

Legal Restraints on the Use of Shareholders' Agreements for Structuring Foreign Investment Deals in Russia

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Introduction

The development of corporate law in Russia is a recent phenomenon. The fall of the Soviet Union in the early 1990s resulted in the Russian government's movement away from socialist-based economic planning and towards a Western-based free market economic model.¹ This led to many quick codifications of relatively new concepts. The earliest laws following the collapse reflect this haste.² Yet vestiges of Russia's socialist past, including an autocratic approach to economic regulation and a preference for exhaustive legislation, remain in contemporary Russian corporate law.³ The result of combining these competing socio-economic models is a conflicted body of corporate law that can often prove unpredictable for entrepreneurs and legal counsel alike, particularly where foreign investment is involved.⁴ The vast power of the government and subsequent widespread corruption has similarly decreased the predictability of the application of the rule of law.⁵ Nowhere is this unpredictability more apparent than in the development of Russian law governing shareholders' agreements in inward foreign direct investment.

A. Past Developments

Shareholders' agreements were not widely used in Russia until the 1990s.⁶ The agreements existed largely between investors—often between Russian and foreign investors—who sought to address gaps in newly codified and quickly expanding Russian corporate law.⁷ However, the Russian government and courts never legally recognized these agreements, and generally only accepted them insofar as they were consistent with currently codified law.⁸ Elements of the existing Civil Code also provided limitations on potential agreements; courts interpreted some code provisions as

1. VLADIMIR ORLOV, INTRODUCTION TO BUSINESS LAW IN RUSSIA 1 (Geraint Howells et al. eds., 2011).

2. See HIROSHI ODA, RUSSIAN COMMERCIAL LAW 2 (2d ed. 2007); see also ORLOV, *supra* note 1.

3. ORLOV, *supra* note 1; see also TOMI P. ASANTI ET AL., CORPORATE COUNSEL'S GUIDE TO DOING BUSINESS IN RUSSIA 12 (2d ed. 2008).

4. See ORLOV, *supra* note 1; see also Michael Schwarz et al., *Russia in Transition* 2-3, 5 (Harvard Inst. of Econ. Research, Working Paper No. 1982, 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=346543.

5. See Timothy Frye, *Corruption and Rule of Law*, in RUSSIA: AFTER THE GLOBAL ECONOMIC CRISIS 79, 79-80 (Anders Åslund, Sergei Guriev, & Andrew C. Kuchins eds., 2010).

6. Hiroshi Oda, *Shareholders' Agreements in Russia*, 21 INT'L COMPANY & COM. L. REV. 359 (2010).

7. See *id.*

8. See Postanovlenie FAS Zapadno-Sibirskogo Okruga "Megafon" ot 31 mart 2006, No. A75-3725-G/04-860/2005 [Resolution of the Western-Siberian District Commercial Court of the case "Megafon" on Mar. 31, 2006, no. A75-3725-G/04-860/2005], available at <http://forum.yurclub.ru/index.php?showtopic=127181> [hereinafter *Megafon Case*]; Postanovlenie FAS Moskovskogo Okruga "ZAO Russkiy Standart Strakhovanie" it 26 dekabria 2006, No. Å40-62048/06-81-343 [Resolution of the Moscow District Commercial Court of the case "Russian Standard Insurance" on Dec. 26, 2006], available at <http://docs.kodeks.ru/document/875421876> [hereinafter *Russkiy Standart Case*].

prohibiting waivers of right and other contracted-for restrictions on legal capacity.⁹ This generally resulted in either narrow agreements that added very little to corporate efficiency and governance, or in overbroad agreements that the courts refused to uphold.¹⁰

Russia already faced an uphill battle in attracting foreign investors due to the political and economic turmoil of the early 1990s. The Organization for Economic Co-operation and Development (OECD) commented on the poor state of corporate governance in Russia in the late 1990s, noting that share dilution, asset-stripping, and poor protection for the interests of creditors contributed to a hostile investment climate.¹¹ The government and courts' general lack of support for shareholders' agreements further contributed to an opaque corporate culture that dissuaded foreign investors.¹² As a result, many investors actively fled Russian jurisdiction.¹³ The West-Siberian District Commercial Court's appellate decision in the *Megafon* case in 2006 exacerbated this problem when that court invalidated a shareholders' agreement based on Swedish law.¹⁴

The government attempted to respond to investor concerns by addressing the problems with existing corporate law. Various government agencies began proposing new legislation to help solve existing problems in the Civil Code and other corporate laws, and to clarify the legality and possible terms of shareholders' agreements. Following the *Megafon* case, the Ministry of Economic Development addressed shareholders' agreements head-on in their 2007 draft law "On Amending the Federal Law on Joint Stock Companies."¹⁵ This draft law proposed vast changes in legislative treatment of shareholders' agreements, but it was not accepted.¹⁶

9. See Oda, *supra* note 6; GRAZHDANSKII KODEKS ROSSIJSKOI FEDERATSII [GK RF] [Civil Code] arts. 9(2), 22(3).

10. See sources cited *supra* note 9.

11. Organization for Economic Co-operation and Development, *Corporate Governance: Getting It Right in Russia*, OECD OBSERVER (Aug. 1, 1999), http://www.oecdobserver.org/news/fullstory.php/aid/21/Corporate_governance:_getting_it_right_in_Russia.html [hereinafter OECD Observer].

12. See Oda, *supra* note 6, at 361; Yuko Adachi, *Corporate Control, Governance Practices and the State: The Case of Russia's Yukos Oil Company*, in *CORPORATE GOVERNANCE AND FINANCE IN RUSSIA AND POLAND* 51, 51 (Tomasz Mickiewicz ed., 2006).

13. See Oda, *supra* note 6, at 361.

14. *Megafon* Case, *supra* note 8.

15. Projekt federal'nogo zakona o vnesenii izmenenii v Federal'nii Zakon "Ob aktsionernikh obshchestvakh (v chasti regulirovaniya aktsionernikh coglashenii)" [Draft federal law on amending the Federal Law "On Joint Stock Companies (in terms of regulating shareholder agreements)], Ministerstvo ekonomicheskogo rasvitiya [Ministry of Economic Development] 2008, available at http://corp-gov.ru/bd/db.php3?db_id=4311&base_id=49 [hereinafter Draft Law].

16. Zakliochenie na projekt federal'nogo zakona o vnesenii izmenenii v Federal'nii Zakon "Ob aktsionernikh obshchestvakh (v chasti regulirovaniya aktsionernikh coglashenii)" [Conclusion on draft federal law on amending the Federal Law "On Joint Stock Companies (in terms of regulating shareholder agreements)"], Ministerstvo ekonomicheskogo rasvitiya [Ministry of Economic Development] July 1, 2008, available at http://www.economy.gov.ru/wps/wcm/connect/8c311600409d93a0a4a1ed2c73e16b99/zakl_aeb.doc?MOD=AJPERES&CACHEID=8c311600409d93a0a4a1ed2c73e16b99&CACHE=NONE [hereinafter Conclusion on Draft Law].

Though primary legislation passed in 2008 addressing investors' agreements for Russian limited liability companies,¹⁷ it was not until 2009 that an amendment to the Law on Joint Stock Companies formally recognizing shareholders' agreements for corporations finally passed.¹⁸

B. Contemporary Problems

Though the 2009 amendment's recognition of the legality of shareholders' agreements eliminated the possibility of courts striking them down solely on the ground that they lack a statutory basis,¹⁹ the 2009 amendment was still problematic. It failed to clarify whether choice-of-law provisions that allowed for application of another country's law were now available in shareholders' agreements.²⁰ As this lack of clarity regarding freedom of contract was an issue for many foreign investors²¹ and was the basis for many court decisions rejecting shareholders' agreements,²² there was an immediate problem with the efficacy of the amended law. Furthermore, Russian courts generally interpret codified corporate law as both mandatory and exhaustive.²³ Given that the 2009 amendment sets out what shareholders' agreements can and cannot include, much of the flexibility inherent to the instrument in other countries is lost, along with much of the value to foreign investors who wish to structure corporate relations in a familiar way.

Rulings on shareholders' agreements in Russian courts following this decision have been sparse, and reception to the practice mixed. Though there is vocal support for conforming shareholders' agreements to the new laws from large and government-supported companies,²⁴ it appears that the judicial trend of rejecting shareholders' agreements is continuing. The 2010 *Verniy Znak* case,²⁵ one of the most recent, illustrates continued judicial reticence towards shareholders' agreements. There, the court found

17. See Dewey & LeBoeuf LLP, *Major Reforms for Limited Liability Companies*, RUSSIAN L. NEWS (Mar. 2009), <http://www.russianlaws.com/newsdetail.aspx?news=7053>.

18. See Federal'nyi Zakon RF o vnesenii izmenenii v Federal'nyi zakon "Ob aktsionernikh obshchestvakh" i Stat'iu 30 federal'nogo zakona "O rynke tsennikh bumag" [Federal Law of the Russian Federation on amendments to the Federal Law "On Joint Stock Companies" and Article 30 of the Federal Law "On the Securities Market"], ROSSIJSKAIA GAZETA [ROS. GAZ.], June 10, 2009, available at <http://www.rg.ru/2009/06/10/akcionernye-obshchestva-dok.html> [hereinafter 2009 Amendment]; see Oda, *supra* note 6, at 364.

19. See Oda, *supra* note 6, at 360.

20. See 2009 Amendment, *supra* note 18.

21. See Oda, *supra* note 6, at 360.

22. *Id.* at 361.

23. *Id.* at 360, 368.

24. See Interview by Alexei Pavlovich with Victor Ragozin, CEO, and Yulia Lazareva, Senior Counsel, Rusnano, GARANT ONLINE (June 3, 2009), available at <http://www.rusnano.com/Post.aspx/Show/18681> [hereinafter Interview by Alexei Pavlovich].

25. See Postanovlenie FAS Moskovskogo Okruga "Verniy Znak" it 25 maia 2011, No. A40-140918/09-132-894 [Resolution of the Moscow District Commercial Court of the case "Verniy Znak" on May 25, 2011, No. A40-140918/09-132-894], available at http://kad.arbitr.ru/PdfDocument/fe377b20-ebf5-4e28-88e5-be5adfd1bb88/A40-140918-2009-20110530_Reshenija%20i%20postanovlenija.pdf [hereinafter Verniy Znak Case]. This case remains contested; however, the Presidium of the Russian Federation and the Supreme Arbitration Court recently denied review. See *infra* note 192.

that the shareholders' agreement contradicted mandatory provisions of existing legislation.²⁶

Though many commentators have noted that the future remains hazy for the enforcement of all but the most conforming shareholders' agreements, it seems clear that Russian courts are quick to limit the extent and usefulness of shareholders' agreements, and that the Russian government's approach is similar in limiting the expansion of negotiated economic rights for foreign investors. In this Note, I will argue that from the watershed *Megafon* case to the most recent *Verniy Znak* decision, the Russian courts, with the support of the government through controlling legislation, have established a tradition where, for many foreign investors, challenged agreements become illegal agreements.

As an initial consideration in Part I, I will explain the legal basis and traditional uses for shareholders' agreements in the United States and Russia in order to highlight important differences that have arisen in the Russian statutory and judicial scheme. This comparison will show that while freedom of contract and statutory flexibility is the norm in the United States, the Russian legal tradition focuses on interpreting corporate statutes and the Civil Code as both exhaustive and mandatory, with little ability to work around statutory norms. This section will also provide further support for the proposition that the Russian courts have a history of disallowing shareholders' agreements as a means of expanding negotiated rights for foreign investors; an examination of the case law leading up to the most recent amendment of Russian corporate law is instructive in this regard.

In Part III of this Note, I will discuss recent legislative limitations on shareholders' agreements, and the corresponding increase in control over strategic investment, which further highlight the Russian government's preference for exhaustive governance.²⁷ This discussion will also address the unlikely possibility of the Russian Supreme Commercial Court changing the tide of judicial interpretation of the legislation controlling shareholders' agreements.

Finally, in Part IV, I will address the ramifications of the trends discussed in Parts I-III for foreign investors in Russia. Given the flight of many such foreign investors from Russian jurisdiction following restrictive decisions on shareholders' agreements, the importance of shareholders' agreements to foreign investors is clear.²⁸ Thus, it appears that foreign investors will have three options in the current legal climate, if they wish to continue using the instrument: (1) they can remain within the constraints imposed

26. Suren Gortsunyan, *Shareholders' Agreements with Respect to Russian Assets: Current Trends*, FINANCIER WORLDWIDE 1, 1 (June 2011), available at http://www.akingump.com/files/Publication/48835fc6-1db9-4001-a086-05c4a400df08/Presentation/PublicationAttachment/87c63b35-bd66-4ecb-8048-063b749ae493/suren_gortsunyan_reprint_june11.pdf; see also Ekaterina Sjostrand & Anna Ovcharova, *A Practical Instrument or a Legal Fiction? The Law and Practice of Shareholders' Agreement in Russia*, CORP. RESCUE & INSOLVENCY ONLINE 1, 1 (June 2010), available at http://www.vegalex.ru/data/2010/07/05/1234613478/CRL_June_Sjostrand.pdf.

27. See discussion *infra* Part III.

28. See Oda, *supra* note 6, at 360.

by Russian law and accept limited options; (2) they can attempt to use old solutions, such as an offshore holding companies, to work around the requirement that Russian law (and only Russian law) governs Russian corporations; or (3) they can take their money elsewhere. Given the judicial trends examined in this Note, it would be extremely unwise for investors to attempt a fourth option: applying foreign law to a shareholders' agreement with a Russian corporation and risking near-certain judicial avoidance.

I. Comparative Legal Grounds for Shareholders' Agreements

Shareholders' agreements serve as basic contractual instruments for structuring the relationship between a corporation and its shareholders. Though the corporation's founding documents traditionally govern this relationship, shareholders' agreements can offer some flexibility in structuring shareholder rights. Different legal systems have various approaches to shareholders' agreements. For example, in the United Kingdom, shareholders' agreements are valuable instruments that allow small companies to work around statutory provisions and increase the flexibility of their corporate structure.²⁹ The key differences between American and Russian conceptions of the role of, and legal provisions for, shareholders' agreements arise from two things: the two countries' different histories regarding the development of corporate law and different methods of judicial interpretation of legislation. To understand why shareholders' agreements have developed on their current track in Russia, an understanding of the role the instrument plays in American corporate law is helpful. In comparison to the American scheme and its history in the country's corporate law development, the Russian requirement of statutory explicitness and deference to the content of particular, hierarchical laws becomes clear.

A. The Basis for and Use of Shareholders' Agreements in the United States

In the United States, state law governs much of corporate activity, including many of the mechanics of formation and governance;³⁰ corporations are thus largely "creatures of state law."³¹ However, federal law plays a role by governing the transfer of securities, and is thus extremely influential when a company is either publicly held or is fundraising through securities sales.³² Thus, both levels of government govern shareholder rights to some degree.

29. Geoffrey Morse, *Partnerships for the 21st Century? Limited Liability Partnerships and Partnership Law Reform in the United Kingdom*, 2002 SING. J. LEGAL STUD. 455, 459-60 (2002).

30. See DAVID A. WESTBROOK, *BETWEEN CITIZEN AND STATE: AN INTRODUCTION TO THE CORPORATION* 23-26 (2007).

31. *Id.* at 23.

32. These include the Securities Act of 1933, the Securities Exchange Act of 1934, and the Sarbanes-Oxley Act of 2002. For the purposes of brevity, the extent to which the federal government impacts corporate action through regulation and legislation in other areas (such as environmental law or employment law) will not be considered here.

The powers of shareholders are limited to what the corporate statutes of each state allow. Most states' statutes are quite similar:³³ twenty-four states follow the original or revised version of the Model Business Corporation Act (MBCA), and the remaining codes are similar.³⁴ These statutes govern the relations among shareholders, between shareholders and the company, and often provide limitations on what shareholders may or may not do without action from the board of directors.³⁵ The constitutional documents of the corporation, such as the charter and the by-laws, specify the scope of these relations and restrictions.³⁶ These private agreements, structured by public law, form the basis of United States corporations. Maintaining private contracts as a means of structural flexibility is also a goal of the statutory regime; in 2010, the American Bar Association, drafters of the MBCA, stated: "providing statutory flexibility for private ordering by boards and/or shareholders within the centralized model generally is preferable to a more prescriptive one-size-fits-all approach."³⁷ Most corporate statutes reflect this flexibility, which allow shareholders' agreements to include provisions that contradict other sections of the corporate statute.³⁸ Though state and federal influence is palpable, as exemplified by the recent financial crises and the passage of the Sarbanes-Oxley Act,³⁹

33. See John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 Nw. U. L. REV. 641, 702 (1999) ("[T]he best documented finding in the empirical literature on the U.S. corporate chartering competition is that a high degree of uniformity has emerged in American corporate laws.").

34. See Lucian Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 844 (2005).

35. See JEFFREY D. BAUMAN, *CORPORATIONS: LAW AND POLICY* 420-21 (7th ed. 2010).

36. See Bebchuk, *supra* note 34, at 843-44.

37. COMM. ON CORP. LAWS OF THE AMERICAN BAR ASS'N SECTION OF BUS. LAW, REPORT ON THE ROLES OF BOARDS OF DIRECTORS AND SHAREHOLDERS OF PUBLICLY OWNED CORPORATIONS 2 (2010), available at http://www.hunton.com/media/SEC_Proxy/PDF/SEC_Agenda_Section2.PDF.

38. See Model Bus. Corp. Act § 7.32(a)(1)-(8). This section itself is drawn in broad terms, providing the following catchall: "[The agreement is in compliance with the statute if it] otherwise governs the exercise of the corporate powers or the management of the business and affairs of the corporation or the relationship among the shareholders, the directors and the corporation, or among any of them, and is not contrary to public policy." *Id.* § 7.32(a)(8). California's Corporate Code is broader, but is somewhat less clear regarding acceptable boundaries. Although it does not provide an exhaustive list of acceptable agreement provisions, it is cross-referenced with many other sections of the Corporate Code to provide applicable boundaries. Cal. Corp. Code § 300(b) ("Notwithstanding subdivision (a) . . . , but subject to subdivision (c), no shareholders' agreement, which relates to any phase of the affairs of a close corporation, including but not limited to management of its business, division of its profits or distribution of its assets on liquidation, shall be invalid as between the parties thereto on the ground that it so relates to the conduct of the affairs of the corporation as to interfere with the discretion of the board or that it is an attempt to treat the corporation as if it were a partnership or to arrange their relationships in a manner that would be appropriate only between partners.").

39. See generally Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002) (increasing federal presence in the corporate regulation through the establishment of PCAOB). However, overall trends are the main consideration in this examination of a tendency towards private contract preference in the United States. Though representa-

the trend over the past two hundred years has been toward more permissive incorporation statutes and the “private ordering of the corporate relationship.”⁴⁰ One key thing to note, however, is that private corporations generally make greater use of shareholders’ agreements than do large, public corporations because the established corporate rules for public companies regarding the sale of securities generally remove the need for private ordering found in most smaller, public corporations.⁴¹

Shareholders’ agreements provide an instrument for corporations to take advantage of statutory flexibility, though the size of the corporation often affects the role the agreement will play in corporate governance.⁴² In small, private, or closely held corporations, shareholders’ agreements are a valuable way to structure the corporate entity through control provisions regarding voting and ownership, dispute resolution, future capital contributions, or governing law.⁴³ Though some commentators claim that large public corporations derive little benefit from shareholders’ agreements,⁴⁴ such agreements remain relevant to large public corporations for mergers,

tive of increased government regulation in the corporate sphere, the Sarbanes-Oxley Act stands as both a political response to the Enron scandal and a codification of governance principles based partially on corporate best-practices standards promulgated by corporations themselves. See Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper’s Guide to the Psychology, Culture, and Ethics of Financial Risk Taking*, 96 CORNELL L. REV. 1209, 1213 (2011); Johanna Pitcairn, *Corporate Compliance and Executive Compensation Since the AIG Scandal*, 82 N.Y. ST. B. J. 35, 35 (Nov.-Dec. 2010), available at <http://www.nysba.org/AM/Template.cfm?Section=Home&ContentID=44567&Template=/CM/ContentDisplay.cfm> (“Compliance is a unique body of law consisting primarily of a combination of government-created incentives and standards for compliance in addition to a small body of judicial decisions. The law of compliance mostly mirrors compliance best practices within organizations, which were created from initiatives that corporations and other organizations developed. Legal compliance could be well described as a give-and-take approach between the business world and the government.”).

40. Henry N. Butler & Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 9 (1990); see also Roberta Romano, Comment, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1601 (1989) (noting that “[t]he history of corporation codes suggests that when a mandatory rule’s constraint becomes binding . . . , then the code is invariably revamped in the direction of less restrictive . . . terms Even when states have restricted the actions of takeover bidders, the provisions have opt-out features. The steady movement toward enabling code provisions should give one pause before declaring any specific provision unalterable.”) (citations omitted); Katharine V. Jackson, *Towards a Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis*, 7 HASTINGS BUS. L.J. 309, 328 (2011) (“Over the course of American history, the corporation transformed from a creature of the sovereign government serving public purposes into privately ordered individual business interests.”).

41. See D. Gordon Smith et al., *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 127-30 (2011) (suggesting that large public corporations could increase efficiency and mitigate transaction costs by privately ordering the corporation using contractual arrangements, similar to the successful use of shareholder agreements in closely held corporations).

42. See *id.*

43. See *id.* at 127-30, 170-71.

44. See Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of Firms*, 93 VA. L. REV. 515, 539-40 (2007).

acquisitions, information sharing, and competition control.⁴⁵

Corporate law in the United States has developed alongside the country's growing free-market economy. Thus, the concept of shareholders' agreements has grown and developed in much the same fashion. The dual system of state and federal law has also prompted different laws throughout the country to respond to various political needs. Quite the opposite is true in Russia, where corporate law has developed over a much shorter time span and in response to a substantially different political climate.

B. The Legal Basis for Corporate Law and Judicial Review in the Russian Federation

Various laws regulate business in the Russian Federation. It is noteworthy that the laws governing corporations in Russia are those of the Russian Federation as a whole, rather than the laws of distinct political regions.⁴⁶ Russia's civil law tradition creates a hierarchy of legal sources from which courts may draw, though the exact scope of Russian "sources of law" remain a basis for debate, and the hierarchy is generally seen as non-exhaustive.⁴⁷ However, Article 120 of the Russian Constitution, Article 13 of the Arbitrazh Procedure Code, and Article 11 of the Civil Procedure Code outline the general sources of law and normative acts from which judges may draw when deciding cases.⁴⁸ On the broadest scale, the

45. See Brian Graves, *Shareholder Agreements*, MCCARTHY TETRAULT LLP (Feb. 21-22, 2005), http://www.mccarthy.ca/pubs/Insight_paper_Ver_two.pdf.

46. See GK RF art. 51 (noting that corporations must register with the state, and that such registration marks the corporation's "creation").

47. See ALEXANDER VERESHCHAGIN, *JUDICIAL LAW-MAKING IN POST-SOVIET RUSSIA* 93 (2007).

48. KONSTITUTSIA ROSSIJSKOI FEDERATSII [KONST. RF] [CONSTITUTION] art. 120, §§ 1-2 ("Judges shall be independent and shall obey only the Constitution of the Russian Federation and the federal law. A court of law, having established the illegality of an act of government or any other body, shall pass a ruling in accordance with law.") (English translation provided by "Garant-Service," available at <http://www.constitution.ru/en/10003000-07.htm>.) (last visited Oct. 2, 2011)); GRAZHDANSKII PROTSESSUAL'NYI KODEKS ROSSIJSKOI FEDERATSII [Civil Procedure Code] art. 11 (For example, Section 1 states:

Суд обязан разрешать гражданские дела на основании Конституции Российской Федерации, международных договоров Российской Федерации, федеральных конституционных законов, федеральных законов, нормативных правовых актов Президента Российской Федерации, нормативных правовых актов Правительства Российской Федерации, нормативных правовых актов федеральных органов государственной власти, конституций (уставов), законов, иных нормативных правовых актов органов государственной власти субъектов Российской Федерации, нормативных правовых актов органов местного самоуправления. [The court is obliged to resolve civil cases under the Constitution of the Russian Federation, international treaties of the Russian Federation, federal constitutional laws, federal laws, normative legal acts of the President of the Russian Federation, normative legal acts of the Government of the Russian Federation, normative legal acts of state agencies and authorities, the constitutions (charters), laws and other normative legal acts of public authorities of the Russian Federation, [and] normative legal acts of local self-governing authorities.]

The remaining sections also lay out specific situations in which certain sources of law may be considered.); ARBITRAZHNO-PROTSESSUAL'NYI KODEKS ROSSIJSKOI FEDERATSII [APK

Constitution of the Russian Federation provides the basis for the government's law-making power in the realm of economic regulation. The Constitution specifically provides for the government's implementation of "a single financial, credit and monetary policy . . ." ⁴⁹ The Constitution also provides for the government's jurisdiction in deciding "the principles of federal policy and federal programmes in the sphere of . . . economic . . . development . . . [and] establishment of legal groups for a single market," as well as for "financial, currency, credit, and customs regulation, money issue, the principles of pricing policy," and "federal economic services, including federal banks . . ." ⁵⁰

Pursuant to this grant of constitutional authority, the Civil Code of the Russian Federation encompasses the basis of corporate law in Russia.⁵¹ Other federal laws adopted in accordance with the existing Civil Code, but not published in the Code itself, are of equal legal importance.⁵²

The Civil Code itself is comprised of four main parts. The first section contains the chapter most relevant to the structure of corporations and their legal standing in the Russian Federation.⁵³ Chapter 4 of the first section introduces the Russian legal conception of the "juristic" or "juridical" person,⁵⁴ which is equivalent to the concept of a "legal entity."⁵⁵ This chapter also introduces the various types of economic partnerships or "societies."⁵⁶ Of these, the joint-stock societies, which are the Russian analogs of corporations, are most relevant to the discussion of shareholders' agreements.⁵⁷

Two forms of joint-stock society are provided in Articles 96 to 104 of the Code—the open and closed joint-stock societies.⁵⁸ These corporations are governed both by their enabling sections of the Civil Code and by subsequent legislation compiled in the Federal Law on Joint Stock Companies and its subsequent amendments.⁵⁹ The main distinction between the two types of joint stock society is in regard to stock sale and placement. Open societies may place shares privately or publicly, and stockholders may freely trade their shares.⁶⁰ Conversely, closed societies may only place shares privately, and shareholders hold right of first refusal if another

RF] [Code of Arbitration Procedure] art. 13 (outlining the same sources as the Code of Civil Procedure); see also VERESHCHAGIN, *supra* note 47, at 1, 93-94.

49. KONST. RF art. 114(b).

50. *Id.* art. 71(f)-(g).

51. See ORLOV, *supra* note 1, at 8.

52. GK RF art. 3(2); ORLOV, *supra* note 1, at 8.

53. ORLOV, *supra* note 1, at 33.

54. GK RF arts. 48-63.

55. ORLOV, *supra* note 1, at 36.

56. GK RF arts. 66-106.

57. Russian Limited Liability Companies are also established in this section of the Code, and are tangentially relevant to this discussion. See discussion *infra*.

58. GK RF arts. 96-104.

59. *Id.*; see also sources, *supra* note 16.

60. GK RF art. 97(1); see also COMMERCIAL LAWS OF THE RUSSIAN FEDERATION DIGEST 123 (Ilya Nikiforov ed., 2006) [hereinafter NIKIFOROV].

shareholder attempts to sell outside the society.⁶¹

The third section of the Code has also proven important to the use of shareholders' agreements in Russia, as it contains the main law applied by the courts in deciding conflict of law problems associated with shareholders' agreements. The two main provisions are Article 1202 and Article 1210. Article 1202 defines the "Personal Law of [the] Juridical Person" as the law "of the country where the juridical person is founded."⁶² This law applies to the entity insofar as questions of "creation, reorganization, and liquidation" arise, and governs legal capacity, procedures for acquisition, and internal relations (specifically, relations of the legal entity to any participants—thus, shareholders).⁶³ Article 1210, which allows choice of law provisions in contracts,⁶⁴ was thought to provide relative freedom regarding choice of governing law for shareholders' agreements in the late 1990s and early 2000s; however, this view shifted following the courts' consideration of shareholders' agreements in cases involving contractual choice of law provisions, as shown by the *Megafon* and *Russkiy Standart* cases.⁶⁵

A cursory consideration of Russian contract law is also necessary to illuminate the controversies surrounding shareholders' agreements. This requires a brief analysis both of the content of the Civil Code regarding contracts and of Russian tradition in contract interpretation. The general view is that the state allows parties to contract and then recognizes the legal force of the instrument.⁶⁶ This view is important in light of two elements of statutory construction in the Russian Federation. First, the only limitation on freedom of contract arises from the stipulation that neither the contract, nor its conditions, be contrary to Russian law.⁶⁷ Second, for an action to be legal, it is generally required that a statute explicitly make it legal.⁶⁸ This interpretation, which will be discussed at length below, is supported by the repetitive nature of the Civil Code's section regarding contracts.⁶⁹ Though the repetition may serve to reinforce the importance of freedom of contract and other principle matters of contract law, some commentators note that if courts view the repetition as establishing a pattern, those courts may consider the principle not to apply when not repeated. Alternatively, the main principles may be lost in a sea of specific

61. GK RF art. 97(2); see also NIKIFOROV, *supra* note 60, at 123–24.

62. GK RF art. 1202(1).

63. *Id.* art. 1202(2).

64. *Id.* art. 1210.

65. See cases cited *supra* note 8, and discussion *infra* Part II.

66. ORLOV, *supra* note 1, at 139.

67. GK RF arts. 421(4), 422(1); ORLOV, *supra* note 1, at 142.

68. See Oda, *supra* note 6, at 360; see also A. Ivanov & N. Pebedeva, *Soglashenie aktsionerov: shag vpered ili toptanie na meste*, KORPORATIVNYI IURIST, Sept. 2008, available at <http://clj.ru/discussion/conflict/090801>.

69. See GK RF arts. 420–53. One commentator has noted that many of the rules laid out in the section follow implicitly from the broader rules found in the first few articles, and that as a result, the subsequent articles are needlessly complex or repetitive. Stephen A. Smith, *The General Provisions on Contract in the Civil Code of the Russian Federation*, 30 REV. OF CENT. & E. EUR. L. 49, 52 (2005).

rules, deadening their importance and effect in specific cases.⁷⁰

Finally, a consideration of the legal landscape of corporate Russia also requires an examination of the federal arbitrazh courts. Judicial decisions are not precedent and have never been granted status as sources of law; in practice, however, judicial decisions remain important for their application and interpretation of the law.⁷¹ Though this Note addresses this topic in greater detail later in the analysis, a cursory introduction to the relevant courts will be helpful at this stage.

Arising from the ashes of Soviet arbitrazh courts,⁷² contemporary arbitrazh courts have jurisdiction over all economic disputes, and with few exceptions,⁷³ are the sole arbiters in most matters of corporate law.⁷⁴ There are four levels of arbitrazh courts, ranging from the commercial courts of first instance to the Supreme Commercial Court, which hears disputes from the highest appeals districts throughout the country.⁷⁵ This exclusivity of purpose is particularly important because judicial interpreta-

70. See Smith, *supra* note 69, at 52.

71. VERESHCHAGIN, *supra* note 47, at 1, 5.

72. OFFICE OF E. EUR., RUSS. & INDEP. STATES, HANDBOOK ON COMMERCIAL DISPUTE RESOLUTION IN THE RUSSIAN FEDERATION 10-11 (July 2000), <http://www.nmfs.noaa.gov/sfa/PartnershipsCommunications/tradecommercial/documents/HandbookJuly2000.pdf>. The "state arbitrazh" system developed from the arbitrazh commissions of the 1920s to deal with:

disputes and difficulties in which a mandatory planning element or a relationship of subordination (as of an enterprise to a state body supervising its activities) was involved. It is important to note, however, that its jurisdiction was not defined in these terms, but rather by the characteristics or legal status of the parties. State arbitrazh courts had jurisdiction over disputes involving enterprises, institutions and other legal entities and over the disputes of legal entities with state bodies. Disputes involving individuals as one of the parties were handled by the courts.

Id. at 10. As such, the state arbitrazh system was not seen as a full court until after the fall of the Soviet Union, when it was granted status as a branch of the judiciary and given "relatively broad jurisdiction." *Id.* at 11.

73. The Constitutional Court has ruled on two cases, while another was specifically refused as not meeting criteria for admissibility; the Supreme Commercial Court has also issued four joint decrees with the Supreme Court (of general jurisdiction). VERESHCHAGIN, *supra* note 47, at 208 & n.4. With these few exceptions, "it is no exaggeration to say that this area of Russian law was mainly developed through judgments and interpretive guidelines of the Supreme Arbitrazh Court." *Id.* at 208.

74. See Federal'nyi konstitutsionnyi zakon ot 28 aprelya 1995 No. 1-FKZ "Ob arbitrazhnikh sydakh v Rossiiskoi Federatsii" (s izmeneniyami i dopolneniyami) [The Federal Constitutional Law of 28 April 1995, No. 1-FKZ "On arbitration courts in the Russian Federation" (as amended)], SOBRANIE ZAKONODATEL'STVA ROSSIISKOI FEDERATSII [Russian Federation Collection of Legislation] 1995, No. 18, Item 1589, arts. 3-5. The Arbitrazh Procedure Code of the Russian Federation similarly reserves disputes arising from joint-stock societies for the jurisdiction of the arbitrazh courts. APK RF arts. 1-2, 27, 33 (assigning jurisdiction over all economic disputes, including those involving joint-stock societies, foreign organizations or corporations, or Russian organizations with foreign investments); see also NIKIFOROV, *supra* note 60, at 143-44. In this note, "arbitrazh court" or "arbitrazh courts" will be used as the general term when discussing the court as comprising all levels, while the more specific "Commercial Court" designation will be used when referring to a particular district court within the arbitrazh courts, or when discussing the Supreme Commercial Court.

75. NIKIFOROV, *supra* note 60, at 143-44.

tion of statutes remains the primary source of applicable law, with considerably less importance placed on precedential cases.⁷⁶

The arbitrazh courts, and the Supreme Commercial Court in particular, are relatively consistent, and some commentators have attributed this consistency to the manageable nature of the courts' limited jurisdiction and the Code of Arbitration Procedure's requirement that the appellant exhaust all other judicial remedies before appealing to the next level of the arbitrazh courts.⁷⁷ The development of the courts in the post-Soviet era has also put a premium on jurisprudential formality. The courts favor literal interpretations of statutes, and there are strict formal requirements conditioning the validity of many legal actions, though policy considerations are gaining strength in the arbitrazh courts.⁷⁸

This preference for strict interpretation arises from another important aspect of the arbitrazh court system: their short history.⁷⁹ After the fall of the Soviet Union, Russian corporate law was cobbled together from many sources, with the arbitrazh courts put in place to begin assessing and applying the relatively new legal concepts.⁸⁰ This implementation of a new legal system resulted in many unresolved issues,⁸¹ forming the legal and historical context for the conflicts arising around shareholders' agreements in the new Russian corporate sphere.

II. Shareholders' Agreements in Practice—the Russian Courts' Response and the Current State of the Law

Shareholders' agreements were widely utilized in Russia after the fall of the Soviet Union.⁸² However, in contrast to the United States and most other common law jurisdictions, both public corporations (open joint-stock societies) and private corporations (closed joint-stock societies) frequently use these agreements.⁸³ In order to provide for financial instruments or corporate structures that Russian law failed to recognize, foreign investors traditionally drafted agreements based on the foreign law most suitable to their purpose.⁸⁴ Aside from the importance of typical shareholders' agreement provisions,⁸⁵ there were three main problems that some investors sought to address using shareholders' agreements: gaps in the

76. NIKIFOROV, *supra* note 60, at 11.

77. See VERESHCHAGIN, *supra* note 47, at 230, 234.

78. See NIKIFOROV, *supra* note 60, at 11–12.

79. See VERESHCHAGIN, *supra* note 47, at 207, 218.

80. NIKIFOROV, *supra* note 60, at 11 (“[S]ecurities law is based on the US model whereas the RF Civil Code is closer to the European tradition, while bankruptcy law relies heavily on German legislation.”); see also VERESHCHAGIN, *supra* note 47, at 207, 218–19.

81. VERESHCHAGIN, *supra* note 47, at 219.

82. See Oda, *supra* note 6, at 359.

83. *Id.*

84. See Andrei Goltsblat, *Deal Structuring in Russia Under English Law*, FOCUS EUR. 116, 116–17 (Summer 2011), available at <http://www.americanlawyer-digital.com/americanlawyer/fe2011summer>.

85. Tag-along and drag-along provisions were, and are, considered especially important. Oda, *supra* note 6, at 362, 365.

Russian corporate law, excessive rigidity in the corporate law that did exist, and rampant abuse of shareholders, or the company itself, by corporate management.⁸⁶ Gaps in corporate law were particularly threatening where foreign investors, often from countries with established corporate law regarding shareholder relations, were involved. In these situations, a shareholders' agreement was necessary to address problems commonly addressed in foreign corporate law but unaddressed in Russian law, such as deadlocks among shareholders.⁸⁷

Rigidity in the laws that did exist was similarly problematic. Shareholder rights were granted by the corporate statutes according to percentage ownership in the corporation rather than by individual agreement specific to each company.⁸⁸ While many rights were granted for ownership of one share or more, others, including the right to pursue the liability of directors vis-à-vis the company in court and the right to propose candidates for board elections, were only granted after a certain level of ownership had been achieved.⁸⁹

Though these constraints were effective in limiting the freedom to contract for other arrangements, many shareholders faced the opposite problem: inability to assert the rights granted to them by the existing corporate laws.⁹⁰ One Russian economist working with the OECD noted that Russian companies were "notorious for the wildest violations of corporate law."⁹¹ In many cases, foreign or minority investors were conspicuously excluded from voting arrangements,⁹² excluded from decisions regarding share dilution that disproportionately affected them,⁹³ or saw their investments radically decline in value when the courts refused to protect invested assets.⁹⁴ High-level employees were frequently scapegoats for creative accounting, the use of the mafia to collect on business debts, or illegal funds transfers.⁹⁵

86. *Id.* at 359.

87. *Id.* This possibility was absent from the Russian law until the 2009 amendment. *Id.*

88. ODA, *supra* note 2, at 150.

89. *Id.*

90. Oda, *supra* note 6, at 359.

91. *Id.* at 360; *see also* OECD Observer, *supra* note 11.

92. *See* ODA, *supra* note 2, at 152. Representative of common tactics, a foreign investor who held 49% of the stock in a closed joint-stock society brought an action in Russian Courts to invalidate a resolution to liquidate the company, which the foreign investor was excluded from voting in. *Id.* Two courts dismissed the claim on the ground that there had been a representative at the meeting; the representative, a Russian citizen, did not in fact have the power to represent the foreign company. *Id.*

93. *See id.* A specific example here arises from a 1999 shareholder meeting for Yukos, Russia's second largest oil company; there was a vote to cause a 194% share dilution in one of Yukos's largest subsidiaries, from which the largest minority shareholder was actively barred. *Id.*

94. OECD Observer, *supra* note 11.

95. *See* ALENA V. LEDENEVA, HOW RUSSIA REALLY WORKS: The Informal Practices That Shaped Post-Soviet Politics and Business 164, 166-70 (2006) (describing the experience of an accountant who faced criminal charges for her previous employer's loan fraud and forced use of criminal organizations to recover unpaid loan amounts).

Though these three situations highlight the reasons foreign investors sought additional protection, they also highlight the reasons many investors began to flee Russian jurisdiction either by avoiding incorporating in Russia or by withholding investment dollars entirely.⁹⁶ Legislators realized the loss of capital sustained due to improper business practices and lack of investor protection, but did little to improve these practices through greater acknowledgement of investor contractual rights.⁹⁷ It was not until the arbitrazh courts invalidated two shareholders' agreements in 2006 that legislators realized the necessity of reforming Russian corporate law.⁹⁸

A. The Watershed Cases: *Megafon* and *Russkiy Standart*

Two 2006 cases serve as the benchmark of both judicial consideration and investor fear of invalidated shareholders' agreements. The first was the now-infamous *Megafon* case, a major ruling that overturned an agreement between the shareholders of one of Russia's largest mobile telephone service providers.⁹⁹ The second was the *Russkiy Standart* case, decided months after *Megafon*, which invalidated a similar shareholders' agreement.¹⁰⁰ Though the courts differed on some points of contract law, the common basis of their rulings was clear—the use of foreign law to govern shareholders' agreements would no longer stand in Russian courts, and the status of shareholders' agreements as valid contracts at all was on shaky ground.¹⁰¹

The *Megafon* case arose from a shareholders' agreement signed by shareholders constituting 97 percent of Megafon's ownership.¹⁰² Governed by Swedish law, it included provisions governing proportional appointment of representatives of certain shareholders to the board of directors, voting agreements to achieve this end, procedures for electing the chairman of the board, and a prohibition on assigning stock to a competitor of Megafon.¹⁰³ Furthermore, any disputes were to be resolved at the Stockholm Institute of Arbitration.¹⁰⁴

A group of companies challenged the shareholders' agreement,¹⁰⁵ claiming that the agreement was in violation of both the Civil Code and the

96. Oda, *supra* note 6, at 359–60.

97. *See id.*

98. *Id.* at 361.

99. *Megafon Case*, *supra* note 8.

100. *Russkiy Standart Case*, *supra* note 8.

101. *Id.*; *Megafon Case*, *supra* note 8.

102. Oda, *supra* note 6, at 360.

103. *Id.*

104. *Id.*

105. The group of companies (JSC Telecominvest, Sonera Holding BV, Telia International AB, Avenue Limited, Santel Limited, Canan Properties Limited, Janow Properties Limited, and IPOC International Growth Fund Limited) held 100% of the shares of a corporation that was a minority shareholder of Megafon and that was party to the shareholders' agreement at issue. *See* Oda, *supra* note 6, at n.31. The plaintiffs purchased the minority shareholder corporation after the shareholders' agreement at issue was signed. *Id.*

Law on Joint Stock Companies.¹⁰⁶ Specifically, the plaintiffs argued that the application of foreign law to the shareholders' agreement was a direct violation of Article 1202 of the Civil Code, and that the rights and duties as outlined in the agreement violated Russian public policy.¹⁰⁷ The claim was initially brought in the arbitrazh court of first instance in the Khanty-Mansiysk Autonomous District in Western Siberia; the lower court ruled that deviation from the rules set forth in Article 1202 regarding the governing law of the juridical person could only occur where explicitly permitted by another law or Code provision.¹⁰⁸ The court found that no provision existed here, and that the shareholders' agreement, a private contract, was insufficient to provide such a legal basis.¹⁰⁹ Thus, the choice of foreign law to govern a juridical person based in Russia, which Megafon is, was against public policy and public order.¹¹⁰ The ruling also made clear that foreign law could not apply to any question regarding the status of the legal entity, and that agreements defaulting to such foreign law were therefore void.¹¹¹

The defendant shareholders appealed the case to the next level of appeals, but the lower court's ruling was upheld without argument.¹¹² The shareholders then appealed to the highest regional appeals court, the West-Siberian District Commercial Court.¹¹³ This court largely agreed with the ruling of the Khanty-Mansiysk court, with one exception: the West-Siberian District Commercial Court did not state that the application of foreign law was against public policy and order. However, their conclusion had much the same effect. The court ruled that while parties are ordinarily able to choose the law governing an agreement, the law governing the status of a legal entity, with "status" including the legal form, capacity, and relations between the entity and its shareholders must be that of the place of the entity's incorporation.¹¹⁴ Thus, because Megafon was incorporated in Russia, the shareholders' agreement regulated the status of a Russian company, and Russian law must govern the agreement.¹¹⁵

Further, the court ruled that a shareholders' agreement should not contradict either mandatory provisions of Russian law or the corporation's own charter documents.¹¹⁶ As a result, various clauses of the shareholders' agreement were automatically void as running counter to provisions of the Civil Code and the Joint Stock Company Law, which also stipulate that corporate charters are the correct platform for addressing any discretion-

106. Megafon Case, *supra* note 8.

107. Oda, *supra* note 6, at 360.

108. Megafon Case, *supra* note 8.

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. *See id.*

114. *Id.*

115. *Id.*

116. *Id.*

ary elements of corporate governance.¹¹⁷ The court noted two particular elements of the shareholders' agreement that were obviously counter to mandatory Russian law: preemption rights of shareholders and non-competition clauses.¹¹⁸ Preemption rights, which allow shareholders in certain circumstances to purchase stock before it is made available on the public stock exchange, were viewed by the court as imposing a burden on the alienation of stock, which is disallowed under Art. 97 of the Civil Code for open joint stock corporations.¹¹⁹ The court similarly rejected the non-competition clause of the shareholders' agreement, which prevented both the transfer of shares to company competitors and participation as a shareholder in a competitor.¹²⁰ The court declared the non-competition clause void as in violation of Russian legal order, particularly noting the requirements of Art. 55 of the Constitution, which ensures that rights granted by the government not be restricted.¹²¹ The defendants attempted to appeal to the Supreme Commercial Court, but review was denied.¹²²

The next major case came shortly after *Megafon*. This case centered on *Russkiy Standart Strakhovaniye JSC*, an insurance company. The shareholders' agreement at issue here was based on United Kingdom law, and contained many of the same provisions as those at issue in *Megafon*.¹²³ Brought in Moscow, and finally appealed to the Moscow District Commercial Court, the case had a strikingly similar final ruling, with the court noting that:

[T]he [shareholders'] agreement regulates questions of the legal status of a [Russian company], the procedure for establishing a company, the size of its share capital, the extent of its legal capacity, the internal relations of the company, that is, questions which by virtue of Art 1202 of the Russian Civil Code shall be determined in accordance with the law of the legal entity,

117. *Id.* ("Соглашения акционеров между собой возможны только по вопросам, прямо определенным законом (ст. 98 ГК РФ, ст. 9 Закона). Заключенные акционерами соглашения не могут нарушать законодательство страны и учредительные документы Общества. Заключением оспариваемого Соглашения нарушены как нормы законодательства, так и положения учредительных документов Общества (п. 2.3, 3.6, 3.7(а), 4.8).") [Shareholders' agreements are possible only on those issues that are expressly defined by law (Art. 98 of the Civil Code of the Russian Federation, art. 9 of the Law on Joint Stock Companies). The agreement reached by the shareholders cannot violate the laws of the country and the founding documents of the Company. The conclusion of the contested agreement violated the norms of the law, as well as the provisions of the founding documents of the Company (sections 2.3, 3.6, 3.7(a), 4.8 of the Agreement).]; see also *Oda*, *supra* note 6, at 361; *ASANTI ET AL.*, *supra* note 3, at 422.

118. *ASANTI ET AL.*, *supra* note 3, at 423-24.

119. GK RF art. 97 (defining an open joint-stock society as one in which stockholders may alienate stock without the consent of other stockholders); *Megafon Case*, *supra* note 8; see also *ASANTI ET AL.*, *supra* note 3, at 423.

120. See *ASANTI ET AL.*, *supra* note 3, at 423; *Megafon Case*, *supra* note 8.

121. KONST. RF art. 55; *Megafon Case*, *supra* note 8; *ASANTI ET AL.*, *supra* note 3, at 423.

122. *Oda*, *supra* note 6, at 361. Review by the Supreme Commercial Court is extremely discretionary and quite rare; the highest level of the appeals court generally has the final word on most matters. *Id.*

123. See *Megafon Case*, *supra* note 8; *Russkiy Standart Case*, *supra* note 8.

which is the law of the Russian Federation¹²⁴

Aside from the recognition that Russian law applies to Russian corporations under Article 1202, the court also noted that the same Article 1210 problem was also present—the agreement could not purport to apply law or to incorporate provisions that directly conflict with mandatory laws of the Russian Federation.¹²⁵ The Moscow Arbitrazh Court also reemphasized that only Russian law and the company’s founding documents could regulate the rights and obligations of any constituent shareholders, and that any shareholders’ agreement could not override any parts of the founding documents of the corporation.¹²⁶ The court was also troubled by shareholders’ agreement terms that went beyond the scope of the founding documents; thus, terms in the shareholders’ agreement that restricted rights unaddressed in the founding documents were also void.¹²⁷ The final ruling was that the agreement was unenforceable and void.¹²⁸

B. The Russian Government’s Initial Response and the Slow Road to the 2009 Amendment

Following the *Megafon* and *Ruskiy Standart* cases in 2006, there was a widespread “flight of companies from Russian jurisdiction.”¹²⁹ This loss of capital became a concern for the Russian government, and two government agencies prepared potential legislation as a response.¹³⁰ The first agency was the Ministry for Economic Development, which began assembling draft legislation to reform the joint-stock company laws.¹³¹ The second was the Commission on the Codification and Improvement of Civil Legislation under the Presidential Administration (the Commission), which began drafting changes for a potential reform of the Civil Code.¹³²

124. *Ruskiy Standart Case*, *supra* note 8; *see also* Sjostrand & Ovcharova, *supra* note 26.

125. *Ruskiy Standart Case*, *supra* note 8; *see also* Sjostrand & Ovcharova, *supra* note 26.

126. *Ruskiy Standart Case*, *supra* note 8 (“Согласно п.1 ст.67 ГК РФ, права и обязанности акционеров могут регулироваться кодексом, ФЗ “Об акционерных обществах”, учредительными документами. Закон не предусматривает возможности регулирования прав и обязанностей акционеров никакими иными документами, в том числе соглашениями акционеров.” [According to Section 1 of Article 67 of the Civil Code of the Russian Federation, the rights and obligations of shareholders can be governed by the Code, the Federal Law “On Joint Stock Companies,” and the founding documents. The law does not provide an opportunity for the regulation of rights and obligations of shareholders by any other documents, including shareholders’ agreements.]).

127. *Id.* (“Пункт 2.6 ограничивает право ООО “РС Инвест” на внесение вклада в уставный капитал общества в неденежной форме, что противоречит п.2 ст.34 Федерального закона “Об акционерных обществах”, так как устав общества не содержит подобного ограничения.” [Paragraph 2.6 [of the Agreement] limits the right of LLC “PC Invest” to contribute to the company’s authorized capital in kind, which is contrary to para. 2, Article 34 of the federal law “On Joint Stock Companies,” as the company’s charter does not contain such a restriction.]).

128. *Id.*

129. Oda, *supra* note 6, at 361.

130. *Id.*

131. *Id.*

132. *Id.*

Though both were attempting similar results through amendment of different laws, the Ministry for Economic Development was the first to publish its draft changes, and thus, the first to receive broad critiques.¹³³

The draft had two goals: the statutory goal of giving a basis to shareholders' agreements without contradicting the provisions in the Civil Code that the arbitrazh courts had singled out as most important, and the financial goal of increasing the "international competitiveness of the Russian model of management."¹³⁴ Thus, flexibility became a focus. The draft accomplished this flexibility by providing a list of what subject matter could be covered in acceptable shareholders' agreements, with the final note that the list was not exhaustive—other terms could be provided for so long as they did not contradict "the principles of civil law."¹³⁵

The draft was discussed at a meeting of the Commission in October of 2007, and two competing views quickly became apparent.¹³⁶ Those proposing the legalization of shareholders' agreements through statutory incorporation believed in its necessity in persuading investors to return to Russian jurisdiction and to boost the Russian economy.¹³⁷ On the opposing side were those politicians who felt that all shareholders' agreements are essentially "circumvention[s] of the law" which would encourage changes to corporate governance that could further harm the interests of minority shareholders.¹³⁸ Neither side won an overwhelming victory and, in July 2008, the Ministry issued a statement noting that the proposed draft required further examination and would not be passed in its current state.¹³⁹ Any possible changes to the law regarding shareholders' agreements languished in the bureaucracy.

Shareholders' agreements were finally considered as serious additions to amendments at the end of 2008;¹⁴⁰ however, they did not appear in the form originally debated. The 2008 amendment modified the Limited Liability Companies Law, rather than the Joint-Stock Society Law.¹⁴¹ This result was peculiar, since the 2007 discussions described amending the LLC laws as a secondary objective.¹⁴² The 2008 amendment formally introduced the concept of "investors' agreements" into the Russian legal lexicon, and thus provided legitimacy for the concept; however, it was a

133. *See id.*

134. Prezident Rossiiskoi Federatsii Poiiasnitel'naia zapiska k proektu federal'nogo «O vnesenii izmenenii b nekotoryye zakonodatel'nye akty Rossiiskoi Federatsii v chasti regulirovaniia instituta aktsionernykh koglashenii» [President of the Russian Federation's Memorandum to the draft federal law "On Amendments to Certain Legislative Acts of the Russian Federation with regard to regulation of the institution of shareholder agreements."], available at http://corp-gov.ru/bd/db.php3?db_id=4311&base_id=49; see Draft Law, *supra* note 15.

135. Draft Law, *supra* note 15.

136. Oda, *supra* note 6, at 362.

137. *Id.*

138. *Id.*

139. Conclusion on Draft Law, *supra* note 16.

140. Oda, *supra* note 6, at 362.

141. *Id.* at 362–63.

142. *Id.* at 363.

non-starter for many legal commentators.¹⁴³ As introduced, the idea of the agreement was extremely vague,¹⁴⁴ and many considered it largely a symbolic gesture on the part of the Russian legislature to provide form rather than accommodate real substance.¹⁴⁵ The move was unexpected, and generally derided, but it provided the impetus for future change.

C. The 2009 Amendment and the Initial Response of the Russian Legal Community

The final amendment to the Federal Law on Joint Stock Companies, after much debate,¹⁴⁶ was signed by President Medvedev on June 3, 2009 after adoption by the State Duma on May 22 and approval by the Council of Federation on May 27.¹⁴⁷ Though the amendment represented a step forward to most Russian legal commentators, its form and wording provided problems for many others.

The amendment began by defining a shareholders' agreement as "a contract concerning the rights certified by shares, and (or) concerning the features of the rights to the shares."¹⁴⁸ The amendment then went on to define the purpose of the contract more generally as one that governs how one may exercise rights certified by shares, or the circumstances where one may or must refrain from exercising these rights. The following sentence described permissible content in line with that scope:

[A] [s]hareholders' agreement may provide for the obligations of parties to vote a certain way at a general meeting of shareholders, to agree on variants of voting with other shareholders, acquire or dispose of shares at a predetermined price and (or) in certain circumstances, to abstain from the sale of shares in certain circumstances, and perform other actions consistently associated with the management of the company, with activities, operations, reorganization and liquidation of the company.¹⁴⁹

With the permissible scope of agreements established, the amendment also addresses key issues regarding consequences of breaching a shareholders' agreement concluded under the law. The first key section regarding breach of the agreement provides that the agreement only binds

143. See *id.*

144. *Id.*

145. See *id.* at 363.

146. See *id.* at 362, 365.

147. 2009 Amendment, *supra* note 18, cl. 1; see also Natalya Morozova, *Russian Joint Stock Companies Law Finally Recognizes Shareholders' Agreements*, V&E RUSSIA/CIS LEGAL UPDATE E-COMMUNICATION (June 16, 2009), http://www.velaw.com/resources/pub_detail.aspx?id=14124.

148. 2009 Amendment, *supra* note 18 ("Акционерным соглашением признается договор об осуществлении прав, удостоверенных акциями, и (или) об особенностях осуществления прав на акции.").

149. *Id.* ("Акционерным соглашением может быть предусмотрена обязанность его сторон голосовать определенным образом на общем собрании акционеров, согласовывать вариант голосования с другими акционерами, приобретать или отчуждать акции по заранее определенной цене и (или) при наступлении определенных обстоятельств, воздерживаться от отчуждения акций до наступления определенных обстоятельств, а также осуществлять согласованно иные действия, связанные с управлением обществом, с деятельностью, реорганизацией и ликвидацией общества.").

signatory parties. Because of this limitation, and the fact that the company itself cannot be a signatory to the agreement, breach of the shareholders' agreement cannot be the basis for invalidation of any resolutions passed by the corporation's governing body.¹⁵⁰ This provision is meant to protect the interests of the company, as well as any shareholders who are not signatories to the shareholders' agreement, from invalidation of majority vote merely due to a breach of the shareholders' agreement.¹⁵¹

The other important provision addressing consequences of breach lays out possible remedies for such a breach. This provision first states that the shareholders' agreement may provide means of enforcing the obligations inherent to the agreement, and that it may provide a measure of civil liability for "failure to perform or improper performance" of the agreement's stipulated obligations.¹⁵² The possible remedies listed include "the right to claim compensation for breach of the Agreement . . . , recovery of penalties (fines, penalties), compensation (a fixed monetary amount or amounts to be determined in the manner specified in the shareholder agreement) or use other measures of liability for breach of shareholder agreement"¹⁵³

The new amendment, while marking a step back from many of the suggestions put forth after the *Megafon* case, was initially viewed by some commentators as a step forward for Russian corporate law.¹⁵⁴ However, the language of the amendment quickly proved problematic, with two key issues noted by Russian lawyers: clauses originally included in draft laws were excluded from the amendment, and the language of many sections was vague.¹⁵⁵

The first key problem arose due to the tradition of exhaustive legislation. The draft law proposed in 2007 had contained a provision that made shareholders' agreements generally available under Russian law, and the provision further noted that shareholders' agreements could vary in con-

150. *Id.* (explicitly noting the restriction on invalidation of company decisions on grounds of agreement breach).

151. See Morozova, *supra* note 147.

152. 2009 Amendment, *supra* note 18.

153. *Id.* Commentators have noted that the inclusion of compensation as a possible remedy is unusual, given that the Civil Code does not include "compensation" as a remedy; however, parties may contract for specified damages, so it is possible the legislators intended "compensation" as a means of providing an opportunity to recover liquidated damages for breach of shareholders' agreements. Morozova, *supra* note 147. Similar to the treatment of liquidated damages in the common law tradition, judges in Russia may limit amount of damages awarded if the stipulated amount is too high, or not in line with the level of breach. See Evgeniya Berezkina, *Recent Developments in Russian Corporate Legislation: Will New Norms Secure the Future for Shareholders' Agreements?*, 16 COLUM. J. EUR. L. ONLINE 31, 34 (2009), http://www.cjel.net/online/16_1-berezkina.

154. Oda, *supra* note 6, at 364.

155. *Id.* Various Russian legal blogs also commented on the vague language and its potential problems. See T. Borisova, *A Good Beginning Is Half the Battle*, RUSSIAN LAW ONLINE: RUSSIA THROUGH LAWYERS' EYES (June 23, 2009), <http://www.russianlawonline.com/shareholders-agreement-joint-stock-company>; S. Smirnov, *Trick or Treat*, RUSSIAN LAW ONLINE: RUSSIA THROUGH LAWYERS' EYES (June 23, 2009), <http://www.russianlawonline.com/shareholders-agreement-joint-stock-company>.

tent as long as such content was consistent with principles of Russian civil law.¹⁵⁶ This general provision is absent from the amended law, which instead provides a much narrower catch-all, allowing agreements to consider “other actions consistently associated with the management of the company, with activities, operations, reorganization and liquidation of the company.”¹⁵⁷ Without a broad catch-all provision authorizing shareholders’ agreements to include any content permissible under Russian law, shareholders’ agreements are limited to the content expressly provided by existing law.¹⁵⁸ If the list provided in the first clause of the amendment is exhaustive, then the exclusion of certain permissible topics listed in the draft amendment (including dividend transfer to other agreement parties, agreements on candidates proposed for corporate bodies, and the possibility of giving a proxy to another party to the agreement) is troublesome in its limitation of shareholder activity.¹⁵⁹

The second problem with the amendment is the vague language used throughout the statute. One example arises from the phrasing of the clause addressing the assignment of shares. This clause allows the inclusion of content addressing the right of shareholders to “acquire or dispose of shares at a predetermined price and (or) in certain circumstances.”¹⁶⁰ It remains unclear whether the shareholders’ agreement must stipulate the details of these transactions, whether they may be addressed by shareholders ad hoc, or whether such ad hoc action would still require the occurrence of the particular “circumstances” noted in the 2009 Amendment.¹⁶¹ This is typical of the generally unclear language throughout the statute,¹⁶² which added complication and confusion to the recently-allowed document for shareholders and lawyers alike, particularly in light of the trend of judicial reliance on exhaustive legislation specifically allowing a particular action.¹⁶³

The amendment’s problems provide support for the theory that the amendment alone will not increase corporate reliance on shareholders’ agreements formed under Russian law. When considered in light of interpretive traditions in Russian legal culture, including the tendency towards exhaustive legislation, the political power such legislation creates, and the judicial preference for such legislation due to lack of precedence, it is clear that the Russian government has little to gain from permissive corporate laws, but much to gain from ensuring compliance with existing legislation and corporate traditions.

156. See Draft Law, *supra* note 15; see also Oda, *supra* note 6, at 364.

157. 2009 Amendment, *supra* note 18.

158. Oda, *supra* note 6, at 364.

159. See *id.* at 366.

160. 2009 Amendment, *supra* note 18.

161. Oda, *supra* note 6, at 366; see 2009 Amendment, *supra* note 18.

162. See Berezkina, *supra* note 153, at 34-35.

163. VERESHCHAGIN, *supra* note 47, at 93-95.

III. The Political Benefits of Exhaustive Governance

The preference for exhaustive legislation has played a key role in the development of the law pertaining to shareholders' agreements. From the reasoning of the court in the foundational cases¹⁶⁴ to changes made in the 2009 amendment,¹⁶⁵ the perception that laws should explicitly state what is allowed in shareholder agreements controls the applicability and scope of these agreements.

The Russian government has little reason to deviate from the tradition of exhaustive legislation. Exhaustive legislation gives the government control not only over actions taken in accordance with the law, both through the actions taken according to the law and through litigation should the action be challenged, but also over how the law is interpreted by the judiciary, given the constraints on the importance of precedence in the civil legal tradition. This control over how the law is practically enacted is essential to the Russian government, which is increasing its control not only over strategic resources and services, but also over the corporations that own and trade them. Thus, it is clearly important that the Russian government also maintain the application of Russian law to shareholders' agreements involving foreign investors. Should a different law apply to the agreements, the benefit of legislation directly controlling corporate activity would be lost.

The political, and frequently-trumpeted motivation behind allowing shareholders' agreements is fear of losing foreign investment. However, in light of the many benefits of retaining exhaustive regulations, it appears unlikely that legislation will expand freedom in the realm of shareholders' agreements. Moreover, in light of these legislative controls, it seems even less likely that the judiciary will relax its strict stance in applying the law to shareholders' agreements.

A. The Tradition of Exhaustive Governance and the Political Benefits of Control

As noted above, statutes are generally required to explicitly authorize an action.¹⁶⁶ Because of this requirement, there is a corresponding preference for normative legislation that is exhaustive regarding what the law permits.¹⁶⁷ This is particularly relevant in the corporate sphere, which has a long history of government control. Under the socialist system, the state's role as the sole owner of organizations firmly entrenched the concept of "imperative regulation" of corporate activity.¹⁶⁸ "Rule by law" rather than "rule of law" was the conceptual norm, with the law acting as

164. See holdings of cases *supra* note 8.

165. See 2009 Amendment, *supra* note 18 (listing acceptable content of shareholders' agreements).

166. See VERESHCHAGIN, *supra* note 47, at 234.

167. *Id.* at 94.

168. Alexander Vaneev, *Corporate Disputes, Arbitration and Shareholders Agreements in Russia: Getting Things Straight*, STOCKHOLM INT'L ARB. REV. (2008), <http://www.magisters.com/publication.php?en/693/articles>.

an expression of the government's political power and political goals.¹⁶⁹ The norms of law as both exhaustive and political survived the transition from socialism to capitalism; one Russian corporate lawyer has noted that "this principle became so entrenched that it survived afterwards as an odd legacy, even despite the advent of a market economy and the introduction of new types of legal entities based on private property."¹⁷⁰

It is particularly beneficial to the Russian government to maintain this norm in regard to foreign investment in the Russian corporate sphere. By conceptualizing the law as laying out the standards of conduct exhaustively, the government increases control over how the law is interpreted by the courts and how corporate actors, both domestic and foreign, respond.¹⁷¹ The Russian government's desire to have a controlling hand in industry, and particularly strategic industry, is clear: foreign investment in Russian companies is strictly controlled and often entirely disallowed for corporations controlling strategic resources, and Putin himself chairs the committee that oversees foreign investment in light of national security.¹⁷² The increase in the number of state corporations in recent years is another indicator of this norm of control. Medvedev consolidated the largest state-owned conglomerates into heavy-industry giant Rostekhnologiiia, which uses "vertically integrated holding groups," also controlled by the state, to concentrate "state-led development of the military-industrial complex and strategic civilian industries . . ."¹⁷³ Concern with control trumps considerations of private shareholders when Russian interests are at stake—when Viktor Chemezov, the CEO of Rostekhnologiiia, was questioned about possible resistance from private, non-state investors, his response was "who cared if there were private shareholders, 'most important is that state corporations provide control.'"¹⁷⁴

Lawyers advising other state-owned corporations have similarly recognized that while increasing the availability of shareholders' agreements simultaneously increases investment, limitations on their scope are necessary. Yulia Lazareva, counsel to state-owned Rusnano (a nanotechnology conglomerate), has stated that shareholders' agreements must be limited in scope to prevent investors from working around the essential requirements of the company's founding documents and relevant federal laws controlling

169. See JEFFREY HASS, *POWER, CULTURE, AND ECONOMIC CHANGE IN RUSSIA: TO THE UNDISCOVERED COUNTRY OF POST-SOCIALISM, 1988–2008*, at 165, 191 (2011).

170. Vaneev, *supra* note 168.

171. See HASS, *supra* note 169, at 164–65, 195–206.

172. *Id.*; *Putin to Personally Control Foreign Investments in Russia's Strategic Industries*, PRAVDA (June 5, 2008), http://english.pravda.ru/russia/economics/05-06-2008/105438-foreign_investments-0/#. Regarding controls on foreign investment in strategic industries, see generally Toby T. Gati, *Russia's New Law on Foreign Investment in Strategic Sectors and the Role of State Corporations in the Russian Economy*, AKIN GUMP STRAUSS HAUER & FELD LLP (Oct. 2008), <http://www.akingump.com/files/upload/Foreign-Investment%20in%20Russian%20Strategic%20Sectors%20-%20by%20Toby%20T.%20Gati.pdf>.

173. See HASS, *supra* note 169, at 213.

174. *Id.*

corporate governance and structure.¹⁷⁵ Thus, even after the amendment, the government still retains a significant amount of control over how shareholder rights are ensured and how shareholder relations are undertaken.¹⁷⁶ When one combines the limiting nature of the amendment, which details what is permissible content for an agreement,¹⁷⁷ and the fact that all other existing provisions of Russian law still apply,¹⁷⁸ the extent of shareholders' agreements after the amendment is not much greater than it was before, aside from the *de jure* recognition of their legality.

The decision not to provide for a choice of law clause in the amendment provides even stronger support for the assertion that the Russian government intended to maintain extensive control over the use of shareholders' agreements, particularly regarding foreign investors. All of the watershed cases regarding shareholders' agreements decided before the 2009 amendment addressed the importance of Russian law governing the agreements of a company incorporated in Russia; one of the primary reasons for invalidation in each case was that the agreements provided for application of foreign law or arbitration in a foreign court system.¹⁷⁹ The failure to address that aspect of shareholders' agreements, quite popular in practice due to the aforementioned preference for more predictable foreign corporate law,¹⁸⁰ is a glaring omission from a law meant to address the fears of foreign investors likely to flee Russian jurisdiction.¹⁸¹ Yet, in light of Russian legislation that increases control over corporate activity (particularly where foreign investment is involved), it is an entirely sensible omission—without a clause allowing choice of law for shareholders' agreements, Russian law must apply the law of the jurisdiction where incorporation occurred in Russia, making it impossible to adjudicate rights set out in a Russian corporation's shareholders' agreement outside of Russia.¹⁸² The goal of maintaining control over the Russian corporate sphere is thus strengthened by the amendment, and adherence to the tradition of exhaustive governance ensures that interpretation.

175. Interview by Alexei Pavlovich, *supra* note 24 (in which Lazarova answers a question regarding the limited scope of shareholders' agreements:

“Наверное, в каком-то смысле такой подход законодателя оправдан, потому что в противном случае акционерное соглашение просто-напросто заменило бы устав общества и императивные нормы закона об акционерных общества, в частности, о компетенции общего собрания акционеров, и так далее.” [Perhaps, in a sense, such an approach by the legislator is justified, because otherwise the shareholders' agreement would simply replace the company's charter and the mandatory provisions of the Law on Joint Stock Companies, in particular, about the competence of the general meeting of shareholders, and so on.].)

176. See *id.* (regarding the supremacy of existing Russian corporate law).

177. See 2009 Amendment, *supra* note 18.

178. See cases cited *supra* note 8 (both affirming that the terms of shareholders' agreements cannot contradict existing Russian law).

179. See cases and accompanying discussion, *supra* note 8.

180. See discussion *infra*.

181. See Sergei Voitishkin et al., *Amendments to Legislation on Joint Stock Companies*, BAKER & MCKENZIE CORPORATE & M&A LEGAL ALERT (July 2009), <http://www.legal500.com/assets/images/stories/corporate.pdf>.

182. See *Megafon Case*, *supra* note 8 (holding that Russian law must regulate subjects of the Russian state).

The role of the judiciary in interpreting the laws is similarly constrained by both an exhaustive amendment and a conservative, even “legally pragmatic,” approach.¹⁸³ Even in the most recent case, the courts have trended towards their initial, pre-amendment approach. As a result, little has changed in the legal landscape since the passage of the 2009 amendment.

B. The Response of the Arbitrazh Courts and Recent Rulings

The arbitrazh court most recently addressed shareholders’ agreements in their ruling on the case of *Verniy Znak*.¹⁸⁴ Though the law at issue is the amendment to the Limited Liability Company Law that passed in 2008, the provisions at issue in the case are similar to those found in the 2009 amendment to the Law on Joint Stock Companies.¹⁸⁵ The agreement at issue in the case was intended to be an experiment to test the scope of agreements under Russian law.¹⁸⁶ In the agreement, the two owners of the LLC *Verniy Znak* included various provisions that either contradicted, or exceeded the scope of the founding documents of the company.¹⁸⁷ The courts of each instance, through the Moscow District Commercial Court (the same court that decided *Russkiy Standart Strakhovaniye*), stated that provisions of the agreement ran counter to Limited Liability Company Law, noting in particular the law’s provision that disallows a shareholders’ agreement from contravening the founding documents of the company.¹⁸⁸ Most legal commentators have noted two things about the outcome of the case: first, that due to the similarities between the Limited Liability Company Law and the Law on Joint Stock Companies, any case presenting a similar issue regarding a joint stock corporation would likely be resolved the same way, and second, while the amendments give shareholders’ agreements legal form, they are practically useless due to the constraints on their content.¹⁸⁹ Even optimistic commentators are concerned with the result of the case—Alexandra Nesterenko, the president of the In-House Lawyers Association and deputy director of the legal department of Rusnano, suggested that perhaps the court disintegrated the agreement specifically because it was an experiment that attempted to test the limits of the law, and was thus invalid on those grounds (though the judgment does not

183. See VERESHCHAGIN, *supra* note 47, at 94, 230.

184. *Verniy Znak Case*, *supra* note 25.

185. See Oda, *supra* note 6, at 363 (describing the provisions in the Limited Liability Company Law).

186. See *False Sign*, VEDOMOSTI (June 10, 2011), http://mfc-moscow.com/index.php?id=59&_newslid=206; Ivan Viktorov, *Ivan Viktorov on Commercial Partnerships*, RUSSIAN LAW ONLINE, <http://www.russianlawonline.com/content/ivan-viktorov-commercial-partnerships> (last visited Jan. 16, 2012).

187. See sources cited *supra* note 186.

188. *Verniy Znak Case*, *supra* note 25; see sources cited *supra* note 186.

189. See Gortsunyan, *supra* note 26; sources cited *supra* note 186; Alexei Knyazhev & Ethan Heinz, *New Landscape, Same Map*, INT’L FIN. L. REV. (Aug. 31, 2010), <http://www.salans.com/en-B/Locations/-/media/Assets/Salans/Publications/2010/20100901New%20landscape%20same%20map.ashx> (highlighting what the law still fails to allow).

suggest that explanation).¹⁹⁰ However, she went on to note that if the basis of the decision was in fact the one feared by the other commentators, it could have drastic effects on the Russian investment climate.¹⁹¹

The Supreme Commercial Court is also unlikely to shift its course of interpretation; it heard none of the cases mentioned herein on appeal.¹⁹² Furthermore, Anton Ivanov, the Chairman of the Supreme Commercial Court, noted in a recent interview that “. . . shareholder agreements should be used with restraint, so they do not regulate too large a spectrum of issues.”¹⁹³ As a result, it seems unlikely that the conservative trend in applying the new amendments will change. The arbitrazh courts have a reputation for difficulty, with one lawyer going so far as to note that “the laws are not [as] tough as arbitrazh judges are.”¹⁹⁴ In such a climate, the current trends will likely continue.

C. The Current State of Shareholders' Agreements in Russia

Though courts can no longer void a shareholders' agreement solely on the ground that it lacks a statutory basis,¹⁹⁵ the current state of the law remains problematic. Following the 2009 amendment, most commentators in Russia stated that only time would tell how courts would respond to the new amendment and, thus, whether investors would begin structuring their agreements under Russian laws.¹⁹⁶ The judicial trends have stayed their course—invalidation of a contentious agreement seems to have become the general expectation.¹⁹⁷ Given the lack of incentive for the Russian government to change a law that so directly meets their goal of controlling the expression of shareholder rights, it is also unlikely that the new legislation will result in a freer use of the instrument. As a result, foreign investors should be wary in attempting to structure an agreement under foreign laws, or in direct violation of a company's charter, if the agreement pertains to a Russian corporation. There are various options remaining,

190. See *False Sign*, *supra* note 186.

191. *Id.*

192. See *Opredelenie ob otkaze v peredache dela v Prezidium Vysshego Arbitrazhnogo Suda Rossiiskoi Federatsii*, ot 12 sentiabria 2011, No. BAC-10364/11 [Determination of refusal to transfer the case to the Presidium of the Supreme Arbitration Court of the Russian Federation, on Sept. 12, 2011, No. BAC-10364/11], available at http://kad.arbitr.ru/PdfDocument/74ca1830-3edd-4e7a-9764-a339abc6cbc8/A40-140918-2009_20110912_Opredelenie.pdf; see also Sjostrand & Ovcharova, *supra* note 26, at 1.

193. See D. Kazmin, “*Nel'zya skazat', chto možhno ne platit'*”—Anton Ivanov, *predsedatel Vysshego arbitrazhnogo suda RF* [“We cannot say that you may not pay”—Anton Ivanov, Chairman of the Supreme Commercial Court of the Russian Federation], *VEDOMOSTI* (June 2009), <http://www.arbitr.ru/press-centr/smi/23873.html>.

194. See Vaneev, *supra* note 168.

195. See Oda, *supra* note 6, at 368.

196. See Morozova, *supra* note 147; Mark Banovich et al., *Tentative Steps Towards Shareholders' Agreements for Russian Open Joint Stock Companies*, LATHAM & WATKINS CLIENT ALERT (July 2009), http://www.lw.com/upload/pubContent/_pdf/pub2757_1.pdf.

197. See sources cited *supra* note 155.

but most are those that existed before the amendments were passed—a sure sign of the ineffective nature of the attempted reform.

IV. Ramifications for Foreign Investors and Russian Corporations

Foreign investors have four options regarding shareholders' agreements: they can remain within the constraints imposed by Russian law and accept limited options; they can attempt to use old solutions, such as offshore holding companies, to work around the requirement that Russian law (and only Russian law) governs Russian corporations; or they can take their money elsewhere. It would be extremely unwise for investors to attempt the fourth option: applying foreign law to a shareholders' agreement with a Russian corporation and risking near-certain judicial avoidance.

While the first option has proven the most useful for state-owned corporations,¹⁹⁸ the second option appears to be the most useful for foreign investors in the current investment climate. One recent article has suggested that “approximately 70 percent of assets controlled by Russian financial and industrial groups are held through offshore holding structures.”¹⁹⁹ Given that this was a popular option prior to the amendment, it is sensible for foreign investors to continue to rely on structures that enable them to apply foreign law to shareholders' agreements by having the agreements apply to shareholders in an offshore holding company.²⁰⁰

Aside from avoiding many of the problems inherent to structuring a shareholders' agreement under solely Russian law, foreign investors derive other benefits from Russian tolerance for forming a corporation in another jurisdiction to do business in Russia. First, direct transfers of shares from a Russian LLC or corporation require the approval of the Russian Federal Anti-Monopoly Service, with approval required at various percentage thresholds; this can be both expensive and time-consuming, given that various approvals may be required over the course of one transaction, at each percentage threshold.²⁰¹ However, if the shares are transferred indirectly from an offshore parent (the offshore holding company), approval is only required if it would result in a change of control.²⁰² Offshore holding companies as the single shareholder also avoid the problems of interested-party transactions²⁰³ and avoid legal restrictions on third-party financing.²⁰⁴ Given the lack of incentives to attempt structuring a shareholders' agree-

198. See Interview by Alexei Pavlovich, *supra* note 24; see also Vaneev, *supra* note 168.

199. See Gortsunyan, *supra* note 26.

200. See *id.*; see also David Cranfield & Denis Nazarevskiy, *New Russian Attitude to Shareholders Agreements—How Useful is the New Law?*, CMS LEGAL ALERT (July 2009), http://www.aeprus.ru/application/views/aeprus/files/legalcommittee_files/New_Russian_Attitude_to_Shareholders_Agreements_-_July_file_update_2009_08_12_12_14_04.pdf.

201. See Knyazhev & Heinz, *supra* note 189.

202. *Id.*

203. Such transactions, which are triggered when a person affiliated with one or more of a company's shareholders begins a transaction, require the approval of a majority of non-interested shareholders; this would require the consent of any joint venture partner

ment under Russian law, and the benefits available to those who establish an offshore holding company, the second option is the most prudent. One commentator has even gone so far as to note that “only the brave are willing to test the new provisions on their investments.”²⁰⁵

The third option, to avoid Russian jurisprudence entirely, is clearly open to all investors. Within the most recent trends, Russian statistics published in 2011 showed that foreign direct investment in Russia fell by 13.2% in 2010 to \$13.810 billion, while overall foreign investment grew by 40.1% in 2010 to \$114.746 billion.²⁰⁶ These numbers, however, are not entirely indicative of which investors choose to invest elsewhere in the aftermath of the changes of 2009-2010, and which instead form offshore holding companies—one 2010 study found that a significant amount of foreign direct investment in Russia originates in Cyprus and the Caribbean countries, and that a large portion of these investments in fact originate in Russia.²⁰⁷ The consideration will likely revolve around the industry at issue; the same study found that market-seeking investors were far more likely to invest in Russian companies than were efficiency-seeking investors.²⁰⁸

Finally, foreign investors could pursue the unwise option of continuing to structure agreements under foreign law, or contrary to the founding documents of the company, in their Russian investment pursuits. This is extremely risky—between the political and judicial trends discussed above and the relatively lax rules on standing, which could prompt competitors to challenge a non-conforming agreement,²⁰⁹ there would be far too many possibilities for avoidance. It seems clear that most investors would prefer to avoid this scenario.

Conclusion

Russia's corporate law has developed over a relatively brief period of time in comparison to most other capitalist market economies. The development of a legal infrastructure that supports sophisticated corporate instruments and balances national and foreign investment interests will correspondingly require time to mature. The Russian government's recognition of the legality of shareholders' agreements was seen by many as a step forward in this process of maturation. However, it seems clear that this optimism is, at least for the moment, misplaced.

in any case where a transaction was proposed between the Russian company and a party to the shareholders' agreement, or any affiliate of either. *See id.*

204. *See id.*

205. *See* Gortsunyan, *supra* note 26.

206. *Direct Foreign Investment into Russia Down 13.2% to \$13.8 Bln in 2010*, RIA NOVOSTI (Feb. 25, 2011), <http://en.rian.ru/business/20110225/162754831.html>.

207. Alexey Kuznetsov, *Inward FDI in Russia and its policy context*, VALE COLUMBIA CENTER ON SUSTAINABLE INTERNATIONAL INVESTMENT 2 (Nov. 30, 2010), available at http://www.vcc.columbia.edu/files/vale/documents/Profiles_Russia_IFDI_Final_November_30_2010.pdf.

208. *Id.*

209. *See supra* text accompanying note 105.

The current Russian government has little to gain from clarifying and liberalizing corporate law regarding shareholders' agreements. The goal of controlling the progress of the corporate sphere as much as possible is outweighing the desire to increase the safety of foreign investment, the original goal of the 2009 amendment. Exhaustive legislation serves this end, as the Russian government risks less in the way of judicial interpretation where laws are exhaustive lists of permissible behavior. A conservative and strict judiciary similarly makes it more difficult for investors to take risks by applying familiar foreign laws to corporate documents, and increases the likelihood that investors will either structure their investments through off-shore holding companies or simply take their money elsewhere.

This situation is unlikely to change while the current government stands. The current policies appear entrenched, and there is too much control to be lost through either liberalizing Russian corporate law or allowing shareholders' agreements to apply foreign law. Thus, it appears that nothing short of a regime change will make shareholders' agreements any more relevant of a document in Russian foreign investment than they were before such agreements became legal.