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HOW TO CREATE AN EFFICIENT BOARD OF DIRECTORS?



Interview with Dr Neville Bain Chairman of the IoD London

Alexander Filatov, CEO of IDA, interviewed Neville Bain on a recent trip to Moscow. This was a precursor to the cooperation between the IDA and of the IoD.

You are chairman of the IoD, can you tell us a little about your role?

The IoD serves almost 53,000 members most of whom are in the UK. The Institute exists for its members and we provide for their needs. I am part time chairman and lead the board and the council.

The running of the Institute is down

to the Director General and his Chief Operating Officer. My focus is therefore as follows:

- To provide leadership to the Council and the Board
- To ensure that there is a focus on services to our members
- To champion continuing development of our members and in particular to lend support to the important chartered director programme
- To help develop links between the IoD and overseas partners that share our aims and our values

What are the services that your members benefit from?

Perhaps the most important is the facilities we have in our flagship Pall Mall premises in London and also in major cities in the UK. This allows directors to free use of working space and access to dining facilities. We have an outstanding research department that will answer members' queries from general enquiries to tax, legal and labour laws. Other services include IoD credit cards, insurance, and special events where members can entertain their guests.

I know you are very keen on providing programmes for director development because you and the Institute see great merit in continuing education. Can you tell me about the scope of these courses, and which ones you feel are of most value?

We think that continuing education for directors is key to their ability to effectiveness in their role. We are talking of company directors in the commercial sector and those that operate in the “Not for Profit” sector and also in government bodies where non-executive directors are appointed. We therefore provide an array of courses from blended learning programmes for the chartered director qualification, to specific tailor made programmes for boards to improve their effectiveness, and to individual net-working sessions around presentations or seminars.

You place a lot of importance on the value of a non-executive director. How do you see them adding value?

First we need to recognise that the code of best practice in the UK recommends that 50% of a public company board be made up of independent non-executive directors. This is to meet good governance requirements, and to ensure that there is appropriate challenge and input to decision making. The breadth of experience of the non-executive director is really helpful in testing proposals put to the board.

So, the balance of the board seems to be quite important if the company is going to get the best use of it.

Yes, you are quite right. The balance on the board is a balance of non-executives and executive directors, and to ensure that there is a good balance of experience and skills to bring to board discussions.

Briefly, what do you think are the key tasks of the board?

I think that it is possible to summarise into four key tasks:

1. Establish and maintain vision, mission and values. The vision is the desired future state of the organisation and usually has inspirational qualities. The mission sets out what has to be done to achieve the vision. The values set the standards of conduct or the deeply held beliefs that permeate the company.
2. Decide the strategy and the organisational structure.
3. Delegate the authority to the management, monitor and evaluate the implementation of policies, strategies, and business plans.
4. Communicate with senior management and with the stakeholders.

Do you have any observations about Russian boards?

I am not expert on Russian boards and therefore my observations should be challenged. However, I think the role of non-executive director is just developing and the role that

IDA News

April 24, 2007. The Independent Directors Association and the UK Institute of Directors (IoD) have made an exclusive agreement in respect of launching a new training program for directors as part of joint training courses in accordance with the IoD Standards in order to obtain a UK Chartered Director Certificate. The purpose of the new joint program is to help Russian companies be in line with the international corporate governance standards. The program is designed for board members and top managers of Russian companies, which have gone through or are planning offering in London, Hong Kong and Moscow.

Commenting on this joint initiative, Andrew Spencer, IoD director for business development and training programs, said: "There is an obvious mutual dependence of corporate governance and company's success. The quality and composition of the Board of Directors is an important part of this success. Investors and stakeholders are interested in reliable corporate governance. A well-prepared Board of Directors strengthens investors' trust in the company. Both organizations have an extensive experience in trainings for boards of directors and best corporate governance

practices. IoD will be happy to continue cooperation with the IDA in Russia".

June 29 – 30, 2007. A workshop Corporate Director's Activity in a Company Offering Securities at the London Stock Exchange was held in Moscow. This was a joint project of the Independent Directors Association and the UK Institute of Directors.

More on p. 4

July 2 – 4, 2007. A 3-day workshop called Activities of Corporate Secretary and IR in the course of IPO Preparation and Subsequent Registration with a Stock Exchange was organized in London by the Independent Directors Association and the UK Institute of Directors (IoD) for Corporate Secretaries and Directors for investor relations.

The workshop received 10 participants, all heads of offices for Boards of Directors of OAO MegaFon, GK PIK, NP National Depository Center, OAO Severstal, OAO MDM Bank, RTS, etc.

they can play may not be fully exploited in every company. There is much merit in having non-executive directors from a different industry than that of the particular company, and to have directors independent of the major shareholder, chairman or CEO. I believe that more can be done to improve the effectiveness of boards through analysis of the board and a pragmatic assessment of how the board works.

Can you tell me a bit more about a board effectiveness programme?

The first thing to say is that this should be tailored to the needs of the company. Generic approaches don't deliver the greatest value. It doesn't need to be a massive exercise. The main components are:

- Analyse the skills and backgrounds of the individual directors
- Examine how the board operates
- Review the information for the board and the topics discussed over the past 12 months
- Have an understanding of the direction the company strategy is taking them and therefore what the future board requirements might be.
- Carry out a brief discussion with each of the directors
- Come to conclusions and discuss these in draft with the chairman and if appropriate with the major shareholder
- Prepare a report with an action plan.

You have authored three books, covering topics such as, strategic management, governance and utilising people effectively in organisations. I understand that you have just completed your fourth book for the IoD entitled "The Effective Director". What is the central thrust of this work?

The book is a helpful book for those studying for the chartered director programme, but also for those who want to get some ideas of how to improve their personal effectiveness. The content covers all of the legal requirements for a director in the UK, good governance and how this can add value with the minimum of process. Other important areas include utilising the talent in an organisation effectively, improving board effectiveness ethics and values. The first issues will be out at the end of September.

Thank you Neville and we look forward to a period of strong cooperation with the IoD and indeed to welcoming you back to Moscow and some of the countries in the CIS.

Speaking about the event, Oleg Tsvetkov, Corporate Secretary of OAO Severstal, said: the London workshop demonstrated once again that the idea of corporate governance in public companies is alive and timely and that the Corporate Secretary's role is very important, including in the course of public disclosure of the company's information both from the standpoint of the emerging Russian experience, and from the standpoint of the English established and constantly developing British experience. The workshop put a significant emphasis on activities of companies traded at the London Stock Exchange, issues regarding information disclosure for regulator and investor purposes, and segregation of information disclosure functions between the investor relations department and corporate secretary's office.

David Jackson, Corporate Secretary of BP p.l.c., said that in London the role of regular monitoring of Unified Code compliance is practically assigned to investors. Which makes them the basis for regulation and assessment of issuers' activities, to whom a company will be able to disclose and explain the existing discrepancies (comply or

explain principle) between the requirements set by the Listing Agency and the actual situation in the company. Corporate Secretary's functions in this process should be about gathering all of the company's information to be officially disclosed and publishing the required information in amounts agreed upon with the IR function. Typically, such agreement is achieved at the level of a special Disclosure Committee. In addition, it would be interesting to learn how public companies interact with their scattered shareholders and investors and what techniques are employed. These issues were covered in presentations prepared by a global registrar Computershare and PRP Group (Public Relations and Promotion Group) representatives.

The workshop was carried out in an interactive mode so that all participants and speakers could discuss issues arising and share their experience".

New Appointments

The Independent Directors Association congratulates the following IDA members with their appointments:

Mr. Vernikov, A.V., member of the Supervisory Board of Bankas Snoras AB (Lithuania), member of the Board of MIEL Real Estate. Appointed as member of the Board of AK Bars Bank.

Ms. Vysotskaya O.S., Partner of Deloitte & Touche CIS, – Appointed as member of the Board of

- OAO EMALians;
- OAO KIT Finans Investment Bank.

Mr. Ikonnikov, A.V., Partner of Board Solutions. Appointed as member of the Board of the National Depository Center (NDC).

Ms. Carey Sarah Collins, Chairperson of Eurasia Fund. Appointed as member of the Board of AK Bars Bank.

Mr. Rodionov, I.I., Executive Director of AIGInterros RCF Advisors, Ltd. Appointed as a new Chairman of the Board of OAO EMALians.

Mr. Rohan Gerald Joseph, Director, Energy Utilities and Mining, PricewaterhouseCoopers. Appointed as member of the Board of OGK-5.

Mr. Stolin, V.V., Chairman of the Board of Ecopsy Consulting. Appointed as member of the Board of OAO MKhK EuroChem.

Mr. Filatov, A.A., Executive Director of the Independent Directors Association. Appointed as member of the Board of OGK-2.

Mr. Shibayev, S.V., Deputy Director of Roland Berger Strategy Consultants GMBH - Moscow, CIS. Appointed as member of the Board of

- OAO EMALians;
- AK Bars Bank.

Mr. Yasin, Ye. G., Research Supervisor of the State Higher School of Economics. Appointed as member of the Board of ZAO Echo of Moscow.

The Independent Directors Association congratulates an old partner of the Association, **Ms. Popova, Anna Vasilievna**, with the appointment to the post of Deputy Minister of the Russian Ministry for Economic Development and Trade.

IDA CORPORATE DIRECTORS INSTITUTE – A STEP FORWARD!

On June 29 – 30, 2007 Moscow saw a success of Corporate Director's Activity in a Company Offering Securities at the London Stock Exchange workshop.

So, the Independent Directors Association and the UK Institute of Directors (IoD) launched a new training program for directors as part of joint training courses in accordance with the IoD Standards in order to obtain a UK Chartered Director Certificate.

The first workshop **Corporate Director's Practices in a Company Listed with the London Stock Exchange** received 16 participants, CEOs, Board members and company owners operating in different industries. As part of a two-day seminar, a special focus was made on corporate governance and its importance, roles and duties of participants in corporate governance, director's fiduciary duties, roles of Board members, risk of director's personal responsibility and legal requirements to public companies.

Addressing the workshop participants, **Alexander Filatov, IDA Executive Director**, expressed his confidence in successful implementation of Russian companies' plans regarding shares offerings in London as these companies meet high professional standards of corporate governance. He emphasized that a series of training workshops planned jointly by the UK Institute of Directors (IoD) and the Independent Directors Association (IDA) will help to organize a vigorous exchange of experience and best practices in the corporate governance of the UK and Russia and set up a basis for the enhancement of efficiency of the Russian corporate directors.

Giving evaluation to the seminar held in Moscow, **David Buckle, Senior Partner and Director for Development of the UK Institute of Directors (IoD)**, said: "It was a remarkable initiative of the Independent Directors Association. The workshop enabled all delegates to exchange the opinions and experience as to the activities of boards. Corporate scandals around Enron, Tyco, WorldCom and Parmalat in the US and Europe indicated that any company's board regardless whether the company operates domestically or internationally should particularly focus on corporate governance issues. This training course provided opportunities to share ideas regarding corporate governance systems and structures and analyze Russian, UK, and USA successful practices.

Serving as an Advisor in the UK Institute of Directors (IoD), I worked for many British and international companies. The workshop in Moscow was my first Russian

experience. I can only say that I am very impressed by the quality of the discussion covering a broad spectrum of areas, by the depth and acuteness of questions asked by the participants. The workshop showed that the present companies' executives understand the importance of the subject and are interested in finding ways to better governance in their companies.

I think Russia has arguments on corporate governance to put up to the international community. The Revision Committee e.g. can be a good contribution, as in the UK and the USA companies have no such committees. I believe sharing of ideas regarding improvement of corporate governance systems is very useful for directors, who strive to be efficient board members and helps their companies on the way to success."

The next workshop **Corporate Director's Activity in a Company Offering Securities at the London Stock Exchange** will be held in Moscow on October 26-27, 2007. The participants will be issued an international certificate upon completion of the workshop.

KAZAKHSTAN INDEPENDENT DIRECTORS ASSOCIATION OPENED



On June 8, 2007, representatives of the Independent Directors Association Russia took part in the festivities dedicated to the opening of the Kazakh Independent Directors Association (KIDA).

The invitees included: Alexander Ikonnikov, Chairman of the IDA Supervisory Board, Alexander Filatov, IDA Executive Director, Rustem Sadykov, Director of Tax and Legal KPMG Kazakhstan, Andrew Main Wilson, Executive Director of the UK Institute of Directors. The opening ceremony was hosted by Ulan Saparovich Bayzhanov, Chairman of the KIDA Board of Directors, and Rustam Zhursunov, KIDA Executive Director, who said that KIDA is an absolutely new project for

Kazakhstan. This project is capable to consolidate the directors' community and develop professional standards for independent directors. All participants of the conference were proactively involved in the discussions on the independent director's role on the board of directors as this issue is the most acute for creation of the independent directors' institute in Kazakhstan.

Speakers from KPMG Kazakhstan, Standard & Poor's, the International Financial Corporation, Board Solutions, the National Corporate Governance Board of Kazakhstan and the Independent Directors Association – Russia were given floor at the event. The Kazakh Independent Directors Association is a public association created at the initiative of major national companies of Kazakhstan, leading advisory services firms, private organizations and with support from the Independent Directors Association of the Russian Federation. KIDA is set up with the purpose to help joint-stock companies and other organizations of Kazakhstan to improve their efficiency and corporate governance level. KIDA's activities is aimed at achievement of the following objectives: unification of the corporate governance system through development of the independent directors' institution, determination independent director's role on the board of directors, solution in respect of human resource shortage, and creation of a unified register of independent directors in Kazakhstan.

KIDA has plans afoot to proactively implement best international practices regarding corporate directors' activities, create and support professional and ethical standards in the corporate directors' activities.

The Independent Directors Association of Russia is the general partner of the Kazakh Independent Directors Association. There are plans to have regular joint events to discuss and find solutions for corporate governance issues. In addition, there are plans to create a unified database on independent directors of Russia and Kazakhstan, which will enable both parties to efficiently and promptly seek highly qualified corporate directors both in Russia and in Kazakhstan.

**"WE WERE TO TAKE A NUMBER
of difficult decisions TO MAKE
THE SUCCESS COME TRUE..."**



**Jacek Gorsky,
General Director
General Motors CIS**

*The Independent Directors
Association and General Motors CIS
implement a cooperation program.
On May 27, 2007, General Motors
CIS organized an exclusive event —
Driving a Cadillac and a Hammer*

*on the Way to the Best Corporate Governance! –
for the IDA partners and members. A test-drive was
held in Sokolniki Park.*

*Jacek Gorsky, General Director of General Motors CIS,
tells about the Company's experience and corporate gover-
nance practices in Russia in his interview to the
Independent Director Magazine.*

*What was the reason of General Motors' interest
in the Russian market?*

I can identify three main factors that made Russia an appealing market for GM.

In the first place, it is the market's size and growth rates. Secondly, the stability of the Russian economy, and thirdly changes in the income levels and preferences of our customers. The income levels of Russians are growing and they are more eager to buy cars from foreign manufacturers.

*When GM planned to work in the Russian market the
Company had certain expectations. Has the reality
changed these, and if yes, what were these changes?*

Yes, an upward adjustment was made. Initially, the Company set the target to win a 10% share of the Russian market. Now GM perceives a 15% goal, as we have already made 10% of the Russian market. WE also set the target to become a leader among companies operating in Russia. GM is now a No.1 Company in Russia among foreign car manufacturers.

*What are the Russian specific factors affecting GM's
operations in the Russian market?*

Factor No.1 is the rate of the market growth. The company feels very strong influence of this factor. The Russian market grows at a uniquely fast pace. When comparing other markets with the Russian one it seems that they do not grow at all. Although, strictly speaking, this is not true. For example, European markets as opposed to the Russian market change slowly and controversially, going through booms and recessions. Due to the Russian mar-

ket our Company gets the immediate results, which are obvious straight away.

The second factor is a broad geography of the country and insufficiency of statistical data in order to make key business decisions. Often in order to make decisions one has to base himself not on facts, but on intuition, which is very untypical for us.

The third factor is a high level of bureaucratization. This gives a lot of problems and tension in the company's work. General Motors Russia has developed instructions describing procedures and specifics of how to deal with an administration. In addition, the company attracts experts to efficiently comply with the requirements set forth by the Russian authorities.

The fourth factor is human resource shortage. General Motors is growing very fast: two years ago the Russian branch employed 50 people, while now we have already 150 employees and plan to extend to 250 people and more in the nearest future.

The company attracts new employees without sufficient experience, as the professionals market in Russia is too small. However, we need to be in line with the market growth rates and effectively run our fast growing business, develop it and at the same time train our people to work in the corporate environment.

*What decisions were especially difficult to make pro-
vided the Russian environment?*

Operating in a fast growing market we have to make many decisions in the environment of limited information. One of the decisions of the kind is to what extent should be the network of dealers and distributors. We have discussed this issue long enough: how deep we should penetrate in the regions and towns of what size will ensure sufficient level of dealer's business. General Motors typically makes such decisions based on statistical information regarding demographical and social situation, which allows assessing regional markets. In Russia we find it difficult to obtain such information and the data made available to us were quite controversial and required additional research. As a result we focused our efforts on the data regarding number of inhabitants and car owners in the regions. Based on these figures, we received an integrated factor of number of car owners per one thousand of inhabitants. If the percentage of car owners is high, therefore the area's potential for GM's purposes is also high. As firstly people in this particular town have sufficient funds to purchase a car. Secondly, the majority of car owners have Russian makes and are likely to want to replace them with foreign cars in the future. This is the Russian situation, quite different from that in Western Europe.

This was the first step in the decision-making process. Having identified towns of high potential in the regions,

we have tried to obtain as much first-hand information as we could through questioning inhabitants, potential partners and dealers. We were interested in what they think about the wealth of population in the town or area, and what are their expectations regarding the development of the region, their opinions in respect of the growth potential and information on extent of dependence of the region/ town on enterprises located nearby. The decision regarding a wide-scale dealers network was very difficult for us to take, but we have made it and successfully achieved the goal. In Russian we have identified 200 towns and cities, in addition to such targets as Moscow and St. Petersburg, which are attractive from the standpoint of the regional dealers' network development. Two years ago GM had about 30 dealers, currently we have already 110, and we go on developing our dealers' network. We have plans afoot to extend the dealers' network prior to the next year-end to include 160-170 dealers.

GM plans to expand further in towns with population of 100, 000-200,000 inhabitants.

What are GM's objectives for the next three-five years?

As I have already mentioned we are challenging to obtain a 15% share of the Russian market. Also, we need to build a distribution network of operations supporting offices and manufacturing facilities. We also strive to achieve the target that Russia become a top five European country in terms of customer satisfaction. Recently, we carried out a survey among our customers to find out their attitude towards GM cars and quality of services provided by our dealers. Similar surveys were conducted in other European countries. Due to the fact that respondents were asked similar questions the survey results became comparable. Now, a No.1 country in Europe in terms of customer satisfaction is Turkey: 90% of GM manufactured car owners said that they are fully satisfied with the quality of services provided by our dealers. Satisfaction of Russian customers is not yet as high as we would want it to be. However, thanks to the survey we have a clear picture, the problems are fixed and we know what we have to do.

General Motors is a huge corporation. How are its operations planned and how are strategic decisions made?

The Board of Directors represents the top level of management at the General Motors. It consists of 13 people, out of which 12 people are independent directors. Rick Wagoner, GM CEO, is the only Board member who works in the corporation. The Board has five committees: the Audit Committee, the Information and Public Relations Committee, the Investment Funds Committee, the Remuneration Committee, and the Operational Management Committee. The Board of Directors is to fulfill two strategic tasks: appoint a CEO and participate in making strategic decisions which determine the future development of the Company.

The second level is the level of operational management represented by the Automotive Strategy Board (ASB). The Automotive Strategy Board is chaired by Rick Wagoner, GM CEO. ASB accumulates information received from the regions and works out a strategy for the Company's development.

GM's organizational structure is built on two parameters: regions and functions. GM's presence is in four regions: North America (USA, Canada and Mexico), Europe, LAAM (Latin America, Africa and Middle East), and APO (Asia and Pacific Ocean). In each region we have a Regional Strategy Board, e.g. in Europe it is the GM European Strategy Board (GM ESB). A Regional Strategy Board from each of the four regions develops a unified development strategy for the region and coordinates efforts of GM country offices located in the region. Presidents of the GM Regional Strategy Boards are members of the Automotive Strategy Board (ASB). Thus, a relationship is maintained between the regional Strategy Boards and the GM Global Strategy Board.

The next level is GM's country offices. These offices have separate committees (an audit committee, a management committee, etc.), but these are management bodies, and not committees under the Board of Directors. Therefore, from the strategic decision-making process point of view, General Motors Russia is a responsibility of the GM European Strategy Board (GM ESB). In each of the four regions of GM's presence operations are organized by functions. There are functions of Global Sales, Service and Marketing (GSSM), Manufacturing, etc. There is a leader of each of the functions. Function leaders of all four regions report to him. For instance, GM CIS, of which I am a General Director, operates in Moscow, Russia. While not far from St. Petersburg there is GM Auto Manufacturing. These two companies are different and GM Auto, i.e. its General Director, reports to the Manufacturing function. GM CIS as a function reports to GSSM. I, therefore, report to the executive director for sales, services and marketing for Central and Eastern Europe. And my colleagues from Turkey, Poland, etc. report to him too. He in turn reports to the GSSM Vice-President for Europe, responsible for the global sales, services and marketing policy in Europe. The Manufacturing Vice-President for Europe receives all information from Directors of Plants located in European countries.

In their turn Vice-Presidents for Sales, Services and Marketing (GSSM Vice-Presidents), for Manufacturing (Manufacturing Vice-Presidents) and for other functions are members of the European Strategy Board. They provide quality information exchange and communicate strategic decisions developed by the Board down their function lines.

Thank you, Jacek. We wish General Motors Russia every success and new achievements.

METHODS OF PROTECTION OF SHAREHOLDER'S RIGHTS TO UNCERTIFIED SECURITIES

Svyatoslav Abramov,
Corporate Governance Department of the Ministry
for Economic Development and Trade
Senior Advisor

The Russian market of hostile takeovers and corporate seizures is growing and developing so fast that the overall situation can be surely called "appalling". Actions of dishonest market players aimed at obtaining control over company's assets and their subsequent resale look appalling. Shares that are, under Russian laws, subject to uncertified securities circulation regime and only accounted for as entries on accounts represent an ideal weapon in hands of corporate aggressors.

The logic of further course of events suggests that such "challenge" needs to be addressed with an adequate "response". Therefore, issues regarding prevention and settlement of corporate conflicts and suppression of such dishonest corporate takeovers, increased guarantees for shareholders in respect of protection of their rights constitute priority areas for the Russian Ministry for Economic Development and Trade to develop as part of work aimed at improvement of the Russian corporate legislation.¹

The logic of further course of events suggests that such "challenge" needs to be addressed with an adequate "response". Therefore, issues regarding prevention and settlement of corporate conflicts and suppression of such dishonest corporate takeovers, increased guarantees for shareholders in respect of protection of their rights constitute priority areas for the Russian Ministry for Economic Development and Trade to develop as part of work aimed at improvement of the Russian corporate legislation.

Currently, the Russian civil law envisages eventually only two methods to protect rights of a shareholder in connection with his lost of uncertified securities: either a return "in kind" of lost uncertified securities ("restoration" or

"conditionally vindication"¹ mechanism), or receipt of compensation for the lost shares ("compensation" mechanism). The specifics of relations in respect of uncertified securities ownership enable to deduce that the law and law-enforcement practice by default allow situation of so called "competition of claims", two requirements totally opposite to one another by nature, which is intolerable in case of protection of solely proprietary rights or solely rights of obligation. In particular, in a number of similar cases heard at courts in respect of thefts of Gazprom shares made by employees Korona Plus, a deposit and trust company, shareholders put up claims requiring both reimbursement for the losses incurred and requirements to restore entries confirming that shares are owned by the claimant².

At any rate, the above "alternatives" do not contradict to the economic component of the relations under our review, moreover, it is implied. The point is not only about the difficulty in determining the cost of a stake in a certain period of time, which is due to the stock market volatility. Thus, the analysis of law-enforcement practices over the past years carried out by D.I. Stepanov revealed a certain consistency: The likelihood that a complainant will claim reimbursement for losses incurred ("compensation" mechanism) is the higher the more liquid and replaceable are the shares traded in the market, and the less control powers allowed by the shares under argument. On the contrary, if the stake under argument is most valued by the shareholder due to its control powers, while its liquidity is low, the shareholder is likelier to strive to get these shares "in kind" ("restoration" mechanism), although this could mean significant time and financial expenses.³

Of course, this rule (just like any other rule) has exceptions, which do not affect the general picture, though. The consistent relationship identified should be definitely taken into account when building new legal models of protection methods or improving the existing ones. At the same time, the issue of what protection method should be selected is not really about the legal area, but rather about economics. The history of legal institutions is a good example of this: from an unrivaled domination to the protection of an actual owner, from the ancient Roman principle "there, where I found a thing, I vindicate" to the

¹ Vindication (vindication claim) is a method of protection of a proprietary right in civil law with the help of which an owner may claim for return of its property from illegal ownership. This form of claim was established as long as in the Roman law. An owner may vindicate its property from mala fide and bona fide buyer (if the property is acquired on a gratis basis) regardless of the way the owner lost proprietary rights on it. It can be vindicated from a bona fide buyer which acquired the property on a gratis basis exceptionally if it was lost by the owner or a person whom the owner vested it (for example, temporary use), stolen from any of them, or withdrawn by any other way without their wish.

² See, for example: Regulations No. KG-A41/12115-06 of Federal Arbitration Court of Moscow District of December 14, 2006, No. KG-A40/11669-06-P-1.2 of December 8, 2006, No. KG-A40/9310-06 of October 3, 2006 and No. KG-A40/16935-06 of November 9, 2006.

³ See for details: D.I. Stepanov. Liability of issuer and registrar for unreasonable shares writing off / News of the Supreme Arbitration Court of the RF. 2007. No. 3 / /

Reference Legal System "Consultant Plus". The author witnesses that "compensation" claims were usually declared due to loss of shares of the largest Russian companies with big capitalization (OJSC Gazprom, OJSC Sibneft, OJSC Lukoil Oil Company, OJSC MMC Norilsk nickel, OJSC Aeroflot – Russian Airlines); written off packages from shareholders did not give them powers of supervision.

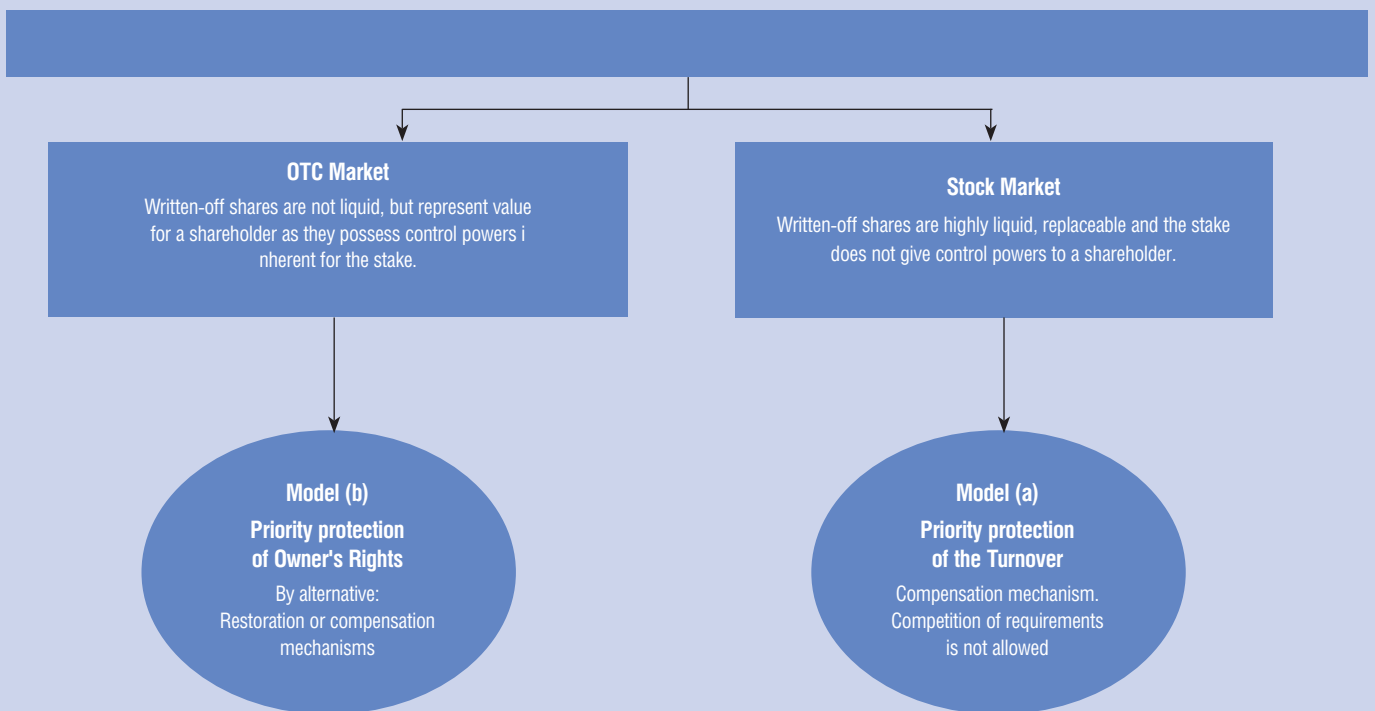
⁴ "Hand muss hand wahren" (Germany). This rule was formulated by the law of medieval cities, first of all, German; the sense was to protect clients of local merchants who came for purchases to the city. If a visitor bought a thing from a person who publicly traded at the city fair, the visitor could not worry that a suddenly appeared owner could vindicate that thing.

rule "Hand muss Hand Wahren".⁴ In other words, the existing relations once again dictate the necessity to set priorities in a civil rights protection area. Provided high circulation rate of uncertified securities, the requirement of finding the solution of the dilemma – who better deserves protection, an owner or the market, is especially noticeable in the area of uncertified securities. An obvious answer to this undoubtedly complicated and acute question is once again suggested by the "logic of the economics" of the uncertified securities relationship. It seems that an organized stock market⁵ should become a dividing ridge between a "compensation" and a "conditionally vindication" ("return in kind") protection. Based on the basic division of shares into liquid and illiquid (non-traded) shares it seems reasonable to legally fix the established positive practice by envisaging compensation mechanism in the first case (model (a)), and in the second case methods of protection aimed at restoration of status quo, which existed prior to the infringement of the right (model (b)) (see Chart 1).

Protection of shareholder's rights in the event of loss of liquid shares

The mechanism of vindication of disputable shares in kind (conditionally vindication or the mechanism of restoration of rights to uncertified securities) can't be with high probability used for protection of the rights of a person whose shares, illegally written off a personal account, have been alienated and are traded in the stock market since it's almost impossible to identify a final buyer of securities. Researchers and specialists working in the organized market outline the following significant circumstance: if shares illegally written off a personal account of the claimant trade in the stock market, it may be almost insoluble to track counterparties by transactions. Most of obligations arising from exchange transactions terminate by offset (netting)⁶ within stock clearing procedures instead of execution (transfer of shares from seller's account to buyer's account). As a result disputable shares may be transferred to the account of a person haven't been or is not in principle in contractual relations with their former illegal holder (bona or mala fide holder)⁷.

Chart 1.
Protection of holders of uncertified securities



⁵ A while ago the author of this article considered the size of a stake of disputable shares as a possible ring between compensation and restoration mechanisms. A waiver of this approach is caused by the fact that in a number of cases relatively small stakes but represented some value to a shareholder in virtue of their existence may be stolen to obtain control (let's say a shareholder owns 25% blocking stake and 2% of shares are lost).

⁶ A remark is required: liquidation netting applied in the international stock market practice is far from an offset structure in the Civil Code, therefore, having no exact analogue we rather conventionally identify these structures.

⁷ In the course of discussion of conceptual approaches to methods of protection of shareholder's rights due to loss of shares V.A. Belov and D.I. Stepanov practically at the same time expressed an interesting idea: the use of compensation mechanism of protection provided the shares are traded in the market is justified also due to reason that there would be nothing to vindicate. Clearing depositary in the course of accounting and reconciliation activity in fact "generates" (mixing the shares) new legal subject matters similar to the existing ones but not identical. These new legal subject matters mainly remind bank money than securities, that's why there is no subject matter of conditional vindication in this case.

Therefore, methods of protection of the rights of a claimant may be specified in the legislation on securities market, first of all, aimed at granting a claimant an opportunity to receive easily compensation for illegally written off securities. "Political" sense of this statement is a need to provide a priority protection for sales turnover in the course of entrepreneurship activity held by individuals and organizations since securities market is their turnover in pure form.

First of all, the claimant should be granted a right to sue for damages and in this case a defendant shall be a register holder liable for the shareholder register. In case the registrar has no sufficient funds, the duty to indemnify for losses shall be imposed on an issuer. This method fully complies with the norms of the existing corporate legislation and legislation on securities not releasing a society-issuer from the obligations to maintain shareholder register even if it is assigned to professional registrar.

At the same time the right of a claimant to claim for return of an unjust enrichment to a person who unreasonably acquired shares being illegally written off a personal account of the claimant (conditiones) is not subject to any doubts. Thus, the person affected will have an efficient mechanism of civil protection with compensatory function.

Protection of shareholder's right in the event of loss of illiquid shares

An adverse approach – a priority protection of a holder⁸, or model (b), should be preferred in case the shares written off from shareholder's account are illiquid (are not traded in the organized market) but are unique for an owner in virtue of control powers of supervision contained in the package. It is out of question that this method of protection a priori presents severe difficulties for a shareholder than compensation mechanisms. Meanwhile it is better adapted for leveling the consequences of loss of corporate control, and this circumstance may become essential for the claimant. Building the above method of protection you should pay special attention to the following moments.

It's obvious that conditionally vindication (let's call it a claim relating restoration of rights to uncertified securities) reminds classical vindication.

According to a famous statement of the clause 7 of the Informational letter No. 33⁹ of the Supreme Arbitration Court of the RF of April 21, 1998 (rather accurate formulation from the point of view of jurisprudence but obvious

for a simple inhabitant) a positive settlement of an issue concerning return of shares depends on availability or lack of conditions necessary to settle a usual replevin. It means that an action is brought against a final buyer and in each case the court shall clear up bona fides of a buyer of disputable shares considering an eternal issue – a holder or a turnover.

If in the previous case (stock market) protection of the turnover is a priority, then in case of the over-the-counter market the situation is different. In our opinion, a need to choose an alternative in each case (a holder or a turnover) just casts the holder in a state of greater uncertainty regarding its rights to disputable stake, and destimulates it to use an efficient method of protection.

Referring to the methods of protection granted by the law, the holder should be sure in the efficiency of one or another method. Therefore, in our opinion, the use of conditionally vindication mechanism by the holder should be limited by bona fides of final buyer of a disputable stake. In this connection it is advisable to formalize in legislation the fact that a claim brought against a final buyer by the holder of illiquid shares shall be settled irrespective of bona fides of a buyer (a principle of unlimited vindication).

The mechanism of a claim regarding restoration of rights to uncertified securities assumes involvement of a person registering proprietary rights to securities since based on the court decision only that person may cancel entries relating to illegally written off uncertified securities and restore book entry on the account of the claimant. In this case if the number of shares at personal account of an "illegal alienator" is insufficient, the shares are written off the subsequent buyers based on the data in the register and transfer orders, or on the principle of equal and proportional distribution in case of lack of such data¹⁰.

Of course, this principle infringes the interests of really bona fide buyers of disputable shares to some extent. With the purpose to protect their interests let's refer to foreign experience in settlement of this problem. For example, Section 8 of the Model Law, a Uniform Trade Code of the USA, states the responsibility of shares alienator to notify the buyer within thirty days regarding claims of another person to warn the buyer on defect of transfer and risk of probable vindication; besides, every previous buyer makes guarantee to the successor which to some extent insures a risk to turn out to be an "illegal buyer".

We think that the use of similar guarantees and compensation mechanism as a kind of "insurance" is justified in

⁸ Of course, it's difficult to speak about it from the point of view of Russian legal doctrine regarding "a holder" in the context of uncertified securities. In this case a property is understood in economic sense, namely as an assignment of a property to a definite person.

⁹ "Claim of a holder (a person authorized by the holder) for return of shares against bona fide buyer has a vindication character and may be satisfied provided there are conditions stipulated by the article 302 the Civil Code of the Russian Federation" / Information letter of the Presidium of the Supreme Arbitration Court of the RF No. 33 of April 21, 1998 // Reference Legal System "Consultant Plus".

¹⁰ For more detailed information about pro rata principle for writing off shares from the buyers' accounts read a monograph of D.I. Stepanov "Protection of rights of the holders of securities recorded by the entry on the account" / M., 2004.

both our models. Besides, an issue regarding a shortened limitation period related to a proper claim should be seriously considered in order to protect a buyer of disputable uncertified securities. It is expected that this shortened limitation period for claims on rights restoration to uncertified securities, first, will be a certain guarantee against actions of mala fide seller of shares aimed at "breaking down" transactions executed (if transfer of rights to shares was lawful and by the seller's wish), and to stimulate counteragents under share sales agreements to check more carefully the history of a transferred property, each other's reputation and other accompanying questions (efficient legal due diligence).

In practice an effective and comprehensive legal due diligence is almost always carried out for large transactions (even if these transactions are made in the stock market). At the same time a shortened limitation period will favor time-saving and funds of a claimant for restoration of rights to illegally written off shares in the part of "tracking" of that shares and "clearing up" a chain of transactions extremely complicated sometimes. Defending a thesis regarding consistency of a selected approach to protect an owner in case of illiquidity of the lost shares, at the same time we don't see any reasons to delete actually existing "alternative" in the choice between "compensation" and "restoration" mechanism for protection of the holder of illiquid shares.

Actually if in the model (a) interests of protection of turnover without bias stipulate inexpedience of competition of claims different by legal nature, in case of priority protection of the holder such competition is even useful since costs to find shares may be incommensurable with their cost and the results of the search may be unsatisfactory. Let's suppose the holder of illiquid shares can't use restoration mechanism in virtue of objective causes (for example, a final buyer hasn't been found). In such situation a restriction to claim for compensation actually means a holder's deprivation of legal protection and we believe it shouldn't occur. Therefore, if the holder of illiquid shares in the circumstances concerned prefers to file a compensation claim than to seek for final buyer and vindicate shares in kind, it is entitled to sue a register holder for damages. Preservation of an opportunity for such holder to choose between compensation and conditionally vindication mechanism at the stage of claiming is a logical development of an idea regarding priority protection of the holder inherent to the model (b).

The use of compensation mechanisms by the holder which lost illiquid shares have no any significant peculiarities in comparison to compensation mechanisms which shareholders apply in the event of illegal writing off of liquid shares. Therefore, all the above relating to shareholder's protection in the event of writing off shares traded in the stock market is fair if a claimant chooses model (b).

Summary

Lack of uniform understanding of the category of uncertified securities and some ambiguity of the law in the issues of methods of protection of shareholder's right to uncertified securities indirectly encourages strategic mala fide behavior of players in the market of hostile takeovers and corporate seizures. All disputes come to a simple formula for a shareholder who, in most cases, has no profound knowledge of legal technicalities: to return alienated property or receive a reasonable compensation for it.

Certainly, this is out starting point in the process of legal modeling of methods of protection of shareholder's rights to illegally written off shares. The question when and under what circumstances restoration or compensation mechanisms shall be applied is obvious, first of all, for the claimant.

Based on it we offer to differentiate by law methods of protection of the infringed right depending on the fact whether shares having been illegally written off the claimant's account trade in the stock market (are liquid) or not. This approach is economically feasible from the point of view of balance between the interests of protection of securities turnover as whole and individual players.

Of course, differentiation made suggests further work on improvement of methods of protection of rights to uncertified securities already stipulated by the legislation. First of all, it refers to compensation mechanisms since they are not able to ensure full and fair protection of infringed rights in the existing form. These issues are left out of scope of this article due to their volume.

Role of Boards in Increased Efficiency of Companies

In 2007, the Independent Directors Association and Alpina Business Books Publishing House prepared and published a 2-volume book "Corporate Governance Practice", which continued a series of Harvard Business Review Classic. The first volume is a unique collection of articles written by foreign recognized experts in corporate governance and boards activities. The second volume contains materials dedicated to the existing Russian corporate governance practices. The Russian volume of the publication contains detailed descriptions of corporate governance experience and system principles of such companies as OAO AFK Systema, GK Interros, OAO MkhK EuroChem, and discussions of hot corporate governance issues.

To continue the discussion begun in the above publication we offer you to seek an answer to the question about the Board's role in the enhancement of the company's efficiency.

John Pound¹² in his article, The Future Corporate Governance Model analyzes corporate success and failure stories and introduces two corporate governance models: **managed corporation and governed corporation**. The key difference between the models is about the role of the Board of Directors and where its efforts should be applied when managing a corporation, as well as the attitude of the Board towards shareholders.

In the managed corporation model the Board focuses on power. A more thorough audit of managers' activities, segregation of the CEO and Chairman of the Board posts – these and some other reforms currently in progress in many corporations throughout the world are designed to strengthen the control over top managers. John Pound believes, however, that power reforms cannot be the key element to resolve the issue. "Of course, the balance of power is important, he writes. But the bottom line of corporate governance is not about the power, but ensuring an efficient decision-taking process".

John Pound believes that erroneous management decisions and the decision-taking procedures form the reason for which corporate disasters happen. The model, which is gradually underway in a number of corporations, called by J. Pound **the governed corporation**, envisages that the focus of the Board's attention and efforts will shift to developing and use of efficient decision-taking procedures and creation of a system, "whereby top managers and the Board of directors cooperate in the decision-taking process". The new governance model "...restores the link between the two most important elements of the corpo-

rate governance, such as shareholders and the Board of directors, with the decision-taking procedure. Reforms based on the governed corporation model do not concern shifting of power. They focus on roles and behavior of participants of the governance process".

J. Pound believes that the governed corporation model provides opportunities to organize a constructive dialogue between all potential participants of the strategic decision-taking process, i.e. shareholders, board members, top managers and even public representatives. Consideration of different points of view provides a systematic view of the situation and set more right directions for development. J. Pound's theory represents an obvious interest. But what is valuable about it for Russian companies in practical terms? What is the expert opinion in respect of the Board's role in the enhancement of companies' efficiency? In order to find out the opinion of the Russian practitioners with profound corporate governance and Board's activity experience we posed a number of questions to them.

What is the main objective of the Board of Directors: control over top management or ensuring maximum efficiency of decisions made? Substantiate your view, please.

L. Porntoy: The main objective of the Board of Directors is to ensure maximum efficiency of decisions made. The Board represents shareholders and protects their interests, and the shareholders expect company's capitalization and dividend growth. Since in a global sense the Board is responsible for anything that happens with the company, then the control over top management is the responsibility of the Board as well. But it is only a small part of its activities, which is primarily performed by the



Portnoy, Lev Mikhailovich,
Member of the Board of Directors, ZAO INGEOCOM Association.



Yermolayev, Serguey Nikolayevich,
CEO of SALVATOR, Consulting Group and HR Agency

11 J. Pound. Future Corporate Governance Model. / Corporate Governance Practices, Moscow: Alpina Business Books, 2007. – p. 86., (Harvard Business Review Classics).

12 John Pound is a professor of Harvard School, Chairman of New Foundation, an interdisciplinary research project on corporate governance on the basis of the Harvard University.

Audit, HR and Remuneration Committees. Operational control over top management is achieved through the right system of delegation of duties and responsibilities.

S. Yermolayev: In order for the Board of Directors not to become a fashionable toy, clear understanding of what are its goals and objectives needs to be achieved prior to the establishment of the Board. At this stage shareholders have to identify goals and objective of the future Board of directors: to control the management or to increase the efficiency of the decision-making process. The balance between the interests and decision made by the Board of Directors is achieved through its "mixed composition", i.e. representation of shareholders and company's management on the Board combined with effective organization of its work. Both the control over management and the enhancement of the decision-making process are responsibilities of the Board to the extent to which these are described in the Board's scope of responsibilities. A key conjunction here is AND, and not OR.

What in your opinion is the optimal distribution of responsibilities between the Board and the management?

L. Porntoy: The Board should only be involved in strategic issues of the company's development and large transactions. Major transactions become the Board's responsibility as they may entail significant changes in capitalization and radically affect further development and competitive position of the company. The company's management are involved in operational direction and operations of the company.

S. Yermolayev: In the most general sense the Board's goals and objectives are about implementation of the company's strategy. However, this goal (implementation of the strategy) faces the company's management too. On the one hand, it is good that the top management and the Board have the same goals, but on the other hand, there are concerns in repeating of the functions and, therefore, losing control within a company. Top managers always have they own interests related to their work in companies and they tend to adjust those interests to periods of 3-4 years, while shareholders' interest are related to a much longer period of time, 10-15 years.

For that reason, yeas, inter alia, for that reason, the Board of directors outlines for themselves the scope of management decisions and responsibilities that define the basics and principles of business existence and development in a long run. This scope essentially concerns the company's strategy and leans on it.

So, the strategy not only defines the Board's scope of responsibilities, but also prioritizes tasks in their day-to-day work.

The management "is left with" development of the strategy and its full-scale implementation accompanied by day-to-day operations.

The balance of distribution of responsibility areas between the Board of directors and the Management is assessed on the basis of factors, which should definitely include the goals of the current strategy phase. It is quite acceptable and expedient to change the responsibility limits depending on the phase of the company's development.

What is the Board's role in the enhancement of the company's efficiency?

L. Porntoy: The Board plays a prime role in the increase of efficiency of companies, which have large amounts of shareholders, without the largest ones (with at least 10% shareholding interests). Also, the Board plays a prime role in those companies, where there are majority shareholders, but they are not mature enough to understand the necessity of modern corporate governance standards in public companies. In companies, where shareholders manage the companies themselves Boards do not have significant impact on the efficiency. However, success of these companies to a greater degree depends on subjective factors.

S. Yermolayev: If promptness of the decision-making process is the measure of efficiency, then the existence of the Board of directors and the necessity to bring some important issues to the Board definitely does not make the process faster. But if minimization of resources to be used to achieve the necessary result, then the achievement of the goals (or their adjustment on a timely basis) using the Board as a tool will be more efficient than without it. In a long run a higher efficiency is ensured by an ongoing and consistent concentration of the company's resources in order to implement its strategic initiatives and goals as a result of the Board's activities.

What in your opinion is a factor that ensures the Board's efficiency?

L. Porntoy: Participation of professionals and independent directors on Boards of directors.

How can efficiency of Boards of directors be measured? What are areas and criteria of such measurement?

L. Porntoy: The key criteria are the capitalization and market share growth.

S. Yermolayev: A well-formulated strategy, e.g. with the use of a balanced scorecard system, should set specific indicators, which based on cause-and-effect relations take into account interests of the company's shareholders and clients, requirements to the company's business-processes and organizational potential. If objective indicators of achievement of strategic goals are fulfilled and the shareholders agree with it, then the Board's activities should be assessed with positive results. From this statement two particular features in respect of assessment of the Board's activities can be deduced: a long period of time comparable with the strategy implementation phases and ongoing efficient communications with shareholders.

EXPERIENCE IN BUILDING A CORPORATE GOVERNANCE SYSTEM



Svyatoslav N. Sorokin,
General Director, B.A.C.

1. Brief description of the Company

B.A.C. Company is among top ten largest IT-companies in the Russian market and one of the largest Russian system integrators. The Company's activity covers all stages of project implementation and includes analysis of efficiency of business processes and complex engineering of enterprise infrastructure, delivery and implementation of software and hardware including further service maintenance, technical support and trainings for specialists. The Company operates in accordance with the ISO 9001 certificate and conducts its business in the territory of the RF and CIS, and has implemented a number of projects on behalf of its clients in the territory of other countries. The structure of the Company is represented by Head office in Moscow, branches in St. Petersburg, Perm, Omsk, Saransk, subsidiary B.A.C.-Asia Ltd. with registered office in Astana (Kazakhstan) and Non-Commercial Educational Institution B.A.C. Training Center. Since its foundation B.A.C. got the name of one of the most dynamic developing companies in the Russian IT-market with \$120 mln. turnover in 2006 financial year. B.A.C. Company cooperates with world IT-leaders and is a partner of such companies as 3Com, Acronis, APC, Avaya, Aquarius, Cisco, Citrix, CommScope, InfoWatch, Fujitsu-Siemens, Hitachi Data Systems, HP, IBM, MGE, Microsoft, Nortel, Novell, Oracle, Panasonic, Polycom, Philips, Radvision, Remedy, SITA, SMP, Sun Microsystems, Symantec, Tandberg, ViewSonic, VMware, Xerox.

2. History of the Company

There are three major stages in the development of the Company:

1. Foundation of the Company, 1998-2001.
2. The Company's growth, 2002-2005
3. Development of the Company, 2006 to present.

Foundation of the Company, 1998-2001. B.A.C. Company was founded by a team of specialists in the sphere of office integration aimed at representation of interests of companies – world IT-leaders. The first agreements were signed with Compaq Computer (now HP), Microsoft, Cisco, Avaya for Systimax products. The principal activity of the Company was the delivery of complex solutions in the sphere of office automation. The activity of the Company was focused on foreign companies establishing their offices and production facilities in Russia. The Company implemented a number of large-scale projects in the sphere of

office automation, the largest of which was deploying PricewaterhouseCoopers office in business center at Kosmodamianskaya embankment.

At this stage the Company was managed by the owners. Shareholders performed direct business management (functions were distributed between them) and managed linear specialists.

The result of this stage of development was wide client base of the Company (over 150 companies), financial stability (with turnover of \$20 mln.), and optimization of technological process of project implementation.

The Company's growth, 2002-2005. At this stage B.A.C. management set a task to grow up from a leader in the sphere of system automation to the level of a leader of system automation of an enterprise as a whole. This period is characterized by the development of new technical service lines in the Company that resulted in full business restructuring in 2004. The Company engaged specialists from leading Western companies including Compaq Computer, Hewlett-Packard, Siemens, Avaya and performed business reorganization. As a result the structure of the Company was organized based on profit centers by key activities. Engineering systems department, Telecommunication department, Corporate systems department and other business units were created. The process of formation of the Company management was started: qualified team of sales managers headed new profit centers and their status was upgraded to Vice-presidents. Owing to formation of top management team the corporate culture changed significantly. The increased status of the qualified employees caused the change of the family atmosphere existed before and added some tension in the relations between the employees. But over the years the management team earned great reputation not only because the fact that most of them had been working in the company since its foundation but also because they reached tangible business results. Thus, the time proved right appointments. During the same period the first Board of Directors was created, to which shareholders delegated decision-making regarding strategic management of the Company. General Manager had to report to the Board of Directors. The first Board of Directors comprised all shareholders (3 persons), General Manager and top managers of the Company responsible for key service lines, total 12 persons. The Board of Directors considered strategic issues, made decision in the course of discussions and delegated decision implementation to top manager of relevant business unit assigning General Manager to control the process. The Board of Directors also had a supervising function. For example, during that period the Company made a strategic decision to invest about \$500 thousand to development of telecommunications. Accordingly, following decision-making the member of the Board of Directors responsible for commercial activity (Commercial Director) was ordered to check the actuality of needs of the existing clients for services in the sphere of telecommunications, Technical Director had to obtain licenses, status, purchase equip-

ment, create a laboratory and obtain relevant expertise in the Company within 6 months. Enhancement of the corporate governance system included adjustment of budgeting business processes, financial administration (implementation of new financial accounting system) and strategic planning. It related to rapid growth of the Company. Since 2003 the shareholders have made heavy investments and reduced dividends. Therefore the shareholders were interested in efficient application of funds. Meanwhile the existing at that moment business processes did not allow balancing the number of orders received and the number of technical staff required for work performance. Hence, the objective to focus on creation of perfect system of budgeting and planning became vital. At that moment the Company provided a wide range of services as well and it was necessary to work out a clear strategy for development to differentiate from the competitors. There was an active work aimed at development of new technological trends of the Company and increase of efficiency of operational business administration. The result exceeded all expectations: within last five years the Company's growth rate exceeded 1.5 times the market, and to 2006 an annual turnover reached \$120 mln. The Company became one of the leaders in the market of system integration being No. 20 in national rating of the IT-companies.

Development of the Company, 2006 to present. The stage of the Company's development, having started about a year ago, is typical for large corporation providing advisory and IT-services. The Company successfully passed through due diligence of two independent auditing firms and issued additional shares. As a result Detroit Investment Fund became a shareholder of the Company have purchased 25%+1 B.A.C. shares. Detroit Investment invested significant funds in the Company allowing more intensive development of the Company. The strategy of the Company changed too. With leading position as a system integrator and provider of information and telecommunication equipment B.A.C. set a task to become a leader in the sphere of advisory services and IT-outsourcing. During 2006 the Company made long-term contracts for automation of systems of the entire enterprise. Such contracts include development of information and telecommunication infrastructure and security systems for TVEL Corporation (leading enterprise of the Ministry of Nuclear Energy), a contract for engineering and installation of IT-infrastructure and data processing center on 33 floors of the "Federation Tower" in Moscow City for Vneshtorgbank, 7-year contract for outsourcing of the whole infrastructure of InBev company in Russia, building of IT-systems for new airport Sheremetievo-3, development of IT-policy for RAO UES of Russia. During this period major changes in the system of corporate governance referred to development of commercial and marketing departments, implementation of new incentive programs for the employees and procedures of analysis and business forecasting. Since the introduction of such procedures the Company shifted away just from actual cost accounting and today has a clear forecast of key business indicators till the end of 2008. During the same period an advisory

department was created. On the initiative of the President 12 top managers of the Company including the President himself completed MBA course at Higher School of Economics. The Board of Directors actively worked on building a new strategy of the Company and supervised the largest transactions, participated in making agreements with the investors of the Company.

In 2007 an Independent investment fund was created for implementation of strategic projects. The Charter of the Company and the composition of the Board of Directors changed. The last Board of Directors comprised 8 persons: 2 representatives of Detroit Investment (Detroit Investment Project Manager and independent Director) and 6 employees of B.A.C. (President, General Manager and 4 top managers). Also the Company management was formed actually duplicating the former Board of Directors. The Board of Directors plays the role of a strategy holder. The management is a collective executive body which makes operative decisions. General Manager, in its turn, has become an executor of all decisions made by the Board of Directors.

3. Corporate governance system

As a result of continuing progressive advance at the moment B.A.C. has complicated structure of corporate governance system. Areas of responsibility and authorities are governed by the Charter of the Company, Statute on the President of the Company, Statute on the structure of the Company, Statute on the corporate governance and Statutes on key units of the Company.

The Company has the following structure of corporate governance:

First level is presented by the Board of shareholders and the Board of Directors.

The authorities of the Board of shareholders comprise designation of the Board of Directors, work estimation and regulation of the activity of the Board of Directors, as well as settlement of such global issues as significant investments into developments of one or another service line, acquisition of companies and approval of significant transactions (over \$5 mln.), dividend policy, etc. The meeting of the Board of shareholders is usually held once or twice a year.

The Board of Directors is empowered to consider issues and make decisions regarding appointment of General Manager of the Company, approve budget for the next year, open branches in regions and approve major transactions. For example, at the recent meeting of the Board of Directors the following issues were subject to approval:

- a project to purchase the company of system integrator in one of CIS countries (with transaction price over \$50 mln.),
- preliminary approval of merger with niche telecommunication player, the portfolio of which is strategically important for the Company's growth,

- investments in new technical service line which will cost about \$7 mln. for the Company during 3 years.

At present the meeting of the Board of Directors is held once a month because the new shareholder, Detroit Investment, (since April 1, 2007) enters the internal process of the Company. It is expected that the meetings of the Board of Directors will be held once a quarter in the future. In the short term development of the structure of the Board of Directors is planned, namely creation of committees by key activities of the Company. Top managers, which are members of the Board of Directors, are expected to supervise the processes and activities in the Company being responsible for the results, in addition to management of relevant service lines, i.e., for example, the Commercial Director will supervise technical policy of the Company, Technical Director will control IT-issues. Global objective of the first level of governance is to obtain more exact understanding of the Company's niche in the IT services market, which is strongly differentiated (about 6,000 players).

Second level is presented by the Management (including General Manager, Commercial Director, CFO, CEO, Advisory Manager, Technical Director, HR Manager and IT Manager, the President is always invited but attend it selectively at its own discretion). The Management discusses and approves the current forecast, development, adjustment of annual and quarter budgets, internal quality control, staff schedule, relatively small transactions, social policy and other issues during one year. The authorities of General Manager are limited by the annual budget. General Manager together with the Management prepares annual budget and presents in at the meeting of the Board of Directors. There is rather collective leadership in the Company. De facto General Manager has no absolute authorities such as, for example, in situations when the owners delegate all authorities and control once a year, when the business plan has been implemented. Major shareholder in B.A.C is the President of the Company and participates in its management on a par with General Manager. Areas of responsibility are distributed between General Manager and the President of the Company.

Major objective of the second level is to maintain balance in operational administration of cash flows of fast growing company: to give a realistic income forecast and balance it with the budget of the Company taking into account seasonal fluctuation of business (50% of revenue falls to Q4) and the fact that 80% of costs of the Company falls to the staff (competitive basis of business is professionals).

Third level, technical level of governance, is presented by the group of top managers (Vice-presidents) who report to General Director, control and organize implementation of technical decisions. The third level is presented by Technical Committee of the Company (meetings are held

once a month), Commercial Council of the Company (meetings are held twice a month) and engagement teams.

4. Perspectives for the development of the Company

In the short-term (1 year) perspective the Company set an objective to increase quality of services provided to customers and reduce the cost of one operation.

During the next three years the Company plans:

1. to become one of the five top system integrators in Russia with turnover exceeding \$600 mln;
2. to set clear industrial specialization in the areas as follows:
 - Public sector
 - Finance
 - Telecommunications
 - Transport and logistics
 - Energy
3. to create an attractive climate for investments in the Company with potential for IPO.

Therefore the Company plans to solve the following tasks:

1. Regarding sales and marketing:
 - to invest significant funds in marketing and brand of the Company.
 - to invest in expansion of sales system by means of further training of the sales department staff.
 - to invest in creation of regional distribution network in big cities of the Russian Federation and capitals of the CIS countries including due to acquisition of regional companies.
2. Regarding technical policy:
 - to create investments units: to complete formation of an advisory service engaging specialists from strategic industries.
 - to develop practices in the sphere of industrial software in accordance with clients needs including mergers and acquisitions.
 - to reorganize center for software developments taking into account industrial peculiarities.
3. Regarding corporate governance:
 - to switch to new system of company and project management.
 - to undergo international certification of the quality system.
 - to adopt requirements of international audit and IFSO.

Key strategic objective of B.A.C. for the next five years is enhancement of its value.

CEO Summit to be held on October 26, 2007 in Moscow

Top managers of major Russian and international companies will get together for the second year in the row at the most important of Moscow events – CEO Summit 2007. The Summit made a successful start in 2006 in Moscow, where it was held in the Manezh Conference Room as part of the Extravaganza Fair, which became an unrivalled leader among international fairs of luxury and de luxe items for the Moscow elite. The first year the summit saw over 150 delegates from all over Russia to discuss innovative ideas and governance issues. The main topics of the Summit 2007 will be:

- The future of the ruble trade
- The Russian stock market as an opportunity for investments
- Brand managing as part of the IPO process
- Relationship of CEO and the Board of Directors
- Business aviation development prospects in Russia
- Real estate in golf resorts – the model of the luxury items market.

Sponsors of the summit are Breitling Watch and Echo of Moscow Radio Station. Forbes Business Lounge will be open for the summit delegates, where they will have the opportunity to rest and continue communicating. In addition, after presentations, which may represent interest the delegates will be able to have a look-see tour around exclusive yachts, planes, real estate, jewelry, and other unique items and services in the exhibition hall. A cocktail party will be arranged at the end of the Summit.

Just like last year, the Summit is sponsored by such leading associations as Business Russia, the Independent Directors Association, and ACI Russia.

CEO Summit 2007 is a major event in the business world for industry leaders, investors and Russian government representatives. For more details please address the Summit organizers:

Shorex Ltd
Tel: +44 20 7482 1000
Fax: +44 20 7482 1100
info@shorex.com
www.shorex.com/moscow
www.extravaganza.ru

BUSINESSInfoRESOURCE – INFORMATION SUPPORT OF BUSINESSES

Special term for IDA members are envisaged as part of the partnership agreement entered into by the Independent Directors Association and Prime-TASS Information Agency. In particular, these include a 5% discount for BusinessInfoResource, one of the Agency's products.

The BusinessInfoResource Database (BIR, <http://bir.prime-tass.ru/>) was begun in 1997. Currently, the database includes information regarding almost five million companies: all Russian registered legal entities, all credit organizations, Russian regions and inhabited areas, and data on the Russian economy in general. BIR uses the following sources of information: the Russian Federal Statistics Service, the Russian Federal Financial Markets Service, the Russian Ministry of Finance, the Central Bank of Russia, etc.

BIR database users may:

- receive information regarding created lists of companies;
- look for and find shareholders of companies;
- perform a full-text search of documents in order to identify relations between companies;
- analyze trends and amounts of production, supplies directions, and product consumption;
- evaluate financial standing of a company and perform an express analysis of its solvency;
- collect contact and reference information;
- evaluate investment appeal of a region, inhabited area, industry or industry segment;
- receive news digests in respect of a certain topic and other information.

Industry analysis opportunity

BusinessInfoResource Database helps to analyze industries by Russian companies and regions, enables to structure the list of companies within an industry and break them down by production and financial parameters, determine a market share of a company or region in the markets of goods or services and analyze flows of goods. Anna Stolyarova, marketing director of ZAO Video International Analytical Center, being a regular user of the system speaks about BusinessInfoResource Database opportunities: "In order to understand the environment of the advertising services market not only statistical data need to be analyzed, but also adjacent industries, Anna Stolyarova comments on the tasks facing her department, - "That's why one of the directions for informational and analytical support of Video International's core activities is an ongoing monitoring of Russian goods and commodity markets, where the situation is changing at a very fast pace and the new information on advertisers and manufacturers appears on an ongoing basis. To provide

a high quality analysis we need to receive actual data in full and without delays, as otherwise the value and the novelty of the analytical results significantly reduce, which may lead to situations when the analysis output offered is well behind the actual market situation. Video International's analysts do not limit themselves to obtaining the commodity markets information from a single source. However, the main source of information for us is the BusinessInfoResource system. We like an easy-to-use interface of this system, says Anna Stolyarova, as it allows to get all sorts of data that represent interest for us. The reference information, macroeconomics, statistical data on advertiser companies and news represent interest for us in the first place. This information allows to quickly assess what is going on with sales of a specific manufacturer and to promptly identify the reasons, which promote or, on the contrary, prevent an advertising campaign."

Information to make decisions in respect of regional development

BusinessInfoResource enables to achieve goals in respect of extending geography of the business, by providing an opportunity to assess the economic and social situation in regions and inhabited areas, determine the range of potential regions for further expansion, analyze competition environment in the selected region or inhabited area, and assess potential vendors and customers.

Andrey Sokolov, a marketing representative of Metro Cash & Carry, which is proactively expanding in the Russian regions, says: Metro Cash & Carry has been proactively using the BusinessInfoResource Database for already more than a year. As we are proactively expanding our operations in the regions we need to order information from the statistics committees in order to evaluate the potential of the regions. New stores to be opened require a significant amount of information on inhabited areas to be gathered and, typically, this work needs to be done in quite tight deadlines. The BusinessInfoResource Database allows to receive and upload all the necessary statistical data on Russian towns and regions very promptly. Selection of new vendors in the regions is also quite easy to do due to the information on manufacturers available from the BusinessInfoResource Database, which provides not only contact information, but also key financial and economic indicators".

IDA Corporate Development Center

The IDA Corporate Development Center (IDA CDC) is a company providing advisory services. The Company was established by the Independent Directors Association and focuses its activity on corporate governance system advisory services provided to companies and their owners.

IDA CDC's advantages include:

- International methodologies for building efficient corporate governance systems developed jointly with IFC;
- A team of experts with advisory experience on corporate governance issues in Russia and CIS.

The IDA CDC's team of advisors has performed a number of successful projects in Russian and international companies such as: Svyazinvest (Moscow), Uralsvyazinform (Yekaterinburg), North-West Telecom (St. Petersburg), MTS (Moscow), RD KazMunaiGaz, NK KazMunaiGaz (Kazakhstan), Magnitogorsk Metals Plant, SUEK, United Metals Company (OMK), MKhK EuroChem (Moscow), OAO Russian Railways (Moscow), GK Victoria, Rosinter Restaurants, Genser.

Services offered to companies, which are preparing public or private securities offering or sale to a strategic investor, include building efficient corporate governance systems in order to enhance control over such companies and their increase investment appeal. The IDA CDC is an authorized listing agent for the Moscow Interbank Currency Exchange in the innovative and fast growing companies section and offers a full spectrum of services in respect of companies' access to the stock market.

Services offered to owners of non-public companies (privately owned entities, partnerships or family companies) include building corporate governance systems in order to enhance efficiency of businesses owned. We help to build a corporate governance system, which:

- is clear and understandable to owners, board members, independent directors, members of control bodies, company's management, potential private and institutional investors;
- facilitates the enhanced efficiency of management of companies, which consequently increases their value, investment appeal and ownership efficiency;
- is in line with the Russian corporate governance standards, the rules of listing in the Russian and foreign stock exchanges,
- takes into account the best international corporate governance practices.

**Independent Directors Association
and PricewaterhouseCoopers present**

Director of the Year 2007 National Award

On the 3 October 2007, Independent Directors Association will accept applications from candidates to compete in the three award categories:

Independent Director of the Year Board of Directors Chairman of the Year Corporate Secretary of the Year

The Director of the Year Award is an annual national award for professional performance.

It recognises directors' personal effort in promoting corporate governance, facilitating the introduction and roll-out of high standards and best practices of corporate governance in Russia.

The 2006 Director of the Year contest and award ceremony received wide media coverage and was followed closely by the business community.

The 2006 Director of the Year award was sponsored and supported on a partnership basis by OAO Vimpelcom as General Sponsor, ZENIT Bank, KazMunaiGas (Kazakhstan), Tatneft, TNK-BP, Pipe & Steel Company, Astor Capital, Board Solutions, Energy Consulting and Standard Bank.

The Award Council of Experts reviewed more than 100 completed entries. The contestants include high-profile Russian and foreign directors of public and private businesses from different industries.

Category:

**Independent
Director 2006**

Winner:

Richard H. Matzke,
OAO LUKOIL

Laureates:

Guy De Selliers
of OAO Wimm Bill Dann,
OAO Norilsk Nickel and OAO
Shatura Furniture Company

Alexander Bolshakov
of OAO MDM Bank

Helmut Reuschenbach
of OAO MTS

Will Andrich
of OAO GK PIK

Category:

**Board of Directors
Chairman 2006**

Winner:

David J. Haines
of OAO Vimpelcom

Laureates:

Yakov Yoffe
of OAO EuroChim

Zakhar Smushkin
of ZAO Ilim Pulp Enterprises

Stanislav Shekshnya
of OAO SUEK

Category:

**Corporate
Secretary 2006**

Winner:

Alexander Semyonov

Laureates:

Olga Mokhoreva
of OAO Rostelecom

Elena Panasenکو
of OAO MDM Bank

Konstantin Chulakov
of OAO UralSvyazInform

Angelika Granitsa
of OAO EuroChim

Please submit your applications via web-site www.directorgoda.ru

NEW IDA MEMBERS

On June 14, 2007 the following applicants were admitted as members of the Association at the regular meeting of the Membership and Ethics Committee of the IDA:

- Mr. Vladimirov A.I.**, member of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Lewis Gremillion**, member of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Davidyuk G.V.**, Partner, Mint Capital Direct Investment Fund, (Moscow)
Mr. Dzhaparidze A.Yu., Chairman of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Zakaty S.V.**, First Deputy General Manager, Partner, Ernst & Young / Ernst & Young Business Advisory Services Ltd (Moscow)
- Mr. Zlatin P.A.**, Head of HR Department, Moscow State Industrial University (Moscow)
- Mr. Ivanov D.V.**, First Vice-President for Finance and Investment, SITRONICS JSC (Moscow)
- Mr. Ivlev A.V.**, Partner, Director, Marketing and Communication group, Ernst & Young (CIS) B.V. (Moscow)
- Mrs. Ieshkina I.N.**, Head of the Internal Audit Service, Wimm-Bill-Dann Foods OJSC (Moscow)
- Mrs. Kandelaki T.L.** General Manager, Info TEK-CONSULT Ltd (Moscow)
- Mr. Korneev V.V.**, Chairman of the Board of Directors, Agrotechnologies OJSC (Moscow)
- Mrs. Kostyrko A.B.**, Corporate Secretary of the Board of Directors, SUEK OJSC (Moscow)
- Mr. Kotov S.O.**, Managing Director, Alfa-Bank OJSC (Moscow)
- Mr. Kucherov E.V.**, Head of the Tax and Law Department, Baker Tilly Rusaudit Ltd (Moscow)
- Mr. Lavrov F.A.**, Chief of the staff of the Board of Directors, Sistema-Hals OJSC (Moscow)
- Mrs. Miller O.A.**, Deputy Head of Department, Russian Railways JSC Subsidiary (Moscow)
- Mr. Petrakov V.L.**, member of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Putilov A.E.**, member of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Sedov V.M.**, CEO, US-Russia Center for Entrepreneurship (Moscow)
- Mr. Smirnov K.A.**, Deputy General Manager, Eastern Gate Securities Investment Company (Moscow)
- Mr. Smirnov G.A.**, Deputy Chairman for Broadcasting, Chief Producer, MIR Interstate Television Company (Moscow)
- Mr. Timonin D.A.**, Vice-President, Legal Support Group, Eurasia Drilling Company Ltd (Moscow)
- Mr. Douglas Thompson**, member of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Utenov N.K.**, Managing Director for Economics and Finance, JSC KazMunaiGas Exploration Production (Kazakhstan, Astana)
- Mr. Ushmalkin N.F.**, Head of the Financial Analytical Department, Oil Service Trading House Ltd, GK Mariisky NPZ (Moscow)
- Mr. Eric Hansen**, Partner, US Russia Center for Entrepreneurship (Moscow)
- Mr. Martin Hansen**, member of the Board of Directors, Eurasia Drilling Company Ltd (Moscow)
- Mr. Peri Hall**, Senior Vice-President, PRP Financial (Moscow)
- Mrs. Shanaeva F.B.**, Adviser to President, CJSC YUKOS RM (Moscow)
- Mrs. Shilina G.**, Director, Advisory Services, Ernst & Young (CIS) B.V. (Moscow)

Bryanskaya str., 5
Moscow, Russia, 121059,
Tel.: +7 (495) 782-1506
Fax: +7 (495) 782-1507
www.nand.ru
E-mail:info@nand.ru

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