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Interim Report **IR-01-062**

Institutional Traps of Russian Forest Enterprises: A Lawyer's View

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21 December 2001

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Abstract

Nowadays, it is generally recognized that it is necessary to change the institutional framework to achieve sustainability of the Russian forest sector. However, before being able to change things for the future one should know what the current situation is like. The aim of this paper is to study the institutions connected with the Russian forest sector from the point of view of a legal department of an individual forest industrial enterprise. The paper discusses the role of the lawyer in a forest enterprise, the main legal problems that Russian forest enterprises face in their business operations, and possible solutions to these problems based on foreign experiences.

Acknowledgments

I would like to thank everyone who contributed to the completion of this paper. I am much indebted to everyone in the Forestry Project, and especially to my supervisor, Soili Nysten-Haarala, for her careful attention to my work and her many useful remarks. I also appreciated the comments I received from Mats-Olov Olsson, Lars Carlsson and Sten Nilsson. I would also like to thank the Russian Academy of Sciences for giving me the opportunity of spending a wonderful summer in Austria and participating in IIASA's Young Scientists Summer Program in 2000.

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Institutional Traps of Russian Forest Enterprises: A Lawyer's View

Maria Kotova

1 Introduction

Today, it is generally recognized that an institutional "deadlock" exists in the Russian forest sector and that it is necessary to change the institutional framework to achieve sustainability in the sector. Even if both Russian and foreign scholars agree on the problems, there is still no real agreement on the methods and ways for resolving this institutional deadlock or on how to avoid what Polterovich (1999) calls "institutional traps." Such institutional traps constitute a major obstacle for any reform process, and it is therefore an urgent task in the current transition to find ways of avoiding these traps.

Any economy may function well when it is supported by a proper legislation regulating the business environment. Since Russia started to transfer from a centrally planned economy to a market economy, legislation has lagged behind. Ten years have now past since 1991, when Russia declared its independence and started its transition to a market economy. One purpose of this paper is to study the situation of Russian economic legislation in order to find out what has changed and what still remains to be done.

There is one myth, which has harmed many economies throughout the world, including the Russian economy. It is the belief that efficient markets can develop spontaneously and in a short time if only an appropriate legislation is established. But all legislative changes allow for the development of different institutions or norms of behavior, and it is not easy to predict which direction developments will take (Polterovich, 1999).

Here, it is argued that the Russian economic legislation has a lot to offer in support of economic growth. But enterprises have to struggle with many institutional problems that are mainly connected with the lack of mechanisms supporting the implementation of the economic legislation.

Polterovich (1999) names six main factors that play an important role in the formation of stable norms or institutions. These are:

1. The structure of individual preferences.
2. Punishment for violations of norms that are stipulated by law or supported by local tradition.
3. The coordination effect — the more consistently a norm is observed in society, the greater are the costs incurred by each individual deviating from it.

4. The learning effect — the prevalent norm becomes permanent as a result of agents learning to be more efficient in observing the norm and improving their skills in applying it.
5. Cultural inertia — denotes agents' reluctance to question behaviors that are already proven to be viable.
6. The linkage effect — with time, an established norm is linked with other norms and rules and internalized in the system of norms.

This paper aims to achieve two things. First, it studies how measures that are supposed to contribute to institutional stability turn out to be inefficient for the activities of a forest enterprise. The second is to investigate ways of overcoming such institutional traps.

Since the author works as a lawyer in a private pulp and paper mill this paper has been written from a business point of view.

The second section of the paper deals with the legal services of a forest enterprise. The section presents the structure of a legal department, explains its legal competence, as well as how it interacts with other departments of the enterprise. Section three is dedicated to problems arising in forest enterprises' relations with their customers and suppliers. Section four focuses on the problems connected to the regulation of international trade and the exports of forest products. The fifth and sixth sections deal with different means of contract enforcement, especially the court system and the institute of arbitration in Russia. Section seven discusses the problems that forest enterprises encounter in the sphere of environmental control. The eighth section deals with the social activities that are the responsibility of a forest enterprise. And finally, section nine gives a summary overview of the findings of the paper.

2 The Role of an In-house Lawyer in a Russian Forest Enterprise

During the Soviet period, the role of an enterprise lawyer was rather insignificant. This can first of all be explained by the existing legislation, which regulated the relations between commercial enterprises. Central planning took care of most of the business relations and the enterprise did not need a lawyer for finding solutions in legal deadlocks. The lawyer's role was just to make standard claims as well as to participate in the state arbitration hearings. During the Soviet period, state arbitration was a non-judicial body, where decisions were made based on strictly formal legal norms. For example, regulations existed on the delivery of products for technical purposes and regulations on the delivery of consumer goods. These regulations strictly governed the procedure of delivery, acceptance of goods, quality checks, the procedure for claims, and even the amount of the fines for each violation of the regulations.

The work of lawyers in enterprises was mostly technical. Therefore, those who graduated from law faculties tried to find a job either within law enforcement or in the courts, where the work was more interesting and the salary higher than in enterprises.

Working as a legal advisor of an enterprise was considered to be an unsuccessful legal career.

This situation significantly changed during the 1990s. The change of the political regime led to changes in legislation and made lawyers' work much more creative.

After 1990, the legislation has become more complicated and this has led to a demand for people who can handle legal problems. Businessmen, especially those who recently started their business activities, have found it impossible to function in the market without legal aid. The necessity of legal aid became even more obvious when businessmen realized that it is possible to sue public authorities — the tax inspection has become an especially interesting authority to sue.

Thus, the attitude towards lawyers and their professional role has changed. It has become prestigious to work as a legal adviser in an enterprise and the salaries have risen to a much higher level than lawyers working in law enforcement agencies and in governmental bodies.

Practically, all forest enterprises in the Arkhangelsk region now have an in-house law department. Some enterprises have had such a department for many years, while others have only recently opened one.

2.1 The Structure of an In-house Law Department of a Russian Forest Enterprise

The structure of the legal service differs depending on the size of the enterprise and the quantity of work for which the lawyer is in charge. Either a single lawyer or a group of lawyers (a department) can provide legal services for an enterprise.

As an example, let us look at the law department of the Solombala pulp and paper mill. Solombala pulp and paper mill is situated in Arkhangelsk Oblast and has about 2,000 employees. Although it is not the largest pulp and paper mill in the Arkhangelsk region, it is still one of the largest enterprises of the region and it contributes substantially to the regional and municipal budgets.

The law department of this company consists of three lawyers who take care of most of the legal work of the enterprise, such as making claims and lawsuits, checking contracts and solving the current legal problems arising in other departments of the mill.

The head of the department is subordinated to the vice-general director for legal issues. He is in charge of the most important legal questions, such as checking the orders of the general director, checking the most important contracts, and supplying legal aid for the general meeting of the stockholders and the board of directors.

The vice-general director for legal issues is also a member of the company's administrative board, which is an executive body. He has also some "representative" functions. Thus, he has the right to sign claims, respond to claims and lawsuits, to submit various applications concerning legal questions and some other matters. This post was established in 1991, just before the company was privatized.

This structure of the law department makes it possible for anyone of the company's employees to reach a lawyer. The head of the law department has the same position as the heads of other departments, which gives an opportunity for good inter-departmental contacts. The vice-general director on legal issues can bring vital legal problems to the top management of the enterprise.

2.2 Who Can Be an In-house Lawyer?

Since they are not regulated in legislation, the requirements on — and functions of — an in-house lawyer may differ between enterprises.

Analyzing the required qualifications in job advertisements, it is possible to identify the main qualities that are desirable of a lawyer and should help him/her to succeed in finding a job.[1] The candidate should be a man, aged 30–35, with a higher legal education and no less than three years of experience in legal work. Sometimes experiences from a certain branch of law are required. Knowledge of foreign languages is not often required, and was found in only 5 out of 60 examined advertisements. Language requirements are often connected with the company's foreign trade activities.

Among all of examined job advertisements of Western firms, there were none in which the gender of the lawyer was indicated, since this would be regarded as discrimination. However, in Russia a majority of the advertisements mention that the job is available for a man.

In the Solombala pulp and paper mill, the requirements for a lawyer as well as for other posts are regulated by officially stated qualifications. For example, the leader of the legal department should be a person with higher legal education and working experience of no less than five years. A senior legal adviser should be a person with higher legal education and working experience of no less than three years. A legal adviser should have a higher legal education but there are no requirements on his/her experiences. However, the management of the company is not bound to follow these qualifications. The author, for example, was given the job of a legal adviser after having finished the fourth year of study in a law faculty.[2]

Earlier, "General regulations concerning the legal departments (bureau), the main (senior) legal advisers of a ministry, department, executive committee of the Soviets of people's deputies, enterprises, organizations, establishments" existed, which were confirmed by a decision of the USSR Council of Ministers in 1972. However, this document no longer has legal force.

Thus, there is no legislation regulating how a company's legal department should be organized and what the requirements for an in-house lawyer should be. This seems to

[1] Based on the newspaper "Job today" and its web site, the author studied the work advertisements of this newspaper during the summer of 2000.

[2] In Russia higher legal education consists of either five years study in a permanent department of a law faculty or six years of study by correspondence. Those, who already have a master's degree in some other discipline, can graduate after four years of study by correspondence.

make sense, because each enterprise has its own conditions and its own goals with establishing a legal department. It is almost impossible, and at least unnecessary, to provide legal regulation for these functions.

2.3 Forest Enterprises and Private Law Firms

Some forest enterprises that do not have an in-house lawyer hire private law firms for dealing with their legal problems. Nowadays, there are many private law firms in Arkhangelsk. Some of them specialize in certain branches of the law.

In 1998, several forest enterprises founded "Konsultant-les", a so-called non-commercial partnership. According to its charter, the main objective of this firm is to provide legal services for the forest enterprises of the Arkhangelsk region and to other companies having business connections with the forest industry (e.g., transportation companies, etc.).

The relations between a law firm and a forest enterprise may be based either on a long-term agreement or on individual contracts for special tasks. The conditions of the long-term agreements differ depending on the firm. Generally, such an agreement means that the law firm deals with all the legal problems occurring in the enterprise. However, the law firm may charge extra fees for the most difficult cases involving litigation.

Earlier, Russian legislation required a license for a private law firm and as a result stipulated some requirements on the persons who were given the right to render legal services to enterprises. Among the requirements were higher legal education and no less than three years legal practice. In 1998, the new law "On licensing" was adopted. This law no longer requires a license for legal services. Therefore, since 1998, any person, even someone who is not a lawyer, is allowed to start a law firm.

2.4 The Functions of an In-house Law Department

In Russia, the law department of an enterprise usually has two main objectives. The first is to pursue the interests of the enterprise as far as possible. The second is to make sure that law is followed within the company. It is not always easy to combine these two functions, because the interests of the company often contradict the requirements of the legal regulations.

The following situation may serve as an example. When the tax inspection comes to an enterprise to check whether the company follows the tax regulations, the task of a lawyer is to try to prevent sanctions against the enterprise. The legislation states that if the tax law is violated the person or persons responsible for the infringement should be punished. The lawyer, on the other hand, tries to prove that there is either no violation at all or that the tax inspection violates some procedural rules.

Hendley *et al.* (1999) have made a survey study of the role of lawyers in Russian industrial enterprises. According to Hendley's report, legal professionals have a rather limited role within Russian enterprises. They are deeply engaged in activities that are clearly defined as legal in nature, such as litigation and negotiations with delinquent

customers, which are activities that precede legal actions. Labor relations retain the legalistic veneer acquired during the Soviet era and remain a preoccupation for the legal personnel. Yet legal advisers generally do not participate in decision-making on financial matters. Interactions with banks are apparently not their concern. In the same way, they have almost no contact with local governmental officials. The involvement of legal advisers in corporate governance matters is low. Apparently, legal professionals are part of the team that implements decisions made by top management, not part of the team that helps to make these decisions (Hendley *et al*., 1999). Although the survey was made three years ago its results are still valid, even if some changes have occurred, especially in the field of tax law and corporate governance.

The legal department in a Russian enterprise usually performs its traditional function, i.e., giving advice on legal questions. It usually deals with the problems when they have already become visible, for example, when contracts have been broken, when violations of legal regulations of governmental inspections can be assumed, and so on. One can say that the main task of a Russian company lawyer is to decrease and, if possible, to eliminate the negative impacts of such problems.

Lawyers also try to protect the enterprise from problems whenever it is possible. If the business purpose can be achieved in several different ways using different legal means, it is the task of a lawyer to analyze all potential ways and means and to describe their potential positive and negative impacts for the company managers.

For example, not far from the Solombala mill there was a transportation enterprise. It had large land areas, good cars, and warm garages. But it was almost insolvent. Solombala mill was interested in its land, cars, and garages. So the manager of the Solombala mill asked the lawyers to investigate different options to acquire the company. The following options were identified:

1. buy the company's stocks/shares;
2. bring the company to insolvency and purchase its property;
3. purchase the land, cars, garages, and other assets (without procedures of insolvency); or
4. reorganize both companies through acquisition or merger.

The law department can describe the ways of acquisition and show their advantages and disadvantages, but it is the manager who will make the final decision.

A lawyer can establish some procedures, which could be followed in settling potential disputes between employees and the company. The same applies to disputes between different departments of the enterprise.

In the 1980s, a discussion started in Western countries on additional functions of in-house lawyers — besides "advice on legal and business issues." Such advice consists of recommendations by the corporate counsel to the management on an issue that is somewhere between a pure legal question and a pure business decision (Jones, 1985). This means that a lawyer makes recommendations based on legal knowledge, not only on the legal problem itself, but also on the business decision. In Russia, the relations with governmental authorities are vitally important in this respect.

Law/business questions appear as legal issues in business. In the above-mentioned example of acquisition, a lawyer can contribute with law/business advice based on the knowledge that the procedure of company reorganization in Russia is really time consuming and complicated and might require huge resources. Giving advice on law/business issues is an area in which a lawyer can make important contributions to corporate operations and it holds promises for the successful development of corporate law departments in the future (Jones, 1985).

The preventive function of in-house law departments has not yet received recognition in Russia. There are two possible main reasons for this:

1. Lawyers themselves are not yet prepared to give advice on law/business questions. In the universities, law students are only taught the contents of legal regulations. Sometimes, they may be taught how to apply legal knowledge to a real situation. Even after graduation, they meet lawyers who have been dealing with pure legal issues for many years. The Russian lawyers' way of thinking about pure legal problems differs significantly from a businessman's way of thinking. In dealing with legal/business issues a lawyer needs to combine both views.
2. Business managers are not used to ask for lawyers' help in law/business matters. They think that it is the manager who should take such decisions. Normally, managers are only interested in obtaining a pure legal analysis of the consequences of their decisions.

Law/business advice is only now being introduced in Russian forest enterprises. Here, one can clearly see the cultural inertia effect, which protects already established ways of work in legal departments. The old methods have proved to be viable and from most managers' and lawyers' points of view the old methods also work quite efficiently.

2.5 Conclusions

It is important to make both lawyers and managers realize that lawyers can provide not only pure legal but also law/business advice. The development of a modern business culture in Russia will inevitably, sooner or later, make this obvious to the managers. Thus, the best way to hasten the development is to promote the idea through publications addressed to both lawyers and managers.

One of the fields in which the preventing function has already found broad application is the tax law. A lot of businessmen nowadays prefer to ask a lawyer for advice before taking any vital decisions. In this field, preventive law is developing very quickly. In order to promote preventive law, a special course on corporate law practice should be introduced in the law faculty curricula. Legal clinics, which have started to spread over Russia, are suitable for this purpose.[3] If the students can learn how to apply their legal

[3] The idea of the legal clinic was brought to Russia from the USA. The name was given in analogy with the clinics for medical students. In general, the legal clinic is a place where law students learn how to apply their knowledge of law to practical situations and how to deal with the client. The studies at the clinic are based on both theoretical lectures with a wide range of interactive methods of teaching and work with clients, who do not have to pay for the legal consultations.

knowledge with the help of a legal clinic, the clinic could also be used to introduce the idea of corporate preventive law. Even if it will take a long time, it is probably the most reliable way, and the way that can produce the best results.

3 Relations with Customers and Suppliers

Relations with customers and suppliers usually belong to the responsibility of special departments of a forest enterprise, namely the procurement and the sales departments. The procurement department is responsible for securing a continuous supply of raw materials for the production process, while the sales department deals with sales of products. Both departments prepare contracts with their partners themselves. Usually these departments are the first ones to deal with any claims that might come from suppliers or customers. For example, if a customer makes a claim for bad product quality, the representatives of the sales department and the quality department will deal with it first trying to settle the problem. Only if they do not succeed, the law department takes over the case.[4] The most typical case when the law department becomes involved concerns violations of contract.

3.1 Violations of Contracts

Violations of contracts are quite common in the relations between suppliers and customers in Russia today. Both suppliers and customers often violate contracts. Either a supplier does not supply the goods, even if the goods sometimes have been paid for in advance (prepayment), or a customer does not pay for delivered goods.

When a supplier violates the contract, the contract partner has three possibilities:

1. to claim for financial compensation for damages;
2. to claim for contribution in kind; or
3. when products have been prepaid, to claim for repayment.

No pre-established order exists for choosing one of these options. The choice depends on the customer and the conditions in the individual case.

3.2 Claims for Financial Compensation of Damages

Claiming damages is rarely used in Russia nowadays. Although Russian legislation allows claiming for damages in contractual relations, such claims are not very popular. The main reason is that it is very difficult to prove the extent of loss (or damage) and the causal relationship between the contract violation and the loss.

It is especially difficult to prove the amount of lost profit. According to Article 393 of the Civil Code, where the extent of lost profit is defined, the measures that the creditor

[4] This way of dealing with customers/suppliers is the rule at the Solombala pulp and paper mill. Other forest enterprises might of course apply different methods.

has taken to obtain the profit should be taken into consideration. Therefore, applying the legal provision, the arbitration courts require written evidence that the creditor actually had the possibility to obtain a profit. For example, contracts with other parties and preliminary contracts can be used as such evidence. However, it is difficult to prove the way the company planned to use its assets or to predict the results of business activities.

Thus, there are situations in which a company really loses some potential profit, but where the arbitration courts have not awarded damages anyway. The following case involving a claim for damages was taken to court.

Firm A used 32 telephone lines to get orders for its products. According to a contract, Firm B was responsible for the proper functioning of the telephones. On one occasion, 20 telephone lines were disconnected and Firm B was responsible for the malfunction. Firm B then increased the average charge from the 12 telephone lines that were working. Firm A required financial compensation for lost business. The court did not award damages for the lost profit. The reason for not awarding compensation was the lack of evidence of a casual relationship between the disconnection of the 20 telephone lines and the reduction in orders.[5]

If the plaintiff fails to prove the amount of loss, the courts do not award damages even if certain losses were obvious.

Article 524 of the Civil Code establishes that the customer who has bought generic goods and not received them can buy similar goods from another source and then charge the vendor at fault with the excess costs. However, even if such a clear rule for the calculation of damages exists, it is rarely used, because the plaintiff must prove that the conclusion of the new contract with a higher price was a consequence of the defendant's broken contract. If the customer regularly buys this kind of goods from many different suppliers losses are difficult to prove.

Instead of claiming for damages, Russian enterprises more often use other tools offered by the law:

- forfeit (penalty) stipulated in the contract. For some conditions the forfeit (penalty) is also stipulated in legislation. One example is deliveries to the State (government procurement).
- the provision of Article 395 of the Civil Code of the Russian Federation.

Forfeit is also quite common in the legal practice of other countries. Thus, in this respect, the Russian legal practice is not peculiar (Zweigert and Kötz, 1992).

Article 395 of the Civil Code regulates that a debtor illegally keeping the money belonging to a creditor has to pay the creditor interest for the non-payment. Article 395, furthermore stipulates that the rate of the interest should equal the rate of the bank interest of the creditor's domicile. The interest is calculated from the amount of the debt for each day of non-payment. The peculiarity of this form of liability is that it may only

[5] This case was heard by the federal arbitration court of the Moscow district (case No. 40/5100-00 on 9 November 2000).

be applied to monetary obligations. If the case deals with any other obligation, for example, to vacate premises or to deliver goods, the legislator has not established any forms of liability but left it for the contracting parties to agree upon.

Interest payments for non-performance of a monetary obligation can be regarded as a simple form of penalty established to avoid the above-mentioned difficulties in claiming for damages.

Another example of the difficulties in claiming for damage may be found in the activities of the Solombala pulp and paper mill.

In 1998, there was shortage of raw material for the pulp and paper industry in the Arkhangelsk region. The Solombala pulp and paper mill had various suppliers of wood chips, which is the main raw material. The Solombala saw mill was the major supplier. In 1998, the saw mill broke the contract and stopped delivering wood chips in order to try to increase the price. It is obvious that this action caused certain damages. The Solombala pulp and paper mill had to take additional bank credits, spend additional money for identifying other suppliers, etc. But the mill never applied to the court for reimbursement of its losses, because it was not possible to prove the strict casual relationship between the broken contract and the losses.

3.3 Claims for Performance in Kind

The Russian legal development generally followed the German tradition. Regulation of the claims for performance of the contract in kind is not an exception. As in Germany and many other civil law countries, Russian law recognizes the right of the customer to claim for the delivery. The main difference between Russian and German laws is in the order of the customer's actions.

According to the German Commercial Code, if a customer *wants* to insist on performance in kind due to delayed delivery, he must notify the other party as soon as the contractual date of delivery passes. If he does not, the claim for performance will fail (Zweigert and Kötz, 1992).

According to the Russian Civil Code, the obligation to deliver the goods is in force as long as the contract is in force. If the customer does not want to receive the delayed delivery, he must notify the supplier, and the customer is obliged to receive and pay for all the goods sent to him before the supplier received such notification.

The claim to perform the contract in kind is not very popular either in Russia or in Germany. In Germany, the drafters of the Civil Code believed that a disappointed contractor who decided to sue would always choose to claim for performance. This is not what happened in practice. Today, businessmen prefer to grant the debtor an additional period for performance and only when this period elapses without result, they claim for damages. The creditors in fact collect a claim for performance only when their interest cannot easily be estimated in financial terms (Zweigert and Kötz, 1992).

In Russia, since the claims for damages are not very popular, the claim for performance in kind is made when the supplier has an interest in receiving the goods back. It should be mentioned that this type of claim is usually used when prepayment was made or when the plaintiff delivered the goods according to a barter contract in advance.

There are several advantages of such claims:

1. The court's fee paid by the plaintiff is significantly lower than the court's fee for claiming damages, or returning prepayment, or any other monetary claim. The court's fee, in the case of a claim for performance in kind, is only 10 minimum salaries,[6] while in monetary claims it is 5 percent of the amount of the claim.
2. If the defendant does not perform the court's decision on performance in kind, it is possible to appeal to the court in a simplified order with an application to change the way of executing the decision and to make the defendant pay money instead of performance. This can be done without any additional fees.
3. The plaintiff may have an interest in performance of the contract in kind. For example, this can happen when the price for the prepaid goods has increased a lot. As already mentioned, it is always difficult to prove the amount of losses.

For these reasons, the claims for performance in kind are a practical legal tool to use in cases of broken contracts.

Unlike German and Russian laws, English law considers the claim for performance of the contract in kind as an extreme possibility. To obtain such a decision, the plaintiff must prove that the normal sanction of damages is "inadequate" and that there is an interest in performance of the contract, which cannot be transferred into monetary terms (Zweigert and Kötz, 1992).

3.4 Conclusions

Difficulties in claiming for damages have made it possible for the debtor to avoid the payment to the creditor for quite long time periods without any negative consequences. Thus, the interest for non-performance of monetary obligations has become some kind of substitution for penalty of the debtor, though they have no connections with the real loss suffered by the creditor. It may happen that the interest brings a considerable amount of money to the creditor even if he did not suffer any damage at all.

The same result may be reached with a contractual penalty. The difference between these two legal institutions in the Russian legal system is both quite unclear and more theoretical than practical. The main difference between contractual penalty and the interest for non-performance of a monetary obligation is the way in which they are established. Contractual penalty, as its name shows, should be stipulated in the contract while the interest is stipulated in the Civil Code. Contractual penalty is considered as a

[6] In January 2001, the minimum salary in Russia for the purpose of court fee calculations was 100 rubles (less than 4 dollars).

method to provide fulfillment of the obligation,[7] while the interest is an alternative of liability for broken contracts. An additional difference is that, as far as contractual penalty is an obligation, the court may decrease the amount of penalty if the consequences of the broken contract are not significant. In the same way, the court may also decrease the rate of interest.

"The penalty interest" for non-performance has found wide application, because it is an effective tool in practice. However, its real effectiveness for business as a whole is doubtful. "The penalty interest" has nothing to do with the real damage suffered by the business. It may be (and often really is) much more than real losses. Thus, it can become a way of unreasonable financial compensation.

During the last four years, there was no case when the Solombala pulp and paper mill applied to the court with a claim for damage. The enterprise prefers other ways for reimbursement. Normally, the penalty interest is such a remedy. For example, one enterprise did not pay for services for more than a year. The court decided that this enterprise should pay the Solombala mill the penalty interest equivalent to the sum of debt. This may seem to be unfair because the mill never suffered such big damage, but it was much easier to claim for the penalty interest than to prove losses.

The penalty interest is an example of the cultural inertia effect. Penalty interest is used because it has proved to be an easy method to punish the debtor. The fact that it is not always fair in proportion to the actual losses does not seem to be important.

One additional effect, which contributes to the stability of this practice, is the coordinative effect. If a creditor wants to claim for damages a lot of time and money must be spent on proving the amount of damage and the causal relationship.

Practice in other countries also shows that claiming for damages is a good tool to protect the interests of the injured party.

Some legal changes may help to overcome the above-mentioned problems. The main task is to find a solution on how to calculate damages. Several proposals have already been made on different methods, which could be used for calculating damages.[8] However, in practice these methods are not always possible to use because business is risky. The stipulation requiring to prove the actual amount of damages in a detailed manner contradicts the risky nature of business because nobody can prove the expected profit in detail. It would be reasonable to introduce the approach that is used in the USA. According to this approach the principles for calculating profits not-received, the volume of the losses, and the amount of damages are based on reasonable assumptions. Difficulties in calculating damages should not be an obstacle for legal steps.

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[7] In Russia, contractual penalty as well as a bank guarantee or a mortgage is considered as a method to provide fulfillment of the obligation, but not as liability for broken contracts.

[8] For example, Brizgalin (1994) has suggested three possible methods for calculating profits not-received:

- Through the profitability of the whole enterprise;
- Through the normative of profit per invested capital; or
- Through the interest rate of the Central Bank.

4 Capital Flight Preventing Measures

Forest enterprises in Russia export a large amount of their production. The Arkhangelsk region contributes about one third of the whole Russian export of forest products. In the Arkhangelsk region, 28.2 percent of pulp is exported (Carlsson *et al.*, 1999). Some 90 percent of the production of the Solombala pulp and paper mill is exported to the countries of South-eastern Asia, the Near East, Africa, Europe, and America. Uzbekistan, Belarus, and Ukraine are close export countries. Old partner relations connect the Solombala pulp and paper mill with companies in Austria, Holland, Sweden, and Germany. Not long ago, business contacts were established with South Korea and China.

The significance of export is the reason why it is very important for the forest enterprises to be aware of what regulations and limitations exist for the export of goods and what capital flight prevention measures are to be followed. Capital flight prevention measures were established in order to prevent extensive capital outflow from the Russian Federation. Such measures are not new to world practice. The obligation of enterprises to repatriate the payment for the exported goods now exists in the legislation of about 50 counties all over the world, mainly in developing countries and in the countries in transition. Countries such as France, Great Britain, and Germany have already abolished the restrictions on the movement of capital. Many major industrial countries continued to maintain capital control throughout the 1960s and 1970s, while some, like France and Italy, abolished the last of their capital controls only during the late 1980s. Japan is said to have had the most effective and efficiently administrated system of capital control up to the late 1970s (Mathieson and Rojas-Suarez, 1993).

The aim of this section is neither to analyze different measures of capital control nor evaluate their effectiveness. Moreover, quite different opinions exist concerning capital control in transition economies.[9] Here we only want to pay attention to the legislation that regulates Russian capital flight control measures inasmuch as it has a profound effect on the business of forest enterprises.

4.1 Legal Regulation of Capital Flight Prevention Measures in Russia

The peculiarity of Russian capital flight prevention measures is that they are on the whole badly regulated. There is only one law dealing with these questions. It is the federal law “On currency regulation and currency control in the Russian Federation”. All other acts are Presidential decrees, Governmental decisions, orders of the Central Bank, and the State Customs Committee. All of this legislation does not regulate issues that are very important for enterprises, such as how the bodies of capital flight control are allowed to inspect and impose a fine on an enterprise. For example, the above-mentioned federal law was passed in 1992 and it identifies several actions considered as

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[9] See, e.g., Mathieson and Rojas-Suarez (1993:19-22), where the authors name several potential benefits of an open capital account; Tamirisa (1999) and Lessard and Williamson (1987) represent an opposite opinion.

currency violations. However, there is still no legal act (not even a law), which would establish such an important provision as a prescription period, i.e., the period from the time of violation during which the authorized body has a right to punish the enterprise.[10] Only quite recently the Federal Arbitration Court of the North-Western district, while settling a concrete dispute on the fine for violation of capital flight prevention measures, applied the prescription period stipulated in the Tax Code. The decision was based on the similarity of currency and tax relations. This decision, even though it does not constitute an actual precedent, will definitely help to defend the interests of enterprises.[11] The Supreme Arbitration Court of the Russian Federation is still to decide on this case, because there is no doubt that the governmental body concerned will appeal and because this decision is of significant value for court practice.

Russian legislation requires that a Russian enterprise, which has sold goods abroad, must provide the full amount of money to a bank account in an authorized bank in the Russian Federation within 90 days after the goods passed the border of the country. A special liability is stipulated for violating this obligation. The enterprise can be held liable if the money has not been repatriated to Russia at all, or if the amount is less than was stipulated in the invoice, or if the money has not been repatriated within 90 days.

Three governmental bodies have the power to punish the enterprise for the same violations.

First, the customs bodies have such powers. They apply article 273 of the Customs Code of the Russian Federation "Illegal operations with goods under certain customs regimes." According to this article, the penalty for such violations may be as follows:

- a fine of 100–200 percent of the price of the goods, in (possible) combination with
- confiscation of the goods, in (possible) combination with
- recovery of the payment for the goods, in (possible) combination with
- annulment of the export license or certificate of qualification.

In other words, the customs authorities may impose a penalty of up to 300 percent of the value of the goods which crossed the border.

Second, the tax service may hold an enterprise liable for not returning money obtained from the export of goods. This is possible even if there are no tax offences. The Presidential Decree number 1163 dated 21 November 1995 gives them such power.

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[10] These questions should be regulated by the law but, since there is no such law, it can currently be handled by any other act of lower hierarchical level.

[11] Unlike in common law countries, in Russia a court decision does not have the status of precedence. It applies only to relations between the parties engaged and has no effect on other similar disputes. However, recent decisions of the High Arbitration Court and especially of the Constitutional Court have started to play the role of unofficial precedents. If a lower court knows the position of a higher court on similar issues it will follow this position. Otherwise, the higher court may overrule the decision of the lower court.

Third, the currency-export control service, which was formerly an independent body but is now a department of the Ministry of Economic Development and Foreign Trade, can impose penalties.

It is usually the customs authorities that impose the penalty, because they have the most effective means of control in the form of special documents for currency control, which are handled by the bank and later given to the customs.

The Japanese experience with capital flight preventing measures is, as was already mentioned, said to be one of the most successful. The basic law in Japan was the Foreign Exchange and Foreign Trade Control Law passed in 1949. This law established measures that in general were similar to contemporary Russian regulations. The foreign exchange transactions were prohibited in principle and permitted only in exceptional cases according to the directives and notifications of governmental ministries. Export receipts of foreign exchange had to be sold to authorized foreign exchange banks. The authorities also specified a standard settlement period and required approval of prepayment on the acceptance of advance receipts. This law served as the main basis for the capital control measures.

The law in Japan was changed during the reform process at the end of 1980. The new regulations allow all foreign exchange transactions unless specifically restricted (Mathieson and Rojas-Suarez, 1993).

A strong and comprehensive legal basis supported Japanese capital control measures. Russian foreign exchange regulations, however, seem to be too complex. Sometimes it is really difficult not to violate them. These regulations could be streamlined to make it easier to apply them in a monitorable and consistent manner and without issuing individual permits (Loungani and Mauro, 2000).

A huge problem for the enterprises with the capital flight preventing measures is that the legislator has not made a difference between definitely illegal business and cases when an exporter has become a victim of unfair behavior of a foreign partner or uncertainties of the market.

The customs legislation is especially strict. The guilt of the infringer is not a decisive fact. The responsibility will be imposed on an infringer even when he did not intend to violate any legal regulation. The Customs Code stipulates that it is only force-majeure circumstances that can prevent a bank transfer. An example is a decision of the Government prohibiting payment in foreign currency. Unfair behavior of a foreign partner is not a reason for releasing the Russian enterprise from its responsibility.

4.2 The Court Practice

To a certain extent court practice tries to soften the unreasonable strictness of the legislation on capital flight measures.

The most frequent violation of capital flight preventing measures is the violation of the obligation to repatriate currency from abroad. Liability for this violation is stipulated in

Article 273 of the Customs Code of the Russian Federation. The arbitration courts consistently take the position that this violation may only be made by inaction meaning that, in the courts' opinion, the mere fact that money for exported goods was not repatriated, or that it was repatriated only after more than 90 days, is insufficient to constitute a violation of the Customs Code. It is also necessary that the enterprise did not take any actions to prevent the non-repatriation of the money. First of all, the conditions of the contract are taken into consideration. There, some kind of penalty should be stipulated for the violation of the terms of payment. The absence of a penalty clause can prove that the enterprise did not bother to take care of the repatriation of the payment. Secondly, several letters must exist, which are claims against the illegal behavior of the partner that are sent to him immediately after the end of the term of payment. And thirdly, there have to be suits against the violated party brought to a court that is competent to settle the dispute. It is essential that all these actions should be taken before the customs authorities intervened.

4.3 Conclusions

Under these circumstances the most favorable arrangement for a Russian enterprise is to ask the foreign partner to pay for all deliveries in advance. Such an arrangement helps to avoid violations of the capital flight preventing measures. However, it is not always possible to include such a condition in the contract because of the lack of trust on the part of the foreign buyer. In such cases there must be a condition in the contract about payment within 90 days from the date when the goods crossed the Russian border.[12]

Russian enterprises find themselves in an institutional trap. On the one hand, the capital flight preventing measures are necessary to prevent an extensive capital flight from Russia, which would harm its economic interests. On the other hand, these measures limit the enterprises' freedom of economic activity and they try to evade them.

The Russian government imposes harder and harder rules for export and import and harsh sanctions on all deviations from these rules.

The problem is that such a strategy incurs high costs for the state and generates even worse institutional traps. The learning effect that comes into full force here is that enterprises must try to develop practices to evade the rules.

If we assume that the capital flight preventing measures are inevitable during this phase of the transition period, they should at least be properly regulated. First of all, a new law is necessary. This law should regulate all the crucial issues of the capital flight preventing measures, like the powers of governmental bodies, the conditions and grounds for punishment of rule violations, etc. The first part of the Tax Code may become a good example for such a law.

Before 1999, there were a lot of laws regulating tax relations. There were also a great number of different instructions, letters and other directives regulating tax questions.

[12] This 90-day period is a demand of the law. The money should be on the bank account of the Russian enterprise in the Russian Federation no later than 90 days after the goods have crossed the border.

Sometimes these acts contradicted each other and there were a lot of questions that were not covered by them. Thus, there were frequent disputes between the tax authorities and enterprises concerning the imposition of penalties. Several tax disputes even had to be settled by the Constitutional Court. The adoption of the First Part of the Tax Code helped bring an end to all these disputes and settled the most controversial issues that had been disputed.

In the summer of 1995, there was a crisis in the pulp market. Prices fell dramatically. At that time a Cyprus based firm bought pulp from the Solombala pulp and paper mill and did not pay for it. To obtain at least part of the contracted payment the mill agreed to lower the price and to transfer part of the debt to a Yugoslav firm and another part to a Russian firm. This decision brought about a dispute between the governmental authorities, the Solombala mill and the Russian firm to which the debt had been transferred. There were several court hearings. The legal provisions gave no clear answer whether or not such a bargain was legal. At last the court supported the Solombala mill, but because of all this it took about five years to receive the payment for the delivered pulp.

Governmental authorities have twice tried to impose a fine upon the Solombala mill because payments for goods delivered abroad were never received. So far, it has been possible to settle these cases through out-of-court agreements. But there is no guarantee that the authorities will not try to bring these events to court at some point in the future. As has been already mentioned, there is no prescription period in such cases.

Fortunately, it does not often happen that the foreign business partners of the Solombala pulp and paper mill violate conditions stipulated in the contract. The best guarantee is the reputation of a partner with whom the mill has worked for a long time. If an offer to conclude a contract comes from an unknown firm the enterprise management tries to learn as much as possible about the firm. A certificate from the trade register of the country where the firm is registered is an obligatory document.

The other main method used in Solombala's relations with unknown partners is prepayment.

Normally, there are no difficulties with foreign partners in export trade bargains. Capital flight preventing measures are mainly directed towards the Russian partner to a deal and do not greatly influence the foreign partners. Under normal circumstances there is usually no need to allow more than three months between the delivery of goods and payment.

The problem is much more difficult in the case of import. For example, when the Solombala mill orders some advanced equipment from abroad it often takes more than three months to produce the goods and have it delivered. Then foreign firms would also often demand prepayment. In these cases the negotiation process is often long and complicated. The Solombala mill may evade the strict capital flight preventing measures in two ways; one is to persuade the foreign partner to start producing the equipment without prepayment, so that the money can be sent within three months before delivery. Sometimes, there may be a special condition in the contract stipulating that the Solombala mill will first have to send money to the foreign partner, and then, when

three months have passed, the partner will send the money back, after which, within a few days, the Solombala mill again will send the money back to the foreign partner. This procedure seems totally absurd, but it is a way of avoiding punishment.

5 The Means of Contract Enforcement

When one party to a contract violates its conditions the question arises what legal (official) and private means exist to make the violating party fulfill his obligations, or at least cover the damages caused by the violation.

It is generally recognized that there are two kinds of contract enforcement, "official" and "private". The most important among the official channels are administrative methods and litigation. Administrative methods mean that governmental bodies or local authorities interfere in the relations between the parties to the contract. And private channels, basically means using the court system.

The range of private methods of contract enforcement is actually very wide. To private methods belong:

- Arbitration — a procedure for the settlement of disputes under which the parties agree to be bound by the decision of an arbitrator, who should be an independent, impartial person selected by the parties, and whose decision is, in general, final and legally binding for the disputing parties.
- Mediation — a process of negotiations, which is conducted with the help of a third independent party. Unlike arbitration, mediation is not a formal procedure.
- Negotiations between the contracting parties.
- Self-enforcement (both legal and illegal).
- Using the mafia.

Today, negotiations between contracting parties is the most frequently used means for settling disputes in business life. But a culture of negotiations has never existed in Russia. During Soviet times there was no need for negotiations. Even today, nobody teaches new Russian businessmen how to negotiate, how to find a compromise, and how to find mutually profitable solutions. All publications dedicated to negotiations that have appeared in Russian business newspapers and magazines are translations of articles by Western authors.[13] It seems that no one has reported on Russian negotiations.

Nevertheless, this does not mean that Russian businessmen do not use negotiations. It is unrealistic to think that courts or private systems of dispute resolution play the major role in current business life. Such means are only used when it is impossible to find a solution through negotiations.

It is typical for Russian negotiations to be only feasible among equal partners. Some Western authors maintain that a stronger party in a negotiation tends to stick firmly to

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[13] See, for example, "Marketing," No. 4, 2000; "Inzhener", No. 10, 2000; "Kozhevenno-obuvnaya promyshlennost", No. 6, 1997; "Energiya", No. 1, 2000.

inflexible positions regarding certain clauses in contracts they negotiate with customers or suppliers (Coulson, 1984). If one of the partners regards himself to be stronger than the other partners to the deal — if he, for example, is a monopolist or otherwise has a large influence over business, while his partner represents small businesses — negotiations become difficult.

Using the Russian mafia is often believed to be one of the most effective means for settling a dispute. Actually, the mafia may rather be used to enforce agreements. Sometimes the mafia even demands a court decision before starting to put pressure on a debtor. Using the mafia is probably the most expensive method for solving disputes and this is why businessmen mostly try to avoid it.

There are two different kinds of state courts for litigation in Russia, namely the courts of general jurisdiction and the arbitration courts. According to the Russian Code of Civil Procedure, courts of general jurisdiction should deal with disputes in which at least one of the parties is a private person. Thus, a forest enterprise may only go to a general court to solve labor disputes or in cases of tort.

Disputes in which forest enterprises are involved are most often settled before an arbitration court. According to the Code of Arbitration Procedure, the arbitration courts are commercial courts, which deal with disputes in commercial life as well as disputes between enterprises and state authorities.

The most common means of settling disputes used by the Solombala mill is negotiations. It is too much to say that a special culture of negotiation exists, even though there are certain procedures, which are normally observed. Negotiations usually start at the middle management level. The parties try to settle the dispute through telephone calls, letters, or meetings with the managers of the business partner. When the dispute concerns ordinary problems of non-payment it is often settled at this level. Disputes concerning the quality of the delivered goods are also often settled at this level.

But if the debt is very large, or if payments have been long delayed, the dispute goes to the top management level, to engage heads of the departments or vice-directors. Vice-directors often meet with the representatives of customers and suppliers. They can agree on a special payment schedule or set a new term for a partner to carry through an obligation. The vice-directors or the director general are also in charge of negotiations with especially important partners or with a stronger partner.

Only when it is impossible to negotiate an agreement does the dispute go to the law department. This also happens if the law or the contract demand legal actions under the threat of loss of rights. For example, the contract might demand (as formerly the law did) a special claim to be made if the quality of the delivered goods is poor.

Normally, the law department would not start with litigation, but with a special claim, a so-called *pretenziya*. Formally, the law required a special claim to be sent to the debtor before applying to the court. Nowadays, however, there is no such requirement and the law department of the Solombala pulp and paper mill handles claims itself. There are two reasons for doing this. The first is that such a claim helps to discover hopeless

debts, as when, for example, a firm with which the contract was concluded has already disappeared and it is impossible to receive any money even through the court.[14] In these cases it would be a waste of time and money to bring the case to court. The second reason is that such pre-litigation claims often means that it is possible to avoid litigation and to settle the dispute through mutual agreement. At the other end of the claim, there is a notice that if the debtor does not carry out his obligation the litigation process will automatically start. Such a threat may prompt the debtor to find a way to settle the dispute through an agreement. For example, in 2000, more than half of all claims prepared by the law department were acknowledged by the debtors without litigation.

Only if all these measures do not produce any results is litigation used.

Mediation is not used at all by the Solombala pulp and paper mill. One reason is that there are no specialists who might act as an independent third party. A center for preparing specialists in mediation has recently been established in St. Petersburg, but its objective is to handle disputes between persons, not between organizations.

5.1 Arbitration Courts as a Means of Contract Enforcement

Russian businessmen are highly appreciative of the work of the arbitration courts. This is a conclusion that can be drawn both from a number of cases taken before the arbitration courts and from surveys of foreign observers.

According to a report of the work of the arbitration courts in 1999, the number of claims handled by the courts increased by 17.9 percent compared to 1998, and approximately doubled in comparison with 1995 (Rabota…, 1999). This can be an indication that businessmen trust the arbitration courts and consider them an effective way of settling disputes.

Hendley *et al.* (1999) confirms that Russian businessmen really trust the arbitration courts. Managers rated the arbitration courts along three dimensions — competence, cost, and confidentiality — and found them significantly superior to private methods. In fact, the arbitration courts are not as expensive for the plaintiff as they are claimed to be (Pappila, 1998). The Code of Arbitration Procedure allows the plaintiff to ask for postponement of the litigation fee. According to statistical data every fourth law suit in 1999 contained an application for postponement, and 89 percent of such applications were approved (Rabota …, 1999). However, nowadays the courts demand quite weighty evidence of the inability to pay the litigation fee, i.e., bank certificates about the amount of money on the enterprise's account and a certificate from the tax inspection about all

[14] Unfortunately, it frequently happens that a firm stops its activity after a contract has been signed and ordered goods have been sent to the firm. The letters sent to the address mentioned in the contract will then only return with a mark that this firm does not exist. The bailiffs cannot find any property belonging to the firm. There is no information on this with the tax authorities. In 2000, seven such firms were discovered that had relations with the Solombala pulp and paper mill. During the first half of 2001, the corresponding number was already ten.

the bank accounts of the enterprise.[15] If there is a sufficient sum of money on any of these accounts the application for delay has only a small chance to be approved. Therefore, only an organization that is really unable to pay the litigation fees can nowadays obtain postponement.

Such frequent use of this institute does not mean that litigation fees are too high. The institute of postponement rather exists to protect the interests of poor or insolvent companies, which only have claims on debtors who do not want to pay, but no cash. Postponement is usually granted up to the court's decision, which means that if a plaintiff wins the case, he does not have to pay the fee at all. The tax authorities collect the litigation fees directly from the defendant according to the court decision (cf., for example, Hendley, 1999).

Beside the legal institute of postponement of litigation fees, enterprises often use another trick. Article 37 of the Code of Arbitration Procedure allows the plaintiff to change the amount of money demanded from the defendant in the lawsuit during the court procedure. Based on this regulation enterprises can bring suits claiming a small amount of money, e.g., one percent of the amount of the debt, and pay the litigation fee corresponding to that claim. Then, during the procedure the plaintiff increases the amount of the claim up to the real debt. In this case, if the claim is approved, the litigation fee will be charged directly from the defendant in the final decision.[16]

Russian law does not require a lawyer's participation in the hearings. If a lawyer participates it usually makes the case easier for the judge and provides the best protection of the interests of both parties. Nevertheless, any person with or without professional legal training may represent a party in court proceedings.

One more problem generally associated with the arbitration courts is the speed of their activity (Pappila, 1998). Arbitration courts are commonly said to be slow. However, the statistics show that the cases are in general decided on time. For example, in 1999, in the first instance of the arbitration courts, only 3.9 percent of the cases were not handled within the period stipulated by the law.[17] In the second instance, this share was 10.4 percent, and in the third it was 3.1 percent. These percentages have only increased a little compared with the numbers for 1998 (3.3%, 9.3%, and 1.2% respectively).

The English lawyers of the international law firm Cameron McKenna also found the speed of work in the Russian arbitrazh courts reasonable. Compared with four countries in Central and Eastern Europe they found the Russian courts to be the most expedient in settling disputes.[18]

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[15] Paragraph 4 of the Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 6 of 20 March 1997.

[16] Russian procedural law allows the plaintiff to change the subject or foundation of the suit during the proceedings. The author has never met any protests against such a method neither in practice nor in the legal literature.

[17] This period is two months from the date when the claim was received by the court for the courts of the first instance, and one month for the courts of the second and third instances (Rabota…, 1999).

[18] For example, they claim that it often takes between two and five years to secure a first instance judgment in the courts of the Czech Republic. In Hungary, they estimate this period to be up to two years

Some authors (cf. Pappila, 1998) have noted the huge gap between the general opinion and the official statistics in this respect. The reason for this difference of opinion seems quite simple. People tend not to separate the court procedure itself from the enforcement of court decisions. While court proceedings in Russia are fast enough, the enforcement of these decisions present a real problem. This goes for both the arbitration courts, the courts of general jurisdiction, and *treteiskie sudi*, which is the Russian name for private commercial arbitration, the decisions of which are enforced in the same way as the decisions of the ordinary courts. Only 60 percent of all court decisions are really enforced.[19] This means that 40% of the plaintiffs never got their money back even though the court ruled in their favor.

5.2. Court Decision Enforcement in the Russian Federation

Enforcement of court decisions in Russia is performed by special enforcement officials, bailiffs, called *sudebnie pristavi-ispolniteli*. A new law, "On bailiffs" determining their powers was adopted by the State Duma in 1997. At the same time the law "On the procedure of enforcement" was adopted. The latter determines the procedure and the tools that bailiffs can use in enforcing court decisions.

Following the continental legal system, Russian legislation offers a simpler and cheaper procedure of enforcement than, for example, English legislation. In the UK, the creditor who has already obtained a court decision needs to apply to the court again every time he wants to obtain an executive document (i.e., a warrant of execution or a charging order, a garnish order, an attachment of earnings order, etc.). Moreover, the creditor has to apply to the court each time he wants to change the way of the enforcement and each time the creditor has to pay an additional fee for any action, although neither the court nor the bailiff can guarantee that he will ever get his money back. The court will only add the fee to the sum the debtor already owes.[20]

In Russia, when the court decision comes into force, the court that decided the dispute as the first instance gives the creditor a writ of execution, which serves as the ground for all activities of the bailiff. The creditor does not need to apply to the court for any single order. When it comes to additional fees that the plaintiff has to pay to enforce the decision, Russian law regulates that the plaintiff *may* pay the enforcement in advance. Only if he insists on searching the debtor or his property with the help of the police, *must* he pay the enforcement in advance. In practice, a plaintiff who is interested in searching the debtor or his property does so himself, because the bailiffs usually have neither the time nor the will to do it.

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and in Poland it is one year. Speaking about the Russian Federation they found the period to be six months and they add that proceedings before the state arbitration courts are very quickly dealt with (Aitken and Spragge, 1998).

[19] This number is given by the Russian Ministry of Justice on its official web site URL: http://www.scli.ru (statistics for 1999).

[20] This information was obtained from the web site of "The Court Service" which is an executive agency of the Lord Chancellor's Department (see URL: http://www.courtservice.gov.uk/index.htm).

Comparing the possibilities of enforcing court decisions according to Russian law with the possibilities offered by foreign legislation, the tools appear to be similar.

The most efficient way to enforce a court decision is to extract a certain amount of the debtor's salary every month. In order to do so the bailiff must send the writ of execution to the debtor's employer and the employer is then required to send a certain amount either to the bailiff, who will transfer it to the creditor, or straight to the creditor. Usually the amount, which can be extracted from the debtor's salary, is no more than 25 percent of the salary. (However, in a few cases, such as maintenance allowance of children, the sum to be extracted can be up to 50 percent of the salary.) The problem is that this method of execution can only be used if the debtor is permanently employed. This method cannot be used if he is unemployed, works without official registration, or if he is a private businessmen.

Russian law allows arresting and selling all the property of the debtor to cover the creditor's interest and even sometimes arresting and selling the property of other persons closely connected with the debtor. There are mechanisms that can be used to declare some bargains of the debtor invalid and to obtain the debtor's property that he has already sold to another person.

5.3 Problems with the Enforcement Procedure

One of the most serious problems relating to the enforcement of Russian court decisions is the fact that bailiffs have insufficient powers to execute the enforcement. For example, bailiffs have no power to enter the debtor's apartment if the debtor does not allow him entry. Thus, there is no way for him to perform the execution of property that the debtor has in his apartment.

The bailiff can efficiently enforce the decision only if he knows what assets the defendant has, i.e., a bank account, car, immovable property, or stocks and shares in companies. However, the ways open to a bailiff to find the debtor's assets are limited, since he may only rely on the information obtained through official sources. He is empowered to make inquiries to tax authorities about bank accounts, to the traffic police about cars, to the registration office about immovable property. However, there is no way to obtain information about stocks and shares that the defendant owns, especially if the defendant is a private person. Russian banks are not required to give the bailiff information about the debtor's bank accounts. The problem is that the law "On banks and bank activity" does not stipulate that the bank security may be violated on the request of a bailiff.

There is a procedure in the English system that makes enforcement easier for both an English creditor and a bailiff when he wants to enforce the decision against a private person. The procedure is called oral examination. Oral examination is not a method of enforcing judgment in the pure meaning of the concept. It is a way of finding out about the debtor's income, spending, property, and assets such as stocks and shares, or other items of value that he/she owns. The procedure consists of asking the debtor questions about his/her financial situation, which is undertaken by a court official in private. The creditor also has the right to be present during the examination and ask the debtor his

own questions. The debtor is required to take an oath that the answers given are true, and he/she bears responsibility upon false answers as for false evidence, which is a very serious crime according to English law.[21]

Another problem of the Russian bailiffs' service is not connected with the legislation on enforcement itself. The crucial problem is the number of cases that each bailiff has to handle. The arbitration courts alone settle more than 500,000 disputes a year. Practically all their decisions need to be enforced. The fact that debtors do not pay voluntarily is a difficult problem in Russia. Adding the number of cases settled by the courts of general jurisdiction to the number of decisions of the arbitration courts the workload of each bailiff can be estimated. According to the chief bailiff of the Russian Federation each bailiff has more than a 1,000 cases per year.[22] It is no wonder that the bailiff can only take the decision to start an enforcement procedure 2–3 months later than he is required by law. (According to the law the enforcement procedure should start three days after the writ of execution reaches the bailiff.)

The bailiffs' service also has problems with its staff. The majority of bailiffs, and sometimes even senior bailiffs, do not have any legal education. Some of them have only secondary education. There are also a lot of demobilized former army officers who have passed special legal training by correspondence and now work as bailiffs. Thus, the bailiffs' lack of legal knowledge is often a significant obstacle for the enforcement of court decisions, especially when securities or currency obligations are a matter of dispute.

The turnover of employees in the bailiffs' service is also quite high. The reason is not only that the work is hard both in a physical and psychological sense, but also that the salary is low.[23]

5.4 Legal Tools to Support the Enforcement Procedure

Russian law offers several legal means to make the debtor fulfill the court decision. The first tool is the so-called "execution fee".

After receiving the writ of execution, the bailiff takes the decision to start the execution procedure. The defendant has five days to voluntarily comply with the decision and fulfill the obligation. If he fails to do so, he must pay the execution fee, which is seven percent of the debt or of the cost of the property. This sum should be transferred to the plaintiff. If the writ of execution is not connected with the transfer of money or property — if, for example, the obligation is to vacate the premises — the execution fee is five minimum monthly salaries, if the debtor is a private person, and 50 minimum salaries if the debtor is a legal (juridical) person. This execution fee goes partly (30%) to the

[21] This information was obtained from the web site of "The Court Service" at URL: http://www.court service.gov.uk/index.htm.
[22] This information was obtained from the official web site of the Russian Ministry of Justice at URL: http://www.scli.ru/news/news160.asp.
[23] This information was obtained from the official web site of the Russian Ministry of Justice at URL: http://www.scli.ru/news/news160.asp.

federal budget and partly (70%) to a special fund for development of the enforcement procedure. The execution fee does not cover the costs of the execution activity itself, which the debtor must pay additionally. On the one hand, it is quite reasonable to establish some kind of responsibility for the non-execution of the court decision but, on the other hand, the requirement to pay such a fee significantly infringes the interests of both the debtor and the creditor.

The execution fee is set at a stable rate. It is seven percent of the debt or of the cost of the property. Thus, it does not depend on the amount stipulated in the court decision. This means that the execution fee is always much larger than the court fee. The execution fee is paid whether or not the bailiff has done anything to enforce the decision. Even if the defendant has voluntarily paid the demanded sum to the plaintiff after the required five-day period, he is still obliged to pay the execution fee. Moreover, the law does not allow a reduction of the fee neither of the bailiff nor of the court. This is why it quite often happens that bailiffs make no efforts at all to enforce the decision but only wait to obtain the fee, which can amount to large sums of money.

The execution fee as well as the execution cost is paid before the debt to the creditor. This means that all the money obtained from selling the defendant's property will first have to cover the execution fee and only the remains will go to the creditor. This is why the creditor may receive nothing at all if the debt and the resulting execution fee are high and the defendant has only little property.

A proposal for amendments to this part of the law "On the procedure of enforcement" is currently being discussed in the State Duma. The proposal suggests, i.e., to divide the sum obtained from selling the debtor's property between the creditor and the bailiff, so that the creditor would be able to obtain at least part of the money owed him.

The second way to make the debtor pay his debt is a fine. If the debtor fails to fulfill a writ of execution, which orders the debtor to carry out some action or to abstain from some actions, the bailiff may fine him. The fine may amount to 200 minimum salaries. If the debtor again fails to fulfill the requirements of the writ of execution, the fine will be doubled, and so on. The fine should be paid to the state budget.

The legislation in other countries stipulates various means to make the defendant fulfill court decisions. The most commonly used method is the fine. In Germany, fines may be unlimited and they all go to the Treasury (Zweigert and Kötz, 1992). French courts have developed another technique called "astreinte". On issuing a judgment requiring a debtor to perform some action or to abstain from some actions, a court may order that for every day he remains in default the debtor must pay a specified sum of money to the creditor as "astreinte". The size and period of "astreinte" depends on the discretion of the court (Zweigert and Kötz, 1992). The main feature of the "astreinte," which distinguishes it from the German fines, is that it goes to the creditor, while the German fine goes to the Treasury. However, it has nothing to do with compensating the creditor for his damages and thus is not related to the degree of harm the creditor has suffered (Zweigert and Kötz, 1992).

English legislation suggests even more severe means of threatening the debtor if he does not comply with the decision of a court. Since time immemorial, English judges have

reserved the right to treat many kinds of behavior as "contempt of court". They also treat the non-performance of a court decision as "contempt" and can fine the debtor for it. Moreover, there are practically no specific rules to limit the extent and kind of punishment that may be imposed, or the ways in which the execution of the decision to punish is started. Instead of fining the debtor, the court may issue a "writ of sequestration". The sheriff then confiscates the entire moveable and immovable property of the debtor "until the defendant shall clear his contempt" (Zweigert and Kötz, 1992).

In modern legal systems, non-performance of a court decision hardly ever leads to imprisonment. However, imprisonment as a means of punishment still exists if the debtor persistently refuses to perform the court decision. For example, English law leaves the judge power to imprison a debtor for up to six months if he malevolently refuses to pay (Zweigert and Kötz, 1992). In Germany, Article 888 of the Code of Civil Procedure first allows threatening the debtor who is unwilling to perform a court decision with imprisonment. Should the debtor still not perform, he may be imprisoned for up to six months.

In Russia, Article 315 of the Criminal Code establishes a punishment for malicious non-performance of court decisions. The defendant may be fined up to 400 minimum salaries or four times his monthly income or imprisoned for up to two years. However, this article of the Criminal Code only exists on paper.

As other Russian enterprises, the Solombala pulp and paper mill may also encounter problems with enforcement of court decisions. One of the most difficult awards to enforce is the award against a municipal enterprise engaged in public utilities. Such an enterprise always has large accounts receivable. Its major debtors are state and municipal establishments, which are financed from the budget. Its assets mainly consist of the equipment and machinery used for specific purposes of public utilities. For example, the municipal enterprise, with which the Solombala mill has permanent court disputes for non-payment, provides water and sewage services. Thus, the majority of its assets are water supply and sewage pipes and everything necessary for their repair. Obviously, it is impossible to sell such property, since nobody will buy it.[24] There is usually also no money on its bank account. So the most effective way to receive money from such an enterprise is offsetting the claims through the local administration.

The enforcement of court decisions in the Solombala mill is actually quite good. In 1999, for example, only 4 out of 60 court decisions were not enforced. There were mainly two reasons for this. The first was that three of the four firms had disappeared (3 cases) and the second reason was that the firms were insolvent (1 case). In 2000, 3 out of 39 court decisions were not enforced.

However, there are a lot of court decisions that are not enforced by the bailiffs' service. They are mainly decisions against municipal enterprises.

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[24] Public utilities are unprofitable in Russia, because of the large number of privileges. About 50 different categories of citizens have privileges in paying for public utilities. The State and the municipalities are supposed to compensate losses incurred by the enterprises rendering the services, but there is never enough money to do so.

As has already been mentioned, the law department of the Solombala mill tries to avoid litigation when the debt is hopeless to receive. This of course decreases the percentage of non-enforced decisions.

5.5 Conclusions

Nowadays, the arbitration courts can be said to be well developed. In spite of all the difficulties, they work satisfactorily and are very helpful in facilitating a smooth functioning of business.

The real problem is the enforcement of court decisions. There are three factors that make the problems of enforcement sometimes even impossible to overcome.

The first factor is the coordination effect. Although the law allows different ways to return the debt to a creditor, the process often requires too much time and money. For example, in many cases the creditor has no right to appeal to the court to declare a bargain with the debtor invalid even if it definitely violates his interests. Thus, he has to appeal to a judicial body that has such powers. The main option is to appeal to the prosecutor's office. Appealing may take much time, which in practice makes all attempts hopeless. If the case is brought to court, the debtor has a lot of possibilities to delay the court hearings. In such cases, it may be easier and cheaper for the creditor to simply forget the debt rather than try to get paid.

The second factor is the linkage effect. Trying to obtain his money back, a creditor has to make use of a lot of different norms and state authorities, which makes the process even more costly.

Finally, there is the learning effect. Debtors, especially those who know from the very beginning that they are not going to serve their debt, tend to invent increasingly complicated systems for evading payments. Thus, the creditor, in his turn, needs to invent ways to make sure that the debtor pays. The creditor's "tools" for achieving this are always less efficient than the debtor's.

Certain legislative changes should be made in order to overcome the problems discussed above. Obviously, the bailiffs need more power to be able to work effectively. There is already a bill in the State Duma suggesting certain amendments to the law "On the procedure of enforcement" that is supposed to increase the power of bailiffs. However, it might still take a long time before these amendments come into force.

Alternative methods for dispute resolution should be developed in Russia. Negotiations and mediation are the first and the most important means among such alternative methods. Negotiations, as a way of settling disputes, is a natural part of the business culture and this will surely develop together with the business culture as a whole.

6 Commercial Arbitration as a Means of Contract Enforcement

According to the Western conception (CIArb, 2001) “[a]rbitration is a procedure for the settlement of disputes, under which the parties agree to be bound by the decision of an arbitrator whose decision is, in general, final and legally binding on both parties.” The arbitrator is “independent, impartial and selected by the parties.” The decision of an arbitrator is “in general, final and legally binding on both parties” (*op. cit.*). Arbitration is highly praised by many Western and also Russian legal authors as an excellent alternative to litigation.[25]

The advantages of arbitration, said to be comparable to those of litigation, are the following:

1. Privacy. Unlike the court procedure, which is generally open to the public, the arbitration process is private and confidential.
2. Expertise. The parties may appoint an arbitrator who is an expert in the matter under dispute.
3. Flexibility. The parties may determine the procedure of arbitration according to the matter under dispute and their own interests.
4. Costs. Arbitration is said to be less costly than litigation.
5. Finality. The award of the arbitrator is final and binding upon the parties.

However, in spite of all these advantages, commercial arbitration is still not (yet) widely used in Russia as a means of dispute resolution in business life. It is mainly applied in disputes with foreign partners and only because the foreign partner does not trust the Russian courts. And, as we will see in the sequel, most advantages listed above do not apply to Russia.

However, during the last 5–7 years, the number of commercial arbitration courts, so-called *treteiskie sudi* has grown, while the number of cases decided by these courts is still very modest. For example, the International Commercial Arbitration Institute at the Chamber of Commerce and Industry in Moscow, which is the most popular of the Russian *treteiskie sudi*, handles approximately 500 disputes per year. Another popular arbitration court in Southern Russia — the “*treteiskii sud*” belonging to the interregional non-commercial organization YugAgroFond in Rostov Oblast — has given 220 awards since 1998.[26] The oldest arbitration court in Siberia (in Novosibirsk Oblast) has given more than 100 awards since 1993.[27] These numbers of awards are of course insignificant compared with the number of decisions made by the arbitration courts.

In general, the *treteiskie sudi* are affiliated with the Chambers of Industry and Commerce in various Russian regions and there are also such courts belonging to bank

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[25] See, for example, Coulson (1984:13–27), who regards litigation as something very negative and harmful. See also Musin (1999).
[26] See URL: http://www.adr.ru/index.htm (28 November 2001).
[27] See URL: http://consult.gcom.ru/sibtret/ (28 November 2001).

associations and unions, which try to minimize their expenses for collecting debts from their clients. Banks often insist on including an arbitration clause in the credit contract.

In December 1999, the Chamber of Industry and Commerce in Arkhangelsk founded an arbitration court. Its founders are now trying to make it popular with the region's forest enterprises but, so far, they have not been very successful.

6.1 Russian Legislation Governing Commercial Arbitration

The main problem with private commercial arbitration, which probably prevents it from becoming more popular in Russia, is the lack of proper legislation. There are currently two legislative acts that regulate ordinary arbitration. The first is the "Temporary Regulations for the *treteiskii sud* on commercial dispute resolution," adopted by the Supreme Soviet of the Russian Federation on 24 June 1992. The other act is "The Regulations on *treteiskie sudi*," which is an appendix to the Code of Civil Procedure. The first act consists of 26 articles and deals only with the most general rules of commercial arbitration. The second act is so old that it is not relevant for the new conditions of life and really incompatible with newer legislation.[28]

The two regulations were intended to be temporary. They were to be substituted with a more appropriate and detailed act in the near future. However, after being in force for eight years there is still no sign of a new act.

The specific legal problems that have not been solved in the present legislation and that are preventing further development of commercial arbitration, are the problem of appeal of the awards and the problem of enforcement.

The existing regulations provide unequal opportunities for the plaintiff and the defendant to challenge the award. Actually, the regulations have no stipulation concerning challenging the award of a *treteiskii sud*. There are, however, grounds on which the arbitration court may refuse to grant a writ of execution to enforce awards. They are:

- the absence of an agreement on dispute resolution in the *treteiskii sud*;
- the arbitrators or the procedure did not correspond to the parties' agreement;
- if the party against which the award was made was not informed properly about the day of proceedings or failed to handle its statement for other reasons;
- if the dispute concerned the sphere of public law and could not be settled by the *treteiskii sud* in accordance with existing law; and
- if the arbitration court finds that the award does not meet the requirements of the law or if it was issued without proper examination of all evidence.[29]

[28] The federal law "On international commercial arbitration" is applied only to commercial arbitration, settling disputes between parties from different countries. This is not further discussed here.
[29] It should be mentioned that the New York Convention on the Enforcement of Foreign Arbitral Awards cannot be applied in the case of Russian *treteiskii sud* awards because, as the Convention states, arbitral

Thus, the defendant against whom the award was made may in practice challenge it only during the procedure of granting the writ of execution. However, a plaintiff whose claim was not successful does not have this possibility. If the court refuses to grant a writ of execution for procedural reasons, the regulations do not stipulate what should happen with such an award. It is not clear whether the parties should again start an arbitration procedure or whether the plaintiff could appeal directly to an arbitration court.

Foreign models of arbitration suggest different approaches to the problems of challenging arbitration awards and their enforcement. Practically all of them have one common ground and that is the lack of jurisdiction or a serious irregularity during the proceedings.

When it comes to challenging the award from the point of view of substantive law, different countries have differing regulations. For example, the United States Federal Arbitration Act provides only a minimum standard allowing the challenge of awards on the grounds of manifest disregard of the law. The federal courts have also worked out precedents, which allow the parties to include in their arbitration clauses the possibility to challenge the award under review standards agreed upon by the parties, such as, for example, substantial evidence or errors of law.[30]

Unlike the American case, the Swedish Arbitration Act of 1999 does not permit appeals on material grounds. The only exception is when the award is clearly incompatible with the basic principles of the Swedish legal system. This means that the award must violate the most significant provisions of the legal system and generally those of the Constitution.[31]

The Arbitration Act of 1996 in the UK allows the possibility to challenge the award if a legal error arose out of an award. Article 69 of the Arbitration Act establishes the necessary conditions to receive leave of the court to challenge the award on the point of law. One of these conditions is that the decision of the tribunal is obviously wrong. This Act also allows the parties to exclude the jurisdiction of the court on the point of law. This means that the parties can agree in advance that neither of them will challenge the award on the point of law. It is worth mentioning that the UK Arbitration Act of 1996 was created as a document that would be easily understood not only by English, but also by foreign parties and their legal advisers (Oyre, 1999). This aim was achieved. The act gives a clear and logical presentation of the main principles of the English law of arbitration.

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awards pronounced on the territory of another state should be recognized and enforced in countries who have signed the convention. This seems to mean that foreign trade should be treated in the same way as domestic trade. Certain limitations on the enforcement of decisions pronounced in another country are necessary to protect public interests and these limitations cannot be applied to the domestic awards. But practically all grounds for refusing to recognize and enforce the arbitral award stipulated in the Convention are also found in the Russian regulations on *treteiskie sudi*.

[30] See *European Arbitration*, issue 25, 27 February 1998 at URL: www.interarb.com/vl/ea/ea25.htm (28 November 2001).

[31] The Swedish arbitration act, see URL: http://www.chamber.se/arbitration/english/ (28 November 2001).

All these acts provide regulations that differ from those existing in Russia. They are detailed, unequivocal and very comprehensive, which cannot be said about the Russian regulations.

Uncertainty in challenging arbitration awards and the unequal positions of the plaintiff and the defendant in challenging the award and, thus, in enforcement, constitute the main problems with the Russian *treteiskie sudi*. These problems prevent commercial arbitration from becoming a widely used means of dispute resolution in Russia.

Apart from the weaknesses with the legislation mentioned above, there are also other reasons making commercial arbitration uncertain. One reason is the arbitrators themselves. Usually they are lawyers or specialists in other fields, such as accounting, construction or sometimes even public servants. For example, all persons listed as arbitrators of the Siberian *treteiskii sud* have a legal background and have demanding full-time jobs, which require all their time. They work as legal advisers to banks, directors of firms, lawyers, and so on.[32] The problem for the parties is to be sure that the arbitrators are competent and that they have enough time for the job. The situation is all the more uncertain since there is practically no possibility to appeal.

6.2 International Arbitration and Forest Enterprises

As was already mentioned, the only field where the *treteiskie sudi* have obtained some popularity is for the settlement of disputes between Russian and foreign enterprises. An arbitration clause is a common feature of almost all export and import contracts, since the majority of foreign enterprises traditionally prefer to settle disputes with the help of non-governmental bodies.

In export and import contracts, forest enterprises normally try to suggest the International Commercial Arbitration Court of the Russian Chamber of Commerce in Moscow as the forum for handling disputes that might arise. For the Russian enterprise, this is much more convenient compared to any other international arbitration institute. The arbitration fees in this court are much lower than in other arbitration institutes. For example, if the value of the dispute is 10,000 US dollars, the arbitration fee in the International Institute of Arbitration of the International Chamber of Commerce in Paris would amount to between USD 5,000 (if the dispute is settled by one arbitrator) and USD 10,000 (if there are three arbitrators involved). The arbitration fee in Stockholm would be from USD 4,300 to 6,800, while in Moscow the arbitration fee would merely be about USD 2,000 for a similar case.

The majority of international arbitration institutes demand advance payments. Moreover, regulations on arbitration procedure normally stipulate that both parties should pay equal shares of the cost in advance.[33] However, the defendant will often try

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[32] See the web site of the Siberian *treteiskie sudi* at URL: http://consult.gcom.ru/sibtret/ (28 November 2001).

[33] For example, see Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, art. 14 (URL: http://www.chamber.se/arbitration/english/) (28 November 2001).

to avoid this payment, forcing the plaintiff to pay the entire sum. If he does not do so, his claim will be dismissed.

During the last few years (and partly for economic reasons) Arkhangelsk enterprises have tried to include in their foreign trade contracts a jurisdiction clause referring possible disputes to the arbitration court of the Arkhangelsk region. This court belongs to the Russian state court system. However, foreign parties often reject this clause, but it is widely used in contracts with enterprises from the CIS countries.

Sometimes, Russian enterprises try to use so-called dual competence. In such clauses the jurisdiction depends on who the plaintiff is. If the plaintiff is a Russian enterprise, the dispute should be settled in the International Commercial Arbitration Court of the Russian Chamber of Commerce, while if the plaintiff is a foreign enterprise the dispute should be settled at one of the international commercial arbitration institutes, of which Stockholm is the most popular.

Fortunately, there have not been so many disputes with the foreign partners of the Solombala pulp and paper mill. The main means for settling these disputes have been negotiations. This is much cheaper than suing. All negotiations are normally conducted through letters. It is only when product quality is in question that the Solombala representatives might have to go abroad. If negotiations do not produce any results the dispute goes to the company's law department.

It is obligatory to have an arbitration clause in all foreign trade contracts. The Solombala pulp and paper mill usually tries to designate the Arbitration court of the Archangelsk region as the organization to handle disputes. This is used in the contracts with partners from the CIS countries and also sometimes with partners from other countries. The International Commercial Arbitration Court of the Russian Chamber of Commerce in Moscow is also often agreed on for settling disputes in the arbitration clause of trade contracts. And only if the foreign partner strongly objects to having a Russian forum for arbitration, is an international arbitration institute chosen (this will often be the Stockholm forum).

In the last 10 years, during which foreign trade has been liberalized, there was only one case that the Solombala pulp and paper mill had to bring to an international arbitration institute to make the foreign partner pay for delivered goods. This arbitration was held in 1994 in Vienna against a company from Luxemburg. The main problem was that Luxemburg has not sign the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards and there were large difficulties in enforcing the award. Finally, the Solombala mill had to threaten the general manager of the Luxemburg firm to make his personal lack of conscience publicly known. Only then was an agreement reached and some of the money could be retrieved.

On only one other occasion the Solombala mill started a procedure in the International Commercial Arbitration Court of the Russian Chamber of Commerce in Moscow. This procedure was never finalized, since the defendant paid the whole sum under dispute before the start of the court hearings.

There was also a case when the Solombala mill prepared to apply to the International Commercial Arbitration Court of the Ukrainian Chamber of Commerce. But the application was never submitted since the fee of this arbitration institution was simply too high and the prospects of enforcing a decision on Ukrainian territory were too weak. In this situation it was better to forget the debt.

Another dispute with a foreign enterprise took place in 1999. It was a dispute with a firm from Uzbekistan. According to the contract the competent forum was the Arbitrazh court of the Arkhangelsk region. Its award was recognized in Uzbekistan and enforcement was in fact allowed, but still no money has come from the Uzbek firm.

6.3 Conclusions

What might be done to improve the situation with the Russian *treteiskie sudi* and make private commercial arbitration more widely used in Russian business life?

First of all a federal law on *treteiskie sudi* should be adopted. This law should regulate procedural matters that the tribunal should follow unless the parties have agreed otherwise, as well as the rules for challenging the award and its enforcement. One more important question that should be regulated in this law is the role of state bodies with respect to private commercial arbitration.

It would seem that private arbitration procedures should need no state regulation and that everything might be left to the discretion of the parties of a dispute and to the permanent arbitration bodies that could establish any rules they like. Abundant experience in West European countries and the USA, however, proves the reverse. These relations should be regulated by law. Such regulation is especially important for defining the power of state bodies with respect to the awards of *treteiskie sudi*.

The UNCITRAL Model Law on commercial arbitration may be used as a model for a new federal law on *treteiskie sudi*.[34] The UK arbitration act may also serve as a good example. Both acts are very comprehensive. Their provisions can easily be used in any country irrespective of its existing legal system. The aim of the UNICITRAL Model Law was to offer a universal model of a law on commercial arbitration that might be used in any country.

Speaking about arbitration in Russia there is one more thing to be taken into account. All advantages that arbitration is said to have compared with litigation do not exist in Russia. For example, as for the privacy of a dispute settlement, in Western countries litigation often affects the reputation and credit rating of a person involved in a negative way.[35] In Russia, it is the other way round. Information that a company has successfully

[34] *The UNCITRAL Model on International Commercial Arbitration*. United Nations document A/40/17, Annex I, adopted by the United Nations Commission on International Trade Law on 21 June 1985. This Model Law has already been used as a model for the federal law "On international commercial arbitration".

[35] Coulson (1984) states, "even the rumor of a pending lawsuit can impair a company's credit or drive down the value of its stock".

sued, for example, the tax authorities, or that it has won a large case against an unfair partner, often affects business opportunities in a positive way.

Another feature — costs — also speaks in favor of litigation in Russia. This has already been illustrated above.

The last and most significant feature — the speed of settlement — also often speaks in favor of litigation. With the exception of extreme cases, it generally takes four months to receive a final decision. When the Solombala pulp and paper mill submitted a dispute to the International Commercial Arbitration Court of the Russian Chamber of Commerce in Moscow it took five months of correspondence before the case was even appointed to a hearing.

7 Ecological Control

Environmental law plays a significant role in the work of law departments of Russian forest enterprises. The Solombala pulp and paper mill mainly deals with three natural resources: water, air, and land. The main question concerns waste disposal. Since the mill is not very engaged in forest harvesting, the problems of using wood as a natural resource are not of great concern to the Solombala mill. The same may be said about minerals.

The purpose of this section is not to discuss Russian environmental law in detail. Such a study of Russian environmental law would require a separate report. There are, however, two significant problems of environmental character that Russian forest enterprises must face and that will be discussed at some length here. The first problem concerns the confused distribution of power between environmental authorities. The second problem concerns “hidden taxation”.

7.1 Confused Distribution of Power Between Environmental Authorities

There is some confusion in the distribution of powers between different governmental bodies engaged in environmental protection, the management of natural resources, and the supervision of the use of natural resources.

The distribution of power between different governmental bodies is probably most complicated in the case of water resource use. Until recently, there were three different governmental bodies in charge of different aspects of water use. In the Arkhangelsk region they were (a) the regional service of sanitary-epidemiological supervision, (b) the Dvinsko-Pecherskoe basin industrial water department, which belongs to the Ministry of Natural Resources, and (c) the regional department of the State Committee on Environmental Protection. All three bodies have their own regulations and requirements for water use and according to their regulations, each of them has the right to supervise the quantity of polluting substances disposed into the water with sewage. Their rights are so mixed that each of the organizations can make inspections of one and the same question, each of them has the right to give mandatory orders to enterprises, and each of

them can fine enterprises. Sometimes, it happens that one of these organizations makes an inspection and finds no violations. Then, a few weeks later, another body comes to a completely opposite conclusion.

Another problem caused by the confused rights of these various government organizations concerns the requirement to obtain decisions from all of them for the same application. When an enterprise has to make a plan or provide documentation concerning ecological matters, it has to take it to every governmental body dealing with environmental protection. Since these bodies have different requirements for the same matters it is not easy to get documents accepted or obtain licenses.

A recent example from the Solombala pulp and paper mill is: Each industrial enterprise in Russia must establish a sanitary zone around its premises. The state committee on environmental protection must confirm the plans for this zone. Before the plan for the sanitary zone can be confirmed it must also be confirmed with the sanitary-epidemiological service. The problem that the mill faced was that the committee and the sanitary service use different Sanitary Norms and Regulations. The Committee uses an earlier, and the sanitary service a more recent version. Each of them is based on the instructions of the federal body to which they belong. However, it is the enterprise that has to disentangle the complicated knot of contradictions. Thus, misunderstandings between governmental bodies engaged in environmental protection create a lot of problems for forest enterprises in need of official sanctions for their environmental activities.

This problem of confused rights in the environmental sphere is not, however, unique for Russia. Even developed European countries have more or less similar problems. The public's increasing awareness and anxiety concerning environmental issues have led to a situation where governments respond by establishing even more agencies to engage in different environmental protection issues. It is hardly surprising that the more governmental agencies a country gets the more unclear the distribution of rights between these agencies becomes. Each of them believes that it is best suited to handle the problems and in this way the regulations of different agencies start to contradict one another.

Today, many European countries have similar systems of governmental bodies in charge of ecological questions. There are normally two such systems. The first usually consists of a Ministry of the Environment (as in Sweden, Austria, and Denmark), or a Department of the Environment (as in the UK — this actually corresponds to a ministry). These ministries are in charge of the environmental policy of the country and have the right to issue regulations on ecological matters. The second type of system consists of an Environmental Protection Agency.[36] This body is usually engaged in pollution control, monitoring and providing information about the state of the

[36] The exact name of the agency can differ: Directorate of Environment in Denmark, Federal Environmental Agency in Austria, Environmental Agency in the UK, and Swedish Environmental Protection Agency in Sweden.

environment in the country. In all these countries, local authorities have a wide range of powers in the ecological sphere.[37]

Even if all these countries have similar environmental organization systems that have already been working for decades, they have still not been able to solve all the problems of confusion of rights between various entities in the system. One of the most vivid examples is probably the United Kingdom. Until the reform of 1995, the English system of environmental protection was severely criticized. It was said to be over-fragmented, and giving rise to grave doubts as to whether ecological matters could be effectively coordinated (Hughess, 1992).

The Environmental Agency was introduced in the UK through the Environmental Act of 1995. Its introduction was an amalgamation of three of four main regulatory agencies — the National Rivers Authority, the Waste Regulation Authorities and Her Majesty's Inspectorate of Pollution. The overall emphasis of the reform was on central guidance to improve the consistency and quality of decision-making. The Environmental Agency assumed responsibility for the majority of powers in relation to pollution control.

However, in spite of the reform there are still some problems with the rights distribution between different environmental authorities. For example, there are some overlaps between the Environmental Agency and nature conservation bodies. The problem of rights distribution also exists at the local level. In non-metropolitan areas there is a two-tier system of county and district councils. The problem is particularly acute in the environmental sphere because of the overlapping powers of the two tiers, and especially problematic in, for example, town planning (Ball and Bell, 1995).

7.2 "Hidden Taxation"

The second main problem in the legal regulation of the environmental field concerns the so-called "hidden taxation" of the users of natural resources by the authorities managing natural resources.

During the recent period, income from paid services rendered by authorities in charge of the management of natural resources has become one of the most significant financial sources for these governmental bodies. According to a report published by *Goskompriroda*, the Russian State Committee on Environmental Protection (Itogy raboty, 2000), paid services brought about 16 percent of the total funding of the Committee in 1999.

Every state organization that wants to be paid for its services has a long list of tariffs. In the forest sector the most significant service for which enterprises have to pay is the one

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[37] See, e.g., the following presentations on the Internet: Ministry of the Environment, Sweden, at URL: http://www.miljo.regeringen.se/english/english_index.htm; Austrian Federal Environment Agency at URL: http://www.ubavie.gv.at; Jensen (1976); Ball and Bell (1995).

connected with the allocation of harvesting sites.[38] In some regions such services as confirmation of lease agreements, and ordering of harvesting tickets are liable to a charge. Apart from this, access to information about the forest fund, preparation of materials for assigning forest plots to lease, preparation of documents for land-allocating purposes, etc., might also be charged.

The governmental bodies themselves determine the price for their services. A majority of these services are mentioned in the laws and regulations for these bodies as their duties. Thus, the above mentioned paid services all have the character of an additional "tax" for the users of natural resources.

One such case of "hidden taxation" has been discussed in the Supreme Court of the Russian Federation. The Land Committee of the Kemerovo region had confirmed the regulations for a Cadastre Bureau that was an integral part of the Land Committee. Several articles of these regulations stipulated the right of the Cadastre Bureau to provide paid services connected with the state land inventory. One of the enterprises appealed to the Kemerovo Regional Court to have this order partly declared invalid. The Court complied with the suit and ruled that conducting the state land cadastre is a governmental function of the Land Committee and must be carried out at the expense of the federal budget and the revenues obtained as land tax and land rent payment. The Supreme Court of the Russian Federation retained the decision of the regional court in force and held that such paid services must be considered as additional taxation. And according to the law "On the foundations of the tax system in the Russian Federation", taxes can only be established by law. Thus, the decision of the Land Committee of the Kemerovo region was declared invalid.[39]

In spite of the decision of the Supreme Court there are still many similar instances (and not only in the environmental field), when state bodies in carrying out some controlling functions, demand payment from the persons they supervise. Usually it is very difficult to argue with them, because all enterprises want to have good relations with supervising authorities. Thus, they prefer paying a small amount of money rather than bringing a dispute to court, which would mean an open fight with a governmental body.

7.3 Conclusions

From the enterprise's point of view there are two disturbing problems in the sphere of environmental control:

1. the confusion in the distribution of powers between different governmental bodies, and
2. the problem of "hidden taxation".

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[38] The certificates issued for this purpose regulate how a certain operation should be carried out. They includes measures to prevent workers' injures, to provide ecological safety and prevent pollution and so on.

[39] Decision of the Supreme Court of Russian Federation, Bulletin of the Supreme Court, No. 2, 1998, URL: http://www.supcourt.ru/ccc/bullettin/98/02-98/102.html (28 November 2001).

Both problems are connected with corruption. It is easier and cheaper for an enterprise, especially for a large enterprise, to bribe a civil servant than to go through the whole complicated system of governmental bodies with their different demands. Four stabilizing effects contribute to this, namely the coordinating effect, the learning effect, the linkage effect, and the cultural inertia effect.

The transaction costs of bribing are lower than those of following all environmental regulations. Moreover, the techniques of giving and taking bribes have become quite sophisticated and the danger to being caught is comparatively small. Some attempts are, however, being made to change this situation in Russia.

In May 2000, a new structure of federal executive bodies was established by a Presidential decree (Decree No. 867). According to this decree, the State Committee on Environmental Protection, as well as the Federal Forest Service, were liquidated. These authorities were merged with the Ministry of Natural Resources of the Russian Federation. Different opinions have been expressed about this Presidential decree. The majority of non-governmental organizations in the environmental sphere protested against the liquidation of the independent bodies of environmental protection.[40] The federal governmental bodies, however, regard such changes as a positive step. In an interview, the Minister of Natural Resources at the time, B.A. Yatskevich, explained that a unified structure would help to eliminate the legal confusion that existed earlier due to the many departmental and interdepartmental barriers.[41]

From a company lawyer's point of view, enterprises will surely benefit from this reorganization of controlling bodies. Unifying all bodies dealing with environmental control under one roof may really help to remove the existing legislative confusion.

The most efficient way to overcome the problem of hidden taxation is that enterprises try to resist it and appeal to courts to declare the practice illegal. It would be good if such court practice could also influence the legislative level. Court precedent is not a source of law in Russia and it cannot therefore provide sufficient protection of the interests of enterprises.

8 The Social Responsibility of Enterprises

Enterprises' social responsibility in Russia differs significantly from that of western companies.[42] During Soviet times enterprises, especially large enterprises, carried a vast social responsibility. Towns were usually built around a large enterprise, which dominated, not only as the most important employer, but also as a source for providing various social services. Enterprises provided housing for their employees and took care of housing maintenance; they also built and ran schools, health care establishments, and

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[40] See e.g. URL: http://www.forest.ru, and http://www.greenpeace.ru.

[41] See URL: http://www.forest.ru/problems/control.

[42] The term "social responsibility" is used here to indicate the obligations of the company to provide for the needs of the local community in the territory where the company is located. It should be noted that during the last years the western conception of corporate social responsibility has been expressed in the form of "stakeholder theories". This has had practically no influence in Russia so far.

cultural clubs. Usually infrastructural constructions, such as drinking water distribution, sewage, and communal heating stations, which were constructed together with large enterprises, were operated at their expense,[43] and the services provided were essential not only for the enterprise itself but also for the whole local community. This was considered a useful arrangement for both the enterprise and the community.

However, after the privatization of state enterprises the situation changed. Economic difficulties made enterprise managers look for ways of decreasing operating costs. One of the most obvious ways was to try to get rid of different social obligations, which required a lot of resources but gave little or no profit. This process has been successful at least to some extent and this is the reason why managers nowadays are against attempts to impose more social responsibility on their enterprises.

The Russian conception of enterprises' social responsibility is special inasmuch as it is based on the law, which stipulates a lot of obligations that enterprises have towards the local community. The most vivid example is housing maintenance. The Housing Code of the Russian Federation stipulates that the enterprise, which "has an apartment on its balance" is a landlord in the relation to the person who lives in this apartment. This means that the enterprise has all the obligations of a landlord, including the obligation to care for capital repair, providing the person with a new apartment if the present one is too old or in a bad condition, etc.

8.1 Types of Social Responsibility of Forest Enterprises

Nowadays, there are three main types of social responsibility of forest enterprises.

The first deals with housing; health care; schools and kindergartens; summer camps; and social and cultural clubs, etc. The main responsibility of the enterprises is connected with the maintenance of all these activities as long as they "remain on the enterprises's balance" and sometimes even afterwards.

The second social responsibility deals with engineering infrastructure, like heating stations, purification constructions for drinking water and sewage, boiler-rooms, etc. In this field, the social responsibility of enterprises takes the form of service provision of vital importance for people or the local community as a whole.

The third social responsibility is sponsorship.

8.2 The First Social Responsibility

The Presidential Decree No. 8 dated 10 January 1993 prohibits the privatization of enterprises' social and cultural activities, which were "on their balance" before

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[43] During Soviet times — and this applies even today to state and municipal unitary enterprises — the enterprise did not own its assets. These were owned by the State. Enterprises merely had state property in so-called "industrial possession". The expression for explaining this kind of possession was that the assets of the enterprise "were on its balance", which actually meant that they were written down in the enterprise's accounting books.

privatization, when the enterprises themselves were privatized. Among such activities are apartments, health care, children's camps, buildings used by the trade organizations, and so on.

According to Paragraph 6.14 of the Program for the Privatization of State and Municipal Enterprises in the Russian Federation, all these objects have to be transferred to municipal authorities within six months from the date of confirmation of the privatization plan. This provision has, however, very often been violated because local authorities have no money to maintain the activities or they just do not want to take the responsibility for a very old infrastructure. Before it has been transferred, this infrastructure is considered to be state property and it stays on the enterprise budget. The enterprise still has the responsibility for the proper functioning of it although it is not the property of the enterprise. Usually nobody covers the maintenance costs of such infrastructure.

Various legislative acts establish the possibility of concluding agreements on joint financial support of social infrastructure by the enterprise together with the State or the municipality. However, usually neither the State nor the local community wants to take any financial responsibility, if there is a chance that someone else might do it.

It is impossible nowadays for enterprises to be reimbursed for the maintenance of social infrastructure even through a court. There are several published court cases about enterprises trying to get compensation for the expenses of maintaining social infrastructure, and the enterprises lost in all cases. One good example is the case of the joint stock company "Gnezdovo" from the Smolensk region.[44] This joint stock company appealed to the arbitration court to obtain compensation from the administration of the Smolensk region and the Government of the Russian Federation for the expenses of maintaining houses. The court disallowed the claim. The court came to the conclusion that the dispute concerns a claim of compensation from the budget and redistribution of the budget funds, which belongs to the competence of the legislator and not the court.

Thus, the share of the costs for maintaining the social infrastructure remains quite high for the forest enterprises in Arkhangelsk Oblast. Studying the institutional embedding of the Arkhangelsk forest sector Carlsson *et al.* (1999) estimated the total maintenance costs for the social sphere to be supported by the region's forest enterprises to be 203.4 billion rubles in 1996.

These costs should be paid by the companies' net profits. Typically, enterprises tend to find more profitable ways to spend their money — if there is any money to spend at all. For example, in 2000, the Solombala pulp and paper mill spent 8 million rubles for social purposes, but this sum should be added to the money that the company spent on reconstruction works.

Enterprises try to get rid of these costs and transfer the social infrastructure to the municipalities. This is, however, not an easy process. Sometimes even a court decision

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[44] Cf. Decision of the Presidium of the High Arbitration Court of the Russian Federation, No. 1566/96 of 25 June 1996.

is necessary to initiate the process. For example, JSC "Solombala saw mill" waged a legal suit against the local administration and the committee for the management of state property to declare illegal the inclusion of a road serving both the company and the city into the property of the mill. The court decided the inclusion illegal. But it did not oblige the municipality to make the road municipal property. So the problem still exists — the road is not the property of the mill, but its maintenance is still the mill's responsibility.

Despite all these problems there are forest enterprises that continue to carry out certain social programs making it a visible feature of their market reputation. For example, the Solombala pulp and paper mill still runs a sanatorium where its workers can receive medical treatment to prevent or cure professional illnesses.

Some forest enterprises situated in small towns and villages still bear the responsibility for various "social objects", such as houses, kindergartens, schools, etc. The "Onegsky saw mill", for example, finances a music school. The JSC "Konetsgorsky lespromkhoz" still has a lot of houses and a school.

8.3 The Second Social Responsibility

The legislation about privatization allowed the technical infrastructure to be privatized if it was situated on the company's premises and if there was a close connection between this infrastructure and the technological process of the company.[45] This means that a lot of technical infrastructure has become the property of privatized enterprises.

Nowadays, enterprises provide local communities with services that are vitally important for the population, such as heating, electricity, drinking water, sewage, etc. The law governing such relations obliges the enterprises to provide certain services and then it considers the company to be a monopoly on this specific market. For example, the Solombala pulp and paper mill has the only sewage purification construction in the city. Therefore, it provides the local community with waste water purification.

Such arrangements raise the question of how to build sound relations between the local community and the enterprises and what legal means can be used to balance the interests of the enterprise and the local community? There are different legal regimes in operation in this field. Each enterprise can use any one of these regimes depending on the local conditions. For example, the joint-stock company "Arkhenergo," which supplies the city of Arkhangelsk with electricity and heat, has direct contractual relations with every enterprise and citizen using electric power. This means that the company has concluded thousands of contracts with organizations and individual citizens, and that the company itself takes care of collecting fees from their customers. The company has a special customer department. This regime has both advantages and disadvantages. On the one hand, the company has to deal with thousands of customers,

[45] The "Regulation about the order of transferring infrastructure used for social, cultural, and communal purposes, which are in federal property to the property of the subjects of the Russian Federation and to municipal property", was confirmed by a Governmental Decision of 7 March 1995.

which is not an easy task. On the other hand, they can control payments and use various ways to deal with different customer groups.

Another regime is used by the Solombala pulp and paper mill. The mill owns the only local waste water purification facilities, the technological process of producing pulp necessitates such facilities. In fact, according to the building plan, 50 percent of all polluting substances produced in the region comes from the mill. Some substances produced during the pulping process are also used in the purification of sewage. The sewage transportation net, however, belongs to the city. There is a so-called unitary municipal enterprise[46] set up especially to manage this net. There is a contract between this municipal enterprise and the mill on the purification of the city's waste water. The mill has only one customer, the municipal unitary company, which represents the whole population and the majority of the enterprises in the city of Arkhangelsk. The municipal enterprise has thousands of contracts with the population and various organizations to supplying them with drinking water and dispose of their sewage.

The main problem for the Solombala pulp and paper mill in this contractual arrangement concerns payments. The municipal company is supposed to earn money and the local administration takes no responsibility for the company's debts. Often the enterprise has no money to pay its debts. The main cause of this cash flow problem is that organizations that are financed over public budgets at all levels do not pay for services. There is a whole chain of non-payments. If the budget does not fund public organizations, such as schools, hospitals, and the army, then these organizations cannot pay the municipal company for water and sewage and the latter has no money to pay the Solombala mill for its purification services. It is easy enough to obtain a court decision against the municipal company, but it is very difficult to enforce this decision. Thus, problems may occur not only because of the main difficulties in this field (which was already described in Section 5.3), but also because of the legal status of the enterprises. On the one hand, the local administration bears no responsibility and is not supposed to make any attempts to solve the problem. On the other hand, it is the local administration that is the real proprietor of all the assets of the enterprise. Moreover, organizations that are funded via the local budget can usually be included among the main debtors of the municipal company.

From a legal point of view, all assets of the municipal company can be arrested and sold to cover its debts, but it is not easy to persuade the bailiff to do so.

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[46] A unitary enterprise is as a form of legal person in Russia. It is a unique legal construction, which does not exist in any other country and it can be traced back to Soviet times. Only state and municipal enterprises may be established in this form. These enterprises have no normal owner's rights to their assets, the assets being in so-called "industrial possession". The real proprietor of the assets is the State or the municipality. These enterprises are entitled to possess and use their assets, but they need to receive permission from the real proprietor if they want to sell or dispose of their immobility in some other way. There are also some further limitations of their market activity.

8.4 The Third Social Responsibility

During recent years sponsorship has become popular in Russia. Large industrial enterprises usually sponsor various cultural establishments, such as dancing collectives, choirs, and so on. Several forest enterprises in Arkhangelsk have become members of the sponsor committee of the local bandy team "Vodnik." Thus, during the Russian championship entrance to the matches where "Vodnik" plays is often free of charge.

8.5 The Western Conception of Enterprises' Social Responsibility

A western company's understanding of social responsibility is very different from the Russian conception. During the last 10 years, the notion that a company has other responsibilities apart from the one it has to its shareholders to make profits, has become prominent in the West. Companies are expected to share the wealth it has acquired with the people in the region or muncipality where they operate. This can be done through the creation of "collective goods" like schools and health care centers. This is looked upon as a matter of distributive justice (Lea, 1999).

This modern western concept of social responsibility is based on two principles, namely, the charity principle and the stewardship principle. The charity principle is based on the idea that more fortunate people in society should take care of those less fortunate. Corporate philanthropy is not, however, the same as corporate social responsibility, because it is not based on a duty or obligation, but on "the desire to do good". Nevertheless, it can still be considered as one of the pillars of current thinking in this area.

According to the second principle, corporate managers, who run privately owned firms, are stewards of trustees able to act in the general interests, rather than just serving their shareholders. Professional managers have been placed in their position by public trust and are therefore expected to act with a certain degree of social responsibility when making business decisions (Kolk *et al.*, 1999).

New theories of corporate social responsibility, so-called "stakeholder theories," are also currently emerging. These theories suggest that there is a multiplicity of groups having a stake in the operations of the firm, and all of them merit consideration in managerial decision-making. A stakeholder is defined as an individual or group who can affect, or is affected by, the achievement of the organization's objectives (Lea, 1999).

All of these theoretical approaches have found their practical reflection in various "Codes of Conduct", containing rules under which a company should operate. A lot of such Codes have been created during the last 20 years by different actors, such as social interest groups, business support groups, international organizations, and companies themselves. Most of them have a voluntary character. These Codes of Conduct generally contain statements about social, environmental and more generic aspects, including community interests, such as community philanthropy (Kolk *et al.*, 1999).

The codes of conduct have often been criticized for their voluntary character, which only allows them to produce limited effect (cf., for instance, Kolk *et al*., 1999; Paton, 2000). But some such codes, typically drafted by business supporting groups, have had real success and are highly appreciated by consumers. The *Principles and Criteria* of the Forest Stewardship Council may be mentioned as an example. This Council is "an international non-profit organization founded in 1993 to support environmentally appropriate, socially beneficial, and economically viable management of the world's forests".[47] Paragraph 4.4 of its *Principles and Criteria* stipulates that "Management planning and operations shall incorporate the results of evaluations of social impact. Consultations shall be maintained with people and groups directly affected by management operations".

In some countries where the voluntary character of Codes of Conduct does not satisfy the people's demand, there have been attempts to make business more socially responsible through legislation. For example, the United States has recently passed a certain "other constituencies" legislation, which stipulates that directors should not only consider company profit margins in their decisions but also the interests of the employees and the general public. These statutes have been enacted by at least 25 US states (Lea, 1999).

8.6 Conclusions

A company functions within society and has to take into consideration the influence its activity may have on the local community and people around. However, producing a profit is the main, although not the only, goal of a company. A company is a commercial entity, not a social one. The social responsibility that forest enterprises now carry in Russia, especially in rural parts of the country, where they are the center of all social activities, is too demanding for them and causes additional obstacles for their economic development.

The Federal law "On the general principles of the organization of local self-governance in the Russian Federation" establishes the obligation of the local community to maintain housing, organize health care and education for the local population, maintain local roads, and so on. It is the local authorities that should be responsible for the entire social services of the community, but they do not have any legal means to take on this responsibility. They may establish special agencies with powers to do much more than an individual enterprise. The funds they receive from enterprises as tax revenues they should be used to provide the necessary services.

It is therefore necessary to redistribute the currently existing social responsibility between the enterprises and the local authorities and to put the main part of this burden on the local authorities.

In this respect the position of Lea (1999) seems reasonable. He states: "…if we expect these collective goods [i.e., public projects, such as education, public highways,

[47] See the organization's web site at URL: http://www.fscoax.org/principal.htm.

hospitals, parks, etc.] to be available, the responsibility must fall upon government rather than commercial enterprises. Private firms will, after all, only support these public projects to a point at which operations remain profitable. The same money which these firms spend on these undertakings could be captured by the government through taxes and used to support government-controlled public works" (Lea, 1999).

9 Summary

The Russian forest sector has ended up in a kind of institutional deadlock, closely related to the institutional traps that has lured the whole Russian economy into a deep crisis. One of the reasons for this deadlock is that the reform measures of the early 1990s were designed and implemented without much consideration of the necessary institutional changes.

In this final section, we try to assess to what extent the Russian economic legislation has been adapted to the new Russian market situation and to see which main mechanisms influence the formation of institutional traps in the forest sector.

- ***Does Russian economic legislation correspond to the new market conditions?***

In this paper, we have basically argued that the Russian economic legislation is in general adequate and of good quality. Russia has a good new Civil Code that regulates the activities of enterprises. There is now a Tax Code that is designed to protect the interests of taxpayers. Laws on joint-stock companies and on limited liability companies have been established using the best examples of Western legislation. Russian law stipulates a strict and easy procedure for the enforcement of court decisions.

However, as we have also seen above, there are still severe shortcomings in the legislation, for example, in the sphere of private arbitration or in the environmental field.

Thus, in general, Russian legislation meets the demands of the market economy fairly well. But good legislation does not help if the laws are not applied in real life. And here Russian reality is far from ideal. Law enforcement is deeply problematic in present day Russia. Reasons for the difficulties in implementation may be found in the fact that the laws are changed too often, there are too many, and there are often contradictory laws affecting businesses. The challenge is to find ways of improving law obedience.

- ***Penalties for the violation of rules and their impact on the emergence of institutional traps.***

The state often uses penalties as a way to prevent violations of rules. This is done all over the world. To a certain extent penalties may serve as a good remedy. But if the state uses too many penalties and these penalties are increased all the time it may produce the opposite effect.

Forest enterprises suffer much from the unreasonable strictness of the Russian capital flight prevention measures. Here, the strict penalties have two negative consequences.

First, they might mean a punishment of enterprises that did not intend to violate the law. Second, they lead to the establishment of various "fake firms" whose only goal is to avoid the capital flight prevention measures. Both of these consequences are highly undesirable.

Forest enterprises really do find themselves in a kind of trap; they need to export in order to survive, but they are always under the threat of becoming bankrupt due to the penalties (high fines) imposed by the Russian legislation if a foreign partner breaks a contract.

Thus, the use of excessive penalties may cause institutional traps, such as trading through fake firms established for a single bargain or the bribing of officials to avoid punishment.

- ***The coordination effect and its impact on the emergence of institutional traps.***

The coordination effect usually serves the formation of efficient rules that are desirable for the state, but it can also trigger the formation of institutional traps. This might happen when it is easier and cheaper for a company not to follow legal regulation.

A good example related to the activity of forest enterprises is the sphere of environmental control. The chaos existing in this sphere since the environmental protection problems were brought up as a legal issue, makes it easier to look for a compromise with controlling authorities than to follow all the different and often contradictory regulations.

As it is today, when several state authorities (with mixed competence) are responsible for the environmental protection, enterprises find themselves in an institutional trap. And the coordination effect plays an important role in this context.

- ***The learning effect and its impact on the emergence of institutional traps.***

This learning effect is one of the most powerful factors influencing the emergence of institutional traps. Once the "rules of the game" have been settled all actors learn how to behave to make the most of existing rules.

In the forest sector the best example is claims for damage. It is very difficult for an enterprise to prove how much money it has lost and that there is a casual relation between the violation of a contract and losses incurred. This is why enterprises prefer the easier way of using the penalty interest. Having once chosen this way out enterprises learn how to use it even more efficiently to serve their purposes. This will happen even if enterprises find this kind of penalty to be unfair.

- ***Cultural inertia and its impact on the emergence of institutional traps.***

Cultural inertia is a prominent effect in operation in situations of fast and profound change. The change from the administrative command economy to a market oriented system might have been too fast. Managers of forest enterprises have not been able to change their ways of thinking and their management principles that used to work well

for so many years. Legislation created for the market economy still contradicts accustomed ways of thinking.

In the forest sector the best example of the consequences of this effect might be the enterprises' social responsibility. In small villages and towns, where a forest enterprise is the only employer and where the company is making some money, people are still thinking about the enterprise as the organization responsible for most facilities in the community.

Thus, the forest enterprise again finds itself in an institutional trap; on the one hand, it is not obliged to take care of the social sphere but, on the other hand, the workers of the enterprise and its managers are all living in this community and depending on it for their subsistence.

- ***The linkage effect and its impact on the emergence of institutional traps.***

All provisions of the legal system are connected with each other through a number of links. The "rules of the game" are also connected. If someone violates one of these rules the whole game may go wrong.

Today, the "rules of the game" in the environmental field make forest enterprises try to find an agreement with the environmental authorities on mutually profitable conditions. If a forest enterprise dares to violate such an agreement it will come under a lot of pressure from the authorities. It is impossible for an enterprise with factories built in 1950s–1960s to meet all the requirements of the current Russian environmental legislation. So the linkage effect results in agreements being made between enterprises and the authorities. This may be a convenient rule for the enterprise but it is detrimental to the community.

It is outside the scope of this paper to provide specific recommendations on how to make the discussed effects support a set of efficient "rules of the game" and how to avoid institutional traps. Some economists believe that an economy is capable of gradually developing new patterns of behavior that will avoid or even dissolve existing institutional traps and all the government must do, therefore, is to support such behavior. They see the solution in the establishment of large corporations capable of reducing transaction costs. However, they also admit that certain reforms are necessary to start moving out of the existing institutional traps. Such reform measures should be directed to weakening the coordination, linkage, learning, and cultural inertia effects that currently support these traps (Polterovich, 1999).

Here, we have mainly concentrated on the legal aspects of the institutional traps that Russian forest sector enterprises meet in their daily activities. It is, however, unrealistic to believe that the law in and by itself should be able to solve all the problems and remove all the existing institutional traps but, at the same time, it is also unrealistic not to try to use the "legislative way" of solving these problems. Only by basing policy measures on a proper legislation can one make further progress in the creation of

socially efficient institutions (formal constraints as well as informal rules). Such development will again affect the legislation giving new incentives for future changes.

The role of an in-house lawyer of a forest enterprise may seem quite insignificant in the larger national context. But in providing advice on the application of legal rules and on issues concerning business and legislation, an in-house lawyer may exert certain influence on the formation of efficient "rules of the game" both inside the enterprise and among its business partners. This may be a small step, but the road consists of thousands of such small steps.

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