

Crisis Management and Investor Protection in Russian Companies

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**The beginning of 1990-es:
Russian regulatory framework for processes of
insolvency and bankruptcy started to develop.**

Has it been finally formed up?

During the last 10-15 years the processes of
financial distress and bankruptcy took place:

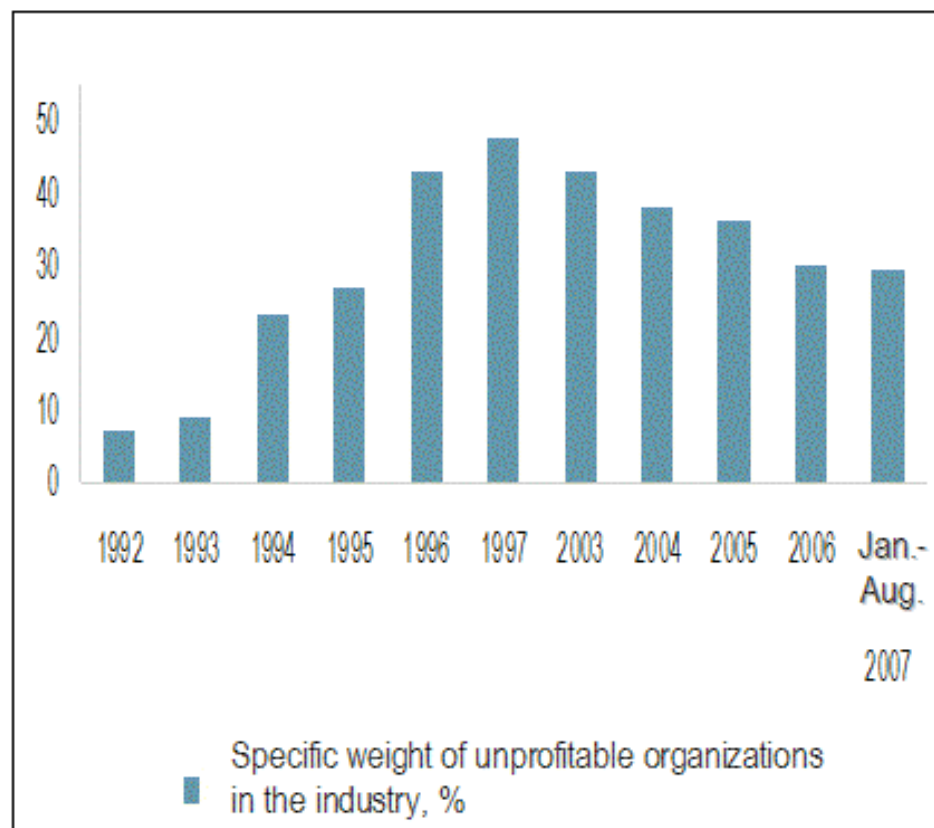
- in constantly changing legal system conditions,
- under complexities of law enforcement
- under restrictions and administrative barriers.

Bankruptcy and property redistribution law amendments are very urgent for Russia because these problems touch a lot of companies.

Relevant economic trends of the last decade:

- Economic growth was observed in few industries while the greater part of Russian economy faced stagnation.
- These enterprises are characterized by negative Economic Value Added and by unprofitability.

The share of the unprofitable organizations in Russian industry, 1992-2007



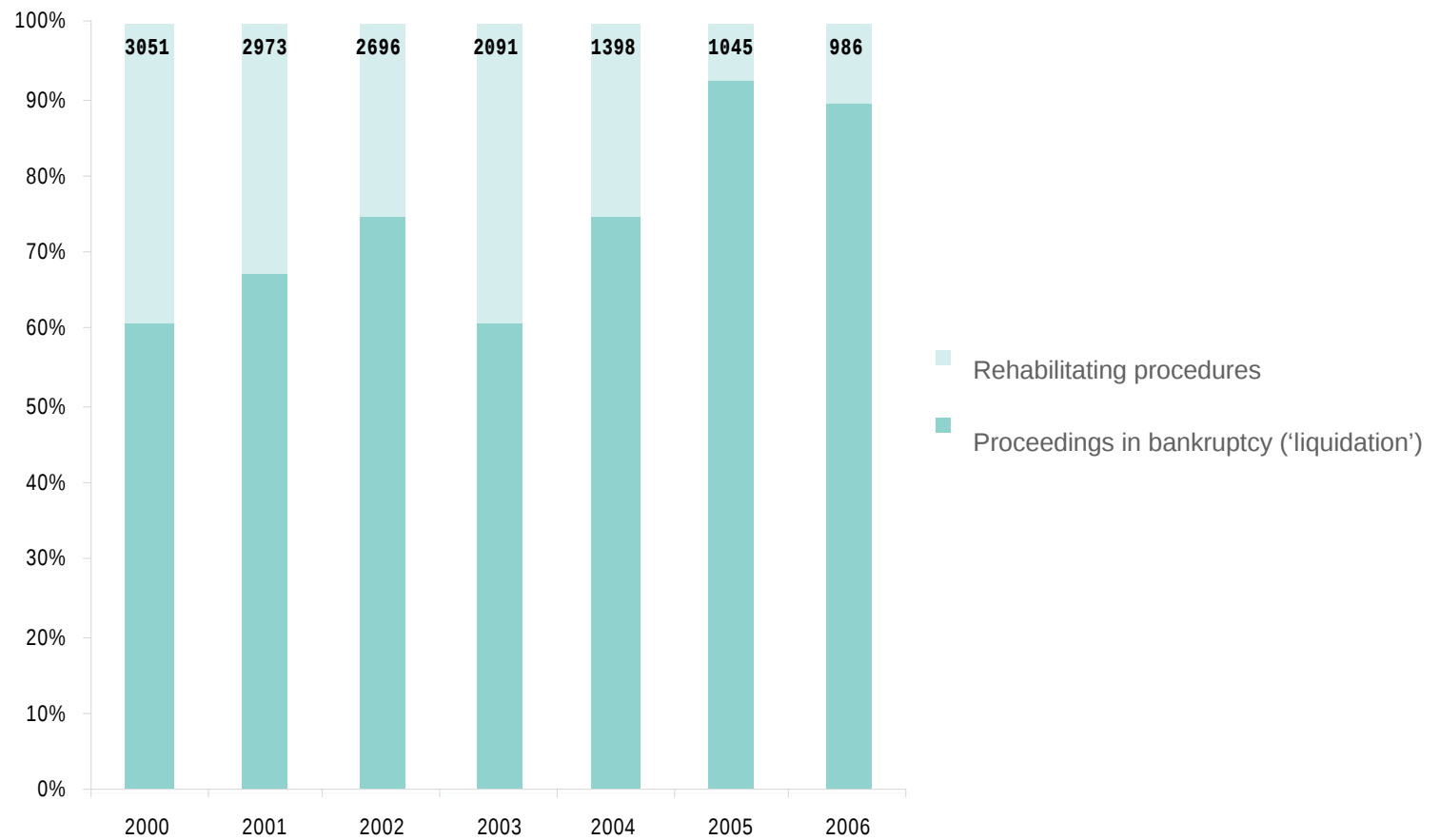
Using bankruptcy laws for property redistribution

Why it happened?

Russian legal system contains regulations which:

- reduce the price of the takeover,
- allow a low threshold for liabilities to begin bankruptcy procedure,
- contain a specific procedure for appointment and control of bankruptcy administrator,
- give an opportunity of debt repayment by the third parties together with the direct participants of the bankruptcy process,
- allow asset stripping by means of unfair bankruptcies, etc.

Decisions taken under bankruptcy proceedings



The means of defense against “unfair” bankruptcy:

- “concerervative” capital structure, the prevalance of internal sources of financing.
- strategic investors are often compelled to form not the control stake of voting shares, but a one close to the absolute.

Influence of unfair takeover threats on the development of financial markets and macroeconomics

- Reduction of investments into the country
- Decrease in free floating of shares
- The increase in the issuer's risk, which leads to the underestimation of Russian corporations and prevents their capitalization growth
- Highly limited disclosure of corporate information for minimizing the takeover threat creates an unattractive corporate image and causes lack of transparency
- The decrease in efficiency of allocation of natural resources and usage of national wealth
- Property concentration which reduces the opportunities of "market" acquisition of the inefficient enterprises

The Laws:

“On Public Companies” (2002),

"On Insolvency (Bankruptcy)" (2002)

In many respects have limited the possibilities of unfair takeovers.

But despite of constant updating bankruptcy laws still cannot fully prevent unfair redistribution of the property by means of bankruptcy.

Bankruptcy is still one of the most widespread unfair takeover techniques in Russia.

The key areas to be addressed when dealing with unfair takeovers based on bankruptcy procedures

1. Legislative regulation
2. Enforcement
3. Control of non-government organisations for the observance of business standards

The major legislation gaps to be bridged

- Detalization of regulations for the companies regarding large purchases: now they are not enough detailed and transparent.
- Leaving the auction as the only possible mechanism of privatization (prevent to use transactions with specific non-market conditions).
- Introduction of regulations which exclude the possibility of hearings of corporate disputes by courts of general jurisdiction, expansion of the network of commercial courts.
- Introduction of regulations which improve owners' structure transparency

Enforcement and control over private organisations'

observance of business standards

Laws are frequently simply broken. With this regard, in our opinion:

- it is necessary to give additional powers to Federal Service on Financial Markets.
- Another possible way – setting up the special supervising body which concentrates on the observance of the rules of fair competition.
- Law enforcement should also be supplemented by a system of non-government organizations oriented on working out business standards, not laws.

To sum up:

- In general, our legislation, enforcement and control of the non-government organizations should create conditions in which the fair “civilized” transfer of property rights might cost less in comparison to the unfair transactions. This will gradually eliminate the reasons for unfair bankruptcy.

The major points of bankruptcy law imperfection

- Bankruptcy proceedings is still oriented on subsequent liquidation
- The extremely low level of rehabilitation procedures efficiency
- Using bankruptcy mechanisms for property redistribution
- Self-regulatory organizations are not able to guarantee proper qualification of bankruptcy administrators
- More than 50% of all bankruptcy cases are connected with “missing debtors”