Russian Company Law Reform: Have Flawed Laws Impeded the Transition to a Market Economy?

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Russia's slow transition to a market economy, as widely reported, was marked by economic hardship, declines in production, and hyper-inflation. Given the central role of law in any market economy, the author questions the extent that *law* may have been to blame for this inefficient and painful transition. As the question is vast in scope, the author addresses it by focusing on Russian company law.

Russia has been criticised for not moving swiftly enough to enact adequate laws for a market economy. In the same breath, some analysts suggest that the transition for Russia was especially difficult because it never had experience in creating a market economy or corporate culture. Examining the case of Russian company law, the author observes that these suppositions are false. Russia not ouly had experience with a market economy and company law, such as during the tsarist era and the N.E.P., but it (and the U.S.S.R.) adopted several relatively comprehensive company laws through the period from 1987-1990. The author's experience with these laws supports the view that the real failures of law in Russia were not in the texts themselves but in their often arbitrary application, their non-application, or the irrelevance or obsolescence of provisions that remain in force.

Recent amendments to Russia's company laws have been positive, although in and of themselves, they have not made a significant difference, and further reforms are slated. In the end, this brief analysis provides a useful reminder that law is much more than a mere set of written texts; on a larger scale, it also suggests that for Russia to become a country truly governed by the rule of law, it must become a state not ouly where good laws are adopted, but where they are also respected and applied.

En Russie, la lente transition vers une économie de marché a été marquée par des difficultés économiques, un déclin prononcé de la production, et une hyper-inflation. Étant donné le rôle central que joue le droit dans une économie de marché, l'auteur se demande jusqu'à quel point le droit est responsable de cette transition lente et difficile. Le sujet étant très vaste, l'auteur se concentre sur le droit corporatif russe.

La Russie a été critiquée pour ne pas avoir adopté assez rapidement des lois adéquates à une économie de marché. De même, certains analystes suggèrent que la Russie a vécu une transition particulièrement difficile, car elle n'avait jamais vécu la création d'une économie de marché, ni connu de culture corporative. Après avoir étudié le droit corporatif russe, l'auteur conclut que ces deux observations sont fausses. Tout d'abord, la Russie a connu une économie de marché sous le régime tsariste et pendant la *New Economic Policy*. Par ailleurs, l'U.R.S.S. et la Russie ont adopté plusieurs lois corporatives entre 1987 et 1990. L'expérience de l'auteur avec ces lois soutient la conclusion que l'échec du droit en Russie ne tient pas tant aux textes de lois qu'à leur application souvent arbitraire, leur non-application, ainsi qu'à des dispositions obsolètes ou hors de propos qui souvent n'ont pas été abrogées.

Des amendements récents aux lois corporatives russes ont eu un effet positif, bien que d'autres réformes demeurent nécessaires. Enfin, cette brève analyse rappelle que le droit est plus qu'un simple ensemble de textes, et suggère que la Russie, avant de devenir un état de droit, doit tout d'abord devenir un pays où de bonnes lois, en plus d'être adoptées, sont aussi respectées et appliquées.

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Synopsis

Mais lorsque, dans un gouvernement populaire, les lois ont cessé d'être exécutées, comme cela ne peut venir *que de la corruption de la république, l'État est déjà perdu.*[1]

Montesquieu

We have strict statutes and most biting laws...
Which for this fourteen years we have let slip... .
...
The law hath not been dead, though it hath slept.
...
My business in this state
Made me a looker-on here...
Where I have seen corruption boil and bubble
Till it o'errun the stew. Laws for all faults,
But faults so countenanced, that the strong statutes
Stand like the forfeits in a barber's shop,
As much in mock as mark.
...
This will last out a night in Russia,
When nights are longest there.[2]

Shakespeare

Introdnction

Given the central role of law in the development and functioning of a market economy, one must ask to what extent *law* has been to blame for Russia's slow and painful transition to such an economy. One occasionally hears variations on two themes which appear to cast such blame: (1) that Russia failed to set up an adequate legal regime to support private investment, because it did not readily adopt comprehensive and sophisticated market-oriented laws; and (2) that the transition and adoption of market-oriented laws were entirely new and difficult, because Russia

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[1] C.L. de Secondat, baron de la Brède et de Montesquieu, *De l'esprit des lois*, t. 3 (Paris: Gallimard, 1995) c. 3 at 116.

[2] Excerpts from W. Shakespeare, *Measure for Measure* iu *The Riverside Shakespeare* (Boston: Houghton Mifflin, 1974) 545 at I.iii, 19; II.ii, 89; V.i, 316-22; and II.i, 134, respectively. The play *Measure for Measure* is, of course, neither about Russia nor transitions to a market economy. It centers around the attempted application by a corrupt government official of a hitherto-unenforced death penalty still lingering on the books for the "crime" of getting one's girlfriend pregnant out of wedlock. Yet, the legal issues it raises are as relevant today as they were in 1604: What happens when the laws on the books are not applied in practice? What happens when those who enforce the laws are more corrupt than those against whom the laws are enforced? What happens to the very *notion* of law in a society where laws out of step with practice become the target of mockery? What happens when the rules on the books provide penalties or sanctions so disproportionately severe that no one takes them seriously?

passed directly from a tsarist state to a communist regime and, thus, never had a capitalist economy or corporate culture. Both propositions, though at first glance plausible, are inaccurate; worse yet, they obscure the real problems.

Few would question that company law is one of the most essential areas of law needed to develop a market economy.[3] In most Western economies today, it is all but taken for granted that an investor may create, with minimum transaction costs and uncertainty, a limited-liability company or other corporate form that enjoys limited liability. This note, therefore, examines the law's role in Russia's difficult transition, and it does so from the point of view of Russian company law.[4]

A brief review of the law and recent practice in this area is revealing. Not only did Russia have relevant previous experience with company law prior to perestroika, but the period of 1987-1990 is marked by the adoption of several, relatively comprehensive company laws. If law failed, it was not for lack of texts nor for an absence of historical precedent; rather, it failed in the application and enforcement of those texts, or the lack thereof. Similar to the legal dilemmas portrayed in *Measure for Measure*, the real problems in Russia have not been so much the laws themselves but about *how* and *whether* they are applied, *who* applies them, and whether they are changed when they no longer correspond to reality.

Recent events in Russia provide a final, timely reason for focusing on Russian company law: in December 1994 Russia adopted significant company law reforms as part of its new *Civil Code*.[5] These, at the very least, have been steps in the right direction. In addition, the reforms are on-going, as the new *Code* calls for the adoption of further new company laws, which, at the time of writing, have not yet been adopted.

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[3] The history of capitalism and Western market economies provides clear evidence of the importance of the basic limited-liability company in the development of a market economy. The importance can be seen especially from societies which did not allow such corporate forms. In Britain, for example, during the middle of the eighteenth century the initial joint-stock companies did not enjoy limited liability. Cases abounded where an individual shareholder, even one with a small interest, was exposed to a risk of loss of all his or her property if the company failed, an obvious disincentive to investment in new projects. Laws providing for the creation of limited-liability companies and joint-stock companies with limited liability were introduced in Britain in the 1850s; similar limited-liability laws were introduced in France and Germany in the 1860s.

[4] This note does not purport to address all or even most aspects of Russian corporate law; moreover, it looks particularly at corporate law as it has been practiced in projects involving foreign investment in Russia.

[5] *Grajdanski Kodeks R.F.* (*Civil Code* of the Russian Federation), adopted by the Council of the Federation (30 December 1994) [hereinafter new *Code*], arts. 48-123. Many of the Russian and U.S.S.R. laws cited in this article are available in English translation in different sources, among which: the LEXIS/WORLD Library, Sovleg File. For this article, the author has used his own translations of the Russian and U.S.S.R. laws discussed herein.

I. Russian Company Law: Neither New, Nor All that Bad

A. Pre-Perestroika Company Law and Capitalism

The supposition that Russia never had relevant experience with corporate law and a market economy defies history. Prior to *perestroika*, Russia had significant experience in establishing a capitalist economy and in adopting company law to do so. The most relevant, no doubt, was Russia's experience during the New Economic Policy ("N.E.P."), adopted in 1921 and which lasted until the late 1920s. Briefly, due to the disastrous state of the Soviet economy at the time, Lenin scaled back nationalisation and allowed a partial restoration of a capitalist economy. What is significant is that legislation on both the limited-liability "partnership" (*tovarischestvo s'ogranichennoy otvyetstvennostyu*) and the joint-stock company (*aktsyonernoye obschestvo* or *A/O*) was adopted and enshrined in the 1922 *Russian Civil Code*.[6] These companies formed the basis of a significant amount of private-sector activity during the 1920s. Even after the termination of the N.E.P. in the late 1920s, several parts of these company laws remained on the books in the 1922 *Civil Code*,[7] which remained in force until the next *Russian Civil Code* was adopted in 1964.[8]

Other relevant experience is also noteworthy. First, prior to the 1917 revolution, tsarist Russia had also begun to develop a significant private sector economy, and a variety of company forms were adopted as law.[9] Second, the N.E.P. cannot be considered the only experience of communist Russia with a market economy. Although statistics can only be surmised, a significant part of the so-called economy of the Soviet Union was clearly outside of the regular state-controlled channels.[10] This unofficial economy existed from the outset of the Soviet Union, though it was a black market and, strictly speaking, criminal under Soviet ideology and law. Finally, from

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[6] *Grajdanski Kodeks R.S.F.S.R.* (*Civil Code* of the R.S.F.S.R.) 1922, arts. 318-21, 322-66, respectively [hereinafter 1922 *Civil Code*].

[7] Even after thirty years of Soviet communism, some of the provisions still remained part of the legislation (see *e.g.* the Gosjurisdat 1956 edition of the 1922 *Civil Code* (Moscow: Gosjurisdat, 1956), which still contains all of the provisions on the limited-liability partnership and indicates the dates of abrogation of the provisions on the joint-stock company.

[8] *Grajdanski Kodeks R.S.F.S.R.* (*Civil Code* of the R.S.F.S.R.) 1964 (adopted 11 June 1964).

[9] In fact, much of what motivated the Bolshevik uprising was a critique of the emerging capitalist economy and its attendant bourgeoisie (see R. Janda, "Something Wicked that Way Went: Law and the Habit of Communism" in this issue). Janda describes, for example, how Lenin characterised certain parts of the emerging bourgeoisie, rather unaffectionately, as "'parasites ... swindlers ... and other "guardians of capitalist traditions"'" (*ibid.* at note 3).

[10] In one estimate, by the time of the dissolution of the Soviet Union, the "G.D.P." of this black-market economy amounted to 110 billion rubles, which was at the time approximately US 60 billion dollars (see S. Handelman, *Comrade Criminal: The Theft of the Second Russian Revolution* (London: Michael Joseph, 1994) at 19). Mr. Handelman aptly debunks the myth that Russia's mafia is a new phenomenon, and he correctly shows that, quite to the contrary, the black-market economy was a central part of the Soviet system.

1987 to the end of 1991, when the U.S.S.R. formally disintegrated, a limited (and legitimate) capitalist economy was allowed to develop, particularly with the creation of "leased enterprises" (where workers leased an enterprise from the state and were entitled to retain any profits), as well as the introduction of joint ventures with foreign investors, which began in 1987.

B. A Spate of Company Laws Adopted, 1987-1991

It would be wrong to assert that Russia or the Soviet Union failed to adopt the basic laws in the area of company law. Russian corporate law has seen a variety of Western-style company laws in the last several years. While the laws adopted have not been perfect, they have generally been comprehensive,[11] with one exception.

1. *Glasnost* and Western Capitalism: *Decree No. 49* of 13 January 1987

Less than two years after Michail Gorbachev introduced his famous policies of *perestroika* and *glasnost*, the Soviet Union formally decided to allow the creation of Western-style companies in the form of joint ventures with foreign partners (*sovmestnoe predpriatiia*). The legislation permitting these new forms — the first new company legislation since the N.E.P. — were the regulations adopted under *Decree No. 49* of January 13, 1987.[12] The new legislation consisted of fifty-three articles, which were later supplemented by some twenty-two complementary decrees, regulations, and instructions. In practice, the texts served as a reasonably adequate basis for creating a joint venture (especially since the common practice was to prepare fairly comprehensive joint venture documents covering any items where the law was still silent). Comparatively speaking, one of the greater hurdles, at the time, was obtaining the typically numerous Soviet governmental approvals necessary to create the joint venture. By 1991, several thousand joint ventures between foreign investors and Soviet state enterprises had been created pursuant to *Decree No. 49*.[13]

2. 1990: U.S.S.R. Company Law

In June 1990, as the Soviet Union expanded the scope of the private sector, the U.S.S.R. Council of Ministers adopted a broader, general company law, the *Regu-*

[11] One could understand Russia, or any ex-communist country, not immediately having the expertise or resources to adopt company laws covering every detail. One would expect, for example, not to find express provisions on more technical matters or sophisticated financial products, such as convertible bonds or specific definitions of minority shareholder rights. In practice, however, the absence of these fine points would not deter most projects anyway.

[12] *Decree No. 49* of the U.S.S.R. Council of Ministers on the Establishment on the Territory of the U.S.S.R. and Operation of Joint Ventures with the Participation of Soviet Organisation and Firms from Capitalist and Developing Countries (adopted 13 January 1987) [hereinafter *Decree No. 49*].

[13] Available statistics may not be accurate, but it is safe to say that over two thousand joint ventures had been created by 1991.

lations Governing Joint Stock and Limited-Liability Companies.[14] At the time, with no obvious end in sight for the U.S.S.R., this new law held the promise of becoming the Union's basic company law, permitting the creation of companies by both Russian enterprises and individuals. The new law provided a comprehensive set of rules for both the joint-stock company (in which stocks were issued) as well as the limited-liability company (where participants held ownership interests).

3. 1990: Russia's Foray into the Field

Seven months after the U.S.S.R. adopted the above company law, Russia passed two company laws on December 25, 1990: the *Law on Enterprises and Entrepreneurial Activity*,[15] and the *Regulations on Joint-Stock Companies*.[16] The *Law on Enterprises* provides general rules on a wide range of enterprises, including state, private,[17] and personal enterprises. *Decree No. 601* provides regulations governing both "open" (public) stock companies and "closed" (closely-held) stock companies.

From the investor's point of view, it is important to understand the context of these two Russian laws. At the time of their adoption in 1990, the *Constitution of the Union of Soviet Socialist Republics*, of 1977,[18] was still very much in force, and it gave considerable powers of primacy to U.S.S.R. law. Not only did Soviet laws prevail in the event of a conflict,[19] but the constitutional powers of the republics, such as Russia, were also defined as those "outside the spheres" given to the Union.[20] At the time, then, it was not at all clear whether these Russian laws would be applied, particularly by the Soviet authorities. The prudent investor thus believed that since U.S.S.R. law prevailed, it would be safer to create a company pursuant to that law.

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[14] *Polojeniie ob aksionniernikh obschestvakh I tovarishestvakh s'ogranichennoy olvyetstvennostyu*, adopted by *Decree No. 590* of the U.S.S.R. Council of Ministers (19 June 1990).

[15] *Zakon RSFSR O predprijatijax i predprinimatel'skoj dejatle'nosti*, adopted by the Supreme Soviet of the R.S.F.S.R. (25 December 1990) [hereinafter the *Law on Enterprises*].

[16] *Polojeniie ob aksionniernikh obschestvakh*, adopted by *Decree No. 601* of the R.S.F.S.R. Council of Ministers (25 December 1990) [hereinafter *Decree No. 601*].

[17] Article 11 of the *Law on Enterprises*, *supra* note 15, is the one exception to the general pattern of adopting relatively comprehensive laws. It provides only four short paragraphs governing the limited-liability "partnership" (sometimes referred to as the limited-liability "company") (see *infra* note 28 and accompanying text).

[18] *Constitution of the Union of Soviet Socialist Republics* (adopted in 1977) [hereinafter *1977 U.S.S.R. Constitution*].

[19] *Ibid.* at art. 74.

[20] *Ibid.* at art. 76, para. 2. Moreover, the powers given to the Union in article 73 contain sweeping language such as "ensurance of uniformity of legislative norms throughout the U.S.S.R." and "direction of the seetors of the economy", which could clearly be interpreted broadly.

4. Corporate Provisions in the 1991 Foreign Investment Laws

The tension between the center and the republics, which began to swell in 1990 and 1991, often manifested itself in a "war of laws" between the U.S.S.R. authorities and Russia. There is no better example of this conflict than the race between the Union and Russia to adopt a, so-called, favourable foreign investment regime in mid-1991. Perhaps an omen of things to come, Russia won that race with the adoption of its *Law on Foreign Investments in the R.S.F.S.R.*, adopted in 1991.[21] A day later, on July 5, the U.S.S.R. Supreme Soviet adopted the law on *Fundamentals of Legislation on Foreign Investments in the U.S.S.R.*[22] Both laws were strikingly similar. They were also highly relevant to the area of company law, because they covered matters such as the types of companies that can be created by foreign investors, the right to create wholly foreign-owned subsidiaries, capitalisation deadlines, and so on.

C. *The Centre Cannot Hold: The Fate of U.S.S.R. Company Law*

The *putsch* of August 1991 — the beginning of the end for the U.S.S.R. — also sealed the fate of much of the above company law. After it became clear that the Union was unlikely to survive, it also became evident that Russian law would become the principal source of company law. Whether some of the above U.S.S.R. company law would continue to apply would depend on the approach adopted by the Russian government. As described below, the choices made were not necessarily the best ones.

II. Where Have the Failures Beeu?

The above overview reveals that there was no shortage of legal texts in Russian and U.S.S.R. company law. Yet, there have been serious failures in this area of the law, notably in how the laws were applied or how government authorities failed to apply them.[23] Some of the major weaknesses were the result of the Union's breakup and the ensuing upheaval, or the failure to respond adequately to that upheaval with laws that would protect private investment.

These failings were not merely theoretical or hypothetical; numerous projects in Russia encountered serious difficulties because of them. Imagine, for example, a

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[21] *Zakon RSFSR ob inostrannikh investitsiakh* v. *RSFSR*, adopted by the R.S.F.S.R. Supreme Soviet (4 July 1991) [hereinafter *Law on Foreign Investments*].

[22] *Osnovi Grandanskovo Zakonadatelstva Soyuza S.S.R. i Respublik*, adopted by the U.S.S.R. Supreme Soviet (5 July 1991).

[23] Of course, it is easy to sit back in the comfort of a law office and second-guess those in power facing the challenge of transforming an entire country, tradition, and economy. The goal here is not to engage in gratuitous criticism. Rather, it is to try to identify the real problems, so that they can be addressed and perhaps resolved.

Western company that in 1991, after a year of negotiating a major Soviet joint venture with a Soviet state enterprise, finally registered the venture with the competent Soviet authorities, only to find that by the end of 1991 Soviet law had become all but an artifact, and that the corporate status of the new joint venture can be seriously questioned. Or consider a major infrastructure project, established in early 1992 as a new Russian joint-stock company, in which the Russian contribution of land-use rights had been delayed and was not made within the one-year deadline; the consequence under one dormant provision of Russian law is that the authorities are apparently obliged to liquidate the entire company. Finally, consider another typical investment project where you are seeking to acquire a major stake in a Russian joint-stock company; the due diligence report you receive states that, under an obscure provision of Russian law, it cannot be stated with certainty that the target company actually owns its assets. What would your investment decision be?

A. Laws Not Applied ... that Should Have Been

Most investors can probably marshall a litany of complaints about Russian laws not being applied as they believe they should be. Perhaps the most striking example occurred during the year following the August 1991 *putsch*. As previously noted, by 1991 several thousand joint ventures had already been registered,[24] and no doubt hundreds of others were in the process of being negotiated and finalised. These joint ventures were created pursuant to *Soviet* law — law which quickly became tainted, in many circles, as a reminder of the old order being laid to rest.

During autumn 1991, the legal status of these joint ventures was precarious, at best. Although Russia eventually adopted a general provision stating that certain Soviet laws would apply until the adoption of Russian law,[25] it was unclear whether Soviet joint-venture law continued to apply, if only temporarily, and whether it was applicable for the purpose of maintaining the corporate validity of existing joint-venture companies. Instead, much "policy-making" was effectively discharged by the respective corporate-registration chambers, which began to indicate that existing joint ventures required re-registration as Russian entities, and that the terms "Soviet" and "U.S.S.R." would have to be removed from all founding documents. Amidst the general uncertainty created, many existing joint ventures during 1991-1992 opted, in the author's experience, for the prudent approach of rewriting and re-registering the joint venture documents.[26] While this was, on the one hand, a pru-

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[24] See *supra* note 13.

[25] The *Agreement establishing the Commonwealth of Independent States*, 8 December 1991, 31 I.L.M. 138 [hereinafter *Minsk Agreement*] declared in Article 11 that Soviet law generally was no longer applicable on the territory of the signatory states. In Russia's ratification of the *Minsk Agreement* on December 12, 1991, the Russian Supreme Soviet tempered this idea by adopting a broadly-worded resolution stating that U.S.S.R. law "shall apply within the territory of the R.S.F.S.R. until the adoption of respective legislative acts of the R.S.F.S.R. in that part which is not contrary to the Constitution of the R.S.F.S.R. and the present Agreement" (Resolution No. 2014-1 of the R.S.F.S.R. Supreme Soviet (12 December 1991) at art. 2).

[26] *Decree No. 601* (adopted 25 December 1990) contained a provision stating that joint-stock com-

dent step, it also ran the risk, on the other hand, of reopening negotiations even on fundamental issues. In addition, the uncertain legal status of Soviet joint ventures became an additional obstacle to external financing, since few if any foreign lenders were or would be willing to lend where there was a risk that the borrower itself did not exist.[27] Clearly, a better policy would have been to declare that existing joint ventures were legally valid under Russian law, at least during a specified provisional period, during which time they would have to be re-registered.

B. Ambiguous, Sometimes Dangerous, Provisions Left on the Books

Most investors in Russia will encounter provisions in Russian law which are, at best, ambiguous. Some potentially pose problems of enormous magnitude. For example, from 1990 until the end of 1994, the following provision remained on the books of Russian company law:

> 3. The assets of a limited-liability company (closed joint-stock company) shall be formed from the partners' contributions, received income and legitimate sources and shall belong to the partners therein on the basis of *common shared ownership.*[28]

The clause appears to provide that the property contributed to the capital of a company is actually owned in joint co-ownership by the shareholders. Indeed, the definition of "common shared ownership" in the *Law on Property of the R.S.F.S.R.* confirms this meaning.[29]

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panies created prior to that date under U.S.S.R. law had to be re-organised and re-registered pursuant to Russian law. This did not, however, expressly (or necessarily implicitly) cover the case of joint ventures, let alone joint ventures that were registered *after* 25 December 1990. The decision to re-do documents and re-register *anyway* was probably a wise course of action in most projects. The author has recently become involved in two projects where the joint-venture partners evidently did not amend the relevant documents and re-register at the opportune time. Disputes have now arisen between the parties in those projects, and the argument has been asserted by at least one party that the basic foundation documents are no longer valid due to failure to re-register.

[27] Of course, the uncertain status of the joint venture may have been one of several significant legal obstacles to the external financing. Other obstacles sometimes included the lack of clarity over corporate ownership of assets as well as difficulties in providing adequate forms of security (see J. Crothers, "Project Finance in Central and Eastern Europe from a Lender's Perspective: Lessons Learned in Poland and Romania", in this issue, for a discussion of standard lending requirements from a lender such as the E.B.R.D.).

[28] *Law on Enterprises, supra* note 15 at art. 11(3) [emphasis added]. In the Russian text, the key term (emphasized above) is *obschshei dolevoi sobstvennosti*, which is not easily translated into English: "*obschei*" means "general" but it also means "common"; "*dolevoi*", from the term for "share" (*dolya*) can be translated as "shared" or "joint"; "*sobstvennost*" can be translated both as "property" or as "ownership". The concept is sometimes also translated as "common shared property" or "common shared ownership".

[29] *Zakon R.S.F.S.R. o* sobstvenosti, adopted by the R.S.F.S.R. Supreme Soviet (24 December 1990) at art. 3 [hereinafter *Law on Property*].

From the point of view of foreign investment, this provision had a curious history. While it appeared never to have been applied in practice, and in fact, few people would seriously argue that a Russian joint-stock company did not own its assets, the provision was clearly on the books. It would undoubtedly have been brought to the attention of any foreign investor aiming to invest in a company in Russia. It certainly would not have been an encouraging item to read in a due diligence report.

C. Extreme Sanctions in the Texts, with Enforcement Uncertain

Much like the harsh, but unenforced, death penalty that lingers on books in the world of *Measure for Measure*, one occasionally finds similar draconian provisions in Russian law. One such provision is article 19(2) of the Russian *Law on Foreign Investments*.[30] Evidently adopted for the purpose of deterring mega-projects that are never capitalised,[31] this provision created a fundamental legal problem in some projects, which went to the very status of the company. It provides that if after one year following registration of the company *each* participant has not advanced at least fifty percent of his or her contribution, then

> the body which has registered the said enterprise shall declare the enterprise to be non-existing and shall adopt a decision concerning its liquidation.[32]

In the complex business climate of the emerging Russian market, a project could easily be delayed over a year, for any number of reasons, before all of the parties' initial contributions were made. For example, in one major infrastructure project, the Russian state partner failed to contribute long-term land use rights within the specified period.[33] As a practical matter, the above provision would never be enforced unilaterally by a registration authority. However, that possibility certainly existed, and such a risk would clearly leave a cloud of doubt hanging over the project in question.

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[30] *Supra* note 21 at art. 19(2).

[31] *Decree No. 49* did not regulate the timing of contributions to the capital of the new joint-venture company. Joint ventures created during the period 1987 to 1991 often consisted of large scale investment projects in which the stated capital was to be substantial (*e.g.* US 50-100 million dollars). Many such projects were never fully capitalised, and both the Soviet and Russian authorities evidently wished to deter the practice of luring Soviet and Russian partners with promises of large investments and then not delivering. Article 19(2), therefore, is a capitalisation deadline aimed at eliminating that practice.

[32] *Supra* note 21 at art. 19(2). In the Russian text ("*priznaet evo nesostayachimsa I prinimael recheniie o evo likvidaisia*"), the notion of "shall" is understood but not unequivocally stated; some jurists have argued that the registration authority therefore has a discretionary power (and not an obligation) to liquidate.

[33] Duties of confidentiality restrict the author from providing further details.

D. The Non-Application of Federal Laws in Some Cities and Regions

In any federation, one could expect that certain federal laws, particularly those with provisions open to different interpretations, may be construed and applied differently in some regions. It is another thing entirely, however, for relatively unambiguous federal laws to be ignored or simply not applied at the local or regional levels. One example of such non-application in Russian company law is the entire procedure for the registration of joint-stock companies. Under *Decree No. 601*, fifty percent of the capital of a new company must be contributed within thirty days of initial registration.[34] The decree establishes a procedure requiring a two-step registration process where a chamber must first issue a temporary registration certificate and then verify a number of matters, such as the actual payment of fifty percent of the capital. Only then may it proceed to the second step, which is to issue the final registration certificate.[35] This procedure is never followed by the authorities in St. Petersburg. The local regulations adopted by the City Government in St. Petersburg[36] provide solely for a one-step process, which clearly contravenes *Decree No. 601*.[37]

E. Rules Out of Step with Practice: Ignored, but in Force Nonetheless

One readily finds examples of Russian company law where the law on the books simply does not correspond to practice; therefore, the rules are either not applied or are treated as inapplicable. A rather visible example under *Decree No. 601* is the provision stating that the board of a joint-stock company shall meet "as and when required, but no less than once a month".[38] It is highly unlikely that many Russian joint-stock companies hold monthly board meetings. Rules such as these — perhaps not in and of themselves overly offensive — create problems precisely *because* they are more honoured in their breach than in their observance. This perpetuates the sense in Russia that laws are not meant to be taken seriously, and can, therefore, lead to a deterioration of the notion of law itself.

F. Endemic Corruption

It is estimated that approximately seventy percent of the private sector in Russia is currently controlled, in some fashion, by the mafia.[39] Some argue, incorrectly,

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[34] *Decree No. 601*, *supra* note 16 at art. 27.

[35] *Ibid.* at art. 38.

[36] See *e.g.* regulation N° 417-r, adopted by Office of the Mayor of the City of Saint Petersburg (16 September 1991).

[37] One practical consequence of this is that local authorities do not verify whether 50 percent of the stated capital was in fact contributed within 30 days.

[38] *Decree No. 601*, *supra* note 16 at art. 121.

[39] In one report prepared for President Boris Yeltsin in 1994, it was estimated that between 70 per-

that the mafia actually serves a relevant purpose during the present transitional phase, as it is the only "organisation" that enforces the law in modern Russia.[40] On the contrary, it is frequently the mafia that stands in the way of many possibilities for the enforcement of laws through the regular state or arbitral channels. For example, if a legal dispute arises today, there is little wisdom in taking one's adversary to court or arbitration if that adversary is controlled or backed by the mafia. In some ways, Russia has again become a police state; except that the enforcers of the rules are no longer the police, nor the state. Organised crime thrives, in part, by keeping people in fear: that fear has become significant in many parts of Russia,[41] and it stands in the way of developing a society that respects and enforces its laws.

III. Recent Company Law Reform: Hope for the Future?

The adoption at the end of 1994 of the new *Code* (Part I)[42] resulted in a number of positive and long-awaited changes to Russian company law. To what extent, however, have the reforms addressed some of the real failures noted above?

One of the most significant reforms is the abrogation of both the Russian *Law on Property*[43] and the *Law on Enterprises*.[44] The result is that the odd and dangerous provision contained in article 11(3) of the *Law on Enterprises*,[45] has been aptly abolished.[46] In addition, a number of ambiguities have been resolved through the adoption of the new general rules regulating the limited-liability company and the joint-stock company.[47]

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cent and 80 percent of all private business and banking activity had fallen into the control of the Russian mafia (see *e.g.* M. Goldman, "Comrade Godfather: In Russia, the Mafia Seizes the Commanding Heights of the Economy" *The Washington Post* (12 February 1995) C2. See also Handelman, *supra* note 10).

[40] The argument is that, given the unstable economy, the weakness of the central government, and fledgling law enforcement institutions, the mafia is seen as the only real power that is in a position to "enforce" such matters as private contracts.

[41] The tragic truth is that no one — not even promising law students — is safe from the possible reaches of the mafia. According to anecdotal accounts, out of fifteen Russian LL.M. students studying last year in the United States under various programs, two have been murdered in what appear to be mafia-related killings.

[42] *Supra* note 5. It is worth noting that the new *Code*'s final adoption owes itself, in some measure, to fortuity; after its adoption by the State Duma, Russia's lower house, it was sent to the upper chamber, the Council of the Federation, for required approval. Reports indicated that significant opposition existed among Council members, yet the Council failed to take action within the prescribed period for doing so. The new *Code* was accordingly then sent on to the President, for signature into law.

[43] *Supra* note 29.

[44] *Supra* note 15.

[45] See Part **II.C.**, above, for a discussion of this provision.

[46] This development is a welcome first step. However, it should be noted that the new provisions in the new *Code* on limited-liability companies do not *expressly* confirm that a limited-liability company owns the assets contributed to it by the founders. Perhaps that point will be confirmed in the new law on limited-liability companies that remains to be adopted.

[47] One of the basic reforms was simply the introduction of a broader set of principles governing the "limited-liability company". In addition, the new provisions clarify that this form is not a

Not all ambiguities have been resolved, however, as the reforms have yet to be completed: the new *Code* calls for adoption of a new law on joint-stock companies,[48] which would replace Russia's existing law in *Decree No. 601*. In addition, the new *Code* calls for a new law on limited-liability companies.[49] Several drafts of a new law on joint-stock companies were submitted from various sources to the Russian State Duma, but none has as yet been adopted.[50]

Not surprisingly, there is nothing in the reforms expressly aimed to aid in the application and enforcement of the laws, and the reforms do not, and did not purport to, address the problem of rampant organised crime in Russia. Yet experience with the new provisions offers several glimmers of hope. The new *Code* itself is a substantial body of law and the product of much work: in the author's experience, the presence of the new *Code* expressly tailored to Russia's new market economy has itself had an impact on how many people in Russia conceive of *law* itself. One notices more and more people, jurists and non-jurists alike, developing a legal reflex and a legal approach to problems, and thus, the new *Code* may have succeeded in creating a greater sense of respect for *law* as an institution.

Conclusion

Law has most certainly been a factor in Russia's slow and painful transition to a market economy. The real failures, however, have not always been in the laws themselves; they have, to a large extent, been in how the laws are applied, or fail to be applied, or are left on the books even when inconsistent with reality and practice. Such basic problems in enforcement and application necessarily lead to a deterioration of the underlying respect for law itself, and in the Russia of today, with so much power in the hands of the omnipresent mafia, corruption remains a further obstacle to the enforcement and development of law.

In the end, Russia's transition to a market economy provides a striking reminder of certain basic truths observed long ago, namely, that it is one thing to have laws enacted, and it is another thing to have those laws respected and justly applied. Law is clearly much more than a mere set of written texts, and if law has been a factor in Russia's slow and painful transition to a market economy, then it has, largely, been in the inability to readily create a legal environment where law — in all its facets — is respected. On a larger scale, it would seem to follow logically that

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"partnership" (*tovarischestvo*) but a "company", as the new form is called an *obschestvo* (company) *s'ogranichennoy otvyetstvennostyu* (with limited liability).

[48] New *Code*, *supra* note 5 at art. 96.

[49] *Ibid.* at art. 87.

[50] The State Duma rejected most of the drafts submitted and, at the time of writing, was considering the draft proposed by the Russian State Committee for State Property (or G.K.I.). The election of new members to the State Duma in December 1995 may have an impact on whether a new law is adopted soon.

for Russia to become a country truly governed by the *rule of law*, it must first become a state not only where good laws are adopted, but where those laws are also applied, respected, and enforced.