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Counter-attack on corporate raiders

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17 May 2007

Overview

The risk to property rights has not been confined in Russia to the "classic" threats of expropriation by the state and disenfranchisement of minority shareholders by controlling owners and managers. Risks in this area include a more direct and primitive threat of fraudulent takeovers and criminal appropriation of real estate and other property.

The government is at last addressing this problem. The first result is a package of new legislation closing loopholes exploited by "corporate raiders." No amount of legislation can eliminate the corruption on which raiders also thrive. But our trusted source reports improving attitudes to private property rights on the part of law enforcement officials and possible enhancements to the "anti-raider" package.

Context

Corporate raiding remains a serious problem; new legislation seeks to reduce the scope for this type of takeover

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> **Svetlina Volina**, CEO of Phoenix Group

Wrap

The state itself is still perceived as posing the main threat

Context

Russian corporate "raiding" (with the English word entering the language) thrives on the combination of legal loopholes and corruption - that is, the ease of bribing officials and judges.

The problem is periodically highlighted by press reports of particularly shocking cases involving foreigners. One such case in 2005 saw the Moscow office of George Soros's philanthropic organisation stormed by armed men representing a "new" owner of the building.

But hundreds of other "raids" go unreported. Even official statistics tend to capture only those cases which culminate in violent seizures of company premises (Moscow City government figures record an annual average of 150 such incidents since 2003, with a mild improvement each year).

Most such incidents involve real estate in Moscow and St Petersburg. Especially vulnerable are not-for-profit owners or lessees of buildings whose title typically dates back to the chaotic legal environment of the early 1990s. Raiding parties interested in grabbing what is now prime commercial real estate can thus start with semi-legal exploitation of weaknesses in the title deeds before continuing with the more standard methods - from bribing officials to physical intimidation (for two case histories of corporate raiding involving force, click [here](#)).

Many raids succeed even without the use of force. A company may receive notice that a court in some remote region has, for example, overturned a shareholders' resolution or approved the decisions of a rival shareholders' meeting such as installing a new board.

New ?anti-raider? legislation

The obvious risk to specific property rights from this corporate raiding, Russian-style, does wider damage to the investment climate - and especially for SMEs, which have an important part to play in diversifying the Russian economy. In 2006, Economic Development and Trade Minister German Gref accordingly put this issue at the top of his policy-making agenda, in the form of a two-year programme on improving company law adopted in May of that year.

The first concrete result of this programme is a package of amendments to existing company law and judicial procedure designed to reduce the scope for corporate raiding. This package was passed in the first reading by the State Duma in April 2007, and should therefore complete its remaining parliamentary stages and reach the statute book during the second half of the year.

Above all, the amendments seek to block various ways that raiders have found to exploit the court system. Raiding parties would lose the option of bringing actions in non-commercial courts and choosing the region where a case can be heard (that is, where they have "influence" over judges). Paralyzing the work of the target company through legal obstacles and keeping it in the dark about a court case brought against it would be made much more difficult. And raiders would no longer be able to use company decisions dating back several years as springboards from which to launch an attack (for full details of the anti-raider package, click [here](#)).

Looking beyond the draft legislation now in the Duma, the government's two-year programme aims to increase the scope for shareholders to call management to account. It envisages separate legislative measures under which minority shareholders will be able to receive compensation for losses caused by management (under current practice, managers are able to escape responsibility for such losses by pointing to existing labour relations with their companies, thereby preventing the court from applying the provisions of the shareholders' law on accountability).

The programme also seeks to ensure that managers who act in bad faith or who are simply incompetent are held to account. It aims to facilitate shareholders' capacity to demand in court the dismissal of negligent directors or managers.

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Svetlana Volina, Chief Executive Officer of Phoenix Group, a Moscow-based advisory firm specialising in hostile takeover defence and corporate dispute resolution.

Companies can be helped to defend themselves

The most positive aspect of the "anti-raider" package is that it reflects how far government officials have come in facing up to the problem and taking steps to tackle it. This welcome heightened awareness has spread to the legislature, as witnessed by a parliamentary hearing which I took part in on 17 May, reviewing the whole issue and considering further policy initiatives.

No less important, the attitude of the law-enforcement agencies has been changing for the better. During the 1990s and beyond, police and prosecutors displayed typical Soviet-era prejudice against entrepreneurs. They were not inclined to view company owners trying to defend or recover their property against raiders as victims of crime, given the assumption that all business people are more or less dishonest. These days, the defence of property rights is taken more seriously.

The legislative changes now going through parliament are a necessary, but still far from sufficient condition for improving defences against corporate raiders. No amount of closing legal and procedural loopholes will remove the risks created by corruption in the form of bribed prosecutors and judges failing to enforce even the soundest of laws.

But the more immediate and practical issue concerns the overall orientation of present "anti-raider" policy. For all the undoubted merits of the proposed package - and I would single out as particularly important the measure to prevent contradictory court rulings in the same dispute - it is not sufficiently results-oriented. A favourite means of foiling raids is to make corporate procedures more complicated. This approach is designed first and foremost to make life easier for officials in this sphere of combating corporate raids rather than simply to create the most effective defences as an end in itself.

A good example is the proposed means of exposing fraudulent amendments to a company's charter or other material changes which predators might have somehow managed to register. The envisaged "solution" would require the CEO to go in person to the relevant agencies and vouch in person for the validity of any such changes within one month of their being made. Only by this means, runs the argument, would it be possible for prosecutors to prove the existence of an attempted raid. But it is clearly impracticable for CEOs to wait in line for hours in, say, the Tax Service offices.

Instead, priority should be given to new rules which would help property owners defend themselves against predators rather than relying on officials. The key to successful defence is early warning. Raids take time to prepare, yet their success depends largely on surprise. If companies became aware of predatory activity, they could take timely counter-measures, including through the civil and (as necessary) criminal courts. Many raids start with tampering with documents in the unified state real estate and company registries. Companies could ensure timely knowledge of any such activity by contracting with those registries (assuming the bureaucracy is not ready to provide this public service free of charge) to receive alerts of any actions taken or requested with regard to their registration documents.

This suggestion, aired again at the 17 May parliamentary hearing, has not yet been formally taken up by officials in the sense of drafting additional legislation. But the proposal has been well received.

Wrap

This is encouraging testimony from an expert practitioner about the improving attitude of law-enforcement agencies to the whole issue of defending private property rights.

Likewise, her report of policymakers giving a favourable reception to ideas on how to help companies help themselves fend off predators indicates a reasonable prospect of improvements to the government's welcome initiative on "anti-raiding" legislation.

On the negative side, the benefits of these efforts by enlightened officials and private sector consultants to reduce this risk to property are diluted by the perception of the state itself as the most threatening of all corporate raiders. Even putting the Yukos affair to one side as a special "political" case, there are other episodes to support that perception. The typical scenario here is the prosecution of a company's management and owners for violations in areas where the law itself is uncertain (taxation) or impracticable (licences for natural resource extraction), leading to those owners selling the company. A topical case perceived in these terms is the recent indictment of Mikhail Gutseriev, the owner of Rusneft.

While there is no failsafe defence against a judge bribed by a private sector raider or intimidated by a senior "bureaucrat-businessman," the key to risk reduction lies with the kind of improvements to company law contained in the "anti-raider" package - together with ongoing tax and regulatory reform - limiting the scope for even a suborned prosecutor or judge to undermine property rights.

Next tests

1. Timing of remaining parliamentary stages of the "anti-raider" package and its signing into law by President Putin.
2. Possible enhancements of this package, including "early warning" systems.