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On Striking the Balance of Shareholder Interests During the Consolidation of Shares[1]

Andrei Bushev and *Vladimir Popondopulo*

Abstract

The authors present an analysis of the developments in Russian state policy in finding a balance of interests between majority and minority stockholders in the event of the use of the legal institution of consolidation of shares. They argue that in the contemporary economic and legal environment, the development of corporate governance in Russia will be drawn towards the German model (in the traditional conception thereof) with its orientation to a large degree on the protection of strategic investors.

The incentivization of institution and individual investors in the corporate governance of a company may significantly be supported by the Russian state during the next stage of economic development of the RF, as the institutional infrastructure, as well as enforcement practice will be improved. That having been said, in resolving a conflict (including in the promulgation of legal norms) among various groups of shareholders, it goes without saying that the lawful interests of all actors need to be taken into account. On the basis of Russian legislation and case law of the RF Constitutional Court, the authors set forth arguments supporting the conclusion that corporate governance is a tool by which, *firstly*, provision is made for various interests, and *secondly* risk of abuse by person having a significant degree of managerial influence is lowered.

If, at the end of the day, the public interest dictates the necessity of a redistribution in law of the risks (of possible gain and loss) in favor of one of the actors involved in an economic conflict (for Russia this would be strategic investors), the interests of the "suffering" investors (first and foremost individual investors) must be restored by way of the payment to them of reasonable compensation. The redistribution in legislative acts of risks in favor of one of the parties in a stockholders' dispute must be fair (*spravedlivyi*). Therefore, a diminution of interests must not only be accompanied by the payment of compensation but must, also, be grounded in the consent of the party that has suffered the diminution of its interests. This line of thinking is illustrated by examples from the case law of the Russian Federation Constitutional Court including the issue of the constitutionality of consolidating shares of stock.

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1. Introduction

A number of Russian joint-stock companies have adopted decisions recently to consolidate their outstanding stock; this has resulted in the creation of fractional shares that the company has reacquired at their market value.[2] In doing so, many shareholders have been unwillingly deprived of their whole shares, thus also losing their shareholder status. The legal basis for this type of transaction can be found in the regulations on consolidation contained in paragraph 1, Article 48, and paragraph 1, Article 74, of the RF Federal Law on Joint-Stock Companies (as of 24 May 1999, hereinafter "the Former Law"). The RF Federal Law of 7 August 2001 (hereinafter "the New Law") on Joint-Stock Companies added a third point to Article 25 of the Former Law, under which fractional shares created during consolidation are not nullified through the payment of compensation, and their owners retain their shareholder status. Moreover, fractional shares have become independently tradable, and their owners have gained the right to demand that such shares be repurchased by the company.

A number of shareholders who did not agree with the decision of these companies on the consolidation and reacquisition of shares have sought judicial recourse by filing the relevant petitions and appeals with prosecutors, the courts, and other state bodies. Meanwhile, the Constitutional Court of the Russian Federation has confirmed the constitutionality of the regulations on the consolidation of shares.[3] The petitioners presented,

[2] "In accordance with a decision of the general shareholders' meeting, a company has the right to consolidate outstanding stock, as a result of which two or more of the company's shares are converted into one new share of the same category (type)" (para.1, Art.74, RF Federal Law on Joint-Stock Companies). Thus, if the co-efficient of consolidation is "one new share for three old ones", then shareholders in possession of one or two old shares will not obtain any new shares; instead, their shares become fractional shares, in the form of one-third or two-thirds of a share.

[3] One of the authors of this article, Vladimir Popondopulo, has given expert testimony during the proceedings of the Constitutional Court's consideration of the case. The legal position expounded by the authors of this article was, on the whole, reflected in the decision of the RF Constitutional Court of 24 February 2004, No.3-P, in the case of the verification of the constitutionality of several provisions of Arts.74 and 77 of the RF Federal Law on Joint-Stock Companies regulating the procedure for the consolidation of outstanding stock by a joint-stock company and the reacquisition of fractional shares, in connection with the complaints of citizens and the company Kadet Establishment and a request by the *Oktiabr' Raion* Court in the city of Penza.

The Constitutional Court found that the interrelated provisions of para.2(1), of Arts.74 and 77, were not in contravention of the constitution; these provisions stipulate that fractional shares created during consolidation shall be subject to reacquisition by the company at their market value,

> "insofar as these provisions, in their constitutional interpretation, propose to take into account the rights and legal interests of the owners of fractional shares by means of the application of the appropriate legal procedures and effective judicial monitoring of the decisions made by the board of directors (supervisory board) and the general shareholders meeting".

inter alia, the following arguments as the basis for their position that consolidation was illegal.

First, they claimed that the loss of ownership rights to whole shares without the consent of the owners thereof and without due process was a violation of the constitutional rights guaranteed by Articles 17 and 35 of the 1993 Constitution of the Russian Federation.

Second, not discounting the fact that federal law has established the right to the consolidation of shares and the resulting partial limitation of the rights of shareholders to dispose of their shares independently, the petitioners claimed that such a limitation is disproportionate.

Third, as support for their conclusion that the regulations on the consolidation of shares in the Former Law were unconstitutional, the petitioners referred to changes made by the legislator in the New Law to the rules on the consolidation of shares by means of allowing fractional shares to be traded. Following the entry into force of the New Law, all shareholders retain their status as a result of consolidation, even if in a limited form, in gaining the right to fractional shares. The petitioners asserted that, by introducing the notion of the tradability of fractional shares resulting from consolidation, the legislator eliminated the contentious constitutionality of the regulations on the consolidation of whole shares that had previously been established. Therefore, prior to the appearance of fractional shares (*i.e.*, on the basis of the Former Law), in any case, deprivation of a shareholder's right to ownership of the shares belonging to him should be recognized as illegal (unconstitutional).

Fourth, the constitutionality of fractional shares themselves was disputed, as were, consequently, the regulations on the consolidation of shares in the redaction of the law in force both before and after the introduction of fractional shares. As the basis for such a position, the petitioners argued that this new legal construct (the fractional share) does not fit into the concept of the legal institution of the securities market in Russia and that, as a result, it is impossible to use fractional shares or to protect the rights thereto.[4]

We shall consider these arguments from the point of view of the conformity of the Russian state's policy concerning the regulation of shareholder relations with the development of economic processes in the country. Once our position has been set forth regarding a number of general aspects of corporate structure, we shall turn to a specific matter:

Normative acts and court decisions cited in this article are available online at <http://www.kodeks.net>.

4 See, for example, Vladimir Em and Dmitriy Lomakin, "Novoe v aktsionernom zakone o drobnykh aktsiiakh", *Vestnik MGU*, Seriia 11 *Pravo* (2002) No.4, 25-28; Galina Shapkina, *Kommentarii k Federal'nomu zakonu "Ob aktsionernykh obshchestvakh" (postateinyi)* (Statut, Moscow, 2002), 135.

that of the permissibility of the consolidation of shares and the resulting reacquisition of fractional shares both with and without the consent of the owners thereof.[5]

2. Russia's Legal Policy on Protection of Shareholder Rights

There is no doubt about the necessity of thoroughly protecting the rights of shareholders, for any law devoid of effective mechanisms for protection loses its appeal. The path to the protection of shareholder rights is predicated not only on considerations of a legal nature; it is also dictated by the influence of the laws of economics. A rational investor will put his capital into an organization in which an estimate of the likely recoupment (the return and the profitability) of that investment (including through the exercise of shareholder rights) is higher than in others. In other words, an investor will not likely part with his capital if he is not convinced that his rights will be protected. It was not by chance, therefore, that the Russian legislator, who was interested in increasing investment in Russia—already in the early stages of formulating a legal policy with respect to shareholders—more than once has proclaimed his adherence to the principle of protection of shareholder rights.

Thus, for example, the Edict of the President of the Russian Federation of 18 November 1995 on Several Measures Regarding Protection of the Rights of Investors and Shareholders named protection of the rights of shareholders from illegal encreachment and commercial risks arising during business activities undertaken by joint-stock companies as one of the most important directions of state policy in the financial and stock markets in the Russian Federation (para.1). The Law on Joint-Stock Companies establishes a guarantee of protection of the rights and interests of shareholders as one of the goals of its adoption (Art.1). In developing these provisions, an Edict of the President of the Russian Federation of 21 March 1996 established a Multifaceted Program of Measures for the Guarantee of the Rights of Investors and Shareholders, which was directed, *inter alia*, at the formulation of a system of regulations to minimize the

5 The authors have also addressed the question of the protection of shareholder rights. In the current article, the approaches taken have been developed in relation to a particular case of shareholder conflict: the consolidation of shares. See, for example, Vladimir Popondopulo, *Pravovoi rezhim predprinimatel'stva* (Izdatelstvo Sankt Petersburgskogo Universiteta, St. Petersburg, 1994); Vladimir Popondopulo and Andrei Bushev, "O pravovom regulirovanii predprinimatel'skoi deiatel'nosti v Shvetsii", *Pravovedenie* (2000) No.1, 299-304; Andrei Bushev and Oleg Skvortsov, *Aktsionernoe pravo* (Intel-Sintez, Moscow, 1997); Andrei Bushev, "Korporativnoe upravlenie: na styke teorii i praktiki", *EKZh-Iurist* (2003) No.46, 3; Andrei Bushev, "The Theory and Practice of Corporate Governance in Russia", 27(1) *Review of Central and East European Law* (2001), 71-91.

possibility of various kinds of abuse by shareholders when exercising their rights and serving their interests.

It is difficult to overstate the importance—for Russia's economic development—of the clear direction that the legal regulation of shareholder relations has been taking. What should the legislator's starting point be, however, when working out the details of this principle and when formulating specific institutions of corporate law? To answer this question, let us first identify some fundamental issues of shareholder relations that have a significant influence on the behavior of entities taking part in an investment in the joint-stock vehicle, and, consequently, on the choice of mechanisms for protecting their rights.

3. The Economic (Objective) Character of Shareholder Relations

A joint-stock company differs from other organizational forms of conducting business in that it affects the interests of many persons, and not just groups of shareholders. In a joint-stock company, there are conflicts between the interests of external creditors and shareholders (internal creditors); shareholders and management (regarding the question of how to use net profits); between management and the labor force; and between other stakeholders. In the end, a company's activities could also have an important social interest for a large group of individuals with no direct link to the company.[6]

The contributions of those taking part in an investment differ in their size, in their form, in the significance thereof for the company, and with respect to other conditions (while the investment of each group is still needed). This circumstance governs the distinction of the groups with respect to the risk (probability) of recoupment of their investment (satisfaction of needs), and, consequently, with respect to their aim to control the use of investments and to gain access to all resources or parts thereof. As a result, the degree and forms of interaction between companies and groups of investors more than likely do not (always) coincide.[7]

6 The concept of the social responsibility (partnership) of companies that has been developing in foreign literature (*e.g.*, Rory Sullivan (ed.), *Business and Human Rights: Dilemmas and Solutions* (Greenleaf Publishing, Sheffield, 2003)) is already partially reflected in Russian legislation as well. For example, Chapter 9 of the Federal Law of 26 October 2002 on Insolvency (Bankruptcy), establishes a number of legal mechanisms that are aimed at the restoration of city-forming enterprises, which are subjects of natural monopolies, *i.e.*, companies whose activities have an important social significance. Another example of the reaction of the Russian legislator to the concept of social responsibility is RF Federal Law No.135-FZ of 11 August 1995 (with subsequent amendments) on Charitable Activities and Charitable Organizations, which is aimed, *inter alia*, at encouraging commercial entities to engage in charitable activities.

7 See, for example, Adolf A. Berle and Gardner C. Means, *The Modern Corporation and Private*

Shareholders who have a controlling block of shares[8] may be interested in reinvesting dividends in order to re-outfit the company's production facilities. Thus, large shareholders use a company's property to meet their business goals and to include the relevant enterprise in a defined production cycle. On the other hand, those shareholders who do not have a controlling block of shares, and, moreover, who possess individual shares, would probably prefer to receive dividends. At the same time, the can be little doubt that each of these groups is important for the company.

Taking these and other circumstances into account, there exists a potential in any joint-stock company for conflict between the interests of various parties to an investment, including between majority and minority shareholders.[9]

Property (Macmillan, New York, 1932); Joseph Weiner, "The Berle-Dodd Dialogue on the Concept of the Corporation", 64 *Columbia Law Review* (1964), 1458; Joseph McCahery, Sol Picciotto and Colin Scott, *Corporate Control and Accountability* (Oxford University Press, Oxford, 1995).

8 The size of a controlling block of shares may be determined in different ways, depending on the composition of shareholders in each specific company. Maximum control of any company is guaranteed by a block of shares exceeding 75% of all votes (this is the number of votes needed for making decisions about amendments to the charter, as well as on other matters. The controlling power of such shareholder is, however, restricted in the case of related parties' transaction). At the same time, control may also be ensured with a lesser number of shares in the possession of one shareholder. Thus, a block of shares making up 50% plus one of the voting shares of a joint-stock company would allow the shareholder in possession of such a block to make decisions at the general shareholders meeting on most (but not all) matters related to the company's activities (para.2, Art.49, Law on Joint-Stock Companies). At the same time, whenever a vote is taken, only the votes of those present at the general shareholders meeting are counted. It is possible, of course, for a situation to develop where not all shareholders participate in the general shareholders' meeting. In such a case, decisions are made even in the presence of less than 50% plus one of the total number of votes. Therefore, under certain conditions (for example, when shareholders do not, in fact, participate in the management of the company), control of the company could be established even with a block of shares of less than 50% plus one or 75% plus one.

Furthermore, in accordance with amendments of 24 February 2004 to the Law on Joint-Stock Companies, the election of members of the board of directors (supervisory board) of any joint-stock company carried out after 17 March 2004 shall be conducted by a cumulative vote, and the board shall comprise no fewer than five members. Previously, a cumulative voting procedure was applied only in joint-stock companies with more than 1,000 shareholders or if such a procedure was stipulated by the charter, and the composition of the board of the majority of companies was freely defined in the charter or by a decision of the general shareholders meeting. This new voting procedure allows shareholders not in possession of a controlling block of shares to elect to the board at least one of *their own* representatives, which, taking into account the significance of the board in the management of a company, makes it more difficult for one shareholder (or an affiliated group) to gain control there over.

9 A state of hidden or open conflict is characteristic for joint-stock companies at all stages of their development (see, for example, Lev Petrazhitskii, *Aktsionernaia kompaniia. Aktsionernye zloupotrebleniia i rol' aktsionernykh kompanii v narodnom khoziaistve* (Iuridicheskaia literatura, St. Petersburg, 1898); Rilka O. Dragneva and William B. Simons, "Peresmotr korporativnogo upravleniia: mozhno li s pomoshch'iu kontseptsii storon, zainteresovannykh v rezul'tatakh deiatel'nosti kompanii, izbezhat' "dikogo" kapitalizma v Vostochnoi Evrope?" in S.S. Alekseev (ed.), *Tsivilisticheskie zapiski: Mezhvuzovskii sbornik nauchnykh trudov* (Statut, Moscow, Ekaterinburg, 2nd ed. 2002), 464-487.

The reason for a permanent conflict of interests in a joint-stock company can be seen in the

At the same time, there are a number of factors that should facilitate the integration of potentially conflicting groups of shareholders despite differences in their interests and in how they foresee serving those interests.

Anyone acquiring shares has, to begin with, a common interest by nature: namely, a material interest (while retaining differences in terms of how to serve that interest depending on whether or not the shareholder has control of the company). This common interest is based, *first of all*, on everyone's aim, in the end, to obtain a return on their investment and, *second*, to receive just compensation or remuneration for "credit" given to the joint-stock company. This interest is served when a shareholder exercises the relevant property rights (to dividends, to a share in the assets of the company upon liquidation, to receive market value for shares repurchased by the company, etc.).[10] Therefore, a company is usually the source for satisfying claims (interests), which are the same (common, but not necessarily the only interests) for different persons. This circumstance makes it necessary for the relevant groups to interact without conflict not only with the company but also with one another.

In addition, the material interest of a shareholder in a joint-stock company is served both directly, when the shareholder exercises his rights, and indirectly, through the activities of the company itself, in which the shareholder is a participant. The more profitable and competitive the company is, the more completely satisfied will be the interests of everyone taking part in the investment. In a market economy, profitability is usually the result of two factors: expenditures and revenues. Simply put, the lower the expenditures and greater the revenues, the higher profitability will be. Thus, in the end, all groups of shareholders and stakeholders should be interested in reducing expenditures and in increasing the revenues of the joint-stock company.[11]

influence of the law of economics on the behavior of an individual whose goal is to maximize his personal gain under conditions of limited resources. Representatives of stakeholders may, of course, also be parties to a conflict.

10 Corporate rights are a means of ensuring that material interests are served, insofar as they allow the shareholder to take part in control and direction of the activities of a joint-stock company (as a debtor) with respect to formulating and defining the conditions of the corresponding material obligation (rights). In acquiring a share, the shareholder has a certain material interest, which is served by granting the shareholder a substantive right of claim. The non-material rights of the shareholder (the right to participation) are, in turn, called upon to ensure the creation and fulfillment, in relation to the shareholder, of the substantive obligations of the joint-stock company. See Andrei Bushev, *Aktsii po zakonodatel'stvu Rossisskoi Federatsii*, dissertation for the degree of candidate of sciences (Sankt Peterburgskogo Universiteta, St. Petersburg, 1997).

11 Of course, achieving the goal of reducing expenses should be planned while considering prospects for the company's development. Additional expenditures may, in fact, prove necessary in order to, for example, increase the company's investment appeal and, as a result, attract "cheaper" credits.

Taking this into account, we think that one of the main—if not the most important—tasks of corporate legislation is to guarantee a balance of the mentioned interests with the goal of maintaining the stability and viability of the joint-stock company as a whole. At the same time, in searching for this balance of interests, the legislator ought to stimulate (activate) different groups of investors by creating among them confidence that their material interests will be protected. If, however, the legislator provides excessive protection for the rights of small shareholders, this will lead to the curtailment of the company's business interests. And, conversely, excessive serving of business interests will lead to a curtailment of the interest of small shareholders in investing in a company, as well as a possible weakening of the company's investment appeal.

Furthermore, one should consider that—in establishing a balance of interests among different persons—the legal procedure applicable both in Russia and abroad secures not just equal protection for all groups of shareholders but also permits the impairment of the interests of one group in favor of another. And it is the case that the impairment of interests is possible only when adhering to certain general principles.[12] One of the premises underpinning this is the notion that disregarding—in certain cases—an individual interest in favor of the collective or public interest, in the end, also satisfies the individual private interest.[13]

[12] For example, the Universal Declaration of Human Rights of 10 December 1948 establishes that:

> [i]n the exercise of his rights and freedoms, everyone shall be subject only to such limitations as are determined by law solely for the purpose of securing due recognition and respect for the rights and freedoms of others and of meeting the just requirements of morality, public order and the general welfare in a democratic society."

Regarding the limitation of rights in shareholder relations, the RF Constitutional Court, in its decision of 18 July 2003 (No.14-P), noted that:

> "in using civil legislation to regulate the business activities of commercial entities, including joint-stock companies, the federal legislator is obliged to take into account that possible limitations, by federal law, of the rights of ownership, use, and disposal of property, as well as the freedom to conduct business activities and the freedom to conclude contracts, proceeding from general principles of law, must meet the requirements of justice, be adequate, proportional, balanced, and necessary for the protection of constitutionally significant values, including the rights and legal interests of other entities."

[13] Constitutional Court Justice G.A. Gadzhiev has noted that:

> "individual freedom is conceivable today only in cooperation with other bearers of fundamental rights. Such an exercise of fundamental rights assumes the introduction of personality into the complex process of making decisions and into specific organizational forms. As an example, one could take the rights of corporations in the area of stock ownership. In organizational structures of this type, individual decisions as well as constitutional freedom are exercised by means of agreement."

See Gadis Gadzhiev, *Zashchita osnovnykh ekonomicheskikh prav i svobod predprinimatelei za rubezhom i v RF* (Iuridicheskaia literatura, Moscow, 1995), 16.

In its decision (No.14-P) of 22 July 2002, the RF Constitutional Court noted that the provisions of the law

4. An Account the Interests of Various Groups of Shareholders: Who Needs Additional Protection?

What is the balance of interests among shareholders? What should the starting point be when establishing this? Whose rights are subject to increased protection? It would be a mistake to think that majority shareholders usually suppress minority shareholders, and that, therefore, minority shareholders—as the weaker party in shareholder relations—ought to always be protected from the majority. Surely we all know that it is not only large shareholders who are prone to abuse their rights, but so can the "weak" minority.

There are countless cases where minority shareholders[14] have not given a joint-stock company anything in the way of "a breather" from their claims. In such cases, it would be appropriate to pose the question of protecting the majority from the "terrorism" of the minority. To illustrate this point, there is the well-known example of the "invention" of several American millionaires who made themselves by acquiring shares in various corporations and then suing them after finding some kind of legal error in their documents or activities. The corporations had to reach an amicable solution and pay these "shrewd" shareholders significant compensation, which, of course, could not but undermine their assets, thus having an influence on the rights of other shareholders.[15] The actions of some minority shareholders are considered by many to be a highly significant additional risk that decreases the investment and commercial potential of a company.[16]

> "that define the procedure for voting and for making decisions at a meeting of an association of creditors are aimed at disclosing and agreeing upon the common interests of the creditors of a given credit organization. The making of a decision by a majority of votes of all creditors, while taking into account the total property claims belonging to them, is a democratic procedure, which does not contradict the principle of equality of the rights of all participants in civil-law relations (para.1, Art.1, RF Civil Code), which is a manifestation of the constitutional principle of equal rights."

This approach should also be applied to agreement of the will of creditors.

14 That is, shareholders who are not in possession of a controlling block of shares. See note 8.

15 See Regina Naryshkina, *Aktsionernoe pravo SSha (pravovoe polozhenie predprinimatel'skikh korporatsii SSha). Uchebnoe posobie* (Iuridicheskaia literatura, Moscow, 1978), 33-34; Olga Syrodoeva, *Aktsionernoe pravo SSha i Rossii* (Iuridicheskaia literatura, Moscow, 1996), 73-80. Russia has also witnessed a recent activation of minority shareholders. See, for example, the sources listed in notes 16 and 17.

16 See Fedor Svarovskii, "Opasnost' dlia investora", *Vedomosti*, 25 June 2002. Such actions of minority shareholders in relation to a joint-stock company have even been given a particular name: "greenmail" (see Alexander Kidriakin, "Korporativnyi shantazh (grinmeil) i metody bor'by s nim", *Sovremennoe pravo* (2002) No.5, 19-21; Alexander Osinovskii, *Aktsioner protiv aktsionernogo obshchestva* (Ekonomika, St. Petersburg, 2003).

In such a situation, it is appropriate to protect the interests of the company (and, consequently, of all shareholders), as well as the interests of the majority shareholders from attacks by the minority.[17]

5. An Attempt to Find a Doctrinal Definition of the Significance of Shareholder Rights and the Permissibility of Impairing Individual Rights

Questions about protection of the rights of shareholders, the relationship among the interests of the majority and the minority, and the granting of certain rights to these groups have been explored for a no small amount of time in legal literature. At the end of the nineteenth and beginning of the twentieth centuries, German scholars were actively developing a theory of the division of rights of shareholders into inalienable and alienable.

In 1874, the German scholar Paul Laband proposed that inalienable rights were those rights that a shareholder could not be deprived of by a decision of the general shareholders meeting. The inalienability of rights—recognized as such by law—is based on the principles of public law and, therefore, may not be annulled by way of a corporate charter. Rather, a charter may confer inalienability on rights that are not recognized as such by law. If certain rights are not identified as inalienable either by a charter or by law, then their appearance may cause an understandable difficulty both in theory and in practice. Furthermore, German scholars sought to find for an answer by attempting to distinguish membership rights that belong to shareholders within the framework of the corporation, on the one hand, and in relation to the corporation, on the other (von Stobbe), from generally-useful rights and rights established in the personal interest of the shareholder (Oertmann).[18] Others considered to be inalienable those rights a violation of which would contradict the fundamental principles of corporate law, particularly the principle of equal rights (Stanb) or the goals of the company (Fischer). Lehmann considered to be inalienable those membership rights that, for the "average" shareholder, are so important that he would not be able to join a company without them. Classification, meanwhile, is done depending on the interpretation of the will of an "average", "reasonable" individual who acquires shares, and not of each specific shareholder. In the end, a single criterion satisfying all of the above-mentioned German scholars was never found, and the resolution

17 Dmitriy Gololobov, *Aktsionernoe obshchestvo protiv aktsionera. Protivodeistvie korporativnomu shantazhu* (Intell, Moscow, 2004).

18 For a short survey of this discussion, as well as references to German sources, see Vladimir Vol'f, *Osnovy ucheniia o tovarishchestvakh i aktsionernykh obshchestvakh* (Iuridicheskaia literatura, Moscow, 1927), 132-136.

of any particular situation led to the subjective application by judges of business practices and custom, reasonableness, and expediency.[19]

Russian civil-law specialists did not remain on the sidelines during this search for criteria for inalienable rights of shareholders. For example, P.A. Rudnev separated (although under the strong influence of German literature) "natural" (*natural'nye*) rights (inherent in shareholders as participants in a joint-stock company) and "incidental" (*sluchainye*) rights.[20]

In analyzing similar problems, P.N. Gussakovskii noted:

> "The corporate structure of joint-stock companies undoubtedly imposes on individual shareholders an obligation to submit to decisions of the general shareholders' meeting even in the case where such a decision does not correspond with their personal views and intentions. Nonetheless, they are obliged to submit only to those decisions of the general shareholders meeting that are made within the bounds of the law and the charter with respect to the company's business, as a legal entity, and that do not in any way interfere with those rights that belong personally to individual shareholders."[21]

According to Gussakovskii—in case of a violation of such rights—"every shareholder is not only not obliged to submit to the decision of the general shareholders' meeting, but he also has the right to demand its annulment and compensation for damages incurred". Gussakovskii did not, however, suggest any criteria for arranging decisions of the general shareholders meeting into general corporate decisions and individual decisions. Scholars and legislators from various countries have undertaken other (thus far, not totally successful) attempts to classify and define the rights of shareholders, with the goal of establishing which of these a shareholder may not be deprived of without his consent.[22]

19 It is likely that such an abundance of opinions of both foreign and (as will be presented later) Russian scholars can be explained, *inter alia*, by the circumstance that a great variety of interests (material and nonmaterial, business and non-business, public and private, etc.) are combined in a joint-stock company. The bearers and representatives of these interests may require varying degrees of state protection. The use of an "average, "reasonable" individual suffers from its very averageness. Thus, it is difficult if not impossible to speak of the existence of objective criteria that would allow a simple and reliable definition of the degree of subjective importance (or lack thereof) of the rights granted to each shareholder. The absence of such objective criteria does not, however, exclude the possibility of the establishment thereof through legislation for the purpose of realizing certain aims of the legal policy of the state.

20 Pavel Rudnev, *Analiz prav i obiazannostei aktsionerov* (Iuridicheskaia literatura, Moscow, 1927), 5.

21 Petr Gussakovskii, "Voprosy aktsionernogo prava", *Zhurnal Ministerstva Iustitsii*, October, November, December, 1915, St Petersburg, 55.

22 See Dmitriy Lomakin, *Aktsionernoe pravootnoshenie* (Statut, Moscow, 1997); Tatiana Medvedeva (ed.), *Zashchita i obespechenie prav aktsionerov* (Statut, Moscow, 1998).

6. A Modern Corporate Law Policy: The Permissibility of Impairment of Shareholder Rights

In our opinion, a modern legal policy may permit the impairment of the rights of some persons in favor of others in order to achieve certain important goals, which we will discuss later. This position is supported, in particular, by the opinion of the Constitutional Court of the Russian Federation expressed in its ruling of 6 December 2001 (No.55-O) on its refusal to consider complaints by a number of citizens that Article 80 of the Law on Joint-Stock Companies violated their constitutional rights. The Court explained that:

> "The provision of Article 19(1) of the Constitution of the Russian Federation that 'all are equal before the law and the courts' means that, under equal conditions, subjects of the law must have equal status. But if conditions are not equal, then the federal legislator has the right to establish for them a different legal status. [...] The granting of additional powers to shareholders in a joint-stock company having more than 1,000 holders of ordinary shares is determined by the necessity of regulating the processes of redistribution of power to prevent the formation of a monopoly [...]."

When regulating shareholder relations, however, both the legislator and companies themselves (majority shareholders) should consider the interests of all members of the company.[23] Such a necessity is dictated, *first*, by recognition of the contribution and mutual dependence of each group taking part in an investment specifically in the joint-stock form of business, and, *second*, by the direction of legal regulation proclaimed in the 1993 RF Constitution: namely, respect for the rights and freedoms of individuals.[24] But what, in this case, should the starting point be?[25]

[23] This legal direction, the goal of which is to take into account the interests of all persons in the relations that are being regulated, has deep roots, with its theoretical basis in the works of Rudolf von Jhering. The RF Constitutional Court has, on more than one occasion, considered the necessity of taking into account the interests of individuals when formulating and applying legal regulations. See Gadis Gadzhiev, *Konstitutsionnye printsipy rynochnoi ekonomiki* (Statut, Moscow, 2002); Alexei Kurbatov, *Sochetanie chastnykh i publichnykh interesov pri pravovom regulirovanii predprinimatel'skoi deiatel'nosti* (Statut, Moscow, 2001); Dennis Dedov, *Sorazmernost' ogranicheniia svobody predprinimatel'stva* (Bek, Moscow, 2002).

[24] "When defining the legal status of joint-stock companies as participants in trade and commerce and the limits within which they may exercise their rights and freedoms, the legislator is obliged to guarantee a balance of rights and legal interests of shareholders and third parties, including creditors." Decision of the RF Constitutional Court (No.14-P) of 18 July 2003.

[25] The necessity of taking account of the interests of all shareholders and stakeholders does not mean that they must absolutely be granted equal rights (*i.e.*, the equal possibility to demand the same behavior from other entities in relation to themselves). The point is that an individual interest itself, belonging to specific shareholders, may not coincide, for example, with respect to its scope. Furthermore, serving one particular interest (including one that differs in scope) may have a greater public significance than serving another interest. Therefore, the rights of groups of shareholders—which they are granted in order to serve their interests—may differ with respect to their substance and to the time frame in which they may be exercised, etc. What is important, however, is that, in the end, it is assured that every legal interest of a shareholder

7. The Fundamental Interest of a Shareholder

That which all groups of shareholders have in common, as has already been noted, is the existence of a certain material (economic) interest. In calling this the fundamental interest, we are proceeding from the notion that this would be reasonable and typical for the majority of representatives of one group or another but not necessarily for each particular shareholder. Legal policy should be directed, first of all, at serving this "generic" (fundamental) interest of a shareholder, specifically his material (economic) interest, through the recognition and protection of corresponding rights.[26]

But how can this be if the interest of a private individual (a single shareholder) is impaired[27] in favor of the public interest or the interest of the majority, for example, to encourage economic development by permitting the concentration of corporate capital or for the long-term reduction of expenditures for supporting shareholders (updating the contents of shareholder registers, calling general shareholders' meetings, identifying "live" shareholders, etc.)? In such a case, how can the material interest of a "victim" be protected?

In Russia at the present time, many corporate holdings are moving to a so-called unified share (*edinaia aktsiia*), where branch companies lose their status as a legal entity and are "transferred" into subsidiaries of the head office. As a result of the merging of a company's assets, there is an increase in the capitalization and liquidity of assets, and an improvement in the manageability of the company, plus a gain in other competitive advantages. For example, banks are more likely to give loans to such reformed companies.

will be served even if through the granting of different rights.

26 While the application of the above-mentioned criterion of an "average", "reasonable" individual in relation to all groups of shareholders taken together does not resolve the task of defining a single criterion, it does make it possible—in our view—to reveal the direction of legal policy. A common interest for all should be guaranteed state protection regardless of group to which a particular shareholder belongs. At the same time, the forms of such protection could differ.

27 The impairment of interests could take the form of the imposition of additional obligations, a more costly redistribution of risks, a prohibition against carrying out certain actions, etc. Impairment of a private interest in favor of a public one is possible, for example, for the purpose of protecting the interests of:

(i) third parties not participating in specific legal relations with the company as a whole or with the assets thereof;
(ii) persons interacting with a party (group of persons) whose rights and interests are being limited;
(iii) an individual from his own mistakes.

See Rilka O. Dragneva and William B. Simons, "Rights, Contracts and Constitutional Courts: The Experience of Russia", in Ferdinand Feldbrugge and William B. Simons, (eds.), *Human Rights in Russia and Eastern Europe: Essays in Honor of Ger P. van den Berg* (Martinus Nijhoff Publishers, Leiden, 2002), 38.

When establishing the rights of a shareholder, it is necessary to proceed from the material nature of his interests. In other words, a shareholder should have the possibility of demanding that a joint-stock company engage in the sort of active behavior that would result in the widening of his *material sphere*, such that he would be able to receive new material gains (*novoe imushchestvo*) from the company (in the form of dividends, a share in the assets of the company upon its liquidation, additional shares, etc.). It is clear that the greater the funds risked by a shareholder when providing a company with "credit", the greater—in comparison with other shareholders—should be his returns from the company.

But how should this material interest be measured, including for the purpose of comparing it with the interests of other shareholders? The property rights of a shareholder are tradable (*oborotosposobny*), (*i.e.*, more liquid in comparison with similar rights not vested in the form of securities: the rights of a member of a limited-liability company, the rights of a member of an ordinary partnership, etc.). The possibility of selling shares is often an additional stimulus for investing funds specifically in the joint-stock form of business.

Since they are tradable, the property rights that are embodied in shares—and the corresponding material interest of a shareholder—can, as a result, be expressed in a monetary equivalent at any time. Thus, if a shareholder's rights are impaired in favor of the public (or collective) interest, his material interest may be satisfied to no less a degree although in another manner: through the payment of proportionate monetary compensation.[28]

[28] The European Court of Human Rights treats the payment of proportionate, monetary compensation as one of the fundamental principles that must be complied with when establishing a balance of public and private interests while limiting or depriving a private individual of the right of ownership (see the decisions of the European Court of Human Rights in the cases of *Lithgow v. the United Kingdom* of 9 July 1986, *Akkus v. Turkey* of 9 July 1986, *Carbonara and Ventura v. Italy* of 30 May 2000); Vladislav Starzhenetskii, *Rossiia i Sovet Evropy: Pravo sobstvennosti* (Statut, Moscow, 2004), 70-74. Art.35 of the RF Constitution calls for prior and commensurate compensation in the case of confiscation of private property for state needs. The RF Constitutional Court has also specified that compensation must be reasonable and proportionate; see the decision (No.8-P) of 16 May 2000 in the case on the verification of the constitutionality of certain provisions of Point 4 of Art.104 of the RF Federal Law on Insolvency (Bankruptcy), in connection with a complaint by the company Timber Holdings International Limited, *SZ RF* 2000, No.21, item 2258. We think a similar approach should be applied in relations between private individuals (different groups of shareholders) in cases where the state establishes the possibility of confiscating the property of one group in favor of another.

8. Limitations on the Exercise of Rights to Serve One's Own Interests

Exploration of the question of the relationship of the interests of majority and minority shareholders is inconceivable without considering the theoretical problem of establishing limitations on the exercise of rights,[29] including the right of the majority to make decisions that do not always please the minority and the right of the minority to seek judicial protection. And it is, indeed, true that not every case of exercising one's rights—even if established by law—is subject to protection. Thus, in accordance with paragraph 1, Article 9, of the RF Civil Code, citizens and legal entities may exercise—at their own discretion—their civil rights, including shareholder rights. It is not permissible, however, to exercise one's rights solely with the intent of rendering harm to another person (for example, to deprive or to limit someone's right to vote) or to abuse one's rights in other ways (para.1, Art.10, RF Civil Code).

Not everything that is not expressly forbidden by law is permitted, and what is permitted is not limited to that which is directly authorized by law.[30] Where exactly is the boundary beyond which the exercise of rights turns into abuse of rights?

While focusing on the fact that "every right presupposes boundaries defining a measure of freedom", Alexei M. Guliaev, in due course, defined—although not very clearly— such boundaries to be only the law and the rights of others.[31] Olimpiad S. Ioffe thought that, "by boundaries of the exercise of civil rights, one should understand boundaries resulting from their intended purpose".[32]

In attempting to establish such boundaries, Vladimir P. Gribanov wrote:

> "The question of the existence or absence of abuse of rights may be resolved, first and foremost, depending on the relations between a legally sanctioned general *type* [author's italics] of potential behavior by the holder of a right and the specific ac-

29 Legal scholars have explored this question on more than one occasion; see Mikhail Agarkov, "Problema zloupotrebleniia pravom v sovetskom grazhdanskom prave", *Izvestiia AN SSSR,* Otdelenie ekonomiki i prava, Moscow (1946) No.6, 427; Sergei Bratus', "O predelakh osushchestvleniia grazhdanskikh prav", *Pravovedenie* (1967) No.3, 82; Olimpiad Ioffe and Vladimir Gribanov, "Predely osushchestvleniia sub"ektivnykh grazhdanskikh prav", *Sovetskoe gosudarstvo i pravo* (1964) No.7, 77.

30 Olimpiad Ioffe, "Iuridicheskie normy i chelovecheskie postupki", in *Aktual'nye voprosy sovetskogo grazhdanskogo prava* (Iuridicheskaia literatura, Moscow, 1964), 13-27, at 25.

31 Alexei Guliaev, *Russkoe grazhdanskoe pravo: Obzor deistvuiushchego zakonodatel'stva, kassatsionnoi praktiki Pravitel'stvuiushchego Senata i proekta Grazhdanskogo ulozheniia. Posobie k lektsiiam* (Izdatelstvo Gutnik, St. Petersburg, 1913), 170.

32 Olimpiad Ioffe, *Sovetskoe grazhdanskoe pravo* (Iuridicheskaia literatura, Moscow, 1967), 311.

> tions that he undertakes with the goal of realizing subjective rights.[33] [...] Abuse of rights is a special type of civil-law violation committed by a holder of a right in the course of exercising the rights belonging to him, and it is connected with specific impermissible types of behavior within the framework of a general type of behavior that is permitted by law."[34]

Taking these discussions into account, it is possible to conclude that the behavior of a shareholder (the holder of shareholder rights) should be measured by the aim of the activities (interests, motives) of an "average", conscientious, and reasonable shareholder who takes account of the rights and interests of others, including the company as a whole. Thus, a situation whereby a shareholder with a controlling stake adopts a decision at the general shareholders' meeting without taking into account the interests of either the company as a whole or of other shareholders should not be subject to protection. For example, one ought to take into consideration that a company's expenses for the payment of compensation to shareholders whose rights have been impaired should be economically justified from the point of view of the condition in which the company will find itself after the implementation of this decision, while taking into account the expenses connected with compensation, possible court costs for suits filed by minority shareholders, etc.[35]

9. Limiting Possibilities for the Abuse of Rights

Thus, when a shareholder exercises his legally established rights, this should be seen as appropriate only if, in doing so, the rights and interests of other persons are taken into account. Furthermore, if the rights and interests of another person are still impaired, then that person must be offered equivalent compensation. But it would be naïve to assume that every shareholder will obey these rules. Therefore, in order to increase the protection of the rights of all shareholders, it is necessary to create procedures that would compel persons making and implementing relevant decisions to take others' interests into account and, when necessary, to offer just compensation.

33 Gribanov, *op.cit.* note 29.

34 *Ibid.*, 53.

35 There is an interesting court case dating from the beginning of the twentieth century known as the "straw man case". At the end of 1901, a group of shareholders with a controlling stake sold their shares to fictitious entities (straw men) and then bought them up again in order to create a board that served their interests. Their actions and the decision of the general shareholders' meeting on the selection of directors were ultimately declared invalid. As the was reported to have observed, the controlling shareholders used their rights not for the goal—as one ought to in accordance with the law and a natural sense of human justice—of managing the bank's affairs in the common interest but, as the record pointed out, for their own selfish goals. See the account of this case reported by Leonid Snegirev in *Podstavnye aktsionery. Protsess aktsionerov Khar'kovskogo zemel'nogo banka s gg. Riabushinskimi i Korenevym* (Gutnik, Moscow, 1904).

The laws of foreign jurisdictions set forth different mechanisms for the adoption of decisions by the administrative organs of a company. The international community has made numerous attempts to bring various national forms of corporate law closer together, including with respect to the protection of shareholder rights.[36] At present, the results of these efforts are to be seen primarily in normative regulation according to the territorial principle.[37] At the same time, one can discern the outline of a trend for regulation on a global scale through the use of documents of a recommendatory nature adopted by international organizations.

This concerns, first and foremost, general principles of corporate governance. As has already been mentioned, the specifics of shareholder relations are such that—in order to serve their own material interests—certain persons abuse their position and fail to take into account the interests of other parties to an investment. To create a system of "checks and balances" that would guarantee a particular balance of interests of various groups and limit opportunities for them to abuse their rights, international practice has tried a variety of mechanisms for internal organization, procedures, and decision-making principles and for monitoring the implementation of decisions adopted. The power of the state is often applied in order to guarantee the functioning of these mechanisms. Companies that have introduced the recommended procedures for the adoption of decisions by their administrative organs (corporate structures) usually have a higher level of investment appeal.[38]

36 The most authoritative studies can be found in the reports of government commissions of various states: the 1992 Cadbury Report on the Financial Aspects of Corporate Governance, the 1994 Rutteman Working Group Report on Internal Control and Financial Reporting, the 1995 Greenbury Report on Remuneration for Members of the Board of Directors, the 1998 Hampel Report on the Fundamental Principles of Corporate Governance, the 1999 Turnbull Report on Internal Control, the 2001 Myners Report on Institutional Investors, the 2003 Smith Report on the Audit Committee of the Board of Directors, and the 2003 Higgs Report on the Role of Non-Executive Directors. See Marina Gracheva, "Razvitie britanskikh standartov korporativnogo upravleniia: Doklad Higgsa", *Zhurnal upravleniia kompaniei* (2004) No.6, 24.

37 Illustrations of this include directives of the European Union on companies, the Model Civil Code adopted by the member states of the CIS, etc. See Vladimir Popondopulo (ed.), *Mezhdunarodnoe kommercheskoe pravo. Uchebnoe posobie* (Iurist, Moscow, 2004), 136-139. The current absence of uniform international regulations may be explained by a number of reasons of a political, economic, and legal nature, in particular, by objectively conditional differences (at times, substantive differences) in the economic system of corporate capital, the condition of the infrastructure of stock markets, etc.

38 The average premium that investors are ready to pay for shares in a company with a high level of corporate governance in Russian is 38%. See McKinsey & Company, *Global Investor Opinion Survey: Key Findings*, 2002, available online at <http://www.mckinsey.com/clientservice/organizationleadership/service/corpgovernance/pdf/GlobalInvestorOpinionSurvey2002.pdf>). It is also encouraging that many Russian companies are beginning to realize the importance of corporate governance for enhancing their competitive position in the market (see the International Finance Corporation/Russia Corporate Governance Project's, *A Survey of Corporate Governance*

In our opinion, a company's management structure and its decision-making procedures should take into account—to the maximum extent possible—the interests of all groups of shareholders, as well as other interested parties to an investment. Therefore, and not by accident, in our view, effective corporate governance is possible, in particular, only where there is the timely and complete disclosure of information concerning adopted decisions to all persons whose interests could be affected by such decisions.[39]

Another (though not the last) example of "special procedures" is a requirement for defined stages of decision-making (a time and format for supplying information, mechanisms for preparing draft decisions, the conditions for discussing draft decisions, informing interested persons, monitoring implementation, etc.).[40] International standards on corporate governance have been formulated in such documents as the *OECD Principles of Corporate Governance*, the EBRD's *Sound Business Standards and Corporate Practices: A Set of Guidelines*, and the *Euroshareholders Corporate Governance Guidelines 2000*.[41]

In addition, the existence within a company of "progressive" decision-making procedures is—in and of itself—still not enough. Indeed,

Practices in Russia's Regions (Compiled and Drafted by the Interactive Research Group [IRG] in Cooperation with the Independent Directors Association), 2003, available at <http://www2.ifc.org/rcgp/Documents/IFC_CG_survey_en.pdf>).

39 It is noteworthy that many of the principles of effective decision-making and of monitoring the implementation of decisions—including the principle of complete, reliable, and timely disclosure of information—are applied not only in commercial organizations. Such principles are needed most in organizations with a large number of persons with non-coinciding interests (state administration, the management of international organizations, etc.). The greater the likelihood of the occurrence of a conflict in such organizations, the more these principles ought to be introduced into the activities of the management bodies that are making decisions of significance for all participants. See Andrei Bushev, "Publichnyi poriadok v sfere mezhdunarodnogo torgovogo oborota", in Vladimir Popondopulo (ed.), *Mezhdunarodnoe torgovoe pravo. Uchebnoe posobie* (Iurist, St. Petersburg, 2005), 45-52.

40 The necessity of effective disclosure and exchange of information is also explained by the economic theory of transaction costs. In a number of cases, the use of electronic voting may facilitate a decrease in expenditures with respect to receiving and exchanging information among the company, shareholders, and other interested persons and, consequently, an increase in the effectiveness of the process of making decisions that are significant for everyone. One of the main legal issues still to be resolved is a proper identification of the voting person.

41 The approaches developed by the international community have been reflected in the Code of Corporate Behavior, a document of recommendations of the RF Federal Securities Commission. See Igor Kostikov (ed.), *Kodeks korporativnogo povedeniia. Korporativnoe povedenie v Rossii* (Ekonomika, Moscow, 2003).

An assortment of information on foreign and international law has been collected with the assistance of the International Financial Corporation, a member of the World Bank Group, within the framework of the Corporate Governance Project in Russia; see <www.ifc.org/rcgp>.

these procedures should not be just "on paper"; rather, they have to be implemented in practice and improved as necessary.

To maintain the smooth functioning of these mechanisms and procedures, and to monitor their implementation, an external force is needed that is unbiased in relation both to the joint-stock company and to the relevant interested persons. Here, the influence of the market as an objective regulator and of economic laws is insufficient. So, if a company is not going to pay its workers competitive wages, it will hardly be able to attract qualified personnel. An investor could be scared off by systematic violations of the rights of shareholders or if the company has significant debts to creditors. It is clear that economic laws alone are not enough to act as a regulator of the behavior of all interested persons:[42] it is necessary to have an apparatus for putting pressure on those persons guaranteeing the functioning of mechanisms and procedures.[43] Public authorities play the role such an external power by establishing rules that need to be obeyed when making decisions affecting the interests of a large number of persons (requirements concerning the disclosure of information, the procedures

42 In our opinion, the modern state of competition in the commodities and securities markets of Russia cannot really allow one to hope for anything in the way of effective influence of a "competition filter", supported by adherents of Armen Alchian; "the logic of natural selection", the rules of "the adaptation of an economic system to its environment"; see, for example, Armen A. Alchian, "Uncertainty, Evolution and Economic Theory", 58(3) *Journal of Political Economy* (1950); Terry M. Moe, "The New Economics of Organization", 28(4) *American Journal of Political Science* (1984), 746-747. Our evaluation of the degree of influence that competition legislation has in Russia on the behavior of those involved in economic relations—including shareholders—is based on the fact that the Russian economy, which is going through a "transitional period", is only now starting to adopt the main tenets of the laws of competition. They have had a very limited effect.

Several authors have seen a need for making better use of the advantages of a competitive environment not only in economics but also in the law-making activities of the state. See Roberta Romano, "The Need for Competition in International Securities Regulation", *Yale Law School John M. Olin Center for Studies in Law, Economics, and Public Policy Working Papers Series*, Paper (2001) No.258, available at <http://lsr.nellco.org/yale/lepp/papers/258/>; Roberta Romano, *The Advantage of Competitive Federalism in Securities Regulation* (AEI Press, Washington, 2002) at <http://www.aei.org/books/bookID.2,filter.all/book_detail.asp>; Roger Van den Bergh, "Regulatory Competition or Harmonization of Laws? Guidelines for the European Regulator", in Alan Marciano and Jean-Michel Josselin (eds.), *The Economics of Harmonizing European Law* (Edward Elgar Publishing, Cheltenham, 2002).

43 Bearing in mind that Russia's legislation is largely constructed according to the German pandect model, the conclusions of a number of German scholars on the influence of state regulation on economic development are worthy of attention. In particular, they think that the formation of a system of market institutions requires a "regulating principle" (*uporiadyvaiushchee nachalo*), some sort of force that is capable of establishing and supporting compliance with the rules of the game in the market. Only the state can play the role of such a force. For an overview of the main arguments, see Viktor Gutnik, *Politika khoziaistvennogo poriadka v Germanii* (Ekonomika, Moscow, 2002); *Teoriia khoziaistevnnogo poriadka. "Fraiburgskaia shkola" i nemetskii neoliberalizm* (Economika, Moscow, 2002), 111.

for forming the board of a joint-stock company, and the introduction of unified standards of financial reporting, etc.).[44]

The activities of many large companies have an influence on whether or not the public interest is served (city-forming companies, monopolists, etc.). In order to protect this interest, the state establishes additional means of exerting influence and of monitoring (state registration, permission to settle certain transactions, support for a system of disclosing information that is accessible to all, etc.). When determining the effectiveness of the functioning of these procedures and mechanisms, impartiality may also be assured by providing the possibility to protect one's rights through judicial proceedings.

Thus, a balance of interests among various groups of shareholders and stakeholders within a company may be assured through the establishment of certain rules and procedures for decision-making within the company, as well by introducing the possibility of monitoring compliance therewith by neutral parties, including the state.

Of course, it would be difficult to suggest mechanisms and procedures that would be equally effective for each and every company, regardless of the sphere, size, or other conditions related to its activities. There are not, and cannot be, an ideal or perfect model (it is sufficient to recall the sensational corporate scandals at Enron, Worldcom, Parmalat, Arthur Andersen, etc.). However, the system should be constructed in such a way that, while it is functioning, any person should have the opportunity to declare its interests with the goal of having them taken into account.[45]

In addition, it is important to note that—under market conditions—public authorities should not consider the substance (for example, whether or not all of the economic aspects of the consequences of a decision have been taken into account, and to what degree) of any decision as long as it complies with the applicable requirements. If such an approach were used, business initiative would be paralyzed. When evaluating adopted decisions, public authorities should pay attention to the existence of, and compliance with, mechanisms and procedures within a joint-stock com-

44 Unfortunately, one has to admit that the organization of public authorities themselves is far from ideal and allows for (occasional if not frequent) abuse of public authority by state officials. The unprincipled behavior of state officials—upon occasion—contributes to the abuse of corporate authority by company officials and, consequently, the impairment of the interests of other partners in the development of an investment (shareholders, stakeholders).

45 We would again like to emphasize the necessity of introducing (Russian) companies—as quickly as possible—to new electronic technologies that allow for the optimization of information exchange between shareholders and stakeholders regarding decisions that are significant for them. One such technology, which is already being used in Russia, is the Internet: namely, publicly accessible company websites for posting information concerning questions of corporate governance, support forums, etc.

pany, the application of which would inevitably lead to the consideration of the interests of other persons.[46]

Taking the above into account, one ought to agree, on the whole, with the opinion of Braude on two different trends in legislative measures for protecting the rights of shareholders. Already in the middle of the 1920s, he thought that it was *first* necessary to work out a mechanism for making well-thought-out decisions, taking into account, where possible, the interests of each shareholder. *Second*, an "unsatisfied" shareholder should have the possibility to leave a company and receive payment from the company for his shares.[47]

10. Fairness and Limitations on Shareholder Rights

No matter how perfect a decision-making procedure may seem, or however profitable and socially oriented a company's activities may be as a result of the implementation of that decision, or no matter how completely the typical material interests of all parties to an investment may be met—including through the offer of commensurate compensation—it will not be difficult to find someone who is unsatisfied. It is, for all intents and purposes, impossible to construct a perfect system that satisfies everyone. Clearly, the rights and freedoms of every individual are of the utmost importance; they define the meaning, content, and application of laws (Arts.2, 18, 1993 RF Constitution). Would a legislative approach be just if a party is not satisfied by the fact that he did not receive that upon which he was originally counting when acquiring shares (for example, a shareholder expected to serve not only material, but also social, interests, or if the amount of compensation paid seems inadequate)? This question ought to be answered in the affirmative: upon compliance with the requirements of legislation and other conditions listed above, limitation of the rights

46 Illustrative of this is the *Smith v. Van Gorkum* case (488 A. 2d 858 (Del. Supr. 1985)). The Trans Union company was offered a chance to sell shares at a "very favorable" price (*i.e.*, at more than 50% above the market value). The decision to accept the offer was confirmed by the company's board of directors and the majority of votes of its shareholders. Meanwhile, several shareholders filed a lawsuit against the company's directors, claiming that "while the price is favorable, it could be even higher". The court did not consider the price itself. However, it forced the directors to pay the company and its shareholders USD 23 million, which was motivated by the fact that the directors failed to meet several reasonable procedural requirements when they were deciding to approve the transaction and in their recommendations to the general shareholders' meeting. If these requirements had been observed, it is possible that the interests of the company and its shareholders would have been better served.

47 Iosif Braude, *Aktsionernye obshchestva i tovarishchestva v torgovle i promyshlennosti* (Sovetskaia Iuridicheskaia literatura, Moscow, 1926), 4. In essence, this respected Russian scholar provided the rationale for the expediency of applying, in Russia, several of the above-mentioned achievements of the German legal school. Vol'f , *op.cit.* note 18.

of a shareholder in favor of other persons would be just, particularly for the following reasons.

First, it is necessary to take into account that a joint-stock company is a special legal form of commercial organization. When creating a joint-stock company or when acquiring shares therein, the founders (shareholders) need to be aware of the kinds of rights and obligations that arise as a result thereof. In particular, a shareholder should (and can) be aware of the possible consequences of owning a small number of shares, including possible limitations of his rights in favor of other persons, insofar as this is directly stipulated by the Law on Joint-Stock Companies. In other words, an individual who is aware of these consequences, which is presumed to be the case, but still acquires a small number of shares, is placing limitations on himself. From the very beginning, the shareholder consents to the possible reallocation of risks in favor of other shareholders when he acquires shares and becomes a participant in a joint-stock company.[48]

Second, a shareholder has an opportunity to compare his perceptions of the commensurability of compensation and of the compliance of decision-making procedures that are directed at taking his interests into account with those of a third person who is unrelated to the company and to other shareholders. The shareholder has the right to judicial recourse.

We shall now apply the above-mentioned general approaches of regulating shareholder relations to the specific question of consolidation.

11. Economic Prerequisites for Impairing the Interests of Minority Shareholders in Favor of the Majority

Are there any objective economic conditions that would justify the Russian legislator's introduction of rules on the consolidation of shares that could potentially limit the rights of minority shareholders in favor of the interests of other persons?

It goes without saying that the Russian stock market needs to be developed, which is expected to facilitate the flow of investment into the Russian economy. This can be done in the American way (by stimulating small investors) or in the German way (by relying on strategic investors).

The American way can be considered only as a goal that the Russian legislator has decided at the present time, to follow in introducing, *inter alia*, rules on the right to fractional shares.

[48] This argument finds support in the ruling of the Constitutional Court of the Russian Federation of 2 March 2000 (No.38-O), in which the Court noted that a shareholder—upon purchasing shares—is aware in advance that other shareholders will possibly have access to information about him. The purchaser thus agrees that shareholders in possession of more than 1% of shares can demand information from the registrar about the name of other shareholders and about the amount, category, and nominal value of stock belonging to them.

However, under conditions where there has not been, and still is not, a developed infrastructure for the stock market and, in essence, where it is not possible to guarantee the effective implementation and protection of the rights of a large number of small shareholders (investors), it would be logical to develop this market through a limited number of large strategic investors (in accordance with the German model).

In fact, the Russian stock market lay, and still lies, within a very narrow space that is determined by the activity of strategic investors and securities-market professionals.[49] To support such investors and market professionals, the Former Law established rules on consolidation; on nullification of fractional shares, which facilitate the concentration of capital; and on the involvement of strategic investors who—in investing their own and outside funds—aim to run the company and control its activities. It is possible to imagine that, by supporting strategic investors, the legislator has likely sought to serve the public interest by attracting large amounts of capital into the Russian economy as a whole.

At the same time, it is impossible to deny that protecting the rights of minority shareholders is important for the development of the economy. The confidence of every investor—regardless of the size of his contribution to the charter capital of a joint-stock company—in the complete satisfaction of his interests (first and foremost material interests) has a large number of positive consequences. We shall name only a few of these. *First*, investor security will lead to the (further) development of the securities market, which should provide competition for the investment of capital in banking institutions. *Second*, investors' trust in placing their funds into stock should facilitate the attraction of additional capital and the development of production ("the real economy"). *Third*, the diversification of share capital among a large number of persons (investors) should have a greater disciplinary effect on the managers of companies, which in turn should increase the effectiveness of their work. *Fourth*, the existence within a company of a large number of shareholders should reduce the risk of controlling shareholders abusing their position.[50]

Furthermore, in our view, it is clear that the functioning of all these mechanisms is possible only if the securities market has a developed infrastructure (stock exchanges, market professionals, etc.). A condition of no less importance is the existence of an effective judicial system that is

49 See Igor Shevchenko, *Strategicheskii analiz rynka aktsionernogo kapitala v Rossii* (Economika, Moscow, 2001); Merrit B. Fox and Michael A. Heller, "Lessons From Fiascos in Russian Corporate Governance", University of Michigan Law School, William Davidson Institute, Paper No.99-012, at <http://papers.ssrn.com>.

50 John C. Coffee, Jr., "Starting from Scratch: The Legal and Institutional Steps to Viable Securities Markets in Transition Economies", 27(1) *RCEEL* (2001), 7-32.

truly independent both from the other branches of power as well as from business.[51] We think that Russia is still a long way from meeting these conditions. Therefore, the path to the diversification of share capital should not be hurried. Otherwise, the result is more likely to be negative than positive. *I.e.*, the dissemination of shares among the population during the process of privatization did not lead to the expected result. Shares in the leading Russian companies were quickly purchased from unprepared Russian citizen-shareholders at prices below their market value and are currently concentrated among a limited circle of people. And those people, by and large, also control the influence of economic laws.

12. The Response of the Russian Legislator to Economic Implications of Redistributing Rights among Groups of Shareholders upon the Consolidation of Shares

The New Law, in our view, serves as a clear example of the change in the position of the legislator in relation to the balance of interests of two groups of shareholders: (1) large shareholders who are strategic investors and who determine the direction of the development of a joint-stock company and its business interests; and (2) minority shareholders.

Fractional shares were not permitted under the Former Law. If they were created upon consolidating outstanding stock, they were subject to reacquisition by the company at their market price. Thus, the legislator has made provision, first of all, for the interests of large strategic investors and, ultimately, of the joint-stock company as a commercial organization (as a subject of business activities). Among the interests of minority shareholders, the legislator emphasized and secured the fundamental (material) interest through the payment of fair (market) value for shares. Other nonmaterial shareholder rights (the right to take part in management) were nominal in essence, without serious practical significance. Therefore, the legislator chose to neglect them, while not excluding, in so doing, the possibility of compensating for this loss by determining the value of the reacquisition price.

The New Law directly stipulates the possibility of the existence of a fractional share, which imparts its holder with rights that are rendered by the corresponding category (type) of share, in an amount corresponding to the part of the whole share that the fractional share makes up (para.3, Art.25, RF Federal Law on Joint-Stock Companies). Thus, the legislator, in

[51] See, for example, Bernard Black, Reinier Kraakman and Jonathan Hay, "Corporate Law from Scratch", in Roman Frydman, Cheryl W. Grey and Andrzej Rapczynski (eds.), *Corporate Governance in Central Europe and Russia Vol.2* (CEU Press, Budapest, 1996), 245-302; Bernard Black, Reinier Kraakman and Anna Tarassova, "Russian Privatisation and Corporate Governance: What Went Wrong?", 52 *Stanford Law Review* (2000), 1731-1808.

inflicting a certain degree of loss (or damage) in terms of the interests of large shareholders and the joint-stock company on the whole as a business, has evened up the score regarding the nominal rights of small shareholders, their right of ownership of their shares, and with all the possibilities stemming there from. Moreover, every shareholder now not only remains a participant in a joint-stock company but has been granted the right to demand the buyout of fractional shares belonging to him that are created as a result of changes and additions made to a company's charter or upon approval of a new redaction of the charter that limits his rights, if he voted against the adoption of the relevant decision or did not take part in the voting (para.1, Art.75, RF Federal Law on Joint-Stock Companies).

Of the legislator's positions found in the Former Law and the New Law, which is preferable? In our view, the preferable position is that of the Former Law, which did not permit fractional shares, insofar as this position reflected—to a significant degree—processes that were actually occurring in the economy. As has already been noted, minority shareholders have certain rights in name only. In exercising such rights, neither a minority shareholder nor the owner of a fractional share can effectively satisfy his material or nonmaterial interests: it is senseless to seriously expect a change of this exchange differential (the Russian stock market is still in the early stages of its formation, and listing only a few companies will not alter this picture); they cannot demand the payment of dividends or count on receiving a share of the assets of the corporation upon its liquidation (such a decision is made by a majority of votes, which are concentrated, as a rule, among a group of affiliated shareholders); they cannot in reality manage the company (to influence decisions made by the general shareholders' meeting). Retention of shareholder status for owners of fractional shares will not entail, in our view, those positive consequences that usually arise in the case of diversification of capital among a large number of persons.

The introduction of the right to fractional shares in the New Law is of no benefit for the development of the stock market or for shareholders themselves: the rights of holders of fractional shares are no more tangible than they were before. But thanks to the introduction of the right to

fractional shares, the interests of large strategic investors and of joint-stock companies themselves have been significantly damaged. Holders of fractional shares form, in a sense, "ballast" for the company, inhibiting its development.[52]

First, the expense of maintaining a shareholder register—in which the holders of fractional shares are also noted—will clearly rise, which makes management of the company more difficult (losses of time and money for notifying shareholders, conducting meetings, counting votes, answering queries, etc.). The amount of such expenses is usually incommensurably higher than the actual investments ("credits") of many individual shareholders.

Second, as a result of the introduction of the right to fractional shares, risks that are borne by those making decisions—*i.e.*, large strategic investors who determine a company's development—are not taken into account. It is a fact that a joint-stock company is a particular organizational form for conducting business. Under conditions of a clear conflict of interests, which objectively exists between large shareholders (strategic investors) and small shareholders, decisions are made at the general shareholders' meeting by the votes of the large shareholders. They invest money and have the right to count on the effectiveness of their investments; they take risks and should have the possibility to control those risks.[53] The legislator, in securing a balance of interests, should take these circumstances into account and should protect this interest of large investors.

Possession (based on the right of private ownership) of fractional shares created upon the consolidation of a company's stock affects the rights and interests of other persons; therefore, we suggest that this may

[52] It is possible that the introduction of fractional shares was the legislator's reaction to the necessity of considering the subjective social risk of the shareholder. However, we again underline that this measure is one-sided, ineffective, and, at the current time, even detrimental to the economy as a whole. As has already been noted, protection of the rights of minority shareholders and, consequently, the removal of the positive economic consequences of diversification of share capital should be of a multifaceted nature. It ought to begin with the fine-tuning of the work of the judicial system. And the legislative changes themselves should also be multifaceted. Thus, for example, the retention of shareholder status for the owners of fractional shares will hardly lead to the desired goal without necessary amendments to the legislation on mergers and acquisitions.

[53] When speaking about a greater risk, we mean an objective risk, which is determined depending on the amount contributed to the overall investment. The more one invests, the more one loses in case a venture does not work out, although the more one gains if it is successful. In a socially oriented state, however, one ought to consider not only this *objective* risk but also the *subjective (individual)* risk. Thus, an individual shareholder can invest all of his savings (for example, USD 1,000) into a joint-stock company and lose all of it; at the same time, for a large company that buys shares, the loss of even 10 times as much (USD 10,000) may go unnoticed. Subjective risk is, obviously, composed not only of an economic value, but also of a psychological feature: the individual perception of the probability of different events and the consequences thereof in an environment of uncertainty.

be limited by a federal law to the degree that it is necessary to protect the rights and legal interests of these persons, as is stipulated by Part 3, Article 55, of the Constitution of the Russian Federation. It was shown above that the right to fractional shares, which is only a nominal right, complicates the activities of a joint-stock company; it infringes upon the legal interests of large shareholders who are strategic investors and who are risking the performance of their own investments; and it interferes in the economic development of the country as a whole.

Of course, we do not argue that the interests of the minority should be totally ignored. If this refers to the owners of whole shares, then they can, in full measure, use the rights granted to them by corporate legislation. Holders of fractional shares should, in our view, be satisfied with the payment of just compensation for the value of their fractional shares. We think that the legal mechanism that existed up to the introduction of fractional shares—both from the point of view of procedure and from the point of view of the essence of the question in the case of the consolidation of shares—fully guaranteed the interests of minority shareholders and balanced their interests with those of large shareholders as well as those of the company on the whole.

13. Characteristics of the Procedure of Accounting for the Interests of the Minority during Consolidation

The legislator took the minority's interests into account in both the Former Law and the New Law not only by granting the right to fair compensation. The legislator foresaw a procedure for making decisions on consolidation, as well as the implementation thereof, as a guarantee for minimizing abuse on the part of large shareholders. Elements of that procedure include, *inter alia*:

(1) Mandatory prior notification of all shareholders of the agenda of any general shareholders' meeting at which a decision on consolidation will be made;[54]

(2) The possibility of adopting such a decision only upon a proposal from the board of directors;[55]

[54] Notification must be sent to
"every person mentioned in the list of persons that have the right to participate in the general shareholders meeting, by registered mail, if the charter does not establish any other method of notification in written form, or each of the listed persons should be notified in person and should sign [that they have been notified], or, if established by the company's charter, [notification can be] published in a written publication that is accessible to all shareholders and that has been determined by the company's charter."
Part 3, para.1, Art.52, RF Federal Law on Joint-Stock Companies.

[55] Point 3, Art.49, RF Federal Law on Joint-Stock Companies. The application of this rule may be excluded by the corporate charter.

(3) Participation in voting either while present at the general shareholders' meeting or by other means while not present;
(4) The possibility of judicial recourse regarding any decisions adopted, etc.

Monitoring mechanisms on the part of the state were also foreseen:
(1) State registration of the issuance of new shares created in the process of consolidation, and a report on their flotation;
(2) State registration of amendments to the charter, etc.

In and of itself, this change in the legislator's position regarding the question of fractional shares and their nullification under the Former Law, and their introduction under the New Law, cannot be an argument in favor of the unconstitutionality of the rules on consolidation stipulated by the Former Law.

In reacting to changing socioeconomic conditions, the legislator has not infrequently altered the mechanism for regulating shareholder relations. Evidence of this can also be seen in amendments to the relevant regulations of tax legislation, bankruptcy legislation, privatization legislation, etc.

This idea can be illustrated by yet another example from the history of the development of Russian corporate law. In accordance with paragraph 39 of the Statute on Joint-Stock Companies (confirmed by a decree of the RSFSR Council of Ministers of 25 December 1990), the general shareholders meeting had the right, by a simple majority of votes, to decrease the charter capital by canceling a portion of shares. That said, in contrast to similar regulations of the previously applicable Soviet Statute on Joint-Stock Companies and Limited-Liability Companies (paras.44, 61),[56] the Russian statute did not clarify whether cancellation could take place only in relation to shares at the disposal of the joint-stock company, including as a result of their being repurchased from shareholders. A literal interpretation of the above-mentioned paragraph 39 allowed for the conclusion that cancellation could also take place in relation to those shares that were distributed among shareholders.

14. The Legal Nature of Fractional Shares

While considering the introduction of the legal institution of fractional shares in Russia in 2001 premature from the point of view of legal policy, it is nonetheless necessary to define the legal nature of fractional shares. While recognizing the expediency of the further improvement of the legal construct of fractional shares, we think that there is certainly room

[56] Confirmed by Decree No.590 of the USSR Council of Ministers of 16 June 1990.

for it in the existing conceptual system. Thus, the fractional share, by its legal makeup, complies with the institution to which it is most similar: securities.

A security, as we know, serves as a means of optimizing trading of the material rights of claim.[57] An increase in the trading of debt is achieved through the strengthening of the trust of the relevant participants in legal relations (first and foremost, of new creditors) not only in the authenticity of the debt but also in the ability to realize it.

The existence of a security, of course, cannot in and of itself replace the value embodied therein; however, it does increase the estimate of probability of receiving that value in comparison with other forms of evidence of entitlement.

This probability increases by means of substantially lowering the legal risks that arise in relations between a creditor (the owner of the right of claim) and a debtor (holder of the "true value"). In case of a debtor's refusal to fulfill his obligations in good faith, the use of securities would increase the chances of a creditor's success in a disagreement with a debtor if the creditor were to resort to the help of the state for compulsory execution. Securities have also made the life of debtors easier by protecting them from unfounded claims by a creditor.

The substantive legal content of a security is found in the rights of claim, which have particular characteristics. The procedural (formal) content of a security consists in the fact that it is a special type of evidential document (a means of establishing information about the right) that comprises both a documentary and a non-documentary (electronic) form.

In order to secure the probative value of this special document (means of establishing information about a subjective right), an objective right is established by the rules for creating, storing, accounting for, and moving this document and the rights thereto. The probative value of a security is also strengthened by limiting, in a defined manner, the challenges that a debtor has the right to declare against a new creditor.

Taking this into account, the legislator is free to clothe in the form of a security any right that has these characteristics. Moreover, this is not prohibited in relation to shareholder rights.

Thus, the material content of a fractional share, as a specific type of security, is found in the legally established set of rights that make up a portion of the rights of a shareholder.

The formal content of a fractional share consists in the fact that it constitutes a special document (rendered at the present time, as a rule,

57 "A security is a document certifying, in compliance with the established form and obligatory requisites, property rights, the exercise or transfer of which is possible only upon its presentation" (para.1, Art.142, RF Civil Code). For more details, see Bushev, *op.cit.* note 5.

in electronic form). The possibility of determining the legal fate of such a document, of using it, facilitates the realization of the material content of fractional shares (the rights embodied therein).

The qualification of a fractional share as a specific form (although a new, corporate form) of security, *i.e.*, an object of civil (commercial) law, was accomplished by the legislator through use of the "share" designation. The trading of fractional shares is subject to the rules on the trading of shares (para.3, Art.25, RF Federal Law on Joint-Stock Companies).

The argument on the indivisibility of a security could be applied to traditional (paper) securities from the point of view of their formal content, since the division of a security (a paper document) would lead to the destruction of its integrity and, consequently, its probative value. However, for a security as a special right, the division of individual rights as independent objects of trade was permitted even earlier. In this light, it is sufficient to recall rules on trading of dividend coupons or parts of a dual warehouse certificate. In such situations, as with fractional shares, there is trading in specific rights that are certified by a separate document.

Taking this into account, the construct of fractional shares, in our opinion, from the point of view of positive law, does not contradict applicable legislation; however, it does not coincide with the legal policy that the Russian legislator should support under current economic conditions.[58]

15. Foreign Experience in Regulating the Consolidation of Shares

Does the corporate law of developed countries provide any examples of regulation of consolidation and the issuance of fractional shares that the Russian legislator could use for guidance on this question?

In our view, the institution of the consolidation of shares in the corporate law of developed, market economies has the same purpose as in corporate law in Russia: decreasing expenditures related to the management of a company and simplifying the management of a company. But the mechanisms for, and ramifications of, concentrating shares may differ.

In the United States, for example, stock markets are more diversified and oriented towards a great variety of investors (small, medium, and large), who, through brokers, acquire and dispose of shares, playing on the difference in their market value. US legislation proceeds from the following principle: the more shareholders, the better; the unsatisfied "vote with their feet", *i.e.*, they simply sell their shares on the stock market. In accordance

[58] With respect to this point, we support the proposal of one of the committees of the State Duma to reject the institution of fractional shares, *Izvestiia*, 15 July 2004. At the same time, we consider it necessary, as quickly as possible, to more clearly codify in law the procedure and conditions for defining the price of reacquisition.

with US corporate law, demand for the nominal value of shares has been completely abandoned. In the same manner, the American legislator has removed the significance of a shareholder's participatory interest in the charter capital of a corporation, concentrating instead on the measure of a shareholder's rights. At the same time, upon the creation of fractional shares in the United States, owners receive monetary compensation in the amount of the value of one share received as a result of consolidation.

In Germany, stock markets are oriented toward the concentration of capital in the hands of large shareholders. Legislation proceeds from the following principle: the fewer small shareholders, the better; a mechanism is used for nullifying fractional shares and for buying up "shares that have lost their force". (See Germany's Shareholders Law of 6 September 1965:[59] Article 8—shares are indivisible; Article 9—the issuance if shares for less than their nominal value is not permitted; Article 69—if one share is offered to several entitled persons, then they can exercise the right to the share only through a common representative; Article 73—if the nominal value of shares is decreased in order to decrease a company's charter capital, then they can be declared to have been cancelled; Article 213—the rights to one new share may be exercised only in the case that the undivided rights, comprising together the complete share, are unified in the hands of a single entity; Article 226—a company may cancel shares that do not reach the level of the number necessary to replace them with new shares. The declaration that shares have lost their force is made through notification in the company's publications.) It is clear that such a mechanism was also used in previous Russian corporate legislation.

In Great Britain, consolidation is possible but only if, in doing so, fractional shares are not created. And in Japan, in accordance with the Commercial Code, if the consolidation of shares results in the creation of fractional shares, then they are subject to cancellation.[60]

Foreign law also offers another illustration of the idea of the need to take account of the interests of the main shareholder upon his gaining complete control of a company. The legislation of many countries provides for the legal mechanism known as "squeeze-out" (*vydavlivanie*), whereby a shareholder who acquires a certain block of shares has the right to demand that other shareholders (even if by force) sell him their shares.[61]

59 *Germanskoe pravo. Chast' 2. Torgovoe ulozhenie i drugie zakony: perevod s nemetskogo,* Seriia *Sovremennoe zarubezhnoe i mezhdunarodnoe chastnoe pravo* (Inostrannaia literatura, Moscow, 1996).

60 See Grigorii Abolonin, "Drobnye aktsii-prakticheskie posledstviia dlia rynka", *Rynok tsennykh bumag* (2002) No.13, 19-23.

61 See Patrick A. Gaughan, *Mergers, Acquisitions and Corporate Restructuring* (John Wiley & Sons, Inc, New York, 3rd ed. 2002); Peer Zumbansen, "German Corporate Law in Constitutional Perspective: The Squeeze-Out Reviewed", 2(2) *German Law Journal* (2001), at <http://www.

It is noteworthy that squeeze-outs are supported by public authorities even in countries with an economy where charter capital is diversified and spread out among a large number of persons. It makes sense, as we have already noted, that the realization of the right to buy up shares from other shareholders should carried out in compliance with a procedure for defining their market value.[62]

16. Conclusion

In conclusion, we would again like to express support for the validity of the position expressed by the Russian Constitutional Court in the above-mentioned ruling of 24 February 2004. In our view, the rules in the legislation on the consolidation of shares (both those that have been revoked, as well as those that are still applicable) comply with the Russian Constitution and do not violate the right of private ownership of shareholders.[63]

germanlawjournal.com>.

62 See Viktor Pleskachevskii, "Nigde, krome Rossii, u aktsionerov net takikh prav", *Russkii fokus*, 19 July 2004.

63 After preparation of this article the Russian legislator confirmed its direction in favour of the interests of the controlling shareholder upon seeking the balance between the interests of majority and minority shareholders. In the meantime the legislator introduced new rules directed on protection of the minority shareholders' interest upon each acquisition of more than 30, 50 or 75% of voting shares (Federal Law No.7-FZ on Amendments to the Federal Law on Joint Stock Companies and to Certain Other Legislative Acts of the Russian Federation, 5 January 2006. The new legislation (in effect as of 1st July 2006) provides for a squeeze out right for the person who with its affiliated parties has acquired more than 95% of the total number of voting shares in an open joint stock company. In protection of the minority interest the legislator laid down (i) the consepts of voluntary, mandatory and competing offers in case of a bid exceeding 30% of all the voting shares; (ii) obligation of the target company's board of directors to consider the offer and to provide the shareholders with recommendations on the offer; (iii) some restrictions on the defensive actions, which can be undertaken by the management and the Board of Directors; (iv) filling of the bids as well as of some other actions with the state agency in charge of regulating the securities market. For more information refer to Baker&McKenzie, "Latest changes to Russian corporate legislation", Legal Alert of March 2006, at <http://www.bakernet.com/NR/rdonlyres/14B40B8B-E11D-4C23-8B54-38EE9A76D669/39697/LegalAlertJSCENG.pdf>.