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**IS THERE THE RULE OF LAW IN RUSSIA? THE CASE OF CORPORATE  
RAIDING: A NOTE**

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# **Is There the Rule of Law in Russia? The Case of Corporate Raiding**

**A Note<sup>1</sup>**

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Our leaders constantly proclaim that Russia is building a democratic state and moving along the road to the rule of law in the market economy. The rhetoric is fine, but what is really happening? In order to answer this question I would like to tackle the problem of raiding in the Russian economy, the problem most acute, urgent and illustrative of the present state of affairs. First, I'd introduce the definitions, then describe the process going on in Russia and then try to make some tentative conclusions regarding the future trends.

## **Definitions**

When business practices are concerned the term "raider" means a captor of companies. Thus, raiders are the companies that take actions aimed at hostile acquisition of other companies. However, in Russia and in the West raidings or hostile acquisitions have different meanings.

In the West, corporate raiders legally take over weak or struggling firms. In Russia, raiders target healthy or successful businesses and capture them by mostly illegal means. In the developed market economies raiding or hostile acquisition means buying-up of shares of a public company with subsequent gaining of control over it without regard to the will or intent of its managers and owners. It usually takes place without any forced penetration into buildings, institution of criminal cases, artificial bankruptcies, document forgery or grafting of public officers. A reason for most of the hostile acquisitions in the West is the "undervaluation" of a company, i.e. the margin between the stock market capitalization of a company and the cost of its assets. Having captured control over such company by means of purchasing a sufficient number of its shares, a new shareholder sells the company's assets by piecemeal thus gaining much more than the amount spent on the purchase of shares. The activities of the present-day Russian raiders have absolutely nothing to do with the term "hostile acquisition" in its genuine meaning. Russian-style raiding implies property being taken away from its legal owners by any means. Having used up all legal or quasi-legal means of attaining his goal, a raider considers criminal options and, by all means, uses them to obtain the property of its target company. A criminal law-based approach is used here to define the illegal techniques - from minor crimes to grave ones.

The former Russian Economy and Trade Minister German Gref put it very concisely. The minister said that raiding is common in the world. "But there are different kinds of raiding. Raiders clean the market and help re-distribute non-effective property, which is legal, since it helps make the capital work more effectively. But in this country raiding is criminal. In Russia

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raiding affects effective property. Assisted by corrupt bureaucrats, semi-criminal structures seize effective, lucrative property”, said the minister after a Cabinet meeting, which confirmed the strategy of the development of corporate law (Vedomosti, 18.05.2006).

***So we may conclude that in Russia corporate raiding means, first of all, a criminal seizure of property.*** This is the most precise definition of the activities of the raiding companies. In most cases the raiders are armed not with pistols or sub-machine guns (although this happens sometimes), but with documents or seals. As practice shows, these arms can be no less efficient than the real ones.

### **The Scope and Methods of Corporate Raiding in Russia**

There are no exact figures for how many raider attacks occur annually. Gennady Gudkov, former head of a working group that tracked raiding in the previous Duma said that they registered about 1,000 cases per year in Moscow and a similar number in the Moscow region. But these "were only the tip of the iceberg." (Moscow Times, 13/02/2008). Other than Moscow and the surrounding Moscow region, the favorite targets for raiders are in St. Petersburg and the Leningrad region. Real estate has top prices in these areas, and competition is brutal for the few properties that are available for legal purchase. So the real figure is probably four to five times higher. The Russian Chamber of Commerce & Industry declares that 8,000 companies a year are targets of lawsuits or investigations at the behest of rivals seeking to put them out of business or take them over. ***Experts estimate that there are 70,000 cases of raiding in Russia a year.*** An estimated 50 percent of all illegal takeovers involve shops and offices. The raiders are rarely interested in the businesses themselves but in the real estate where they are located. The properties can be rented for a high price or demolished to construct higher buildings.

Raiders can be split into two groups -- those who raid for their own gain and those who organize raids for money. Those seeking their own gain spot locations on their own and work out a takeover plan. These raiders usually target small -- and easy to get -- businesses. The hired raiders tend to work for big businesses and to target medium-size companies. The small-time raiders pay bribes out of their own pockets, while the hired raiders get their expenses covered by their employers. Usually they charge a fee of about 20 percent of the value of the targeted business.

***Raiders use various illegal methods.*** As for smaller companies the police can just come to search the offices, arrest the owner on some fake pretext, such as use of drugs or illegal keeping of arms, detain him for a day or two and then force him to sign a contract transferring ownership to a company the raider represents.

The standard method for bigger companies is to be hit by a large invented tax bill. The owner is then arrested. While the owner is in prison, raiders using forged documents and shareholder protocols sell the bankrupted company to another firm. By the time the owner emerges the business has been re-sold numerous times. Often raiders rely on corrupt courts to rule that they are legal owners of a company. In other cases, raiding companies or their agents use legal pressure as a tool to force controlling shareholders to sell their stakes.

It is quite difficult for raiders to attack big companies who have large and efficient security departments. In such cases top officials are always involved. Oil giant Yukos was

broken up and actually renationalized by the Russian government between 2003 and 2007. (Of course there were other, political, reasons to destroy the company besides seizing its property). Earlier this year police raided the Moscow offices of BP and its Russian joint venture, TNK-BP and Hermitage Capital Management, a British investment fund, pretending to investigate alleged tax evasion. Certain documents of the Fund disappeared. Among the recent victims there are several other huge companies: Rusneft – Mikhail Gutseriev’s oil company; Arbat Prestige - Russia’s biggest cosmetics chain; Togliatty Azot - an ammonia factory; and Moscow’s Domodedovo airport.

***Methods and tactics of the raiders are changing.*** As a very vivid example we can cite the words of a former Russian intelligence officer (given in The Guardian interview): "When someone opened a shop in the beginning of the '90s, bandits would visit him to offer protection in exchange for money," he said. Those who refused to pay lost their businesses. "Now, these bandits have been replaced by the police and FSB. I'm not talking about ordinary guys, but people who have good links" (The Guardian, 24.06.2008).

The Businessweek in its article on Russian raiders cites the words of a medium-scale enterprise owner, who gave 30% of his property to intelligence officials. "Besides intelligence officers, businessmen take police officials and local bureaucrats as co-owners. In the '90s the bandits protected us. Now I see former bandits giving shares of their now-legalized businesses to police officers or intelligence officers to protect themselves from the raiders." (The Businessweek, 05.06.2008).

## **Conclusions**

### **1. Main reasons of corporate raiding in Russia**

We have shown, that the raiders’ activity is related to serious breaches of law, including those that are criminally liable. This brings up the question of why the activities of such companies become possible as a matter of principle and on such wide scale? It looks like the main reasons are the following:

a) Imperfection of the legislation. Many norms of the legislation have flaws that enable raiders to act without control (interlocutory injunction, provisions of the potential invalidation of deals or resolutions of the management bodies of business entities, limitation periods).

b) Low level of legal and business culture among owners or managers of enterprises. Many owners of enterprises and real estate objects often refrain from taking even a minimum set of measures in order to duly formalize or ensure even the least possible protection of their assets. Moreover, many enterprises perform their operations in contravention of the laws thus providing the raiders with the grounds for its capture, e.g. by way of initiating criminal prosecution against its managers..

c) Widespread corruption in the law enforcement agencies and courts. The raiders would not be able to implement even one tenth of the overall number of their "projects" without the resource

of this kind. No criminal seizure of property can be accomplished without the documents drawn up or actions taken by the government authorities that are paid by the raiders. Asked why officials did not intervene, Valeria Filimonova of Moscow's Centre for political technologies said: "They are the ones who order the raiders' attacks." (Guardian, 24.06.2008). The following documents and actions are always in place when measures are taken with a view to arrange for a criminal seizure of property: forged or illegal sentence of court, resolution on interlocutory injunction, illegal entry of record in the Unified State Register of Legal Entities made by tax inspectorate employees, investigator's decision, contracted criminal case, actions of engaged court marshals, staff or interior agencies or public prosecutor's offices.

A price list for the services of law enforcement agencies in the illegal seizure of property can even be found in the Web. "Getting police to open a criminal investigation costs \$20,000 to \$50,000, an office raid is as much as \$30,000, and a favorable court ruling runs from \$10,000 to \$200,000. A judge could be bought for \$5,000 to \$9,000, while it cost \$5,000 to \$70,000 to get someone arrested. Through their connections with intelligence officers, raiders are able to listen in on the telephone conversations of their targets at a cost of several thousand dollars per week (The Businessweek, 05 06.2008).

d) Super-profits gained in the raiding business. Its cost-effectiveness may be as high as 50,000%. Usually a project of criminal seizure of property is aimed at a profit of no less than several thousand percent. This is why the struggle against raiding is as difficult as the struggle against other highly profitable types of criminal business – trade in arms, drug dealing, prostitution. High earnings of raiders make a good compensation for all risks and expenditures related to the criminally punishable acts aimed at the illegal seizure of property. One raider, speaking anonymously to The Guardian, said the profits from raiding were enormous. "It costs around \$120,000-\$170,000 to bankrupt an average company. But you can then make \$3-4m profit" (The Guardian, 24.06.2008).

## **2. Counter-measures to be taken**

As, the head of the Centre for Political Technologies, Igor Bunin, said, "Illegal raids had become the main problem afflicting the country's economy" (Moscow Times, 13.02.2008). Raiders started creating such a huge problem that this spring the State Duma began to consider legislation to fight the raiders. Now it's debating a 20-year jail sentence for raiders who illegally acquire companies. There are suggestions to introduce amendments to The Bankruptcy Law and the Law on Joint Stock Companies.

Our new President Dmitry Medvedev, who is a former law professor, has pledged to wipe out raiding. In his speech in June this year he made it clear he wants to end bureaucratic corruption and what he calls Russia's "legal nihilism". "Our job is to create absolutely independent modern courts," he declared.

## **3. Prospects**

Unfortunately for the time being my forecasts are pessimistic. Raiders can be stopped at the lower level. But on the whole, the ruling elite is interested in corporate raiding as an instrument of acquiring more property and – what is more dangerous - as an instrument of political pressure.

Many opposition economists are also sceptical. I would like to cite one of them. “Russian leaders have been talking about legal reform since the time of Ivan the Terrible,” Mikhail Delyagin, the head of Moscow’s Institute for Global Problems, recently told the Guardian. It is very unlikely that Medvedev can curb the Kremlin’s meddling in judicial affairs. “Putin also talked repeatedly about reform, but the results were the opposite of what he declared. Maybe Medvedev will succeed. But I doubt that Putin’s loyal apprentice would wish to correct his master’s actions. “We shouldn’t forget that Medvedev was Putin’s main lawyer. It was Medvedev who wrote the laws ramping up pressure on the opposition and who ruled out the possibility of legal opposition activity in Russia.” ( The Guardian, 24.06.2008).

***As our politologist Stanislav Belkovsky put it, “ In order to bring the rule of law to Russia you don’t only need to change judges, you have to change the ruling elite.”***

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