THE EVOLUTION OF RUSSIAN FORMS OF BUSINESS ENTERPRISE

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Jusqu'à la révolution bolchevique, les entreprises commerciales de Russie avaient des formes analogues à celles des entreprises des pays occidentaux. On trouvait, entre autres, des entreprises individuelles, des sociétés de négoce, des sociétés par actions et des coopératives. Le droit des sociétés était quelque peu archaïque et reflétait un méfiance envers la libre entreprise ainsi qu'une prédilection pour l'intervention gouvernementale.

Après la révolution bolchevique, l'État a pris le contrôle de la plupart des entreprises, ce qui a laissé planer un doute sur le statut juridique de nombreuses sociétés. Les coopératives ont continué d'exister et ont commencé à prospérer dans les années 20. La N.E.P. de Lénine a brièvement desserré le contrôle total de l'État sur l'industrie, mais les poliques d'industrialisation et de centralisation de Staline ont redonné le contrôle à l'État. Les entreprises d'État étaient la forme d'entreprise commerciale la plus courante, mais il y avait aussi des coopératives et un nombre limité d'entreprises individuelles dont on autorisait l'existence.

Le régime communiste a créé des entreprises fondamentalement différentes des entreprises occidentales. La perestroïka *a entraîné un assouplissement des restrictions s'appliquant aux entreprises d'État et aux entreprises individuelles, ainsi qu'à plusieurs formes nouvelles d'entreprises : la coentreprise créée par le* Décret 49, *la coopérative réorganisée et l'entreprise louée. Ces mesures temporaires visant à favoriser l'entrepreneuriat et l'investissement*

Until the Bolshevik Revolution, Russian forms of business enterprise were analogous to those in Western countries, and included individual economic activity, trading firms, joint stock companies, and cooperatives. Corporate law, however, was somewhat archaic and reflected a distrust of free enterprise and a predilection for government interference.

After the Bolshevik Revolution, most enterprises were taken over by the State, leaving the juridical status of many companies in doubt. Cooperatives continued to exist and began to flourish in the 1920s. Lenin's NEP provided a brief respite from complete state control of industry, but Stalin's policies of industrialization and centralization returned control to the State. State enterprises were the most common form of business enterprise, but cooperatives existed, and individual economic activity was permitted to a limited extent.

Communist rule created enterprises inherently different from their Western counterparts. Perestroika *brought relaxed restrictions on state enterprises and individual economic activity, along with several new forms of enterprise: the* Decree 49 *joint venture, a revamped cooperative, and the leased enterprise. These tentative measures intending to foster entrepreneurial initiative and foreign investment were replaced by bolder initiatives of the Russian Federation after the fall of the USSR. The 1994 Civil Code establishes various forms of enterprise, many of which are modelled after Western forms. The recently enacted* Law on Joint Stock

étranger ont été remplacées par des initiatives plus hardies de la Fédération de Russie, après la chute de l'URSS. Le Code civil de 1994 a créé diverses formes d'entreprises, dont un bon nombre s'inspire de formes d'entreprises occidentales. La Loi sur les sociétés par actions *qui vient d'être adoptée a un champ d'application aussi vaste que celui des lois occidentales portant sur le même domaine et elle renferme des dispositions visant à surmonter les difficultés qui touchent la régie des entreprises et auxquelles font face les entreprises nouvellement privatisées en Russie.*

Companies *is as comprehensive as Western corporate statutes and includes provisions intended to overcome some of the corporate governance difficulties experienced in Russia's newly privatized enterprises.*

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I. INTRODUCTION

The last few years have seen tremendous upheaval in what was once the USSR. The Marxist experiment has come to an end and in its place is a disparate group of autonomous bodies, freed from the yoke of central planning but in chaos under the economic, social and political forces pulling simultaneously in all directions.

This paper will deal with one of these forces: the need for forms of business enterprise that will provide vehicles for the individual initiative and private investment necessitated by the move towards an economy driven by market forces. My intent is to avoid presenting a myopic view of the Russian business enterprise for fear that a strict legal analysis, without some notion of the historical, social and political context, would paint a misleading picture for anyone trying to gain a better understanding of business in Russia. Thus, the first part of the paper offers a brief historical account of the development of forms of business enterprise in Russia from the inception of communist rule to the advent of *perestroika.*

Subsequently, I will deal with attempts by the USSR, in the few years before its downfall, to create several forms of business enterprise in the hope of attracting foreign capital and technology as well as tapping domestic initiative. Finally, the current forms of business enterprise will be outlined, culminating with the recent enactment of a comprehensive new corporate law.

II. THE LEGACY OF COMMUNISM

A. *Business Enterprise before the Revolution*

Until the Bolshevik Revolution, business forms were developing in Russia in a way roughly analogous to that in the West. The simplest form of business entailed the economic activity of a single person. Merchants undertaking such activity were required to join a guild, with membership in a guild offering such privileges as exemption from military duty and freedom from corporal punishment. Alongside individual economic activity existed partnerships (commonly known as trading firms): both full partnerships (with all partners assuming full liability for partnership debts) and limited partnerships (which consisted of full partners and limited partners). Trading firms were easily established, simply requiring that a contract signed by the parties be presented to a municipal clerk. Although there were a large number of trading firms in Russia before the Revolution, they tended to be rather small, with the average firm in 1914 having a capital stock less than one fiftieth that of the average joint stock company.[1]

Joint stock companies were also gaining acceptance in Russia, although their development by Western standards was somewhat backward. Even on the eve of the Revolution, corporate law was still governed by an archaic 1836 law, the provisions of which had been subsequently incorporated into the *Commercial Code*.[2] The legislation required that a charter be granted for the creation of each new joint stock company, and

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[1] T.C. Owen, *The Corporation under Russian Law, 1800-1917: A Study in Tsarist Economic Policy* (Cambridge: Cambridge University Press, 1991) at 11. For a thorough discussion of Russian corporate law before 1917.

[2] Or *torgovyi ustav.* See *Polnyi svod zakonov,* vol.10, part I, in various editions, for example 1857 and 1900. A compilation of these articles, with reference to the law and later amendments to 1911, is found in Maksimov, *O tovarishchestvakh,* 29-53.

a charter was only granted subsequent to a review by several government ministries and approval by the Tsar. This concession system resulted in much confusion in Russian corporate law since the charters of specific companies were given the status of legislation and often derogated from the provisions of the *Commercial Code*. With its inherent delays and excessive bureaucracy, the concession system was to remain until 1917 in spite of persistent criticism by foreign investors and domestic business people.

Investors in joint stock companies enjoyed limited liability, but many restrictions on the activities of companies and their directors and managers reflected the Russian distrust of free enterprise and a predilection for government interference and constraint. The law contained burdensome restrictions on the capitalization and ownership of the companies,[3] and government policy demanded strict adherence to a company's charter. Changes to a charter, for example with respect to the activities a company could undertake, could not simply be made by the company's shareholders but required the permission of the government ministers and the Tsar.

Because of the bureaucracy involved in establishing joint stock companies, along with xenophobic restrictions on the involvement of foreigners and Jews in corporate affairs, this form of business enterprise was slower to develop in Russia than in the West. Many Russians incorporated under German law instead, a move which had unfortunate repercussions when German companies operating in Russia were dissolved by decree during the First World War.

Although difficult to establish, joint stock companies benefitted from exclusivity, and were often the recipients of special government favours, such as monopoly control over a specific sector or tax concessions. Companies tended to be very large enterprises, and control of industry was concentrated in a small number of hands.[4] The formation of cartels (agreements between several companies to control a market) and trusts (fully integrated enterprises operating in a single field) was common even though prohibited by law.[5]

The final form of business enterprise prevalent before 1917 was the cooperative. A popular form of business organization, the cooperative's leaders and members comprised not the bourgeois industrialists, but rather the peasants and artisans. Although in existence throughout the nineteenth century, cooperatives began to flourish after 1905, especially during the First World War.[6] The Stolypin reforms of 1906 to 1911, which tended to break up the peasant communes and to reallocate land among the peasants, set the stage for a reorganization of peasant enterprise, spurring the growth of cooperatives.[7]

The central government generally held cooperatives in disfavour. This was partly because the personal and business connections that had developed between the industrialists and government officials meant that preference was generally accorded to the wishes of the industrialists when they conflicted with those of the cooperatives. As well, the government saw cooperatives as a means of organizing popular forces,

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[3] *Ibid.* at 15-21.

[4] S.O. Zagorsky, *State Control of Industry in Russia during the War* (New Haven, Conn.: Yale University Press, 1928) at 10.

[5] *Ibid.* at 11-12; *supra* note 1 at 132-37.

[6] J.N. Westwood, *Endurance and Endeavour: Russian History 1812-1992*, 4th ed. (New York: Oxford University Press, 1993) at 181. See also A.T. Griffin & L.D. Soderquist, "The Soviet Cooperative before Perestroika: The Leninist Versus the Stalinist Concept" (1991) 39 Am. J. Comp. L. 599.

[7] Westwood, *ibid.* at 169-72.

organization which would pose a threat to the existing political regime.[8] But cooperatives received support from local governments, and especially began to thrive when the war created havoc in the supply of consumer goods and agricultural products. By the time of the Bolshevik Revolution, membership in the cooperative form of private enterprise included over one-third of the country's population.[9]

B. *The Socialist Revolution and Its Effect on Forms of Business Enterprise*

While the tsarist government had furthered policies that tended to inhibit entrepreneurial business activity and protect the handful of industrialists that controlled large enterprises, the Provisional Government established following the abdication of the Tsar in February 1917 intended to foster individual initiative, and to shift economic power away from the elite in favour of the workers. Although the regime was short-lived, the economy was ripe for change and the new government was quick to implement its policies.

Within two months of the revolution, corporate law was completely overhauled, bringing it up to date with similar legislation in the West. The archaic provisions of the 1836 law were repealed and replaced with modern legislation that took the fate of budding entrepreneurs out of the hands of corrupt bureaucrats. Despite the continued requirement that a charter be granted for joint stock companies, the formalities for applying for one were curtailed to such an extent that creating a company became a relatively simple process. Gone were the religious and citizenship restrictions on corporate officers, minimum capital requirements were substantially reduced, and approval by the Ministry of Trade and Industry was easy to obtain. As well, the regulations governing the modification of corporate charters once established were substantially simplified.[10]

In an effort to give workers more say in the management of business enterprises,[11] the Provisional Government required the establishment of workers' committees in many factories. While the official powers of the committees were circumscribed such that they were to play a role similar to that of today's labour unions, committee members, spurred by the less moderate representatives of the labour class and dismayed at the reluctance of the government to assume complete control of industry, began to assert a high degree of control. In many cases they ousted management or took the place of deserted managers. In spite of attempts by the Provisional Government to establish regulating boards in order to assume a greater degree of supervisory control over industry, the workers' committees had a much better knowledge of the functioning of the enterprises, and thus were able to keep much control in their own hands.[12] The establishment of workers' committees marked a notable shift in the control of existing enterprises, and would play an important role in the transformation of the Russian economy from a capitalist to a communist one.

Having built up momentum during the decade preceding the Tsar's overthrow, cooperatives were suddenly being supported by the new regime. Cooperative leaders

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8 *Supra* note 4 at 169.

9 Westwood, *supra* note 6 at 181; Griffin & Soderquist, *supra* note 6 at 600-601.

10 *Supra* note 1 at 189-90.

11 Until the Revolution, labour unions were illegal.

12 *Supra* note 4 at 171-78.

sought exemptions from the price and distribution controls implemented for purposes of sustaining Russian efforts in the First World War, endeavouring to gain a competitive advantage over private traders still subject to the controls. In this way, it was hoped that cooperatives would become the dominant force in the economy, taking the place that had traditionally been reserved for private traders.[13]

C. *The Bolshevik Revolution and War Communism*

With the Bolshevik Revolution in late 1917 came communist ideology, condemning private ownership of property and advocating instead collective (State) ownership of the means of production. During the period of War Communism,[14] communist idealists found themselves in conflict with members of private cooperatives. The leaders of the cooperatives initially resisted the State's infiltration into the commercial sector, offering general hostility and organized sabotage in the supply and distribution of food. However, the cooperative movement's working class base began to work with the Bolshevik government, undermining the authority of the cooperative leadership and eventually allowing state authorities to gain control of the cooperative sector.

Immediately after the Revolution, workers were given extensive control over the operations of the factories by means of the workers' committees established by the previous regime. These committees operated relatively independently of the Bolsheviks, in effect subjugating the management of the factories to the dictates of the committees.[15] The power of the committees was gradually subsumed by the Party as industry was quickly nationalized.

The nationalization of industry proceeded much faster than Lenin had originally envisioned. The banking sector, for example, was nationalized almost immediately when the existing banks refused to issue funds to the Bolshevik government. Various nationalizing decrees were passed,[16] often more in the form of policy statements than statutes,[17] authorizing the nationalization of particular industries. Under the authority of these decrees, state representatives, usually armed with guns, proceeded to enter upon

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[13] *Ibid.* at 169.

[14] War Communism refers to the period consisting of the first few years after the Revolution in which the country was in a state of civil war. The new rulers were endeavouring to tighten their power, the old rulers were trying to get their power back, industrial and agricultural output plummeted, and starvation was rampant.

[15] Westwood, *supra* note 6 at 278.

[16] The first industrial enterprise, a mill, was nationalized on November 30, 1917. As a result of extensive sabotage by industrialists, the Council of People's Commissars issued the decree, *On the Rights of Local Soviets in Combating Sabotage by Employers and on the Rules of Confiscating Saboteurs' Enterprises* (7 December 1917), trans. Y. Akhapkin, ed., *First Decrees of Soviet Power* (London: Lawrence & Wishart, 1970) at 184. The government first began passing decrees nationalizing particular enterprises, but later nationalized entire sectors of industry: the merchant marine on 5 February 1918; all grain storage facilities on 15 February 1918; the sugar-refining industry on 2 May 1918; and the oil industry on 20 June 1918. A host of other industries were nationalized in a single decree, *On the Nationalization of Enterprises in a Number of Industries, Railway Transport Enterprises, Public Utilities, and Steam Mills* (28 June 1918), trans. Akhapkin, *ibid.* at 147 [hereinafter *Nationalization of Enterprises*].

[17] For the text of the decrees nationalizing banks, see *Russian Commercial & Industrial Bank* v. *Comptoir D'Escompte de Mulhouse*, [1925] A.C. 112 [hereinafter *Russian Commercial*].

the premises of the enterprise and confiscate its property.[18] The former owners and managers, if they had not already fled in fear, were often harshly dealt with. The property was thus assumed by the State, with no compensation ever being provided.

The Bolshevik government began by nationalizing large industries in key sectors, but inspired by revolutionary fervour, local Soviets and groups of individuals acting in the name of the State began nationalizing smaller industries on their own initiative. Even more so than the officially sanctioned nationalizations, these spontaneous nationalizations were crude and unorganized requisitions of the enterprises' property with no legal authorization.[19] By 1921 virtually all but the smallest businesses had been taken over in the name of the State.

The fervent and chaotic approach to nationalization meant that little attention was paid to the legal nature of the process. As a result, the juridical status of the nationalized companies was left in considerable doubt.[20] In some cases, the nationalizing decrees purported to confiscate the shares of companies; in other cases, the assets would be assumed, the corporate structure left to wither. The practical effect in Russia was not significant for it mattered not whether the corporate shell remained. If the State confiscated the shares of the company, the company became an organ of the State. If the State had taken over the assets of the company, the corporate shell was left with no property, no rights, and no recognition by the legal system.[21] Outside of Russia, however, the post-1917 juridical status of Russian corporations created some legal difficulties.[22]

Whatever may have been the immediate juridical effect of the nationalization efforts of the new Bolshevik regime on the existing business entities, the status of those enterprises was clarified by the 1922 Russian Civil Code, which provided that any legal person that was to continue as such was required to have its statute confirmed by an appropriate government body,[23] and any legal relations that arose before the coming into effect of the Civil Code were subject to a three-year limitation period.[24] In this way, the business entities that the government controlled or wished to continue could be

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[18] See *e.g.* Lord Wright's brief account of the nationalization of a bank in *Lazard Brothers & Co.* v. *Midland Bank, Ltd.*, [1933] A.C. 289 at 294 (H.L.), aff'g *sub nom. Lazard Brothers & Co.* v. *Banque Industrielle de Moscou*, [1932] 1 K.B. 617 (C.A.) [hereinafter *Lazard Brothers*].

[19] A. Baykov, *The Development of the Soviet Economic System* (Cambridge: Cambridge University Press, 1947) at 5.

[20] See *Nationalization of Enterprises*, *supra* note 16.

[21] See however *Provincial Milling Office* v. *Air Industry* (30 December 1924), trans. Z.L. Zile, ed., *Ideas and Forces in Soviet Legal History: A Reader on the Soviet State and Law* (New York: Oxford University Press, 1992) at 230, in which the Arbitrahz Commission dealt with a dispute over rights to certain grain storage facilities nationalized by the *Nationalization of Enterprises* decree (*ibid.*).

[22] See *e.g. Russian Commercial*, *supra* note 17; *Employers' Liability Assurance Corp.* v. *Sedgwick, Collins & Co.*, [1927] A.C. 95 (H.L.); *Russian & English Bank and Florance Montefiore Guedalla* v. *Baring Brothers & Co.*, [1936] A.C. 405 (H.L.); *Russian & English Bank* v. *Baring Brothers & Co.*, [1932] Ch. 435; *Lazard Brothers*, *supra* note 18.

[23] See art. 12 of the *Civil Code of the RSFSR* (1922).

[24] Resolution of the All-Russian Central Executive Committee, *On the Carrying into Effect of the Civil Code of the R.S.F.S.R.* (21 October 1922) para. 7, trans. *Lazard Brothers*, *supra* note 18 at 631.

maintained under the new regime; any other entity would be left to wither and die.[25]

D. *Lenin's Approach to Business Organization under the NEP*

In the years of War Communism, organizational chaos reigned as the new Bolshevik regime did not have the administrative network necessary to take over the productive and distributive apparatus of the entire country. Nationalization of industries, whether legally sanctioned or not, meant that thousands of enterprises were now in the hands of the State; yet without the means to manage these enterprises, productivity suffered.

In 1921, Lenin adopted the New Economic Policy ("NEP") in an attempt to re-establish order and economic productivity.[26] Central to this policy was the harmonization of public interest with individual initiative, and thus the NEP signalled a temporary return of control to managers. While the actual ownership of assets during this period is somewhat ambiguous, most small enterprises and farms reverted to private management, although almost all large-scale industry remained under government control.

The NEP brought about a clearer delineation of private and state enterprises. By leaving small enterprise to private entrepreneurs, Lenin's government could concentrate on organizing and managing the larger industries. The Supreme Council of the National Economy ("SEC")[27] was handed the task of organizing the economy. Under the SEC's control were placed certain large-scale industries considered essential to the State as a whole, as well as other industries necessary to supplement the essential industries.

To coordinate the production activities of the industries under SEC control, individual state enterprises were grouped together under the authority of trusts.[28] These trusts, established by statutes requiring approval of the Council of Labour and Defence, were juridically independent bodies with a high degree of commercial and economic autonomy.[29] They often held monopoly positions in their respective industries, and were given a free rein by the State to enter into contracts with respect to distribution, transportation and financing.[30] Each trust was administered by a board of directors appointed by the SEC.

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[25] In 1991, when the privatization efforts of the Russian Federation began in earnest, the Russian Supreme Soviet adopted the *Law on Privatisation of State and Municipal Enterprises in the Russian Federation* (3 July 1991), trans. W.E. Butler, ed., *Collected Legislation of Russia* (New York: Oceana, 1993) at IV-1, which included a provision (art. 2(3)) that was possibly meant to forestall the revival of rights associated with the post-Revolution nationalization of industry.

[26] See the resolution of the Tenth All-Russian Conference of the Russian Communist Party, *On the Economic Policy* (27 May 1921), trans. Zile, *supra* note 21 at 154. The NEP was established by the RSFSR Decree, *On the Implementation of the Principles of the New Economic Policy* (9 August 1921), trans. Zile, *ibid.* at 224 [hereinafter *Implementation of the NEP*].

[27] The SEC was created in 1917 by the decree, *On the Establishment of the Supreme Economic Council* (15 December 1917), trans. Akhapkin, *supra* note 16 at 50.

[28] For a discussion of how enterprises were grouped into trusts, see Y. Avdakov & V. Borodin, *USSR State Industry during the Transition Period*, trans. J. Sayer (Moscow: Progress Publishers, 1977) at 40ff.

[29] The first decree concerning trusts was issued in 1923, although trusts had been used as an organizational tool beginning in 1921. See A. Arakelian, *Industrial Management in the USSR*, trans. E.L. Raymond (Washington: Public Affairs Press, 1950) at 64.

[30] See A. Smith, *Russia and the World Economy: Problems of Integration* (London: Routledge, 1993) at 21.

The stated aim of a trust was to derive a profit, which was to be handed over to the state treasury subject to holdbacks for reserve working capital. The fixed capital of the trusts, however, belonged not to the trust but to the State. The SEC or other government authorities could reallocate the capital of trusts without compensation, and trusts could be liquidated or fused at the State's command. In practice, however, trusts often "sold" assets to other trusts or to the private sector when working capital was insufficient to meet the trusts' obligations.[31]

While the productive activity of the state enterprises was concentrated in the hands of trusts, the government was slow in providing for the trade of goods between one enterprise and another, or between the enterprises and the public. These trade activities of the State soon became concentrated in the hands of trade syndicates.[32] Trade syndicates were created by the trusts through voluntary cooperation with the intention of avoiding competition for markets and sources of raw materials. Although trade syndicates were set up and controlled by the trusts, the statutes of the trade syndicates required approval by either the SEC or the Council of Labour and Defence, as did their boards of directors, the members of which were appointed by the trusts. Thus, the trusts were primarily concerned with the production of goods, while the syndicates assumed responsibility for the distribution of the goods.

Under the control of the trusts, individual state enterprises did not have independent legal status; they were simply organs of the trusts. The day-to-day management of an enterprise was delegated to a manager appointed by the trust. Yet, control of the enterprise was divided in a myriad of ways. The trust retained control of the commercial and financial aspects of the enterprise's operations, and the SEC regulated prices and had a hand in determining the allotment of fixed capital to the enterprise. At the same time, the workers' committee wielded substantial power in the day-to-day decisions of the manager, as did the enterprise's Communist Party representatives. This divided authority led to much confusion as to who was ultimately responsible for the activities of the enterprise.

As the SEC focused its attention on larger enterprises of importance to the national economy, smaller enterprises that had been nationalized during the period of War Communism were leased to cooperatives or to private entrepreneurs. Any enterprises which could not be leased were simply closed.[33] There remained enterprises that were supposed to have been nationalized under the nationalization decrees but had not in fact been taken over by the State. Under the NEP, these enterprises were restored to their former owners, as were enterprises with less than twenty workers.[34]

Before the NEP was introduced, severe food shortages resulted in a government policy of requisitioning all grain produced by the peasants for distribution as the government saw fit. When the grain requisitioning policy was replaced by a tax-in-kind,

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[31] See Baykov, *supra* note 19 at 110-11, 117.

[32] Arakelian, *supra* note 29 at 65.

[33] *Implementation of the NEP*, *supra* note 26.

[34] *On the Denationalization of Small Industrial Establishments* (10 December 1921), trans. V. Gsovski, *Soviet Civil Law: Private Rights and Their Background under the Soviet Regime*, vol. 1 (Ann Arbor, Mich.: University of Michigan, 1949) at 295. According to a 1923 census, 88.5% of the enterprises that existed in the USSR were in the hands of private persons, while 8.5% were operating as state enterprises and 3% as cooperatives. However, the average private enterprise employed two workers, the average cooperative 15, and the average state enterprise 155. See Baykov, *supra* note 19 at 106-107; Westwood, *supra* note 6 at 285.

which allowed peasants to privately dispose of grain in excess of the tax, a need for a simple, efficient distribution system developed. Private traders, or nepmen, filled this void. Operating as sole proprietors, the nepmen, known as "Russia's last capitalists",[35] derived a profit from the difference between the price at which they bought goods and the price at which they resold them. Initially involved in the distribution of agricultural commodities, the nepmen soon dominated all retail trade, operating on a much smaller scale and much more efficiently than the syndicates that facilitated the trade and marketing of raw materials and output of the state enterprises. Although enterprises controlled by trusts were officially required to acquire and distribute goods through the trade syndicates, the managers of these enterprises often resorted to nepmen when the larger, bureaucratic syndicates failed to respond effectively to their needs.

Cooperatives under the NEP reverted to their pre-Revolution status. Lenin assumed an almost *laissez faire* approach to cooperatives,[36] allowing them to operate free of government interference so long as they did not conceal anything or carry on their operations in a deceptive manner.[37] Criticized by more hard-line communists, this approach allowed the cooperative to flourish under the NEP, first in the war-ravaged agricultural sector, and later finding application in the production of urban consumer goods.

E. *From Stalin to Gorbachev*

Lenin had intended that the NEP foster private initiative. To a certain extent it had that effect, with the private sector experiencing a resurgence through the nepmen, small businesses returning to their former or new owners, and the cooperatives regaining their traditional role. But private enterprise was counter to the ideology of many communists, who saw it as a threat to communism. This clash of ideologies was manifest in sporadic retaliation against the nepmen and against the kulaks, the more prosperous farmers.

With Stalin's consolidation of power in the late 1920s,[38] adherents of the stricter view of communism began to win out. Beginning in 1928, Lenin's NEP was gradually phased out, and by 1936 virtually all productive capacity other than that held by the agricultural cooperatives, was under the direct control of the State.

Under Stalin, industrialization and centralization were the dominant themes. The first five-year plan was instituted in 1928, with the intention that the planning of all production in the Soviet Union could be administered through the central agencies. During this period the SEC began to diminish in importance as the government body coordinating and directing economic activity, and was finally abolished by decree in 1932. Upon the abolition of the SEC, ultimate authority resided in government ministries. The number of ministries fluctuated over the years, beginning with three in 1932, rising to thirty-two during the Second World War, falling to eleven after Stalin's death, and again rising to more than thirty in the mid-1950s. Coordinating the activities of each of the ministries became increasingly difficult, and ministries tended to become

[35] See A.M. Ball, *Russia's Last Capitalists: The Nepmen, 1921-1929* (Berkeley: University of California Press, 1987).

[36] See Griffin & Soderquist, *supra* note 6 at 601.

[37] *Ibid.* at 603-604.

[38] Lenin had died in 1924.

self-contained economic empires.[39] In the late 1950s, the ministries were abolished and replaced by regional economic councils, each council having authority over a particular type of activity within a particular region. Further reforms in 1965 abolished the councils, and placed authority back into the hands of ministries, either All-Union ministries (controlling the activities of a sector of the economy throughout the USSR) or Union-Republican ministries (which were located in the various republics).[40]

1. *The Coordination of State Enterprises*

One way in which Stalin attempted to centralize the industrial sector was by the creation in the early 1930s of an intermediate organization between the SEC and the trusts. These organizations, called corporations or combines, were legally autonomous and answered to the SEC or, later, to a ministry.[41] Under the control of the corporations were placed trusts or the enterprises themselves, as trusts were gradually liquidated, as well as some cooperatives. Each corporation had authority over an entire industry, either nationally or within a given region, and performed the functions previously held by both the trusts (with respect to production) and the syndicates (with respect to trade). In fact, one of the reasons for the establishment of the corporations was to do away with the syndicates, whose authority over trade and distribution was leading to greater control of production planning, a role reserved to the government.[42]

Corporations were set up by the SEC, subject to approval by the Council for Labour and Defence. Each corporation was headed by a chairperson appointed by the SEC, and had its own statute, which defined the corporation's statutory capital consisting of state property assigned exclusively to it. The corporation generally did not have the prerogative of hypothecating or transferring its capital to other bodies or private persons, but the corporation was exclusively liable for its own debts. Prices for the output of the corporation were established by the corporations following SEC directives.

While trusts were originally given a mandate to derive a profit, a 1927 decree stated that trusts were to "act on the basis of commercial principles *in accordance with planned tasks* which have been approved by the said State institution".[43] While the distinction may appear subtle, the new decree sent a clear signal that profitability would henceforth play second fiddle to central planning. By the early 1930s, the powers of the trusts were being significantly curtailed, requiring them to conform to the central plans and the dictates of the corporations. Gradually, many trusts were phased out or operated as holding companies through which the corporations held enterprises.

The transfer of authority from trusts to corporations was short-lived. Corporations were too far removed from the enterprises to effectively become involved in their operations, and supervision of the enterprises by the corporations tended to consist solely of the issuance of plans based on statistical indices, leading to excessive bureaucracy and

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[39] A. Nove, *The Soviet Economy: An Introduction* (New York: Frederick A. Praeger, 1961) at 68-69.

[40] D. Lane, *Soviet Economy and Society* (Oxford: Basil Blackwell, 1985) at 8.

[41] See *Economic Conditions in the USSR: Handbook for Foreign Economists, Specialists and Workers* (Moscow: USSR Chamber of Commerce, 1931) at 122.

[42] Arakelian, *supra* note 29 at 70-71.

[43] As quoted in Baykov, *supra* note 19 at 113 [emphasis in original].

red tape.[44] Gradually, then, both trusts and corporations were phased out. Some trusts remained, but only as convenient geographical administrative groupings of a number of related enterprises.[45] In this way, government ministries eventually acquired direct control of the actual enterprises, with no intermediate bodies interposed.

By the early 1970s, a perceived need for convenient groupings of enterprises again arose, and many state enterprises were grouped into production associations or combines.[46] The production association or combine had an independent juridical personality and a charter detailing the ambit of its authority. Upon becoming part of a production association or combine, a state enterprise lost its juridical personality. Many enterprises, however, remained outside of the control of production associations or combines, and thus continued to be controlled directly by a government ministry.

2. *State Enterprises*

A number of major organizational changes occurred over the years at the upper levels of the hierarchical chain, but the status of state enterprises during this period remained fairly stable. In the late 1920s, most enterprises operated under the authority of trusts and did not have independent legal status, although some enterprises were under the direct control of a commissariat (a division of the SEC) and did have independent legal status. Whether a state enterprise had independent legal status or not, it was treated the same in practice. After a proclamation of the Central Committee in 1929, which was intended to define more clearly the status of the state enterprise and its relationship with the trust,[47] the courts and much Soviet legislation tended to treat state enterprises as being independent entities regardless of their formal legal status. With the phasing-out of trusts and corporations in the 1930s, most enterprises were granted independent legal status.[48]

The status of all state enterprises, as well as their organization, rights and obligations, were clarified in 1965 with the adoption of the statute, *On the Socialist State Production Enterprise,*[49] which was the closest equivalent to a Western corporate statute that existed in Russia at any time between the Revolution and *perestroika.* The law included detailed provisions concerning the rights of an enterprise with respect to the

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[44] *Ibid.* at 175. The abolition of corporations and trusts, however, did little to stop the flow of red tape. See B.A. Konstantinovsky, "Note on Red Tape", trans. Zile, *supra* note 21 at 246.

[45] Nove, *supra* note 39 at 63.

[46] *Statute on the Production Association (or Combine)* (27 March 1974), trans. W.E. Butler, *The Soviet Legal System: Legislation and Documentation* (New York: Oceana, 1978) at 135. See also J.S. Berliner, *The Innovation Decision in Soviet Industry* (Cambridge, Mass.: MIT Press, 1976) at 31.

[47] Proclamation of the Central Committee of the All-Union Communist Party (5 December 1929), as cited in D. Granick, *Management of the Industrial Firm in the USSR: A Study in Soviet Economic Planning* (New York: Columbia University Press, 1954) at 24; Arakelian, *supra* note 29 at 68.

[48] For a discussion of the 1977 Civil Code provisions relating to juridical persons, see O.N. Sadikov, ed., *Soviet Civil Law* (London: M.E. Sharpe, 1988) c. 5; O.S. Ioffe, *Soviet Civil Law* (Dordrecht, Netherlands: Martinus Nijhoff, 1988) at 35ff. Note also that many state enterprises lost their separate juridical personality upon the creation of production associations and combines in the mid-1970s. See *supra* note 46 and accompanying text.

[49] (4 October 1965), trans. Butler, *supra* note 46 at 169.

property entrusted to it, its obligations toward its employees, and the relationship of the enterprise with its superior agency. Since state enterprises were not joint stock companies, the law contained no provisions with respect to share capital; nor did the law provide for a board of directors, since the superior agency retained ultimate control of the activities of the enterprise.

After the phasing out of the NEP, the state enterprise began to operate with a greater degree of freedom than it had during the Lenin period. The notion of economic accountability was developed, which viewed the state enterprise as an independent and economically self-sufficient unit.[50] Production and financial plans were established by higher organs (notably the trusts or the SEC) but the enterprise operated independently within the limits established by the plans. Management was solely responsible for carrying out the plans and entered into contracts on behalf of the enterprise for the purchase of raw materials and supplies and the sale of its products. The enterprise could sue or be sued for a breach of those contracts.[51] Each enterprise maintained its own bank account and its own accounting system, and the manager of the enterprise had the right to hire and dismiss employees, with the exception of the chief bookkeeper.[52]

The capital of each enterprise came from three sources. First, each firm was allocated a supply of fixed capital consisting of buildings and equipment. Second, each firm had its own working capital. The working capital was granted to the enterprise from the higher organs and was kept in the State Bank. The purchases and expenses of the enterprise would be paid out of the working capital, and receipts from the sale of its products would be added to the account. Finally, credit could be issued from the State Bank[53] to cover additional working capital requirements. Although the issuance of credit between enterprises was forbidden in an effort to retain financial control in the State Bank,[54] evidence suggests that such credit was extended nonetheless.[55]

In spite of the operational and legal independence of the state enterprises, the capital of an enterprise could be varied at will by the higher authorities. Buildings or equipment could be taken from the enterprise with or without compensation. Similarly, the amount of working capital could be re-established each year depending on the enterprise's assigned production plans, and even during the year any surplus of working capital could be taken away.[56]

Beginning in the Stalin period, the principle coined "one-man management" was entrenched, with the goal of consolidating responsibility in the manager for the enterprise's day-to-day operations.[57] Trusts were prohibited from bypassing the

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[50] See L. Gintsburg, *On Economic Accountability* (1931), trans. Zile, *supra* note 21 at 240.

[51] Granick, *supra* note 47 at 24.

[52] Arakelian, *supra* note 29 at 67.

[53] See Avdakov & Borodin, *supra* note 28 at 286.

[54] See Arakelian, *supra* note 29 at 69, referring to a resolution of the Central Executive Committee and Council of the People's Commissars of the USSR of 30 January 1930.

[55] Granick, *supra* note 47 at 26.

[56] *Ibid.* at 26-27. However, the 1964 statute, *On the Socialist State Production Enterprise*, *supra* note 49, art. 12, prohibited the withdrawal of working capital from a state enterprise during the year unless there was a change in the enterprise's production plan.

[57] For an interesting analysis of "one-man management" during this period, see H. Kuromiya, *Stalin's Industrial Revolution: Politics and Workers, 1928-1932* (Cambridge: Cambridge University Press, 1988) at 50-75. The principle of one-man management was continued in the statute, *On the Socialist State Production Enterprise*, *ibid.*, Part V.

manager's authority, and the manager had the right to select his own managerial staff. By clearly defining the manager's role, it was hoped that the manager would be more personally accountable for the activities of the enterprise. In practice, however, while the participation of employees in the management of the enterprise diminished[58] the influence of the Party cell, the trust or corporation, the various branches of the SEC or the ministries, and the trade-unions persisted.[59] The principle of "one-man management", however, remained an essential means by which the State endeavoured to instill a degree of accountability in the organizational structure of the Russian economy.

3. *Cooperatives*

Stalin's approach to cooperatives in the 1930s was quite different from that of Lenin. Far from utilizing the cooperative form of business organization as a means of harnessing individual initiative, Stalin saw the cooperative as "a way to tie large numbers of people into the collective mode of work."[60] Under Stalin, cooperatives in the agricultural sector became essentially "Party and state-run estates with peasant serfs".[61] Although technically still an independent form of business organization, the cooperative in effect had become an extension of the central government and a means for assimilating workers into the collective form of production espoused by communist ideology. The State assumed complete control of cooperatives, and taxes were levied against any farmers or producers who were not members of a cooperative. In 1935, all urban consumer goods cooperatives were abolished, with their assets being turned over to the Ministry of Internal Trade.[62] Some producers' cooperatives remained, primarily concentrated in the handicrafts industry. During the 1940s, cooperatives again became more numerous (in 1946, eleven thousand producers' cooperatives were registered in the RSFSR[63]) but they remained under the close control of the State.

Thus, in the cooperative sector, only agricultural cooperatives remained a dominant force. General turmoil prevailed in the agricultural sector during the 1930s, with constant struggles between the kulaks (the richer farmers) and the poorer peasants, and between the managers of the cooperatives and the member farmers, who often preferred to maintain their own farms instead of working for the cooperatives. Gradually, the obligations of farmers toward their respective cooperatives were defined, and individual agricultural production was curtailed.

The cooperatives under Stalin's regime retained the legal right to own and acquire machinery and other things necessary for production, but because of a shortage of working capital and the increasing use of machinery, cooperatives relied largely on the equipment supplied by central machine-tractor stations ("MTSs"). Cooperatives were given permission to sell surplus produce (that which was in excess of what they were required to transfer to the State in return for working capital, supplies and use of the

[58] Granick, *supra* note 47 at 235.

[59] See *ibid.* at 16ff; A. Vucinich, *Soviet Economic Institutions: The Social Structure of Production Units* (San Francisco: Stanford University Press, 1952) at 17ff.

[60] Griffin & Soderquist, *supra* note 6 at 605.

[61] P. B. Maggs, "Legal Forms of Doing Business in Russia" (1992) 18 N.C. J.I.L. & Com. Reg. 174.

[62] Griffin & Soderquist, *supra* note 6 at 605-606.

[63] Arakelian, *supra* note 29 at 114.

MTS equipment) on the open market, but in many ways their operations were dictated by state authorities, and became more and more controlled by the State as the years passed. Much of the state control was effected through the MTSs, which used their monopoly on equipment to control agricultural production and to have selected people appointed to the managing boards of the cooperatives.[64] Yet, in spite of *de facto* control by the State, cooperatives retained the status of a juridical person throughout the communist regime, and *de jure* control remained with the members.[65]

4. *Individual Economic Activity*

As in other areas of private enterprise, individual economic activity during the Stalin era was significantly curtailed. The hiring of employees for purposes of production was forbidden, and pressure from state trading and financial agencies and the police forced private businesses to reduce their prices, pay higher taxes, and often to close altogether. The pressure was especially hard on the nepmen and the kulaks, who were often evicted from their apartments or farms and sent into exile, their property turned over to the State or to cooperatives.[66] The result was a tremendous reduction in the number of private traders. The number of registered private traders declined from approximately four hundred thousand in 1926 to less than fifty thousand in 1929 and less than twenty thousand in 1931.[67] Yet the right of individuals to engage in individual economic activity was entrenched in the 1936 Constitution.[68] Individual economic activity was thus maintained and continued to survive throughout the communist regime, albeit on an extremely restricted scale.[69]

5. *The Concession*

A final form of business enterprise existing in Russia at this time deserves brief mention. This was the concession, a form of joint venture between foreign businesses and soviet industrial entities. The concession was the only form of business enterprise comprising foreign investment permitted in the Soviet Union during the late 1920s and the 1930s, and was intermittently encouraged by Soviet leaders in an effort to attract much needed foreign industrial technology. Because of several incidents involving the confiscation of their property and the arrest of their employees for spying, foreign firms were reluctant to maintain a business presence in the Soviet Union. After these incidents

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64 Baykov, *supra* note 19 at 209.

65 See the *Model Collective Farm Charter* (28 November 1969), trans. Butler, *supra* note 46 at 197. See also Sadikov, *supra* note 48 at 71ff.

66 R.W. Davies, *The Soviet Economy in Turmoil, 1929-1930* (Cambridge, Mass.: Harvard University Press, 1989) at 100ff.

67 *Ibid.* at 76, 101. Note, however, that official figures may be misleading as some of the private traders continued to operate without official sanction.

68 *Constitution of the Union of Soviet Socialist Republics* (5 December 1936) art. 9, trans. W.E. Butler, *The Soviet Legal System: Selected Contemporary Legislation and Documents* (Dobbs Ferry, New York: Oceana, 1978) at 61.

69 See Akhapkin, *supra* note 16, c. 10. Toward the end of the communist regime, there were approximately one hundred thousand individuals legally involved in small crafts and trades. Many more were illegally involved. See J. Leitzel, *Russian Economic Reform* (London: Routledge, 1995) at 27.

in the early 1930s, a few concessions remained but were an insignificant part of the Soviet industrial landscape.[70]

III. Initial Steps toward Westernization: Joint Ventures, Cooperatives and Leased Enterprises

A. *The Ramifications of Communist Ideology on Soviet Business Enterprises*

Concentration of ownership in the apparatus of the communist state has had a number of important effects on the organization of business enterprises, effects which are still significant in the post-*glasnost* era. For example, state ownership, accompanied by the alleged efficacies of central planning, has had ramifications on the average size of enterprises, Russian enterprises being larger by far than those of Western countries. On average, an industrial enterprise in the Russian Federation in 1987 employed 821 people, almost ten times as many as the average industrial enterprise in the West.[71]

State ownership of entire sectors of the economy has also led to a monopolization of these sectors by single, state-controlled enterprises. Since production and distribution were determined by central planning and not market forces, no need for antitrust policies existed. Over the years, there has evolved a concentration of production capacity around product groups such that most product groups were produced by single enterprises.[72] These monopolies made up a large portion of the Russian economy, creating an impediment to privatization[73] and to the transformation to a market-oriented economy.

Historical factors have also had a significant effect on the internal structure of Russian enterprises. Responding to external stimuli completely different from those faced by Western businesses, the internal structure of Russian enterprises developed around the exigencies of a centrally planned economy dominated by state-controlled monopolies. Profit was not a motivating factor in Russian enterprises; rather, planning focused on an analysis of physical inputs and outputs, and enterprise managers strove to "make the plan".[74] There was little need for marketing departments or strategic product development.[75] The same forces prompted a management and worker approach relatively devoid of entrepreneurial initiative, especially with respect to aspects of

[70] Davies, *supra* note 66 at 109-10. For a discussion of foreign investment in the form of industrial cooperation agreements, see J.F. Pederson, "Joint Ventures in the Soviet Union: A Legal and Economic Perspective" (1975) 16 Harv. Int'l L.J. 390. The representative office, which was an accredited office set up in the USSR to represent the interests of a foreign parent, was not a separate legal entity nor could it become directly involved in contractual relations, and accordingly, I have chosen not to treat it as a form of business enterprise.

[71] World Bank, *Russian Economic Reform 1992: Crossing the Threshold of Structural Change* (Washington: World Bank, 1992) at 82. See also L.D. Nelson & I.Y. Kuzes, *Radical Reform in Yeltsin's Russia: Political, Economic and Social Dimensions* (Armonk, New York: M.E. Sharpe, 1995) at 99-102.

[72] World Bank, *ibid.* See also R. Frydman, A. Rapaczunski & J.S. Earle, *The Privatization Process in Russia, Ukraine and the Baltic States* (London: Central European University Press, 1993) at 6.

[73] See World Bank, *ibid.* at 96.

[74] M. Kiblitskaya, "We Didn't Make the Plan" in S. Clarke, ed., *Management and Industry in Russia: Formal and Informal Relations in the Period of Transition* (Aldershot, England: Edward Elgar, 1995) 198.

[75] World Bank, *supra* note 71 at 82.

marketing that are considered essential to the success of Western enterprises.[76]

In addition, the Russian enterprise has tended to become quite paternalistic with respect to its workers. Enterprise managers will often provide housing for their workers and procure scarce consumption goods at low prices for distribution to the workforce. As one author states, "[Enterprise managers] are turning from managers of enterprises into guardians of their workers, and the activity of the enterprise as a whole is oriented not just to production, but to supporting every aspect of life, to paternalism."[77]

It is before this backdrop that Gorbachev's policies of *glasnost* and *perestroika* were introduced in the mid and late 1980s. The unique economic, social and political forces inherent in the communist system have produced a Russian enterprise fundamentally different from its Western counterpart. This difference created an inertia that had to be reckoned with in efforts to westernize Russian business enterprises.

The reform of Russian enterprises began with modest changes to individual labour activity. A new law adopted in 1986 offered more freedom to undertake individual economic activities.[78] The employment of hired labour was still forbidden, and various activities were restricted, but the law signalled a much more liberal approach to economic activity.[79]

In 1987, economic reform was spurred by a law purporting to make major changes to state enterprises.[80] Increased autonomy was granted to the managers of the enterprises, and provisions provided for retention by the enterprises of a greater share of their profits. Ultimately, however, the law did not have the intended effect, for central planning, artificially-established prices and government bureaucracy stifled the initiative that the law was supposed to unleash.[81]

In the latter part of the 1980s, bolder initiatives were undertaken to release the economy from the quagmire into which it was sinking. These initiatives resulted in forms of enterprise hitherto unknown to the Russian economy: the *Decree 49*[82] joint venture, a new form of cooperative, and the leased enterprise.

B. Decree 49 *Joint Ventures*

A major step toward opening up Russia and its allies to Western-style forms of

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[76] See Nelson & Kuzes, *supra* note 71 at 78-80.

[77] P. Bizyukov, "The Mechanism of Paternalistic Management of the Enterprise: The Limits of Paternalism" in Clarke, *supra* note 74, 99 at 99.

[78] *Law on Individual Economic (Labour) Activity* (19 November 1986), trans. (1989), 26(1) *Soviet Statutes and Decisions* 39.

[79] The 1986 law, *ibid.*, was replaced in 1991 with the law, *On General Principles of Entrepreneurship of Citizens of the USSR* (2 April 1991), which granted individuals almost complete freedom to engage in individual economic activity. See F.J.M. Feldbrugge, *Russian Law: The End of the Soviet System and the Role of Law* (Dordrecht, Netherlands: Martinus Nijhoff, 1993) at 257-58. For a discussion on the effect of the liberalized approach toward market activity on the underground economy, see Leitzel, *supra* note 69 at 30-33.

[80] *On the State Enterprise* (30 June 1987), trans. (1990) 26(4) *Soviet Statutes and Decisions* 19.

[81] Feldbrugge, *supra* note 79 at 258-59.

[82] *On Questions Concerning the Establishment in the Territory of the USSR and Operation of Joint Ventures, International Amalgamations and Organizations with the Participation of Soviet and Foreign Organizations, Firms and Management Bodies* (13 January 1987) USSR Council of Ministers Decree No. 49 [hereinafter *Decree 49*].

business enterprise came in January 1987 when legislation was passed by the Soviet Union authorizing the formation of joint ventures between Soviet business enterprises and foreign entities. As a major policy instrument of *perestroika*, the aim of *Decree 49* was to encourage foreign investors to pool their resources with domestic enterprises in the hope of attracting much needed capital, technology and management expertise.

The *Decree 49* joint venture was a separate legal entity, and enjoyed limited liability. The joint venture was founded by the submission of foundation documents consisting of a feasibility study, a joint venture agreement and a charter, to the government agency controlling the Soviet partner and then to the Ministry of Finance, upon whose approval the joint venture would be registered. Contributions to the joint venture could be made in cash, tangible assets and intangible assets, with foreign investors usually providing a contribution of convertible currency and technology, and the Soviet partner providing structures and equipment.[83]

As might have been expected in a system so long dominated by communist ideology and central planning, the legislation's approach to attracting foreign investment was quite tentative.[84] While it hoped to entice foreign capital, it was still bound to furthering the objectives of the communist state as it then existed, some of which were contrary to the objectives of foreign investors. Provisions intended to strengthen the domestic currency markets,[85] to promote exports and reduce "superfluous" imports,[86] and to subject joint ventures to the full range of Soviet labour legislation,[87] significantly increased the complexity of establishing a joint venture, dissuading Western manufacturers from pursuing opportunities in the USSR.[88] In addition, foreign ownership of a joint venture was initially limited to forty-nine percent[89] and the law required that both the chairperson and the CEO of the joint venture be Soviet nationals.[90]

The legislation establishing *Decree 49* joint ventures did not open the floodgates to foreign investment. Rather, the results were somewhat disappointing[91] and amendments in December 1988 were enacted in an effort to make this form of business enterprise more attractive to foreign investors.[92] The creation of the *Decree 49* joint venture did, however, serve to pique the interest of Western observers at the same time as signalling a change to the closed nature that had characterized Soviet policy for the previous seven decades.

The demise of the *Decree 49* joint venture came in December 1990, with the passing

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83 W.G. Frenkel & M.Y. Sukhman, "New Foreign Investment Regimes of Russia and Other Republics of the Former USSR: A Legal and Historical Perspective" (1993) 16 Boston C. Int'l & Comp. L. Rev. 321 at 339ff.

84 See *ibid.* at 339ff.

85 *Decree 49*, *supra* note 82, art. 25.

86 *Ibid.*, art. 3. See C. Osakwe, "The Death of Ideology in Soviet Foreign Investment Policy: A Clinical Examination of the Soviet Joint Venture Law of 1987" (1989) 22 Vanderbilt J. Transnat'l. L. 1 at n. 66.

87 *Decree 49*, *ibid.*, art. 47. See Osakwe, *ibid.* at 29. Note that amendments in December 1988 reduced the employment requirements significantly: *On Further Development of the Foreign Economic Activities of State, Cooperative, and Other Social Enterprises, Associations, and Organizations* (2 December 1988) art. 31, trans. (1991) 27(2) *Soviet Statutes and Decisions* 15.

88 Osakwe, *ibid.* at 30.

89 *Decree 49*, *supra* note 82, art. 5.

90 These provisions were later amended. See *supra* note 87, art. 31.

91 Frenkel & Sukhman, *supra* note 83 at 324.

92 *Supra* note 87.

of the Russian law, *On Enterprises and Entrepreneurial Activity*.[93] That law and the accompanying implementation decree required the re-registration of all business enterprises established under the previous Soviet legislation.

C. *Gorbachev's Cooperative*

The next major initiative by the Soviet regime was the re-introduction of the cooperative as a general form of autonomous business enterprise by the passing of the USSR law, *On Cooperatives in the USSR*,[94] in 1988. Until that date, the cooperatives that existed in the USSR were primarily confined to the agricultural sector and were granted very little autonomy from the State, having maintained the structure imposed by Stalin in the 1930s. The new form of business enterprise granted its members much more autonomy and control over its activities than had previously been allowed under communist rule,[95] recalling the pre-Revolution cooperatives common among the peasants.

The cooperative had a separate legal personality whose members were its employees. This form of business enterprise allowed the managers to make fundamental decisions regarding the activity of the business that had until then always been the prerogative of the state ministry controlling an enterprise. The cooperative could decide for itself what its major business activity would be, who would be the partners, and with whom it would contract. More significantly, it had discretion to set the prices for which its products were sold and to determine the level of payments for its labour, as well as the right to retain profits.[96]

Unlike the joint venture legislation of the previous year which was meant to appeal to the foreign investor, the cooperative initiative was directed to the Soviet citizen. A bold step toward non-state control of property, cooperatives gained rapid acceptance in the first few years after their introduction.[97] These newly formed enterprises tended to centre their activities on consumer goods and services, and they were often closely linked to a particular state enterprise that supplied the inputs to and purchased the output of the cooperative. For labour, cooperatives relied heavily on employees who held several jobs. Overhead was generally kept to a minimum, utilizing rented premises and concentrating on activities that had short production cycles and required little in the way of fixed capital.[98]

While the cooperative allowed for non-state ownership of property and allowed a

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[93] *Infra* note 104.

[94] *On Cooperatives in the USSR* (26 May 1988), trans. (1989) 26(2) *Soviet Statutes and Decisions* 42, and amended by *Introducing Amendments and Additions to the Law of the USSR "On Cooperatives in the USSR"* (24 June 1990), trans. (1993) 29(4) *Statutes and Decisions: The Laws of the USSR and Its Successor States* 70. These laws remained in effect until 1996; see text accompanying note 126.

[95] See A. Bim, D. Jones & T. Weisskopf, "Hybrid Forms of Enterprise Organization in the Former USSR and the Russian Federation" (1993) 35 Comp. Econ. Studies 1 at 3.

[96] *On Cooperatives in the USSR*, *supra* note 94, arts. 17, 19, 20.

[97] Before the legislation was introduced in 1988, there were less than 14,000 cooperatives operating in Russia. By the end of 1988, that number had risen to 77,000, by 1989 to 193,000, and peaked in 1990 at 245,000. By the end of 1991, there were 197,000 cooperatives in operation (Bim, Jones & Weisskopf, *supra* note 95 at 3).

[98] *Ibid.* at 5.

group of individuals to profit from their own initiative, it retained the communist ideal of collective ownership, and thus it provided only an intermediate step in the transition from communism to a Western-style economy. When newer forms of business enterprise were introduced in 1991 and 1992, the popularity of the cooperative form of enterprise began to wane. While the statistics suggest a decline in the number of cooperatives after 1991,[99] they simply reflect a transformation of the form of enterprise — from cooperative to joint stock company.

D. *The Leased Enterprise under the USSR*

The final form of business enterprise in the initial phase of westernization was the leased enterprise. Like the joint venture and the cooperative, the leased enterprise found its origin in USSR initiatives.[100] The leased enterprise provided Russians with another form of business enterprise while at the same time providing a means of transferring state-owned property to private hands. Although the State, acting through ministries and local authorities, remained the proprietor of the property, it was hoped that the lessee, operating under a detailed lease agreement, would be able to operate the property more efficiently than could the State. Not only could the lessee gain by keeping the profits generated by the enterprise, any increase in the value of the property that resulted from the lessee's personal resources accrued to the lessee. The State, however, still maintained a high degree of control over the operations of the leased enterprise, especially where the lease was held by a workers' collective that could not raise enough assets to furnish a security deposit.[101]

As a form of business organization, the leased enterprise failed to live up to expectations. The legacy of seventy years of communist ideology took its toll, with the tether of control by central planning authorities all too well established. Lease contracts were often heavily biased in favour of the State, workers' collectives were often refused the opportunity to lease, entrenched management stymied the process of transferring control, and government policies regarding subsidies, sales guarantees and allocation of inputs favoured state-owned enterprises over leased enterprises.[102]

The position of the leased enterprise as an intermediate step in the westernization of Russian business enterprises was anchored in the inability of the State to discard its desire to maintain direct control of the economy and the business entities it encompassed. Many leased enterprises were re-established under Russian legislation as closed joint stock companies or employee operated enterprises. At the same time, the Soviet legislation that established the leased enterprise as a form of business organization included built-in means by which a leasehold could be terminated: the lessor (*i.e.* the State) could buy back the object of the lease (for example, if the State wanted to privatize the enterprise outright), or the lessee, upon making rental payments

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99 See *ibid.*

100 *On Leasing and Relationships Based on Leasing in the USSR* (7 April 1989), trans. (1990) 27(1) *Soviet Statutes and Decisions* 23; *On the Economic and Organizational Foundations of Relationships Based on Leasing in the USSR* (7 April 1989), trans. (1990) 27(1) *Soviet Statutes and Decisions* 30; *Fundamental Principles of the Legislation of the USSR and the Union Republics on Leasing* (23 November 1989), trans. (1990) 27(1) *Soviet Statutes and Decisions* 9.

101 *Supra* note 95 at 8.

102 See O.S. Ioffe, "Privatization in the USSR and Commonwealth" (1992) 8 Conn. J. Int'l L. 19 at 25-26; Frydman, Rapaczunski & Earle, *supra* note 72 at 20-22.

throughout the asset's full depreciation period, could acquire the property. In this way, the leased enterprise as a form of business enterprise would gradually disappear.

E. *The Final Days of the USSR*

Thus the last days of the USSR saw the introduction of several forms of business enterprise that were intended to harness the entrepreneurship and decentralization efficiencies that are the hallmarks of Western business, and to attract foreign capital and management know-how to the stagnating Soviet economy. The forms introduced — the joint venture, the cooperative, and the leased enterprise — were but initial steps in the direction of westernization. While one may argue that they did not go far enough in providing their members with the autonomy and control required to fully capture individual initiative, the inertia of seventy years of communist ideology and practice precluded a complete about-face in such a short span of time.

In June 1990, the USSR passed a law establishing forms of business enterprise with limited liability.[103] Much more progressive than the legislation setting out the forms of organization discussed above, this legislation provided a model for the Russian Federation legislation that was to follow several months later. But because of the existing tension between the central authorities of the two governments, and the ultimate downfall of the USSR in December 1991, the legislation of the USSR had little lasting impact.[104] The next stage in the evolution of business enterprises was to find its beginnings in the laws of the Russian Federation.[105]

IV. FORMS OF BUSINESS ENTERPRISE IN THE RUSSIAN FEDERATION

A. *The 1990* Law on Enterprises *and the 1994 Civil Code*

The starting point for a discussion of the current forms of business enterprise in Russia is the *Law on Enterprises*.[106] Passed on December 25, 1990, by the Russian Supreme Soviet, this legislation was introduced as part of the battle between the USSR

[103] *On Enterprises in the USSR* (4 June 1990), trans. (1991) 27(2) *Soviet Statutes and Decisions* 60; *On Joint Stock Companies and Limited Liability Companies* (19 June 1990), trans. (1993) 29(4) *Statutes and Decisions: The Laws of the USSR and Its Successor States* 39. For more discussion on the USSR legislation, see *supra* note 83 at 347ff.

[104] Companies established under the USSR legislation were required by the RSFSR to re-register under Russian legislation: *On the Procedure for the Implementation of the Law of the Russian Federation "On Enterprises and Entrepreneurial Activities"* (25 December 1990) art. 2, trans. Butler, *supra* note 25 at V.1.22 [hereinafter *Implementation Decree*], that accompanied *On Enterprises and Entrepreneurial Activity* (25 December 1990), trans. Butler, *ibid.* at V.1 [hereinafter *Law on Enterprises*], and trans. Academy of Jurisprudence of the Ministry of Justice of the Russian Federation, *Trade and Commercial Laws of the Russian Federation: Official Codification and Commentary* (New York: Oceana, 1995) at 5.25 [hereinafter *Official Codification*]. For a discussion of the USSR reforms in 1990 and 1991, see Feldbrugge, *supra* note 79 at 259-64.

[105] Russia was officially known as the Russian Soviet Federated Socialist Republic (the RSFSR) until the end of 1991, when the name of the State was changed to the Russian Federation: *On Changing the Name of the State Russian Soviet Federated Socialist Republic* (25 December 1991), trans. Butler, *ibid.* at I.85.

[106] *Supra* note 104.

and Russia over control of economic matters. The legislation purported to repeal all pre-existing USSR legislation to the extent that the USSR legislation was in conflict with the *Law on Enterprises.*[107]

The *Law on Enterprises* established ten forms of business enterprise: the state enterprise, the municipal enterprise, the individual (or family) private enterprise, the full partnership, the mixed partnership, the closed joint stock company (or limited liability partnership), the open joint stock company, the association of enterprises, the branch of enterprise, and the enterprise created on the basis of lease and purchase of property by a labour collective (the "labour collective enterprise").

An analysis of the *Law on Enterprises* suggests that even though ten forms of business enterprise were listed, some of these forms were not business entities *per se*, while others were merely variations of standard forms of enterprise. An association of enterprises, for example, was not a unique form of enterprise; rather, it could adopt any form that the founders deemed appropriate, usually a closed joint stock company. The enterprises of which the association was comprised retained their independent legal status, although, unlike subsidiaries of a holding company, the enterprises were not necessarily owned by the association but were merely bound by contract. In practice, however, many associations of enterprises were created on the eve of the privatization program, and were set up in such a way that the association either controlled its constituent enterprises or was the lessor of the enterprises' assets.[108] While the association of enterprises had a separate legal personality, the branch or representation of enterprise did not have a separate identity, and was merely a division of a business entity. Similarly, the labour collective enterprise was also listed as a form of enterprise, although it was essentially a partnership of the workers of a state enterprise which then leased the assets of the state enterprise from the State.

The remaining forms of business enterprise listed in the *Law on Enterprises* fall into four basic categories: state enterprises (including municipal enterprises), individual economic activity, partnerships (both general and limited) and joint stock companies (both open and closed). The *Law on Enterprises* provided scant details as to how these forms of enterprise were to be organized, although a separate decree issued at the same time as the *Law on Enterprises* provided a more detailed regime for joint stock companies.

In 1994, a new Civil Code[109] was introduced in the Russian Federation. The Civil Code abrogated the *Law on Enterprises*, establishing the basis for a new legal regime governing Russian forms of business enterprise. The Civil Code clarifies and provides a more coherent approach to the status of the forms of enterprise set out in the *Law on Enterprises*. The Civil Code, however, does not provide a complete set of rules for each of the forms, leaving more detailed provisions to be included in separate legislation. Curiously, the Civil Code refers by name to a number of statutes intended to regulate specific forms of enterprise but, in most cases, those statutes have yet to be enacted. The

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[107] See *Implementation Decree*, *supra* note 104, art. 2.

[108] See Frydman, Rapaczunski & Earle, *supra* note 72 at 22-26; I. Starodubrovskaya, "Attitudes of Enterprise Managers toward Market Transition" in M. McFaul & T. Perlmutter, eds., *Privatization, Conversion, and Enterprise Reform in Russia* (Boulder, Colo.: Westview Press, 1995) 57 at 62-64.

[109] *Civil Code of the Russian Federation* (Part 1) (21 October 1994) [hereinafter C.C.R.F. or Civil Code], trans. *Official Codification*, *supra* note 104 at 16.1. Part 2 of the Civil Code was enacted on 22 December 1995.

Civil Code envisions six forms of business enterprise: individual economic activity; partnerships (general and limited); limited liability companies (ordinary and with additional liability); joint stock companies (open and closed); industrial cooperatives; and unitarian (state or municipal) enterprises.

1. *Individual Labour Activity*

The *Law on Enterprises* was somewhat obscure with respect to entrepreneurial activity carried on by an individual. Individual labour activity was permitted but someone engaged in it could not employ hired labour.[110] At the same time, the law provided for an individual (or family) private enterprise, which appeared to be structured like a closed joint stock company in that it had a charter and its own name, but it was permitted only one owner (one person or one family).

The Civil Code did much to clarify the status of individual entrepreneurial activity. The Code makes no mention of any restrictions on the use of hired labour, and no separate legal entity need be established. The only requirement is that an individual wishing to undertake entrepreneurial activity be registered with the appropriate state agency.[111] Individual entrepreneurial activity under the Civil Code thus has a status equivalent to that of a Western sole proprietorship.

2. *Partnerships*

The Civil Code provisions regarding partnerships are quite extensive. Unlike the articles dealing with joint stock companies and limited liability companies, no provision is made for a separate law on partnerships. It is assumed by the Code that much of the details regarding the relationship between the partners of the partnership will be provided in the partnership agreement, avoiding the Western practice of providing detailed supplemental provisions in a partnership law which, in practice, tend to be displaced by provisions in particular agreements.

The Russian general partnership is the equivalent of the Canadian general partnership. In contrast to the Quebec civil law as well as the common law of other Canadian provinces, but similar to the partnership in France, the Russian general partnership is a legal entity.[112] At the same time, the partners are personally liable, jointly and severally, for the debts of the partnership.[113]

The Russian limited partnership is the functional equivalent of the Canadian limited partnership[114] but, as with the general partnership, the Russian limited partnership is a legal person.[115] The limited partnership consists of general partners whose rights and obligations are the same as partners in a general partnership, and limited partners who are liable for obligations only to the extent of their contributions.

During the time in which the *Law on Enterprises* was in force, partnerships were not a popular investment choice among foreign investors, partly because of the lack of clarity in the provisions of that law dealing with partnerships. It is not yet clear whether

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110 *Law on Enterprises, supra* note 104, art. 2(3).
111 Art. 23(1) C.C.R.F.
112 Art. 48 C.C.R.F.
113 Art. 75(1) C.C.R.F.
114 See Arts. 82-86 C.C.R.F.
115 Art. 48 C.C.R.F.

the new codal provisions will make partnerships more attractive. A major disincentive to the use of Russian partnerships, however, is that partnerships are considered legal entities and thus do not offer the flow-through tax benefits available to Western partnerships.

3. *Limited Liability Companies*

The Civil Code provides for the establishment of limited liability companies. Although this form of business enterprise is uncommon in Canada, it is becoming increasingly common in the United States. A hybrid of a partnership and a corporation, a limited liability company is a separate legal entity in which none of the participants are personally liable for the company's debts. The authorized capital of the company is divided among the participants,[116] but the issuance of shares by the company is prohibited.[117]

The *Law on Enterprises* made no mention of limited liability companies, and the Civil Code provides only the barest of information on this type of business entity. The Civil Code, however, makes reference to a *Law on Companies with Limited Liability* which will provide additional detail. To date, no such law has been enacted.

The Civil Code also includes an interesting twist on limited liability companies by introducing a form of enterprise known as a "company with additional liability". This version of a limited liability company follows the same regime as ordinary limited liability companies, except that the participants are "jointly and severally liable, such liability to be in an amount equal to the value of the participant's contribution."[118] In addition, upon the bankruptcy of any of the participants, the other participants are allocated the bankrupt participant's liability in proportion to their contributions. This version of limited liability company is not known in Western law, and is intended to provide additional security to creditors of the company. The provisions of the Civil Code dealing with companies with additional liability are very brief and quite obscure. Clarification will have to await the enactment of a comprehensive law on companies with limited liability.

4. Decree 601 *Joint Stock Companies*

The Russian corporation is generally referred to as a joint stock company. Although the joint stock company as a Russian form of business enterprise was established by the *Law on Enterprises*, the brief sections of that law were elaborated on by *Decree 601*,[119] a decree of the Council of Ministers of the RSFSR issued concurrently with the enactment of the *Law on Enterprises*. *Decree 601*, however, was a far cry from being a fully developed corporate statute. Although it provided a general framework for the creation and functioning of joint stock enterprises, it did not provide any detail into most of the areas of corporate law addressed by modern Western statutes.

In keeping with Russian corporate law dating back to the 1800s, a *Decree 601* joint

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[116] Art. 87(1) C.C.R.F.

[117] Art. 66(7) C.C.R.F.

[118] Art. 95(1) C.C.R.F.

[119] Decree of the Council of Ministers of the RSFSR, *On Joint Stock Companies* (25 December 1990), trans. Butler, *supra* note 25 at V.3 [hereinafter *Decree 601*].

stock company was created upon its charter[120] being approved and registered by the appropriate government department, in this case, the Ministry of Finances. Unlike the pre-Revolution legislation, however, changes to the corporate charter could be made rather simply: confirmation of the change at a general meeting of shareholders with notification provided to the Ministry of Finances. Yet, much confusion surrounded the registration of joint stock companies in the early 1990s, with continuous tension between the traditional red tape of the Russian bureaucracy pervading the registration process and a seemingly genuine interest in stimulating the economy and encouraging the creation of new private-sector enterprises.

Decree 601 clearly differed from its Western counterparts in that the emphasis of *Decree 601* was on the creation of joint stock companies, and not on regulating the on-going relationships between the various parties associated with the company. Conspicuously absent were detailed provisions concerning proxies,[121] financial disclosure,[122] takeover bids [123] and insider trading. This is not surprising given the Russian lack of experience in regulating such relations. No public securities market existed at the time *Decree 601* was promulgated, and in spite of *perestroika*, the State still controlled most economic activity. The notion of completely autonomous business entities requiring a set of rules to determine the rights, duties and obligations of shareholders, directors, officers and the public was completely foreign to the way economic activity had been conducted for well over half a century.

Yet, *Decree 601* is notable not only for its dearth of detail, but also for several provisions geared to the unique context of Russia's business environment. For example, companies were given the explicit right to provide for the purchase of shares by the companies' employees on preferential conditions, and for the payment to employees of a percentage of after-tax profit.[124] While it might be argued that such provisions belie a lingering communist ideology, they might also have been included as a means of garnering the support of employees for the government's privatization efforts.

As a further example of a unique Russian provision, *Decree 601* provided for the compulsory establishment of an audit commission comprised of stockholders who are not officers of the company.[125] Although an external auditor may also be appointed, the audit commission is entrusted with the internal auditing of the company's financial activity and finds its inspiration in the extensive controls used by the State throughout the communist period to control its own enterprises.

In spite of the differences between *Decree 601* and Western corporate statutes,

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[120] The contents of the company's charter were defined by section 20 of *Decree 601, ibid.* The presidential decree, *On Organizational Measures for the Transformation of State Enterprises and Voluntary Associations of State Enterprises into Joint Stock Companies* (1 July 1992), often referred to as *Decree 721*, trans. *Official Codification, supra* note 104 at 3.41, and the accompanying statute, *On Commercialization of State Enterprises with Simultaneous Transformation into Joint Stock Companies* (1 July 1992), included a model charter to be used by all enterprises undergoing privatization.

[121] See arts. 103, 107 of *Decree 601, ibid.*

[122] *Decree 601, ibid.*, arts. 130, 133.

[123] Although *Decree 601, ibid.*, contained no takeover provisions, other statutes required that government agencies be notified upon the acquisition of 15 or 50 percent of the company's shares.

[124] *Decree 601, ibid.*, arts. 83, 84.

[125] *Ibid.*, art. 130.

Russian law was suddenly transformed, allowing for the first time since the Revolution the establishment of private business entities with an independent juridical status. The fine tuning of this form of enterprise would take several years, but a means was now available to facilitate the wholesale transfer of state assets to private hands, and to harness the foreign investment capital that was eagerly waiting at Russia's borders.

The Civil Code, upon its enactment in 1994, replaced the *Law on Enterprises* as the basic law permitting the establishment of joint stock companies. Yet, like the *Law on Enterprises*, the Civil Code provided only the skeleton for such entities, and *Decree 601* remained as Russia's corporate law until the enactment of the 1996 *Law on Joint Stock Companies.*[126]

5. *Industrial Cooperatives*

Curiously, the *Law on Enterprises* did not include the cooperative as a form of business enterprise, leaving cooperatives, most notably those created during the Gorbachev period, to be governed by antecedent USSR law.[127] The Civil Code, however, provides for an entity referred to as an industrial cooperative, a commercial organization to be distinguished from consumer cooperatives which are classified as non-commercial organizations. Industrial cooperatives may be engaged in a host of activities including manufacturing, processing or sale of industrial, agricultural and other products, or rendering retail or other services.[128]

The Civil Code provisions dealing with the industrial cooperative are expanded upon in the *Law on Industrial Cooperatives*[129] enacted in 1996. The new cooperative was modelled on the historical, democratic form of cooperative. The entity is intended as a collective labour effort, requiring that at least three-quarters of the members of a cooperative provide personal labour services.[130] The members are granted extensive rights, including the right to vote on a wide range of matters at general meetings, the right to take part in the economic activities of the cooperative, the right to receive a share of the profits and the right to receive compensation for providing labour to the cooperative.[131]

The industrial cooperative is a separate legal entity and must be registered with the appropriate state authorities. The activities of the cooperative, and the relationship between the cooperative and its members, are governed by the cooperative's bylaws. Along with details regarding the name and address of the cooperative, the bylaws must also include information regarding the costs of acquiring a share in the cooperative, the procedure for joining or leaving the cooperative, the manner of labour participation in the cooperative's activities, the structure of the cooperative's management, and the distribution of profits.[132]

Although the industrial cooperative has a separate legal identity, the members are

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[126] See *infra* note 144 and accompanying text.

[127] See *supra* note 93 and accompanying text.

[128] Art. 107(1) C.C.R.F.

[129] *On Industrial Cooperatives* (10 April 1996) RF Federal Act No. 41-FZ [hereinafter *Law on Industrial Cooperatives*].

[130] *Ibid.*, art. 7(2).

[131] *Ibid.*, art. 8(1).

[132] *Ibid.*, art. 5(2).

nonetheless jointly and severally liable for the cooperative's liabilities.[133] This characteristic alone suggests that the cooperative will not become a dominant force on the Russian commercial landscape, and is meant to satisfy a need for a form of business enterprise other than that which can be filled by the joint stock company. Given the unique position held by the cooperative in Russia's past, it may yet find a place as an appropriate vehicle for small scale agricultural, production or distribution activities, and recapture its place as an important form of Russian business enterprise.

6. *Unitarian Enterprises*

The Civil Code refers to state and municipal enterprises as unitarian enterprises.[134] In spite of the name change, these enterprises remain essentially as they were throughout the communist regime: entities having a separate legal identity and controlled by a government body. However, the law provides the enterprise with a greater degree of control over its assets than was the case throughout most of the previous seventy years. Ownership of those assets, however, remains with the State.

State enterprises (as they were still referred to in the *Law on Enterprises*) played a significant part in the privatization process of the early 1990s. It was often necessary, before state assets could be transferred to the private sector, to clearly define a business entity containing those assets. By segregating the assets and their corresponding business activities into a separate legal entity, the assets could be more easily valuated and the business' profitability more easily determined, thus facilitating its conversion into a joint stock company and its ultimate transfer into private hands. In many cases, new state enterprises were created so as to divide a large monopoly into numerous competing businesses.

The Civil Code anticipates a *Law on State and Municipal Unitarian Enterprises* which has not yet been enacted. With the privatization program largely completed, the unitarian enterprise will likely fill the role played by Crown corporations in Canada.

B. *Privatization and Its Effect on Joint Stock Companies*

Transforming Russia's economy into a capitalist one required a number of major initiatives, including the deregulation of prices,[135] the breaking up of monopolies,[136] and the privatization of state enterprises. The Russian privatization program, simply stated, consisted of defining a state enterprise, continuing it as a joint stock company,[137] and

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[133] Art. 107(2) C.C.R.F.

[134] See arts. 113ff C.C.R.F.

[135] See the Presidential Decree, *On Price Liberalization* (3 December 1991) Decree No. 297. For a more general, and very insightful, discussion of the liberalization of the Russian economy, see A. Åslund, *How Russia Became a Market Economy* (Washington: Brookings Institution, 1995).

[136] Anti-monopoly legislation was first enacted by the USSR. Russia had enacted parallel legislation before the downfall of the USSR with the law, *On Competition and Restriction of Monopolistic Activities on Commodity Markets* (22 March 1991), trans. *Official Codification, supra* note 104 at 6.3, and in Butler, *supra* note 25 at VI.1.

[137] This process is often referred to as corporatization. The process began with the adoption of a charter and the setting up of a board of directors. Next, the initial number of shares was determined using a formula whereby the number of shares of the enterprise would be equal to its

transferring the shares of the joint stock company to private hands. The privatization laws provided for the distribution of a certain percentage of the shares to the employees of the enterprise.[138] A further twenty-nine percent of the shares were sold to the public for vouchers, the vouchers having been distributed to all Russian citizens by the State for the purpose of allowing them to purchase shares in enterprises. The remainder of the shares could be sold to private (domestic or foreign) investors. It was intended that the exchange of vouchers would stimulate trade in securities, and provide the basis for more fully-developed securities markets in the future.

The privatization process, which extended from approximately 1991 to 1994, resulted in the creation of thousands of privately-held joint stock enterprises. Because of the manner in which privatization was carried out, majority ownership of most enterprises rested with employees and managers of each of the firms, with the remainder of the shares being held by investment funds, companies with previous ties to the enterprise, and Russian or foreign investors. This ownership structure will undoubtedly change over time as capital becomes more concentrated and securities markets develop. In the meantime, however, the significant degree to which employees own the enterprises in which they work is having an impact on corporate governance of Russian joint stock companies.

Although much Western debate concerning high levels of employee ownership focuses on possible diversion of profits to wages and benefits for workers and away from capital investment, such tendencies have not surfaced in Russia. Rather, employee ownership has not yet led to employee control of the company, control of the enterprise having become entrenched in its senior managers.[139] The authors of a study completed in 1994, consisting of a series of interviews with senior managers of one hundred and fifty recently privatized Russian enterprises, concluded:

> The top managers have engaged in a series of actions which essentially turn the firms into closed corporations, take them out of the market of corporate control, emasculate employees as shareholders, restrict outsider access to information, and tightly control boards and shareholder meetings and registries.[140]

When shareholders meetings were held, the voting was usually carried out by a show of hands. The employees of larger corporations generally did not attend shareholders meetings; rather, proxies were given to representatives who would vote on behalf of the employees. There was even discussion of the development of plans by which senior managers would control the votes of employee shareholders through voting

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charter capital (which was based on a formula-assigned valuation of fixed assets) divided by a nominal share value of one thousand rubles.

[138] The privatization law (*supra* note 25) provided for three privatization options: option 1, in which the employees were entitled to 25% of the shares free and another 15% at a discount; option 2, in which 51% of the shares could be purchased by the employees and managers at a price determined by the government; and a third option which seldom saw practical application.

[139] L.M Webster *et al.*, *Newly Privatized Russian Enterprises* (World Bank Technical Paper No. 241) (Washington: World Bank, 1994) at 28, 34; M. McFaul, "Agency Problems in the Privatization of Large Enterprises in Russia" in McFaul & Perlmutter, eds., *supra* note 108, 39; K. Pistor, "Privatization and Corporate Governance in Russia: An Empirical Study" in McFaul & Perlmutter, *ibid.*, 69.

[140] J. Blasi, *Privatized Enterprises in Russia: Some Initial Observations* (Internet: http://www.fed.org/fed/internat/private.html) at 13, 19.

trusts.

Although shares of an enterprise were often held by non-employees, there was commonly very little or no information provided to the outside investors unless those outside investors were suppliers to or customers of the enterprise, or otherwise related to the enterprise. Share registers were maintained by management, and access to the register was often restricted. Control of senior management by the boards of directors of the enterprises was equally weak. Senior managers generally held most or all of the seats on the board of directors, blurring the division between the board and the executive. In most enterprises, no provision was made for cumulative voting of shares, further entrenching management's control of the board of directors.

Rather than handing over control of the private sector to Russian citizens, the State's privatization program resulted in the handing over of control to the managers of the enterprises. Problems of corporate governance appeared almost immediately, and a need for modifications to corporate law was obvious. Toward the end of 1993, President Yeltsin issued two decrees which helped to rebalance the power between an enterprise's shareholders and its entrenched management.[141] The decrees provided for cumulative voting of the board of directors, allowing outside minority shareholders a greater chance for board representation. Further, not more than one third of the members of the board of directors[142] could be employed by the enterprise, thus re-establishing the division between the board and senior management. The decrees also provided that certain transactions must be approved by a seventy-five percent vote at a shareholders meeting. Annual meetings of shareholders were required to be held within one hundred and twenty days of the end of the fiscal year, and various rules were implemented to ensure a minimum degree of financial disclosure.

The degree to which the 1993 decrees will impact on the corporate governance of Russian enterprises is not yet apparent.[143] Resistance to a rebalancing of power is to be expected from managers, but increasing involvement of outside investors, notably investment funds and foreign investors, in the affairs of the enterprises might help shift power. Recently, many Russian enterprises have been experiencing a dire need for capital investment, and such investment might only be made available if the investors could be assured of some degree of control over the enterprise. Senior managers might be forced to relinquish some control in order to attract investment and so to ensure the survival of their enterprises.

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[141] *On Measures for Securing Shareholders' Rights* (27 October 1993) Presidential Decree No. 1769; *On the Privatization Program for 1994* (24 December 1993) Presidential Decree No. 2284 (collectively the "1993 decrees"); see also *On Measures to Protect the Rights of Shareholders and to Ensure the Interests of the State as Owner and Shareholder* (18 August 1996) Presidential Decree No. 1210, which addresses the issue of squeezing out minority shareholders through the restructuring of companies.

[142] *Decree 601* required that the board of directors consist of at least three members (or five members in open joint stock companies). The 1993 decrees required a minimum of seven directors (or nine in enterprises with more than 10,000 shareholders).

[143] There are reports that a struggle for control is underway, with management and outside investors vying for control by buying the shares held by employees. See *e.g.* "Privatization Notes" (March 1995) 5(2) *Russian Far East Update* 5. There are also increasing reports of the infiltration of organized crime into the affairs of enterprises. See *e.g.* Nelson & Kuzes, *supra* note 71 at 75-78.

C. *The 1996* Law on Joint Stock Companies

Russian corporate law took a major step forward on January 1, 1996, upon the replacement of *Decree 601* with a new comprehensive corporate law, the *Law on Joint Stock Companies*.[144] Whereas *Decree 601* was an underdeveloped corporate law, the *Law on Joint Stock Companies* is at least as comprehensive as the most modern Western corporate laws, and clearly shows the influence of Western input.[145] While it is beyond the scope of this article to provide a detailed analysis of the new law, some of its significant features deserve mention.

The *Law on Joint Stock Companies* applies not only to enterprises created under the new law, but applies equally to enterprises created under previous laws.[146] The founding of a company entails the adoption of a charter, which includes information such as the name and location of the company, details of its share structure, the composition and authority of its board of directors, and information concerning branches and representative offices of the company.[147] A company may be open or closed, the latter being restricted to fifty shareholders who hold a pre-emptive right with respect to subsequent share issuances.[148]

Unlike Western corporate laws, the *Law on Joint Stock Companies* includes detailed provisions with respect to branches and subsidiaries of a company. Curiously, the law provides certain rights to a subsidiary *vis-à-vis* its parent. For example, if a parent issues binding instructions to a subsidiary, the parent may be jointly and severally liable with respect to any transactions entered into by the subsidiary in furtherance of the instructions, and may be vicariously liable for the debts of the subsidiary if the subsidiary becomes insolvent due to the fault of the parent. Similarly, shareholders of a subsidiary can demand compensation from the parent if losses accrue to the subsidiary through the fault of the parent.[149] It is too early to predict the purport of these provisions, but they do provide an interesting approach to problems encountered in the West with respect to corporate veil theories.

Like the corporate laws of continental Europe, the Russian law requires a minimum charter capital. *Decree 601* had a similar provision, requiring a minimum capital of ten thousand rubles for closed joint stock companies and one hundred thousand rubles for open joint stock companies.[150] The hyper-inflation that Russia experienced throughout the early 1990s meant that the minimum capital requirements were set at ridiculously low levels. The new law provides a formula instead which ties the minimum charter capital levels to the minimum wage,[151] doing away with the need to amend the *Law on Joint*

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[144] Federal Law No. 208-FZ, *On Joint Stock Companies* (26 December 1995) [hereinafter *Law on Joint Stock Companies*].

[145] The drafting style of the new law is clearly civilian, which accords with the Roman-Germanic roots of Russian law. Provisions dealing with minimum charter capital requirements (art. 26) and the establishment of a reserve fund (art. 35) belie a western European influence.

[146] Article 94(3) of the *Law on Joint Stock Companies, supra* note 144, requires that the founding documents of joint stock companies formed before enactment of the law be brought into conformity with the new law by 1 July 1996.

[147] *Ibid.*, art. 11(3).

[148] *Ibid.*, art. 7(3).

[149] *Ibid.*, art. 6(3).

[150] *Decree 601, supra* note 119, art. 36.

[151] *Supra* note 144, art. 26.

Stock Companies in inflationary times.

Continuing along the path established by the 1993 decrees regarding corporate governance issues, the *Law on Joint Stock Companies* provides additional support for shareholder control over the activities of management. Under the new law, shareholders have increased access to corporate documents.[152] Shareholder meetings must be held annually,[153] and the law provides an extensive list of matters over which the shareholders at a general meeting have authority and which cannot be delegated to an executive body of the company.[154] Where there are more than one hundred shareholders, a vote can only be carried out by ballot.[155] Most matters may even be voted on by an external poll of shareholders, dispensing with the need to convene a shareholders meeting.[156]

The law also provides for a counting commission comprised of three or more persons who cannot be members of the board of directors, senior managers or members of the audit commission.[157] The function of the counting commission is to ensure that the voting at shareholders meetings is undertaken in an enlightened and impartial manner.

These provisions are intended to remedy the excessive concentration of power in senior management by giving the shareholders a much stronger voice in the affairs of the company and ensuring that their voting power is not usurped by management. Additional provisions which incorporate requirements set out in the various shareholder rights decrees ensure that the board of directors does not become (or remain) the puppet of management. For example, managers of the company cannot comprise a majority of the board, and in companies with over one thousand shareholders, cumulative voting is obligatory.[158]

Curiously, the "one-man management" concept established in the late 1920s seems to have been continued in the new law. Article 69 of the *Law on Joint Stock Companies* provides for the establishment of a "one-person executive body" with authority over all matters not within the exclusive authority of the general meeting of shareholders or the board of directors. Although this concept is not at all unusual by Western standards, where companies are invariably headed by a president or chief executive officer, its entrenchment in the legislation is unique to Russian law. Although Stalin's legacy may be one reason for the inclusion of these provisions, it is also likely that the legislators were being extra cautious in delineating the authority of the triumvirate of authoritative bodies: the general meeting of shareholders, the board of directors and senior management. Given the excessive concentration of power in senior management upon the completion of the privatization program, the delineation provided by the *Law on Joint Stock Companies* may prove to be a wise means to establish a proper balance of power.

The *Law on Joint Stock Companies* does not include a sweeping oppression remedy. Rather, the members of the board of directors and senior management are required to "operate in the interests of the company and exercise their rights and perform duties with

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[152] *Ibid.*, art. 91.
[153] *Ibid.*, art. 47.
[154] *Ibid.*, art. 48.
[155] *Ibid.*, art. 60.
[156] *Ibid.*, art. 50.
[157] *Ibid.*, art. 56. A counting commission is only compulsory for companies with more than one hundred shareholders.
[158] *Ibid.*, art. 66.

respect to the company in good faith and reasonably",[159] and can be sued by a shareholder for losses to the company caused by "their guilty actions (or failure to act)".[160] Like the oppression remedy, these provisions are somewhat vague and will rely extensively on judicial interpretation and application. Yet, the unfamiliarity of the Russian judiciary with the notion of shareholder rights might present some difficulty, and it is too early to predict how these rights will develop and the extent to which Western experience with them will be incorporated into Russian law.

The *Law on Joint Stock Companies* will have to be supplemented by other legislation and regulations, most notably in the area of securities, and anxiously awaits judicial interpretation of its provisions. As a corporate law, however, it is more than adequate in providing Russia with a regime governing the most common and useful form of business enterprise.

V. CONCLUSION

To the extent that trends can be determined from an analysis of legislative enactments, Russia is making great strides toward developing a comprehensive regime regarding forms of business enterprise necessary for the development of a market economy. The revolution of the last ten years is having no less of an impact on forms of enterprise than did the Bolshevik Revolution in 1917. The tentative steps taken in the last few years of the Soviet reign have been replaced by bold initiatives of the Russian government under Yeltsin. Individual economic activity is more liberal than it ever has been in Russian history; the 1994 Civil Code provides a basis for the development of a complete set of forms of enterprise; and corporate law as embodied in the *Law on Joint Stock Companies* parallels the most modern corporate statutes of Western countries.

Yet, vestiges of communist ideology and practice remain, and endemic corruption and a penchant for red tape which have existed throughout Russian history have still to be eradicated. The laws may be changing rapidly, but the complete transformation of the Russian economy will take time, and current political instability and uncertainty indicate less than total support for reform.

The events of the next few years will be crucial to Russian reform. Signs that conservative political factions are gaining support suggest a possible reversion to communist ways. In the same way that the NEP was a temporary but necessary step in the conversion to a planned economy seventy years ago, a retreat from reform in the next few years might be needed to give the economy and society a chance to catch up to the legislative changes of the past few years. In spite of much current doubt and uncertainty over Russia's future, a study of the evolution of Russian forms of business enterprise provides a clear indication that tremendous progress has been made and that the potential exists for complete transformation to a market economy.

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159 *Ibid.*, art. 71(1).

160 *Ibid.*, arts. 71(2), 71(5).