use of insider information shall be established by the Supervisory Board.
- 8.7. The General Director shall be responsible for ensuring compliance with the Law and any special requirements provided for in the Company's charter,

Annex 25. A Model By-Law on Information Disclosure

by-laws, and other internal documents to prevent conflicts of interest and to prevent the improper use of insider information by the employees and business units of the Company.

Article 9. Information Provided to the Company

- 9.1. If the Company is required to disclose information that is provided to it by other persons or legal entities, the Company shall use its best efforts to ensure the timely receipt and continuous update of such information.
- 9.2. The Company shall be entitled to receive information that is material to the business activities of the Company in accordance with the Law.
- 9.3. The Company's internal regulations shall set forth the appropriate procedure and deadlines for filing, and define the personal information required to be filed by candidates for the Company's elective bodies.
- 9.4. Supervisory Board members, the General Director, Executive Board members, and shareholders owning more than 20% of voting shares of the Company who have been deemed interested parties in any transaction shall provide the Supervisory Board, the Revision Commission, and the External Auditor with information regarding:
 - 9.4.1. Legal entities in which such person owns 20% or more of the voting shares (interest), regardless of whether individually or jointly owned with affiliated persons;
 - 9.4.2. Legal entities in which they hold positions in the governing bodies; and
 - 9.4.3. All executed, negotiated, or proposed deals known to them in which they might be considered an interested party.
- 9.5. When requested by the General Director or other persons duly authorized by the General Director, the External Registrar shall make available that information included in the shareholder register in accordance with the procedures set forth by the Law.
- 9.6. The Company shall keep a record of its affiliates and file reports on such affiliates in accordance with the Law.
- 9.7. Affiliates of the Company shall notify the Company in writing within ten days of the purchase by such affiliate of any of the Company's shares, and

The Russia Corporate Governance Manual

such notification shall state the number and type (class) of the shares so purchased.

- 9.8. If any damage is caused to the Company because of the failure by any affiliate to disclose such information, or by the untimely disclosure of such information by the affiliate, then that affiliate shall be held liable for any damages caused thereby to the Company.
- 9.9. The External Auditor shall provide the Company with the results of any audit of the Company's financial and business operations in accordance with the Law and the contract with the External Auditor.



Annex 26

A MODEL BY-LAW FOR THE REVISION COMMISSION

Approved
by the General Meeting of Shareholders
of the Open Joint Stock Company «_____»

Minutes of the [Annual or Extraordinary]
General Meeting of Shareholders

No. _____
of _____ 200_.

dated this __day of _____, 200_
[The Company's SEAL]

BY-LAW FOR THE REVISION COMMISSION

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	264
ARTICLE 2.	AUTHORITY	265
ARTICLE 3.	RIGHTS AND DUTIES	266
ARTICLE 4.	COMPOSITION, STATUS, AND TERM OF OFFICE	267
ARTICLE 5.	PROCEDURE FOR NOMINATING CANDIDATES TO THE REVISION COMMISSION.....	268
ARTICLE 6.	ORGANIZING THE WORK	270
ARTICLE 7.	REMUNERATION AND COMPENSATION OF REVISION COMMISSION MEMBERS.....	272

Article 1. General Provisions

- 1.1. This By-law for the Revision Commission (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed in accordance with relevant provisions of laws of the Russian Federation (hereinafter the Law), the Company charter, other internal corporate documents, and the recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-law determines the authority, composition, rights and duties, nomination and working procedures, and remuneration of the Revision Commission.
- 1.3. The Revision Commission shall act in accordance with the law, the charter, and other internal documents of the Company.
- 1.4. The Revision Commission shall report to the General Meeting of Shareholders (hereinafter the GMS).
- 1.5. The relations of the Revision Commission's members with the Company shall be regulated by contracts signed on behalf of the Company by the person duly authorized by the GMS.

Annex 26. A Model By-Law for the Revision Commission

Article 2. Authority

- 2.1. The Revision Commission shall be responsible for the control of the financial and business activities of the Company and its bodies. The Revision Commission shall further be responsible for compliance by the executive bodies and the Supervisory Board, as well as Company's officers, business units, branches, and representative offices with provisions of the Law, the Charter and by-laws of the Company regarding the Company's business activities.
- 2.2. The Revision Commission shall:
 - 2.2.1. Perform regular and extraordinary inspections of the financial and business operations of the Company, and present its findings to the GMS;
 - 2.2.2. Perform inspections of specific aspects of the financial and business operations of the Company at the request of a shareholder (or a group of shareholders) owning not less than 10% of voting shares, or at the request of the Supervisory Board;
 - 2.2.3. Ensure that the Supervisory Board and the executive bodies of the Company act in compliance with the Law, the charter, by-laws, and relevant internal documents of the Company;
 - 2.2.4. Investigate cases of the use of insider information;
 - 2.2.5. Check the timeliness of payments to contractors, mandatory budget payments, accrual and payment of dividends, as well as the meeting of other financial obligations of the Company;
 - 2.2.6. Check the appropriateness of the use of reserve and other funds of the Company;
 - 2.2.7. Check the timeliness of payment for the issued shares of the Company;
 - 2.2.8. Review the financial condition of the Company, its solvency, liquidity of its assets, and creditworthiness;
 - 2.2.9. Confirm the accuracy of information contained in the annual report and financial documents of the Company;
 - 2.2.10. Oversee the timeliness of valuation of the Company's net assets;
 - 2.2.11. _____; and
 - 2.2.12. _____.

Article 3. Rights and Duties of the Revision Commission

- 3.1. The Revision Commission shall have the right to:
 - 3.1.1. Perform checks and inspections of the financial and business operations of the Company at any time and at its own initiative;
 - 3.1.2. Request from the Company's officers and governing bodies the necessary documents on the financial and business operations of the Company;
 - 3.1.3. Request from the Company's officers and employees written and oral explanations on any issues that may arise in the course of inspections;
 - 3.1.4. Issue instructions to remedy the identified violations;
 - 3.1.5. Request the calling of an Extraordinary General Meeting of Shareholders (hereinafter EGM), as well as a Supervisory Board meeting;
 - 3.1.6. Familiarize itself with the External Auditor's opinion;
 - 3.1.7. Use the services of outside experts, specialists, and/or auditors who are not the Company's employees as required;
 - 3.1.8. _____; and
 - 3.1.9. _____.
- 3.2. Revision Commission members shall have the right to attend meetings of the Executive Board and Supervisory Board as observers.
- 3.3. The Revision Commission shall:
 - 3.3.1. Make reports based on the results of inspections and submit them to the GMS and the initiator of the inspection within ____ days of the completion of the inspection;¹⁹⁴
 - 3.3.2. Register all instances of noncompliance with the Law, the charter, by-laws, and rules and instructions by the officers and employees of the Company during business operations of the Company;
 - 3.3.3. Inform the shareholders of the violations identified;
 - 3.3.4. Monitor compliance with its instructions by the Company's officers;
 - 3.3.5. Not later than 40 days prior to the date of the Annual General Meeting of Shareholders (hereinafter AGM), submit to the Supervisory Board its opinion on the accuracy of data contained in the annual report and annual financial statements of the Company;

¹⁹⁴ Best practice suggests two weeks.

Annex 26. A Model By-Law for the Revision Commission

- 3.3.6. Maintain records of violations it identifies and furnish information on such violations to the Supervisory Board and its Audit Committee;¹⁹⁵
- 3.3.7. _____; and
- 3.3.8. _____.
- 3.4. Revision Commission members must participate in the Revision Commission meetings and its inspections, as well as attend the GMS and answer questions of the attendees.

Article 4. Composition, Status, and Term of Office of the Revision Commission

- 4.1. The Charter determines the number of Revision Commission members. Members shall be elected to serve until the next AGM.
- 4.2. Only individuals may be Revision Commission members.
- 4.3. Revision Commission members may not at the same time be members of the Supervisory Board, the Executive Board, the Counting Commission, or the General Director of the Company, or of a legal entity competing with the Company.¹⁹⁶
- 4.4. The same person may be re-elected as a Revision Commission member an unlimited number of times.
- 4.5. The Revision Commission members must have the necessary business, financial, and accounting experience, as well as knowledge of accounting and financial reporting.
- 4.6. The GMS may at any time terminate the powers of any Revision Commission member before expiration of his term.
- 4.7. Revision Commission members shall elect from among themselves the Chairman at their first meeting.
- 4.8. The Chairman of the Revision Commission shall:
- 4.8.1. Organize the work of the Revision Commission;
- 4.8.2. Call Revision Commission meetings;

¹⁹⁵ As recommended by the FCSM Code in Chapter 8, Section 2.1.2. The internal regulations of the company should provide for the establishment of the Audit Committee.

¹⁹⁶ It is recommended that the Revision Commission does not include family members of directors or managers. The GMS may establish additional categories of persons who may not be Revision Commission members.

The Russia Corporate Governance Manual

- 4.8.3. Preside over Revision Commission meetings;
 - 4.8.4. _____; and
 - 4.8.5. _____.
- 4.9. The Deputy Chairman of the Revision Commission shall perform the functions of the Chairman during the absence of the latter.

Article 5. Procedure for Nominating Candidates to the Revision Commission

- 5.1. Candidates to the Revision Commission may be nominated by a shareholder (or a group of shareholders) owning at least 2% of voting shares of the Company as of the date of such nomination.
- 5.2. Shareholder proposals must be received by the Company within _____ calendar days of the end of the financial year.¹⁹⁷
- 5.3. The Supervisory Board may nominate candidates to the Revision Commission if shareholders have nominated an insufficient number of candidates.
- 5.4. The number of candidates nominated to the Revision Commission by each proposing shareholder or shareholder group may not exceed the number of the members to be elected to the Revision Commission pursuant to the Company's charter.
- 5.5. Proposals on the nomination of candidates may be made by:
 - 5.5.1. Registered mail to the following address: _____, to the attention of _____ [*specify title and name of the person responsible for receipt of proposals*]; or
 - 5.5.2. Personal delivery against confirmation of receipt to _____ [*the Secretary of the Supervisory Board or the Corporate Secretary, if such position has been established, or another person authorized to receive written correspondence addressed to the Company*].
- 5.6. The deadline for proposing candidates shall be established in accordance with the requirements for preparing, calling, and conducting the GMS established by the Law.¹⁹⁸

¹⁹⁷ LJSC, Article 53, Clause 1. The company must receive such proposals within 30 days from the end of the financial year, unless the company's charter provides for a longer period.

¹⁹⁸ See FCSM Regulation No. 17/ps on the Approval of the Regulation on Additional Requirements to the Procedure for Preparing, Calling, and Conducting the General Meeting of Shareholders.

Annex 26. A Model By-Law for the Revision Commission

- 5.7. Proposals on the nomination of candidates shall be made in writing and shall state:
 - 5.7.1. The name of the shareholder(s) submitting the proposal; and
 - 5.7.2. The number and category (class) of shares owned by them.
- 5.8. The proposal on the nomination of a candidate shall contain the following information:
 - 5.8.1. The first name, patronymic, and surname of each of the nominated candidates, and date of birth;
 - 5.8.2. Educational background, including continuous professional education (name of educational institution, date of graduation, degree or diploma, honorary mention, etc.);
 - 5.8.3. Place of work and positions held over the past ___ years, and positions held by the candidate in the governing bodies of other legal entities over the past ___ years;¹⁹⁹
 - 5.8.4. List of legal entities of which the candidate is a shareholder, stating the number of shares (interest) in the charter capital of such legal entities;
 - 5.8.5. List of persons with which the candidate is affiliated, stating the nature of the affiliation;
 - 5.8.6. Relations of the candidate with affiliated persons and major partners of the Company, as well as candidate's affiliation with the Company;
 - 5.8.7. Outstanding criminal convictions and administrative disqualifications, if any;
 - 5.8.8. Name of the body to which the candidate is nominated (the Revision Commission in this case);
 - 5.8.9. _____;
 - 5.8.10. _____; and
 - 5.8.11. Other information material to the election of the candidate as a Revision Commission member.
- 5.9. Such proposals may also contain the candidate's consent to stand for election.
- 5.10. The proposal shall be signed by the shareholders or their representatives. If a representative signs the proposal, a power of attorney shall be attached.

¹⁹⁹ FCSM Code, Chapter 3, Section 2.3.1 recommends five years.

The Russia Corporate Governance Manual

- 5.11. The Supervisory Board shall review the proposals and make a decision on accepting or rejecting the candidates to be included into the list of candidates for the position of the Revision Commission within five days after the end of the period set forth in Clause 5.2 hereof.
- 5.12. A motivated decision of the Supervisory Board to reject the inclusion of a candidate into the list of candidates shall be sent to the proposing shareholder(s) within three days of when the decision was made.
- 5.13. The nominated candidates shall be included into the list of candidates, unless:
 - 5.13.1. The shareholder(s) failed to submit the proposal within the time-frame set by Clause 5.2 hereof;
 - 5.13.2. The shareholder(s) do not own a sufficient number of voting shares of the Company as set forth in Clause 5.1 hereof; and
 - 5.13.3. The proposal does not meet the requirements set forth in Clauses 5.7 and 5.8 hereof.
- 5.14. Candidates nominated to the Revision Commission may stand down until the moment the Supervisory Board includes the candidate into the list of candidates.

Article 6. Organizing the Work

- 6.1. The Revision Commission shall organize its work in the form of regular and extraordinary inspections, as well as meetings to discuss issues related to conducting inspections and organizing its work.
- 6.2. Scheduled inspections shall be conducted based on a fixed schedule that is based on target dates for approving the results of the financial and business operations for the year.
- 6.3. Extraordinary inspections shall be conducted:
 - 6.3.1. On the basis of a decision of the GMS;
 - 6.3.2. On the basis of a decision of the Supervisory Board;
 - 6.3.3. Upon the request of shareholders owning not less than 10% of voting shares of the Company; or
 - 6.3.4. At the initiative of the Revision Commission.
- 6.4. Extraordinary inspections of financial and business operations of the Company shall start not later than ___ days after the shareholder's request to

Annex 26. A Model By-Law for the Revision Commission

perform such an inspection is received by the Company, or after the date of the relevant minutes of the GMS, or the Supervisory Board meeting. The inspection must be completed within ___ days.²⁰⁰

- 6.5. Upon the results of scheduled and extraordinary inspections, the Revision Commission shall prepare a report. All Revision Commission members who participated in the inspection shall sign the report. Any Revision Commission member who disagrees with the Revision Commission's report may prepare a dissenting opinion that shall be appended to and shall be deemed an integral part of the Revision Commission's report. If a Revision Commission member does not sign the report and does not provide a dissenting opinion, the report must contain an explanation.²⁰¹
- 6.6. In accordance with its report, the Revision Commission may issue instructions to the officers of the Company requiring them to remedy the identified violations. The instructions shall be approved by the Revision Commission and signed by the Chairman of the Revision Commission.
- 6.7. The Revision Commission shall meet as required but at least once a quarter, as well as before and after the completion of each inspection.
- 6.8. Revision Commission meetings may be called by the Chairman of the Revision Commission or by written request of any of its members. The request must contain the list of issues to be discussed at the meeting. The meeting must be called within ___ days after the date of the request.
- 6.9. The Revision Commission meetings shall be held in the form of joint attendance. Meetings on organizational issues may be held in the form of video- or teleconferences.
- 6.10. Revision Commission members shall receive advance written notice of ___ days before the date of the meeting. The notice shall contain information about the date, time, and location of the meeting, as well as the agenda of the meeting.
- 6.11. Any Revision Commission member may make proposals and amendments to the meeting agenda subject to the terms of notification of the meeting.
- 6.12. The Revision Commission meeting shall be valid if at least half of its members participate in the meeting.

²⁰⁰ The FCSM Code recommends that the inspection of financial and business activities start within 30 days. The inspection must be completed within 90 days.

²⁰¹ FCSM Code, Chapter 8, Section 3.1.4.

The Russia Corporate Governance Manual

- 6.13. Decisions on all issues shall be made by a majority vote of Revision Commission members attending the meeting.
- 6.14. In case a member withdraws from the Revision Commission and if the number of Revision Commission members becomes less than the quorum as set forth in Clause 6.12 hereof, the Revision Commission shall request the Supervisory Board to call an EGM.
- 6.15. Revision Commission members may not delegate their powers to other persons, including by power of attorney.²⁰²
- 6.16. Minutes of Revision Commission meetings shall be signed by its Chairman and filed in the book of minutes kept by the Chairman of the Revision Commission or in the Company's files.

Article 7. Remuneration and Compensation of Revision Commission Members

- 7.1. Subject to the decision of the GMS, Revision Commission members shall receive compensation (receipts) of expenses incurred by them in connection with the performance of their duties and receive remuneration for their work.
- 7.2. Revision Commission members shall receive remuneration in the amount of _____ Rubles.
- 7.3. Remuneration shall be payable once every _____ months.

²⁰² FCSM Code, Chapter 8, Section 3.1.2.



Annex 27

A MODEL BY-LAW ON RISK MANAGEMENT

APPROVED
by decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

dated this __ day of _____, 200_
[The Company's Seal]

BY-LAW ON RISK MANAGEMENT

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	274
ARTICLE 2.	DEFINITIONS, PRINCIPLES, AND OBJECTIVES OF RISK MANAGEMENT	275
ARTICLE 3.	RISK IDENTIFICATION.....	276
ARTICLE 4.	ANALYSIS, EVALUATION, AND CLASSIFICATION OF RISKS	276
ARTICLE 5.	RISK MANAGEMENT METHODS.....	277
ARTICLE 6.	MONITORING AND CONTROL OF THE RISK MANAGEMENT SYSTEM...	277
ARTICLE 7.	BODIES RESPONSIBLE FOR THE RISK MANAGEMENT SYSTEM	277
ARTICLE 8.	INFORMATION DISCLOSURE ON RISK MANAGEMENT	279
EXHIBIT 1.	RISK MANAGEMENT CHART.....	280
EXHIBIT 2.	RISK MANAGEMENT MATRIX.....	281

Article 1. General Provisions

- 1.1. This By-law on Risk Management (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been developed and drafted in accordance with the laws of the Russian Federation (hereinafter the Law), the charter of the Company, by-laws, and other internal corporate documents, and recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).²⁰³
- 1.2. The By-law defines the principles and elements of the risk management system, risk management methods, monitoring and control over the efficiency of the risk management system, the bodies responsible for the risk management system, and information disclosure.

²⁰³ This By-law has been developed to help companies implement the requirements of the FCSM Code and is consistent with recommendations of specialized institutions. For more information see:

- Internal Control, Guidance for Directors on the Combined Code, The Institute of Chartered Accountants in England & Wales, 1999.
- Implementing Turnbull — A Boardroom Briefing, The Institute of Chartered Accountants in England & Wales, 1999.
- A Risk Management Standard, The Institute of Risk Management (IRM), The Association of Insurance and Risk Managers (AIRMIC), The National Forum for Risk Management in the Public Sector, 2002.
- Internal Control — Integrated Framework, Committee of Sponsoring Organizations of the Treadway Commission (COSO), U.K.
- Act on Corporate Control and Transparency (KonTraG), Germany.

Article 2. Definitions, Principles, and Objectives of Risk Management

- 2.1. For the purposes of the By-law, risk shall be defined as the probability of an event occurring, and its expected effect upon the Company's activities. The Company's approach to risk management takes into account the potential of unfavorable events or threats, and the potential of favorable events or opportunities.
- 2.2. The Company views risk management as one of the most important elements of strategic management and internal control. Risk management is a process utilized by the Company which regularly identifies, evaluates, and controls threats and opportunities; modifies its operations for the purpose of decreasing the level of threats and in order to take advantage of any opportunities; and informs shareholders and other stakeholders thereof.
- 2.3. The Company's system of risk management is not designed to eliminate risks, but to increase the probability that the Company's strategic goals will be attained and in addition, take appropriate actions to decrease the probability and amount of potential losses. To this end, the Company clearly defines the levels of risk acceptable for each category of corporate activity.
- 2.4. An integrated risk management system takes into account the interrelation of various risks for the purpose of evaluating their aggregate effect on the Company's operations, and uniformly evaluating the potential of financial, operational, and other risks.
- 2.5. The By-law is not limited to the protection of shareholder interests; it also takes into account the potential consequences of the Company's operations for other stakeholders.
- 2.6. Implementing and maintaining the risk management system has the following objectives:
 - 2.6.1. Compliance with corporate governance standards which focus on identifying, monitoring, and managing the risks, and properly disclosing information regarding such risks;
 - 2.6.2. Preventing situations that threaten the strategic goals and objectives of the Company, and providing protection against them;
 - 2.6.3. Coordinating and integrating risk management affecting various aspects of the Company's financial and business activities to generally increase the efficiency of management;
 - 2.6.4. Taking advantage of opportunities for increasing the value of the Company's assets and the Company's long-term profitability; and
 - 2.6.5. _____.

Article 3. Risk Identification

- 3.1. The Company uses its best efforts to identify all material risks. To achieve this objective, the Company uses standardized questionnaires, joint meetings of those persons responsible for risk identification, surveys conducted by external consultants, benchmarking, results of internal and external audits, and other methods of risk identification.
- 3.2. The Company identifies the risks related to all aspects of its operations, and maintains a register of risks. The register is limited to the description of the nature of the risk, and an experts' opinion regarding the materiality of such risks for the Company's operations. The register shall be updated periodically to reflect any changes in the external and internal conditions of the Company's operations.

Article 4. Analysis, Evaluation, and Classification of Risks

- 4.1. For each of the material risks, the Company assesses the probability of all possible outcomes, and the expected effects of each risk on shareholder value.
- 4.2. Based on this assessment and the allocation of certain risks to a certain management function (e.g. strategic, operating, financial), risks are classified in the form of a "risk chart" and "risk matrix."²⁰⁴
- 4.3. The Company uses simple, measurable, and well-defined indicators that allow it to assess the current probability of an expected event that correspond to each material risk. When an indicator approaches a certain critical threshold, it signals the necessity for management's and/or the Supervisory Board's intervention and decision-making.
- 4.4. For each risk indicator, the Company determines critical thresholds based on the level of acceptable risk and the relevant objectives of the Company.
- 4.5. After a preliminary assessment of the risks identified, the Company reviews registered risks in light of the Company's priorities and needs. As a result, risks that have been rated as high or low may receive a different rating.²⁰⁵

²⁰⁴ Methods of assessment and the risk chart/matrix format depend upon the objectives and specific features of a company's operations. The main goal of the chart is to illustrate relative priorities of material risks and allocate them by certain areas of functional responsibility. An example has been included at the end of this By-law in Exhibits 1 and 2.

²⁰⁵ If the risks are re-evaluated, minutes reflecting the relevant discussions on this matter should be kept. Many of the risks may be insignificant, but sometimes they may be numerous. This, in turn, may impede focusing on major and material risks.

Annex 27. A Model By-Law on Risk Management

Article 5. Risk Management Methods

- 5.1. For each material risk, the Company develops methods and solutions for dealing with such risks, for minimizing possible losses, but also to take advantage of opportunities presented. Such methods include, but are not limited to, detailed response programs when risk indicators reach critical thresholds.
- 5.2. The type and structure of the method is based on a reasonable balance between the expected economic effect of its application and the costs of its implementation.
- 5.3. Main risk management methods applied by the Company are:
 - 5.3.1. Acceptance and recording of risk;
 - 5.3.2. Sharing the risk with other parties;
 - 5.3.3. Termination of risk (e.g. canceling the project);
 - 5.3.4. Financing the risk (insurance, additional investments, or financing for the project, reducing the risk to an acceptable level);
 - 5.3.5. Diversification of risks; and
 - 5.3.6. _____.
- 5.4. Key considerations for choosing risk management methods are:
 - 5.4.1. The Company's willingness to accept a certain amount of risk;
 - 5.4.2. Balance between preventive versus detective controls;
 - 5.4.3. Weighing the costs versus the benefits of control; and
 - 5.4.4. _____.

Article 6. Monitoring and Control of the Risk Management System

- 6.1. The Company shall ensure ongoing monitoring and review of the risk management system.

Article 7. Bodies Responsible for the Risk Management System

- 7.1. The Heads of the Company's structural units are responsible for identifying risks in their respective areas of the Company's operations and within the scope of their authority as vested in them by the General Director.
- 7.2. The General Director is responsible for the implementation of the Company's overall risk management policy.
- 7.3. The General Director establishes a standing body _____ [a council, committee, commission, risk management department] that reports

The Russia Corporate Governance Manual

directly to the General Director. This body consists of the following persons:

- 7.3.1. Deputy General Director;
 - 7.3.2. Heads of structural units;
 - 7.3.3. _____;
 - 7.3.4. _____; and
 - 7.3.5. _____.
- 7.4. The body shall meet regularly, once every ___ weeks to address the following issues:
- 7.4.1. The Company's operational, financial, and strategic risks, and any other risks identified by the structural units of the Company;
 - 7.4.2. The appraisal and analysis of identified risks;
 - 7.4.3. The development and review of the risk chart;
 - 7.4.4. The development of risk management methods for each separate risk; and
 - 7.4.5. _____.
- 7.5. Results of the risk management body meetings are reported directly to the General Director.
- 7.6. The General Director is responsible for submitting regular reports to the Supervisory Board that include information on the overall condition of the risk management system, any deficiencies in the system which have been identified, and specific proposals for its improvement.
- 7.7. If the Supervisory Board receives information on any material deficiencies in the risk management system, it commences an audit of the executive bodies and, if necessary, an assessment of the effectiveness of the risk management system.
- 7.8. The Supervisory Board approves the Company's risk management policy, reviews its efficiency, and takes measures to improve it on regular basis.
- 7.9. The control over the Company's risk management system is the responsibility of the Supervisory Board [the Audit Committee and/or the Strategic Planning and Finance Committee, if established].
- 7.10. The Supervisory Board reviews the following issues on a regular basis:
- 7.10.1. The nature and relative weight (significance) to be assigned to various risks faced by the Company;
 - 7.10.2. Identification of acceptable and unacceptable risks for the Company;
 - 7.10.3. The Company's ability to compensate for losses associated with risks or manage those risks deemed acceptable;

Annex 27. A Model By-Law on Risk Management

- 7.10.4. The cost of maintaining a comprehensive risk management system relative to its potential economic effect;
 - 7.10.5. Structure and arrangements of the Company's risk management system; and
 - 7.10.6. _____.
- 7.11. After receiving the annual appraisal of the risk management system, the Supervisory Board shall discuss and take a position on:
- 7.11.1. Changes in the nature and priorities of material risks since the most recent annual review, and the Company's ability to react to such changes;
 - 7.11.2. Quality and volume of activities of the executive bodies, Internal Auditor, and other bodies of internal control in the area of risk management;
 - 7.11.3. Whether the reports on the status of risk management are provided by the executive bodies to the Supervisory Board and its committees in a timely and complete fashion;
 - 7.11.4. Material errors in the risk management system during the reporting period, and the consequences of such errors for the Company's financial and business activities;
 - 7.11.5. The efficiency of the Company's accountability to outside stakeholders; and
 - 7.11.6. _____.

Article 8. Disclosure of Information on Risk Management

- 8.1. The risk management policy is viewed as an important element of the internal organizational culture, and shall be communicated to all employees. The company maintains communication channels between the Supervisory Board, the executive bodies, and all functional units for appropriate management of operational and strategic risks.
- 8.2. The Company discloses in its annual report the following information for outside stakeholders:
- 8.2.1. The structure of responsibility for various risk management functions;
 - 8.2.2. An analysis of material risks to the Company;
 - 8.2.3. Control processes for material risks, and risk management methods;
 - 8.2.4. Changes made to the company's risk management system and the grounds for such changes; and
 - 8.2.5. _____.

EXHIBIT 1. RISK MANAGEMENT CHART

Company/Project Name: _____

Project Status: _____

1. PARTIES INVOLVED:

Name	Title	Department/Company

2. POTENTIAL RISKS:

Potential Risks	Reasons/Explanations

3. RISK MANAGEMENT PLAN:

Potential Risks	Actions taken/planned (include staff name, date/timeline of action)

Prepared by: _____ Date: _____ Signature: _____

Reviewed by: _____ Date: _____ Signature: _____

Received by: _____ Date: _____ Signature: _____

Annex 27. A Model By-Law on Risk Management

EXHIBIT 2. RISK MANAGEMENT MATRIX

[Company Name] Risk Register			As of: [Enter Date]			Next Review: [Enter Date]			
Risk Serial No.	Risk Category	Description of Risk		Risk Assessment		Risk Priority	Adequacy of Existing Controls	Action (Treat, Tolerate, Transfer, Terminate)	Close Date
	Risk Sponsor	Risk Owner	Likelihood	Impact					
1	[Enter Risk Category]								[Enter Date]
	[Enter Risk Sponsor]								
	[Enter Risk Owner]								
2	[Enter Risk Category]								[Enter Date]
	[Enter Risk Sponsor]								
	[Enter Risk Owner]								
3	[Enter Risk Category]								[Enter Date]
	[Enter Risk Sponsor]								
	[Enter Risk Owner]								

Risk Assessment: High (H), Medium (M), or Low (L)

Adequacy of Controls: Uncertain, Inadequate, Adequate

Assessment Order: Highest Likelihood first, then by Impact

Risk Categories: External, Operational, Technology, Resource



Annex 28

A MODEL BY-LAW ON INTERNAL CONTROL

APPROVED

By decision of the Supervisory Board
of the Open Joint Stock Company «_____»

Supervisory Board Minutes

No. _____
of _____ 200_

Signature of the Chairman of the Supervisory Board

_____ dated this __ day of _____, 200_
[The Company's Seal]

BY-LAW ON INTERNAL CONTROL

of the Open Joint Stock Company
«_____»

The city of _____
_____, 200_



Table of Contents

ARTICLE 1.	GENERAL PROVISIONS	284
ARTICLE 2.	DEFINITIONS	285
ARTICLE 3.	PRINCIPLES.....	285
ARTICLE 4.	CONTROL ENVIRONMENT	286
ARTICLE 5.	RISK ASSESSMENT	287
ARTICLE 6.	CONTROL ACTIVITIES.....	287
ARTICLE 7.	INFORMATION AND COMMUNICATION	288
ARTICLE 8.	CONTROL AND MONITORING.....	288
ARTICLE 9.	BODIES AND PERSONS RESPONSIBLE FOR INTERNAL CONTROL.....	289
EXHIBIT 1.	GENERAL OVERVIEW OF THE INTERNAL CONTROL SYSTEM AND PRELIMINARY EVALUATION OF ITS RELIABILITY.....	291
EXHIBIT 2.	CONFIRMING THE EVALUATION OF MATERIAL ELEMENTS OF THE INTERNAL CONTROL SYSTEM	293

Article 1. General Provisions

- 1.1. This By-law on Internal Control (hereinafter the By-law) of the Open Joint Stock Company «_____» (hereinafter the Company) has been drafted in accordance with the laws of the Russian Federation (hereinafter the Law), the charter and other internal corporate documents of the Company, and relevant recommendations of the Federal Commission for the Securities Market's Code of Corporate Conduct (hereinafter the FCSM Code).
- 1.2. The By-Law defines the goals and objectives, principles, and processes, as well as the Company's bodies and persons responsible for internal controls.

Article 2. Definitions

- 2.1. Internal control is a process conducted jointly by the Supervisory Board, management, and the company's employees, the aim of which is to provide reasonable guarantees that the following Company objectives are attained:
 - 2.1.1. Financial reporting is reliable and accurate;
 - 2.1.2. Operations are efficient and effective; and
 - 2.1.3. Activities and processes comply with the Law, the Company's internal rules and guidelines.
- 2.2. The internal control system includes the following interrelated elements:
 - 2.2.1. Control environment;
 - 2.2.2. Risk assessment;
 - 2.2.3. Control procedures;
 - 2.2.4. Information and communication; and
 - 2.2.5. Control and monitoring of the internal control system's efficiency.

Article 3. Principles

- 3.1. The Company's internal system control is based on the following principles:
 - 3.1.1. The internal control system functions at all times, without interruption. A system of internal control that functions on an ongoing basis allows the Company to identify deviations on a timely basis, and helps to predict such deviations in the future.
 - 3.1.2. Each person involved in the internal control process is held accountable. The performance of each person carrying out internal control functions is, therefore, managed by yet another person within the internal control system.
 - 3.1.3. The system of internal control segregates duties. The company prohibits any duplication of control functions, and distributes functions among the employees so that one and the same person does not combine functions relating to the authorization of operations with certain assets, recording of such operations, ensuring and safe-keeping of assets, and inventory of these same assets.

- 3.1.4. Proper authorization and approval of operations is established. The Company establishes procedures for the approval of all financial and business operations only by authorized persons acting within the scope of their authority;
- 3.1.5. The Company ensures the organizational separation of its subdivision responsible for internal control and, moreover, ensures that this subdivision is accountable directly to the Supervisory Board (specifically its Audit Committee);
- 3.1.6. All persons involved in the Company's internal control process are responsible for the proper performance of control processes;
- 3.1.7. All units and departments integrate and cooperate with one another to ensure proper implementation of the internal control system;
- 3.1.8. A culture of continuous development and improvement has been put in place. The Company's internal control system is structured in such a way to ensure that it can be flexibly "tuned" to address new issues, and be receptive to expansions and upgrades in the system;
- 3.1.9. A system for timely reporting any deviations has been put in place. Ensuring the timeliness of reporting on deviations with the shortest possible deadlines allows authorized persons to receive such information in a timely manner and act in an expeditious manner to correct them;
- 3.1.10. The level of complexity of the internal control system corresponds to the level of importance of the object under control;
- 3.1.11. The Company prioritizes its activities. The Company's areas of strategic importance are covered by the internal control system, even if the efficiency of monitoring such areas, and the ratio between the costs and the economic benefits are difficult to measure; and
- 3.1.12. The Company's internal control system is comprehensive, that is, it covers all operational areas.

Article 4. Control Environment

- 4.1. The control environment within the Company can best be described as the general attitude of directors, senior managers, and shareholders towards the internal control system, and their awareness and practical actions aimed at establishing and maintaining the internal control system in the Company.

Annex 28. A Model By-Law on Internal Control

- 4.2. Control environment factors include:
- 4.2.1. The integrity, ethical values, and competence of the Company's employees;
 - 4.2.2. Management's philosophy and operating style;
 - 4.2.3. The way management assigns authorities and responsibilities, and organizes and develops its own employees; and
 - 4.2.4. The attention and direction provided by the Supervisory Board.

Article 5. Risk Assessment

- 5.1. The identification and assessment of the Company's risks is performed in accordance with _____.²⁰⁶

Article 6. Control Activities

- 6.1. Control activities are the policies and procedures that help ensure that management directives are carried out, and that necessary steps to address risks are taken.
- 6.2. Specific internal control procedures include:
- 6.2.1. Controlling the implementation of the financial and business plans of the Company;
 - 6.2.2. Comparing current operational data with the budget;
 - 6.2.3. Comparing data provided by various operating units of the Company;
 - 6.2.4. Examining the accuracy of accounting entries;
 - 6.2.5. Checking the accuracy and timeliness of document flows;
 - 6.2.6. Evaluating the efficiency of certain specific transactions;
 - 6.2.7. Checking for the management approvals of the underlying primary documents;
 - 6.2.8. Conducting periodic and unscheduled inspections, inventories of assets and liabilities;
 - 6.2.9. Reconciling and confirming settlement accounts;
 - 6.2.10. Using information from external sources for the purposes of control;

²⁰⁶ Insert the name of the by-law or other document regulating the company's risk management procedures. See also Annex 27 for a model by-law on risk management.

The Russia Corporate Governance Manual

- 6.2.11. Controlling the use of tangible assets;
- 6.2.12. Physically limiting access to the Company's assets, the underlying primary documents, accounting registers, and electronic accounting files;
- 6.2.13. _____; and
- 6.2.14. _____.

Article 7. Information and Communication

- 7.1. Information and communication refer to the identification, capture, and exchange of information in a timely and useful manner.
- 7.2. The Company ensures the availability of full and accurate information on events and conditions that may affect the Company's decision-making.
- 7.3. The Company is committed to creating a comprehensive system of information dissemination to cover all areas of the Company's activities. Information system software is authorized and protected in accordance with procedures adopted by the Company.
- 7.4. The Company seeks to create efficient communication channels to ensure that all governing bodies and persons involved in the internal control process understand and adhere to approved policies and procedures.
- 7.5. The Company ensures the protection of information by prohibiting and preventing unauthorized access.

Article 8. Control and Monitoring of the Internal Control System

- 8.1. An ongoing evaluation of the internal control system is conducted to determine the probability and materiality of errors, the occurrence of which could influence the accuracy of financial statements, and in order to determine whether the internal control system is meeting its stated objectives.
- 8.2. The review of the Company's internal control system is conducted in two stages:
 - 8.2.1. A general overview of the internal control system and preliminary evaluation of its reliability (Annex 1); and
 - 8.2.2. The confirmation of evaluations of material elements of the internal control system (Annex 2).

Article 9. Bodies and Persons Responsible for Internal Control

- 9.1. The Supervisory Board and the executive bodies of the Company are responsible for establishing the proper internal control environment and maintaining high ethical standards at all levels of the Company’s operations.
- 9.2. The Supervisory Board (through its Audit Committee, if established) shall be responsible for the approval of the internal control procedures that fall within the authority of the Supervisory Board.
- 9.3. The General Director is responsible for devising and implementing the internal control system throughout the Company. For this, the General Director delegates certain authority to managers who are responsible for internal control functions within specific areas of the Company’s activities.
- 9.4. The control and audit body of the Company²⁰⁷ or _____ [*specify the name of another person/body in charge of the internal audit function*] implements control activities on a daily basis and reports to the Supervisory Board (or its Audit Committee, if established) and the Company’s executive bodies on the results of the internal audit of the internal control system. The control and audit body reports to and is functionally accountable to the Supervisory Board, and is administratively accountable to the General Director.
- 9.5. The control and audit body is comprised of ____ staff members that have the following qualifications:²⁰⁸
 - 9.5.1. _____;
 - 9.5.2. _____; and
 - 9.5.3. _____.
- 9.6. The control and audit body holds regular meetings whenever necessary, but not less than one meeting every ____ weeks.
- 9.7. The results of the meetings of the control and audit body are presented to the General Director [Finance Director] and the Chairman of the Supervisory Board [Chairman of the Audit Committee].

²⁰⁷ The control audit body may be the Control and Revision Service, or the Internal Auditor, or any other company department.

²⁰⁸ For example, a higher educational degree, __ years of professional experience in the __ industry or sector, etc.

The Russia Corporate Governance Manual

- 9.8. The Company's executive bodies shall annually prepare a report on the internal control regarding the preparation of financial statements for the Supervisory Board __ days before the Supervisory Board shall approve the annual report and the annual financial statements.²⁰⁹
- 9.9. The report on the internal control over the preparation of financial statements shall contain:
 - 9.9.1. A confirmation of the top managers' responsibility for implementing proper internal control over the preparation of the financial statements;
 - 9.9.2. A description of the internal control system and methods used to evaluate the efficiency of the system;
 - 9.9.3. Evaluation of the efficiency of the internal control over the preparation of the financial statements as of the end of the latest fiscal year as carried out by top managers;
 - 9.9.4. Confirmation that the Company's External Auditor prepared an opinion on management's evaluation;
 - 9.9.5. _____; and
 - 9.9.6. _____.
- 9.10. The Company develops a schedule of audits of its internal control system, and its subsidiary companies.
- 9.11. The following functions shall not be allocated to one and the same person:
 - 9.11.1. Immediate and unrestrained access to the assets of a business entity;
 - 9.11.2. Approval of operations with such assets;
 - 9.11.3. Conducting business operations; and
 - 9.11.4. Accounting of business operations.
- 9.12. The proper functioning of the internal control system depends upon the professionalism of its employees. The Company employs systems of selection, engagement, promotion, and professional training of personnel that ensure the highest qualifications and integrity of such personnel.
- 9.13. Executive bodies shall disclose information on material deficiencies in the internal control system.

²⁰⁹ Article 404 of the U.S. Sarbanes-Oxley Act (2002) requires use of this particular report. Accordingly, Russian companies are strongly advised to consider using this report.

Annex 28. A Model By-Law on Internal Control

Exhibit 1. General Overview of the Internal Control System and Preliminary Evaluation of Its Reliability²¹⁰

	Control Environment	Yes	No	N/A
Organizational Structure				
1.	The organizational structure has been developed and approved. It illustrates all departments, clearly indicating relations among management and the subordination of departments (employees).			
2.	The organizational structure of the department responsible for maintaining accounting records has been developed and approved indicating the relations within management and subordination of departments (employees).			
3.	Approved procedures on document flow exist, which list all of activities involving the production, review, and processing of documents performed by the departments and individual employees, and specifies relevant deadlines.			
Allocation of Duties, Powers, and Liability				
4.	The duties of those employees responsible for conducting commercial, financial, and business operations are clearly separated from the duties of those employees in charge of reflecting such operations in the operating system and/or accounting records.			
5.	The separation of functions and duties exists among the employees involved in the operations in a particular segment from their ability to exercise control over the accounting in such segment.			
6.	There are job descriptions for accounting unit employees which specify the allocation of duties, define liability, and establish the scope of authority for each position.			
7.	Those officers having the right to sign underlying documents are clearly identified.			
8.	The persons responsible for safekeeping assets have been officially appointed, and there is a clear system of accountability for such persons.			
9.	If the Company owns expensive assets, the number of persons authorized to dispose of them is limited in number.			
Human Resources Policy				
10.	Training sessions, and continuing professional education seminars are conducted for: <ul style="list-style-type: none"> • The members of the inventory commission in connection with the procedure for conducting and summarizing the results of the inventory of assets; • The cashier regarding rules for conducting cash operations; • Those persons accountable for assets regarding matters of control over the assets; and • The accounting employees to offer additional training and advanced training, etc. 			

²¹⁰ The list of questions in the exhibit is not exhaustive.

Notes:

- 1) The Company uses three levels — high, medium, and low — for the purpose of assessing the efficiency and reliability of the internal control system in general, the control culture, and the specific control procedures employed by the Company.
- 2) The grading at this stage is done by analyzing the data in the table. The ratio of positive answers, i.e. those checked “yes”, in relation to the total number of questions in the questionnaire will be the basis for the assessment. If the ratio is 40–60%, the preliminary assessment of the internal control system shall be assessed as medium. If the ratio is less than 40%, the level of the internal control system will be defined as low, and if it is more than 60%, as high.
- 3) The results of any preliminary review of the accounting and internal control systems are generally insufficient to draw a final conclusion as to the overall efficiency of the internal control system, since a low assessment of reliability of the internal control system and/or separate controls does not preclude a medium or high assessment of the level of other individual controls. However, the results of the first stage should be taken into account during the process of further review (see Exhibit 2).
- 4) The completed table is used as the basis for assessing each section and the entire stage, in general. Subsequently, a review is planned based on the given results. One should not rely on the existing internal control system in the areas affected by the sections graded as “low,” and items for which the answer was “no.” Attention should be paid to those specific areas assessed negatively, although the section as a whole may have been graded as “medium” or “high.” Based on the initial result received upon assessment of the entire stage, a decision is made whether one can rely on the internal control system or not.

Annex 28. A Model By-Law on Internal Control

Exhibit 2. Confirming the Evaluation of Material Elements of the Internal Control System²¹¹

No.	System of Control	Notes
General Matters		
1.	Does management create the appropriate atmosphere and culture in the Company regarding matters of internal control?	
2.	Does any control and audit body implement internal control?	
3.	Does any regular program regarding the review and assessment of the internal control system exist as the Company's operations change?	
4.	Does the reporting system provide sufficient information to identify any material financial and operational problems in a timely manner?	
5.	Does the Audit Committee receive the same comments from the External Auditor regarding the internal control system as management does?	
6.	How does the External Auditor evaluate the Company's internal control system? What suggestions have been made? Does the External Auditor prepare a report regarding internal control measures for preparing financial statements? Do the Company and its External Auditor provide a report on the internal control system to the Company's shareholders?	
7.	Has the External Auditor identified any material defects in the internal control system's structure or functioning? Were any of them serious enough to be considered "material defects"? What was done to cure such defects?	
8.	Do both management and the Supervisory Board consider the Company's internal control system to be effective? What mechanisms exist within the Company to prevent accounting fraud or other violations of accounting principles?	
9.	How often do the control and audit bodies of the Company (the Revision Commission, the Control and Audit Service, or the Internal Auditor) examine the Company's internal control policies and procedures? Have any serious defects been identified? And, if so, what was done to cure such defects?	
Fraudulent and Illegal Practices		
10.	Does the Company have any program in place to detect and prevent fraud? Who is responsible for corporate security? Does the Company have a good control system to protect the Company's technology, commercial secrets, and other confidential information?	
11.	Are the internal control policies and procedures efficient enough to reveal any potential defects, fraud, or illegal practices? Is the the control system sufficient enough to uncover any unauthorized transactions, for example, unauthorized securities operations?	

²¹¹ The list of questions in the exhibit is not exhaustive.

The Russia Corporate Governance Manual

No.	System of Control	Notes
Fraudulent and Illegal Practices (continued)		
12.	Is there any system in place which protects against the misappropriation of the Company's assets?	
13.	Does the control and audit body of the Company have any processes specifically intended to prevent fraud? Do they include discussions with management regarding implementing of measures to prevent fraud? Does the Audit Committee discuss with the External Auditor its review of the risk of fraud during the course of audits?	
14.	Did the Audit Committee receive any information regarding fraudulent or illegal practices occurring during the previous year? If such practices occurred, what arrangements did management and the auditing authorities make for dealing with such events?	
15.	Were any employees involved in committing fraud? If so, what sanctions were imposed against such employees? Were these cases disclosed to the public?	
16.	What policies and procedures does the Company have in order to uncover and prevent any insider transactions? Were any such violations revealed during the previous year? If so, what measures did management and the control and audit body take to rectify the situation?	
17.	Does the Company have any policies or procedures concerning voluntarily disclosing information as to material terms (the price, periods, payment procedures) of supply agreements with counterparts representing the interests of state agencies or departments?	
18.	Who is responsible for the enforcement of the Company's internal control policies and procedures? Does this person have a sufficiently high level of experience and expertise to ensure efficient performance of its duties and responsibilities?	
19.	Are the Company's lawyers required by the Company to report any possible violations of laws and regulations to executives at the relevant level? Has such information ever been reported? If so, what measures were taken as a result?	
External Audit		
20.	How often does the External Auditor meet with the control and audit body and the Audit Committee? Does management take part in such meetings? Does the Audit Committee meet with the External Auditor separately, i.e. without management being present?	
21.	Does the Audit Committee analyze the breadth and degree of the External Auditor' intended audit prior to such audit? Does it hold any meetings with the External Auditor when the audit is completed? What mechanism ensures that the Audit Committee follows the Auditor's recommendations?	
22.	Who appoints the External Auditor? What is the decision-making process for the Audit Committee to decide on appointment of the existing Auditor or election of a new one? If shareholders do not approve this decision, what are the reasons?	
23.	Does the External Auditor have any relationship with management or the Supervisory Board that may be viewed as a conflict of interest?	

Annex 28. A Model By-Law on Internal Control

No.	System of Control	Notes
External Audit (continued)		
24.	What kind of non-audit services does the External Auditor provide? Do the fees for such non-audit services significantly exceed typical audit fees and if so, why? How do the fees for non-audit services compare with the fees paid by other companies in the same industry in terms of their form and amount?	
25.	Has any competitive selection process been carried out, or any other method used to guarantee that the External Auditor's services are offered at market prices and pursuant to accepted standards? What fees do other consulting firms charge, and what is the percentage of the total fees for such consulting services that the External Auditor receives?	
26.	Does the External Auditor provide the Company with any internal audit services? Does the Company plan on having the External Auditor provide such services?	
27.	Does the External Auditor advise the Company on matters of structuring transactions? If so, what kind of advice is provided? Does the External Auditor analyze any material and complex transactions from the point of view of accounting and tax matters? Is the control and audit body informed about such transactions? What methods are applied to supply the External Auditor with all the necessary information in order to ensure accurate taxation? Does the Company consult with the technical staff of the External Auditor? Has the Company ever had any disagreements with the External Auditor concerning the accounting for such complicated transactions?	
28.	Has the Company ever considered periodic rotation of the External Auditor's lead partner, or even the entire audit firm?	
29.	How many years has the External Auditor audited the Company?	
30.	If the External Auditor was dismissed/replaced, what were the reasons? If the External Auditor refused to conduct further audits of the Company, what were the reasons?	
31.	Did the company have any disagreements with the previous External Auditor concerning the Company's accounting practices? If so, what were the reasons of such disagreements?	
32.	What are the nature and scope of errors in the financial statements which were revealed by the External Auditor and which were not corrected by management?	
33.	Did the Audit Committee have any consultations with its advisers or any other audit firm? What necessitated such consultations? Does the Audit Committee believe that such consultations will become a standard practice in the future?	
34.	Does the Company use the services of any other audit firms in order to audit its subsidiaries? Are all the Company's divisions audited? Is any Auditor's report on financial statements of Company's subsidiaries qualified? If yes, why did the Auditor's report on the parent company not disclose such information?	
35.	Does the External Auditor visit the main operating units of the Company on a regular basis?	

The Russia Corporate Governance Manual

No.	System of Control	Notes
Internal Audit		
36.	Does the Company have an Internal Auditor or internal audit unit? If not, does the Company plan on establishing one? When will it start operating? What costs are involved in its creation?	
37.	How many Internal Auditors are there in the Company, and how does this figure compare to similar companies? What is the amount of annual expenses for maintaining the Internal Auditor? What have been the trends for changing the personnel of the Company's Internal Auditor over the last five years?	
38.	How often do the internal audit representatives meet the Audit Committee? Does management take part in such meetings? Are any meetings held without management's participation? Does the Audit Committee meet the Internal Auditors separately?	
39.	Does the Audit Committee conduct a preliminary evaluation of the scope of work of the Internal Auditors? What mechanism, if any, ensures the Committee's compliance with the Internal Auditors' recommendations?	
40.	Does the Internal Auditor participate in the audit of financial statements?	
41.	Does the Company have any Internal Auditors specializing in the audit of information systems and control systems? Do their responsibilities include examination of computer security and business continuity planning?	
42.	Does the Internal Auditor include specialists in the area of operations with financial instruments? How often does the Internal Auditor inspect operations with derivative instruments and risk management procedures?	
43.	Is the Internal Auditor encouraged to receive additional professional training (for example, to qualify as a certified accountant)? How is the appropriate professional level of the Company's Internal Auditor maintained?	
44.	What governing body does the Internal Auditor report to? Does the head of the Internal Auditor function have permanent access to Audit Committee members? Does the Supervisory Board approve the By-law on Internal Control and the scope of work of the Internal Auditor? Can management dismiss the head of the Internal Auditor without the consent of the Audit Committee?	
45.	Are there any limitations on the scope of work of the Internal Auditor? Do the Internal Auditors have unrestricted access to all units, documents and personnel of the Company?	
46.	How often do the representatives of the Internal Auditor visit each of the operating units? Do they audit foreign units? Are there any offices or units of the Company that the Internal Auditors have never visited?	
47.	Does the Internal Auditor conduct operational (managerial) audits intending to identify opportunities to increase production efficiency and eliminate instances of inefficient operation? How much time does the operational audit take in comparison with the financial audit?	
48.	Do the Internal Auditors prepare written reports for each audit? Who receives such reports? Who is responsible for implementing the recommendations?	
49.	Does the Company use the External Auditor's employees to conduct internal audits? If so, does this procedure violate the requirements regarding the External Auditor's independence?	

Annex 28. A Model By-Law on Internal Control

No.	System of Control	Notes
Internal Audit (continued)		
50.	Does the Company engage any other audit firm to conduct the internal audit? What is the relationship between the External Auditor and the firm that provides internal audit services?	
51.	Has an external audit of the standards and efficiency of the Internal Auditor ever been conducted?	
General Financial Accounting Matters		
52.	How does the Company gauge the quality of its accounting practices? Can the Company's accounting policy generally be described as aggressive or conservative?	
53.	Have the press or analysts expressed any concerns regarding the accounting policy of the Company?	
54.	How does the Company's accounting policy compare with those of its main competitors?	
55.	Is the Company's accounting policy consistent with the last year's policy? Were there any changes in the accounting policy? If so, how did such changes influence the financial results? Are there any plans to change the accounting policy next year? What is the expected effect?	
56.	What quantitative and qualitative factors does the Company consider important for purposes of making decisions regarding the materiality of violations during reviews of the financial statements?	
57.	Did the Company have to amend the profit and loss statement? If yes, what was the reason for the misstatement, and how was it discovered? Is there any possibility that these misstatements were deliberate?	
58.	Why has the information about _____ (a material event such as acquisition, write-off, or sale) not been made available earlier? How long did such information remain undisclosed? Is the Company considering any similar transactions in the near future?	
59.	Are the financial statements of the Company available on the internet? Does the Company plan to distribute hard copies of its annual report directly to shareholders?	
60.	Why did the Company change its accounting method of _____ [name transactions]? Why is the new method better than the old one?	
61.	What is the cause for the increase/reduction of _____ [name account] as compared to the last year?	
62.	What general items were included into _____ [name account]?	
63.	What is the Company's accounting policy regarding _____ [name transaction]?	
64.	What extraordinary accounting entries affected the comparability of results?	
65.	What items are included into "other" in _____ (name the balance sheet line)?	
66.	What kind of information does the Company provide regarding its trading activity, in particular, its over the counter transactions where fair or market value price must be determined separately?	

The Russia Corporate Governance Manual

No.	System of Control	Notes
Financial Accounting Matters: Information Disclosure in the Annual Report		
67.	Does the Company include in its annual report information on material aspects of its accounting policy, assumptions and uncertainties that affect the application of its policy, and the probability of the amounts being materially different based on other assumptions? What are the most material assumptions and qualifications that management uses in preparing the financial statements?	
68.	What does the Company do in order to make its financial statements transparent and easy to understand? Do the financial statements of the Company and its annual report reflect actual business risks and economic reality accurately, completely, and clearly?	
69.	Why does the Company not increase the scope of information in its annual report by including more analytical information and forecasts, and information about current issues and steps to resolve problems?	
70.	Does the Company's annual report clearly explain the external environment, industry dynamics, and the Company's position in the market?	
71.	Does the Company's annual report reflect its strategy in terms of its market capitalization?	
72.	Are the Company's financial objectives clearly stated, and to what extent have they been fulfilled by the Company? Is information included about the managerial and governance structures responsible for fulfilling the Company's strategies?	
73.	Is it clear from the annual report what the basis for the Company's financial performance is, how efficient the Company is in managing such resources as personnel, innovations, clients, trademarks, and suppliers, and what the Company's reputation is with stakeholders in terms of its environmental responsibility?	
Financial Accounting Matters: Accounting		
74.	Have accounting records been kept in accordance with the Company's approved accounting policy for the relevant period?	
75.	Does the Chief Accountant or any other authorized person check internal transactions to control whether all current business transactions are fully reflected in the accounts, and whether internal transactions comply with the rules in effect?	
76.	If the Company is conducting internal transactions which are not referenced or reflected in the chart of accounts (accounting records), do these internal transactions lead to a violation of accounting rules and, as a result, are misstatements of the taxable base and financial results material?	
77.	Are the business transactions authorized by management, both in their entirety and on each phase of the transaction (for example, all underlying petty cash vouchers and accounts payable are approved by the authorized manager)?	
78.	Do the accounting records reflect all business transactions based on the primary documents only?	
79.	Do the synthetic accounting balance data in the ledger correspond to the accounting balance data in the order record books or in any other backup accounting registers?	

Annex 28. A Model By-Law on Internal Control

No.	System of Control	Notes
Financial Accounting Matters: Accounting (continued)		
80.	Does analytical accounting data correspond to primary document data regarding the designation, terms and amount, and to the synthetic accounting data?	
81.	Do the closing balances in the accounting registers correspond to the opening balances of the next reporting period?	
82.	Are there any inconsistencies between the amounts of a particular internal transaction as reflected in different accounting registers (for example, in the order register and in the ledger)?	
83.	Are there any inconsistencies between the balances of any particular account as reflected in different accounting registers (for example, the balance of the cash account which is registered in the ledger may not correspond to the same account balance registered in the cashbook)?	
84.	Are primary documents and accounting registers free from any notes made in pencil or unspecified corrections?	
85.	Are accounting operations registered on the basis of the accrual method?	
86.	Has any particular person been appointed to be responsible for, and is there any control over the timing of payments under invoices to avoid penalties for the breach of contractual obligations?	
87.	Are earmarked funds used for their intended purpose (subject to approved estimates and plans)?	
88.	Are all funds created in accordance with the Company's charter spent in accordance with their purpose?	
Financial Accounting Matters: Financial Results		
89.	How do actual sales and revenues relate to the numbers in the forecasts and the budget, or the numbers for the previous year? If any differences exists, what are the reasons for such differences? To what extent did operating volumes influence these differences? Or the assortment of goods/services? Or the price?	
90.	If the financial results of the Company differ from the forecasted figures or from forecasts by analysts, what are the reasons?	
91.	What percentage of any increase in sales is accounted for by new acquisitions?	
92.	How much money did the Company save over the past year because of cost-saving measures?	
93.	What share of the Company's net profit accounts for one-time transactions? What kind of transactions were they?	
94.	How do revenues and the major financial indices of the Company compare with the data for other companies in this industry? How do cash flows and the Company's liquidity compare with those of its competitors? If operational cash flows fail to grow as fast as the net profit, what are the reasons for that?	
95.	How much money was spent on advertising and goods promotion this past year? Will these expenses increase or decrease next year?	
96.	If the Company's receivables increase faster than sales, what are the reasons for that? Does the Company provide major clients with additional financing in order to encourage sales? Has the Company had to write off any part of such debts?	

The Russia Corporate Governance Manual

No.	System of Control	Notes
Financial Accounting Matters: Financial Results (continued)		
97.	What was the total amount of debt written off last year? How can it be compared with other companies in this industry? What were the largest amounts of debt written off?	
98.	How much in receivables are owed by insolvent or bankrupt companies? Has any reserve been set aside, and if so, do such reserves cover the full amount of these debts?	
99.	Is there any risk of default from the Company's major suppliers or customers, or other major contracting parties, because of financial problems or bankruptcy?	
100.	Are there any direct or indirect operational risks, including risks connected with off-balance contracts, with a company that has initiated bankruptcy proceedings?	
101.	Does the Company have any joint investment projects, derivative, or other contracts with a company that has claimed bankruptcy? If yes, has the value of such joint investments decreased as a direct result thereof? What was the estimated value of those investments at the end of the year?	
102.	Why are ____ [a competitor's] operational results so much better than the Company's results?	
103.	How does the Company's return on investments compare with other companies in this industry?	
104.	How does the Company's profitability compare with changes in revenues? If the net profit has not grown in proportion to revenues, then what factors influenced the situation?	
105.	Were there any material revisions of profit data made in the fourth quarter?	
Control Over Computer Data Processing System		
106.	Is software appropriately licensed?	
107.	Is the program protected from access by third parties who may change or delete data?	
108.	Are electronic accounting data backed-up on a regular basis to prevent loss or deletion?	
109.	Do the original electronic forms (templates) of primary documents and accounting registers developed by the company (an order register, a cash register, the ledger) satisfy the requirements for unified and approved forms?	
110.	Does the business accounting data processing algorithms comply with current laws? When using the electronic business accounting method overall, or in certain areas, is it necessary to selectively check and confirm the validity of calculations under the main orders? For example, when using the computerized method of filling in tax returns, are the tax accounting formulas and the tax rates correct? When using the computerized method of filling in accounting forms, are the formula and synthetic accounts which are involved in the calculations correct?	

Annex 28. A Model By-Law on Internal Control

Notes:

- 1) The processing of the data is carried out in the same way as for the table in Exhibit 1. Thereafter, an evaluation of the functioning of the accounting and internal control system should be separately conducted for each Company unit and for the Company as a whole.
- 2) The report on the evaluation shall provide a description of any identified shortcomings with suggestions for remedying such deficiencies. In this way, those parts of the accounting and internal control systems that require special attention and focus from the Supervisory Board will be identified, and efforts made to minimize the risks of recurrence. The resulting data analysis should indicate the status of the internal control system in each Company unit, and will readily allow the identification of strengths and weaknesses in the accounting and internal control systems.²¹²
- 3) The results of the aggregated data analysis in each Company unit should indicate the level of the internal control system in the whole Company. A low estimate indicates that material deficiencies in the internal control system exist, and that the existing accounting and internal control systems in the Company are not capable of identifying and curing significant deficiencies and/or preventing such deficiencies from occurring.²¹³

²¹² Approximate results of the estimates:

- Financial operations reflected on the accounting with violations of legal requirements bring into question the correctness of recording these transactions;
- Misstatement of cost and financial results records in certain accounting periods;
- Lack of control functions leads to unjustified expenditures of the company's funds; and
- Contracts entered into which violate laws and regulations might be declared null and void under Article 168 of the Civil Code.

²¹³ Some examples of the most common deficiencies:

- Lack of proper delineation of duties, or multiple duplication of duties;
- Lack of proper control over, and approval of business transactions;
- Lack of proper control while preparing and entering into business agreements;
- Inefficiency of control procedures;
- Intentional or unintentional violations of control procedures by company officials; and
- Accounting system violations by employees who are in charge of preparing initial documents.



Annex 29

GUIDELINES ON THE ANNUAL REPORT

Table of Contents

PART I. DRAFTING, APPROVING, AND PUBLISHING THE ANNUAL REPORT.....	303
1. <i>The Importance of the Annual Report for the Company</i>	304
2. <i>Preparing Information for the Annual Report</i>	304
3. <i>Procedures for the Approval and Publication of Annual Reports</i>	305
4. <i>The Annual Report's Structure</i>	307
PART II. A MODEL STRUCTURE OF THE ANNUAL REPORT	307
1. <i>The Cover Page</i>	307
2. <i>Overview</i>	307
3. <i>The Address of the Company's Chairman of the Supervisory Board</i>	308
4. <i>Information about the Company</i>	308
5. <i>Management's Discussion and Analysis</i>	309
6. <i>Market Share, Sales, and Marketing</i>	310
7. <i>Securities and Equity</i>	311
8. <i>Corporate Governance Structures and Principles</i>	312
9. <i>Environmental, Social, and Economic Sustainability</i>	313
10. <i>The Revision Commission's Conclusions and Report</i>	313
11. <i>The External Auditor's Opinion</i>	314
12. <i>Financial Statements, Notes, and Comments</i>	314

Part I. Drafting, Approving, and Publishing the Annual Report

The purpose of these guidelines is both to summarize the standards and requirements of current Russian legislation, and to succinctly present good corporate governance practices relative to drafting annual reports for Open Joint Stock Companies. This document consists of two parts. The first part



contains general recommendations on procedures for drafting, approving, and publishing the annual report, while the second part contains specific guidelines and recommendations regarding the structure and content of annual reports.

1. The Importance of the Annual Report for the Company

The annual report is more than just a legal requirement — it should be seen first and foremost as an information tool for the company's shareholders. It may also serve to highlight the company's accomplishments and help attract potential investors. The annual report should, however, present a balanced view. Balance requires that the company not only focus on successes, but on setbacks as well. The manner in which information about the company is presented, how that information is grouped, and the key elements of the document's layout and structure can all have a significant impact on readers. The specific structure chosen by the company will of course depend upon the nature of its business activities, and the specific goals and objectives chosen for the annual report. Ultimately, it is the information contained in the annual report that will define its quality.

2. Preparing Information for the Annual Report

a) Defining the aims of the company's information disclosure policy

The principal aims and purposes of disclosing information in the annual report should be clearly defined at the outset of the preparation process, and might include any of the following:

- To demonstrate to shareholders the ability of management to respond successfully to changes in the external business environment;
- To convince potential investors of the benefits of investing in the company;
- To convince key stakeholders of the company's ability to withstand industry crises; and
- To inform the markets of the company's earnings, how earnings were generated, and future performance potential.

b) Defining the target audience

Defining the target audience and its expectations in terms of disclosure is important. The potential target audience may include one or more of the following groups: shareholders, potential investors, state and local authorities, customers,

Annex 29. Guidelines on the Annual Report

suppliers, creditors, and employees. At a minimum, the following questions about the target audience must be addressed:

- Who is the intended recipient?
- What level of knowledge and skills in the fields of management, finance, and marketing, and the company's industry and sector does the potential reader have?
- What effect should the report have on the reader?
- What information about the company is the most important to potential readers?

c) Defining responsibility

The Supervisory Board should ultimately be responsible for supervising the drafting of the report. Nevertheless, it is advisable to establish a separate committee or charge a specific person with the responsibility for preparing the information and drafting the report.

d) Defining the contents

In terms of preparing the information to be included in the report, it should be borne in mind that the report should do more than simply recite the company's recent financial achievements — it should reflect the dynamics of the company's current and future development. For example, today's market and potential investors not only require information about the company's recent profits, but also information about the company's investments in R&D, its market share, capital expenditures, technological innovations, and a description of its corporate governance, social, and environmental policies. The prevailing practice today is to divide the annual report into various sections for quick reference. If the company intends to attract foreign investment, the report should be drafted in a number of languages, ideally in English.

3. Procedures for the Approval and Publication of Annual Reports

In Russia, procedures for the preparation and publication of annual reports of Open Joint Stock Companies are regulated by:

- The Federal Law of December 26, 1995, No. 208 on Joint Stock Companies;
- The Federal Law of November 21, 1996, No. 129 on Accounting and Book-keeping;

The Russia Corporate Governance Manual

- The Order of the Ministry of Finance of the Russian Federation of November 28, 1996, No. 101 on Procedures for the Publication of Financial Statements by Open Joint Stock Companies;
- The Federal Commission for the Securities Market (FCSM) Resolution of May 31, 2002, No. 17/ps on Approving the Regulations on Additional Requirements for Preparing, Calling, and Conducting the General Meeting of Shareholders; and
- The FCSM Resolution of April 04, 2002, No. 421/r on Recommendations to the Application of the Code of Corporate Conduct (hereinafter the FCSM Code).

The principal requirements of Russian law regarding the approval and publication of annual reports can be summarized as follows:

- The executive body is responsible for the annual report;
- The data contained in the annual report must be verified by the company's Revision Commission, and certain companies are also required to have their annual financial statements verified by an independent External Auditor;²¹⁴
- The annual report has to be preliminarily approved by the company's Supervisory Board, but not later than 30 days before the date of the Annual General Meeting of Shareholders (AGM);
- The annual report must be signed by the General Director, as well as the chief accountant, and contain a specific statement regarding its preliminary approval;
- Companies are required to disclose their annual reports to shareholders;
- The publication of financial statements is subject to AGM approval, but good corporate governance practices dictate that they be publicly disclosed, ideally through the company website as well; and
- The annual financial statements must be published no later than June 1st of the year following the reporting year.²¹⁵ The publication of financial statements shall mean public disclosure through publication in the mass media, and they are deemed publicly disclosed in the event of actual publication in at least one

²¹⁴ Law on Auditing, Article 7, Clause 1, Paragraph 2 provides that companies must have an annual, external audit conducted by a certified independent External Auditor (or a licensed audit company), when the company is incorporated as an Open Joint Stock Company, or has revenues for the reporting year greater than 500,000 times the minimum wage, or has a book value of assets as of the year-end greater than 200,000 times the minimum wage.

²¹⁵ Order of the Ministry of Finance of the Russian Federation, No. 101 on Procedures for the Publication of Financial Statements by Open Joint Stock Companies, 28 November 1996, Section 1.1.

Annex 29. Guidelines on the Annual Report

printed media as may be set forth by the charter or decision of the General Meeting of Shareholders (GMS).

4. The Annual Report's Structure

Until recently, there was no legal regulation of the structure of annual reports in Russia. Lately, the trend has been to toughen regulations in this area. The FCSM Regulation No. 17/ps on Approving the Regulations on Additional Requirements for Preparing, Calling, and Conducting the General Meeting of Shareholder contain requirements for the contents of annual reports. The FCSM Code also includes certain recommendations with this regard.

In accordance with requirements of FCSM Regulation No. 17/ps and the FCSM Code recommendations, the annual report should contain a statement of the company's industry position and business; disclose the company's sales and financial performance; report on the payment of dividends; include detailed information about the company's securities; list extraordinary transactions and related party transactions; disclose information about the company's Supervisory Board and the executive bodies, as well as information regarding remuneration; and finally, disclose information regarding the company's corporate governance practices, and its employee, social, and environmental policies.

Part II. A Model Structure of the Annual Report

1. The Cover Page

The cover page should be attractive, professional, and designed to reflect the principal idea and the main focus of the company's business, and should include, if applicable, the following:

- The company's logo or trademark; and
- The company's slogan or motto.

2. Overview

This section should provide the reader with a brief overview of key events and issues that have had an impact on the company — both with respect to the past financial year and in the foreseeable future.

3. The Address of the Company's Chairman of the Supervisory Board

The address of the company's Chairman of the Supervisory Board (commonly referred to as the Chairman's report) must be balanced and targeted specifically at its intended audience. A principal theme or topic should be chosen, and typically, the following items should be included:

- A general discussion of the company's financial results and highlights;
- An overview of the company's share performance and the payment of dividends;
- The company's principal achievements during the year;
- A brief overview of the general business environment and the company's principal markets;
- The company's business strategy and plan, and product initiatives and innovations; and
- Principal changes in the company's management structure.

4. Information about the Company

This section is critical, especially for potential investors. It is necessary to bear in mind that much of the intended audience does not necessarily possess sufficient historical or up-to-date information about the company. Accordingly, this section should provide a sufficiently comprehensive description of the company, and might include the following main points:

- A brief history of the company, its products or services, and a description of its governance structure (consider presenting the company's structure in the form of a diagram);
- The company's organisational structure, including any subsidiaries and related companies;
- An overview of the main events of the year that affected the company's development and success;
- A brief review of the company's key markets and product groups;
- An overview of its production capacity and output, where applicable; and
- Any other information, including contact and reference information about the company, and information about its achievements and policies that might be deemed interesting or attractive for potential investors.

5. Management's Discussion and Analysis

Financial information about the company, including the utilization, sale, and purchase of assets, is essential for both current shareholders and potential investors alike. Therefore, in this section entitled Management's Discussion and Analysis (MD&A) it is advisable to provide a comprehensive picture of the company's assets and financial situation, and disclose this information to an even greater degree than that currently required by law. For example, certain business transactions between the company and its senior executives or major shareholders should be disclosed. As another example, it may be desirable to present net profit figures both as a total net profit, and net profit broken down by products or market segments. In addition, detailed information regarding changes in asset composition, an analysis of the company's liquidity, its profit margin and debt to equity ratio, and the percentage of export earnings relative to the total earnings of the company for the year should be included. The sections presenting the financial results and condition of the company should contain both current and historical data covering, for example, the preceding three-year period. Since the company's executives often have the most complete information about the company's financial situation, the annual report should include management's discussion and analysis of the results and the factors affecting its financial situation, and the current trends that are likely to affect the company's financial strength in the future. The following topics should be addressed in detail:

- A review of significant business transactions entered into or contemplated for the future;
- An analysis of the factors contributing to the discrepancy between planned and actual results;
- A thorough presentation of the company's accounting methods and policies, including the legal basis on which the annual report was prepared, which accounting standards were utilized in preparing financial statements beyond Russian Accounting Standards (RAS), e.g. International Financial Reporting Standards (IFRS) or U.S. GAAP, and any deviations from these standards, methods for asset reporting (for example, depreciation and amortization of assets), and methods for cost and tax accounting;
- Inflation figures and foreign currency calculations and accounting, if applicable;
- An analysis of any restructuring of the company and the effects of such restructuring;

- A detailed and comprehensive analysis of the company's financial results, including, but not limited to, presentation of data on sales, product costs, operational profits broken down by business units, products or market segments, a breakdown of operational and non-operational income and expenses, earnings before tax, depreciation, and amortisation, net profit, taxes on profit, and earnings per share;
- A detailed and comprehensive analysis of the company's financial condition, including, but not limited to, a presentation of data regarding the company's balance sheet, such as information on the composition of current assets including inventories, payables and receivables, equity structure, the debt to equity ratio, details as to current and long-term liabilities and debt repayment, and changes in the company's policy regarding asset and debt management;
- The company's liquidity and sources for additional funding for current and long-term operations; and
- A detailed description of the company's risk management system, including a description of the principal risks associated with the company's business operations, e.g. market price and interest rate fluctuations, and an overview of the procedures employed for managing and minimizing such risks, including the setting aside of additional reserves and the purchase of insurance policies.

6. Market Share, Sales, and Marketing

In general, this section should enable the reader to obtain a comprehensive understanding of the company's sales and marketing position in its principal markets. Further, this section should provide adequate information about management's activities and efforts aimed at strengthening the company's position. To facilitate the reader's understanding, it is especially appropriate and desirable in this section to utilize tables, graphs, and diagrams to present and illustrate the data, and additionally, it may prove useful to provide references to the financial statements and cash flows when explaining how certain events or decisions affected the financial results of the company. Consider providing a detailed analysis of the following:

- Key market trends, both macro- and micro-economic;
- Summarize the company's competitive environment and changes in its market share;
- Present sales data expressed in unit volumes and in monetary figures, and by market segments and products as applicable;

Annex 29. Guidelines on the Annual Report

- Present detailed product and price information, including new products, sales, and pricing policies;
- Provide a summary of the company's relationship with its principal suppliers; and
- Summarize management's efforts to counteract negative developments in the company's markets, and efforts aimed at maximizing the company's competitive advantages.

7. Securities and Equity

This section is primarily addressed to shareholders and potential investors. It should include information about the company's ownership structure, and a description of the main principles of the company's dividend policy and disclosure of dividends paid or reasons for non-payment. The aim of this section is to give shareholders and potential investors a thorough understanding of the current value of the company's shares, existing stock market trends, and associated risks. Characteristically, this section utilizes an abundance of charts and graphs to present the data. It is important as well to note that, in accordance with Russian law, the company must disclose information on shareholders who own 20% or more of the company's shares. However, this is insufficient information for understanding the true ownership structure of the company. Therefore, it is also recommended that information on shareholders who own as little as 5% or more of the company's shares be disclosed. While disclosing this information, the company should also disclose any information in its possession about indirect ownership of the company's shares. The following issues should be covered:

- Information regarding the issuance of company securities and its capital share structure, including information on the number of outstanding shares, a list of major shareholders, and any share buyback plans or other acquisitions and divestitures implemented by the company;
- Any steps undertaken by management to raise the market capitalization of the company;
- Current and historical trading data for the company's shares, including maximum and minimum prices and volume of shares traded over a specified period; and
- A description of the company's dividend policy and payments of dividends.

8. Corporate Governance Structures and Principles

In general, shareholder protection mechanisms, good board practices, disclosure and greater transparency, as well as the establishment of adequate risk management and internal control mechanisms, lead to more than just an increased flow and volume of investment capital — they should also lead to increasing operational and managerial efficiency, increasing growth and profits, and enhancing reputation. For these reasons, it is imperative that the annual report include a section on the company's corporate governance policies and procedures.

In addition to providing a diagram of the company's governance structure, the annual report should contain the company's statement of firm and continuing commitment to corporate governance principles and practices. Further, it is worthwhile to consider providing a list of corporate governance principles that the company has adopted and adheres to, and provide a detailed accounting of the company's efforts and successes in satisfying such principles during the reporting period. While no list can be considered completely exhaustive, the following items regarding the corporate governance policies and practices should be considered for inclusion in the annual report:

- The company's statement of firm commitment to the most progressive principles and practices of corporate governance;
- A statement of compliance with the principles of the FCSM Code and regulations;²¹⁶
- Details regarding the composition of the Supervisory Board, including background information for each member, and a statement as to which directors are independent;
- A statement regarding the company's remuneration policy, and the details of the individual remuneration of Supervisory Board members and senior executives during the reporting period;
- A statement regarding the existence and competencies of any Supervisory Board committees, and details of their relationship and interaction with the company's Supervisory Board;
- A disclosure of the company's risk management and internal control systems, and a statement of compliance therewith;
- A detailed disclosure of all material related or interested party transactions entered into or that were being considered during the reporting period;
- A disclosure regarding the existence and role of the Audit Committee or Revision Commission in ensuring transparency and full information disclosure;

²¹⁶ For an example of a detailed statement of compliance, see the IFC Russia Corporate Governance Project's website under www.ifc.org/rcgp.

Annex 29. Guidelines on the Annual Report

- A disclosure of the process for evaluating the performance of the company's Supervisory Board and executive bodies, including information regarding any performance evaluations conducted during the reporting period; and
- A statement regarding the adoption of a code of ethics and adherence thereto.

9. Environmental, Social, and Economic Sustainability

The establishment and implementation of an environmental policy is one area in which, regardless of the existence or absence of mandatory disclosures and practices, the companies themselves should be proactive, and voluntarily develop and disclose their policies, projects, and related expenses. As to personnel, labor, and social policies, the annual report should consider including a discussion of the following topics:

- The main areas in which the company has concentrated its efforts, especially in terms of its environmental policy, and its principal achievements;
- The social expenses incurred by the company and contributions to any charities;
- The number of employees and current changes being experienced or implemented;
- Its primary goals and important steps taken in terms of personnel development; and
- Wages and growth rate for wages.

10. The Revision Commission's Conclusions and Report

Pursuant to Russian law, the Revision Commission's report regarding the results of its inspection of the business and financial performance of the company must contain a verification regarding the accuracy of the data contained in the annual report and financial statements of the company. While the Revision Commission typically conducts an annual audit and inspection of the previous year's results, Russian law also provides certain circumstances and procedures for conducting extraordinary audits at different times during the year.

The scope of duties and responsibilities of the Revision Commission include the following:

- An inspection of the financial documents and reports, and an analysis of the accuracy and completeness of the company's accounting, tax and statistical reporting;

- An analysis of the company's financial condition, specifically, its solvency, asset liquidity, debt to equity ratio, net assets, and charter capital;
- Developing recommendations for management;
- Conducting an inspection of the timeliness and correctness of payments; and
- Verifying the reliability of data included in the annual reports of the company and the annual financial statements.

11. The External Auditor's Opinion

It is important to note that the company must under legally defined circumstances employ the services of an independent External Auditor whose opinion would be included as a separate section of the company's annual report. The focus of the External Auditor's opinion is on whether or not the financial statements of the company are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they can be relied upon. It gives shareholders, managers, employees, and market participants an independent opinion about the company's financial position and, if performed properly, should attest to the accuracy of the statements. An independent external audit conducted by a publicly recognized accounting firm normally enhances the company's credibility and prospects for attracting investment.

12. Financial Statements, Notes, and Comments

The financial statements are to present a true and fair view of the company's financial position to enable shareholders and other market participants to gauge the company's performance and assess the stewardship of the executive bodies. Any comments and presentation of financial statements should contain an explanation of the principles used in preparing those financial statements, and their effect on the key performance indicators of the company. The company should disclose and provide detailed comments regarding the following:

- The balance sheet;
- The profit and loss statement;
- The statement of changes in owners' equity
- Its cash flow statement
- The notes to the financial statements; and
- Explanations to financial statements.

Annex 30

GLOSSARY OF ENGLISH AND RUSSIAN CORPORATE GOVERNANCE TERMINOLOGY

No	English	Русский
1.	Accountability: The liability of management and the Supervisory Board to Shareholders and other stakeholders for corporate performance and the actions of the company.	Подотчетность: ответственность руководства и <i>совета директоров</i> перед <i>акционерами</i> и другими заинтересованными лицами за действия и результаты работы общества.
2.	Administrative Authorities: Governmental authorities. In the context of this Manual: Regulators.	Государственные органы: в контексте настоящего Пособия — органы государственного управления.
3.	ADR (American Depository Receipts): Certificates that are traded in the U.S. representing shares of corporations listed outside of the U.S. market.	АДР (американская депозитарная расписка): сертификаты акций компаний, зарегистрированных на иностранных биржах. Американские депозитарные расписки обращаются на фондовом рынке США.
4.	Affiliated Person: An individual or a legal entity that can influence the activity of legal entities, and/or individuals who are engaged in entrepreneurial activity. See more detailed definition in Chapter 12, Section B.	Аффилированное лицо: физическое или юридическое лицо, которое может повлиять на деятельность юридических лиц и (или) физических лиц, занимающихся предпринимательской деятельностью. См. более подробное определение в разделе В главы 12.
5.	Annual General Meeting of Shareholders (AGM): An AGM shall be held two not earlier two months and not later than six months after the end of each reporting year, at which shareholders, directors and managers discuss the company's results and future. Synonyms: General Meeting or Annual Meeting. See related: Extraordinary Meeting.	Годовое общее собрание акционеров: общее собрание акционеров, которое проводится не ранее чем через 2 месяца и не позднее чем через 6 месяцев после окончания каждого отчетного года и на котором <i>акционеры</i> и руководство обсуждают результаты и будущее общества. Синонимы: общее собрание и годовое собрание. См. также: <i>внеочередное собрание.</i>

No	English	Русский
6.	Annual Report: A document that must be provided to a company's shareholders and other interested parties for the AGM. It usually includes full set of financial statements, including notes, the report of the External Auditor and Revision Commission, management's discussion of results, as well as commentary on corporate governance and the outlook of the company.	Годовой отчет: документ, который должен быть предоставлен <i>акционерам</i> общества и иным заинтересованным лицам при проведении годового общего собрания акционеров. Как правило, он включает баланс, отчет о прибылях и убытках, примечания к финансовой отчетности, заключение аудитора и ревизионной комиссии, изложение мнения руководства по поводу результатов деятельности общества, а также комментарий по вопросам корпоративного управления и перспективам развития общества.
7.	Anti-takeover Defense: A device designed to prevent a takeover of the company.	Защита от поглощений: механизм, призванный предотвратить поглощение компании.
8.	Arbitration: A dispute settlement process that occurs outside the court system. This should be distinguished from state arbitration (commercial) courts.	Третейское производство: процесс внесудебного урегулирования споров. Следует отличать от государственного арбитражного суда.
9.	Audit Committee: A committee of the Supervisory Board that oversees the company's financial reporting, risk management, and internal control processes.	Комитет по аудиту: комитет <i>совета директоров</i> , отвечающий за контроль за финансовой отчетностью, управлением рисками и процессами внутреннего контроля в обществе.
10.	Audit: An examination and verification of a company's financial and accounting records and supporting documents by a professional and independent External Auditor.	Аудиторская проверка: изучение и проверка документов финансового и бухгалтерского учета общества профессиональным и независимым <i>аудитором общества</i> .
11.	Audited Financial Statements: A company's financial statements that have been prepared and certified by an independent External Auditor. See related: Auditor and Auditor's Report.	Проверенная аудитором финансовая отчетность: финансовая отчетность общества, подтвержденная независимым <i>аудитором общества</i> . См. также: аудитор и заключение аудитора.
12.	Auditor: A person certified at the government level to conduct an audit. Synonym: External Auditor	Аудитор: лицо, обладающее государственной лицензией на право проведения аудита.

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
13.	Auditor's Report: An auditor's opinion on the accuracy of the company's financial statements commonly included in the annual report.	Заключение аудитора: отчет аудитора о достоверности финансовой отчетности общества, как правило, включаемое в годовой отчет.
14.	Authorized Shares: Maximum number of shares of any class a company may issue in addition to issued and outstanding shares	Объявленные акции: максимальное количество акций любой категории, которое общество может выпустить в дополнение к выпущенным акциям.
15.	Ballot: Any printed or written document used in voting during the GMS.	Бюллетень: документ, используемый для голосования во время общего собрания акционеров.
16.	Bankrupt: A person, firm, or company that has been declared insolvent through a court proceeding.	Банкрот: физическое и юридическое лицо, которое было признано банкротом по решению суда.
17.	Bankruptcy: A proceeding in a state court in which an insolvent debtor's assets are liquidated and the debtor is relieved of further liability. See related: Liquidation.	Банкротство: судебная процедура, в ходе которой активы неплатежеспособного должника ликвидируются, а должник освобождается от дальнейшей ответственности. См. также: ликвидация.
18.	Bearer Form: A security in bearer form is not registered on the books of the issuing company. Bearer securities are payable to the one who physically holds them. See related: Registered Security.	Ценная бумага на предъявителя: ценные бумаги на предъявителя не регистрируются в учетных документах эмитента. Доход по таким бумагам выплачивается их фактическому держателю. См. также: именная ценная бумага.
19.	Beneficial Owner: The individual who enjoys the benefits of owning a security or property, regardless of whose name the title of the security or property is.	Реальный собственник: лицо, получающее выгоду от владения ценной бумагой или имуществом, вне зависимости от того, на чье имя зарегистрированы такие ценная бумага или имущество.
20.	Beneficiary: An individual or legal entity that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract.	Выгодоприобретатель (бенефициарий): физическое или юридическое лицо, которое получает либо может получить право на получение выгод по завещанию, страховому полису, пенсионному плану, договору ренты, договору доверительного управления имуществом (договору траста) или иному договору.

No	English	Русский
21.	<p>Benefits: A payment or entitlement, such as one made under an employment or service agreement, such as health insurance, vacation, a company car, a phone allowance, etc.</p>	<p>Пособия: выплаты или право на получение дополнительных благ по трудовому или гражданско-правовому договору, таких как медицинское страхование, оплаченный отпуск, служебный автомобиль, оплата телефонных разговоров и т.д.</p>
22.	<p>Best practice: The best procedures that can be observed in multinational and national companies for which other companies should aim.</p>	<p>Надлежащая практика: наилучшая практика, которая применяется международными и национальными компаниями и к следованию которой должны стремиться остальные компании.</p>
23.	<p>Board Member: An individual elected by shareholders to provide strategic guidance and oversee management on their behalf. Also called: Supervisory Board Member and Director.</p>	<p>Член совета директоров: лицо, избранное акционерами для осуществления стратегического руководства и контроля за деятельностью исполнительных органов от имени акционеров. Синонимы: член наблюдательного совета и директор.</p>
24.	<p>Board of Directors: A governance body of the company that is responsible for providing strategic guidance and overseeing the management on behalf of shareholders. The Board of Directors in a unitary board system corresponds to a Supervisory Board in a two-tiered board system. See related: Supervisory Board.</p>	<p>Совет директоров: орган управления общества, отвечающий за стратегическое руководство и контроль за деятельностью исполнительных органов от имени акционеров. Совет директоров в одноуровневой системе соответствует наблюдательному совету в двухуровневой системе управления обществом. См также: наблюдательный совет.</p>
25.	<p>Bond: A debt corporate security that obligates the issuer to pay the holder a specified sum of money, usually at specific intervals, and to repay the principal amount at maturity. Bondholders have no corporate ownership and governance rights as shareholders do. Synonym: Debenture.</p>	<p>Облигация: долговая корпоративная ценная бумага, по которой эмитент обязуется выплачивать ее держателю определенные суммы, как правило, с фиксированной периодичностью, и погасить основной долг по наступлении срока платежа. Держатели облигаций, в отличие от акционеров, не обладают правами собственности и правом на участие в управлении обществом.</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
26.	Book Value: Value of a company or an asset according to accounting records. The book value does not always bear a relation to the fair market value of an asset or a company.	Балансовая стоимость: стоимость компании или какого-либо актива, отраженная в документах бухгалтерского учета. Балансовая стоимость не всегда соответствует рыночной стоимости актива или компании.
27.	By-Laws: The internal rules and regulations that govern a company's structures, policies, and procedures. Synonym: Internal corporate documents.	Положение: внутренние правила и положения, регулирующие структуры, политику и процедуры общества. Синоним: внутренние документы общества.
28.	Capital Gains: An increase in the market price of an asset (e.g. shares).	Прирост капитала: увеличение рыночной цены актива (например, акций).
29.	Capital Surplus: 1. A part of the company's equity which typically results from funds accumulated from any re-valuation of non-current assets and the positive difference between the nominal value and the issuing value of the company's shares. 2. Common umbrella term for more specific classifications such as acquired surplus, additional paid-in capital, donated surplus, and re-valuation surplus (arising from appraisals). Synonyms: Paid-In Surplus; Surplus, Additional Paid-in Capital.	Добавочный капитал: 1) часть акционерного капитала общества, которая, как правило, образуется за счет средств, накопленных в результате переоценки внеоборотных активов, и положительной разницы между номинальной стоимостью и стоимостью размещения акций общества; 2) общий термин для обозначения таких понятий, как приобретенный дополнительный капитал, дополнительный оплаченный капитал, капитал, переданный на безвозмездной основе, и добавочный капитал, полученный в результате переоценки.
30.	Capacity: Legal qualification, generally in terms of age, residence, and character necessary for certain purposes, such as for holding office, for marrying, making contracts. Sometimes translated from the Russian as dispositive capacity. Synonym: Competency. See: Dispositive Capacity.	Деспособность: способность гражданина своими действиями приобретать и осуществлять гражданские права, создавать для себя гражданские обязанности и исполнять их.
31.	Charter: A document that establishes a company.	Устав: учредительный документ общества.

The Russia Corporate Governance Manual

No	English	Русский
32.	<p>Closed Joint Stock Company: A joint stock company the shares of which have limited transferability. Synonym: Closely Held or Private Company.</p>	<p>Закрытое акционерное общество: общество, акции которого распределяются среди учредителей или иного заранее определенного круга лиц.</p>
33.	<p>Common Share: The type of shares that grants to their owners certain voting and property rights. Synonyms: Ordinary Share or Ordinary Stock.</p>	<p>Обыкновенная акция: акция, предоставляющая ее держателю определенные имущественные права и право голоса.</p>
34.	<p>Company (Joint Stock Company): A legal entity the charter capital of which is divided into a defined number of shares. Synonyms: Corporation, Joint Stock Company.</p>	<p>Общество (акционерное общество): юридическое лицо, уставный капитал которого разделен на определенное число акций. Синоним: компания, корпорация.</p>
35.	<p>Compensation: Reimbursement for expenses incurred while fulfilling official duties. In the context of this Manual, the term Compensation is used for the members of the Revision Commission. Different from remuneration, which includes wages, bonuses, perks, and other benefits.</p>	<p>Компенсация: возмещение расходов, понесенных в ходе выполнения служебных обязанностей. В контексте настоящего Пособия используется в отношении членов <i>ревизионной комиссии</i>. В отличие от вознаграждения не включает оплату труда, премии, поощрения и иные выплаты.</p>
36.	<p>Conflict of Interests: A situation that occurs when a person in a position of trust needs to exercise judgment on behalf of others but also has interests that might compromise the exercise his judgment. In such a situation, the person is generally required to abstain from making any judgments.</p>	<p>Конфликт интересов: ситуация, возникающая, когда лицу, наделенному доверием, необходимо вынести суждение от имени других лиц, но при этом он имеет заинтересованность, которая может препятствовать вынесению такого суждения. В принципе в подобной ситуации заинтересованное лицо должно воздерживаться от каких-либо суждений.</p>
37.	<p>Consolidation (in reorganization): The combination of separate companies into a single one whereby consolidating companies terminate and their assets and liabilities transfer to the new company.</p>	<p>Слияние: объединение нескольких обществ в одно. При этом объединяющиеся общества прекращают свою деятельность, а их активы и обязательства переходят к новому обществу.</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
38.	<p>Consolidation of Shares: The process of converting two or several shares of the same type and class into one share of the same type and class. Synonym: Reverse Split. Antonym: Split.</p>	<p>Консолидация акций: процесс конвертации 2 или нескольких акций одной категории (типа) в 1 акцию той же категории (типа). Антоним: <i>дробление акций.</i></p>
39.	<p>Control and Revision Service: An internal company department that is responsible for carrying out internal control on a daily basis as recommended by the Code of Corporate Conduct of the Federal Commission for the Securities Market (the FCSM Code). See: Internal Audit.</p>	<p>Контрольно-ревизионная служба: внутреннее подразделение общества, отвечающее за осуществление текущего внутреннего контроля в соответствии с рекомендациями Кодекса ФКЦБ. См. внутренний аудит.</p>
40.	<p>Control Transaction: A transaction in which the control of the corporation is established or changes hands.</p>	<p>Сделка по приобретению контроля: сделка, в результате которой контроль над обществом устанавливается либо переходит к другому лицу.</p>
41.	<p>Controlling Shareholder: A shareholder who personally or with affiliated parties effectively controls decision-making in the company</p>	<p>Контролирующий акционер: <i>акционер</i>, который сам либо совместно с аффилированными лицами фактически контролирует процесс принятия решений в обществе.</p>
42.	<p>Convertible Security: A bond or preferred share that is exchangeable at the option of the holder for common share (or preferred share of another class) of the issuing company.</p>	<p>Конвертируемая ценная бумага: облигация или привилегированная акция, которая может быть обменена по усмотрению ее держателя на обыкновенную акцию (либо на привилегированную акцию другого типа) эмитента.</p>
43.	<p>Corporate Governance: The structures and processes for the direction and control of companies. See: Part I, Chapter 1 for other definitions.</p>	<p>Корпоративное управление: структуры и процедуры управления и контроля в обществе. См. также определения, приведенные в главе 1.</p>
44.	<p>Counting Commission: A body or a person that counts and verifies the votes cast at a GMS. Synonyms: Tabulation Commission.</p>	<p>Счетная комиссия: орган или лицо, осуществляющее подсчет и проверку голосов, поданных на общем собрании акционеров</p>

No	English	Русский
45.	<p>Cumulative Voting: A method of voting when each shareholder entitled to vote at an election of directors has the right to cast a number of votes equal to the number of voting shares held by the shareholder multiplied by the number of directors to be elected, and the shareholder may cast all such votes in favor of one candidate or distribute them among the candidates in any manner. See related: Standard Voting.</p>	<p>Кумулятивное голосование: метод голосования, при котором каждый <i>акционер</i>, имеющий право на участие в голосовании по вопросу об избрании <i>членов совета директоров</i>, имеет право отдать число голосов, равное количеству принадлежащих ему голосующих акций, умноженное на число избираемых членов совета директоров, при этом акционер может отдать все свои голоса в пользу одного кандидата либо любым образом распределить их между кандидатами. См. также: стандартное голосование.</p>
46.	<p>Damages: The expenses that a person, whose right is infringed, bear or shall bear in order to restore the infringed right, as well as a loss or harm to his property.</p>	<p>Ущерб: расходы, которые лицо, чье право нарушено, произвело или должно будет произвести для восстановления нарушенного права, утрата или повреждение имущества такого лица.</p>
47.	<p>Debtor: The entity that is liable for debts. Synonym: Borrower.</p>	<p>Должник: лицо, несущее обязательства по долгам. Синоним: заемщик.</p>
48.	<p>Dilution (of Ownership): A reduction in the existing Shareholder's ownership of the company (in terms of the percentage of the company shares owned) resulting from the issue of additional shares or the exercise of convertible securities and/or options.</p>	<p>Размывание собственности: уменьшение доли существующих акционеров в капитале общества (доли принадлежащих им акций) в результате дополнительного выпуска акций или осуществления права на конвертацию ценных бумаг и (или) реализация опционов.</p>
49.	<p>Director: See Board Member.</p>	<p>Директор: См.: член совета директоров.</p>
50.	<p>Disclosure: The release of relevant information to the public. Synonym: Information Disclosure.</p>	<p>Раскрытие информации: опубликование соответствующей информации.</p>
51.	<p>Divestiture: The disposition or sale of an asset by a company. A company will often divest an asset that is not performing well, is not part of the company's core business, or that may be worth more as a separate entity than as part of the company.</p>	<p>Отделение: общество нередко выделяет неэффективно работающие активы, активы, которые не связаны с его основной деятельностью, и активы, стоимость которых в рамках отдельного юридического лица может быть выше их стоимости в составе активов общества.</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
52.	Divided Balance Sheet: A document drawn up in case of a company divestiture and split-up, by which assets and liabilities of reorganizing company(ies) are transferred to the new entity(ies).	Разделительный баланс: документ, который составляется в случае выделения или разделения общества и по которому активы и обязательства реорганизуемого общества (обществ) передаются на вновь создаваемым обществам.
53.	Dividend: A portion of the net profits of the company distributed to the shareholders of a company.	Дивиденд: часть чистой прибыли общества, распределяемая между <i>акционерами</i> .
54.	Dividends Payable: The amount of dividends to be paid as reported in the financial statements.	Объявленный дивиденд: сумма дивидендов, объявленная к выплате по данным финансовой отчетности.
55.	Equity: An ownership interest in a company.	Акционерный капитал: собственный капитал общества.
56.	Ex-Dividend: The time period between the declaration of a dividend and the payment of the dividend. Shares bought during this period are not entitled to dividend payments.	«Без дивидендов»: период между объявлением и выплатой дивидендов. Акции, приобретенные в течение этого периода, не дают права на получение дивидендов.
57.	Executive Board: A collective executive body of the company responsible for the day-to-day management. The Executive Board reports and is accountable to the Supervisory Board. Synonyms: Directorate, Management Board, or Managerial Board.	Правление: коллегиальный исполнительный орган, отвечающий за текущее руководство деятельностью общества. Правление подотчетно <i>совету директоров</i> . Синоним: дирекция.
58.	Executive Body: For the purposes of this Manual, the governing bodies of a company are divided into oversight bodies and Executive Bodies. The Executive Bodies include the General Director and the Executive Board. See: Oversight Bodies.	Исполнительный орган: в контексте настоящего Пособия органы управления общества делятся на <i>наблюдательные органы</i> и исполнительные органы. К исполнительным органам относятся <i>генеральный директор</i> и <i>правление</i> . См.: наблюдательные органы.
59.	Executive Director: A member of a company's Supervisory Board who is also an employee of the company.	Исполнительный директор: член <i>совета директоров</i> общества, являющийся работником общества.

The Russia Corporate Governance Manual

No	English	Русский
60.	<p>External Auditor: The auditor responsible for conducting the audit of the financial statements of the company. Synonyms: Independent Auditor. See related: Annual Report.</p>	<p>Аудитор общества: аудитор, отвечающий за проведение аудиторской проверки финансовой отчетности общества. Синоним: независимый аудитор. См. также: годовой отчет.</p>
61.	<p>External Director: A director who is not an employee of the company. Synonyms: Non-Executive Director or Outside Director. Antonym: Internal Director.</p>	<p>Внешний директор: член совета директоров, не являющийся работником общества. Синоним: неисполнительный директор. Антоним: внутренний директор.</p>
62.	<p>External Manager: An individual or a management company called in from the outside to manage the company.</p>	<p>Управляющая организация, управляющий: физическое лицо или управляющая компания, приглашенные для управления обществом.</p>
63.	<p>Extraordinary General Meeting of Shareholders (EGM): Any General Meeting of Shareholders (GMS) other than an AGM.</p>	<p>Внеочередное собрание акционеров: любое, помимо годового, общее собрание акционеров.</p>
64.	<p>Extraordinary Transaction: A sale of assets or a substantial portion of the company that requires shareholder or Supervisory Board approval. The term is often translated from the Russian as major transaction, major deal, or large transaction and large deal. The term extraordinary transaction is used throughout the Manual.</p>	<p>Крупная сделка: продажа активов или значительной части общества, требующая одобрения акционеров или совета директоров.</p>
65.	<p>Fair Market Value: The price that a (an informed) buyer would be willing to pay and a (an informed) seller would be willing to accept on the open market assuming a reasonable time for a transaction to take place.</p>	<p>Рыночная стоимость: цена, которую информированный покупатель готов заплатить, а информированный продавец готов принять на свободном рынке, при условии, что сделка совершается в разумные сроки.</p>
66.	<p>Fiscal Year: In Russia, an accounting period of one year starting on January 1.</p>	<p>Финансовый год: в России — годовой отчетный период, начинающийся 1 января.</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
67.	<p>Fixing Date: The date set by the company on which an individual must own shares in order to be eligible to vote at GMS or receive a dividend. Synonym: Record Date.</p>	<p>Дата закрытия реестра: дата, которую устанавливает общество и по состоянию на которую лицо должно владеть акциями, чтобы получить право голосовать на общем собрании или право на получение дивидендов.</p>
68.	<p>General Director: An individual executive body of the company responsible for the day-to-day management of the company. Synonym: Chief Executive Officer (CEO).</p>	<p>Генеральный директор: единоличный исполнительный орган общества, отвечающий за текущее руководство деятельностью общества.</p>
69.	<p>General Meeting of Shareholder (GMS): The highest governing body of the company. Synonym: General Assembly. See related: Notice.</p>	<p>Общее собрание акционеров: высший орган управления обществом. См. также: уведомление.</p>
70.	<p>Generally Accepted Accounting Principles (GAAP): A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by accounting standard setters. Best known is US GAAP though other countries may also refer to their standards as GAAP. Russian Accounting Standards (RAS) are used in the Russian Federation though some companies also prepare statements in accordance with US GAAP or International Financial Reporting Standards (IFRS), most often when they seek foreign listings.</p>	<p>ГААП (общепринятые принципы бухгалтерского учета): принятый набор правил, положений, стандартов и процедур для представления финансовой информации, установленных органами регулирования. Наиболее широко известны ГААП США, хотя другие страны также могут называть свои стандарты ГААП. В Российской Федерации применяются российские стандарты учета и отчетности, хотя некоторые компании также подготавливают свою отчетность в соответствии с ГААП США или международными стандартами финансовой отчетности (МСФО), как правило, в случае, если они хотят включить свои ценные бумаги в листинг на иностранных фондовых биржах.</p>
71.	<p>Golden Share: A special right of the state to participate in the governance of the company.</p>	<p>Золотая акция: специальное право государства на участие в управлении обществом.</p>

No	English	Русский
72.	<p>Governing Bodies: Structures that are involved in the governance of the company. They include the GMS, the Supervisory Board, the General Director, and the Executive Board. For the purposes of this Manual, governing bodies are divided into two subsets: oversight bodies that exercise an oversight function and executive bodies that are responsible for the day-to-day management of the company.</p>	<p>Органы управления: органы общества, занимающиеся его управлением. К ним относятся <i>общее собрание акционеров, совет директоров, генеральный директор и правление</i>. Для целей настоящего Пособия органы управления подразделяются на две группы: <i>наблюдательные органы</i>, осуществляющие функции контроля, и <i>исполнительные органы</i>, отвечающие за текущее руководство деятельностью общества.</p>
73.	<p>Holding Company: A company whose assets include control shares of another company or a group of companies.</p>	<p>Холдинговая компания: компания, активы которой включают контрольные пакеты акций другой компании или группы компаний.</p>
74.	<p>Immovable property: Immovable property includes land, land interior, detached water objects, and everything else that is tightly attached to the earth, detachment of which without a material damage to their purpose is impossible, including forests, long-term plants, buildings, and constructions.</p>	<p>Недвижимое имущество: такое имущество включает земельные участки, участки недр, обособленные водные объекты и все, что прочно связано с землей, то есть объекты, перемещение которых без несоразмерного ущерба их назначению невозможно, в том числе леса, многолетние насаждения, здания, сооружения.</p>
75.	<p>Independence: The freedom from control or influence of others. The concept of independence is used in different contexts in this Manual: 1) with respect to Supervisory Board members; 2) with respect to the independent External Auditor; 3) with respect to the Internal Auditor, and 4) Independent Appraiser. See: Annex 18 for the definition of an independent director.</p>	<p>Независимость: свобода от контроля и влияния других лиц. Понятие независимости в настоящем Пособии используется в различном контексте: 1) по отношению к <i>членам совета директоров</i>; 2) по отношению к <i>независимому аудитору</i> или <i>аудитору общества</i>; 3) по отношению к <i>внутреннему аудитору</i>; и 4) к независимому оценщику. См. определение независимого директора в Приложении 18.</p>
76.	<p>Independent Auditor: See: External Auditor See related: Annual Report, Auditor, and Independence.</p>	<p>Независимый аудитор: См. аудитор общества. См. также: годовой отчет, аудитор и независимость.</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
77.	Inside Director: A director who is an employee of the company. Synonym: Executive Director. Antonyms: Outside Director, External Director or Non-executive Director.	Внутренний директор: член совета директоров, являющийся работником общества. Синоним: исполнительный директор. Антоним: внешний директор или неисполнительный директор.
78.	Insider: An individual with access to material information before it is announced to the public.	Инсайдер: лицо, имеющее доступ к существенной информации до ее публичного раскрытия.
79.	Insider Dealing: Trading by insiders based on Insider Information.	Инсайдерская торговля: совершение инсайдерами сделок на основе инсайдерской информации.
80.	Insider Information: Material information about a company known to insiders (generally, directors, management, and/or employees) but not to the public.	Инсайдерская информация: существенная информация об обществе, известная инсайдерам (как правило, членам совета директоров, руководству и (или) работникам общества), но не являющаяся общедоступной.
81.	Internal Audit: An appraisal of the financial health of a company's operations by its own employees. Employees who carry out this function are called Internal Auditors.	Внутренний аудит: оценка финансовой целесообразности операций общества его работниками. Работники, выполняющие эту функцию, называются внутренними аудиторами.
82.	International Financial Reporting Standards (IFRS): Accounting standards promulgated by the International Accounting Standards Board (IASB).	Международные стандарты финансовой отчетности: Стандарты учета и отчетности, принятые Международным советом по стандартам учета и отчетности
83.	Issue: The group of securities of the company which confer upon their holders identical rights.	Выпуск ценных бумаг: совокупность ценных бумаг общества, предоставляющая их держателям одинаковые права.
84.	Issue (verb). Legally specified steps necessary to place securities.	Эмиссия: предусмотренные законом действия по размещению ценных бумаг.

No	English	Русский
85.	<p>Issued and Outstanding: Shares of a company, which have been issued and are outstanding. These shares represent capital invested by the firm's shareholders. Shares that have been issued and subsequently repurchased by the company are called treasury share, because they are held in the corporate treasury pending reissue or retirement. Treasury shares are legally issued but are not considered outstanding for purposes of voting, dividends, or earnings per share calculations.</p>	<p>Выпущенный и находящийся в обращении: выпущенные и находящиеся в обращении акции общества. Эти акции представляют собой инвестированный капитал акционеров общества. Акции, которые были выпущены и впоследствии выкуплены обществом, называются казначейскими акциями, поскольку они находятся на балансе общества до их повторного выпуска или погашения. Казначейские акции являются выпущенными, но не считаются находящимися в обращении в целях голосования, начисления дивидендов или расчета прибыли на одну акцию.</p>
86.	<p>Joint and Several Liability: An obligation for which multiple individuals are equally liable.</p>	<p>Солидарная ответственность: обязательство, по которому несколько лиц несут равную ответственность.</p>
87.	<p>Liquidation: To sell all of a company's assets, pay outstanding debts, and distribute the remainder to shareholders, and then go out of business.</p>	<p>Ликвидация: продажа всех активов общества, выплата долгов и распределение оставшегося имущества между <i>акционерами</i> с последующим прекращением деятельности общества.</p>
88.	<p>Listed: Traded on a stock exchange.</p>	<p>Включенный в листинг (или котирующийся): обращающийся на фондовой бирже.</p>
89.	<p>Listing Requirements: The conditions set by a stock exchange to list the company's securities. Listing requirements may impose certain conditions on the governance of the company.</p>	<p>Правила листинга (включения в котировальные листы): условия, устанавливаемые фондовой биржей применительно к листингу ценных бумаг общества. Требования в отношении листинга включают определенные требования в отношении корпоративного управления в обществе.</p>
90.	<p>Loss: The expenses that a person, whose right is infringed, bear or shall bear in order to restore the infringed right, as well as a loss or harm to his property (real damages), as well as unrealized profit, which the person could have received in ordinary conditions of civil turnover if his right would have not been infringed (lost profit).</p>	<p>Убытки: расходы, которые лицо, чье право нарушено, произвело или должно будет произвести для восстановления нарушенного права, ущерб в результате утраты или повреждения имущества такого лица (реальный ущерб), а также неполученные доходы, которые такое лицо получило бы при обычных условиях гражданского оборота, если бы его право не было нарушено (упущенная выгода).</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
91.	<p>Majority Shareholder: A shareholder who alone or with a group of affiliated parties exercises significant control over the company.</p> <p>See related: Controlling Shareholder.</p>	<p>Крупный (мажоритарный) акционер: <i>акционер</i>, который сам либо совместно с аффилированными лицами осуществляет значительный контроль над обществом.</p> <p>См. также: контролирующий акционер.</p>
92.	<p>Management: The group of individuals who run the day-to-day operations of the company.</p>	<p>Менеджмент: группа лиц, осуществляющая текущее руководство обществом.</p>
93.	<p>Mandatory Bid: The offer to buy all the outstanding common shares and securities convertible into common shares made by the acquirer to all other shareholders in control transactions.</p> <p>Synonyms: Buyout, Mandatory Offer.</p>	<p>Предложение об обязательном выкупе: предложение выкупить все находящиеся в обращении обыкновенные акции общества и ценные бумаги, конвертируемые в обыкновенные акции, которое приобретает в рамках сделки по приобретению контроля обязан сделать всем остальным акционерам.</p> <p>Синоним: обязательное предложение.</p>
94.	<p>Material Events Report: A document that is used to report the occurrence of any material events that have not previously been reported by the issuer. Sometimes referred to in the Russian context as material facts report.</p>	<p>Сообщение о существенных фактах: документ, раскрывающий информацию о существенных событиях, которая ранее не раскрывалась эмитентом.</p>
95.	<p>Material Information: Information whose omission or misstatement could affect the economic decisions taken by users of information. Materiality is a characteristic of an event or information that is sufficiently important to have an impact on a company's stock price.</p>	<p>Существенная информация: информация, упущение или искажение которой может повлиять на принятие экономических решений ее пользователями. Существенность — это характеристика события или информации, означающая, что такие событие или информация достаточно важны, чтобы повлиять на цену акций общества.</p>
96.	<p>Merger: The termination of one or several companies while their assets and liabilities are transferred to another company. Mergers differ from Consolidations in that no new entity is created from a Merger. Some translations of the Company Law refer to merger as an «accession».</p>	<p>Присоединение: прекращение деятельности одного или нескольких обществ при одновременной передаче их активов и обязательств другому обществу. Присоединение отличается от слияния тем, что в этом случае не образуется нового общества.</p>

The Russia Corporate Governance Manual

No	English	Русский
97.	<p>Minority Shareholder: A shareholder with less than 50% ownership of a company's voting shares, or insufficient ownership to control company operations. See related: Majority Shareholder.</p>	<p>Миноритарный акционер: акционер, владеющий менее чем 50% голосующих акций общества либо числом акций, недостаточным для осуществления контроля за деятельностью общества. См. также: мажоритарный акционер.</p>
98.	<p>Natural Person: A single person as distinguished from legal entities and individual entrepreneurs. Synonyms: Individual, Private Person, or Physical Person.</p>	<p>Физическое лицо: лицо, не являющееся юридическим лицом или индивидуальным предпринимателем.</p>
99.	<p>Nominal Shareholder: A person or organization named to act on behalf of someone else. Synonym: Nominee Shareholder.</p>	<p>Номинальный владелец: физическое или юридическое лицо, действующее от имени другого лица.</p>
100.	<p>Nominal Value: Value of a bond or a share as given on "the face" of the certificate or instrument.</p>	<p>Номинальная стоимость: стоимость облигации или акции, указанная на лицевой стороне сертификата или инструмента.</p>
101.	<p>Nominee: The person, bank, or brokerage in whose name securities are transferred.</p>	<p>Номинальный держатель: лицо, банк или брокер, от чьего имени осуществляется передача ценных бумаг.</p>
102.	<p>Non-Executive Director: A member of a company's Supervisory Board who is not a manager (an employee) of the company. Synonyms: Outside Director or External Director.</p>	<p>Неисполнительный директор: член <i>совета директоров</i> общества, не являющийся менеджером (работником) общества. Синоним: внешний директор.</p>
103.	<p>Non-Standard Operations: Operations that go beyond the scope of the financial and economic plan of the company as defined by the FCSM's Code.</p>	<p>Нестандартная операция: операция, выходящая за рамки финансово-хозяйственного плана общества (в соответствии с определением, приведенным в Кодексе ФКЦБ).</p>
104.	<p>Notice: Official proclamation of a legal action or intent to take a legal action. Notice in this Manual is used in the context of giving notice of or calling a GMS.</p>	<p>Уведомление: официальное извещение о совершении юридического действия или намерении совершить такое действие. В контексте настоящего Пособия используется в значении «уведомление о созыве общего собрания акционеров».</p>

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
105.	Oversight Bodies: The bodies of the company tasked with oversight functions including the Supervisory Board and the GMS.	Наблюдательные органы: органы управления общества, в задачи которых входит осуществление контроля. Включают <i>наблюдательный совет</i> и <i>общее собрание акционеров</i> .
106.	Participating Shareholder: A shareholder who participates in the GMS in person, through a representative, or by sending completed voting ballots.	Участвующий акционер: акционер, принимающий участие в общем собрании акционеров лично, через представителя или посредством направления заполненного бюллетеня для голосования.
107.	Place: To market new securities.	Разместить: продать новые ценные бумаги.
108.	Placement: The acquisition of the ownership of securities by the first owners through transactions.	Размещение: приобретение права собственности на ценные бумаги их первыми владельцами посредством совершения сделок.
109.	Pre-Emptive Right: The right of current shareholders to maintain their proportion of ownership in a company by buying shares in any future issue of shares and convertible securities. Synonym: Right of First Refusal.	Преимущественное право приобретения: право существующих <i>акционеров</i> на сохранение своей доли собственности в обществе, обеспечиваемое посредством приобретения акций и конвертируемых ценных бумаг последующих выпусков.
110.	Preferred shares: Non-voting shares, which provide a defined dividend and liquidation value, paid before any dividends paid to the owners of common shares.	Привилегированная акция: неголосующая акция, которая предоставляет их держателю право на получение определенного <i>дивиденда</i> и ликвидационной стоимости, выплачиваемых до выплаты дивидендов владельцам обыкновенных акций.
111.	Prospectus: A formal offer to sell securities. The Prospectus sets forth the business plan of the company and sufficient facts for the investor to make an informed decision regarding the purchase of such securities.	Проспект ценных бумаг: официальное предложение о продаже ценных бумаг. В проспекте содержится бизнес-план общества и информация, необходимая для принятия инвестором обоснованного решения о покупке предлагаемых ценных бумаг.
112.	Proxy Card: The instrument by which Shareholders cast their votes, or assign their proxy.	Доверенность: документ, посредством которого <i>акционер</i> назначает доверенное лицо (и осуществляет через него свое право на участие в голосовании).

The Russia Corporate Governance Manual

No	English	Русский
113.	Proxy: An authorization by a shareholder giving another person the right to vote the shareholder's shares. Proxy also refers to the document granting this authority, as in proxy card.	Представительство: передача <i>акционером</i> другому лицу права голосовать по его акциям. Также употребляется в значении документа, удостоверяющего такое право.
114.	Quarterly Report: Unaudited document reporting the financial results for the quarter.	Ежеквартальный отчет эмитента эмиссионных ценных бумаг: не проверенный аудитором документ, содержащий финансовые результаты деятельности эмитента за квартал.
115.	Quorum: The minimum percentage of votes of shareholders or directors that must be present at a meeting in order for a vote to be legally effective.	Кворум: минимальное число голосов <i>акционеров</i> или <i>директоров</i> , присутствие которых необходимо на собрании с тем, чтобы результаты голосования были действительны по закону.
116.	Redemption Rights: Right of shareholders to require the company to repurchase their shares under certain circumstances.	Право выкупа: право акционеров потребовать от общества выкупа их акций при определенных обстоятельствах.
117.	Redemption: The return of an investor's principal in a security at or before maturity.	Погашение (облигации): возврат основной суммы долга инвестору не позднее срока погашения.
118.	Registered Security: A security whose owner's name is recorded on the face of the security certificate or books of the issuer (for non-documentary securities).	Именная ценная бумага: ценная бумага, имя держателя которой указывается на лицевой стороне сертификата (в случае документарных ценных бумаг) или в учетных документах эмитента (в случае бездокументарных ценных бумаг).
119.	Registrar: The organization, that maintains a shareholder register that includes information on the shareholders and the number of shares held. The term External Registrar is used in this manual	Регистратор: организация, которая ведет <i>реестр акционеров</i> . В реестре содержится информация об акционерах и числе принадлежащих им акций.
120.	Related Party Transaction: A transaction in which a related party is involved and which must be approved by the GMS or the Supervisory Board in accordance with requirements of the law.	Сделка с заинтересованностью: сделка, в совершении которой имеется заинтересованность и которая должна быть утверждена <i>общим собранием акционеров</i> или <i>советом директоров</i> в соответствии с требованиями закона.

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
121.	Reorganization: In Russia, the reorganization is the changing of a legal structure, such a consolidation, merger, divestiture, split-up, and transformation.	Реорганизация: реорганизация — это прекращение или изменение правового положения юридического лица, влекущее отношения правопреемства юридического лица.
122.	Reserve Fund: A part of owners' equity set aside in a separate fund to supplement the charter capital. It can be used to cover the company's losses, or to redeem bonds and shares if other funds are not available.	Резервный фонд: часть собственного капитала общества, выделенная в отдельный фонд. Может использоваться для покрытия убытков общества, выкупа акций и облигаций при отсутствии иных средств.
123.	Restructuring: The reorganization of a company's operations without changing the legal form.	Реструктуризация: реорганизация деятельности общества без изменения его организационно-правовой формы.
124.	Revision Commission: A special body of the company elected by shareholders to oversee the financial and business activities of the company and the compliance with relevant laws and regulations. It fulfills a different function than the Audit Committee, or the Internal Auditor.	Ревизионная комиссия: специальный орган общества, избираемый <i>акционерами</i> для осуществления контроля за финансово-хозяйственной деятельностью общества и выполнением требований законодательства. Его функции отличаются от функций <i>комитета по аудиту</i> и службы <i>внутреннего аудита</i> .
125.	Share Buyback: The repurchase of a company's own shares.	Приобретение акций обществом: выкуп обществом собственных акций.
126.	Shareholder of Record: The name of an individual or entity that an issuer carries in its records as the registered holder (not necessarily the beneficial owner) of the issuer's securities. Synonyms: Stockholder of Record, Holder of Record, or Owner of Record.	Акционер: физическое или юридическое лицо, указанное в учетных записях эмитента в качестве зарегистрированного держателя (не обязательно реального собственника) ценных бумаг эмитента.
127.	Shareholder Proposal: A proposal for an agenda of the GMS submitted by a shareholder (or a group of shareholders) that own at least 2% of voting shares.	Предложение акционера: предложение для включения в повестку общего собрания акционеров, представленное акционером (или группой акционеров), владеющим (владеющими) не менее чем 2% голосующих акций.

No	English	Русский
128.	Shareholder Register: The register of shareholders used to record ownership of shares and determine shareholders of record on the record date. A shareholder register is generally maintained by an independent body to avoid conflicts of interest.	Реестр акционеров: реестр, который используется для учета прав собственности на акции и определения списка <i>акционеров на дату закрытия реестра</i> . Реестр акционеров, как правило, ведет независимая организация, так как это позволяет избежать конфликта интересов.
129.	Shareholder List: A list setting out the names and addresses of the shareholders of record used to determine who may participate at a GMS and receive dividend payments. Shareholder lists must be compiled on a fixing date or a date of record. See related: Shareholder of Record.	Список акционеров: список, содержащий имена (наименования) и адреса акционеров, имеющих право на участие в <i>общем собрании акционеров</i> и полученные <i>дивидендов</i> . Список должен быть составлен на <i>дату закрытия реестра</i> .
130.	Simple Majority: More than 50% of votes. See related: Supermajority.	Простое большинство голосов: более 50% голосов. См. также: квалифицированное большинство голосов.
131.	Spin-Off: An independent company created from an existing part of another company through a divestiture.	Выделение: создание независимого общества из части другого общества в процессе <i>выделения</i> активов.
132.	Split of Shares: The process of converting one share of a specific type and class into two or more shares of the same type and class. Antonym: Consolidation of Shares.	Дробление: процесс конвертации 1 акции определенной категории (типа) в 2 или более акций той же категории (типа). Антоним: консолидация акций.
133.	Split-Up: The splitting or division of a company into new entities followed by the cessation of activity of the original company.	Разделение: разделение общества путем его прекращения и создания новых обществ.
134.	Stakeholder: Any party that has an interest or stake in a company.	Заинтересованное лицо: лицо, имеющее ту или иную заинтересованность в обществе.
135.	Standard Voting: Method of shareholder voting in which shareholders cast all their votes either for or against an issue put for vote or refrain from voting. Synonym: Regular Voting. See related: Cumulative Voting.	Стандартное голосование: метод голосования акционеров, при котором акционеры отдают свои голоса «за» или «против» того или иного решения или воздерживаются от голосования по определенному вопросу повестки дня общего собрания акционеров. См. также: кумулятивное голосование.

Annex 30. Glossary of English and Russian Corporate Governance Terminology

No	English	Русский
136.	Subscription: An agreement to buy newly issued securities.	Подписка: соглашение о покупке вновь выпущенных ценных бумаг.
137.	Subsidiary: A company that is owned outright or controlled by a parent company.	Дочернее общество: общество, находящееся в собственности или под контролем материнского (основного) общества.
138.	Supermajority: Any vote requiring more than simple majority of votes. Commonly two-thirds or three-fourths.	Квалифицированное большинство голосов: число голосов, необходимое для принятия какого-либо решения, для которого простого большинства голосов недостаточно. Обычно 2/3 или 3/4 голосов.
139.	Supervisory Board: Part of a two-tier board structure. The Supervisory Board provides strategic guidance and exercises oversight over the Executive Board. The Supervisory Board corresponds to the Board of Directors in a unitary board system. See related: Executive Board and Board of Directors.	Наблюдательный совет: часть двухуровневой структуры, при которой наблюдательный совет обеспечивает стратегическое руководство обществом и осуществляет контроль за деятельностью его исполнительных органов. В одноуровневой структуре наблюдательному совету соответствует совет директоров. См. также: правление и совет директоров
140.	Transfer Balance Sheet: An act drawn in case of consolidation, merger and transformation by which assets and liabilities of reorganizing company(ies) are transferred to newly created company(ies).	Передаточный баланс: документ, который составляется в случае слияния, присоединения, выделения, разделения или преобразования и по которому активы и обязательства реорганизуемого общества (обществ) передаются вновь создаваемому обществу (обществам).
141.	Transformation (in reorganization): Changing a legal form of a joint stock company into a limited liability company, production cooperative, or non-commercial partnership.	Преобразование: изменение организационно-правовой формы акционерного общества, в результате оно становится обществом с ограниченной ответственностью, производственным кооперативом или некоммерческим партнерством.
142.	Takeover: Acquisition of control of a company, called a target, by purchase or exchange of shares. A takeover may be either hostile or friendly.	Поглощение: приобретение контроля над обществом посредством покупки или обмена акций. Поглощение может быть враждебным или дружественным.

The Russia Corporate Governance Manual

No	English	Русский
143.	<p>Treasury Shares: Shares reacquired by the issuing company and available for retirement or resale. Treasury shares cannot be voted and receive dividends. It is not included in any of the ratios measuring values per common share.</p>	<p>Казначейские акции: акции, выкупленные эмитентом и предназначенные для погашения или перепродажи. Казначейские акции не голосуют, и по ним не начисляются дивиденды. Они также не включаются в расчет показателей на одну обыкновенную акцию.</p>
144.	<p>Voting Shares: Common shares, and preferred shares when providing such rights on all agenda items (if dividends were not fully paid) or certain items (e.g. reorganization).</p>	<p>Голосующие акции: обыкновенные акции, а также привилегированные акции в случае предоставления им права на участие в голосовании по всем вопросам повестки дня (в случае неполной выплаты дивидендов) или по ее отдельным пунктам (например, по вопросу о реорганизации).</p>
145.	<p>Written Consent: A way of participating in the GMS or a meeting of the governing body by sending a written document to the company with voting results.</p>	<p>Заочное голосование: возможность участия в общем собрании акционеров или заседании коллегиального органа управления посредством направления письменного документа с результатами голосования.</p>