

## **SOME ISSUES OF DEVELOPMENT OF CORPORATE GOVERNANCE IN RUSSIA IN THE LIGHT OF EUROPEAN AND INTERNATIONAL LAW**

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### ABSTRACT

*In the present paper the development of corporate governance in Central Europe and Russia is compared. All these countries understand the importance of good corporate governance in the economic reforms and its role for companies. The focus of this paper is directed at the necessity of including such academic disciplines for students as the topic 'Corporate governance' and the theme 'Corporate Law' into the magister program of two diplomas 'European and International Law'.*

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## 1. DEFINITION OF 'CORPORATE GOVERNANCE'

The process of globalization, the concentration of capitals, and the development of international economic relations determine the necessity of formulation of public economic relations between entities in different countries. In this regard, the role of studying the legal aspects of the organization and operation of corporations in the free economic zone increases.

Representatives of the economic and legal sciences define 'corporate governance' on the basis of a variety of purposes and characteristic for each branch of knowledge. Thus, economists consider the system of corporate governance as a set of institutional arrangements to limit deviations from the behavior which maximizes the market value of the firm.<sup>1</sup>

Academic lawyers in their definitions of corporate governance combine two values of this concept - the actual system of relationships and a set of legal rules. Thus, V.V. Dolinskaya<sup>2</sup> believes that corporate governance is a system of organizational and property relations regulated by rules of law, by which corporate organization implements, represents and protects the interests of investors and shareholders in the first place.

S.D. Mogilevskiy,<sup>3</sup> based on data from various fields of modern science, concludes: 'as a kind of social control, the corporate governance being carried out by economic society is a continuous and meaningful impact on the ordering behavior of the people involved in the activity of economic society (persons authorized by law and the constituent documents), in terms of corporate interests (participants, members of the management bodies) or related labor relations (employees and officials). This impact is realized through managerial relationship between these persons of a subject and an object of the corporate governance.'

So, corporate governance is a set of methods of influence or the process by which corporate activities are managed and controlled.<sup>4</sup>

But corporate governance narrowly, as the management of stocks, must be distinguished from that of production, the organization of production and direct

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<sup>1</sup> Kapelyushnicov, R., *The Largest and Dominant Owners in the Russian Industry*, in *The Economic Issues*, Moscow, 2000, p. 119.

<sup>2</sup> Dolinskaya, V., *Company Law: Fundamentals and Trends*, Moscow, 2006, p. 420.

<sup>3</sup> Mogilevskiy, S., *Controls Business Entities. Legal Aspect: PhD Thesis*, Moscow, 2001, p. 166.

<sup>4</sup> Shitkina, I. (ed.), *Corporate Law: a Textbook for University Students*, Moscow, 2008, p. 169.

production activities (manufacturing technology). Administration of production and business activities of corporations, including investment, technology, human resources and marketing has been received the name 'management'.

They say about what is corporate governance quite a long time. Not less has been said about why corporate governance is necessary for companies and also useful as an academic discipline.

In the light of the importance of corporate law in all areas of practice, all students should consider taking the introductory course in Corporations. This course provides students with a general overview of law governing corporations, as well as law of agency, partnerships, and limited liability companies. Students would learn on how law operates in the business world, how it helps to advise clients on using law to achieve specific business objectives.

## **2. THE ROLE OF CORPORATE GOVERNANCE IN BUSINESS ACTIVITIES**

In a market economy corporations are the main legal form of organization through which business activity is performed. They are 'the quintessential institutions of modern capitalism'.<sup>5</sup> A well-run and profitable corporation means through which a country provides "employment, wealth, and satisfaction",<sup>6</sup> that is not only material but also social welfare. Success of a corporation depends on corporate governance. Corporate governance 'refers to control of corporations and to systems of accountability by those in control'.<sup>7</sup> It is the system by which companies are directed and controlled, which include legal rules as well as systems of self-regulation. As a rule, a company is built according to the principle of separation of ownership and control and has outside capital suppliers, such as external shareholders.

Corporate governance determines the relationship between shareholders, directors and management of a company and helps to solve the agency problem between outside owners and inside managers. Good corporate governance makes a company attractive for external investors and ensures the inflow of outside finance.

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<sup>5</sup> Owen, T., *Autocracy and the Rule in Russian Economic History*, in J Sachs and K Pistor (eds.), *The Rule of Law and Economic Reform in Russia*, Boulder, CO: Westview Press, 1997, p. 26.

<sup>6</sup> Charkham, J., *Keeping Good Company: a Study of Corporate Governance in Five Countries*, Oxford University Press, 1995, p.128.

<sup>7</sup> Farrar, J., *Corporate Governance in Australia and New Zealand*, Oxford University Press, 2002, p 143.

The desire to attract foreign investments is one of the reasons why transition economies find good corporate governance so important.<sup>8</sup> Another significant role which corporate governance plays in transition economies is expressed through its function of 'a key determinant of enterprise restructuring'.<sup>9</sup> Through the scope and depth of enterprise restructuring, the quality of corporate governance is reflected in a company's profitability and productivity.<sup>10</sup> Good corporate governance can help to discipline corporate insiders 'in the way they allocate and especially in the way they use, or waste, the sizeable real resources they control'.<sup>11</sup> Through performance of a company, successful corporate governance contributes to general welfare of a country and influences national economic performance. It helps to achieve a developed capitalist economy.<sup>12</sup> All countries in transition to market economy realize the interrelation between improved corporate governance and better economic performance and pay serious attention to the problems of corporate development.

The importance of development good corporate governance mechanisms cannot be overestimated in the world that is getting more and more globalized. Globalization opens exciting opportunities for transition economies, but at the same time, it places the burden of huge responsibility on them. When more and more countries become members of the global community, each participating country has to realize that its economic performance and the quality of corporate governance are now vitally important not only for that very country, but for the whole world. The interconnectedness of economies all over the globe makes them very powerful, yet vulnerable at the same time, just like the world itself.

### **3. COMPARISON OF CORPORATE GOVERNANCE IN CENTRAL EUROPE AND RUSSIA**

When comparing the development of corporate governance in Central Europe and Russia we can identify some similarities and differences. On the one hand

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<sup>8</sup> Osipova, V., *The Problems of Development of Corporate Governance in Russia: Comparison with Central Europe and China*, Gold Coast, 2013, p. 20.

<sup>9</sup> Blasi, J. and Shleifer, A., *Corporate Governance in Russia: An Initial Look*, in Frydman, R., Gray, C. and Rapaczynski, A. (eds.), *Corporate Governance in Central Europe and Russia*, Budapest, 1996, p. 231.

<sup>10</sup> Andreff, W., *Beyond the Principal-Agent Model*, in Rosenbaum E., Bönker F. and Wäger H-J (eds.), *Privatization, Corporate Governance and the Emergence of Markets*, London, 2000, p. 25.

<sup>11</sup> Oman, C., *Corporate Governance and National Development*, <<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.7716&rep=repl&type=pdf>>

<sup>12</sup> Fox, M. & Heller, M., *Lessons from Fiascos in Russian Corporate Governance*, <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=203368](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=203368)>

the countries of Central Europe and Russia have much in common: they all have been involved in the two major economic periods of the twentieth century: the communist experiment with a command economy, and the subsequent transition from plan to market.<sup>13</sup> The latter still continues, and has yielded different results in different countries. For example, between 1990 and 1999, GDP in Poland grew by more than 40 percent, while in Russia it fell by 40 percent.<sup>14</sup> The awareness of the interrelation between the success of reforms and the quality of corporate governance brought forward the issue of corporate governance improvement.

The Bank of Russia Financial Market Service notes that the purpose of corporate governance is to give shareholders opportunity of effective control and monitoring of management's activity and all that should help for company's capitalization increasing.<sup>15</sup>

Comparative analysis of certain corporate governance institutions in Russia and major EU countries also shows that they have much in common. For example, boards of directors in France, Germany or Italy, as well as in Russia, are not particularly active and are mainly comprised of 'insiders' affiliated with the owners and management of the companies. Minority shareholders are clearly in the minority there. In the UK and the United States, boards of directors are vigorously active and include mainly independent directors.

According to the Merit Research Corporate Governance Risk Survey,<sup>16</sup> the countries of Central Europe show similar weak and strong points in corporate governance. Thus, the law enforcement is their weakest point, while regulatory framework is the strongest. Slowness of courts, inefficiency of arbitrage, as well as evasion of the final verdict are the most commonly observed problems. At the same time, it is admitted that regulatory institutions are independent and well functioning. In Hungary and Poland, the quality of the regulatory framework is defined as approaching the standards of economically developed countries. Company laws in all these countries are of good quality as regards shareholder rights, but creditor rights and laws dealing with bankruptcies, quality of contracts and conflicts of interests remain less pronounced.

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<sup>13</sup> Stiglitz, J., *Quis Custodiet Ipsos Custodes? Corporate Governance Failures in the Transition*, Paper presented at the Annual Bank Conference on Development Economics-Europe, Paris, June 21-23, 1999, p. 68.

<sup>14</sup> Andreff, W., *Beyond the Principal-Agent Model*, London, 2000.

<sup>15</sup> The Bank of Russia Financial Market Service, *Corporate governance: history and practice* <[http://www.fesm.ru/ru/legislation/corp\\_management\\_study/](http://www.fesm.ru/ru/legislation/corp_management_study/)>

<sup>16</sup> The Merit Research <<http://www.merit-research.cz/cgr/>>

According to the opinion of the European Commission,<sup>17</sup> harmonization of the rules relating to EU company law and corporate governance is essential for creating a Single Market for EU legal Services. In the fields of company law and corporate governance, objectives include: providing equivalent protection for shareholders and other parties concerned with companies; ensuring freedom of establishment for companies throughout the EU; fostering efficiency and competitiveness of business; promoting cross-border cooperation between companies in different Member States; and stimulating discussions between Member States on the modernization of company law and corporate governance.

EU laws and codes set the standards for good and responsible management of companies. They are meant to ensure a company's management stays focused on the long-term interests of their shareholders. As part of a wider reform of EU corporate law, the Commission is now examining how to strengthen the rules and make them less dependent on self-regulation. Managers and boards of directors would be held more accountable for their decisions.

On the other hand corporate governance practices in the EU and in Russia differ considerably. There are certain objective and subjective factors that allow for comparisons and analogies to be made.

Furthermore, even within the euro zone, corporate governance institutions differ in the levels of their maturity. These differences became especially pronounced in the wake of EU enlargement with a number of East European states, although several 'old' EU members (e.g., Portugal or Greece) are only slightly ahead of Russia in the development of such institutions.<sup>18</sup>

In Europe, it is the state that calls the shots in reforming corporate governance. The business community – not only in Russia, but also in many European countries – is not yet self-organized and self-sufficient enough to influence the formation of corporate governance principles. The prevalence of concentrated ownership in Russian and the majority of European companies has a substantial impact on such essential aspects of their activity as relations between shareholders and management of a company, transparency, and the status of independent directors.

Also, the comparison of development of corporate governance in Russia with Central Europe helps to reveal the factors that influence its poor performance. In the paper 'Factors influencing corporate governance in post-socialist com-

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<sup>17</sup> The EU Single Market, *Company Law and Corporate Governance* <[http://ec.europa.eu/internal\\_market/company/index\\_en.htm](http://ec.europa.eu/internal_market/company/index_en.htm)

<sup>18</sup> Porshacov, S., *Improving Corporate Governance in Russia and the EU*, Russia in global affairs, Moscow, 2006, p. 14.

panies: an analytical framework”<sup>19</sup> writers indicates that “in summary, there are four factors which can influence corporate governance performance, in the form of pressure exerted by: majority shareholders; outside minority shareholders; internationalization/globalization and the state (via legal regulation)”. Although in the process of reforms all those countries have encountered similar problems, such as insider-dealing, violation of shareholders’ rights, residual state property in enterprises and others,<sup>20</sup> it seems that the initial conditions in a country as well as its characteristics and implemented policy reforms play a key role in shaping the performance of a national system of corporate governance.

#### **4. FROM THEORETICAL KNOWLEDGE TO PRACTICE**

Of course, all this and other theoretical knowledge specialists should apply in their practical activities. According to experts,<sup>21</sup> the effectiveness of a lawyer is strongly dependent on how he understands the economic and management processes. Thus the law schools have to provide to students the opportunity to acquire complex legal and business skills necessary to enter a wide array of corporate law career. Students interested in pursuing a transactional practice should take courses designed specifically to teach them to structure complex deals, representing businesses in mergers, acquisitions, and licensing deals. Students interested in corporate litigation should take courses geared to the preparing and participation them in the trial and to handle high-stakes corporate governance and securities litigation.

Persons trained in corporate law help to create, finance, and operate the business enterprises that account for the vast bulk of the world’s economic activity. They bring corporations, limited liability companies, partnerships, and other enterprises into being. They structure the stock and bond offerings the bank and insurance company loans that provide the enterprises with capital, they affect the joint ventures and perform an important role in the implementation of its activities corporation. Such activities are done amidst constraints arising from market forces, varying notions of social responsibility, and state, federal, and international law and regulation.

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<sup>19</sup> Heinrich, A., Lis A. and Pleines H., *Factors influencing corporate governance in post-socialist companies: an analytical framework*, William Davidson Institute Working Paper, Michigan, 2007, p.7.

<sup>20</sup> Pistor, K., *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, in *European Business Organization Law Review*, Princeton, NJ, Cambridge University Press, 2000, p. 29.

<sup>21</sup> Higher school of economics, *Master of Law – is professional with communicative skills* < <http://www.hse.ru/news/2953181.html>

It is also important that students at the law school benefit directly from the scholarly research engaged in by the faculty. In the corporate area, such matters as the headline flaws in corporate governance, the derivatives revolution in the financial markets, and the recent stock market bubble raise fundamental, often complex, issues. Research of a profile department on such matters can filter through to the ideas discussed in practice lessons. This will promote the development of students' knowledge and raising the level of teacher development. The law schools, in our opinion, also could offer specialized courses, some of which are taught by distinguished professors from foreign universities and lawyers practicing in major law firms. During training students should learn the essence and the basic principles of corporate governance, development trends, apply knowledge of the regulatory framework for the protection of matters of shareholder rights, acquire knowledge on the implementation of a corporate culture in the company, as well as they would develop skills in independent practice and further development of theoretical knowledge of corporate legal regulation.

Students sometimes mistakenly assume that corporate and commercial law courses are relevant only for 'big business' entities and transactions, and that only lawyers in large firms deal with them.<sup>22</sup>

However, the practice of most lawyers involves working with some forms of business organizations, and in its broader sense commercial law includes consumer interests and transactions.

Some lawyers engaged in a corporate law practice focus on business transactions and corporate regulation, but others emphasize corporate and securities litigation. Even if one does not plan to specialize in this area, one should consider taking one or more of the courses since corporations are so pervasive and corporate law questions are important in all areas of legal practice.

The basic course in Corporations provides an introduction to law of business organizations and is a prerequisite for many other corporate and securities law courses. Other courses in the area prepare you for a practice that focuses on corporate organization, governance, and financing. Courses in corporate finance and securities regulation deal with issues basic to corporate practice and provide a foundation for even more specialized practice.

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<sup>22</sup> The University of San Francisco School of Law, *Corporate & Commercial Law* <<http://www.usfca.edu/law/jd/curriculum/ccl/>>



## **5. ‘CORPORATE LAW’ IN THE CURRICULA OF LAW SCHOOLS**

It is necessary to pay attention to the fact that the course ‘Corporate Law’ containing theme ‘Corporate governance’ is included in the curricula of a number of law and economic schools. Academic discipline of corporate law is complex because it educates features of private law regulating corporations and features public law regulation of their activities, their management.

A need for specialists deeply versed in corporate governance, due not only lawmaking trends. With the increasing complexity of the legal system and the realities of life specialty lawyers areas will only increase.

In our opinion students should learn the basics of the discipline in full volume firstly and the course for bachelors should be named e.g. ‘Fundamentals of European law’. And master’s program should consider the specific branches of European law, including the theme of corporate governance as a separate section ‘Corporate law’ of the curriculum.

## **6. EUROPEAN LAW AND INTERNATIONAL LAW**

However, speaking of the relationship between legal systems we should take into account the controversial question of the relationship between European and International law. Thus, for example, Katja S Ziegler writes<sup>23</sup>: “the EU is an international organization by birth, but has become highly constitutionalized: with supranational legislation and a dense web of detailed norms due to the sheer amount of regulation, it is characterized by advanced and widespread law-making procedures and output; the EU courts have jurisdiction in procedures that create an elaborate system of compulsory dispute settlement mechanisms which has been described as a ‘complete system of remedies’”. She believes that there is the question of the international or sui generis/constitutional nature of the EU cannot be answered here, but three points should be highlighted. These points are tensions between internationalism and constitutionalism in EU law (both they are very prominent when analyzing the relationship between EU and international law), the nature of the EU (it is not merely of academic relevance, not the least because there are consequences and “even if taking the position that EU law is only an especially advanced type of international law, the relationship between EU law and international law has become a complex one due to a number of factors” (such as the triangular relationship between EU law, international law and the EU Member

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<sup>23</sup> Ziegler, K. S., *The Relationship between EU law and International Law*, University of Leicester School of Law Research Paper No. 13-17, Leicester 2013, p. 89.

States; possibilities of conflicts of norms and conflicts between courts and tribunals about jurisdiction and substantive interpretation of rules between EU law and general international law ('fragmentation'); fact that general international law also benefits from the more evolved, more constitutionalised parts of international law/international organizations in several respects).

Generally, in order to understand the relationship between EU and international law, two broad questions need to be discussed.<sup>24</sup> First, does international law allow for action by the EU? And second, what is the effect of international law in the EU's legal order?

The first of these questions itself divides into various different issues. First, there is the issue of the legal personality of the EU under international law, and its capacity to act internationally; second, there is the scope of the powers of the EU. As it is noted, discussing such issues unearths some complicated (and unresolved) underlying jurisprudential debates into such topics as the precise nature and function of legal personality and the concept of legal powers. By the same token, the relationship between international law and EU law provokes reflections on the co-existence of distinct legal orders. In what follows, the terms EU and EC will be used interchangeably, except where the context dictates otherwise.

So, the role of the EU within the international legal system is still shrouded in myth and mystery.<sup>25</sup> While there are excellent studies of the details of EU external relations law, most of these focus on the constitutional dimension or on concrete policies, rather than on the place of the EU in the broader scheme of things. It is difficult, moreover, to identify serious jurisprudential work on the EU's position in international law: arguably academic specialization has made this all but impossible, as the EU lawyers would feel uncomfortable with the jurisprudential aspects and the international law, and vice versa. 'Yet, it is by no means eccentric to suggest that such serious work ought to be undertaken: the more the EU matures, the more it acts as a global power, the more fundamental issues concerning its position in international law will be raised'.<sup>26</sup>

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<sup>24</sup> Klabbers, J., *Presumptive Personality: The European Union in International Law*, in Martti Koskeniemi (ed.), *International Law Aspects of the European Union*, Martinus Nijhoff Publishers, 1998, p.47.

<sup>25</sup> Klabbers, J., *The EU and International Law* >[http://ivr-enc.info/index.php?title= The\\_EU\\_and\\_International\\_Law](http://ivr-enc.info/index.php?title=The_EU_and_International_Law)

<sup>26</sup> Klabbers, J., *The EU and International Law*.

## 7. CONCLUSION

Based on the above, it is difficult not to agree with the need to include the ‘Corporate Law’ in the curriculum of the course of European Law. This section helps for students to perform the following tasks:

- acquisition of new and in-depth knowledge of corporate governance, including public policy formation and development of corporate standards international joint-stock companies;
- familiarization with different conceptual theories of corporate governance;
- use of corporate assets protection through mergers and acquisitions of companies and assessing their effectiveness;
- studying of methods and practice of ratings of the quality of corporate governance market entities, issued to international and local agencies (institutions).

To summarize, we can say it’s really important for students as future specialists learn actual questions of Corporate law such as the issues of corporate governance and this is certainly the reason for the teaching and studying of the topic in the master’s double-degree program ‘European and International Law’.

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