Russia's Lack of American-Style Agency Principles: A Primary Cause of Corporate Governance Problems Today

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RUSSIA’S LACK OF AMERICAN-STYLE AGENCY PRINCIPLES: A PRIMARY CAUSE OF CORPORATE GOVERNANCE PROBLEMS TODAY

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OVERVIEW

With the collapse of the Soviet Union, Russians found themselves in a situation comparable to redesigning an aircraft in mid-flight: a massive, poorly-functioning economy had to be redesigned before total collapse. The first step was rapid, thorough privatization of formerly state-owned entities, which set the stage for looting on an unprecedented scale. Privatization created miniature oligarchs that snatched up the majority of Russia’s wealth, and the corrupt loans-for-shares program allowed them to turn millions into billions, almost overnight, skimming fortunes off the top in the process. The second step was a complete overhaul of the legal system, but the legacy of civil-law pandectic compounded the problems of privatization: the code had no room for broad agency principles to protect companies and shareholders. The mini-oligarchs had little desire to protect shareholders that legitimately acquired their interests, and corruption and looting ran wild, due in part to the pandectic tradition’s rigid, micro-focused legal system that precludes any doctrine of fiduciary duty flexibly applied by judges. The drafters of the new civil code

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1 Interview with Ronald R. Childress, Adjunct Professor, Univ. of S.C. Sch. of Law, in Columbia, S.C. (Mar. 30, 2011) (Russians themselves have used this comparison to describe their situation at the collapse of the Soviet Union.).


3 Id. at 1742-23.


5 Black, supra note 2, at 1733.
failed to consider the bigger picture, and, without agency principles, the resulting failures of corporate governance should come as no surprise.

Part I of this paper introduces a metaphor that represents Russia’s lack of agency principles. This paper then discusses the importance of agency principles in corporate law. Next, the paper provides an overview of pandectism and introduces the lack of agency principles. Lastly, Part I provides a short history of Russian business forms and discusses the privatization of Russian business in the early 1990s.

Part II discusses several examples of problems with Russian corporate governance today then focuses on one particular problem. Part III is the heart of this paper and discusses the lack of agency principles in detail. Then, Part III analyses specific examples of the lack of these principles and details other examples that may be used to infer that the principles do not exist in Russian law. This paper calls attention to a problem with Russian law and concludes that American-style agency principles provide the best solution to this problem, although other solutions exist.

I. INTRODUCTION

A. RUSSIAN CORPORATIONS AND CORPORATE LAW: POTEMKIN VILLAGES

With the dissolution of the Union of Soviet Socialist Republics (“USSR”) in 1991, the new Russia faced an economic crisis of historic proportions; the Soviet economy was ill-equipped to function in a modern world. To this day, Russia suffers problems stemming from the Soviet-era and the rapid, forced transition to a market economy. Businesses are plagued by poor management and constant theft by directors. A major cause of this is the lack of adequate corporate law, combined with the lack of enforcement of other laws.

Russian law can be compared to a “Potemkin village” in that Russian corporate law presents a façade of adequate legal protection for corporations and shareholders that in reality is insufficient. Grigory Alexandrovitch Potemkin rose to prominence under Empress Catherine II in the eighteenth century and was for seventeen years “the most powerful man in Russia and as such one of the most powerful men in Europe.” Potemkin is remembered as “one of Catherine’s many

favorites, a particularly unsavory and extravagant character who bamboozled the Empress during her trip to the Crimea by putting up cardboard villages on the way and importing thousands of peasant serfs . . . to create a picture of sham prosperity.”

The alleged creation of hollow façades of villages overshadowed the real history, and the phrase “Potemkin village” has come to signify a façade meant to impress and mislead (i.e., to hide some undesirable fact or condition). Many Russian companies mirror Potemkin villages: although the companies function on the surface, many are façades for massive self-dealing by directors and managers. While the companies may function for some time, the façades eventually come crumbling down as the enterprises fail due to corruption and theft.

The body of law treating corporate governance problems is itself a Potemkin village. Although the Civil Code of the Russian Federation (“GK”), in its full pandectic glory, appears to cover all possible justiciable situations, a glaring problem lurks behind the façade: American-style agency relationships do not exist in any Russian body of law. Directors do not work for the company; they are the company, which allows for massive fraud and corruption. Unsupported by other areas of the law, corporations, the public, and shareholders are defenseless against looting by corporate directors, whose actions on behalf of the corporation are not bound by agency principles. Russian corporate governance has suffered greatly from this lack of proper defenses.

B. THE ROLE OF AGENCY PRINCIPLES IN CORPORATE LAW

Agency principles are fundamental to American corporate law. The Restatement (Third) of Agency (the “Restatement”) defines agency as “the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.” Thus, agency is important since companies must operate through its human

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8 Id.
9 See, e.g., ALLINA-PISANO, supra note 2, at 3.
11 RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).
counterparts, the agents; for example, “a corporation’s CEO is its agent.”

According to the Restatement, the agent owes the principal a number of duties. In general, an “agent has a fiduciary duty to act loyally for the principal’s benefit in all matters connected with the agency relationship.” This concept is fundamental to corporate structure in the United States: “Because it disallows the pursuit of self-interest as a motivating force in actions the agent determines to take on the principal’s behalf, compliance with the general fiduciary standard reduces the likelihood that an agent will not comply with the agent’s duties of performance.” The principles are legally binding guidelines to ensure that the agent, e.g., a director, acts in the best interests of the corporation. When this relationship does not exist, as in Russia, numerous corporate governance problems arise.

C. RUSSIAN PANDECTISM

To understand the reasoning behind the lack of American-style agency principles, one must first understand the nature of Russian law. The GK is, following the German civil code, a pandectic body of law. Pandectism is a jurisprudential school of thought begun in the late nineteenth century by German scholar, Friedrich Carl von Savigny, who painstakingly organized Roman law to create a hierarchical system of law, “within which every legal concept has a clearly defined meaning.” The purpose of such a formalistic, hierarchical code is to contain the entire body of law of the nation. Max Weber described a pandectic system as follows:

Present-day legal science, at least in those forms which have achieved the highest measure of methodological and logical rationality, i.e. those

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12 Comparative Study, supra note 10, at 65.
13 See, e.g., Restatement (Third) of Agency § 8.01 (2006).
14 Id.
15 Id. at illus. 3.
16 See, e.g., Gábor Hamza, Continuity and Discontinuity of Private/Civil Law in Eastern Europe After World War II, 12 Fundamina 48, 61 (2006) (“The new Russian Civil Code, like its predecessors, follows Pandectist traditions with regard to both structure and terminology.”).
which have been produced through the legal science of the Pandectists’ Civil Law, proceeds from the following five postulates: viz., first, that every concrete legal decision be the “application” of an abstract legal proposition to a concrete “fact situation”; second, that it must be possible in every concrete case to derive the decision from abstract legal propositions by means of legal logic; third, that the law must actually or virtually constitute a “gapless” system of legal propositions, or must, at least, be treated as if it were such a gapless system; fourth, that whatever cannot be “construed” legally in rational terms is also legally irrelevant; and fifth, that every social action of human beings must always be visualized as an “application” or “execution” of legal propositions, or as an “infringement” thereof.\(^\text{19}\)

In summary, a pandectic code is a theoretically complete system of law; thus, unlike their American counterparts, Russian courts cannot make law, because the law is a “logically closed system wherein right outcomes in adjudication were said to flow, by logical deduction, from the generally applicable and definitionally complete legal rules and principles found in the civil codes.”\(^\text{20}\) In other words, this system of law allows judges little discretion in interpreting the law;\(^\text{21}\) there is simply no such thing as a case of first impression.\(^\text{22}\) Thus, the lack of agency principles must be considered a systemic flaw, as the GK has not prevented corporate governance problems.

\section*{D. AGENCY, PANDECTISM, AND THE GK}

Since Russia follows the pandectist tradition of law, the GK is the comprehensive collection of laws, even though more specific statutes exist, including the Law on Joint-Stock Companies.\(^\text{23}\) Juridical person

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\item \(^\text{19}\) Max Weber, Max Weber on Law in Economy and Society 64 (Edward A. Shills & Max Rheinstein trans., 1954).
\item \(^\text{20}\) Lind, supra note 18, at 139.
\item \(^\text{21}\) Id.
\item \(^\text{22}\) See Weber, supra note 19, at 64.
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or “legal person”\textsuperscript{24} is the Russian term for “company,” although there are, of course, different forms, such as a corporation or limited liability company. However, the problem for Russia is that American-style agency cannot be found in the GK or anywhere in the entire body of Russian law.

As shall be discussed in the following section, the privatization of Russian businesses was a true shock to the system. “When the Russian reformers set out . . . to create a modern market economy, . . . they were up against a historical legacy the full weight of which was probably poorly understood and the relevance of which was publicly denied.”\textsuperscript{25} In other words, Russia had significant momentum in a direction that had little, if anything, to do with a traditional market, capitalist economy.\textsuperscript{26} The privatization program managers hoped that, “[i]f the general population could be turned into shareholders, they would also become stakeholders in making the process irreversible.”\textsuperscript{27} This solution seems like a good way to help the new market support and drive itself, but the full momentum of Russia’s non-capitalist history went unrecognized. Following the tradition of pandectism, a comprehensive code of laws was promulgated,\textsuperscript{28} and the trust placed in the managers to make the system work left the GK without proper means to enforce shareholders’ rights. It was like saying that agency principles would not be needed, because managers had to make the system work. That did not happen as hoped.

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\textsuperscript{24} Grazhdanskii Kodeks Rossiiiskoi Federatsii [GK RF] [Civil Code] art. 48, translated in Peter B. Maggs & A.N. Z. Zhiltsov, Civil Code of the Russian Federation, 32 Stat. & Dec.: The Laws of the USSR and Its Successor States, no. 5, Oct. - Sept. 1996 at 19 (“A legal person is an organization that has separate property under ownership, economic management, or operative administration and that is liable for its obligations with this property and that may, in its own name, obtain and exercise property and personal nonproperty rights, bear duties, and be a plaintiff and defendant in court.”).\textsuperscript{25} Stefan Hedlund, Property Without Rights: Dimensions of Russian Privatisation, 53 Eur.-Asia Stud. 213, 225 (2001).
\textsuperscript{26} Id.
\textsuperscript{27} Id. at 215.
\textsuperscript{28} See Burnham, supra note 4, at 12-13 (4th ed. 2009).
E. BRIEF HISTORY OF RUSSIAN BUSINESS FORMS & THE ERA OF PRIVATIZATION

To an American, the legal and practical history of Russian companies would appear riddled with holes. Corporate law in the United States has evolved over the years, changing through the courts and the legislature to meet the needs of different eras. Corporate law in Russia has changed little, not benefitted by the many years of evolution and guidance of the courts as seen in the United States.

Pandectism is the reason for the static nature of Russian law; there is simply no room for the courts to change or add to the law. The pandectic tradition is plagued by a top-down approach, where the legislature and other ruling bodies promulgate laws that all lower courts and the public must follow: “Russian case law has always been an instrument of power in the hands of the ruler.”

Laws are not created through a democratic process and thus are unable to be tested by lower courts, meaning the laws do not always “fit” in the context of the system as a whole. In the United States, different corporate forms came into being by necessity; companies needed to operate in a particular way so the law evolved to meet those needs.

Margaret M. Blair’s article, “Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century,” emphasizes this stark contrast and details why the corporate business forms were created:

Entity status under the law, and the associated separation of governance from contribution of financial capital through the formation of a corporation, allowed corporate participants to do something more than engage in a series of business transactions, or relationships, or even projects. It made it possible to build lasting institutions. Investments could be made in long-lived and specialized physical assets, in information and control systems, in specialized knowledge and routines, and in reputation and relationships, all of which could be sustained even as individual participants in the enterprise came and went. And these business institutions, in turn, could accomplish

29 Hedlund, supra note 25, at 222.
more toward the improvement of the wealth and standard of living of their participants in the long run than the same individuals could by holding separate property claims on business assets and engaging in a series of separate contracts with each other.\textsuperscript{31}

This is the epitome of legal evolution by necessity and is a far cry from the “evolution” in Russia. The purpose of the newly developing corporate law was to allow corporations to be built from the ground up through the efficient accumulation of capital.\textsuperscript{32} This, unfortunately, was not possible in Russia, where the government found a sudden need to privatize many entities that had already been operating for years under state ownership. While U.S. laws evolved enough over time to meet the needs of the entire country, Russian law had no time to evolve, as it had to meet the present demands of huge, functioning entities, so the pandectic model likely seemed the best approach.

Part of the problem is Russia’s inorganic legal growth.\textsuperscript{33} Instead of allowing the law to naturally evolve, Russia grabbed laws from elsewhere to see if they would “grow.”\textsuperscript{34} “Well paid foreign consultants would create laws for Russia that in many cases were nothing but adaptations of existing German or US [sic] legislation”,\textsuperscript{35} then, the USSR collapsed.

The collapse of the Soviet Union brought massive, abrupt change to the country in the form of privatization of eventually all businesses that had previously been state-owned. The privatization began with “voucher auctions,” during which managers gained control somewhat honestly but instituted rampant self-dealing, which the government failed to control.\textsuperscript{36} The later auctions proceeded with even less honesty and centralized power in the hands of few, “who got the funds to buy these companies by skimming from the government and transferred their skimming talents to the enterprises they acquired.”\textsuperscript{37} The results of privatization were astounding:

\textsuperscript{31} Id.
\textsuperscript{32} See id.
\textsuperscript{33} Although this paper proposes that Russia needs to adopt agency laws similar to American agency principles, this is not to say that there should be a wholesale adoption; the laws need to retain their basic form yet be molded to the needs of Russia.
\textsuperscript{34} Hedlund, supra note 25, at 216.
\textsuperscript{35} Id.
\textsuperscript{36} Black, supra note 2, at 1733.
\textsuperscript{37} Id.
The largest Russian companies were sold in massively corrupt fashion to a handful of well-connected men, soon dubbed “kleptocrats” by the Russian press . . . , who made their first centimillions or billions through sweetheart deals with or outright theft from the government, and then leveraged that wealth by buying major companies from the government for astonishingly low prices. The “reformers” who promoted privatization regretted the corruption, but claimed that any private owner was better than state ownership.38

Russia pursued a top-down, all-in approach to privatization, taking little time to consider the real implications of what was happening.

However, Russians are not entirely at fault. So-called “shock therapy,”39 a Western theory, which entails the “rapid decontrol of prices, freeing of markets, and privatization of industry,” defined the beginning of the era of privatization.40 This period lasted from 1992 until around 1995.41 In a country as large as Russia, which was teeming with companies set up by the Soviets, “shock therapy” was seen as simply the only way to accomplish reform.42 Thus, the voucher auctions became the vehicle of choice to accomplish the task: “Citizens would be given vouchers, which they could use to buy shares of privatized companies.”43 In the beginning, managers owned a majority of the shares, given as an incentive to not fight privatization.44 Workers owned on average merely twenty percent, a “bow to the Communist ideology.”45

Managers worked the system, often illegally, to gradually acquire large stakes in their companies.46 Since the vouchers could be traded, managers “illegally ‘privatiz[ed]’ company funds” to purchase vouchers to trade for shares.47 These voucher purchases were not the product of equal bargaining, with managers “convincing or coercing

38 Id. at 1736.
39 Id. at 1739.
40 Id.
41 Id.
42 Id.
43 Id. at 1740.
44 Id.
45 Id.
46 Id. at 1741.
47 Id. (citation omitted).
employees to sell their shares cheaply.”\textsuperscript{48} One strange feature of these voucher auctions further helped managers gather shares: “[I]f fewer vouchers were bid for a company’s shares, more shares would be distributed per voucher.”\textsuperscript{49} This led managers to devise creative ways to minimize the number of vouchers bid, including holding the auction at a difficult-to-reach location, changing the location at the last minute, miraculously making it impossible to travel to the set location, and even barring bidders from the auction with armed guards.\textsuperscript{50} However, the corruption did not go unnoticed, and the privatizers knew “that manager/worker control of privatized companies would limit shareholder oversight of managers. They saw this as an acceptable political price to pay for rapid privatization.”\textsuperscript{51}

The largest companies, including the major manufacturing, oil, and gas entities, were treated differently:

[T]he government created pyramid structures, bundling controlling stakes in a number of operating companies into a few holding companies, and later sold controlling stakes in the holding companies . . . . Pyramid structures everywhere are an invitation for controlling shareholders to siphon wealth from companies that they control, but have a limited economic stake in.\textsuperscript{52}

The voucher auctions and subsequent illegal acquisition of shares through “trades” set the stage for rampant corruption in the corporate realm. Instead of incentivizing true managerial skills, the privatizers unintentionally created a system in which the best managers were those that could most artfully grab shares.

With the number of shares available for acquisition through “trade” dwindling, ever resourceful crooks devised new methods to steal shares, including “loans-for-shares” and blatant theft.\textsuperscript{53} In 1995,
Vladimir Potanin proposed the “loans-for-shares” program with the support of the new Russian banks: “The banks proposed to loan funds to the government for several years, with repayment secured by the government’s controlling stakes in these enterprises.”\(^{54}\) Although this sounds like a valid plan to jump-start an ailing government, “[e]veryone understood that the Government would not repay the loans, and would instead forfeit its shares to the banks that made the loans.”\(^{55}\)

The auctions to acquire these shares were an absolute sham:

The right to manage the auctions was parceled out among the major banks, who contrived to win the auctions that they managed at astonishingly low prices. The bid rigging that was implicit in divvying up the auction-managing role became explicit in the actual bidding. The auction manager participated in two separate consortia (to meet the formal requirement for at least two bids), each of whom bid the government's reservation price or trivially above that. No one else bid at all.\(^{56}\)

Those that acquired these shares became the managers and directors of the companies at little cost, far less than fair market value.\(^{57}\) Managers could also acquire 30% of a firm’s shares at a discounted price with a written agreement with the employees of the firm that the manager would not allow the firm to go bankrupt for a period of one year.\(^{58}\) This so-called agreement amounted to little more than a wink and a nod, meaning “this was an all-but-open gift of a controlling stake to the managers, in return for a phony agreement with the employees.”\(^{59}\)

with Bank of America. Indeed, the President invites Bank of America's CEO to become a cabinet secretary, in charge of economic reform. For a time he agrees, before deciding that there is more profit to be made by dealing with the government than by helping to run it. This story isn’t remotely possible in the United States. But change the bank to Oneksimbank (owned by kleptocrat Vladimir Potanin), run the money not through Oneksimbank itself but through two affiliated banks, and reduce the amount to $502 million, which is a rough Russian equivalent of $25 billion as a proportion of GNP, and it becomes a true Russian story, less widely known than it ought to be.”\(^{Id.}\) at 1742-43.

\(^{54}\) \textit{Id.} at 1744.

\(^{55}\) \textit{Id.}

\(^{56}\) \textit{Id.}

\(^{57}\) \textit{Id.}

\(^{58}\) \textit{Id.} at 1746.

\(^{59}\) \textit{Id.} (citation omitted).
While the foregoing practices were slowly phased out near the end of the era of privatization, the corruption continued unabated. Before privatization, “[e]nterprise directors relied heavily on the accumulation and use of personal connections or ‘pull,’ known colloquially as blat,” to keep their companies running.\(^60\) With the increasing autonomy of privatized companies, directors had to evolve their skills. The massive fraud during the era of privatization allowed directors to acquire the majority stakes in their companies, which gave these directors the “opportunity to appropriate the returns to the relationships they had developed and cultivated under the previous system.”\(^61\) Because “[m]uch of the relational capital was both enterprise specific and person specific,” this meant that these directors had to remain with the same companies and somehow keep them afloat.\(^62\) Fortunately for the directors, the momentum of an economy not based on traditional notions of supply and demand meant that little was required of the directors in terms of managerial skills. Appropriation, i.e., theft, had become easy: “The director had more power than before; there were now fewer people to please. The director could now directly appropriate the returns to investment in relational capital.”\(^63\) Unbound by the fiduciary duties of agency law, directors took advantage of the ailing system, and corporations suffered.

II. THE REALITY OF CORPORATE GOVERNANCE IN RUSSIA TODAY

A. INTRODUCTION: WHAT THE LACK OF AGENCY PRINCIPLES HAS CAUSED

Russia’s historically bad corporate governance trends continue; the corporate form itself has become a Potemkin village. The laws purport to create successful business forms, but the lack of American-style agency principles and the lack of enforcement in other areas of the law have allowed many businesses to become fronts for massive fraud. Because no agency principles are in place to differentiate directors from their companies, looting has become a commonplace occurrence. The most significant problem is a shortened managerial time horizon,

\(^{60}\) CLIFFORD G. GADDY & BARRY W.ICKES, RUSSIA’S VIRTUAL ECONOMY 57 (2002) [hereinafter VIRTUAL ECONOMY].
\(^{61}\) Id. at 58.
\(^{62}\) Id.
\(^{63}\) Id. at 60.
which has disincentivized long-term goals. Without the protection of agency principles, companies are being forced to produce money for immediate use or sequestration abroad rather than ensuring stable, long-term growth.

In part, this is due to the past. The paradigm of pull has given way to the paradigm of looting: “Under Communist rule, a good manager often had to obtain the parts and supplies needed to keep a factory running in unofficial ways. In a market economy, those skills were easily transferred to the new tasks of asset stripping and self-dealing.”65

Another cause of these problems is the history and current form of the economy itself. Due to necessity, the Russian economy had become almost exclusively a barter economy.66 While this barely worked for the Soviet Union, modern Russia cannot survive as a barter economy but, due to momentum, will have a difficult time becoming a true market economy.

The problems today will not be solved in the next few years. While the goals behind the large-scale privatization of Russian enterprises were noble,67 path dependency slowed progress: “[T]ransformation of a rules-based programme of privatization into what Russians have called ‘prikhvatizatsiya’ (asset grabbing) represented a path dependent institutional response to the drastic change in rules that was implied by the collapse of the Soviet order.”68 This path dependent nature is a constant struggle in Russia’s fight to solve its corporate governance problems.

Scholars and lawmakers disagree about what will solve Russia’s problems, but the lack of American agency principles remains a fundamental issue. Some argue that the problem is a lack of


65 Black, supra note 2, at 1753 (footnote omitted).

66 See Virtual Economy, supra note 60, at 24 (“Throughout the economy, transactions were occurring where either no payment of any kind was made or the payment was in the form of goods rather than money.”).

67 Hedlund, supra note 25, at 214 (The purpose of privatization is to improve corporate governance by “shifting power over enterprise decision making from the bureaucracy to the market, [and thus] enterprise management may be forced to improve performance.”).

68 Id. at 213.
enforcement of good laws, not a lack of good laws, but this position places too much trust in pandectism. While the pandectic model certainly may work, some overarching principles, such as agency, are needed to create order. Those same scholars recognize the problems, without proposing a proper solution:

We called the Russian company law that we helped to draft a “self-enforcing” model because we thought that stating sensible rules would encourage corporate norms to coalesce around those rules (even with minimal enforcement), and that the courts could enforce simple procedural rules (for example, approval of self-dealing transactions by noninterested [sic] shareholders). Instead, self-dealing transactions were hidden, courts were of little help even when self-dealing was obvious, and managerial culture coalesced around concealing self-dealing instead of disclosure and a noninterested shareholder vote.

This comment belies the problems inherent with pandectism: attempting to create “simple” procedural laws that cover every justiciable situation leads to ignorance of the key principles that allow systems of law to function properly.

What all of this means today is a host of problems, driven in significant part by the fact that corporate directors are themselves the company, not agents of the company. While some law exists that should minimize these problems, the status of the directors of a company as principals, not agents, cannot be ignored: there is ample evidence that the directors themselves are the source of the problems in Russia today.

69 Black, supra note 2, at 1755 (footnote omitted) (“Russia’s core problem today is less lack of decent laws than lack of the infrastructure and political will to enforce them. For example, the company law prohibits much of the rampant self-dealing by managers and large shareholders that occurs every day. But the courts respect only documentary evidence, which is rarely available given limited discovery and managers’ skill in covering their tracks.”).

70 Id. at 1756 (footnote omitted).

71 Comparative Study, supra note 10, at 65.

72 See, e.g., GRAZHDANSKIYE KODEKS Rossiiskoi Federatsii [GK RF] [Civil Code] art. 103, translated in THE CIVIL CODE OF THE RUSSIAN FEDERATION, http://www.russian-civil-code.com/ (last November 5, 2011) (This article gives the stockholders general powers over the company, such as the approval of accounting documents.).
B. THE SHORT TIME HORIZON: POOR MANAGEMENT, LOOTING, CORRUPTION, AND SELF-DEALING

The short managerial time horizon of many corporate directors is a major problem today because it skews focus and rewards looting, corruption, and self-dealing. In the transition from the Soviet economy to a forced market economy, the paradigm became “take the money and run.” This happened almost by laziness: when actual production of wealth was centered on natural resources, “resource addiction” to oil and gas created major problems when booms ended and rents decreased.73 “[A]ddiction leads to short-time horizon—inability to think long-term. . . . This leads to an inability to implement reforms.”74 When the era of privatization left the oil and gas rents in the hands of a small number of people, the rest of the country’s directors were left with two options that persist to this day: steal from the company or actually increase its value, which was, and still is, much more difficult.75

Theft became the easiest option for those managing the company. Since directors and officers are the company, they can actively steal, and courts will not enforce the existing laws that purport to protect corporations and shareholders.76 Directors “were expert[s] at [looting]; and it was sure to produce a handsome profit that could be tucked away overseas beyond the reach of a future Russian government.”77 The effect snowballed:

[M]any managers who started out honest changed their minds, because they saw what their fellow managers were able to get away with; the tax system demanded that profits be hidden (which made them easy to steal); they saw the Mafia and dishonest managers becoming wealthy while they struggled to

73 Addiction and Withdrawal, supra note 64, at 2.
74 Id. at 12.
75 Black, supra note 2, at 1736.
76 Id. at 1756.
77 Id. (For example, “Bank Menatep (controlled by kleptocrat Mikhail Khodorkovski) acquired Yukos, a major Russian oil holding company, in 1995. For 1996, Yukos’ financial statements show revenue of $8.60 per barrel of oil—about $4 per barrel less than it should have been. Khodorkovski skimmed over 30 cents per dollar of revenue while stiffing his workers on wages, defaulting on tax payments, destroying the value of minority shares in Yukos and its production subsidiaries, and not reinvesting in Yukos’ oil fields.” Id. at 1736-37 (footnote omitted)).
survive; and the authorities were too corrupt to do anything about obvious theft. Others, discouraged by the hostile business environment, sold out to crooks who could earn a swift return on investment in ways that honest managers couldn’t. Honest and dishonest behavior alike can be contagious, and Russia fell into a dishonesty equilibrium. 

This is where Russia sits today, stuck in an equilibrium that incentivizes theft and corruption, because the law is either incomplete or unenforced.

In the United States, one way for a company to thrive is to please shareholders by maximizing profit. The reward for profit maximization comes in the form of approval of a higher salary. The U.S. system is not perfect, but such widespread corruption also does not exist likely due to its system of “true” agency.

The primary goal of Russian directors differs greatly: “do not make a profit that can be observed.”

This may be counterintuitive to Americans, but this method allows the company to shelter its earnings from high taxation. The problem is that it also allows directors to steal from the company without authorities or shareholders noticing.

This is not to say that continuous theft is possible. “Suppliers and employees can’t be defrauded indefinitely, even if they have no legal recourse. Sooner or later, they will stop doing business with the firm.”

Thus, the current iteration of a looting scheme involves a mixture of profit maximization and theft of the firm’s value. One might ask why the market would not trend more towards profit maximization; but, this assumes that the managers in charge have the requisite skill, and the uncertain future of the market makes actual profit maximization more challenging. Possible future sanctions further complicate the situation:

Thieves who will be caught if they linger too long won’t capture the firm’s long-term value anyway. An amoral [director] then has a sharp choice: create value (perhaps with self-dealing at a level unlikely to

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78 Id. at 1767 (footnote omitted).
79 VIRTUAL ECONOMY, supra note 60, at 67.
80 Id. at 66.
81 Black, supra note 2, at 1767.
82 Id. at 1751.
83 Id. at 1752.
lead to sanctions), or steal as much as you can and then flee the jurisdiction.  

Two important factors for the short time horizon are economic and political uncertainty, a future government could choose to enforce the rules or might even add American agency principles. This increases the challenge of profit maximization, which, in turn, increases the incentive to steal in the short run. Poor management skills compound all of these problems.

This system can be taxing, both literally and figuratively, so shareholders end up with little of the company’s value and have few means to effect change. Informal taxes are a major hindrance to proper allocation of capital between the firm, its management, and its shareholders. Bribes constitute a major portion of lost profits, as bribes must go “to tax inspectors, to customs officials, to the police not to harass you, to the many bureaucrats from whom you need a permit to operate,” etc. The past few years have changed little; Putin transformed “the previous rent-sharing schemes into a single, centrally run scheme . . .—requiring constant investments by oligarchs to protect property rights.” For example, the oil stabilization fund should overflow with profits, yet it received only 14 percent of the total rents. The rest “is distributed throughout the economy in other forms to different claimants. The owners of the resource companies—the oligarchs—keep a healthy amount as profits.” This is the definition of looting, and agency principles should prevent this self-dealing and stabilize the market.

84 Id. at 1751.
85 Id. at 1765.
86 Id. at 1764.
87 This includes “(1) bribes paid to government officials; and (2) payments made for the support of public sector needs that are nominally voluntary but in fact mandatory for businesses, for example, payments made by enterprises to support the social sector of towns and regions, cultural programs, philanthropic giving, and so on.” CLIFFORD G. GADDY & BARRY W. ICKES, THE VIRTUAL ECONOMY REVISITED: RESOURCE RENTS AND THE RUSSIAN ECONOMY 3 (2006) [hereinafter VIRTUAL ECONOMY REVISITED].
88 Black, supra note 2, at 1759 (footnote omitted).
89 VIRTUAL ECONOMY REVISITED, supra note 87, at 4.
91 Id.
There is ample documentation of the problems surrounding Russian corporate governance. This paper indicates a major source of the problems but barely scratches the surface in terms of hard evidence. While the lack of agency principles is certainly not the only cause of the problems in Russia today, it is a significant cause nonetheless. The lack of agency principles manifests itself in a number of ways; the short time horizon is one major issue that must be overcome, because it is the basis for other issues, specifically looting and self-dealing.

III. RUSSIA’S LACK OF AMERICAN-STYLE AGENCY PRINCIPLES

A. AGENCY PRINCIPLES CANNOT BE FOUND IN RUSSIAN LAW

Unlike the codes of the United States or any state, the GK lacks principles that are truly similar to agency law. Further, U.S. corporate law differs from Russian corporate law in a significant way: “the CEO of a Russian company (also known as [a] director . . . ) is not normally viewed as a representative or agent of the company; rather he is a company’s ‘governing body’ controlled by corporate law.”92 Thus, managers aren’t working for the company as agents; they are the company (principals)—this is the main difference between American and Russian corporate law. If an agent is supposed to “act on the principal’s behalf and subject to the principal’s control,”93 what happens when the person acting for the corporation is not acting on anyone else’s behalf and is not subject to anyone else’s control? The director becomes a miniature oligarch of his or her organization, which allows, and even incentivizes, theft from the company. For example, the Restatement states that an “agent has a duty . . . not to use property of the principal for the agent’s own purposes.”94 The lack of this fundamental doctrine in the GK could create serious problems, for example, if other principles were not enforced.

92 Comparative Study, supra note 10, at 67; see also Federal’nyi Zakon RF ob Aktsionernykh Obshchestvakh [Federal Law of the Russian Federation on Joint Stock Companies], SOBRANIE ZAKONODATEL’STVA ROSSISKOI FEDERATSII [SZ RF] 1996, No. 1, Item 1, art. 69, translated in WILLIAM E. BUTLER, RUSSIAN COMPANY AND COMMERCIAL LEGISLATION 277 (2003) (“A one-man executive organ of a society (director, director-general) shall operate in the name of the society without a power of attorney, including represent its interests, conclude transactions in the name of the society, confirm the personnel establishment, and issue orders and give instructions binding for execution by all workers of the society.”).
93 RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).
94 Id. § 8.05.
Consider another example: Russian directors often act with reckless disregard for the best interests of the company, knowing that their time to make (i.e. steal) money is limited. The existence of agency principles would set up a standard of care to prevent this from happening. “[A]n agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.”95 Someone familiar with Russian corporate governance practice might note that the standard of care is in fact theft, so this provision would have to be adapted to the unique status of the Russian corporate environment. The Restatement further provides that:

An agent has a duty, subject to any agreement with the principal, (1) not to deal with the principal’s property so that it appears to be the agent’s property; (2) not to mingle the principal’s property with anyone else’s; and (3) to keep and render accounts to the principal of money or other property received or paid out on the principal’s account.96

This further reinforces the commitment to preventing theft from the company, but this concept is only possible under true agency. This cannot work in Russia, because a director cannot be distinguished from the principal.

The Russian pandectist will counter that there are laws that cover these very situations, but the problem with this argument is that the laws that protect shareholders are not enforced or are too weak.97 This is where agency principles should help to limit the ability of directors to harm the corporation and its shareholders. This is not related to apparent agency or ultra vires actions—the issue is the director himself or herself as an agent of the corporation. The American lawyer will then ask the pandectist where he or she can find principles that link directors to the corporation through agency. The pandectist might point to a number of provisions, but these provisions only look like, but are not in reality, agency. Through global research, I found no link between Russian corporate directors and agency. Similarly, the personal research of Ronald M. Childress,98 which entailed a systematic

95 Id. § 8.08.
97 Black, supra note 2, at 1756.
98 Ronald M. Childress is a University of South Carolina School of Law professor and former director of Project ROSCON and the Rule of Law Consortium in Moscow.
review of Russian Supreme Court and Supreme Commercial Court
explanations (“rulings” (postanovleniiia) or “informational letters”),99
revealed only a limited number of pronouncements that could even
remotely be compared to American paradigms.

The American lawyer may then ask himself or herself whether the
lack of agency principles is actually a problem. The pandectist would
deny that a problem exists, but the problem may be seen with a quick
reflection on the basic tenets of pandectism. Because agency principles
are not found in the GK, judges will not read them into the law, which
American judges often do, inventing entire bodies of law not found in
any statute, ordinance, etc. Russian judges will not even recognize the
existence of agency principles as we know them—there is not even a
proper Russian word for agency in the GK. To a pandectist, this is not
a problem, because the GK theoretically covers all possible justiciable
situations. Only the Federal Assembly—the Russian legislature, with
the Duma as the primary entity—really “defines” what can be an issue
or problem before the courts, because courts will only consider issues if
they fit the narrow definitions found in the codes.100

Since other portions of the GK and portions of the applicable
corporate laws are either not enforced or are too weak to support a
healthy corporate environment, the lack of agency principles is a direct
cause of the problems with corporate governance. The problem is
circular: because agency principles are not in the GK, courts will not
recognize them; but, because courts will not recognize and create them,
the problem cannot be solved. And, since it is unlikely that courts will
undergo a true paradigm shift away from pandectism, the best solution
will be for the legislature to rewrite the laws to include agency
principles to protect shareholders.

The problem for American lawyers trying to understand this
system is that we want a real answer: a “yes” or “no,” followed by a
“because,” such as a court saying “we do not recognize American
agency principles, because our system provides adequate protection for
shareholders.” But, the closest thing an American lawyer can get to an
answer is something like the informational letter and ruling discussed
below, where the court circles around the topic, never actually

99 See BURNHAM, supra note 4, at 22 (“The purpose of explanations is to
authoritatively interpret the law and instruct the entire court system concerning
its application. Explanations are addressed directly to the lower courts and
often instruct them to interpret and to apply specific rules of law in a specific
matter.”).
100 Id. at 9.
mentioning or disclaiming agency. Therefore, this behavior is our “no” to the question of whether agency principles exist and is also a “yes” to the question of whether there really is a problem, because, as was shown in Part II, the problems today are significant and numerous.

B. **Evidence of the Lack of Agency Principles**

Although the explanations do not actually mention a lack of agency, the discussions and principles behind them may be used to infer that agency principles do not exist. One informational letter, Number 144 (18 January 2011), of the RF Supreme Commercial [Arbitrazh] Court discussed “the presentation of information upon demand by participants in limited liability companies and by stockholders”\(^{101}\)—a concept American lawyers know as shareholder inspection rights. In the context of inspection of corporate records, the basic agency premise is that inspection rights exist to protect the shareholders, the owners of the company, by allowing them to monitor the directors, the agents of the corporation.\(^ {102}\) This informational letter supports the proposition that true agency principles do not exist in Russian law. Without agents, as the term is used in the United States, there is no need to provide thorough inspection rights, because there is no one from whom the shareholders must be protected. Further, transparency of a company is limited, meaning the mini-oligarch directors are able to hide more from investors/participants, thus making it easier to steal.

The informational letter states that, in “accord with Article 91(1) paragraph one of the Joint Stock Company statute, stockholders (a stockholder) holding no less than twenty-five percent of company

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\(^{101}\) Informatsionnoe Pis’mo Vestnik Vysshego Arbitrazhnogo Suda RF “O nekotorykh вопrosakh praktiki rassmotreniya arbitrazhnymi sudami sporov o predostavlenii informatsiiuchastnikam khozyaystvennykh obchestv” [The Highest Commercial Court of the Russian Federation Informational Letter on Several Questions of Practice in Commercial Court Consideration of Disputes On Presenting Information to Participants in Commercial Companies], VESTNIK VYSSHEGO ARBITRAZHNOGO SUDA RF [Vestn. VAS] [The Highest Commercial Court of the RF Reporter] 2011, No. 144 [hereinafter Informational Letter].

\(^{102}\) Guthrie v. Harkness, 199 U.S. 148, 154-55 (1905) (citing Cincinnati Volkablatt Co. v. Hoffmeister, 62 Ohio St. 189-201, 48 L. R. 732, 78 Am. St. Rep. 707, 56 N.E. 1033 (1900)) (“The right of inspection rests upon the proposition that those in charge of the corporation are merely the agents of the stockholders who are the real owners of the property.”).
voting shares have a right of access to accounting documents." This shows just how weak shareholder inspection rights are: to inspect corporate records, one must own at least twenty-five percent of the company. Even combined, shareholders cannot access the information, unless at least one shareholder in the group has the requisite twenty-five percent. This would be considered ludicrous in the United States. In Delaware, “[a]ny stockholder . . . shall, upon written demand under oath stating the purpose thereof, have the right . . . to inspect for any proper purpose, and to make copies and extracts from: (1) The corporation’s stock ledger, . . . and its other books and records.”

A shareholder may not even find out who can participate in the stockholders general meeting, unless he or she owns at least one percent of the company:

[T]he list of persons having the right to participate in the stockholders general meeting shall be presented by the company for familiarization upon demand of persons included on the list and possessing no less than one percent of the votes. . . . In connection with this, stockholders not included on the list or not possessing more than one percent of the votes in the aggregate, do not have the right to demand presentation to them of such list . . .

Imagine if this were the case in the United States for a large company with a market capitalization of, e.g., $150 billion: a shareholder would have to own at least $1.5 Billion worth of shares, just to see who is accountable for the important decisions made at the shareholders general meeting. Thus, for large companies in Russia, this is a significant barrier to shareholders trying to monitor the company’s performance. The corresponding provision of the Delaware Code reads: “Such list shall be open to the examination of any stockholder for any purpose germane to the meeting.” As the U.S. Supreme

103 Informational Letter, supra note 101, ¶ 17.
104 Id. (“Besides this, court should keep in mind that in a case when a stockholder, having less than twenty-five percent of company voting shares, has applied to court with a claim to compel a joint stock company to present documents of account reporting and/or their copies, his claim is not subject to being satisfied even if this stockholder has earlier applied to the company with an appropriate demand together with other shareholders and the aggregate share [is] no less than twenty-five percent of company voting shares.”).
105 DEL. CODE ANN. tit. 8, § 220 (West 2010) (emphasis added).
106 Informational Letter, supra note 101, ¶ 19.
107 DEL. CODE ANN. tit. 8, § 219 (West 2009).
Court stated in *Guthrie v. Harkness*, shareholder inspection rights are grounded in agency principles,\(^{108}\) so the lack here of proper inspection rights is evidence that agency principles do not exist in Russia.

On April 2, 1997, the RF Supreme Court Plenum and RF Supreme Commercial Court Plenum set forth ruling number 4/8, “On Some Questions in Applying the Federal Statute on Joint Stock Companies.”\(^ {109}\) The court stated:

> A decision by the board of directors (board of overseers) or executive agency of the joint stock company (individually or collectively) may be disputed in a judicial proceeding by presenting a law suit to deem it invalid as in cases when the possibility of [such] dispute is contemplated in the statute (Article 53, 55 and others), as in the absence of an appropriate directive, [or] if the decision does not meet the requirements of the statute and other normative law acts and violates stockholder rights and statutorily protected interests. The defendant in such case is the joint stock company.\(^ {110}\)

In the United States, this is known as a shareholder derivative suit and is based on agency principles.\(^ {111}\) Normally, such a suit alleges that the directors or officers violated their fiduciary duties to the company.\(^ {112}\) This did not transpire in the Russian court. In this ruling, the courts defined a concept, very common and fluid in the United States, in

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\(^{110}\) *Id.* ¶ 10 (emphasis in original).

\(^{111}\) Stephen P. Ferris et al., *Derivative Lawsuits as a Corporate Governance Mechanism: Empirical Evidence on Board Changes Surrounding Filings*, 42 J. FIN. & QUANTITATIVE ANALYSIS 143, 144 (2007) (“In a derivative lawsuit, the plaintiff shareholders theoretically act in the interests of all shareholders, thus employing a legal mechanism to address agency problems that exist between shareholders and management.”).

\(^{112}\) *Id.* at 145.
extremely static terms: the suit can only be brought if specifically contemplated by statute, in the absence of appropriate directive, or “if the decision does not meet the requirements of the statute and other normative law acts and violates stockholder rights and statutorily protected interests.” This ruling stems from the pandectic nature of Russian law. The court is not willing to allow any fluidity in the law, which would have bolstered shareholders’ rights. The last part reduces our idea of violations of shareholders’ rights, an agency issue, to a basic statutory violation. This compounds the problem, because these very laws are not enforced by the courts. Thus, shareholders have almost no chance of vindicating their rights, unless the law specifically mentions what can be challenged if allegedly violated.

Ruling 4/8 supports the proposition that agency principles do not exist. By limiting the situations where shareholders may institute derivative suits, the court is saying that there are limited situations where directors or officers have done something wrong. In the United States, this involves violations of fiduciary duty principles, a subset of agency. Because the Russian directors are the corporation, they are not independent persons that can be sued on behalf of the corporation for wrongful acts. Thus, the mechanism to solve agency problems is limited simply because it is not needed under the law. Shareholder derivative suits are not needed if it cannot be recognized that the directors violated some duty.

The informational letter and ruling exhibit a common theme: shareholders have few rights to inspect and question the actions of the corporation. The informational letter showed that there is a high bar to inspect corporate records, and the ruling showed that only in narrow circumstances may shareholders challenge actions of the board or other executives. The second plays off of the first: to know something is truly wrong, shareholders must inspect the corporate records, meaning there is, at the least, a two-step bar to the vindication of rights. This is real evidence of a lack of agency principles, despite the fact that both the informational letter and the ruling failed to mention agency in any form. With few shareholder checks on their power, directors have been able to exploit the companies for which they work, stealing billions in the process.

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113 Ruling on Joint Stock Companies, supra note 109, ¶ 10.
114 Ferris, supra note 111, at 144.
C. **Similarities to American Agency Principles as Evidence of the Lack Thereof**

A number of passages in the GK resemble the American agency concepts of principal and agent or govern situations that would, in the American paradigm, require application of agency principles. “Representation” seems to be of the same mold as the concept of a principal and agent relationship, however, it is much narrower and is different as applied. Like a Potemkin village, “representation” purports to be agency but is without any substance to truly make it agency. GK Chapter 10, Article 182 reads:

> A transaction made by one person (a representative) in the name of another person (the person represented) by virtue of a power based upon a power of attorney, a provision of a statute or an act of a state agency of local self-government empowered thereto directly creates, changes, or terminates the civil law rights and duties of the person represented.

“Power of attorney” is a common translation, meaning this article applies most often in the context of the attorney-client relationship. The concept of “representation” is a much more static representation of legal rights, not dynamic like our system. For example, Chapter 10, Article 185 requires that the “power of attorney” be a “written authorization issued by one person to another person for representation before third persons.” Thus, “representation” is really a transaction, or occurrence-specific contract, which differs greatly from our principal-agent relationship.

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116 Comparative Study, supra note 10, at 66.


118 Id.

One might argue that a director could be considered a representative under the last sentence of Article 182, which states that this authority “may also arise from the circumstances in which the representative (salesperson in retail trade, cashier, etc.) acts.”\(^\text{120}\)

However, “while the Civil Code leaves open the list of cases where authority may be inferred from a situation, in fact the above-mentioned cases (a salesman and a cashier) are practically the only instances where such ‘inferred’ or ‘implied’ authority is recognized.”\(^\text{121}\) Russian courts, unwilling to stray from the pandectic model, will likely not hold that a director is a representative. Ruling that a director is a representative of the company would in fact be a major change for Russian corporate law, because Chapter 10, Article 186 states that the “term of a power of attorney may not exceed three years.”\(^\text{122}\) Thus, directors and officers would be required to sign new employment contracts every three years for this provision to work like agency. Further, only directors, and perhaps officers, may sign a power of attorney on behalf of a company, meaning directors and officers could not themselves be representatives.\(^\text{123}\) This strengthens the proposition that agency principles do not exist, because under the concept that most closely resembles agency, a director cannot be a representative; thus, the director certainly cannot be an agent.

Another problem is the means to challenge a power of attorney. Article 189 of Chapter 10 states that only the grantor of the power of


\(^{121}\) Comparative Study, supra note 10, at 66.


\(^{123}\) GRAZHDANSKII KODEKS ROSSIISKOI FEDERATSIII [GK RF] [Civil Code] art. 185, translated in Peter B. Maggs & A.N. Z Zhiltsov, Civil Code of the Russian Federation, 32 STAT. & DEC.: THE LAWS OF THE USSR AND ITS SUCCESSOR STATES, no. 5, Oct. - Sept. 1996 at 76 (“A power of attorney in the name of a legal person shall be issued under the signature of its manager or other person authorized for this by the founding documents, with an attachment of the seal of this organization.”). This provision might even strengthen the need for agency relationships, because, theoretically, a director could assign himself a “power of attorney” saying that the company would transfer all of its assets to him. Thorough research has revealed no examples of this actually occurring, but it is certainly possible.
attorney can challenge the transaction. But, would a company challenge the actions of a director in granting the power of attorney? The answer is likely no, especially since the rights of shareholders to institute derivative suits are very weak.

Several articles of Chapter 25 of the GK mimic another American agency concept, respondeat superior. According to the Restatement, under the doctrine of respondeat superior, an “employer is subject to liability for torts committed by employees while acting within the scope of their employment.” However, respondeat superior “is inapplicable when a principal does not have the right to control the actions of the agent that makes the relationship between principal and agent performing the service one of employment.” Thus, this American doctrine presumes that the employee is in fact an agent and encompasses all acts that might occur during employment.

Chapter 25, Article 402, states the Russian equivalent in terms of “obligations”: “Actions of employees of the debtor in performance of its obligation shall be considered to be actions of the debtor.” An “obligation” is when “one person (the debtor) is obligated to take for the use of another person (the creditor) a defined action.” Although this appears very similar to respondeat superior, the Russian version is much narrower and does not truly contemplate an agency relationship. The liability of an employee arises here with regard to a specific transaction or occurrence and does not reflect the ongoing employment status. True American-style agency would be the adoption of liability throughout the ongoing employment status, but this provision is limited to one specific instance. The problem is that the employee owes no

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125 RESTATEMENT (THIRD) OF AGENCY § 2.04 (2006).
126 Id. at cmt. b.
129 It should be noted that the RF Labor Code (TK) governs employment law-relationships, so the theory of ongoing respondeat superior is governed by
duties outside the context of the particular transaction, meaning the link to American agency principles is weak. The essential difference from American agency principles is that the Russian approach is static and mechanistic.

Another instance in which Russian law differs from American agency principles is Chapter 49, the title of which is often translated as “Commission”\(^ {130} \) and sometimes translated as “Agency.”\(^ {131} \) Article 971 states:

1. Under the [commission] one party (agent) shall undertake to perform certain legal actions on behalf and at the expense of the other party (principal). The rights and obligations under the transaction completed by the agent shall accrue directly for the principal.

2. A [commission] may be concluded with reference to the period during which the agent has the right to act on behalf of the principal or without such reference.\(^ {132} \)

This seems to be the perfect setup for concepts similar to American agency principles, so one would think that the rest of the Chapter actually contained agency principles, but it falls short. First, “agent” is sometimes translated as “attorney,”\(^ {133} \) which shows how narrow this Chapter might truly be; this would conform to the pandectic goal of specificity. “Agent” is not likely the proper translation,\(^ {134} \) so this Chapter could not actually match American agency principles.

\(^{130}\) See, e.g., GRAZHDANSKII KODEKS ROSSIISKOI FEDERATSII [GK RF] [Civil Code] ch. 49, translated in WILLIAM E. BUTLER, RUSSIAN CIVIL LEGISLATION 465 (1999).


\(^{132}\) Id. § 971 (“contract of agency” changed to “commission,” which is likely a better translation).

\(^{133}\) GRAZHDANSKII KODEKS ROSSIISKOI FEDERATSII [GK RF] [Civil Code] art. 972, translated in WILLIAM E. BUTLER, RUSSIAN CIVIL LEGISLATION 466 (1999).

\(^{134}\) For example, another translation uses the word “delegate” instead of agent. By avoiding the word “agent,” most translations seem to be implying
Second, even if “agency” is the proper translation, the duties mentioned in Article 974 do not establish any duties similar to those of American agency principles:

The agent [is required]: to perform the [commission] given to him in person, . . . ; to communicate to the principal all information about the progress of the execution of [commission] at his request; to convey to the principal without delay all the things received under the transactions, performed in pursuance of the [commission]; to return without delay to the principal the [power of attorney] whose validity term has, not expired upon the execution of [commission] or in case of the termination of the [commission] before it is executed and to submit a report with appended covering documents, if this is required by the terms and conditions of the contract or the character of commission.\(^\text{135}\)

None of these duties include any sort of fiduciary duty, so, even assuming that this Chapter could apply to company directors in the form of agency, it would be useless to solve the corporate governance problems.

Although Chapter 49 likely relates to attorneys and power of attorney, Chapter 51, titled “Commission”\(^\text{136}\) or “Commission Agency,”\(^\text{137}\) is similar to American agency in that it presupposes the

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\(^{135}\) G R A Z H D A N S K I I K O D E K S R O S S I S K O I F E D E R A T S I I [G K R F ] [C i v i l C o d e ] a r t . 4 8 , t r a n s l a t e d i n P e t e r B . M a g g s & A . N . Z Z h i l t s o v , C i v i l C o d e o f t h e R u s s i a n F e d e r a t i o n , 3 2 S T A T . & D E C . : T H E L A W S O F T H E U S S R A N D I T S S U C C E S S O R S T A T E S , n o . 5 , O c t . - S e p t . 1 9 9 6 a t 3 2 8 .

\(^{136}\) G R A Z H D A N S K I I K O D E K S R O S S I S K O I F E D E R A T S I I [G K R F ] [C i v i l C o d e ] a r t . 9 7 4 , t r a n s l a t e d i n T H E C I V I L C O D E O F T H E R U S S I A N F E D E R A T I O N , h t t p : / / w w w . r u s s i a n - c i v i l - c o d e . c o m / ( l a s t v i s i t e d J u l y 1 4 , 2 0 1 1 ) ( s e v e r a l w o r d s o r p h r a s e s r e p l a c e d w i t h b e t t e r t r a n s l a t i o n s ).

\(^{137}\) G R A Z H D A N S K I I K O D E K S R O S S I S K O I F E D E R A T S I I [G K R F ] [C i v i l C o d e ] c h . 5 1 , t r a n s l a t e d i n W I L L I A M E . B U T L E R , R U S S I A N C I V I L L E G I S L A T I O N 4 7 3 ( 1 9 9 9 ) ( t h e t i t l e o f t h i s c h a p t e r m i g h t s i m p l y c o n t a i n “ A g e n c y ” t o d i f f e r e n t i a t e i t f r o m C h a p t e r 4 9 , w h i c h t h e a u t h o r t i t l e s “ C o m m i s s i o n , ” m e a n i n g “ A g e n c y ” m i g h t n o t b e m e a n t t o p a r a l l e l t h e A m e r i c a n t e r m ).
ability of an “agent” to make purchases. However, this Chapter more closely mirrors contract law regarding the sale of goods; for example, it mentions the ramifications of incomplete performance, failure or refusal to perform, etc. It should also be noted that nowhere does Chapter 51 mention power of attorney. These concepts are a formulaic approach to contract law, with no place for an agency concept like fiduciary duty. This Chapter also fails to rise to the level of American agency principles in that no real duties are mentioned. Chapter 52 follows a similar pattern.

The title of Chapter 52, Article 1005 is often translated as “Agency Contract.” This article deals with what Americans would call an “undisclosed principal” and “disclosed principal.” While this might be a slight incorporation of American agency principles, there is certainly no fundamental incorporation of agency law. The contract is far narrower than in the United States and cannot pertain to directors of a company, because the principal may not be a juridical person. Thus, while adopting a feature similar to American agency principles, Article 1005 is not in fact “true agency.” It should also be noted that this article might pertain specifically to the shipping industry and have less in common with broad agency principles. This would fit the specificity goal of pandectism. The title of Chapter 52 is sometimes translated as “Agency Service” or “Shipping Agency Service,” and the title of Article 1005 is sometimes translated as “The Brokerage

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139 Id. § 1004.
141 See, e.g., Comparative Study, supra note 10, at 65.
142 Id.
143 Id.
Although these translations are not dispositive and no other supporting references could be found, this chapter might deal exclusively with shipping and, if not, is still not a true incorporation of agency principles.

While Chapter 4 details what American attorneys would think of as normal partnerships, Chapter 55 covers a “simple partnership.” The simple partnership allows several people to pursue profit or some other legal purpose jointly without forming a juridical person. This Chapter comes very close to exhibiting principles similar to American agency principles but also falls short. For example, Article 1043 states that the “obligations of the partners to maintain their common property and the procedure for the reimbursement of expenses relating to the discharge of these obligations shall be determined by the contract of [simple] partnership.” This seems to say that partners, as agents of the partnership, owe the other partners fiduciary duties. However, instead of creating an agency relationship, this article turns a potential fiduciary duty into a contract right that shall only exist if specifically included by the partners in their contract. Article 1045 even appears to support the proposition that this Chapter is similar to agency: it provides that all partners have rights of inspection of the partnership’s documents. As previously discussed, the relationship between agency principles and shareholder inspection rights is that the inspection rights exist to protect the shareholders, by allowing them to monitor the directors (agents). Thus, by allowing all partners to

151 Id.
153 Guthrie v. Harkness, 199 U.S. 148, 154-55 (1905) ("The right of inspection rests upon the proposition that those in charge of the corporation are
inspect the records of the partnership, the GK seems to imply that agency principles exist in some form. However, the implication is lost on the rest of the Chapter, as no real duties are created.

In summary, while a number of articles in the GK appear to be or come close to being American-style agency principles, the code lacks true agency principles. This does not mean that the GK completely ignores agency; to the contrary, the articles discussed above might show that the drafters of the Code recognized agency principles, but purposefully chose not to include such broad concepts. Thus, the provisions that are similar to agency reinforce the proposition that real agency principles do not exist in Russian law. Why would such overarching principles be needed when the pandectic model of this code should account for all possible justiciable situations? The answer is that they technically would not be needed, but this answer fails to recognize the real, practical problems caused by this lack of agency. The failure lies with the inherent problems in creating a pandectic code of laws from scratch, where the prevailing practices in the preceding years differed so greatly. The drafters, even with help from abroad, were simply not equipped to create the necessary code of laws. The problem persists today because Russia has become so entrenched in the pandectic model. The greater problem is what was shown in Part II: the lack of agency principles has transcended legal and scholastic bounds and has caused real life problems.

IV. CONCLUSION

This paper should not be read to infer that the drafters of the GK intended to deprive shareholders of their rights, as this is not the case. The drafters had good intentions, but, with the micro-level focus of pandectism, they missed the macro-level protection offered by agency principles.

So, what happens next? A number of important questions remain. What will happen in the future? How can the existing problems be solved? Are individual directors at fault, or should we blame history? How can Russia be taken off its current path, which likely will lead to self-destruction of the corporate structure as a whole?

The overall solution might be a continuation of the pandectic theme, i.e., a top-down approach: “For both already privatized and not-
yet-privatized firms, Russia needs a serious, top-down effort to control corruption, organized crime, and self-dealing.”\textsuperscript{154} Although a number of scholars hold this view, the answer is not so simple. One possible solution to fix corporate governance issues is twofold: 1) adopt American agency principles, and 2) strengthen the requirements of founding documents so that directors cannot escape liability. This remains an oversimplification though. Massive reform is needed. In addition to the foregoing, Russia needs better measures to counteract corruption and self-dealing, perhaps through new tax or corporate laws to disincentivize self-dealing through strong penalties.

Although other solutions may exist, the adoption of American agency principles could prove to be the easiest, most effective solution. Simple procedural laws have failed; despite provisions against self-dealing, courts consistently refuse to hold directors liable. Perhaps broader, thematic provisions are needed that would rewrite the role corporate directors play. Agency principles could even take the form of constitutional laws, which could aid enforcement.

These problems raise the broader issue of the desirability of pandectism in general. Some of the corporate governance problems today might be caused in part by the nature of a pandectic code: it might simply be more difficult to litigate under such a comprehensive code than under a system like the United States. The difficulty of litigation might manifest itself in lower success rates of those trying to challenge companies but lacking the resources a company has to defend itself. Similarly, this difficulty might deter litigation altogether due to the complexity of the code and number of provisions that must first be followed. The basic pandectic concept of trying to cover all possible justiciable situations might have created a monster that defies all but the mightiest challenger.

However, Russia will not likely stray from pandectism in the near future—this would be a major paradigm shift, therefore, the Potemkin village of corporate law must be dismantled and rebuilt as a whole “village.” Current laws allow for the creation of a façade: companies appear to be functioning, but, behind the wall, directors are skimming profits until the company fails. History cannot be ignored though, and it must be recognized that the current generation of leaders may be incapable of reform. Path dependency is a major problem for Russia, and it is highly likely that only time will heal the wounds. Perhaps the best option for the current leaders is enact American agency principles

\textsuperscript{154} Black, \textit{supra} note 2, at 1798.
and let implementation occur naturally. Since the Russian market cannot be forced to act in a certain way, the best move might simply be to equip future leaders with the proper tools to succeed, and the adoption of true agency principles is the proper tool.