



Corporate Takeover In Russia

**A comparative analysis of the present Russian market for
corporate control, directed at identifying possibilities for
improvement**

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Abstract

This paper focuses upon the problem of “corporate raiding” in Russia as a quasi-legal method of an acquisition of corporate control. It is shown that presence of the loopholes in the Russian takeover legislation can partially explain the expansion of the phenomena of corporate raiding, which brings substantial damage to the economic development of the country. The paper examines the present state of Russian market for corporate control, analyzes the legal regulation and provides recommendations for improvement. Recommendations are directed towards the implementation of sound anti-takeover devices, increased level of corporate transparency, establishment of an independent institutional framework, strengthening of personal liability for corporate crime and more detailed and precisely formulated legal provisions.

Table of Content

Abstract	i
Table of Content	ii
Introduction	1
Chapter 1 - Elucidating Corporate Takeovers through a theoretical lens	4
Chapter 2 - Market for Corporate Control: Russian Style.....	6
2.1 Phenomenon of corporate raiding in Russia	6
2.2 Peculiarities of the Russian Corporate Market	8
2.3 Takeover Scenarios	13
2.3.1 Stock share manipulation	13
2.3.2 Bankruptcy proceedings.....	16
2.3.3 Mercenary Management	17
2.4 Conclusion	19
Chapter 3 - Legal overview of Takeover Regulation: Russia vs. the Netherlands.....	22
3.1 Outline of legal provisions.....	22
3.1.1 Russia.....	23
3.1.2 The Netherlands.....	24
3.2 Takeover Bid.....	25
3.2.1 Russia.....	26
3.2.3 The Netherlands.....	28
3.3 Squeeze-out/Sell-out rights	29
3.3.1 Russia.....	30
3.3.2 The Netherlands.....	32
3.3 Anti-takeover measures	33
3.4.1 Russia.....	34
3.4.2 The Netherlands.....	35
Chapter 4 - Recommendations.....	39
Conclusion.....	42
Bibliography	44

Introduction

Corporate takeovers have been widely advocated by the scholars for their ability to increase the value of the company. Consequently, the market for corporate control can be seen as a resource for external growth of the companies. However, a proper corporate governance system should be in place, in order to ensure an efficient functioning of this market.

The Russian market for corporate control considerably differs from the ones in the countries with developed principles of good governance. In the last decade, the phenomenon of “corporate raiding” has become very peculiar to the Russian market. Corporate raid is defined as “a particular type of hostile takeover in which the assets of the purchased company are immediately sold off and the target company essentially disappears in the process.”¹

The topicality of the question is closely connected to the harm that corporate raiding imposes on the Russian economy. Reduction in the confidence of foreign investors in domestic market, unwillingness of the prosperous companies to increase their capital in order not to become a target of raid group, the waste of the resources on the protectionist measures against raiders are all negative consequences of raiding that reversely influence the path of growth of the economy.

Evidently, the wide spread of the raid practice on the market for corporate control signals the existence of the weak spots in the takeover regulation. Since raiders successfully take advantage of the underdeveloped state of the corporate governance system in Russia, the paper attempts to ascertain the major loopholes in the Russian legislation and to propose the modifications that might discourage the practice of a violent takeover. The objective of this paper is to provide recommendations for Russian takeover regulation in order to stabilize its

¹ *Encyclopedia Babylon*, retrieved from <http://dictionary.babylon.com/Corporate%20raid>

market for corporate control and ensure its efficient functioning. In order to achieve this purpose, the paper analyzes the current situation on the Russian market for corporate control and the relevant legislation that regulates corporate transactions.

The methodology used in this paper includes logical reasoning, analysis of the legal documents and literature review of the relevant scientific articles. Furthermore, the paper uses a comparative approach for the analysis of the legal provisions of takeover legislation. The reasoning behind this is to identify the possible solutions that a developed corporate governance system may offer in order to fill in the gaps in the Russian takeover legislation. Through out the paper, the references are made to European Takeover Regulation in the context of 13th EC Directive on Takeover Bid, but the Netherlands is chosen as a benchmark for comparative analysis on the following ground: Dutch regulation of major corporate transactions perfectly balances between protection against undesirable takeovers and an efficient market for corporate control.

This paper is structured in the following way. It begins with presentation of the main theories that justify the positive effect of corporate takeovers from the economic point of view. Chapter 2 is devoted to the analysis of the market for corporate control in Russia. It begins with a short historical review of the development of corporate raiding as a method to acquire corporate control in Russia. Further on, attention is given to the current peculiarities that characterize the Russian corporate control market. Afterwards, the main takeover scenarios are represented, in order to spot the main weaknesses that the takeover regulation in Russia suffers from. The chapter concludes with the identification of the main vulnerable areas that will be referred to when recommendations are made. Chapter 3 compares the takeover legislation of Russian and the Netherlands on three main issues: takeover bid, squeeze-out/sell-out right and anti-takeover measures. Comparison of legal documents lays the ground

for recommendations that are represented in Chapter 4. The paper concludes with a short summary of the main findings.

There is a limitation to the scope of the present work. Even though the literature suggests that the propagation of the violent raid of the Russian companies is reinforced by the all kinds of illegal methods such as violent crime, robbery, swindle bribery etc, analysis of these issues lies outside of the scope of this paper. The paper focuses only on the legal side of the problem.

Chapter 1 - Elucidating Corporate Takeovers through a theoretical lens

Scientific literature reports that takeovers generate substantial gains for both target and acquiring firms. Scientists on average estimate the benefit for target shareholders to be around 30%, whereas acquiring shareholders receive approximately 8% gain.² There are several theories about where the premium comes from. First of all, it may be a result of the inner reorganization of the firm. In other words, replacement of an inefficient management as a result of the successful corporate takeover may shift the resources to a more profitable use. Secondly, potential threat of the takeover that might result in a replacement of the current management automatically corrects the managerial behavior in favor of shareholders. Minimization of the agency costs positively influences the value of the company, which is reflected in an increase in stock price. Therefore, the market for corporate control has been defined as an efficient tool for resolving the principal-agent problem between the investors and management of the company, because it disciplines the management's actions. This theory has been known in literature as "Agency Costs Reduction"³.

The "Synergy Gains" theory provides another explanation for the wealth creation coming from corporate acquisitions. Economic analysis distinguishes between financial synergies and operating synergies. Both of them result from the fact that two companies join their resources in production and benefit from economies of scale.⁴ It would be fair to note that these benefits are more likely to be realized if both companies operate in the same industry.

² Michael Jensen, "The Takeover Controversy: Analysis and Evidence," in *The Revolution in Corporate Finance*, ed. Joel M. Stern, Donald H. Chew Jr., [Cambridge: Blackwell Finance, 1992], p 480

³ Ibid., 486

⁴ Roberta Romano, "A guide to Takeovers: Theory, Evidence and Regulation," in *European Takeovers Law and Practice*, ed. Klaus J. Hopt and Eddy Wymeersch [London: Butterworths, 1992], 9

In case a company acquires its strong competitor, the gains might come from increased market power. The theory of “Market Power” provides that a monopoly position of the resulting company may allow it to obtain the monopoly rents, as the firm will be able to increase the price above its marginal costs.⁵ The possible restriction of competition, resulting from the anti-competitive acquisitions is an issue for the national regulation and is outside the scope of this paper.

Apart from the main theories explaining the efficiency gains from takeovers, there are also other considerations that induce corporate acquisitions. Generally, individual investors try to reduce the total risk of their investment portfolio by investing in unrelated businesses. If a company acquires a firm in another industry, diversification will reduce the corporate risk within the company, which would attract investors, and raise the stock price on the market.⁶ There can also be tax considerations that motivate mergers and acquisitions. When financial resources of both companies are put together, the company may benefit from reduction of the interest payments.⁷

To conclude, there is a substantial body of research that advocates the beneficial nature of corporate takeovers and supports more liberalized markets for corporate control.

⁵ Ibid., 19

⁶ James C. van Horn, *Financial Management and Polic*, 10th ed. [Englewood Cliffs, N.J.: Prentice Hall, 1992], 660

⁷ Ibid., 661

Chapter 2 - Market for Corporate Control: Russian Style

The acquirers in Russia do not necessarily want to pay a market price for the target. Therefore they come up with different scenarios for taking over the company. The meaning of a takeover as a restructuring device, and potentially improvement of the managerial incentive has lost its relevance in the context of the Russian corporate market. This chapter introduces the concept of “corporate raiding” as a widely used method to acquire control over a company, which has been developing since the 1990`s in Russia. Next, the peculiarities of the Russian market for corporate control are identified; and the most common takeover scenarios used by raiders are presented. Based on the analysis of the takeover scenarios and characteristics of the Russian corporate control market mentioned, the chapter concludes with the identification of weak areas in takeover regulation in Russia, which should be given special attention.

2.1 Phenomenon of corporate raiding in Russia

Russia does not have a long history of corporate governance development. Due to the domination of the state control over the economy there was no strong necessity for corporate governance legislation. It only emerged during the mass privatization of 1993-1994 and has continued developing to the present day.⁸ The beginning of the 1990`s can also be marked as a beginning of the raiding in Russia, when privatization led to the occurrence of property rights. However, insufficient legal protection of the property rights and a low level of development of corporate law could explain failure of privatization to bring the expected positive effects.

⁸ Alexander Radygin, “Corporate Governance, integration and reorganization: the contemporary trends of Russian corporate groups,” *Econ Change* 39 [October 2007]: 278.

In the second half of the 90`s, raiding had obtained a notion of “national phenomena”, whereas methods of company takeover became violent. Raiding became the way to redistribute the property in the key industries of Russian economy: mineral resource industry, metallurgy and petrochemical industry. At this time, raiding itself had become a profitable business. Some estimate the profitability of the raiding business to be from 200% to 1000%⁹

In the beginning of the 21 century, the techniques for raiding have become more sophisticated and semi-legal as raiders start using the faults in Russian legislation. Annually, around 70,000 raid attacks on Russian companies are reported.¹⁰ Raiding in Russia is essentially different from corporate takeovers in developed countries. It is merely directed towards redistribution of existing property rights rather than achieving efficiency through putting the resources to better use. Furthermore, the raiding business is very detrimental to the economy. Analysts have estimated that fear of raid attacks on business reduces the foreign investment in the country by 3-4 times.¹¹ Obviously the company that is successful on the market and therefore becomes a potential target for the raider is forced to take defensive measures, which in turn prevent the management from putting the resource to its best use.

Raiding can be rightfully defined as a problem ancillary to the developing state of a Russian corporate governance system. The faults in legal regulations and administrative environment allow the raiders to use the methods to acquire control over the company, which would not be possible under a developed system of corporate governance.¹²

⁹ Bunin, “Reiderstvo kak socialno-ekonomicheskiy i politicheskiy fenomen covremennoy Rossii” [Raiding as a socio-economic and political phenomenon of contemporary Russia], *Research center of “Political Technologies”* (may 2008), <http://www.politcom.ru/6192.html> [accessed april 2009]

¹⁰ Brenden Carbonell, Dimitry Foux, Vera Krimnus and Lisa Safyan “Hostile Takeovers: Russian Style”, *Knowledge@Wharton*

¹¹ See *supra* note 8

¹² See *supra* note 9

2.2 Peculiarities of the Russian Corporate Market

It is essential to analyze the trends and structures in the market for corporate control in order to identify the weak points of the system and lay down the ground for recommendations. As Radygin correctly points out, “The model of corporate governance is largely being formed outside the framework of the law.”¹³ Leaving the analysis of the current corporate governance legislation in Russia aside, this chapter attempts to present the distinctive features of the Russian corporate market.

Separation of ownership and control

Unlike most of the Western companies, Russian ones are frequently characterized by the low level of separation of ownership and control, since managers often own a major block of shares in the companies that they run.¹⁴ Kuznetsov reports that ownership allocation within Russian firms favors the insiders, who on average control 41% of the shares. Notably, in the course of 1995-2007 the number of shares belonging to the managers has increased, when the amount of shares in possession of other employees have shown a decrease. Furthermore, participation of foreign investors, banks and investment funds remains at a low rate.¹⁵

Literature suggests that insiders often enter into a practice of diluting the shares of outsiders, or in any other way misuse the power given to them. As a result, the Russian corporate governance system can be characterized as having low separation of ownership and control

¹³ Alexander Radygin, “Corporate Governance, integration and reorganization: the contemporary trends of Russian corporate groups,” *Econ Change* 39 [October 2007]: 278.

¹⁴ Peter Barta and James Gillies, “Corporate governance in Russia: is it really needed?” in *Handbook on International Corporate Governance*, ed. Christine A. Mallin [Cheltenham, UK: Edward Elgar Publishing, 2006], 86.

¹⁵ Andrey Kuznetsov, Olga Kuznetsova and Rostislav Kapelyushnikov, “Ownership structure and Corporate Governance in Russian firms” In *Corporate Governance and Finance in Poland and Russia*, ed. Tomasz Mickiewicz, [New York: Palgrave Macmillan, 2006], 182.

Ownership structure

Concentrated ownership has been one of the traits of the corporate structure in Russian companies. There has been a stable trend of increased share of the largest shareholder: from 1999-2005 the average stake of the largest shareholder has increased from 32.9 to 51.8.¹⁶ Researchers have pointed out that managers are likely to restrict the access of the outsiders to the company's shares through a number of devices: restrict the workers possibility to sell their shares to outsiders through threat of dismissal, keeping several registries etc.¹⁷

Among other ways used in Russian companies for consolidation of corporate power, researchers emphasize redemption of shares from different stakeholders: employees, financial institutions etc, lobbying of regulations that support large share holding by certain Financial and Industrial groups, authorization of state-owned shares, manipulation with the transactions on dividends payment etc.¹⁸ Concentrated ownership is often related to the so-called "Private Benefits of Control".¹⁹ It means that the controlling shareholder is able to misuse his control power and extract private benefits by transferring corporate value from the minority shareholders.

Board of Directors structure

The representation of the shareholders in the Board of Directors (BoD) often does not correspond to the amount of share holding. Ragygin, referring to the survey conducted by the Bureau for Economic analysis, reports that nevertheless the share interest of insiders accounted on average for less than 50%, their participation in the BoD was higher than

¹⁶ Ibid., 187

¹⁷ Ibid., 190

¹⁸ Alexander Radygin, "Corporate Governance, integration and reorganization: the contemporary trends of Russian corporate groups," *Econ Change* 39 [October 2007], 268.

¹⁹ Klaus Hopt J. and Eddy Wymeersch, eds., *European takeovers: law and practice*. [London: Butterworths, 1992]

57%.²⁰ Whereas, for the external private owners and to some extent the state bodies of authority, the situation is reversed: their representation on the BoD is disproportionately lower their shareholdings. The data presented below concludes that the structure of the BoD presently favors the interests of insiders to the detriment of other stakeholders.

*Table.1: Representation of shareholders in the Board of Directors*²¹

Type of shareholder	Charter capital	Board of Directors
<i>Employees</i>	35,8	59,2
<i>State bodies of authority</i>	8,6	5,3
<i>External private owners</i>	55,6	28,9
<i>Total sample</i>	243	202

State intervention in the corporate market

According to the OECD report, there were 24 large and medium size companies taken over by the state in 2004-2006.²² Furthermore, literature suggests that the state prefers to acquire firms in the strategic industries such as the ones connected to the natural resources, which leads to the conclusion that decision to take-over the company is influenced by political reasoning rather than economic interests.²³

Russian government actively restricts the amount of foreign investment in the sectors of industry that it considers strategic. The Russian Foreign Investment Review Board (FIRB) is assigned to examine foreign investors willing to buy shares in Russian companies and only

²⁰ See *supra* note 17

²¹ Alexander. Radygin, "Corporate Governance, integration and reorganization: the contemporary trends of Russian corporate groups," *Economic Change and Restructuring*, Vol.39, N3/4, [October 2007], table.6

²² Lucy Chernykh. "Understanding State Takeovers in Russia" [Working paper, preliminary draft, Bowling Green State University, 2008], 16.

²³ *Ibid.*, abstract

with the permission of the FIRB; a company is able to sell its shares.²⁴ Moreover, Russian companies are restricted to issue stock outside Russian borders up to 30% of the total amount of shares.²⁵ In addition, by same regulation foreign investors are deprived from acquiring more than 50% of the shares in a company, making it impossible to become a dominant shareholder.

Financial and industrial groups (FIG)

FIGs are usually formed around a bank or industrial enterprise. The rationale behind the integration of industrial and financial organizations comes from the consolidation of the assets for a common investment purpose, which is expected to bring economic benefit.²⁶

The Financial and Industrial groups have been playing an important role in the Russian economy since the redistribution of property took place in 1996-1997. Resulting from the privatization, FIGs have acquired sufficient control over large strategic enterprises, which enabled them to continue investment activity, which in turn ensured further accumulation of corporate power.²⁷ As a result, due to their financial and industrial reserves, FIGs in Russia have been criticized for their monopolistic behavior and misuse of power.²⁸ In support of the argument of increasing dominance of financial and industrial groups, Carsten Sprenger reports that “in 1998 only registered FIGs accounted for 4.4 per cent of the gross domestic

²⁴ Kurt Schacht, James Allen, Matthew Orsagh, “Shareowner Rights across the Markets: A Manual for Investors”, *CFA Institute Centre Publications*, [April 2009].

²⁵ Russian Federal law “On the procedures of foreign investments to companies of strategic importance for state defence and security” from 5 May 2008

²⁶ Tatiana Popova, “Curse or Blessing? Financial-Industrial Groups in Russia”, *Beyond Transition: the Newsletter about reforming economies*.

²⁷ Alexander Radygin, “Corporate Governance, integration and reorganization: the contemporary trends of Russian corporate groups,” *Econ Change* 39 [October 2007], 283

²⁸ See *supra* note 24

product and about 10 per cent of industrial production. They unite over 2,000 legal entities – production, scientific, financial and trade companies, employing over 4 million people.”²⁹

Raiding Business

There is a new niche for quasi-legal business which specializes in supervising the potential acquirers in the process of take over, which in the context of the Russian corporate market might include violent methods, settlement with the authorities for a favorable outcome and other illegal ways.³⁰ Among the public institutions and private entities involved in the process of a successful takeover one can name: courts, consulting companies, which gather information, allied enterprises or financial institutions etc.³¹

The companies that offer raiding services are publicly known, they have web-sites, which provide information on the costs and details of the service provided. Very often, the companies that fear the possibility to become a target of the raider consult these companies having experience in corporate raiding on possible methods of defense. From pure economic point of view, such organized crime brings market inefficiency, as resources are spent on a non-productive activity. In the same way, resources are wasted when the company is forced to strengthen its security in order to reduce the possibility and attractiveness of the raider attack.

²⁹ Carsten Sprenger, “IBRD Ownership and corporate governance in Russian industry: a survey”, *Russian European Centre for Economic Policy (RECEP)*, [2001]

³⁰ Richard N. Dean, Barry Metzger, Derek A. Bloom and Kirill Ratnikov “Abusive corporate takeovers in Russia: proposals for reform,” *International Corporate Governance Review* [march 2003]

³¹ Vadim Volkov , “Hostile Enterprise Takeovers: Russia`s economy in 1998-2002,” *Review of Central and East European Law* 29, no.4 [2004], 534

2.3 Takeover Scenarios

Researchers have estimated that annually around 70,000 Russian companies are taken over by the raiders.³² The methods of hostile takeover in Russia differ significantly from the ones used by the developed nations. In order to fully establish the loopholes of the Russian corporate governance legislation concerning takeovers, it is essential to look at the specificity of the acquisition process that has been used in the Russian takeover market. Therefore, this chapter provides a literature review on the methods and strategies that have been most frequently chosen for raiding in Russia. It is worth mentioning that most of these methods have engaged in the abuse of the present corporate governance legislation in Russia and can therefore rightfully be addressed as “quasi-legal”, where rights of certain parties are seriously infringed. Evaluation of the legislation that makes these schemes legally possible is also presented in this chapter, which will help identify the weak points of the Russian corporate law. Most frequently, takeovers in Russia are realized through the following scenarios:

- Stock share manipulation
- Bankruptcy proceedings
- Mercenary management.

2.3.1 Stock share manipulation

Minority shareholders can be used by a potential acquirer in order to take over the control of a target firm. According to the Law on Joint Company Stocks, there are two kinds of General Shareholder Meetings: annual and special. In case of a set-up scheme for the takeover, the focus lies on the special Shareholder Meeting (SSM). The meeting can be called by the

³² See supra note 9

request of the auditor, supervisory board, or shareholder whose shares account for not less than 10% of the shares. Art.55 Law on Joint Stock covers the rules for calling a Special Shareholder Meeting. This provision is meant to provide protection for minority shareholders by allowing them to call a Special Shareholder Meeting, which results in giving shareholders, owning at least 10% of the stock, the opportunity to influence the management of the company. However, Russian takeover practice has shown how this provision can be abused. Art. 55(8) establishes that even in the absence of the approval of the Supervisory Board of the SSM, minority shareholders holding at least 10% of the shares hold the right to call and conduct a SSM. Furthermore, Art 55(4) provides that the Supervisory board may not introduce amendments to the form and agenda of the planned SSM, if the meeting has been called on request of the shareholders holding at least 10% of the shares. A potential acquirer can suborn the minority shareholder or a group of shareholders (holding at least 10% of the shares) to act in his interests and convoke a GSM, independently of Supervisory board opinion.³³

The agenda of the Special Shareholder Meeting is formed by the parties who requested its holding, taken into account that the Supervisory Board has no right to make alterations to it.³⁴ Therefore, during the SSM, the minority shareholder brings forward propositions that are in the interests of the acquirer. There are several ways how the controlling shareholder can be deprived from voting against the proposed resolutions. First of all, a minority shareholder could beforehand file a formal complaint to the court that the decision of the controlling shareholder has been detrimental to him. If a court approves the complaint, the controlling shareholder will be deprived from the voting on the SSM, as an equitable penalty. Another

³³ Richard N. Dean, Barry Metzger, Derek A. Bloom and Kirill Ratnikov “Abusive corporate takeovers in Russia: proposals for reform,” *International Corporate Governance Review* [march 2003]

³⁴ Russian JSC law, Art. 55(4)

way would be not to inform the controlling shareholders of the called meeting.³⁵ Both ways would require a certain level of fraudulent and illegal cooperation with the authorities. However, this lies outside of the scope of the present paper and will not be analyzed.

In case the first SSM did not muster a quorum, a second meeting can be called, which will be authorized if participation of the shareholders amounts for not less than 30% of the total voting shareholders of the company.³⁶ Moreover, the JSC law allows for separate voting on the issues of the agenda for different categories of voting shares, therefore a quorum is established for deciding on each question separately rather than on the whole meeting.³⁷

During the SSM, several actions can be taken: 1. Election of a new board of directors, with subsequent election of a General Director, 2. Amendments of internal documents; 3. Obtainment control over the register and cash flows, 4. Manipulation of the voting rights can be performed, etc.

Any shareholder has a right to lodge a complaint against a decision taken during the Special Shareholder Meeting, if he /she has voted against the decision and suffered damage as a result of the decision, which violates shareholders rights.³⁸ However, the court may order a decision to remain in force if violations were insignificant or if the voting of the shareholder in question could not possibly influence the outcome of the voting, and if the shareholder has not sustained damages as a result of the decision. The unclear definition of the “insignificant violations” in the provision ensures that the court might have a room for justification of a fraudulent decision taken during the GSM, sustaining the legality of the new owners. While the appeal case from the former Board of Directors is pending, new directors might try to

³⁵ See *supra* note 31

³⁶ Russian JSC law, Art. 58(3)

³⁷ Russian JSC law, Art. 58(2)

³⁸ Russian JSC law, Art. 49(7)

frustrate the operation of the company by *stripping* the assets, destroying the physical capital etc. in order to pressure the opposite side to withhold its position.³⁹

2.3.2 Bankruptcy proceedings

The Corporate Governance legislation in Russia has a close connection to *The Federal Law N6 “About insolvency (bankruptcy)” from December 10, 1997*. The latter allows instituting legal bankruptcy proceedings against the companies whose outstanding debt is not less than 100.000 Russian Rubles, equivalent to 2.308 Euro.⁴⁰ It has often been used as a tool to acquire control over the target company by the following strategy. The acquirer forms an alliance with the creditor of the company that it desires to get and buys the outstanding debt from it. In this way, the target company becomes the debtor of the potential acquirer, who initiates bankruptcy proceedings against the company after making it impossible to pay off the loans. As soon as the insolvency complaint is satisfied, the appointed trustee, who is likely to be a “straw man”, leads the process of transfer of assets from the in-debt company to the creditor.⁴¹ If the acquirer has used a front company in this scheme, then as soon as this company has received the control over the assets it resells them to the actual acquiring company, leading to the accomplishment of the takeover.

The problem is worsened due to the weak banking sector in Russia. In general, Russian banks are not able to provide sufficient financial support for the industrial firms, because saving in private banks is perceived risky by households. Therefore companies find it difficult to get a loan on favorable terms and are most likely to rely on internal funds. Consequently, potential creditors take advantage of the lack of competition within the banking sector, by dictating

³⁹ Richard N. Dean, Barry Metzger, Derek A. Bloom and Kirill Ratnikov “Abusive corporate takeovers in Russia: proposals for reform,” *International Corporate Governance Review* [march 2003]

⁴⁰ The Federal Law N6 “About insolvency, Art. 6(2)

⁴¹ Richard N. Dean, Barry Metzger, Derek A. Bloom and Kirill Ratnikov “Abusive corporate takeovers in Russia: proposals for reform,” *International Corporate Governance Review* [march 2003], 533.

their lending conditions to companies, which they have to accept in order to get a loan.⁴²

According to the director of the Federal Service for Financial Recovery, “30 per cent of the 30,000 pending bankruptcy procedures are “commissioned” (ordered) in order to change ownership and not to reestablish financial solvency.”⁴³

2.3.3 Mercenary Management

The raider uses mercenary management in order to undertake the actions that will certainly worsen the company’s state. Management may intentionally dilute the company’s assets by transferring the valuable assets to off-shore companies. It can also take on unnecessary loans under high interest rates which will put the company’s solvency in risk. All mentioned above methods have the unity of purpose to destroy the company until the raider will be able to buy the company with “ineffective management”. According to the JSC law 64(p) and Civil Code 103(3), management performs daily business operation, and the scope of its competence excludes the issues of strict competence of the General Shareholder Meeting or Supervisory Board. It means that management actions mentioned above do not require any consent from the side of the shareholders.

This scheme of a raiding is easier accomplished in companies with less than 50 shareholders. According to Art.64 (1) of the JSC law, supervisory board that could restrict certain actions taken by the executive body is not necessary in Joint Stock companies with less than 50 (fifty) voting shares, furthermore the provision does not explicitly exclude a member of the executive body to be a person, whose competence would allow for the calling of a General Shareholder Meeting. All mentioned above implies that there is no explicit authority that would control the decision-making process of the management. Furthermore, in the absence

⁴² Ilya Okhmatovsky, “Sources of Capital Structure of Influence: Banks in the Russian Corporate Network”, in *Corporate Governance and Finance in Poland and Russia*, ed. Tomasz Mickiewicz, [New York: Palgrave Macmillan, 2006.]

⁴³ See *supra* note 27

of a Supervisory board, its functions are performed by the General Shareholders Meeting;⁴⁴ which makes it legally impossible to define the date, place, list of the participating shareholders and other issues arising before the GSM takes place.⁴⁵ The Russian court system follows the Business Judgment Rule (BJR) in respect to the responsibility of management to conduct business reasonably and to the best interest of the shareholders. BJR is based on the presumption that decisions of the Board of Directors are taken in a good faith and are not reviewed by the court unless there is a sufficient evidence of the serious violation of the major rule of conduct.

To conclude, possible scenarios for raiding presented in this chapter indicate a common feature of “Russian raiding” that distinguishes it from “Western raiding”. In the Western context, raiding is aimed at the companies, whose management does not perform its role well, meaning that the company’s stock is highly undervalued. Situation is reversed in Russia, the company that has shown a high level of corporate performance, possesses valuable assets and attracts interests of foreign investors is most likely to become a raid target. Furthermore, the literature review on the methods of raiding performed in Russia, has pointed out two main reasons for the illegal character of the takeovers in Russia: lack of a judicial system and a corrupt network of the administrative, political and military authorities.

To be consistent with the scope of this paper, the next section will identify the loopholes of the judicial system that facilitate the raid practice.

⁴⁴ Russian JSC law, Art. 64(1)

⁴⁵ Bernard Black, Reiner Kracker and Anna Tarasova, “Kommentariy Federalnogo Zakona ob Akcionernix Obschestvax”, [Comments to the Federal law on Joint-Stock Companies], Budapest: Labirint, 1995.

2.4 Conclusion

Raiding in Russian has proven to be detrimental to the economy. First of all, contradictory to the takeover theory of efficiency improvement, raiding is merely a way of redistributing existing wealth, without any improvement in productivity. Secondly, corporate raiding imposes a discouraging effect on foreign investment flows into Russia. Furthermore, Russian companies remain underestimated due to increased investor risks.

Taking into account the techniques that raiders use in order to take over a company; and the peculiarities of the Russian corporate governance system, this chapter identifies the most vulnerable areas in Russian Corporate Governance legislation that should be tackled in order to prevent and/or minimize the negative consequences of raiding. The problematic areas are the following

1. Violation of shareholders rights

As has been represented in the previous chapter, a takeover practice in Russia is accompanied by a range of violations of shareholders rights. Among the most significant violations, one can name deprivation of the right to participate in the shareholder's meeting, which results in the change of the governing body; as a result shareholders lose the ability to influence the decision on the major corporate transactions. This seriously undermines the goal of a strong corporate governance system: to pursue the interests of the shareholders. Protection of minority shareholders receives special attention from the legislators, as the interests of this group of shareholders are often perceived to be sacrificed in favor of other stakeholders. In the context of Russian corporate governance, the violation of the minority shareholders rights becomes even a more serious issue due to the highly concentrated nature of the ownership in the companies. However, as has been seen, corporate raiders often misuse the provision in the

Joint-Stock Law directed towards protection of the minority shareholders, in order to limit the legitimate power of the controlling shareholders. The resulting duality of the problem requires alterations in the regulation of the takeover legislation that would accurately balance the interests of both groups of shareholders.

2. Abuse of the managerial power

Within the inner structure of the companies in Russia, senior managers enjoy a very powerful position. Furthermore, the power in the board structure of the company is not dispersed enough, but rather concentrated in the hands of a General Director.⁴⁶ Due to low confidence in the future, managers are highly inclined to pursue goals which bring them personal benefits in the short run with no consideration to the long-term perspective of investors.⁴⁷ This fact worsens the consequences of the so-called “principal-agent” problem, when managers of the firm lack incentive to act in the interest of investors and the corporation as a whole, but rather achieve their own objectives. It is believed that having managers acquire shares in the company may help reconcile the conflict of the interests between managers and shareholders, because managers will then be more likely to take actions, aimed at increasing the share value. However, it should be taken into consideration that managers might want to buy shares in the company to strengthen the control, and not for the economic reasons. To sum up, the Russian corporate governance system lacks accountability of managers for their actions to the shareholders. This provides managers with a certain level of uncontrolled

⁴⁶ Peter Barta and James Gillies, “Corporate governance in Russia: is it really needed?” in *Handbook on International Corporate Governance*, ed. Christine A. Mallin [Cheltenham, UK: Edward Elgar Publishing, 2006.], 82

⁴⁷ See *supra* note 14

power, which can be abused to the detriment of investors, especially in the context of a takeover transaction.⁴⁸

3. Lack of corporate transparency

The requirement for disclosure of information has been widely advocated in the literature for being a powerful corporate device to ensure accountability of the governing body of the company for its actions⁴⁹. However, Russian companies have not been taking advantage of it, but rather can be described as having very low level of corporate transparency.

Lack of corporate transparency has been widely used by the raiders to perform “quasi-legal” acquisitions. Among the examples of limited corporate transparency, scholars identify the fact that court decisions on the corporate cases are not made public, which undermines the predictability of law⁵⁰. Evidently, greater transparency in the company increases the transaction costs for raiders by making it harder to ‘frame up’ charges.⁵¹

⁴⁸ Yuko Adachi. “Corporate Control, Governance Practices and the State: The Case of Russia’s Yukos Oil Company”, in *Corporate Governance and Finance in Poland and Russian*, ed. Tomasz Mickiewicz, [New York: Palgrave Macmillan, 2006], 66.

⁴⁹ Report of the High Level of Group of Company Law experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, [4 nov 2002], 45-48

⁵⁰ See *supra* note 9

⁵¹ *Ibid.*,

Chapter 3 - Legal overview of Takeover Regulation: Russia vs. the Netherlands

The 13th EC Directive on the Takeover Bid represents a Common European legal framework that governs takeover regulation in the European Union (EU). It was adopted in April 2004, and was due for implementation on May 2006.⁵² The Directive attempts to harmonize takeover regulation and stimulate integration of the European markets for corporate control. EC takeover regulation emphasizes the importance of balancing between strong protection of shareholders and promoting measures that would stimulate the takeover activities.⁵³ Therefore the main focus within the directive lies on three issues: general principles, mandatory bid and squeeze-out rules.⁵⁴ This chapter provides comparative analysis of the Russian and Dutch takeover regulation on the main issues regulated by the EC Directive: Takeover Bid, Anti-takeover measures, and Squeeze-out/Sell-out rights. Analysis of the mentioned above subjects attempts to identify the present faults in the Russian takeover legislation and provide recommendations for further development, based on the Dutch regulation of corporate acquisitions.

3.1 Outline of legal provisions

In the sea of legal documents, it is hard to find the provisions related to takeover transactions in Russia and the Netherlands, since the provisions are scattered along several remote and specific document. An overview of the takeover legislation in both Russia and the

⁵² Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids

⁵³ Guido Ferrani, ed., *Reforming company and takeover law in Europe*, [Oxford: Oxford University Press, 2004], 619

⁵⁴ *Ibid.*, 613

Netherlands, outlining provisions that regulate the corporate acquisitions is represented below.

3.1.1Russia

Takeovers of companies in Russia are mainly subject to regulation by the following legal documents⁵⁵:

The Federal Law "About Joint Stock Companies" N208 - RF from November 24, 1995

The Civil Code N51 from October 19, Part 1

The Federal Law N6 "About insolvency (bankruptcy)" from December 10, 1997

The Federal Law N46 "About the protection of rights and legitimate interests of investors of the securities market"

Basic rules concerning the rights of shareholders and protection of their interests are included in the law "On Joint Stock Companies". This law also covers the functional tasks, powers and liabilities associated with the management of joint-stock company's affairs. It covers the issues related to the conduct of General Shareholder Meeting,⁵⁶ as the main authority for decision-making. The law establishes the rules concerning the takeover bid⁵⁷, it primarily regulates the possible changes that are allowed to be made after the offer is in force, the period of validity of the offer, as well disclosure requirements etc. The regulation restricts the actions that may be undertaken by the Board of Directors to frustrate the takeover⁵⁸. The law also contains provisions on voluntary and mandatory bid that the bidder is to make if it

⁵⁵ The Institute of Corporate Law and Corporate Governance, retrieved from www.iclg.ru/enlaw1, on May 12 2009

⁵⁶ Russian JSC law, Art.7

⁵⁷ Russian JSC law, Art. 84(4)

⁵⁸ Ibid., Art. 84(6)

acquires 30% of the company⁵⁹. Furthermore, takeover regulation covers the rights of minority shareholders in case the takeover has been approved by the majority⁶⁰. It also regulates the state control over the acquisition of joint-stock company.⁶¹ It is important to note that provisions covering the main issues concerning the rules accompanying takeover transactions have been implemented into the Law on Joint Stock Companies only in 2006. Therefore, it would be fair to claim that the takeover regulation in Russia does not have a long history of existence.

The Bankruptcy Law does not have a direct connection to the corporate takeover transactions; however, as was pointed out previously in the paper, change of the corporate control in Russia is often accompanied by bankruptcy proceedings.

The Federal Law N46 “About the protection of rights and legitimate interests of investors of the securities market” establishes some regulations concerning the protection of the minority shareholders: for example, allowing the shareholders owning 20% of the stock capital to nominate at least one member to the Board of Directors.

3.1.2 The Netherlands

Prior to the proposal of the Takeover Bid EC Directive, the public bids in the Netherlands were exclusively regulated by the *Act on the Supervision of the Securities Trade* (Wet toezicht effectenverkeer 1995), which incorporates Merger Rules (SER-besluit Fusiegedragsregels 1975), and the Decree on the Supervision of the Securities Trade 1995.⁶²

⁵⁹ Ibid., Art. 84(1), 84(2)

⁶⁰ Ibid., Art 84(7), 84(8)

⁶¹ Ibid., Art 84(9)

⁶² Baums Theodor and Thoma Georg F, eds., *Takeover laws in Europe*. [Köln : RWS-Verlag, 2003].

However with adoption of the 13th EC directive, Dutch Public Offers Decree (Besluit Openbare Biedingen) has formed new legislation that came in effect on 28 October 2007.⁶³ New statutory regulations are included in the *Act on Financial Supervision* (Wet op het financieel toezicht, Wft), whereas exemptions are identified in the exemption regulation (Vrijstellingregeling).⁶⁴

After the enactment of the Act on Financial Supervision, prevailing supervision acts, like the Act on the Supervision of the Credit System 1992 (Wet toezicht kredietwezen 1992), the Act on the Supervision of the Securities Trade 1995 (Wet toezicht effectenverkeer 1995), the Act on the Disclosure of Major Holdings (Wet melding zeggenschap), the Financial Services Act (Wet financiële dienstverlening) etc were merged into one act.⁶⁵ The Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten, AFM) has been established for supervising the process of the Public Takeover Bids and monitoring compliance with the rules. The squeeze-out and sell-out rules are defined in the (Nederlands Burgerlijk Wetboek). The possible anti-takeover devices are provided for in the Listing and Issuing Rules (Fondsenreglement). The main effect of the implementation of the 13th EC Directive in the national Dutch law is the introduction of the mandatory bid rule. There were also no sell-out rules available for the minority shareholders before the 13th Directive entered into force.⁶⁶

3.2 Takeover Bid

The mandatory bid rule has been designed as a measure towards the protection of the minority shareholders in case of a public offer. According to the rule, a shareholder who has acquired control over the firm is required to extend the offer to the remaining shareholders at

⁶³ New Dutch Legislation on public offers, *Law Alert*, [nov 2007].

⁶⁴ <http://www.afm.nl/>

⁶⁵ Ibid

⁶⁶ Schuit Steven and Janssen Jan-Erik. M & A in the Netherlands : acquisitions, takeovers, and joint ventures : legal and taxation, [The Hague: Kluwer Law International, 1996], 28.

a reasonable price.⁶⁷ In the context of the EC Takeover Directive, the Mandatory Bid is expressed in the following way:

*“The Member States should ensure such protection by obliging the person who has acquired control of a company to make an offer to all the holders of that company’s securities for all of their holdings at an equitable price in accordance with a common definition”*⁶⁸

This chapter looks at the provisions of takeover regulation in Russia and the Netherlands which are devoted to the Mandatory bid, in order to identify the differences and decide how well the protection of minority shareholders rights are ensured in both jurisdictions.

3.2.1 Russia

Provisions of the JSC law, regulating takeover transactions, provide for both mandatory and voluntary bids. A person intended to acquire more than 30% of the shares **may** send a public offer (voluntary bid) to buy the shares of the remaining shareholders.⁶⁹ As appears evident from the legal language of the provisions, the potential acquirer of substantial shareholding is not obliged to give a public offer, but rather has a right to do so. Therefore there is no legal responsibility to make a public offer. The law neither provides for any liability that the acquirer might be exposed to in case he does not adhere to the conditions of the offer made.⁷⁰

A person or legal entity that has already acquired 30% of the shares of a company, is required to make a public offer (mandatory bid) to purchase the remaining shares.⁷¹ The mandatory bid must include the information about the bidder: name, characteristics and amount of shares

⁶⁷ Bergström, Clas & Högfeldt, Peter, 1994. "An Analysis of the Mandatory Bid Rule," Working Paper Series in Economics and Finance 32

⁶⁸ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, art 5

⁶⁹ JSC law 84.1 (1)

⁷⁰ V. I Dobrovolskiy *Problemy korporativnogo prava v arbitraznoy praktike*, [Problems of corporate law in arbitrage practice], published by WoltersKluwer, 2006, 366.

⁷¹ Russian JSC law, Art 84.2 (1)

owned, purchase price and method of payment.⁷² Until the tender offer expires, the bidder is not allowed to obtain shares under conditions different from the public offer.⁷³ The tender period set in the JSC law ranges from 70-80 days from the moment the offer was made public.⁷⁴ The price of shares offered in the mandatory bid can not be lower than the weighted average of the prices for which the shares were selling on the market for the last six months. In case shares were not sold on the security market, then the price can not be lower than the market price, which is to be determined by an independent appraiser.⁷⁵ According to the Art 84(6) before the mandatory bid is made, the person or legal entity, which has acquired more than 30% of the shares, is restricted in voting to the 30%, whereas the rest of the shares in possession do not participate in the voting and are not taken into account for quorum determination.⁷⁶ The legal language of the provision concerning the mandatory bid does not allow for the minority shareholders to demand “buy-out” of their shares by the bidder.⁷⁷ This leads to the conclusion, that the provision favors the buyer, rather than the minority shareholder.

The JSC law allows for changes to be made in the voluntary or mandatory bid by the bidder concerning the increase of the price and/or the reduction of payment period for the shares.⁷⁸

In case the company has received the competitive offer, the bidder is given the right to prolong the time limit of an offer till the day of termination of that competitive offer.

Any competitive offer can be put forward not later than 25 (twenty-five) days before the termination of the previously made offer.⁷⁹ Due to the low transparency of the corporate

⁷² Ibid

⁷³ Ibid

⁷⁴ Russian JSC law, Art. 84.2 (1)

⁷⁵ Ibid

⁷⁶ Ibid

⁷⁷ See Supra note, 68

⁷⁸ Russian JSC, Art. 84.4 (1)

governance system in Russia, the accomplishment of these provisions becomes a troublesome matter, which in turn undermines proper protection of the shareholders rights. In addition, the JSC law has provisions for state control over the acquisition of shares of open-joint stock companies.⁸⁰ According to the provision, a voluntary and/or mandatory bid should be given to the state authority for examination before it is made public.

3.2.3 The Netherlands

Public offers in the Netherlands were subject to the regulation by the Act on Financial Supervision (Wet op het financieel toezicht, Wft). Provisions on mandatory bid are directed towards creation of a legal ground, which will ensure that no shareholder is deprived from his/her right to access information in order to make a proper decision concerning the sale of shares. The Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten, AFM) has been given authority to observe whether the process of making public offers is in line with the regulation.

The Act on Financial Supervision defines the disclosure requirements relevant for public offers as well as indicates the sanctions that can be imposed in case of non-compliance with the rules.⁸¹ One of the peculiarities of the regulation is that even though subject to certain exceptions, but for a period of one year after the public offer has been made, the acquirer is not allowed to buy shares under more favorable conditions, then defined in the public offer.⁸² In my opinion, this relatively strict provision disciplines the acquirers in their intention to make a public offer, which in turn ensures that only the most economically viable offers will be made. Under the Dutch Law, the obligation to make a public offer is of mandatory nature,

⁷⁹ Ibid., Art. 84.5

⁸⁰ Ibid., Art. 84.9

⁸¹ Dutch Act on Financial Supervision, Art. 5:80(2)

⁸² Ibid., Art. 5:79

and must be made in order to sustain the principle of fair trading. In case of a friendly offer, the conditions of the offer can be determined in the course of negotiation between the target management and the offeror⁸³, otherwise consultations with the trade unions and works council are required. Regulation allows for any competing offers from third parties to be made while another offer is under consideration.⁸⁴ The period for the offer to be in force is subject to the minimum verge of 30 (thirty) days.⁸⁵ The Enterprise Chamber is given power to impose certain sanctions on the party that violates the law by not making the mandatory bid.⁸⁶ Whereas the Netherlands authority for the Financial Markets monitors the process from the moment the offer is made.⁸⁷ Dutch takeover legislation does not restrict foreign participation in the domestic market for corporate control; therefore there is no discrimination between foreign and domestic acquirers.⁸⁸

3.3 Squeeze-out/Sell-out rights

The 13th Takeover Directive establishes the right for shareholders to sell-out and squeeze-out the shares after the public offer has been made. According to the article 15 of the Directive:

*“...an offeror is able to require all the holders of the remaining securities to sell him/her those securities at a fair price in case the offeror holds securities representing not less than 90% of the capital carrying voting rights and 90% of the voting rights in the offeree company...”*⁸⁹

⁸³ Steven Schuit and Jan-Erik Jannsen. *M & A in the Netherlands: acquisitions, takeovers, and joint ventures : legal and taxation*, [The Hague: Kluwer Law International, 1996], 98.

⁸⁴ Merger Rules Art3. (2)(g)

⁸⁵ Dutch Act on Financial Supervision, Art.5:72

⁸⁶ Dutch Act on Financial Supervision, art. 5:73

⁸⁷ See supra note 62

⁸⁸ Steven Schuit and Jan-Erik Jannsen. *M & A in the Netherlands: acquisitions, takeovers, and joint ventures : legal and taxation*, [The Hague: Kluwer Law International, 1996], 117

⁸⁹ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, art 15(2)

According to the Winter Group⁹⁰, introducing the possibility to squeeze out the minority shareholders increases the attractiveness of the takeover bid for the acquirer, since his/her rights are given more protection.⁹¹ Scholars also advocate the squeeze out rules for its ability to solve the free-rider problem, as minority shareholders are deprived from the opportunity to take advantage of the increased stock price, resulting from the successful takeover.

The sell-out rights, provided for in the article 16, ensure that minority shareholders are able to sell the shares at the “fair price” and prevent the major shareholder from abusing its dominant position:

*“...holder of the remaining securities is able to require the offeror to buy his/her securities from him/her at a fair price under the same circumstances as provided in art 15(2)...”*⁹²

In the result, sell-out and squeeze out rights are the mirror images of each other, and have been implemented into the 13th EC Takeover Bid Directive in order to balance the rights of shareholders.

3.3.1 Russia

The JSC law is in line with the EU takeover directive in providing for the squeeze-out and sell-out rights. If as a result of a voluntary or mandatory bid, an acquirer has got 95% of the total amount of shares, the owners of the remaining 5% shares have a right to demand the redemption of their shares.⁹³ In the course of 35 (thirty-five) days from the moment of acquisition of the 95% of the shares, the shareholder is obliged to send an official statement to the remaining owners with notification about their right to sell the shares. This document

⁹⁰ The High Level Group of Company Law Experts, with the chairman Jaap Winter

⁹¹ Guido Ferrani, ed., *Reforming company and takeover law in Europe*, [Oxford: Oxford University Press, 2004], 754.

⁹² ⁹² Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, art 16(2)

⁹³ Russian JSC law, Art. 84.7 (1)

should include full information about the shareholder, including the amount and category of shares in possession, the price of the shares; and in case it was determined by the independent appraisal, a copy of the report should be enclosed.⁹⁴ The minority shareholders are given a six months period from the moment of notification to demand the purchase of their shares by the majority shareholder.⁹⁵ In order to protect the rights of the minority shareholders, Art. 84.7 (6) provides that the price for the remaining shares can not be less than the price set in the voluntary or mandatory bid, which has led the shareholder to acquire the 95% of the shares. The law envisages the right of the shareholder to demand the purchase of its shares even in the absence of the receipt of notification. In this case, within 15 (fifteen) days, the majority shareholder is requested to pay for the shares that will be written off from the account of the minority shareholders.⁹⁶

To provide fair treatment to all shareholders, the person/legal entity with 95% of the shares in the company also has a right to forcibly acquire the remaining shares.⁹⁷ In case the majority shareholder decides to avail himself of this right, the shares on the account of the minority shareholder get blocked till the moment they are paid for and transferred to the account of the majority shareholder. The share price for the transaction cannot be less than the price established in the voluntary or/and mandatory bid, which was paid by the shareholder who acquired 95% of the shares. Absence of mutual agreement about the price does not prevent shares from being written-off from the account of minority shareholders.⁹⁸ The only remedy the shareholders have at their disposal, in case they feel the price paid for the shares is underestimated, is to ask for reparation of damages through arbitration proceedings.

⁹⁴ Ibid

⁹⁵ Ibid

⁹⁶ Ibid

⁹⁷ Ibid., Art. 84.8 (1)

⁹⁸ Russian JSC law, Art. 84.8 (4)

3.3.2 The Netherlands

The Article 359c of the Dutch Civil Code (Burgerlijk Wetboek) establishes that:

*“Hij die een openbaar bod heeft uitgebracht en als aandeelhouder voor eigen rekening ten minste 95% van het geplaatste kapitaal van de doelvennootschap verschaft alsmede ten minste 95% van de stemrechten van de doelvennootschap vertegenwoordigt, kan tegen de gezamenlijke andere aandeelhouders een vordering instellen tot overdracht van hun aandelen aan hem.”*⁹⁹

“The person that through a public offer has acquired 95% of the share capital of the company and therefore his shareholding represents at least 95% of the voting rights, can request the remaining shareholders to transfer their shares to him.”

This regulation is known as a "squeeze-out procedure" (uitkoopregeling) and gives the right to the majority shareholder to acquire the rest of the shares at a fair price. According to the Dutch legislation the squeeze-out right also applies to two or more shareholders that jointly possess the 95% of the share capital¹⁰⁰, therefore allowing for collective action from the side of several shareholders.

The notification statement is required to be reviewed by the Enterprise Chamber of the Court of Justice in Amsterdam¹⁰¹ within three months after the closure of the public offer bid.¹⁰²

Upon the approval of the request, the Enterprise Chamber determines the equitable price to be paid by the shareholder for the shares of the minority shareholders, which is usually equal to the bid price.¹⁰³

The peculiarity of the squeeze right regulation in the context of Dutch Civil Code is that it also provides for transactions not related to public offers. In this way, Article 2:336 allows owners of at least one-third of the share capital to demand the transfer of shares from the shareholders that have been engaged in a conduct that puts the value company at risk and/or

⁹⁹Dutch Civil Code, Art. 2:359c1

¹⁰⁰Ibid

¹⁰¹Ibid., Art. 2:359c4

¹⁰²Ibid., Art. 2:359c3

¹⁰³Dutch Civil Code, Art. 2:359c6

jeopardize the interests of the minority shareholders.¹⁰⁴ This provision establishes a very strong protection device at the disposal of the minority shareholders.

In addition, minority shareholders are given the right to demand the buy-out of their shares at the fair share price, if in the result of the public offer the shareholder has obtained 95% of the share capital. Article 2:359d provides that:

*Tegen degene die een openbaar bod heeft uitgebracht en als aandeelhouder voor eigen rekening ten minste 95% van het geplaatste kapitaal van de doelvennootschap verschaft alsmede ten minste 95% van de stemrechten van de doelvennootschap vertegenwoordigt, kan door een andere aandeelhouder een vordering worden ingesteld tot overneming van de aandelen van de andere aandeelhouder.*¹⁰⁵

The provision applies to the shareholder that through a public offer bid has acquired 95% of the share capital and therefore can be requested to buy the rest of the shares from the remaining shareholders at their demand. The procedural rules for sell-out transactions are regulated by Article 2:359d and are the same as for squeeze-out transactions. Compliance with the rules for both transactions is monitored and reviewed by the Chamber of Commerce.

3.3 Anti-takeover measures

The use of the anti-takeover measures has been a very controversial subject. Some analysts consider them an unjustified edge to the efficient functioning of the market for corporate control; others see them as a necessary tool to safeguard the continuity of the firms existence.

¹⁰⁴Ibid., Art. 2:336

¹⁰⁵Ibid., Art. 2:359d

The Takeover-Bid Directive proposes the restriction of takeover defenses, but due to the strong divergence of views on this issue by different countries, it leaves to each individual EU Member State the decision which measures (and to which extent) should be allowed.¹⁰⁶

Nevertheless, article 11 of the 13th EC Directive provides for a breakthrough rule, according to which:

*“Where following a bid, the offeror holds 75% or more of the capital carrying voting rights, no restrictions on the transfer of securities or on voting rights nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided for in the articles of association of the offeree company shall apply; multiple-vote securities shall carry only one vote each at the first general meeting of shareholders following closure of the bid, called by the offeror in order to amend the articles of association or to remove or appoint board members”*¹⁰⁷

This chapter attempts to identify the anti-takeover devices available in the corporate legislation of Russian and the Netherlands.

3.4.1 Russia

The Russian takeover regulation does not provide for proper anti-takeover measures.

From the moment the offer is submitted to the company, the power of management is limited to prevent them from taking actions that might frustrate the takeover. From that moment until 20 days after the expiration of the bid, the following matters can only be resolved during the General Shareholder Meeting¹⁰⁸:

- Increase of the charter by issuing additional shares
- Placement of securities convertible to shares
- Approval of a transaction or several interrelated transactions associated with the purchase

¹⁰⁶ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, art 12(2)

¹⁰⁷ Ibid., Art. 11(4)

¹⁰⁸ Russian JSC law, Art. 84.6

- Approval of the transactions that the board might have interest in
- Acquisition of own shares
- Increase of the remuneration of the company's executive

The only power left for management to influence the decision of the shareholders is to provide them with their opinion and recommendations about the public offer, including the assessment of the offered price and future perspectives for the shareholders and stakeholders.¹⁰⁹

Taken into account the concentrated ownership of the Russian firms, and the fact that managers often possess sufficient shares in the company for calling the General Shareholder Meeting to change the articles of associations of the company, restricting the powers of management does not prove to be efficient in preventing managers from frustrating profitable takeovers.

3.4.2 The Netherlands

The Dutch corporate legislation historically has been very protective to takeover threats. The approach to allow anti-takeover measures was advocated by the idea of safeguarding the continuity and integrity of the company. Nevertheless, the proposed 13th EC Directive insists on diminishing the number of the anti-takeover devices used within Europe: it allows for national legislation to decide on the restrictions of defensive measures.¹¹⁰

Therefore, in the context of Dutch legislation, Public Companies have an option to insert defensive measures to restrict a public bid in its Articles of Association. In case shareholders are willing to prevent the managers from frustrating attractive takeover bids, they may stipulate in the Articles of Association that restrictions on the transfer of securities,

¹⁰⁹ Russian JSC law, Art. 84.3

¹¹⁰ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids

preference shares, voting shares and other defensive devices do not apply to the introduction of a public bid.

Among the anti-takeover devices possible for Dutch public companies the following can be distinguished: Depository receipts, (certificaten), Protective preference shares (Preferente beschermings aandelen) and Priority shares (Prioriteits aandelen). These protective measures are available for public companies under the Amsterdam Listing Rules,

Depository receipts (certificaten van aandelen)¹¹¹ are used to separate the legal ownership from the economic. Holders of depository receipts of shares do not possess voting rights. The voting rights over the shares are issued to a foundation called “Stichting Administratiekantoor” which can hold the shares in trust and exercise the voting rights.

The holders of depository receipts are not deprived from other shareholders rights like: receiving the agenda of the meeting¹¹², attending and participating in it (without voting power)¹¹³, reviewing the annual accounts of the company¹¹⁴ and requiring investigation into corporate affairs. This mechanism in turn prevents a competitive bidder to gain voting control over the shares, therefore depository receipts are considered as an effective takeover defense. After the introduction of the 13th EC takeover-bid Directive “Stichting Administratiekantoor” is required to grant power of Attorney to the holders of depository receipts, which facilitates the exercise of voting rights in case of the takeover. This initiative is in accordance with the proposal of the European Community to restrict the negative effect of the anti-takeover measures and will certainly help in removing the monopolistic effect of depository receipts. In other words, the holders of the depository receipts are given a legal right to convert them into the shares with the voting right by submitting a request to the Foundation. Furthermore,

¹¹¹ Listing and Issuing Rules, bijlage X: A – 2.7, B

¹¹² Dutch Civil Law, Art 2:113(1)

¹¹³ Ibid., 2:117(2)

¹¹⁴ Ibid., 2:102(1)

the management of the foundation should maintain its independence from the issuing company, and may not have common members in the management board.

Protective Preference Shares¹¹⁵ are another anti-takeover measure employed by the Dutch listed Companies. In this case, again a foundation works as a special purpose trust and Protective Preference Shares are issued generally at par value, to the foundation if there is a fear of hostile takeover. It is not essential to get the approval of specific shareholder to issue Protective Preference Shares since management of the company holds the power of issuance. Moreover, the Protective Preference Shares with their characteristic to afford very high voting power at comparatively low cost, allow the same voting rights equivalent to the all issued ordinary shares in the company. However, new amendments made to the legislation and subject to the approval in the Articles of Association, allow any party holding 75% of the shares of the target company to break through (doorbraakregeling) any anti-takeover mechanism after a six-month period, which fairly restricts the use of the anti-takeover device.¹¹⁶

Priority shares (Prioriteits aandelen)¹¹⁷ provide their holders with exclusive powers. According to Dutch Civil Code, special rights can be granted to the holders of priority shares if so provided in the articles of associations (statuten).¹¹⁸ Among the special treatment privileges that priority shares holders may be given, the scholars distinguish the following.¹¹⁹ First of all, amendment can be initiated in the articles of corporation using the special power attributed to the Priority Shares. Furthermore, the Corporation can seek Approval regarding the issuance of shares using the power of Priority Shares. In addition, the exclusive power

¹¹⁵ See *supra* note 111, A – 2.7, A

¹¹⁶ Dutch Civil Code, Art 2:359B (2)

¹¹⁷ See *supra* note 111, A – 2.7, C

¹¹⁸ Dutch Civil Code, Art. 2:92, 3

¹¹⁹ Steven Schuit and Jan-Erik Jannsen. *M & A in the Netherlands: acquisitions, takeovers, and joint ventures : legal and taxation*, [The Hague: Kluwer Law International, 1996], 133

attributed to the Priority shares can be used to nominate managing and/or supervisory directors. This nomination is considered as binding. The special power is also used to find out the exact amount of distributable profits which is facilitated by allocation of profits to the corporate reserves.

To conclude, Dutch legislation allows for the use anti-takeover measures considering them as useful if they are in the interests of the company. However, legitimate use of these devices is made subject to the shareholders decision when they set up the Articles of Association.

Chapter 4 - Recommendations

In order to fulfill the main purpose of the paper, this chapter provides recommendations, based on previously identified inefficiencies in Russian corporate control market and faults in the takeover regulation.

It appears evident from the research that raiding in Russia is perceived as a relatively easier and less costly method of taking over a company compared to the normal acquisition process. Taken this into account, recommendations provided in this chapter require establishment of a solid legal framework that will increase the cost of raiding, making it a less attractive method. To note, the costs of raiding do not necessarily include only monetary expenses, but also the likelihood and severity of the criminal charge.

The language of the Russian regulation concerning the mandatory bid should have a more binding nature, otherwise provisions do not offer a sufficient level of protection to minority shareholders, but would rather pursue the interests of acquirers. Furthermore, I consider it useful to have an independent agency, like The Authority for the Financial Markets in the Netherlands, as an effective way of ensuring that compliance with the rules is achieved and shareholders rights are not violated. Nevertheless the requirement to consult the Trade Unions, Work Council and role of the Netherlands Authority for the Financial Markets might appear time-consuming and costly it ensures the transparency of the process, providing fair treatment for all stakeholders.

With regard to squeeze-out and sell-out rights, Russian legal provisions are very similar to the European standards and do not require any further improvements. However, there is no supervisory authority, and as a result there is room for rights violation. Therefore, it is advisable to introduce an independent institution for monitoring compliance with the squeeze-out and sell-out rights, as it is practiced in the Netherlands.

Furthermore, in the present circumstances in the market for corporate control in Russia and the danger that successful companies are exposed to from corporate raiding the implementation of effective protective techniques could be a legislative solution to the problem. In other words, Russian regulatory legislation should allow companies to defend themselves better against hostile takeovers. In principle, the best approach would be to allow anti-takeover measures to be incorporated in the articles of the association instead of implementing them when a takeover offer has been made, in order to restrict management from opportunistic behavior.

As was pointed out in the chapter on peculiarities of the Russian market for corporate control, companies are usually characterized as having a very concentrated ownership structure. It constitutes a structural barrier to efficient takeovers, since the majority shareholders might agree not to sell their share, which would prevent the takeover. Due to the concentrated ownership structure of firms, many raiders find it impossible to acquire a company in the usual way by making a public offer and are therefore forced to recourse to quasi-legal methods. I therefore think that Russian legislators should opt for implementation of sound legal anti-takeover devices, which might in the long run stimulate a more dispersed ownership structure in the companies, making it more transparent and efficient. The Dutch takeover regulation offers a range of protective devices, which were presented previously in the paper, that ensure a certain level of protection against takeover of the company without distorting efficiency in the market for corporate control.

In order to strengthen investor protection and eliminate the possibility of fraudulent operations with the corporate legal documents, an independent state authority should be introduced, that would keep books of company's holdings and be responsible for any changes made in them.

In addition, to discipline managerial behavior and prevent abuse of power by large shareholders, it is advisable to broaden the application of personal liability of managers and controlling shareholders for damage to particular stakeholders.

Increased corporate transparency will raise the operational cost for corporate raiders and reduce the incentive for quasi-legal methods of takeovers. In other words, when information receives wide public resonance, it becomes much more difficult to juggle with facts. A higher level of corporate transparency would increase the investors interest in Russian stock, which would positively affect the development of the financial market. In order to achieve that, legal takeover regulation in Russia should require more stringent provisions on disclosure of information.

Conclusion

The development of a corporate governance system in Russia does not have a long history. However, in the course of its evolution it has acquired specific traits that significantly distinguish it from other corporate governance systems. One of such peculiarities is the wide expansion of “corporate raiding” as an alternative, quasi-legal method for corporate takeover. This paper has attempted to analyze the Russian market for corporate control and identify the faults in Russian takeover legislation, that allow for corporate raiding to distort and harm the economy. The eventual purpose of the paper has been to provide a number of recommendations that will discourage the raiding activity and/or minimize its consequences.

In the current situation of potential threat from corporate raiders and the absence of available legal anti-takeover measures investors are faced with very little protection of their ownership rights. This situation has had an impact on the inner structure of the companies: under threat of raid attack, ownership in companies becomes more concentrated, with senior management controlling a major share of the stock. As a result, managers are likely to abuse their power to the detriment of minority shareholders, and prevent efficient takeovers. As a result, violation of the minority shareholders rights becomes a topical issue. Structural barriers prevent the occurrence of value-maximizing takeovers and lead to distortion in the market for corporate control.

The need for structural changes in the Russian takeover regulation has become evident beyond any doubt. The goal for takeover regulation is to implement measures that not only stimulate public offers and thereby establish a well-functioning market for corporate control, but also to ensure equal legal protection for all shareholders.

This paper argues in favor of employing protective legal devices in takeover regulation together with providing a legal background that creates civilized conditions for more

transparent, market-orientated takeovers. Furthermore, pursuance of measures that increase corporate transparency in large corporate transactions is advocated. As has been argued in the paper, larger transparency leads to a greater level of public awareness, which in turn increases the costs for corporate raiders, making it less attractive to resort to illegal methods of takeover.

In conclusion, in order to sustain a strong and efficient system for corporate control, apart from proper corporate legislation, there must be a reliable judicial and enforcement system in place, strong opposition to corruption and fraudulent activities. Consequently, further research is required to find the ways of reducing its impact on the investor's choice.

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