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POWERFUL START-UP NEEDED FOR THE REAL SECTOR OF THE RUSSIAN ECONOMY



We have already become accustomed to the realities of the economic crisis, which has revealed and aggravated many unresolved problems and issues. Although uncertainty still remains high, while the general measures in overcoming the crisis on a global scale have not been worked out yet, business continues to be conducted on the market. The editorial office of the Independent Director magazine invited David Yakobashvili, Chairman of the Board of Directors of Wimm-Bill-Dunn, to shed light on the pressing issues being resolved today by a company operating in the country's vitally important real sector of the economy.

Independent Director: Mr. Yakobashvili, what do you think about the state of affairs in the Russian economy as compared with the economies of other countries?

David Yakobashvili: Russia entered the crisis later than some other countries. Therefore, we had the opportunity to prepare for the situation. Certainly, we wanted the state of affairs to be better. Today, Russia has special problems: there is deflation abroad, while we have inflation and very high lending rates.

This is troubling, because not all business companies can cope with such high lending rates. Most probably companies borrow money to have time to sell something and then simply close the credit situation. I doubt that such high lending rates can be closed by using resources from the profit made. Hopefully, the global economy will develop and we will follow suit.

Since your company is operating in the food industry, how do you assess the situation there?

D.Y.: The situation in the food industry is not so bad, although certainly there are difficulties. A case in point is the relations between retailers and food suppliers, between producers and processing companies. What worries us is that dairy consumption has dropped, and this may entail certain problems of food production, namely, milk production. Will producers have enough milk at the current price to develop production or even to survive, or will they start slaughtering cows?

Powdered milk production is a pressing problem. In the Soviet Union, only powdered milk was consumed, but now it has been completely discredited from the consumer's standpoint. The refusal to produce powdered milk because there is no demand for it has led to the refusal to purchase ordinary milk in order to make it into powder. This caused a chain reaction: milk producers do not know what to do with their milk and are therefore selling it very cheaply; this is not quite fair, and milk producers come across certain problems. As a result, the producers may slaughter their cows and stop producing milk. This situation is troubling us, and we are now trying to convince the government to reconsider a paragraph in the technical regulations that discredits powdered milk as a product and to regard the product made out of powdered milk as restored milk and not as a milk beverage.

How well does the Russian product compete with the imported product?

D.Y.: We process 15 million tons of milk in Russia and import 3 million tons from Belarus. This is quite a large volume. We compete with rather great difficulty, because milk producers in Belarus receive far more state aid than their counterparts in Russia. According to the Ministry of Agriculture, for instance, a kilogram of Russian milk accounts for 4% of state subsidies, while in Belarus, the figure is 24-28%. Therefore, it is very difficult for us to compete with Belarus as regards the prices of finished products, powdered milk and butter, especially since we have a transparent customs zone with it.

Things are easier in relation to other importers, because the subsidy which the producers abroad receive for exporting finished products is compensated by our customs duties.

Due to great price competition, is our government taking any steps to support the Russian producer?

D.Y.: There is some support. In any case, support is declared, but unfortunately it is not always given in time. The government admits that there is a lag in payments to cover two-thirds or 100% of the refinancing rate, or aid for every liter of milk sold or supplied. Sometimes, this aid was even refused to be given. Moreover, issues concerning subsidies for the acquisition of fertilizer as well as fuels and lubricants remain unresolved.

IDA News

On **July 17, 2009**, a general meeting of members of the Independent Directors Association (IDA) was held. It was attended by 288 members (56.4% of all members), who voted on four items of the agenda.

As a result, the following decisions were adopted by majority vote:

- the number of persons on the IDA supervisory board is to be increased from 13 to 14;
- K.N. Korischenko, President of ZAO FB MMVB and General Director of MICEX is to be elected to the new supervisory board;
- D.S. Gordin, Managing Director of ROSNANO, is to be elected to the new supervisory board;
- J. Wilkinson, Partner at PricewaterhouseCoopers in Russia, is to be elected to the new supervisory board.

On **June 24, 2009**, members of the Independent Directors Association were chosen as nominees to the boards of directors of companies with state participation. Among the 38 candidates presented by IDA, who expressed willingness to be nominated to more than 50 companies, the Commission for the Selection of Independent Directors, Representatives of the Interests of the Russian Federation, of the Federal Agency for the Management of Federal Property selected 5 persons for 7 positions.

For details, see p. 6.

On **June 16, 2009**, the extended meeting of the Club of Directors of the Independent Directors Association was held in the conference room of OAO VimpelKom on the subject **Corporate Governance: Russian vs Anglo-Saxon vs Japanese Approaches.**

For details, see p. 7.

Is the government working to resolve these issues?

D.Y.: I cannot say that the accountable persons who are currently managing the industry are not trying. They are trying very hard and are working round the clock, and they deserve credit for this. Unfortunately, our system is inflexible, the rules of the game have not been worked out, instructions are not delivered in time, and much depends on pettifoggers holding the lowest or middle level. There are problems which we always face, and we try to resolve them.

How does this situation affect your company's business results?

D.Y.: The only problem that greatly worries us is the drop in consumption. The company was not loan overburdened, and therefore our position is quite stable.

Having foreseen this situation, did you intentionally limit yourself to taking loans?

D.Y.: Wimm-Bill-Dunn always followed a conservative policy of taking loans. All companies should have limited themselves to taking loans, because everyone knew that the crisis began in 2007, but thought it would bypass us.

What key issues facing your company should be resolved in the current situation?

D.Y.: The first key issue which worries us is the adoption of an absolutely clear-cut and comprehensible law on trade in foodstuffs or, on the whole, a law on trade which promotes the development of industry and civilized trade in Russia. Another key issue which interests us is the ersatz problem: the replacement of milk products and dairy fat by vegetable oils produced from tropical crops, such as palm oil, to which our people are unaccustomed.

In fact, palm oil was at first imported strictly to produce soap. Later, it was discovered that palm oil could replace animal fat in foodstuffs, reducing their cost, since dairy fat costs three times as much as palm oil. Certainly, our body withstands such replacement, but I would like to avoid making decisions which bring only material gain, and not social gain.

Therefore, legislation should determine the admissible limits to the replacement of animal fat with vegetable oil in each product which is to undergo such change. The replacement of animal fat reduces the cost of a product but may adversely affect the consumer's health.

Animal fat should not be fully replaced with vegetable oil. There should be regulations governing the best ratio of animal fat and vegetable oil in a product, a certain "golden mean", say 60% and 40%, respectively.

We have many supporters, including the Ministry for Health Care, to resolve that issue in such a manner, but the financial argument may be an outweighing factor in a difficult economic situation.

However, we will defend our stand and try to drive it home to the people so that they will see what is good for them.

Were you obliged to adjust your company's development plans due to the crisis, and what changes were made?

D.Y.: Yes, we had to adjust our development plan slightly. We thought of acquiring certain enterprises for extensive development, but we changed our mind in some cases. The enterprises were loan overburdened, thereby not allowing us to acquire them; otherwise, our indicators would have dropped. To choose a company for acquisition in the current situation, we should take account of not only the region in which it operates and its significance there, but also its financial status. An acquired company should be included by synergy in our holding company, or at least should not mess up our indicators.

Do you have an anti-crisis program worked out, and what are its basic concepts and orientations?

D.Y.: An anti-crisis program, or a cost-cutting program, was worked out as early as in 2006 and is being successfully implemented. To begin with, we cut down certain costs: expenses on motor cars, phone calls, advertisements and a few other expense items. We slightly reduced personnel according to plan. There is no need for each plant to have several employees performing the same duties.

In implementing the cost-cutting program, we combined all the enterprises under the Lianozov Plant's guidance, creating a holding company, the financial, legal and other services of which are centralized and serve the needs of several plants.

What would you recommend the heads of small companies engaged in the food industry to do to overcome the crisis?

D.Y.: Responsibility is crucial in any situation. Companies in the food industry cannot be there for a "short stay". We should have long-term plans and win the trust of consumers and employees every day. We should eat the products which we produce and should care for the consumer in the same manner as we care for ourselves.

We try to tell the people being employed by our company that a responsible attitude should be taken to one's duties and the company as a whole, and consequently to the environment and our consumers.

The food industry is where irresponsibility and deception are fraught with dire consequences for the company.

In May 2009, the Forbes magazine published the rating of global companies with the best reputation, prepared by the Reputation Institute. Wimm-Bill-Dunn was 37th. How and due to what was your company so successful?

D.Y.: I think that we were so successful because the company and all its employees from the top to bottom consistently adhere to the basic principle of being responsible to oneself, to close friends and relatives, to our consumers, and to our future generation. Even if I will not work, I think that the company will remain true to its basic principle.

Earlier, you said your company was not loan overburdened and was stable financially. However, the company continuously increased production in the course of a few years. How did you manage to maintain a balance in attracting investments?

D.Y.: Yes, currently our loan constituent is slightly larger than EBIDA. We are taking a conservative approach: loans should constitute not more than 50% or, even better, 10-15% of the assets so that the company can repay its debts if the market collapses. At the beginning of the year, for instance, the price of assets dropped to one-tenth of their value. True, now it rose to half of their value, but, all the same, 50% is substantial. And what if the company is loan overburdened!

Loan overburdening was one of the reasons why some store chains could not cope with the situation. They quickly fell apart because, instead of settling their accounts with the suppliers, they used all their revenue to open new stores.

Sinking deeper into debt, such companies are now late in repaying it. Consequently, the suppliers filed lawsuits, and other problems cropped up.

Construction companies acted likewise, investing 10% of their own resources and 90% of the borrowings. Currently, they face great difficulties, because the interest rates increased and the demand dropped.

What key risks did your company have in view a year ago and how did this outlook change now?

D.Y.: High competition on the market was one of the key risks a year ago. Today, these risks have been somewhat modified. Although our relations with store chains are good, we do have some problems with them. The fact is that the chains are trying to replace half of our products with their own brands. Their products are cheaper for the end consumer, since we pay rather high bonuses and

trade markups for our products. Besides, the chains are putting their products on the front shelves and are moving ours to the back.

However, the chains' cheap own products are not always good for the consumer. Putting out its own products, a store chain places orders for their production with small enterprises, but it cannot adequately assess their quality because of its lack of experience in this respect.

Ultimately, nobody is responsible for the quality of the products. In difficult situations, a store refers to an unknown enterprise on the outskirts. I think this is an irresponsible approach.

How and due to what do you manage to maintain the proper quality of the products?

D.Y.: Due to constant control. The production of dairy products is a low-profitable and highly delicate business which requires particular care at every technological stage. There should always be control. Great responsibility is borne by employees who see to it that the technological process, starting from milk production and ending with the sale of products from the warehouse, operates properly.

Our plants have modern equipment, and we use up-to-date technologies to process milk. The quality of the products will be high and no unexpected situations will arise when the technological process is strictly maintained.

What contribution do independent directors make to your company's success and what role do they play in adopting decisions?

D.Y.: They play quite a big role. Independent members of the board of directors are heading all the board's committees and are taking part in resolving every issue, such as corporate responsibility and strategic plans, the purchase of assets and audit, and the assessment of the management's work and its remuneration. No decision is adopted without the independent directors' participation. They are very demanding on the managers. In this respect, they assess how efficiently the management works and how well the company copes with the output of new products, and see whether the work results are in line with the planned economic indicators.

Our independent directors consider the company's problems to be their own and take them close to heart.

Did anything change in the work of your company's board of directors as a result of the crisis? Are you paying more attention now to the issues of operational management?

D.Y.: No, nothing changed. The Board is working like it did before the crisis. The frequency of meetings in presentia remained the same, four or five annually, while issues which should be considered quickly by the Board and be promptly resolved are subject to absentee voting.

I have no right to intervene in operational management and don't do that. I deal with other issues which worry us today, namely, the development of agriculture and the processing industry. We are taking an active part in discussing these issues in Parliament and at the meetings of the Government and the Ministry of Agriculture of the Russian Federation.

What are the principles of maintaining effective relations with the Director General?

D.Y.: To begin with, an understanding of and a need for one another. This is fundamentally important when people need one another. There are issues which I cannot resolve, and there are things which he cannot resolve without me. He quickly grasps the situation, sees it, excellently knows production, and understands better than anyone else how to manage the company, reduce expenses and arrange a product line. He is far more skilled in this respect. I devote a lot of time to public relations as well as relations with the government bodies. I take a certain stand in the Dairy Union of the Russian Federation, the Russian Union of Enterprises of the Dairy Industry, and NP RosBrand. Frequently, we act not only on behalf of the company in resolving certain important issues concerning the industry's development.

What principles do you adhere to as an owner?

D.Y.: It is necessary to learn every day, and only then will the company be honorably defended.

It is also important to act with responsibility and display care for the company and its people. It should be seen to it that the salary is paid in time, the products are good and are sold in time, excellent milk is purchased, the dairy farmers are paid normally, headway is made, and that a common language is found with our competitors.

What do you think are the key principles of work of the chairman of the Board of Directors?

D.Y.: Trust, care, demand and responsibility are central. The chairman takes the blame for all blunders. Therefore, he should regard the company as being part of himself, as his right hand which is not to be severed, and should not sell or betray it. Certainly, business can be sold, but while you are working and performing the function of chairman of the board, you should bear greater responsibility for the company.

The chairman should devote a great deal of attention to people. He must get in touch more frequently with the company's executives as well as managers and members of the Board of Directors, hear them out, see how they view the company and what problems they come across, and what they would like to hear, see and perceive. Attention should always be devoted to people, because if they are treated light-heartedly, sooner or later they will feel offended or get some nonsense into their head, such as that they are being neglected, their views are not taken into account, and decisions are adopted without their participation. A company functions like a human body, reacting to innuendos and feeling offended.

What does the corporate governance system created in the company offer you as a contributor?

D.Y.: Everything should work according to business laws. When a company becomes larger, it becomes obvious that the up-to-date methods of management used globally should be applied so as to conform to ratings and standards. Only effective management will help preserve and develop the company with 20,000 employees and an output of millions of tons: several trains loaded with products leave a plant every week.

Managing such a company is no easy matter, and old methods of running it are not good enough. It is necessary to be up to date. The company's management should meet the requirements of a sufficiently high level. It should be able to manage large companies and cope with the given situation, harnessing the driving forces in it.

The corporate governance system has allowed me to manage my time more efficiently and to resolve issues which are more important than routine operations, and to give charge over these operations to experienced managers.

In what ways do you think corporate governance should be improved in your company?

D.Y.: We are working on the issue of establishing closer relations between the Board of Directors and the management and making them more effective, and demand that the management be more active and successful in preventing various abuses in the company. We are seeking to make reporting fully transparent in line with global practice.

We are also developing a new product and opening new production plants, and are actively entering new markets and assimilating new territories of the distant and nearby republics.

We seek to produce delicious and healthy products and deliver them to our purchaser in time.

Thank you, Mr. Yakobashvili. Would you like to add something to this interview?

D.Y.: Let us develop not only the raw-material economy, but also the economy which will allow the country to advance and overcome the crisis. Footwear and clothing as well as machinery and devices can also be produced in

Russia. We have an adequate material and technical basis and the relevant experience. We should engage more brains and pay them well so that they would work here and considerably develop the country. Certainly, new roads should be built, and also air traffic should be promoted so that it would no longer be necessary to fly to Petropavlovsk or Khabarovsk via Moscow.

NEW NOMINATIONS

The Independent Directors Association would like to congratulate the IDA members elected to the Board of Directors in 2009.

V.V.Bulatov – elected to the Board of Directors of OAO Kavkazgidrogeologia (Stavropol Territory);

A.A.Vinkov – elected to the Board of Directors of OAO Chukotkasvyazinform (Chukotsky Autonomous District);

A.G.Gavrilenko – elected to the Board of Directors of S.P. Korolev RSC Energia;

A.A.Gogol – elected to the Board of Directors of OAO Central Research Institute for Water Transport Economics and Operation (Moscow), JSC Sevmorneftegeofizika (Murmansk Region);

V.A.Gusakov – elected to the Board of Directors of OAO Agency for Housing Mortgage Lending;

M.M.Dmitriyev – elected to the Board of Directors of JSC Institute for Research and Development of Tractors NATI;

I.A.Zavorotchenko – elected to the Board of Directors of OAO Design Technology Bureau for Concrete and Reinforced Concrete (KTB GB) and OAO PNIIS;

Ye.V.Kornev – elected to the Board of Directors of OAO Interregional Specialized Post Center (Moscow) and OAO Agency for Cargo Luggage Express Delivery (Moscow);

I.V.Kravchenko – elected to the Board of Directors of OAO Vichuga Powergrid (Ivanovo Region);

Ye.V.Ksenchuk – elected to the Board of Directors of OAO Novosibirskrybkhkh (Novosibirsk Region);

I.N.Repin – elected to the Board of Directors of OAO Novosibirsk Design and Research Institute “Gosradioprojekt (Novosibirsk region), OAO State Testing and Certification Center for Software Tools of Computation Engineering (Tver Region), and OAO Airport Salekhard (Yamalo-Nenets Autonomous District);

I.I.Rodionov – elected to the Board of Directors of OAO Svyazinvest;

A. V. Severilov – elected to the Board of Directors of OAO Troitsky Iodine Plant (Krasnodar Territory);

A.A.Filatov – elected to the Board of Directors of OAO VolgaTelecom;

A.V.Filatov – elected to the Board of Directors of JSC Institute for Research and Development of Tractors NATI and OAO Mosmetrostroy.

CORPORATE GOVERNANCE: RUSSIAN VS ANGLO-SAXON VS JAPANESE APPROACHES

The IDA Directors Club met to discuss and compare the Russian, Anglo-Saxon and Japanese approaches to corporate governance at an extended session on June 16, 2009. The meeting was hosted by VimpelCom at its conference hall.

The meeting discussed the structure, role and responsibility of boards of directors and specifics involved in decision-making processes in companies operating in different countries, including Russia, Japan, Germany, France and the USA and using different models of corporate governance.

Speakers:

Yury Voitsekhovskiy, President and Chairman of the Management Board, Standard Bank

François Guillon, Partner Energy Audit Services, PricewaterhouseCoopers

Alexander Ikonnikov, Partner Board Solutions, Chairman of the Supervisory Board, Independent Directors Association

Franz Kaiser, Partner Energy Audit Services, PricewaterhouseCoopers

Jeffrey McGhie, Vice President VimpelCom

Tetsuaki Omura, General Manager, Regional Representative in the CIS (Russia and Ukraine), Mitsubishi Corporation

Alexander Filatov, Executive Director, Independent Directors Association, chaired the meeting.



Jeffrey McGhie

Referring to the example of VimpelCom, **Jeffrey McGhie** described corporate governance in a Russian company listed in New York.

“Since 1903, VimpelCom was the first Russian company to be listed on the New York Stock Exchange (NYSE) in 1996. We comply with all requirements of Russian legislation, the NYSE and SEC and follow best international practices”.

“The objective of VimpelCom’s corporate governance framework is to ensure that the management acts in the long-term interest of the company and that the company complies with the established legal and ethical standards”.

“The General Meeting of Shareholders is the supreme management body of VimpelCom. As required by Russian legislation, the company has established the Board of Directors and the Audit Commission. The Board consists of nine directors, including three independent directors. There are three Board committees, including the Compensation Committee, Corporate Governance Committee and Financial Committee. The General Director is the sole executive body accountable to the Board of Directors. The General Meeting of Shareholders elects members of the Board and decides on a limited range of key issues, such as reorganizations and additional share offerings. The Board of Directors is responsible for making strategic decisions, including approving budgets and major deals and appointing the C-suite. Issues brought before the Board of Directors are studied by its committees. The General Director is responsible for the operational management of the company. A Russian public company may also have a management board. In VimpelCom, the Management Board plays a consultative role”.



“To make a decision, the Board of Directors will consider three important elements. These are the possible market response, changes in international law and reputation factors”.

“The corporate governance framework of VimpelCom reflects Russian corporate legislation. But it is somewhat similar to the Anglo-Saxon model”.



Franz Kaiser

Speaking on the subject of the meeting, **Franz Kaiser** outlined the German model of corporate governance.

“In Germany, companies use a two-level system of corporate governance, which consists of the supervisory board and the management board/executive board. Within this framework, the executive board is responsible for the management of the company, and

its members are equally responsible for the activities of the board. The role of the supervisory board includes control, making recommendations for the management board and appointing its members. The chairman of the supervisory board coordinates the work of board members, while the general meeting of shareholders elects them”.

“German supervisory boards are unique in that they include staff representatives. For companies with a staff of over 500 or 2,000, it is required that staff representatives account for one third or one fifth of the board membership, respectively. If staff exceeds 2,000, the chairman of the supervisory board has the casting vote. Staff representatives in the supervisory board are expected to comply with legislation and act in the best interest of the company”.

“Crucial decisions of the supervisory board are developed at the level of the management board and then reviewed by the supervisory board. This does not mean, however, that the supervisory board may not make independent decisions. Typically, there is close cooperation between the two boards”.

“The German Code of Corporate Governance has been supplemented with 80 recommendations and 23 proposals. Recently, a decision was adopted to make new changes in the Code”.

“Corporate governance regulations have also evolved in other countries. For example, the Shareholder Bill of Rights Act of 2009 was introduced in the US Senate in May 2009. We will keep track of developments in global corporate governance practices. We are living at an interesting time of an ongoing change in corporate governance models. I believe we should anticipate growth in demand for skilled directors”.



François Guillon

François Guillon continued to overview corporate governance models of EU companies.

“Broadly speaking, there is no such thing as a continental model of corporate governance. French companies use three models of corporate governance”.

“The first one is known as the Integrated Model whereby the board of directors is authorized to make management decisions. The board defines the company’s strategy, appoints officers responsible for strategy implementation and controls the implementation process. The board chairman contributes to decision making and ensures that board members meet their obligations. This model is most common in France”.

“The Double Model, also known as the German model of corporate governance, includes the supervisory board and the executive board. This approach suggests that the supervisory board does not interfere with the management of the company. In France, 25% of public companies use the Double Model”.

“The third model is a modified version of the first model. It separates the roles of the chairman of the board of directors and the CEO, as it is strongly recommended in the EU”.

“The third model is designed to ensure effective and independent control over the work of the management. It is especially effective for companies in recession”.



Tetsuaki Omura

“Speaking at the meeting of the Directors Club, **Tetsuaki Omura** said, “I will try to explain the specifics involved in the decision-making process of a typical Japanese company. I’d rather leave out legal aspects to focus on the features which puzzle foreigners, namely, the mechanism of making decisions, who makes decisions in Japanese companies, what is the timing of Japanese decision-making, and why decisions take so much time”.

“Japanese companies use a variety of mechanisms in decision-making, but I will describe the one that is most common for major corporations. A Japanese company has two unique features making it different from both Russian and Anglo-Saxon companies”.

“First is lifelong employment. Second, achieving internal consensus is crucial”.

“Japanese companies employ people for a long time. It is so-called lifelong employment. Commonly, university graduates come to work for a company to remain with it until retirement. And people realize this when they receive a job offer. The objective of any employee is gaining experience and moving upward in a career to finally rise to a management position. All employees share the company’s policy for selecting the best talent and promoting it to management positions. Therefore, in most Japanese companies, key management positions are filled by people who have been with their company for over a decade”.

“The second feature is related to the first one. A Japanese company is somewhat similar to a big family. Companies tend to encourage a company-wide exchange of financial and business information, which is made available also to employees who do not deal with it directly. In Japan, this is viewed as a way to ensure development and success of the overall company”.

“The Board of Directors of a Japanese company is a “body of insiders”. In most companies, the line between the board of directors and the board of management is blurred, and the difference between them is insignificant. This is due to the fact that board directors are selected from among people who have served on the management board for a long time and have worked for the company for many years. You will hardly find more than a couple of “outsiders” on the board of directors of a Japanese company”.

“How are decisions made in a Japanese company? Most decisions are worked out by the management, whose members have long worked together and know each other well. In this environment, it is crucial that internal consensus is achieved and all relevant data and information are brought to the knowledge of all colleagues before a decision is made. Decisions are made on the basis of consensus without voting. Once the management has made a decision, it is reviewed by the board of directors who either approve or reject the decision. Rejection is not common, for the decision-making process begins from the bottom in Japanese companies. A business unit will discuss any initiative or pro-

posal with other business units first in order to achieve consensus. So by the time a decision reaches the management, it has already been approved and adopted at lower levels”.

“This is precisely why decisions take so long in Japanese companies, and it is difficult to ‘spot’ the decision-maker”.

“The benefit of such a procedure for making decisions is that all board directors are well informed of all details involved in any decision. Employees involved in the decision-making process may suggest alternatives. Formally, the Japanese organization of decision-making is similar to the Anglo-Saxon approach. Duties, responsibility and rights of board directors are formalized in Japan just as they are in Europe”.



Yury Voitsekhovskiy

To bring the discussion of global approaches to corporate governance to a conclusion, **Yury Voitsekhovskiy** said, “Russian companies are at an early stage of building their corporate governance frameworks. Most of them copy the Anglo-Saxon one-level model. So far, there are instances when independent directors are appointed from among board members, who rely on their positions financially and therefore may not be considered independent. Or else, independent directors represent major clients, implying a conflict of interest and giving grounds to question their independence”.

“Indeed, rules and tradition of corporate governance take time to develop. I believe it is crucial that board directors of a company share common values. The board of directors and the corporate governance model of a company are the product of the environment. But implementing the most forward-looking models and appointing directors from among the most experienced and advanced people with impeccable reputations can change the environment”.

RESERVED OPTIMISM IN A CHALLENGING TIME

Over half (52%) of the CFOs of major private companies in Russia are convinced that the Russian economy will take a positive turn in the next 12 months. This is the finding of a survey conducted by Ernst & Young and the Independent Directors Association.

The study, “Reserved Optimism in a Challenging Time”, surveyed fifty-seven CFOs of Russian companies in seven sectors of the economy who are in the Finance-500 rating list.

The study was performed to obtain data on the impact that the economic crisis is having on Russian companies as well as information on anti-crisis strategies and the measures that companies are taking to minimize external and internal risks.

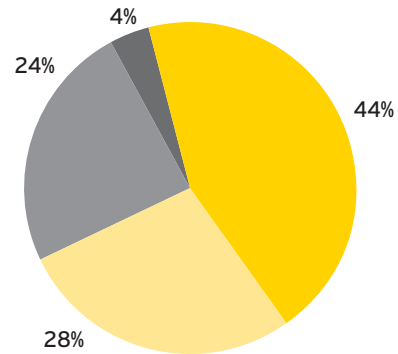
“Our survey indicated that, despite a number of adverse factors in the current situation, CFOs are optimistic about the Russian economy and expect the first signs of recovery sometime next year”, said Karl Johansson, Managing Partner, Ernst & Young (CIS). “This optimism is very important for supporting economic activity and the companies’ readiness to seize new opportunities when the market begins the next growth cycle”.

“We think Russian companies should take a look at this study’s findings, because it demonstrates effective management in a crisis and illustrates anti-crisis strategy”, said Alexander Ivlev, Partner and CIS Accounts and Industries Leader with Ernst & Young. “Many companies are actively reviewing their business strategies and finding a variety of ways to improve their performance by means of cost cutting, restructuring, outsourcing and risk management”.

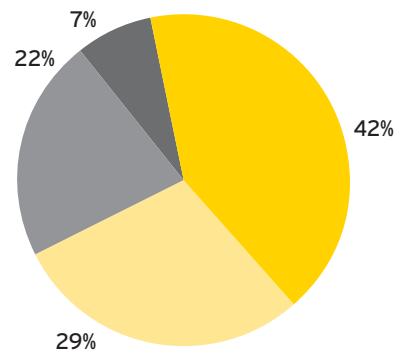
“The results of the survey are helpful in understanding the prospects for Russia’s economic development,” said Alexander Filatov, Executive Director, Independent Directors Association (IDA). “Quite notable, we believe, is the favorable assessment by companies of their ability to raise external financing for investment projects at present, as expressed by 52% of the participants. We share this optimism, because we see that Russia’s economy offers opportunities and that corporate governance and independent directors will be the drivers in building the investors’ confidence in the Russian market”.

Key findings

- The first half of 2008 prevented the crisis from dramatically impacting the year’s financial results. Only 11% of the companies finished last year with a loss. In the latter 6 months, however, over half (56%) of the major Russian companies cut production, and 58% witnessed falling sales.

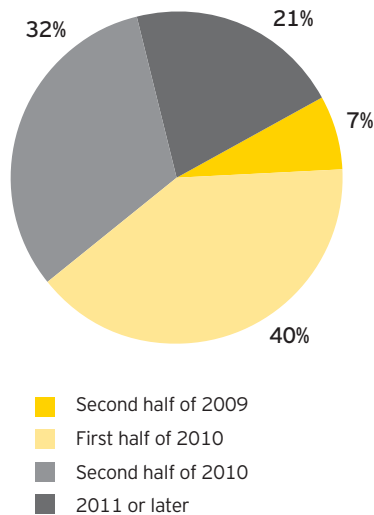


- No reduction in output
- Reduction by less than 25%
- Reduction by 25-50%
- Reduction by over 50%

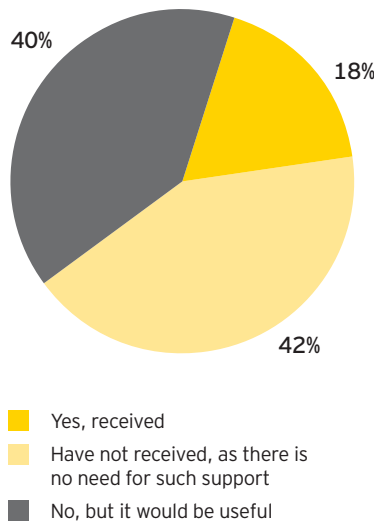


- No reduction in sales
- Reduction by less than 25%
- Reduction by 25-50%
- Reduction by over 50%

- The current difficulties have not shaken the respondents’ reserved optimism about the future. Over 40% expect that the Russian economy will begin to grow as early as in the first half of 2010. Noteworthy is the significant difference between the forecasts of companies with state participation and private companies. Most CFOs of private companies expect the situation to improve in the near future, and only 14% do not expect an economic upturn before 2011, while that pessimistic view is shared by 42% of companies with state participation.



- Respondents were unanimous in the belief that the oil & gas sector will be the driving force to pull the Russian economy out of the crisis.
- Fifty-eight percent of the respondents said they would welcome financial support from the government. Over half of the companies with state participation that needed government support have already received it. This explains why 42% of the companies with state participation describe government support as adequate and timely, noting that the government is making every possible and necessary effort in the current environment.



- Declining consumer demand is viewed by CFOs as a major external risk, with 53% of the respondents regarding it as the most significant of all. Inability to forecast future developments ranked internal risk No. 1 (44%). As a result, most Russian companies (93%) have either already revised or will revise their strategies for 2009.

- Cost cutting (95% of the respondents point out the increasing importance of cost reduction), cash flow control (89%) and risk management (65%) now rank as top priorities. The management of customer and partner relations (53%) and restructuring (43%) have gained significantly in importance. According to 70% of the respondents, the current financing structure is the main weakness.



- As a result of strategy revision and cost minimization, over half of the companies (53%) have cut personnel. On average, these companies terminated 10.7% of their employees and plan to cut staff by another 11.6% in the next 12 months. Companies have significantly cut back on bonuses: 35% of the survey participants discontinued their incentive programs and year-end bonuses. Fifty-six percent of the companies do not plan to pay dividends. However, nearly half of the companies (48%) have not cut back on compensation packages for senior management.
- In spite of the challenges and problems described above, 52% of CFOs favorably assess their companies' ability to raise external financing for investment projects at present (100% before the crisis began).

The full text of the Report is available at www.nand.ru, **Section Analysis**

RECESSION TO CLEANSE CORPORATE GOVERNANCE



**Felix Blinov, CEO
Rosvagonmash
Investment Group**

In times of increased business activity and expansion amid favorable market conditions, many companies placed special emphasis on building their corporate governance processes, inviting independent directors to their boards, including well-known international managers, and complying with other corporate governance procedures.

In the current environment, corporate governance, however effective it may be, is not a cure-all solution. Companies with established corporate governance practice need to comprehensively redesign it along with overhauling business in the new market context.

It is useless to blindly follow formal procedures of corporate governance, especially where such procedures were initially designed to prepare for an IPO, raise financing and enter international financial markets; these initiatives have been postponed to better times. If the goals underlying the creation of the corporate governance framework have been successfully attained, the work of the board of directors still needs to be redirected towards new goals in the current environment.

The crisis has uncovered a number of gaps in corporate governance, preventing companies from standing on firm ground today. Properly approached, these gaps may be eliminated fast enough. I believe the following aspects should be addressed:

1. Greater involvement of the board of directors in a company's actual state of affairs;
2. A review of whether the board members are the right people to achieve the goals set before the board;
3. Prompt decision-making;
4. Account taken of the interests of staff at all levels;
5. A change in the attitude to a company's openness.

Involvement in a company's actual state of affairs

To ensure that shareholders understand the situation in their company without directly participating in the management process, it is necessary first and foremost to improve the quality and organization of work of the board of directors.

As our experience suggests, in order to support and promote the company's business in the current environment, the board of directors must get involved more deeply in business issues. This will enable the board to make well-considered and good decisions, helping improve the efficiency of corporate governance in the current economic climate. I believe the quality and efficiency of the work of the board of directors can be enhanced along four main lines.

First of all, the board of directors must really work and not just pretend to do so. In one of our companies, we met five times this year merely to discuss and approve the budget before coming to a consistent and well-considered decision. But making a decision is just half the battle. So we began to monitor our budget targets on an ongoing basis to see whether we were achieving our objectives or, if not, to promptly decide on appropriate measures to remedy the situation. In my opinion, monitoring performance on an ongoing basis, including reporting to the board, is a good tool to keep track of things. It is quite common, however, for the actual state of affairs to be hidden from shareholders by numerous formal reports prepared to conduct another board meeting only. Therefore, it is imperative for both senior executives and shareholders to focus on monitoring key operational, financial and marketing indicators illustrating the company's performance.

Second, it is desirable to establish board committees to oversee the specific aspects of business and make recommendations to the board on key issues. This will ensure a more comprehensive analysis of the current issues. The inclusion of industry experts with an in-depth knowledge of the company's business can help improve the quality of such recommendations. Board committees often raise the most essential issues which are indiscernible from the top of the corporate governance structure. A joint discussion of key issues helps strike the right balance between the interests of shareholders and the company itself.

Third, the direct involvement of board members in the company's operations will be advantageous. However easy, central decisions are often wrong when made thousands of miles away from such operations. Therefore, simply holding a board meeting locally, i.e. at the plant in question, can give many board members a true picture of the situation.

Fourth, measures proposed at board meetings must not be harsh and rash. Some companies rush to cut down on investment or freeze their investment projects altogether. To begin with, we believe investments should be divided into the following types:

- Committed investments, where the owners of a company are committed to the government to make;
- Transient investments, which relate to nearly finished projects requiring a little more effort before they start to pay off;
- New investments;
- Long-term capital investments.

In my opinion, it is reasonable to suspend the latter two types and to consider the feasibility and economic advantage of cutting down on committed and transient investments.

Right people for the right goals

I believe it is crucial for the board of directors to be composed of the right people to assume the responsibility for corporate governance.

Frequently, inaction or inefficiency of the board is directly related to its composition. People serving on the board may not be quite ready to tackle the issues assigned by the owners or expected by the management to be resolved. Seeking to create an attractive profile to potential investors, organizations may offer board positions to notable persons who do not have enough time or simply do not wish to understand the company's affairs. While this could have been necessary when preparing for an IPO, it is more reasonable now to choose a person who knows the art of crisis management and has the right experience and skills to effectively help your company.

The work of government officials on the boards of directors tends to be formal. Typically, these people do not delve into business issues. As an owner, the government supervises rather than manages operations and does not always understand important market trends and demands. It is good for the government when the company grows. Government officials should be interested in a company's success, but unfortunately this is not always the case. I believe that instead of simply being listed on the board, it would be more reasonable for the government to place assets in trust, where for a certain fee the trust managers will be interested in the company's business development.

Prompt decision-making

Другой насущной проблемой эффективного корпоративного управления сегодня становится скорость принятия решений советом директоров компании. Если до кризиса совет директоров мог позволить себе запланировать график встреч на год вперед, то сегодня этот орган управления вынужден работать в постоянно меняющихся условиях и оперативно реагировать на изменения ситуации. Планы управленцев подвергаются корректировке, как минимум, каждые 2-3 месяца. Поэтому для создания качественной системы управления компании необходимо обращать особое внимание на повышение мобильности и оперативности органов управления.

Account taken of the interests of staff at all levels

The fourth important aspect is the ability to take account of the interests of staff at all levels. A company is composed of not simply owners, the board of directors and management. It also has people. Extensive media coverage has been given to a number of situations vividly illustrating the inability of the management of certain companies to effectively communicate with employees and the inability of the boards of directors to adequately control the management. In the current economic environment, such inability is absolutely inadmissible.

I believe tough times are just the right moment for the trust to build up (unless it already exists) as the basis for relations among all participants in the business process.

For instance, we discussed the possibility of reducing staff by 10% at one of our meetings. But the management strongly opposed this measure, proposing instead to cut the salaries of all employees, including the company's management, and thus keep the resources for carrying on core activity as well as the staff.

Another example of the management's responsibility is our plant, where the board directors chose not to be paid year-end bonuses in view of the current situation and the possible future threats, although they were entitled to the bonuses, as the plant closed the year with a positive result.

To summarize the above, all participants in the management process should be able to reach a consensus in the current environment. Disregarding the interests of any party may result in serious economic consequences.

Openness of information

ΠLast but not least, the attitude to a company's openness should be changed. Before the crisis, many companies regarded publicity simply as a means of raising funds and an indispensable condition for public listing. In Russia, openness has been transformed from an effective way of enhancing the quality of corporate governance to an image attribute and formal compliance with international standards.

Cut off from the usual sources of financing, companies must seek other ways to raise capital. As a result, the openness of information showing the real situation in a company is now a key requirement. Private equity funds have recently become an important source of financing. Investing capital, they begin to work on increasing a company's value. Investment coupled with effort ensures that both the management's responsibility and the company's transparency improve, thereby sharply reducing the risk of loss of investment. Therefore, private equity funds not only invest in the expansion of business, but also help companies build highly efficient corporate governance frameworks.

Ultimately, corporate governance is an effective tool to do business. And just as any other tool, it should be handled intelligently, instead of simply following a limited number of initial templates of business processes. Depending on the relations between the management and shareholders, sometimes it may be reasonable to increase the frequency of board meetings and adopt stricter reporting rules or, conversely, give more discretion to the management.

Liability of Management in Times of the Crisis



Yuri Ganus,
Managing Partner
Tomorrow Business
Laboratorium LLC

The crisis urged businesses to revisit sustainability of actions taken by management, board members and shareholders and reassess the impact of such actions on operating performance.

We are not going to speculate on miscalculated macro-economic risks as a key contributor to the crisis not just for separate businesses but for economies in general. Up until recently, risk-based strategic planning has been a formality for any business plan – not only in Russia but, evidently, in any other country around the globe.

In this article we review the following three key factors pushing Russian companies to the brink of collapse:

1. Insufficiency of key competencies, lack of prudence and due care on part of company executives in conducting business.
2. Willful misconduct on part of company executives, board members, shareholders and stakeholders to further their personal interests that pushes the company to the brink of bankruptcy.
3. Willful misconduct on part of those charged with governance¹ with the intent to push the company to the brink of bankruptcy.

Liability of those charged with governance lies at the root of each of the above three factors.

Among key challenges of corporate governance in Russia is establishing an effective system of checks and balances to ensure due care on part of shareholders, board members and management in exercising their crucial governance and control powers and precluding abuse of such

¹ For the purposes of this article, 'those charged with governance' means the persons having powers to give instructions, which are binding on the company's employees; such persons include management, members of the Board of Directors (Supervisory Council), persons performing functions of a temporary sole executive body, members of a collegiate executive body, members of a temporary collegiate executive body, an entity or an individual acting as a management company in relation to a given company, representatives of public institutions sitting on the Board of Directors and controlling shareholders who are actively involved in the management of the company.

powers. In times of the crisis, a good balance of across-the-board responsibilities is needed to ensure sustainability of businesses and stable development of domestic corporate governance practices.

A major challenge to practical application of legal principles governing liability of key management personnel is finding a 'happy medium' between an acceptable level of business risk - failing which no efficient operations are possible – and an excessive level of risk, i.e. when any act or failure to act on part of management causes damage to the company's business and is qualified as an *actus reus* (guilty act).

We have herein systemized the existing types and forms of liability of key management personnel having powers to administer the estate of the company in order to determine the areas of their competence and liability.

Elements of management liability

Sole executive bodies – Russian specifics

In considering a sole executive body, attention should be directed to establishing a person performing such functions and having powers to give binding instructions. The need to apply such an approach is dictated by specifics of Russian corporate governance practices, existence of nominal and real directors as well as shareholders having the powers and ability to give binding instructions or otherwise direct the company's activities. Russian law envisages joint liability for all obligations of an insolvent debtor. For a person to be held liable, it is necessary to prove that it had the powers to give instructions to the insolvent debtor.

Nowadays in Russia it is quite typical for one shareholder (or a small group of shareholders) to be actively involved in the management of their company's business not just by establishing management bodies but through exercising a formal - or informal - control over the activities of such bodies. Given the increased risk of encumbrance over the portion of the company's assets controlled by such shareholders, such approach results in the enhanced level of internal and external liability of shareholders for any decisions they take.

Against the backdrop of immature corporate governance environment in Russia, the growing trend towards assigning management powers from shareholders who are actively involved in the management process to a team of professional executives who do not own any stock or shares in the company they manage has not only resulted in conflicts among management, board members and shareholders, but provoked abuse on part of the hired executives. A special focus should be placed on developing a standard set of duties and responsibilities of a person

performing the functions of a sole executive body of the company, since it is the one who conducts current operations and is entitled to act on behalf of the company without a power of attorney in representing its interests, executing transactions on its behalf, issuing orders and giving instructions which are binding on the entire staff (the JSC Law, Article 69.2.3).

Business liability of a company executive

Liability of a company executive is established in a number of branches of law:

- **Civil Law** – an executive shall be liable to general public for any damage sustained by general public as a result of a guilty act (failure to act) on part of such executive (the JSC Law, Article 71; the Civil Code, Article 15)
- **Criminal Law** – liability for deliberate bankruptcy (the Criminal Code, Article 196) and a persistent decline to provide information containing details of an issuer, the issuer's financial and economic activities and securities, deals and other transactions in securities on part of the person having the duty to provide this information to an investor or a controlling body or the provision of deliberately incomplete or false information, if these actions have inflicted a large-scale damage on citizens, organizations or the state (the Criminal Code, Part 1, Article 185)
- **Administrative Law** – liability for engaging in transactions and committing other actions by a person exercising managerial functions in an organization which go beyond the limits of his authority (the Code of Administrative Offences, Article 14.22)
- **Labor Law** – imposition of disciplinary sanctions on a chief executive officer for failure to fulfill or improper fulfillment of the assigned employment duties through his own fault (the Labor Code, Article 192).

Various branches of law prescribe both remedial and punitive measures in response to misconduct by a company executive. For instance, if a company has sustained damages as a result of actions committed by its executive, the latter may be held liable not only for a civil offence (the JSC Law, Article 71; the Civil Code, Article 15), but also for an administrative and labor offence. In addition, Article 14.21 of the Code of Administrative Offences provides liability for improper management of a legal entity, that is, the use of management powers contrary to the legitimate interests of the legal entity which has resulted in the decrease of equity and/or damages. Besides, disciplinary sanctions may be imposed on a company executive in accordance with Article 192 of the Labor Code. However, no matter of what nature a punishment may be, the most important for a business entity would be remediation of damages incurred due to actions taken by such executive.

In determining the scope of liability for a sole executive body, consideration should be given to a legal status of its various forms as well as to specifics of individual branches of law - e.g. special legal treatment of a management company as a sole executive body of a managed company (the JSC Law, Article 69.1.3), whereby a management company, as such, may only be held liable for a civil offence and may not be held liable for a criminal offence since it is a legal entity. Criminal liability may only be imposed upon the management company personnel (the Criminal Code, Article 19).

Besides, pursuant to the Labor Code, the Articles of Association and internal regulations of the company, the Board of Directors may impose disciplinary liability upon a company executive. Similar violation, however, on part of a board member may not give rise to disciplinary liability since board members are not company employees (the Labor Code, Part 1, Articles 20 and 192).

A company executive (a sole executive body), being one of the responsible persons charged with governance, establishes a corporate responsibility framework also covering a group of entities involved in corporate relations (a company itself, its owners, shareholders, a public institution having a special right to participate in the management of the company, a trustee of shares in the company) as well as persons having an indirect impact on the management of the company, including members of the check-up committee, liquidation commission and counting board, an auditor and company members, representatives of a public institution sitting on the company's check-up committee and counting board.

A primary focus in developing a framework for relations with a company executive should be placed on unity and diversity of major types of liability attributable to executives.

In analyzing various phases within a company's lifecycle to determine meaningful sources of liability for its executive, attention should be first of all directed to the executives' personal liability for the decisions they make.

Liability of a company executive depending on severity of unfavorable outcome and nature of guilt

Depending on the nature of guilt and severity of unfavorable outcome, a company executive may be subject to the following two types of liability:

- Moral punishment: a reprimand (labor law), disqualification (administrative law), imprisonment (criminal law)
- Pecuniary punishment: a fine (criminal and administrative law), damages (civil law).

Liability of a company executive within the scope of granted authority

A company executive is liable for any actions committed both within and beyond the limits of granted authority. For a company executive to be held liable, a review should be conducted into (i) whether or not such executive acted within the scope of granted authority and with malicious intent; (ii) whether damages were caused by inadvertence; and (iii) whether, in exercising the authority vested in his office, the executive acted to the benefit of the company.

Liability of a company executive depending on a source of such liability

Liability of a company executive may be divided into contractual liability arising from a breach of a civil contract or employment agreement and non-contractual liability, which is envisaged by civil, administrative and criminal law.

Material civil liability as an instrument of remedial function of civil law should open a discussion on business liability of company executives.

Material civil liability of a company executive

Material civil liability of company executives is regulated by the Civil Code, Federal Law No. 208-FZ of 26 December 1995, On Joint Stock Companies, Federal Law No. 14-FZ of 8 December 1998 (the "JSC Law"), *On Limited Liability Companies* (the "LLC Law"). Pursuant to Article 71 of Law No. 208-FZ and Article 44 of Law No. 14-FZ, a person charged with governance shall be liable to the company for any damages sustained by the company as a result of his guilty action (failure to act), unless otherwise established by federal laws.

The following shall form the basis for imposing civil liability:

1. Misconduct
2. Damages or losses sustained by the company
3. Causal relation between misconduct and damages
4. Guilt

Misconduct is an act violating imperative norms of law (the JSC Law) or the terms and conditions of a contract (e.g. non-compliance by an executive with the decisions of the General Shareholders' Meeting; acting outside competence limits).

A failure to act may also constitute misconduct on part of a company executive (the JSC Law, Article 71.2) provided that it is proved that no damage would have been sustained had the executive taken the necessary actions.

From the example below it appears that establishing and proving the fact of misconduct on part of a company executive is really a difficult task.

Example 1

Vysokiye Tekhnologii JSC filed a lawsuit against Parket Trading House LLC² claiming invalidity of the contract for the sale of a manufacturing facility entered into by and between Vysokiye Tekhnologii JSC, as represented by its Receiver V.S. Zimin³ (the “Seller”), and Parket Trading House LLC, as represented by its Director (the “Purchaser”), and unwinding the sale transaction resulting from a malicious agreement between the representatives of the Parties.

Pursuant to Article 179.1 of the Civil Code of the Russian Federation, a transaction concluded under the influence of fraud, coercion, intimidation or a malicious agreement of the representatives of the parties, may be declared invalid by a court at the suit of the affected party. In considering this case, the court found no grounds for upholding the suit, since the plaintiff failed to prove malicious intent in the disputable transaction

Regardless of any indicators of misconduct on part of either Party, the court requires justifiable evidence supporting the fact of violation of law or breach of legitimate terms of the contract, including those which, though not being expressly addressed by law, are not in conflict with the spirit and letter of civil law.

Damages and losses sustained by the company

The assessment of actual damages and loss of profit referred to in Article 15.2.1 of the Civil Code shall constitute evidence of the fact that the company has sustained damages and losses (the JSC Law, Article 71.2.1):

- actual damages mean expenses which an affected party has incurred or will have to incur in order to restore a violated right or compensate any loss or damage to its property (losses due to a decrease in the company's equity, additional investments or borrowings raised, a decision – expressed in value terms – regarding the issuance of additional capital and sale of property to restore creditworthiness and pay off outstanding debt)
- loss of profit means the profit that the company could have made had its right not been violated through disposal of property.

The example below illustrates the imposition of civil liability on a company executive.

Example 2

T.V. Vakhnina holding one third of the charter capital of Deso LLC⁴ (hereinafter, the “Company”) filed a lawsuit with an arbitration court against the Company claiming invalidity of orders Nos. 08, 18, 41 and 45 issued by B.G. Nevorotov, the Company Director, on 21 March 2005, 12 April 2005, 27 July 2005 and 19 August 2005, respectively, and seeking compensation of actual damages in favor of the Company in the amount of RUR 2,880,616. 23.

The plaintiff asserted that the orders to pay bonuses had been illegal and that the respondent, having paid a bonus to himself, had misappropriated cash funds in the amount of RUR 2,506,136, which affected the Company's net profits and caused damages both to the Company and to the plaintiff being a shareholder of the Company.

In accordance with Minutes No. 2/04 of the General Shareholders' Meeting of the Company dated 13 January 2004, the timing and the amount of bonus and other additional payments on top of salary shall be subject to approval by the Company shareholders. The case file does not contain evidence that the above orders had been approved by the Company shareholders.

The court concluded that, in acting as the Director, the latter violated the limits of his authority and obtained no consent of the Company shareholders to issue such orders, he violated Articles 40 and 33 of the LLC Law. Therefore, the cash funds received by B.G. Nevorotov should be classified as the Company's losses and the Director should compensate the Company for such losses in accordance with Article 15 of the Civil Code and Article 44 of the LLC Law. The court rendered invalid the orders issued by the Company's Director and awarded damages in the amount of RUR 2,506,136.23 payable by B.G. Nevorotov in favor of the Company.

In upholding the claims of the plaintiff, the court acted in accordance with Article 43.3 of the LLC Law, whereby a decision of the sole executive body of the company (director) which has been adopted in violation of the LLC Law, other legal acts of the Russian Federation and the company's Articles of Association and which violates the rights and legitimate interests of a shareholder in the company may be invalidated upon a petition of that shareholder.

² Determination No. 17473/07 of the Supreme Arbitration Court of the Russian Federation on Case No. A55-5218/2006

³ In accordance with the Ruling of the Arbitration Court of 23 December 2002 on Case No. A72-4867/02-Kh320-B, Vysokiye Tekhnologii CJSC was declared insolvent (bankrupt) and entered into receivership.

⁴ Ruling of the Federal Arbitration Court for the West Siberian Region No. F04-6767/2008 (15436-A46-16) of 11 November 2008.

The above case falls within the executive jurisdiction of the arbitration court, as the plaintiff, rather than asserting violation of labor law, claimed that the Company had sustained damages resulting from misappropriation of corporate funds on part of its Director. Pursuant to Article 40.4 of the LLC Law, the rules governing the activities of the director of a company are established by the company's Articles of Association, internal documents of the company and the agreement entered into by and between the company and the director (a person performing the functions of a sole executive body).

A company or its shareholder are entitled to file a lawsuit claiming damages from a member of its board of directors (supervisory council), sole executive body, a member of its collegiate executive body or a person charged with governance (Article 44.5 of the LLC Law).

The following may constitute evidence of damages suffered by the company: res judicata court judgments invalidating the transactions entered by its director and the resolutions of the shareholders' meetings; valuation reports on assets, which have been deliberately sold below their market value; the company's financial statements (losses reported on the balance sheet); court decisions to initiate bankruptcy proceedings against the company; creditor claims against the company resulting from failure by the company to meet its liabilities due to insolvency; court rulings to collect money owed by the company; evidence to prove that the company has taken actions (e.g. entered into loan arrangements) to restore its creditworthiness and pay off the outstanding debts, etc.

Causal relation between misconduct and damages becomes an element of civil liability of a company executive provided that misconduct on part of such executive has led to a real outcome or has created the requisite environment for such outcome to happen. In assessing available evidence, the courts analyze whether there is a causal relation between the guilty actions on part of a company executive and their outcome.

Guilt is considered to be a prerequisite of civil liability (the JSC Law, Article 71.2.1). A company failing to meet its obligations will in any event be liable to its counterparty, regardless of guilt. Note, however, that a company executive will be held liable for entering into a deal, which has resulted in losses suffered by the company, only to the extent that such an executive is guilty (i.e. where he has not used his best efforts to prevent any unfavorable outcome of his actions).

The guilt of a company executive may be twofold: intentional (ill motive) and unintentional (carelessness). There is also a mixed form of guilt, where a failure to act or improper performance of duties on part of a company

executive has occurred through the fault of both the executive and the company, thus changing the scope of civil liability and reducing the extent of the executive's liability (Article 404.1 of the Civil Code). Specifically, a company suffers shared damages when a corresponding decision was made by a board of directors on a collegiate basis.

Below is an example illustrating a systemic approach to civil liability.

Example 3

State Corporation "Agency for Deposits Insurance", acting as the Receiver of Mosobinvestbank LLC (the "Bank"), filed a lawsuit with the Moscow Arbitration Court claiming the imposition of joint liability for the Bank's debts upon persons who previously held office of Chairman of the Bank's Management Board and upon former First Deputy Chairman of the Bank's Management Board.

The lawsuit was initiated in accordance with Article 14 of Federal Law, On Insolvency (Bankruptcy) of Credit Institutions, whereby the bankruptcy of a credit institution shall be deemed to have occurred through the fault of its managers having the right to give instructions which are binding on the credit institution or being otherwise able to determine its actions if it is established by an arbitration court that those persons were giving instructions which were directly or indirectly aimed at bringing about the bankruptcy of the credit institution, or if a court establishes that those persons failed to take actions which they were obliged to take in accordance with Federal Law, On Insolvency (Bankruptcy) of Credit Institutions, in order to prevent the bankruptcy of the credit institution.

The plaintiff alleged that the defendants failed to take preventive actions from 1 July, 2004 to 14 July 2006 which were required to prevent bankruptcy when the Bank was showing the signs of bankruptcy and there existed grounds for taking such preventive actions, as provided in Article 4.2.2 of Federal Law, On Insolvency (Bankruptcy) of Credit Institutions. In the plaintiff's opinion, failure to take the actions referred to in Article 11 of the above Federal Law was indicative of the above persons' guilt in respect of the Bank's bankruptcy.

Besides, the plaintiff charged the defendants (V.I. Simonyan and G.I. Kaliberde) with lack of due care in issuing loans from 1 October 2005 to 1 February 2006 which were never repaid, thus resulting in significant deterioration of the Bank's financial standing. According to the plaintiff, the borrowers were not present at the place of registration, had no founders or managers, and were not engaged in any business.

The above allegations, however, were not supported by any evidence in the case file (according to the case file, the borrowers were registered in 2004). The plaintiff failed to demonstrate that the above legal entities had 'phantom' executives and, following the audit, no evidence was obtained to prove that these entities were not filing tax returns. The legal addresses, which were used for registration of the above entities, are not a mass registration address.

Additionally, the court indicated that an actual place of business of a legal entity may be different to its official registration address stated in the constituent documents, such inconsistency not being construed as a violation.

To establish the guilt of the accused and impose joint liability upon company officials in accordance with Article 14.1 of Federal Law, On Insolvency (Bankruptcy) of Credit Institutions, the court needs to satisfy itself that the above persons were giving instructions which were directly aimed at bringing about the bankruptcy of the credit institution.

Based on the case file evidence relating to former chairmen of the Bank's Management Board (T.A. Romashchenko and V.I. Simonyan) and former First Deputy Chairman of the Bank's Management Board (G.I. Kaliberdy), the court found that:

- there was no sufficient evidence to support non-recoverability of the loans, which had been designated by the plaintiff as bad loans;*
- during the period of time stated above, there were no grounds for taking actions to prevent the Bank's bankruptcy referred to by the plaintiff;*
- the plaintiff failed to prove the defendants' guilt in relation to disposal of liquid assets and lack of due care in issuing loans which were never repaid, thus resulting in deterioration of the Bank's financial standing;*
- there was no causal relation between the actions of the above defendants and the Bank's bankruptcy occurring at a later stage; the plaintiff failed to name which specific actions on part of the defendants could determine the activities of the Bank, which specific instructions they were giving or which preventive actions they should have taken and failed to take to prevent the bankruptcy.*

The plaintiff failed to present any specific evidence to prove that actions (failure to act) on part of the defendants had resulted in the Bank's bankruptcy and, therefore, the plaintiff failed to prove the circumstances which were meaningful for the case.

Note that in its Ruling on Case No. A40-47940/07-103-141 issued on 24 October 2008 the Moscow Arbitration Court qualified the actions on part of F.V. ogly Mamedov as a deliberate attempt to bring about the bankruptcy of the Bank, although the court took into account the witness testimony of the Bank's Chief Accountant (I.Yu. Ilyin) and the record of criminal case No. 140494 against F.V. ogly Mamedov and I.M. Mirzakhanov on charge of offence under Article 196 of the Criminal Code of the Russian Federation.

The appellate court, therefore, denied the motion filed by State Corporation "Agency for Deposits Insurance", acting as the Receiver of Mosobinvestbank LLC Mosobinvestbank LLC, and affirmed Ruling of the Moscow Arbitration Court on Case No. A40-47940/07-103-141 issued on 24 October 2008.

This is a stark example of a failed attempt of appeal, whereby despite the existence of meaningful facts which one would think should be sufficient to prove criminal nature of actions on part of the Bank's executives, the court denied a motion for appeal filed by Mosobinvestbank LLC as the plaintiff neither presented requisite evidence of guilty actions on part of the defendants leading to the Bank's bankruptcy, nor proved the causal relation between the defendants' actions and the subsequent bankruptcy of the Bank.

Consequently, the imposition of civil liability upon a company executive would be possible only to the extent that all of the above conditions are met. If a company is managed by several executives, these will be jointly liable to the company (the JSC Law, Article 71.2).

In determining the subject of proof, it should be noted that the burden of proof of good faith, reasonable and customary behavior lies with a company executive (the Civil Code, Article 401.1). The lawmakers, however, specifically indicate that where the law makes the protection of civil rights dependent on whether or not those rights have been exercised reasonably and in good faith, the reasonableness of the actions and good faith of the parties in civil relations shall be assumed (the Civil Code, Article 10.3). Therefore, considering that a company executive is obliged to apply a reasonable and good faith approach in exercising his rights and performing his duties, it could be assumed that according to Russian law the burden to prove the guilt of a company executive lies with a person claiming the corresponding behavior on part of such executive.

To be continued in the next issue.

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