

RUSSIAN LAW ONLINE



The military forces will do what the nation pleases.

S. Alekseev

Timing is everything



IN MARCH 2004 a group of international investors led by Hermitage Capital Management and its vociferous president William Browder launched a legal action against Surgutneftegaz aiming to cancel 62% of its shares that were held indirectly by the company.

If they had succeeded one of largest oil companies in Russia, rumoured to have close ties to Vladimir Putin, would have passed to minority shareholders, a group of foreign companies - Hermitage Capital Management, Firebird Management LLC and Prosperity Capital Management.

The plaintiffs claimed that Surgutneftegaz kept the majority of its own voting shares through a web of subsidiary companies. In effect, the company was controlled by the management which held less than 0.5% of its shares.

In Russia companies must cancel or sell their *treasury stock* (shares owned by the company) within one year from the time of acquisition. Shares, though, held indirectly through subsidiaries are not, strictly speaking, a treasury stock and, therefore, can be voted by management.

Six years after the legal battle and four years after Browder's exile from Russia, the idea that what acts like a treasury stock should be recognised as such in law is carrying the day. On May 7 the members of the Russian Parliament introduced a bill that aims to put an end to a quasi-treasury stock by depriving daughter companies from voting by their shares in the parent company and from receiving dividends.

The bill was proposed by four members of the leading political party United Russia which means it is likely to be adopted.

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photo: Poles - Fotolia.com



IS THE SOLUTION EQUAL TO THE TASK?

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The legislator intends to resolve a very important issue but the proposed changes may not achieve the right balance.

The ban on voting by 'quasi' or 'pseudo-treasury' shares is the right move. Management of a joint stock company should not be encouraged to control shareholder meetings.

Of course, there is always someone who tries to get round the new restriction, eg by not including some companies in the consolidated accounts of a joint stock company. However, such manipulation may adversely affect the performance figures which goes against the interests of both shareholders and management.

With regard to the ban on dividends, this remedy is supposed to stimulate elimination of circular structures. But is the solution equal to the task?

When a consolidated company lost its voting rights it does not stop being a shareholder of the main company (unlike a company that buys its own shares). So, why should this shareholder have fewer property (economic) rights than other shareholders? According to the Russian Constitution any restriction of rights can be permitted in order to protect the rights and interests of others. The prohibition of voting by quasi-treasury shares already guards shareholders against the abuse of power by the company management, even without prohibiting payment of dividend.

Without voting rights the management of a main company is also restricted in its ability to approve the payment of dividend and the amount to be distributed. Essentially, consolidated companies can receive dividends only if 'ordinary' shareholders vote for the payment of dividends. There is, therefore, no real danger of asset stripping by management without shareholders' consent.

Finally, quasi-treasury shares may be needed for entirely legitimate purposes. For example, when the company is being prepared for an M&A deal. In such a case is the consolidated company also to be denied dividends?



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