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Information—The Key to Fair Privatization: British Successes and Russian Pitfalls

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**INFORMATION—THE KEY TO FAIR PRIVATIZATION: BRITISH
SUCCESSSES AND RUSSIAN PITFALLS**

I.	INTRODUCTION.....	838
II.	WHAT IS PRIVATIZATION?	839
III.	WHY IS INFORMATION IMPORTANT TO PRIVATIZATION?	840
IV.	PRIVATIZATION IN THE UNITED KINGDOM	842
	A. Historical Context.....	842
	1. Nationalization of Industries	842
	2. The Shift Toward Privatization	845
	B. The Objectives of British Privatization	847
	C. The British Telecommunications Act of 1984	848
V.	PRIVATIZATION IN RUSSIA	851
	A. Historical Context.....	851
	1. The Soviet Era of State Ownership.....	851
	a. War Communism.....	852
	b. New Economic Policy (NEP).....	853
	c. Stalin and Beyond—The Command Economy ..	854
	2. The Early Reform Period.....	856
	a. The Gorbachev Era	856
	3. The Yeltsin Approach to Privatization.....	858
	a. Creating Joint-stock Companies.....	860
	b. Vouchers.....	861
	B. Objectives of Russian Privatization	862
	C. The Pitfall—Article 18 of the Privatization Act	864
VI.	COMPARATIVE LEGAL ANALYSIS	869
	A. Observations & Analysis of British Privatization	
	Laws	869
	B. Observations & Analysis of Russian Privatization	
	Laws	869
VII.	CONCLUSION.....	870

I. INTRODUCTION

The United Kingdom and Russia have undergone impressive privatization efforts in the 1980s and 1990s, respectively. By juxtaposing the statutory information requirements found in the privatization laws of these countries, it is possible to glean insightful lessons regarding privatization planning.

Before the 1970s, the United Kingdom nationalized major public utilities such as coal, railways, electricity, telecommunications, and gas.¹ During the late 1970s and the 1980s, however, British Prime Minister Margaret Thatcher reversed this policy. She decided that private ownership of these utilities would improve efficiency and provide the British state with much needed capital. The Thatcher government approached privatization not through one set plan, but rather through piecemeal legislation.² This legislation guaranteed that citizens and potential investors had extensive and accurate information about the newly-privatized companies. This aspect of British privatization legislation enabled participants to invest wisely, thus ensuring the efficiency of privatized industries and the fair price of their stocks.

More recently, under the leadership of President Boris Yeltsin, Russia has also enacted legislation that has, at a dizzying speed,³ transferred thousands of enterprises from public to private hands.⁴ The scope of this legislation dwarfs that of the United Kingdom. The success of Russia's privatization legislation continues to impress many because it has accomplished many of its goals. It has given fewer assurances than British legislation, however, that potential investors are provided comprehensive and meaningful information. Privatization legislation that fails to ensure public availability of material information about privatized

1. See Andrew Gamble, *Privatization, Thatcherism, and the British State*, 16 J.L. SOC'Y 1, 1-2 (1988).

2. See Andrew J. Ritten, Comment, *Perspectives on Privatization and Plant-Level Industrial Relations: Great Britain in the 1980s, Germany in the 1990s*, 12 J. INT'L L. BUS. 216, 232 (1991).

3. For a discussion on the pace of Russian privatization, see Pekka Sutela, *Insider Privatisation in Russia: Speculations on Systemic Change*, 46 EUROPE-ASIA STUD. (formerly SOVIET STUD.) 417, 418-20, 424 (1994).

4. See Merton J. Peck, *Russian Privatization: What Basis Does it Provide For a Market Economy?*, 5 TRANSNAT'L L. & CONTEMP. PROBS. 21, 22 (1995).

companies allows investors who have access to non-public information to secure an unfair advantage over those who do not.⁵

This Comment contrasts the privatization legislation of the United Kingdom and Russia in a limited context. It focuses on the requirement that potential investors receive the information they need to participate effectively and fairly in the privatization process. To exemplify their differences in this regard, it contrasts two acts—the British Telecommunications Act of 1984,⁶ and the Russian Federation Privatization of State and Municipal Enterprises Act of 1991 (Russian Privatization Act).⁷

Before reviewing the information provisions of these two acts, Part II of this Comment introduces the notion of privatization and sets out its general objectives. Part III overviews the important role information plays in privatization legislation. Part IV explores the historical background of the British privatization campaign and briefly discusses its goals. It then examines the information requirements mandated by the British Telecommunications Act, which privatized the telecommunications industry. Part V provides a similar analysis of the Russian privatization efforts. It reviews the Russian nationalization efforts that began early in the twentieth century, briefly summarizes Russia's privatization efforts, and examines the information provision of the Russian Privatization Act. Section VI contrasts the British and Russian approaches and comments on their differences. Lastly, Part VII presents some concluding remarks.

II. WHAT IS PRIVATIZATION?

Stated simply, privatization is the process of transferring state activities and assets from the public sector to the private sector.⁸ The reasons for privatizing state assets do not vary dramatically. Among the most widely espoused reasons are to create an enterprise culture, increase competition, reduce government involvement in industry decision-making, eliminate waste,

5. See discussion *infra* Part III.

6. See British Telecommunications Act, 1984, ch. 12 (Eng.).

7. See Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), Economic Law of Russia, reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. Russica Info. Inc. trans., 1995).

8. See Ritten, *supra* note 2, at 231.

minimize state dependency, and increase and improve the quality of goods and services.⁹

In practice, however, implementing the goals of privatization is much more complex. No set scheme or formula for privatization exists. Consequently, privatization plans differ widely across their sundry geographical and temporal settings.

III. WHY IS INFORMATION IMPORTANT TO PRIVATIZATION?

Information plays a vital role in securities markets.¹⁰ Modern economists agree that the price of securities (such as shares of stock) reflects a general consensus of value by the majority of investors,¹¹ and that their consensus fully reflects available information.¹² As long as all investors have adequate, accurate information, and can analyze that information reasonably well, the price they agree upon in the market place will reflect the best estimate of the security's true value.¹³ This notion is called the Efficient Capital Market Hypothesis (ECMH).

ECMH is important for two reasons. First, it means that the market uses all available information as it directs capital to those investments that are most profitable.¹⁴ Identifying and investing in undervalued enterprises tends to maximize efficiency, boost employment, and minimize waste. If investors cannot accurately identify and invest in attractively-priced enterprises, capital will

9. See generally *id.* at 231-32; see also Peter Rutland, *Privatization in East Europe: Another Case of Words that Succeed and Policies that Fail?*, 5 TRANSNAT'L L. & CONTEMP. PROBS. 1, 9 (1995).

10. For the authoritative discussion on the importance of information on the pricing of securities, see generally WILLIAM F. SHARPE, INVESTMENTS 79 (4th ed. 1990).

11. See generally *id.* at 77.

12. See generally Christopher Paul Saari, Comment, *The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 STANFORD L. REV. 1031 (1976-77). The hypothesis that market efficiency is dependent on information flow is called the Efficient Capital Market Hypothesis (ECMH). See *id.*; see also BRADFORD CORNELL, CORPORATE VALUATION TOOLS FOR EFFECTIVE APPRAISAL AND DECISION MAKING 39-42 (1993).

13. See SHARPE, *supra* note 10, at 77.

14. See Saari, *supra* note 12, at 1035. "Directing capital" here expresses a two part trend. First, investors will sell (rather than buy) more securities of disfavored enterprises. This drives the securities' prices down to meet the lower demand. Second, the converse is also true—investors will purchase (rather than sell) more securities of favored enterprises. This drives the price up to meet the increased demand. Investors, both buyers and sellers, thus direct capital from company to company depending on their assessment of the securities' value. Their assessment is controlled by the information those investors receive.

flow to endeavors in amounts disproportionate to the endeavors' true values. If ECMH is correct, therefore, markets that do not efficiently provide all material information necessary to making prudent investment decisions can expect to be less efficient than those that do provide such information.¹⁵

Second, investors cannot accurately estimate the value of a security unless they have all information material to their analysis. If they cannot accurately estimate the value of a security, then they cannot identify those securities that are undervalued or overvalued.¹⁶ When incomplete or inaccurate information is made available to the public, persons such as insiders, who have access to superior, non-public information, are able to secure an unfair advantage because they can more accurately determine whether the security is overvalued or undervalued in relation to their fundamentals. If the security is overvalued, the investor is able to sell the security for more than it is worth, and thereby realize a profit. Conversely, if the security is undervalued, the investor can purchase the security, wait for its price to climb to reflect its true value, and then sell at a profit. Those who have access to non-public information, therefore, can secure an unfair advantage over those who do not, and can trade in securities at the expense of the ignorant investors.¹⁷

Investors analyze many factors in determining the value of securities. Certainly, daily information about the activities of a company, such as law suits filed against it or on its behalf, new

15. For a discussion on this and on the ECMH, *see generally id.* at 1031.

16. *See id.* An undervalued stock is one that is priced lower than the price would be if all material information were known. Conversely, an overvalued stock is one that is priced higher than all material information would warrant. *See id.* at note 23. Economists assume that investors value stocks based on expected returns, i.e. the average probability of receiving forecasted returns. *See id.* at 1036. When combined with the ECMH theory, this proposition postulates that in an efficient market, "all available information is used to determine expected returns on securities, and therefore to establish security prices." *Id.* at 1038. Market efficiency implies, therefore, that without all available information, it is impossible to determine which stocks are overvalued or undervalued in relation to their fundamentals. *See id.* at 1036.

17. Note, for example, that to prevent this kind of unfair use of information, the United States Congress prohibits trading by certain insiders. *See Securities Exchange Act (1934)*, 15 U.S.C. § 78j(b); *see also SEC Rule 10b-5.* (A corporate insider, who because of his position or intimate association with a corporation, has greater knowledge of financial affairs of the corporation and because of that superior knowledge, has a duty to disclose known facts, not available to those with whom he deals, which he should reasonably know would be material to them in determining the value of the corporation's stock. *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967).

contracts entered into, and announcements of earnings composes an essential element in their analysis. Daily information, however, makes up only part of the equation.

The financial posture of a company is another key element in the valuation process. When valuing a company and forecasting its earnings, investors heavily rely on information about trends in earnings over periods of five years (often regarded as short-run analysis) and ten years (often regarded as long-run analysis).¹⁸ For the price of a company's securities to equal its true value, therefore, all investors must have material, accurate information about the company, including its financial data over a number of years.¹⁹

If economists are correct that information plays an indispensable role in market efficiency and the fair pricing of securities, privatization laws that transfer national assets to private hands by selling securities, if they are to be fair, must ensure the public availability of all information material to making investment decisions.

IV. PRIVATIZATION IN THE UNITED KINGDOM

A. *Historical Context*

1. Nationalization of Industries

Since the Industrial Revolution, the British State has played

18. See generally MARY BUFFETT & DAVID CLARK, *BUFFETTOLGY—THE PREVIOUSLY UNEXPLAINED TECHNIQUES THAT HAVE MADE WARREN BUFFETT THE WORLD'S MOST FAMOUS INVESTOR* 201 (1997).

[I]nvestors and creditors can use the information on the income statement to evaluate the past performance of the enterprise. Although success in the past does not necessarily mean success in the future, some important trends may be determined. It follows that if a reasonable correlation between past and future performance can be assumed; then predictions of future cash flows can be made with some confidence.

DONALD E. KIESO & JERRY J. WEYGANDT, *INTERMEDIATE ACCOUNTING* 138-39 (8th ed. 1995) (emphasis omitted).

19. Financial data over a number of years also helps to ensure that no accounting manipulations occur. For example, on any one income statement, a company's earnings may be artificially increased by writing-off an untruthfully small bad-debt expense, or by capitalizing certain expenditures instead of expensing them. Similarly, earnings or cash flows may be artificially decreased. In the United States, Generally Accepted Accounting Principles (GAAP) minimize potential dangers such as biases, misrepresentations and ambiguities. See generally KIESO & WEYGANDT, *supra* note 18, at 9, 17-18.

an active economic role by regulating wages and certain prices. Although large-scale nationalization of industries in the United Kingdom did not exist until the 1940s, the government began increasing state ownership in the late nineteenth century.²⁰ This nationalization sought to break the natural monopolies that developed with the advent of new technologies, and to combat problems of inadequate services provided by private companies in vital industries such as water supply.²¹

By 1907, the British government owned many industries, including much of the gas and electric industries, water, telecommunications, shipyards, and the postal service.²² By 1918, the Labour Party had adopted a policy to equitably distribute income by means of state ownership of industries.²³ Nevertheless, the overall percentage of state-run industries at that time was only about 7.9%.²⁴

Britain undertook much of the state ownership of industries for strategic and defense purposes.²⁵ For example, Prime Minister Winston Churchill purchased British Petroleum shares on behalf of the British Government in 1914. The government also sponsored the amalgamation of four major airline companies in 1924 into the subsidized Imperial Airways. Later, the government also formed and subsidized British Airways.²⁶

From 1945 to 1951, the Labour government effected a significant shift in the process of nationalization.²⁷ Two reasons account for this. First, the Labour Party was ideologically inclined toward state ownership of the means of production, transportation, and distribution.²⁸ Second, it thought that state control of industries would allow the government to plan a national economic recovery and postwar reconstruction.²⁹

20. See generally James Foreman-Peck, *The Privatization of Industry in Historical Perspective*, 16 J.L. & SOC'Y 132 (1988).

21. See *id.* at 129, 134. For example, poor water services often caused outbreaks of cholera and inadequate fire-fighting services. See *id.* at 132-33.

22. See *id.* at 135.

23. See *id.* at 137-38.

24. See *id.* at 135.

25. See *id.* at 136.

26. See *id.*

27. See *id.* at 129. See generally *id.* at 131-40.

28. See generally Ritten, *supra* note 2, at 229.

29. See *id.*

The upshot is that the war-time experience of physical planning tended to create an administrative hubris that carried over to the peace time. There was a widespread belief that large units were more efficient than small ones. Because of the monopoly problem, the policy issue was whether the units would be directly controlled through state ownership or whether some form of indirect control through regulation was preferable. A landslide majority for the Labour Party in 1945 provided further ideological support for nationalization, buttressed by the voting power within the Trade Union Congress of the coal, railway, and transport unions.³⁰

This post-war period ushered in a new and durable policy that redefined the relationship between the public and private sectors.³¹ At the core of this relationship was a vast increase in the role and responsibilities of the state.³² The public sector grew rapidly, not only by nationalizing major public industries such as gas, coal, electricity and railways, but also by expanding its role in collective welfare, social security, public housing programs, economic and environmental planning, and by restructuring public education.³³

For a time, the Conservatives found public programs such as the funding of housing, health care, and education, to be a necessary responsibility of the modern state.³⁴ Their ideology, however, did not last. Upon returning to control of government in 1951, the Conservatives slowly began to taper the nationalization policy of the 1940s.³⁵ During the 1950s, high levels of public spending and taxation caused a growing number of people to question the need for public ownership of the means of production, distribution and exchange.³⁶

30. Foreman-Peck, *supra* note 20, at 138.

31. See Gamble, *supra* note 1, at 1.

32. See *id.*

33. See *id.* at 1-2.

34. See *id.* at 2. For a discussion on British nationalization, see R. KELF-COHEN, BRITISH NATIONALISATION 1945-1973 (1973).

35. See Gamble, *supra* note 1, at 2.

36. See *id.*

For many in the [Conservative] party the question of public or private ownership has always been a question of expediency not principle. There was a ritual battle over the steel industry, but even here its eventual inclusion in the public sector in 1967 was accepted. As long as the private sector remained vigorous and competitive the existence of a large public sector did not trouble Conservatives.

2. The Shift Toward Privatization

The British nationalization policies implemented during the 1940s slowed dramatically during the 1970s because Britain lacked relative economic success.³⁷ In the mid-1970s—a period of world economic deceleration—the weakness of the British economy was fully exposed and exacerbated by the changes in technology and patterns of global divisions of labor.³⁸

When Margaret Thatcher came to power in 1979, the British economic situation was ripe for change.³⁹ From the beginning, the Thatcher government blamed the lagging productivity of nationalized industries on public ownership and state intervention in the market.⁴⁰

The years following 1979 marked a fundamental reversal in British nationalization policy.⁴¹ Three factors help explain this reversal:

First, the long-term tendency was based on errors that were only fully appreciated after 1979; secondly, privatization is a mistaken policy that neglects the lessons of history; and thirdly, the underlying conditions that had warranted state ownership had changed by the beginning of the 1980s and new policies were therefore justified.⁴²

After the shock of the currency slump in the first two years of the Thatcher government, privatization emerged as one of the major themes of the economic recovery and of the government's plans for the economy.⁴³ By 1983, the government realized it had to reform the nationalization policy to effect economic recovery.⁴⁴ In 1983, the Financial Secretary to the Treasury, John Moore MP, stated that:

37. See Gamble, *supra* note 1, at 2–3.

38. See *id.* at 3.

39. See Ritten, *supra* note 2, at 231. The Thatcher General Election manifesto expressed the party's opposition to more nationalization and the intent to shift aerospace and shipbuilding duties to the private sector. See Foreman-Peck, *supra* note 20, at 140.

40. See Ritten, *supra* note 2, at 231.

41. In 1980, however, large numbers of industries still remained state-owned. See *id.* at 229.

42. Foreman-Peck, *supra* note 20, at 129.

43. See Gamble, *supra* note 1, at 9.

44. See Foreman-Peck, *supra* note 20, at 140.

Privatization is a key element of the government's economic strategy. It will lead to a fundamental shift in the balance between the public and private sectors. It is already bringing about a profound change in attitudes within state industries. And it opens up exciting possibilities for the consumer; better pay, conditions and employment opportunities for the employees; and new freedom for the managers of the industries concerned.⁴⁵

During Thatcher's first term, the British government only privatized small companies that could effectively operate in competitive markets.⁴⁶ After 1983, however, the Thatcher government created new regulatory rules and agencies, and privatized very large industries such as British Gas and British Telecommunications.⁴⁷

Scholars have identified several stages in the privatization program in Britain.⁴⁸ The first two stages are relevant to the discussion here.

The first stage encompassed the period from 1979 to early 1984.⁴⁹ At that time, while no formal privatization program existed, extensive "disposals" transferred ownership of public agencies to private parties.⁵⁰ Motives were mixed, "with the short-term effect on the Public Sector Borrowing Requirement dominant. Most of the industries sold were in some sense competitive, and disposals did not include the major public utilities."⁵¹

The second stage commenced with the adoption of the program set out in the Public Expenditure White Paper, which initially called for the privatization of £2 billion worth of state assets each year.⁵² In 1985, the figure was raised to £4.75 billion in the Chancellor's Autumn Statement.⁵³ The government privatized the major public utilities during this stage.⁵⁴

45. Gamble, *supra* note 1, at 9 (citations omitted).

46. See Foreman-Peck, *supra* note 20, at 141.

47. See *id.*

48. See Cosmo Graham & Tony Prosser, *Privatizing Nationalized Industries: Constitutional Issues and New Legal Techniques*, 50 MOD. L. REV. 16, 17 (1987).

49. See *id.*

50. See *id.*

51. *Id.*

52. See *id.*

53. See *id.*

54. See *id.*

In short, Margaret Thatcher's government, motivated by an economic slump and a change in economic ideology, privatized many companies through a series of piecemeal decisions and acts.⁵⁵ These efforts smoothly transferred ownership of numerous industries from the public to the private sector.

B. The Objectives of British Privatization

The United Kingdom undertook its privatization campaign for many typical reasons. One scholar identifies the following key objectives to the British privatization efforts under Margaret Thatcher's government:

[E]xtension of freedom of choice; efficiency and the elimination of waste; reduction of Public Sector Borrowing Requirement; control of public sector pay and weakening of the power of public sector unions; the removal of many decisions from the political process altogether; the widening of share ownership both among citizens and employees; the promotion of liberalization and competition; and the enlargement of active citizenship and the contraction of state dependency.⁵⁶

Scholars John Vickers and George Yarrow present seven aims of the privatization program, repeating several of those identified above. The aims are: to improve efficiency in the privatized industries; to ease problems in public sector pay determination; to reduce government involvement in industry; to reduce the Public Sector Borrowing Requirement; to widen share ownership; to encourage employee share ownership; and to gain political advantage.⁵⁷

In Britain, the privatization scheme was seen not as one strictly structured program, but rather as a set of various initiatives. There was no comprehensive plan for how privatization should proceed, rather it took place through a series of ad hoc decisions and experiments. Although the Thatcher government maintained that its privatization policy incorporated a coherent and well thought-out program, commentators have suggested that there really have been a variety of themes often with conflicting implications.

Ritten, *supra* note 2, at 232 (citations omitted).

55. See Gamble, *supra* note 1, at 7.

56. *Id.* at 11.

57. See JOHN VICKERS & GEORGE YARROW, *PRIVATISATION: AN ECONOMIC ANALYSIS* 157 (1988); see also Cosmo Graham, *Privatization—The United Kingdom Experience*, 21 *BROOK J. INT'L L.* 185, 191 (1995).

C. *The British Telecommunications Act of 1984*

The process of privatizing whole enterprises in Britain is well illustrated by the privatization of British Telecommunications.⁵⁸ British Telecommunications had traditionally been a part of the post office. In 1981, British Telecommunications split from the post office, pursuant to the Telecommunications Act of 1981.⁵⁹

Several years later, on April 1, 1984, a limited company with the same British Telecommunications name was created.⁶⁰ On April 6, 1984, in accordance with Section 60 of the Telecommunications Act of 1984,⁶¹ the corporate business of British Telecommunications was transferred to a limited company with the same name.⁶² Pursuant to Section 61 of the Telecommunications Act, the Secretary of State was issued all shares.⁶³ On November 16, 1984, the government offered 50.2% of the shares for sale to the public.⁶⁴

Section 70 of the Telecommunications Act of 1984 requires the government to provide information to the public in the form of a prospectus.⁶⁵ Specifically, it requires that any form of application for shares or debentures be issued either with a "full prospectus" or, if certain requirements are met, with an "offer prospectus."⁶⁶ A "full prospectus" is defined in Section 70(1) as a "prospectus which complies, or is deemed to comply, with the requirements of Schedule 4 to the Companies Act [of] 1948."⁶⁷

The Companies Act of 1948 governs corporations, including the prospectus requirements.⁶⁸ Schedule 4 to the 1948 Companies Act specifies numerous items that each prospectus must contain. The Act provides detailed information to all prospective investors.

58. See Graham & Prosser, *supra* note 48, at 21.

59. See British Telecommunications Act, 1981, Ch. 38, art. 10 (Eng.).

60. See Graham & Prosser, *supra* note 48, at 21.

61. See British Telecommunications Act, § 60, *supra* note 6, § 60.

62. See *id.*; see also Graham & Prosser, *supra* note 48, at 21.

63. British Telecommunications Act, *supra* note 61, § 61.

64. See Graham & Prosser, *supra* note 48, at 21.

65. Section 70 applies "where the Secretary of State or a nominee of his offers for sale to the public shares or debentures of the successor company at a time when that company is wholly owned by the Crown." Telecommunications Act, § 70(1). After the initial public offering, section 70 presumably no longer applies, leaving the Companies Act and other securities regulations to apply as they otherwise would.

66. *Id.* §§ 70(2)-(3).

67. *Id.* § 70(1).

68. See Companies Act, 1948 11 & 12 Geo. 6, ch. 38 (Eng.). The Companies Act was amended in 1985, and again in 1989.

Among the more important items the government must include in a prospectus are:

- 1) The number, description, and amount of any shares or debentures of the company which any person has,⁶⁹ as well as the names and addresses of the vendors;⁷⁰
- 2) The dates of, parties to and general nature of every material contract (not entered into in the ordinary course of the business), or contract entered into more than two years before the date of issue of the prospectus;⁷¹
- 3) A report by the company's auditors with respect to profits and losses, assets and liabilities, and the rates of the dividends paid by the company and in respect to each class of shares in the company in respect to each of the five⁷² financial years immediately preceding the issue of the prospectus (and if no accounts were made for any part of the five year period, a statement of that fact);⁷³
- 4) If the company has no subsidiaries, the report must deal with the profits or losses of the company in respect to each of the five⁷⁴ financial years immediately preceding the issue of the prospectus; and deal with the assets and liabilities of the company at the last date to which the accounts of the company were made;⁷⁵
- 5) If the company has subsidiaries, the report must either set out the company's profits and losses as a whole with the subsidiaries' combined profits, or list each subsidiary's profits and losses separately; and the company's assets and liabilities must also be set out either as a whole with the combined assets and liabilities of subsidiaries, or of each subsidiary individually;⁷⁶ and
- 6) If the company is to use the proceeds from the sale of shares or debentures to purchase any business, a report must be made by accountants (who must be named in the prospectus) as to the

69. *See id.* at schedule 4, § 7.

70. *See id.* at schedule 4, § 9(1). Studies have shown that information regarding the vendor of stocks can affect a stock's market price. *See Saari, supra* note 12, at 1047.

71. *See Companies Act*, schedule 4, § 14.

72. *See discussion supra* Part III.

73. *See id.* § 19(1).

74. *See discussion supra* Part III.

75. *See Companies Act*, § 19(2).

76. *See id.* § 19(3).

business' profits or losses for the preceding five⁷⁷ years, and its assets and liabilities at the last date to which the accounts of the business were made.⁷⁸

These requirements enable investors to discern the financial soundness of the company whose shares are being offered for sale. Furthermore, they provide information spanning a period of five years. Such a span of information allows investors to study trends in earnings and project future earnings. This helps investors to value the company's securities and determine whether they are a good investment.⁷⁹ This legislation thereby promotes fair pricing of the securities and market efficiency.

Furthermore, Sections 43 and 44 of the Companies Act set out stiff civil and criminal penalties, respectively, for providing untrue statements in the prospectus.⁸⁰

Section 43, which imposes civil liability, provides that all company's directors and everyone who has authorized the issue of the prospectus are liable to compensate anyone who purchases shares or debentures in reliance on untrue information in the prospectus.⁸¹ By creating civil liability "for the loss or damage . . . sustained by reason of any untrue statement included" in the prospectus, Section 43 substantially deters vendors from making any untrue statements in the prospectus.⁸² Furthermore, this section allays the private investors' fears by providing them recourse for their reliance on any untruthful information.

In addition to the civil liability, Section 44 further promotes the dissemination of truthful information by imposing criminal liability, with the possibility of imprisonment, on any person who authorizes the issuance of a prospectus containing untrue information.⁸³

The British Telecommunications Act of 1984 allows the Secretary of State to distribute application forms without having to issue each application with a full prospectus. For that exception to

77. See discussion *supra* Part III.

78. See Companies Act, Schedule 4, § 20.

79. See discussion *supra* Part III.

80. See Companies Act, §§ 43-44.

81. See Companies Act, Schedule 4, § 43.

82. See *id.*

83. See *id.* § 44. This section allows a person to avoid criminal liability if "he proves either that the statement was immaterial or that he had a reasonable ground to believe and did, up to the time of the issue of the prospectus, believe that the statement was true." *Id.* § 44(1)(b).

apply, the full prospectus must be published in at least four national newspapers before shares are sold, and copies of the full prospectus must be made “generally available in the United Kingdom for inspection by members of the public.”⁸⁴ When these conditions are met, the Secretary of State may issue, instead of a full prospectus, a “notice” (called an “offer prospectus”) that tells where a full prospectus can be obtained. The “notice” also briefly describes the shares offered, the terms of the offer, and the company’s financial position.⁸⁵ Presumably, this provision is merely a paper-saving exception. It allows the Secretary of State to issue an abbreviated notice, instead of a voluminous prospectus, that provides the most relevant information and that tells the prospective investor where he or she may obtain a full prospectus.

In short, the Telecommunications Act of 1984, by and through its incorporation of the Companies Act of 1948 (and its subsequent counterparts), provides a scheme for ensuring that potential investors have comprehensive, truthful information regarding the company’s financial situation. Such information promotes the underpinnings of the Efficient Capital Market Hypothesis.

V. PRIVATIZATION IN RUSSIA

A. *Historical Context*

1. The Soviet Era of State Ownership

A variety of factors led to the nationalization of industries in the Soviet Union.⁸⁶ In the last two decades of the nineteenth century, Russia underwent rapid and wide-scale industrialization at a rate that outpaced even the United States.⁸⁷ At the beginning of this century, Russia’s economy continued to develop. By some

84. Telecommunications Act 1984, § 70(3).

85. *See id.* § 70(2).

86. Although this Comment will not provide a comprehensive treatment of Soviet nationalization, the following discussion briefly overviews the subject. For a discussion on the fascinating nationalization efforts in Russia and the Soviet Union, *See* GEOFFREY HOSKING, *THE FIRST SOCIALIST SOCIETY, A HISTORY OF THE SOVIET UNION FROM WITHIN* (1990); *See also* NICHOLAS RIASANOVSKY, *A HISTORY OF RUSSIA* (4th ed. 1984).

87. *See* Stanley Fischer, *Russia and the Soviet Union Then and Now*, in 1 *THE TRANSITION IN EASTERN EUROPE* 221, 222 (Olivier Jean Blanchard, et al. eds., 1994).

estimates, Russia's national income in 1913 equaled that of the United Kingdom and slightly trailed that of Germany.⁸⁸

On November 7, 1917, the Bolsheviks took power in Russia.⁸⁹ Two days later, they organized the government of the Soviet Union.⁹⁰ While their seizure of power came rather easily, the Bolsheviks struggled for several years to consolidate their power.⁹¹ During their struggle to establish power, the Bolsheviks mobilized the resources and population they controlled, and implemented a policy of "War Communism," followed by a "New Economic Policy," (NEP).⁹² Subsequently, under Joseph Stalin's leadership, they developed the Five Year Plan (FYP), which survived into the Gorbachev era.

a. War Communism

War Communism refers to the period of Bolshevik control, characterized by large-scale nationalization of industry, which lasted from June 1918, until March 1921, when the NEP began.⁹³

Nationalization efforts were systematized with the decree of June 28, 1918.⁹⁴ The decree ordered the "nationalization, without recompense, of all industrial enterprises and railroads with capital of one million rubles or more owned by corporations or partnerships."⁹⁵ The state took over equipment and assets of the nationalized businesses, and managers were ordered to remain at their posts under the threat of severe penalties.⁹⁶

88. *See id.* at 221.

89. For a comprehensive treatment of the Great October Revolution of 1917, *see* RICHARD PIPES, *THE RUSSIAN REVOLUTION* (1990). For a somewhat more abridged treatment, *see* MARTIN MCCAULEY, *THE SOVIET UNION SINCE 1917* (1981).

90. The Old Style date was October 25, thus the name "the Great October Revolution." *See* RIASANOVSKY, *supra* note 86, at 461.

91. *See id.* at 474.

92. *See id.*

93. *See* MCCAULEY, *supra* note 89, at 33.

The large-scale nationalisation of June 1918, partly in response to the fear that vital industrial plants could fall under German control if left in private hands, saw all important enterprises placed under the control of VSNKh (the Supreme Council of the National Economy). Although Lenin would have preferred a mixed economy he finally accepted what most workers wanted, a socialist economy.

Id. at 34. For a discussion about the NEP, *see* discussion *infra* Part V.A.1.b.

94. *See* PIPES, *supra* note 89, at 692.

95. *Id.*

96. *See id.*

While War Communism saw the build up of a nationalized economy, the economy stumbled. Money became worthless, barter emerged on a large scale, and famine was rampant.⁹⁷ The dire economic situation caused peasant and military uprisings.⁹⁸

Although the Bolsheviks won the Civil War, they lost the economic war.⁹⁹ The Bolsheviks' lack of economic success throughout the civil war, perhaps more than any other factor, shaped the Soviet regime.¹⁰⁰

b. The New Economic Policy (NEP)

In March 1921, the Bolsheviks hesitantly changed their economic planning strategy because of the severe economic problems of the War Communism period.¹⁰¹ Their new policy, the NEP, legalized private trade, and generally took steps to ameliorate the harsh effects of the choke-hold policies of War Communism.¹⁰²

These steps partially succeeded. Industrial and agricultural

97. See MCCAULEY, *supra* note 89, at 33.

Something like eight million people perished during the years 1918–1920, seven and a half million due to hunger and disease. The working class was decimated, the cities lost many of their inhabitants and the intelligentsia was either dead or had emigrated. Culturally Russia was at a very low ebb.

Id. at 35.

98. See RIASANOVSKY, *supra* note 89, at 488. For example, in March 1921, the Kronstadt naval base, celebrated by the Communists as one of the sources of the October Revolution, rose in rebellion against the Communist rule Although Red Army units ruthlessly suppressed the uprising, the well-nigh general dissatisfaction with Bolshevik rule could not have been more forcefully expressed. And it was against this background of utter devastation and discontent that Lenin, who, besides, had finally to admit that a world revolution was not imminent, proceeded in the spring of 1921 to inaugurate his New Economic Policy in place of War Communism.

Id.

99. See MCCAULEY, *supra* note 89, at 33.

100. See *id.*

101. For a more comprehensive treatment of War Communism and the New Economic Policy, see generally Riasanovsky, *supra* note 86, at 474–91.

102. See Fischer, *supra* note 87, at 224–25.

If War Communism was a leap into socialism then the New Economic Policy (NEP) was a leap out of socialism. The extreme egalitarianism, the ever expanding role of the State, the breakneck speed of the attempt to make the economic life of the country socialist and the concomitant rejection of economic laws gave way to the legitimisation of small-scale commodity production and the acceptance of the market.

MCCAULEY, *supra* note 89, at 48.

output increased moderately,¹⁰³ and a class of wealthy retailers and traders, called the Nepmen, grew under this policy.¹⁰⁴ But all along, the Bolsheviks viewed the NEP only as a temporary and necessary economic measure,¹⁰⁵ tolerated as a compromise to maintain social peace.¹⁰⁶

Throughout the NEP, the government ensured its control over the Soviet economy by maintaining ownership of most of the country's major banks and heavy industries.¹⁰⁷ But even the NEP decayed. Leaders of the Communist Party criticized its provisions, perhaps in reaction to the failure of the German revolution in October 1923, and Lenin's death in 1924.¹⁰⁸

Due to these domestic crises and others, the NEP gave way to a new surge in nationalization. Five Year Plans replaced the NEP shortly after the inauguration of Joseph Stalin in December 1927.¹⁰⁹

c. *Stalin and Beyond—The Command Economy*

In 1928, the first Five Year Plan (FYP) replaced the NEP.¹¹⁰ Under the FYP, the private sector declined rapidly.¹¹¹ Beginning in 1928 and throughout his rule, Stalin had heavily emphasized the need for industrial build-up. In a February, 1931 speech, Stalin stated "One feature of the history of old Russia was the continual beatings she suffered because of her backwardness. . . . We are fifty or a hundred years behind the advanced countries. We must catch up this distance in ten years. Either we do it or we go under."¹¹²

While it is difficult to explain the ideological reasons behind the FYP, it can perhaps be best explained as an attempt to bring the Soviet economy into line with Marxist theory.¹¹³ Although

103. See Fischer, *supra* note 87, at 225.

104. See RIASANOVSKY, *supra* note 86, at 489; see also Fischer, *supra* note 87, at 226 n.15.

105. See RIASANOVSKY, *supra* note 86, at 495.

106. See DAVID SHEARER, *INDUSTRY, STATE, AND SOCIETY IN STALIN'S RUSSIA 1926-1934*, at 27 (1996).

107. See *id.* at 27-28.

108. See *id.* at 7.

109. See RIASANOVSKY, *supra* note 86, at 492-508.

110. See Fischer, *supra* note 87, at 226.

111. See *id.*

112. See HOSKING, *supra* note 86, at 150.

113. See RIASANOVSKY, *supra* note 86, at 494-95.

Marxism never mentioned five year plans, or even large-scale industrialization, it nevertheless presupposed high levels of industrialization, which Russia lacked.¹¹⁴ Whatever the explanation,

[t]he First Five-Year Plan and its successors hit the Soviet Union with tremendous impact. The U.S.S.R. became a great industrial nation: from being the fifth country in production when the plans began, it was eventually second only to the United States. . . . A vast social transformation accompanied the economic, while at the same time the entire Soviet system as we have come to know it acquired its definitive form in the difficult decade of the '30's.¹¹⁵

During the six-year period between 1930 and 1936, the Soviet Union collectivized almost all of the agricultural industry, with devastating consequences.¹¹⁶ While the output of industry at this time increased at a rapid 10% per year, millions died of famine in 1933 alone.¹¹⁷

World War II then began. It devastated the Soviet Union. The losses were so immense that they were almost incalculable: 70,000 villages, 98,000 kolkhozes, completely or partly destroyed, 1,876 sovkhoses, 17 million head of cattle and 7 million horses driven away; 65,000 kilometers of railway track, half of all the railway bridges in occupied territory, over half of all urban living space there, 1.2 million houses destroyed as well as 3.5 million rural homes. And then there was the greatest loss of all, the twenty million dead, as well as the maimed in body and in mind.¹¹⁸

The FYP remained the economic planning device up to and into the Gorbachev era.¹¹⁹ In short, ideology and necessity inspired Soviet nationalization. From 1917 until the end of Gorbachev's rule, the Soviet Union industrialized and nationalized the entire economy.

114. *See id.*

115. *Id.* at 494.

116. *See Fischer, supra* note 87, at 226.

117. *See id.*

118. MCCAULEY, *supra* note 89, at 138 (citations omitted).

119. *See generally*, JOHN L.H. KEEP, *LAST OF THE EMPIRES, A HISTORY OF THE SOVIET UNION 1945-1991*, at 337-41 (1995). In 1959, the Khrushchev government scrapped the then-current Five Year Plan and replaced it with a new Seven Year Plan, which was seen as somewhat more realistic. At the end of that Seven Year Plan, the government reinstated the Five Year Plan. *See RIASANOVSKY, supra* note 86, at 546.

2. The Early Reform Period

a. The Gorbachev Era

Although General Secretary Mikhail Gorbachev introduced the liberal policies of *glasnost*,¹²⁰ *perestroika*,¹²¹ and *uskorenie*,¹²² his government avoided “fundamentally disturb[ing] the crucial role of central planning or state ownership.”¹²³

In early 1987, Gorbachev issued the Joint Venture Decree, which opened the Soviet Union to foreign capital by allowing joint ventures with foreign entities. This seemingly minor proclamation “constituted in substance, if not intent, the first privatization decree.”¹²⁴ In June 1987, the Central Committee of the Communist Party of the Soviet Union adopted “Basic Tenets for the Radical Restructuring of the Management of the Economy” to serve as the official blueprint for economic reform.¹²⁵ These two pieces of Soviet legislation served as the basis for the first steps toward privatization.

By 1988, the Soviet State began to relax the close monitoring of enterprises.¹²⁶ At first, this had the result of diverting profits from public companies to private hands, and the development of a “black market.” In this market, factory employees and bureaucrats took products that they manufactured and later privately traded those products for goods produced by their friends, neighbors and acquaintances.¹²⁷

120. The term *glasnost* “first signified greater ‘openness’ in handling information from official sources and more lively self-criticism. Gradually it came to imply a limited freedom of expression in the media.” KEEP, *supra* note 119, at 342. For a complete discussion of *glasnost*, see STEVEN WHITE, GORBACHEV AND AFTER 17, 76–103 (1992).

121. The term *perestroika*, or “reconstruction,” commonly refers to the liberal economic policies of the Gorbachev era. See MARSHAL GOLDMAN, WHAT WENT WRONG WITH PERESTROIKA 124 (1992).

122. The term “uskorenie,” or “acceleration,” refers to the policy of “introducing new technologies, such as computerization, and shifting investment into modernizing the engineering industry.” KEEP, *supra* note 119, at 339.

123. Richard C. Schneider, *Privatization in One Country: Foreign Investment and the Russian Privatization Dynamic*, 17 HASTINGS INT’L & COMP. L. REV. 697, 703 (1994).

124. *Id.* at 715. For a discussion on foreign investment laws relating to oil and gas industries in the pre-privatization period, see Lisa Halustick, Note, *Privatization of the Russian Oil and Gas Industries*, 2 PARKER SCHOOL J.E. EUR. L. 201 (1995).

125. See Schneider, *supra* note 123, at 703.

126. See Andrei Shleifer & Robert W. Vishny, *Privatization in Russia: First Steps*, in 2 THE TRANSITION IN EASTERN EUROPE 137, 146 (Olivier Jean Blanchard, et. al. eds., 1994).

127. See *id.*

Lax laws, lenient law enforcement, and bribing of local law enforcement officials made a growing black market possible.¹²⁸ In mid-1989, however, the Supreme Soviet established the Abalkin Commission. In October of that year, this commission proposed a new approach to economic reform and introduced the idea of non-state ownership in the context of worker control.¹²⁹

In November 1989, one of the first legislative steps toward privatization came when the USSR Supreme Soviet adopted the Fundamentals of the USSR and the Union Republics on Leasehold (the Fundamentals). Under the Fundamentals, "the work collective of a state enterprise was given the right to form an organization of leaseholders (tenants) as a free standing legal person for the purpose of founding a leasehold enterprise."¹³⁰

For a variety of reasons, however, the Fundamentals failed. Department and ministry officials, armed with discretion over many of these transactions, often refused to lease state property.¹³¹ Even when they did grant leases, the Fundamentals "placed restrictions on the leasing of a fairly wide range of state owned facilities and also on buyouts."¹³² These problems caused great difficulties in attaining the desired objectives of boosting economic production by handing over state property to work collectives and citizens.¹³³

Another main turning point in the process toward privatization came with the "500-day plan," which economist Stanislav Shatalin and others created and presented to the USSR Supreme Soviet in late 1990.¹³⁴ The proposal identified "universal

An enterprise manager sets up a parallel private firm or cooperative next to the state firm or even inside it. That private firm then buys the output of the state firm at the official controlled price and resells it at the market price. The profits are in part kept by the managers, who of course are the owners of the private firm, and in part distributed as higher wages to the workers.

Id.

128. *See id.* "Informal reports indicate that most state enterprises that produced desirable output have engaged in at least some form of such profit diversion. Gains for all parties at the expense of the central government made spontaneous privatization very popular in Russia." *Id.*

129. *See Schneider, supra* note 123, at 705.

130. Andrei A. Voitko, COMMENTARY: *Privatization of State and Municipal Enterprises*, in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA 2-36 (Mark C. Swords ed. & Russica Information, Inc. trans., 1995).

131. *See id.*

132. *Id.*

133. *See id.*

134. *See Schneider, supra* note 123, at 707.

state ownership" ["*vseobshchenost' gossobstvennosti*"] as one of the main factors responsible for the failure of the Soviet economy.¹³⁵ Under the plan, the process of instituting the reforms were to be known as the "*destatization*" stage, the completion of which would lead to a full-scale privatization program.¹³⁶

In September of 1990, the Supreme Soviet gave President Gorbachev the power to regulate the economy by decree until March 31, 1992.¹³⁷ Pursuant to this authority, Gorbachev proposed a reform plan that carried over many of the ideas contained in the 500-day plan. This plan, however, lacked specifics and failed to set forth a detailed timetable for the privatization of state properties.¹³⁸ As a result, this plan was viewed as largely unsuccessful.

At the same time, the wall separating East and West Berlin fell, symbolizing the open failure of Communism. A stark demonstration of discontent with Gorbachev's leadership culminated in an attempted coup in August 1991.¹³⁹ On October 28, 1991, after months of uncertainty in the wake of the failed coup attempt, President Gorbachev declared that disorganization and a "paralysis of power" were leading the Soviet Union towards financial collapse.¹⁴⁰ On December 25, the Soviet Union was dissolved, ending Gorbachev's rule.

Although the Soviet economy was partially liberalized during Gorbachev's rule, privatization was never seriously considered. Indeed, many Russians condemn Mikhail Gorbachev for not doing more to create a free market economy and privatize industries.

3. The Yeltsin Approach to Privatization

On July 3, 1991, the Russian Federation parliament enacted the Russian Federation Privatization of State and Municipal Enterprises Act (Privatization Act).¹⁴¹ The Act sought to "lay

135. *See id.*

136. *See id.*

137. *See id.* at 708.

138. *See id.*

139. *See* WHITE, *supra* note 120, at 23.

140. *See* Anthony V. Raftopol, *Russian Roulette: A Theoretical Analysis of Voucher Privatization in Russia*, 11 B.U. INT'L L.J. 435, 440 (1996).

141. *See* Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), *Economic Law of Russia*, reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. & Russica Information Inc. trans., 1995). This Act is the main

down the legal and organizational principles for transforming property relations in producer goods in the RF (Russian Federation) through privatization of state and municipal enterprises with the aim of creating an efficient and socially oriented market economy.”¹⁴² The attempted coup in August and the subsequent collapse of the Soviet Union, however, delayed the Act’s implementation.¹⁴³

The official breakup of the Soviet Union came on December 25, 1991. That day also marked the so-called “war of legislation” by the Russian Federation, which began to introduce full-scale privatization legislation¹⁴⁴ to supplement and extend the Privatization Act.

On December 30, 1991, then-Deputy Prime Minister Yegor Gaidar revealed Russia’s 1992 plan for privatization. The plan aimed to privatize in two stages. During the first six months, efforts were devoted to privatizing various industries such as retail and wholesale trade, certain state agricultural enterprises and equipment repair sites, and various food services. During the second six months privatization efforts focused on, among other things, small light industry, construction, and road repair facilities.¹⁴⁵

On January 2, 1992, the Russian government liberalized prices, exacerbating the already severe market shortages.¹⁴⁶ On January 29, 1992, President Boris Yeltsin issued President’s Edict No. 66, which set out the basic structure of privatization in seven appendices.¹⁴⁷

In July of 1992, the Russian government undertook its mass privatization program.¹⁴⁸ Without any evidence of thorough

focus of this Comment.

142. *Id.*

143. See Peter Rutland, *Privatization in Russia: One Step Forward: Two Steps Back?*, 46 EUR.-ASIA STUD. 1109, 1110 (1994).

144. See Kent F. Moors, *The Failure of Russian Privatization 1992-1994: How the Industrial Nomenklatura Prevented Genuine Reform*, 3 J. INT’L LEGAL STUD. 1, 5 (1997).

145. See Moors, *supra* note 144, at 8.

146. See *id.* at 9. To give the reader an example of the severity of the market shortages, it is worthy of mention that when the author of this Comment visited Khmel’nitsky, Ukraine, in the Summer of 1990, he witnessed a large shopping mall, which had previously been in full operation, completely closed and devoid of all goods and services.

147. See RF President’s Edict No. 66, Jan. 29, 1992, annexes 1-7; see also Moors, *supra* note 144, at 9.

148. See Moors, *supra* note 144, at 24.

planning, the government ordered that 25,000 firms be converted into joint-stock companies. In November, 1992, it issued 148 million vouchers, each simplistically and curiously with a nominal value of 10,000 rubles.¹⁴⁹

The Russian privatization process can be broken down into the following stages: 1) the creation of joint-stock companies; 2) the distribution of privatization vouchers; 3) the establishment, regulation, and coordination of state-run auction houses for the trade of enterprise shares for vouchers; and 4) the creation of financial middlemen, information systems, and voucher investment funds.¹⁵⁰ The first two stages serve best to contrast the British privatization experience with that of Russia.

a. Creating Joint-stock Companies

In privatizing, Russian companies had discretion to select one of three plans.¹⁵¹ Each company would vote on its plan at a general meeting of the work collective, each employee having one vote.¹⁵²

Under the first option, a company could provide its workers with twenty-five percent of the non-voting shares, and the management with five percent of the voting shares at a nominal price.¹⁵³

The second option allowed managers and workers to use cash or vouchers to acquire fifty-one percent of the voting shares at 1.7 times the July, 1992 book value.¹⁵⁴ A majority of companies, contrary to the expectation of the government, chose this option over the others.¹⁵⁵

The third option allowed managers to purchase forty percent of the company's voting shares if they gave assurances that the company would continue its operations.¹⁵⁶

149. See Edict Enacting RF System of Privatization Vouchers; Statue of Privatization Vouchers (RF President's Edict No. 914, Aug. 14, 1992), reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.36 (Mark C. Swords ed. & Russica Information Inc. trans., 1995).

150. See Raftopol, *supra* note 140, at 454.

151. See J. Robert Brown, Jr., *Order from Disorder: The Development of the Russian Securities Markets*, 15 U. PA. J. INT'L BUS. L. 509, 514 (1995).

152. See Moors, *supra* note 144, at 26.

153. See Brown, *supra* note 151, at 514-15. See also Sutela, *supra* note 3, at 420.

154. See Brown, *supra* note 151, at 515.

155. For an explanation of the reasons for this, see Sutela, *supra* note 3, at 420.

156. See Brown, *supra* note 151, at 515.

*b. Vouchers*¹⁵⁷

The privatization voucher program was introduced on August 14, 1992, through the issuance of Edict No. 914.¹⁵⁸ The voucher program constituted a critical component of the privatization effort in Russia. In Britain, privatizing industries was achieved simply by putting the target companies' shares up for sale on the open-market. This method is just, assuming that each citizen has relatively equal access to wealth, fair access to the purchasing of shares, and full and truthful access to information about the privatized companies.

Russia, however, faced a different situation. Rather than privatizing a relatively small percentage of companies, Russia underwent massive privatization at a very rapid pace.¹⁵⁹ Furthermore, the common Russian citizen did not have enough capital to invest in companies had they simply been sold.¹⁶⁰ If privatization in Russia was to have any semblance of fairness, a system would have to be devised whereby the entire country's holdings (or those that were to be privatized) would be divided up into equal shares and distributed equally. The solution settled upon was the voucher system.

157. For a good overview of voucher legislation, see Aleksandr Postnikov, *Commentary, Privatization Vouchers*, in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.42 (Mark C. Swords ed. & Russica Information Inc. trans., 1995). For a discussion on the political reasons for voucher privatization in Russia (as opposed to privatization by sales, such as in Great Britain), see Maxim Boycko et al., *Voucher privatization*, 35 J. FIN. ECON. 249 (1994).

158. See Edict Enacting RF System of Privatization Vouchers; Statute of Privatization Vouchers, RF President's Edict No. 914, *reprinted in* 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.36 (Mark C. Swords ed. & Russica Information Inc. trans., 1995); see also Moors, *supra* note 144, at 30.

159. For example, by the end of the voucher phase of privatization in June 1994, about 70% of government enterprises had been transferred to private ownership. See Brown, *supra* note 151, at 514.

160. See Boycko et al., *supra* note 157, at 254. A low level of wealth among common citizens does not by itself pose a significant problem for privatizing through sales, because if everyone were equally poor, the price of securities would simply be very low. More importantly, however, in Russia there is a dramatically uneven distribution of wealth. During the voucher privatization stage in Russia, there existed a sizable class of black market businessmen and ex-communist officials who were extremely wealthy. See *id.* Privatizing by sales in the face of such an unbalanced distribution of wealth would give the wealthy class an extremely unfair advantage. The appeal of voucher privatization, then, is to allow a much broader segment of the population to participate in the privatization process. See *id.*

Each Russian citizen stood to receive one privatization voucher with a face value of 10,000 rubles. With this voucher he could theoretically do one of three things: 1) trade it for shares of joint-stock companies; 2) trade it privately with other individuals; or 3) use it to purchase stocks in investment funds.¹⁶¹ In practice, however, each of these three options had severe limitations. This Comment focuses primarily on one limitation of the first option, i.e. the lack of information provided to investors, precluding them from investing intelligently directly in the privatized companies.

B. Objectives of Russian Privatization

The Law of the Russian Federation of July 3, 1991, Privatization of State-owned and Municipal Enterprises Act¹⁶² ("Privatization Act") sets out a rather lengthy definition of privatization:

Privatization of state and municipal enterprises [means] the purchase by citizens and joint-stock companies (partnerships) from the state and local Soviets of People's Deputies into the private ownership of enterprises, shops production sectors and other divisions of these enterprises set up as independent enterprises; equipment, buildings, structures, licenses, patents, and other tangible and intangible assets of enterprises in operation and those wound up by decision of agencies duly authorized to take such decisions on behalf of the owner; holdings (stakes, shares) of the state and local Soviets of People's Deputies in the capital of joint-stock companies (partnerships); holdings (stakes, shares) owned by enterprises up for privatization in the capital of other joint-stock companies (partnerships), and also of joint ventures, commercial banks, associations, concerns, unions and other associations of enterprises.¹⁶³

The State Program of Privatization of State-Owned and Municipal Enterprises in the Russian Federation sets out the main objectives of Russian privatization. It identifies these goals as:

161. See Raftopol, *supra* note 140, at 455.

162. See Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), Economic Law of Russia, reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. & Russica Information Inc. trans., 1995); see also Georgi G. Angelov, *Legal Framework of Privatization in Russia*, 2 MINN. J. GLOBAL TRADE 207, 210 (1993).

163. *Id.*

- 1) the formation of a broad stratum of private owners as the economic basis of market relations;
- 2) the attraction of broadest possible spectrum of the population to the privatization process by means of the sale of denationalized state-owned and municipal property for privatization cheques (vouchers) via special cheque (voucher) auctions held prior to July 1, 1994, and for money at auctions held after July 1, 1994;
- 3) the completion of privatization with privatization cheques (vouchers), completion of privatization of objects of "small-scale privatization" and the accelerated development of trade in the consumer services sphere;
- 4) the completion of the privatization of most large and medium-scale enterprises in industry and construction, enhancing the efficiency of enterprises and the national economy as a whole on the basis of restructuring the economy, expansion of post-privatization support to enterprises, creation of a competitive environment, and the development of a securities market;
- 5) the attraction of investment, including foreign investment, in production; and
- 6) the promotion of measures aimed at providing the population with social protection, including the protection of stockholders' rights.¹⁶⁴

The reforms, according to the Program, will "deregulate the economy, stabilize the financial and monetary system, privatize state-owned property, develop entrepreneurship, make structural adjustments to and demilitarize the economy, and create a competitive market environment and an active social policy."¹⁶⁵

The British campaign for privatization largely reflected a conservative political movement. Privatization in Russia, however, comes not only amid vast political change, but also amid an onslaught of truly revolutionary transformations of the government, society, culture, and economy. Privatization in Russia is one aspect of a broader reform strategy which stresses four points: "macroeconomic stabilization (stabilization of the

164. See The State Program of Privatization of State-owned and Municipal Enterprises in the Russian Federation (Approved by Decree of the President of the Russian Federation No. 2284 of December 24, 1993) (GARANT 10001975), Economic Law of Russia, March 14, 1996.

165. Angelov, *supra* note 162, at 208.

ruble); the freeing of prices and economic activity in general by ending central planning; comprehensive privatization; and the continued provision of essentials to the impoverished (a social safety net)."¹⁶⁶

C. *The Pitfall—Article 18 of the Privatization Act*

The Privatization of State and Municipal Enterprises Act of July 3, 1991 (Privatization Act), according to its own terms, "lay[s] down the legal and organizational principles for transforming property relations in producer goods in the RF [Russian Federation] through privatization of state and municipal enterprises with the aim of creating an efficient and socially oriented economy."¹⁶⁷ The Act contains a total of thirty-one articles, arranged in three chapters: general provisions (arts. 1-12); procedure and modes of privatization of state and municipal enterprises (arts. 13-26); and concluding provisions (arts. 27-31). The Privatization Act is one of the core acts of the Russian privatization legislation.¹⁶⁸

Article 18 of the Privatization Act sets out the statutory requirement for providing information regarding the companies being privatized.¹⁶⁹ Only minimal information must be provided.

Clause one of Article 18 mandates that information on the privatized state and municipal enterprises, and on the results of that privatization, be "published in special bulletins of properties funds"¹⁷⁰ at least one month before competitive bidding or auction, or offer of shares for public sale.¹⁷¹

In privatizing municipal enterprises, the information may be published in the unrealistically short period of two weeks prior to

166. Schneider, *supra* note 123, at 701-02.

167. Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), Economic Law of Russia, art. 27, reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. & Russica Information Inc. trans., 1995).

168. See Voitko, *supra* note 130, at 2-38.

169. See Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), Economic Law of Russia, art. 18, cl. 1, reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. & Russica Information Inc. trans., 1995).

170. For enterprises with authorized capital in excess of 50 million rubles, information must be published in the Bulletin of the Russian Federal Properties Fund. See *id.*

171. See *id.*

the sale.¹⁷² Furthermore, unlike the British Telecommunications Act, which mandates either the issuance of a full prospectus with every form of application or an offer prospectus, which tells the public where they can find a full prospectus, Article 18 makes no mention of where citizens may find the “special bulletins.”

Where the British Privatization Act provides generally for 5 years of financial data, Article 18, clause two of the Privatization Act only requires the publication of a balance sheet for the one year preceding privatization.¹⁷³ That Clause only mandates the publication of:

- the area of the land parcel and description of the structures located on it and the terms of their lease or sale;
- holdings (stakes, shares) in the capital of other enterprises owned by the enterprise (if any);
- intangible assets (patents, trademarks, and others);
- the obligations of the enterprise (commercial, budgetary, credit);
- the enterprise balance sheet for the past year;
- overall product mix; [and]
- average listed number of employees.¹⁷⁴

In addition to the above requirements, Article 27 requires that, “irrespective of the mode of privatization, a contract shall be concluded between the vendor and purchaser of a state or municipal enterprise.”¹⁷⁵ That article also requires that the contract recite:

information about the vendor, the purchaser, and the broker; the name of the enterprise and its location; the structure and price of enterprise assets, including the price of the land parcel (in the event of its sale) or the terms of its lease; the number and price of shares in joint-stock company (holding in partnership); procedure for transfer of the enterprise, form and

172. *See id.*

173. *See discussion, supra* note 19.

174. Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), Economic Law of Russia, art. 18, cl. 2, *reprinted in* 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. & Russica Information Inc. trans., 1995).

175. *Id.* art. 27.

dates of payment, and mutual obligations of parties in further use of enterprise, terms on which the given enterprise was sold by bidding; and other conditions laid down by mutual agreement between the parties.¹⁷⁶

Article 28 specifies the duties of the vendor and purchaser as follows:

The vendor . . . shall have the duty to publish notice of its privatization, to produce for the purchaser on demand the assets of the enterprise and the statements on its business and financial condition, complete the transaction formalities, convey the enterprise (assets, stakes, shares) to the purchaser, and perform other obligations in conformity with the contract between the vendor and the purchaser.¹⁷⁷

In short, the Privatization Act merely requires that minimal financial data, such as a balance sheet for the past year, be published in so-called "special bulletins of properties funds" within two to four weeks of being put up for sale. Such limited information, if the public receives it at all, provides no more than a snap shot of the balance sheet of the privatized entity. The Act even fails to require that the privatized enterprises' profits and losses be disclosed. Such a paucity of information prevents an investor from gathering the necessary information to find trends in earnings, undermining his ability to determine whether the company's securities are a good investment.¹⁷⁸

Not only are the Privatization Act's information requirements weak, but the penalties for non-compliance with the Act are comparatively weaker than the British Telecommunications Act. Specifically, Article 29 of the Russian Privatization Act—the enforcement article—provides that the state will "guarantee respect for the rights of vendors, purchasers, their agents and brokers."¹⁷⁹ It further provides that where the privatization legislation has been breached, various entities, including purchasers, can "file lawsuits (take action) for rescission of transactions, elimination of breaches, and institution of

176. *Id.* art. 27 (2).

177. *Id.* art. 28 (1).

178. See discussion *supra* Part III.

179. See Law of the Russian Federation No. 1531-1 of July 3, 1991 on the Privatization of State and Municipal Enterprises in the Russian Federation (GARANT 10005710), Economic Law of Russia, art. 29, reprinted in 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.02 (Mark C. Swords ed. & Russica Information Inc. trans., 1995).

proceedings against the person at fault.”¹⁸⁰ Article 30 provides that privatization actions shall be deemed invalid where, among other things, the bidding or auction rules are “grossly violated.”¹⁸¹ In contrast to British legislation, the Russian provisions lack an intent element and fail to describe actions that amount to “grossly violated.”

Article 31, clause one, provides for administrative liability for, among other things, the failure to provide information as follows:

nonpublication of privatization notice, concealment of information about an enterprise up for privatization from purchasers or brokers, misleading the purchaser or broker concerning assets structure or price of the enterprise up for sale concealment of information concerning the fact of enterprise sale, and of outcome of competitive bidding or auction—a fine in the amount of 10 to 30 times the statutory minimum monthly wage. The information listed in the present Clause shall be published at the expense of the person at fault.¹⁸²

Taken together, these provisions do not explicitly mention the possibility of imprisonment for violation, nor do they explicitly provide for full compensation for losses resulting from the publication of false information.

In the years following 1991, the State Committee for the Management of State Properties (“Goskomimushchestvo”) drafted, and the Yeltsin government enacted, a whole series of legislation that supplemented and implemented the Privatization Act. The supplementary legislation generally does not appear much better than the Privatization Act in terms of information requirements. For example, the Provisional Statute on Privatization by Auction of State and Municipal Enterprises in the RF, enacted January 29, 1992, requires that vendors of enterprises for sale publish in the “local press” and in “special information bulletins” only basic information.¹⁸³ While it requires the

180. *Id.*

181. *Id.* art. 30.

182. *Id.* art. 31, cl. 1.

183. That statute requires the publication of:

- 1) the area of land parcel and a description of structures located thereon; 2) the volume and basic mix of products, goods and services, the market share, and the size and structure of the work force; 3) a list and a valuation of fixed assets by groups, including nonproducer facilities; 4) started investment projects, their estimated cost, and outlays to date; 5) state of money assets; 6) stocks and inventories; 7) enterprise owned securities, holdings and stakes in the authorized

publication of little more significant information than does the Privatization Act, it at least mandates that profit and loss accounts be divulged.

Another example of subsequent legislation is the Decision of the Government of the Russian Federation No. 547, passed in August 1992.¹⁸⁴ That Decision sets out the procedure for registering shares of public companies (joint-stock companies). The decision provides that joint-stock companies publish "information about the issue of shares, in the mass media,"¹⁸⁵ and provides for the "open sale of shares."¹⁸⁶ Article 7 of the Decision requires information similar to the Privatization Act. Like its predecessor, it neglects to define key terms such as "mass media," and requires only rudimentary information.¹⁸⁷ Article 9.5 requires

capital of other enterprises, and intangible assets (patents, trademarks and others); 8) enterprise obligations (commercial, budgetary, credit); 9) annual balance sheet and profit-and-loss accounts for the previous year [note, in contrast to the British requirement of five years of financial data, this requirement overlooks the investor's need for long-term stability analysis]; 10) the form of the auction sale; 11) the initial selling price; 12) a procedure for the preliminary inspection of the objects by auction participants; 13) a closing date for acceptance of applications and other documents for participation in the auction; 14) the date, time and venue of the auction sale; and 15) the vendor's telephone number.

Provisional Statute on Privatization by Auction of State and Municipal Enterprises in the RF, to RF President's Edict No. 66, annex no. 4 (Jan. 29, 1992), *reprinted in* 1 BUSINESS AND COMMERCIAL LAWS OF RUSSIA § 2.08 (Mark C. Swords ed. & Russica Information Inc. trans., 1995).

184. See Garant 4321, Decision of the Government of the Russian Federation No. 547 of Aug. 4, 1992 on Measures of Realizing the Decree of the President of the Russian Federation No. 721 of July 1, 1992 on the Organizational Measures for Converting State-owned Enterprises and Voluntary Associations of State-owned Enterprises into Joint-stock Companies (amended July 12, 1993), Regulations for the Order for Registering Shares of Public Companies Set Up During Privatization, art. 2, § 3.

185. See Decision No. 547 of August 4, 1992 on Measures of Realizing the Decree of the President of the Russian Federation No. 721 of July 1, 1992 on the Organizational Measures for Converting State-owned Enterprises and Voluntary Associations of State-owned Enterprises into Joint-stock Companies (amended July 12, 1993), art. 2, § 3.

186. *Id.* art. 2, § 5.

187. *Id.* art. 7. Specifically, Article 7 requires the publication of:

- 1) the full name and legal address of the joint-stock company; 2) the size of the authorized capital (the total volume of the issue of shares at their nominal value); 3) the nominal price of one share; 4) the amount of balance profit for 1991, and for the last date of account; 5) the number and nominal value of shares allocated to the labour organization members, and to persons entitled to receive benefits in accordance with the legislation of the Russian Federation on privatization; 6) the number and nominal value of shares offered for open sale; 7) the time-limit for the beginning of open sale; and 8) the address and location,

that shares be "sold openly upon publication of the information about the issue of shares in the mass media."¹⁸⁸

VI. COMPARATIVE LEGAL ANALYSIS

A. Observations & Analysis of British Privatization Laws

The British Telecommunications Act of 1984 provides ample information to potential investors. As a result of the requirement that either a full prospectus or offer prospectus be issued in selling securities, investors receive full, reliable disclosure of the company's financial records. Particularly, investors may analyze the company's financial data for each of the five years preceding the privatization sale. Such information is critical to potential investors because in its absence, they cannot discern trends in earnings, and thereby, properly value securities offered for sale.¹⁸⁹

In addition to setting out the requirements, the Companies Act provides stiff criminal and civil penalties. This aspect of the British privatization legislation ensures that the vendor of securities adheres to the information requirements.

B. Observations & Analysis of Russian Privatization Laws

Although the Russian privatization efforts have been largely successful in transferring numerous industries from public to private hands, many pitfalls compromised Russian privatization legislation. The shallow information requirements of its privatization laws and the massive scope of its privatization efforts hinder Russia's success in transforming into an efficient market economy. Perhaps most problematically, Russia's Privatization Act merely provides investors with a snap shot of financial information, preventing them from making fully informed investment decisions.

Insufficient enforcement agencies and poorly-defined standards requiring dissemination of information caused a

the telephone number of the organization in which buyers may get acquainted with the prospectus issue (privatization plan), to learn about the time and place of sale, and the telephone number of the seller.

Id.

188. *Id.* art. 9.

189. See generally BUFFETT & CLARK, *supra* note 18.

majority of individuals,¹⁹⁰ in practice, to either place their vouchers in private investment funds¹⁹¹ or to trade their vouchers privately.¹⁹² The frustrations and difficulties caused by the Russian voucher legislation prompted many Russians to sell their vouchers to entrepreneurs and wealthy capitalists. In return, the former voucher holders received a mere bottle of vodka or other foodstuffs at a time when the face nominal value of the vouchers was 10,000 rubles.¹⁹³ Furthermore, even if there had been greater efforts to disseminate accurate material information, the sheer scale and pace of privatization would have made enforcement very difficult, if not impossible.

VII. CONCLUSION

In the context of securities investment, an investor needs full, accurate, and reliable information about the companies being sold. The Russian public never had such information during the massive privatization that occurred in Russia throughout this decade. Some scholars have gone so far as to suggest that:

[i]f [Russian] privatization was seen as an attempt to break the traditional hold on industrial power, it failed. Ultimately, capitalization will provide sufficient investment and working capital for some, leaving others to either fend for themselves or declare insolvency. But we shall not see the real transfer of board room power from the old guard to the new capitalists for

190. As some commentators have noted, in practice, the common Russian citizen had little ability to personally bid on and invest directly in private companies. "Despite a series of presidential edicts to guarantee public awareness, require advance announcement of auctions and tenders, and provide equal access, the real alternatives to investment funds were nonexistent." Moors, *supra* note 144, at 33.

191. Private investment funds, or mutual funds, present a separate problem. Most private funds became classic "Ponzi" schemes that paid large dividends to early investors with money collected from later investors. Such "pyramiding" was possible because of the astronomical inflation rate (which was doubling every month throughout the voucher period) and because "the market for additional subscribers was wide open Only the investment funds could provide [an] avenue [for investment which could keep pace with inflation]." Moors, *supra* note 144, at 32. A classic and prominent example of such pyramiding schemes in Russia is the failed "MMM" stock fund, which collapsed in July 1994. In television ads, MMM promised annual returns of 7500% after a year, and as many as ten million people invested and lost their money in MMM. See *Russian Investors Learn Tough Lesson*, USA TODAY, Aug. 1, 1994, at 5B.

192. See *id.*

193. For this assertion, the author relies on his conversations with various Russian citizens who participated in the voucher program.

perhaps a generation.¹⁹⁴

In contrast, the British Telecommunications Act of 1984 requires full disclosure of financial records over the five years preceding the privatization. Furthermore, the enforcement provisions of this Act strongly discourage circumvention of the information requirements. Together, these provisions promote the fair pricing of securities and equal access to the privatization process.

Privatization laws and regulations must be written to ensure full, accurate and reliable information. They must also ensure the enforcement of these requirements. To provide an adequate enforcement infrastructure, lawmakers must consider the rate and scope of privatization. Rapid privatization and massive sell-offs, such as those implemented during the Russian privatization efforts, impose large risks and perhaps will inevitably encounter many problems.

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194. Moors, *supra* note 144, at 51.

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