Analysis of Corporate Governance Disputes in the Russian Context: A Case Study of TNK-BP

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Abstract: The purpose of this paper is to contribute to the debate on the scope of corporate governance convergence. The paper analyses the extent to which the Anglo-Saxon model of corporate governance is able to deal with the Russian corporate governance environment. The investigation was conducted via a case study of TNK-BP where the British style board of directors co-exists with the oligarchic form of corporate ownership and control in the context of a 50-50 joint venture. Having considered the experience of the equal stake partnership between BP and the group of Russian investors, two practice advancing propositions have been formulated.

Key words: Russia, corporate governance, disputes, oil industry.
JEL classification: G30

1. INTRODUCTION

The subject of corporate governance has been widely researched in the past 30 years. The majority of research has been based on the agency theory initially formulated by Jensen and Meckling (1976) and Fama (1980). At the earlier stage of the discipline, the emphasis was on the largest economies, namely the US, Europe and Japan. The vast majority of such studies focused primarily on positivistic investigations looking at various corporate governance mechanisms as a proxy for financial success in the context of publicly owned organisations. The late 1980s and early 1990s were dominated by the dismantlement of the Soviet Union and consequently, a substantial amount of research was dedicated towards studying how the market-based system evolves in the hostile environment of a transition economy. Iwasaki (2007) produced a comprehensive review of such studies. The Russian experience of transition showed that although the market-based system is resilient enough to withstand the turbulence of regime change (Shleifer & Treisman, 2005), the national characteristics have the capacity to reshape and reformulate the
corporate landscape. In Russia, oligarchs\(^1\) have emerged as significant investors at the national level over a relatively short period of time (Guriev & Rachinsky, 2005). The concentration of financial resources and administrative powers in the hands of a small group of government-connected individuals has been unprecedented. This, coupled with weak market-based institutions (Pistor & Xu, 2005) and strong national heritage (Judge & Naoumova, 2004) has produced a unique corporate governance environment where significant corporate decisions depend upon self-centred motives of oligarchs who act within the constraints of political agendas and bring with them their own personalities and views on what corporate governance should in reality do for the firm. This paper addresses the question of how the Anglo-Saxon corporate governance system adapts to the above specified aspects of the Russian environment.

This organisation of this paper is as follows. Firstly, key corporate governance issues are discussed in the Anglo-Saxon context. Then, the key features of the discipline are examined in the context of a transition economy. The third section of the paper introduces the case study methodology followed by an outline of the joint venture explaining its relevance and importance to the study of corporate governance in a transition setting. The fourth part discusses three major corporate conflicts that have occurred throughout the lifetime of the venture illuminating key areas of concern. The final part offers two case-related propositions which seek to explain the main challenges to corporate governance convergence.

2. CORPORATE GOVERNANCE IN THE ANGLO-SAXON CONTEXT
In its all-encompassing sense, corporate governance is a discipline which is concerned with the way companies are controlled. In the Anglo-Saxon context, there has been a particular focus on public companies where ownership and control are separate. Berle and Means (1932) inspired a body of literature which seeks to examine the influence of ownership structures on managerial conduct. In this context, the input of wider stakeholders is of secondary importance and the role of corporate governance is more narrowly defined and manifests itself through various control mechanisms that shareholders need to put in place in order to protect their interests and ensure that the profit-maximisation agenda is achieved. Board composition, disclosure

\(^1\) The term ‘oligarch’ refers to the Russian corporate elite who accumulated their wealth and control over key corporate assets in Russia by taking advantage of poorly designed and obscure privatisation rounds of the 1990s. The original meaning of the term however, may no longer technically apply to this class of Russian society in the contemporary setting. This is because within the last decade, there has been a significant shift of political and economic powers in the direction of the Russian state and away from private wealth (Hanson & Teague, 2005). However, we chose to continue using this term because firstly, it is widely used and is highly recognisable in the Russian context and secondly, the use of other terms (such as Russia’s richest businessmen or tycoons) camouflages the kleptocratic origins of the individuals in question.
requirements, remuneration policies, accountability, internal and external audits are all control mechanisms that seek to reduce agency costs by both minimising the extent of insider dealing (managers acting in self-interest) and encouraging profit-maximisation and thus establishing “a nexus of optimal contracts” (Solomon, 2010). Although the above mentioned mechanisms are prima facie consistent with the agency theory, other theoretical perspectives such as institutional theory, resources dependency theory, stewardship theory, legalistic and eclectic perspectives have been relied upon in terms of their explanatory powers relating to and highlighting the complexity of the corporate governance discipline. For a comprehensive review of research efforts informed by the spectrum of theoretical perspectives, see Daily, Dalton and Cannella (2003).

It is thus no surprise that the practical development of the above mentioned mechanisms has been a relatively lengthy process with corporate scandals highlighting existing inefficiencies and producing targeted regulatory responses. However, the task of monitoring and incentivising top managers has revealed itself to be a delicate balancing act (Brenner & Schwalbach, 2009). For example, if pay is insufficiently linked to performance, then management may be less dedicated to the task of shareholder wealth maximisation. Increasing the performance-linked element of the remuneration will address this issue, but may lead to short-termism, manipulation of performance figures, and other unintended outcomes made possible by the deficiencies of the board structure and weaknesses in the legal environment. Each corporate governance mechanism suffers from this characteristic and thus shareholders will inevitably continue being exposed to agency-related risks (Fama & Jensen, 1983; Eisenhardt, 1989). In this context, corporate governance at its best should create the right environment for top managers to be sufficiently incentivised and monitored while the external environment should be capable of objective arbitration and enforcement of the adequate rules (Tricker, 2009). The Anglo-Saxon system of corporate governance, although not without its criticisms, has produced a wealth of experience of how this can be achieved in the context of public organisations.


3 Some countries have had a head start with strong traditions of the rule of law (La Porta, Lopez-de-Silanes, & Shleifer, 1998). In Britain for example, capital markets are relatively well-developed precisely because of the reliance on the rule of law (Charkham, 2005).
3. CORPORATE GOVERNANCE IN THE CONTEXT OF RUSSIA’S TRANSITION

The Russian system of corporate governance is the product of two inherent faults which are characteristic of transition economies. In the first instance, shady privatisation has produced a class of corporate owners not through a record of worthy business achievements, but by overcoming Machiavellian challenges of mass scale redistribution of national assets known as “shock therapy”. The second issue relates specifically to the much documented absence of the rule of law in the country where the balance of power has become skewed in favour of the state (Hanson & Teague, 2005).

Given the persistent deficiencies of the regulatory infrastructure, Russian companies need to make full use of the available corporate governance mechanisms if they are to retain and attract investment from outside shareholders. The argument here stems from the assertion that strong firm governance should send the right signal to potential investors who will be willing to expose themselves to unfavourable institutional prerequisites. However, in the Russian context, this theory does not hold true. Russian companies do not make full use of independent non-executive directors, do not disclose individual director’s remuneration and have vague ownership structures and internal control procedures. In this respect, the trajectory of the development of the Russian corporate governance system has been extensively debated. Some conclude that moderate improvements have been achieved (Roberts, 2004; Hendley, 2007), while others continue to emphasise particular inefficiencies of the legal system and the persistent lack of the rule of law (Kochetygova et al., 2004; Hanson & Teague, 2005).

It has been suggested that the absence of the rule of law leads to the dominance of informal institutions, which in turn prevent the full development of the required legal infrastructure. According to Gel’man (2004), this is the case in Russia. Economic actors locked within informal institutions are likely to create non-contractual enforcement mechanisms and collaborate within closed networks (Modigliani & Perotti, 1997). These social networks transmit informal rules that fill the gap created by inchoate laws and/or ineffective enforcement. Despite an obvious lack of access to this information, it is critically important to have a reasonable understanding of the informal rules and associated enforcement mechanisms prior to committing to a contractual relationship with a partner who is conditioned by such an environment. This is particularly relevant in relation to large investment projects which are more likely subject to significant political and economic pressures.

In the context of Russia’s transition from command to market economy, shock therapy refers to a process of rapid privatisation of previously state-owned assets. Although defended by some academics (Shleifer & Triesman, 2005), the practice was severely criticised because, at the time, the country’s institutional infrastructure was completely unprepared to deal with such a drastic change (Black, Kraakman, & Tarassova, 2000).
The Russian government, particularly over the last decade, has been an active participant in the corporate development of the country and thus the concept of the “state” has been introduced into the agency dilemma of large, publicly owned organisations. This is linked to the fact that the state is steadily regaining its capacity and is doing so by means of large-scale renationalisation of strategic assets. This together with insufficient improvement in the legal infrastructure and the absence of judiciary independence has produced an environment where “selective” application of law has turned into a business norm (Kuznetsov & Kuznetsova, 2003; Hendley, 2006; Hendley, 2009). Additionally, corrupted officials and economic agents possess the obvious desire to retain power and wealth and as such, represent a strong opposition to the natural evolution of the market-based infrastructure.

A number of comprehensive surveys of the discipline in the Eastern European context (Djankov & Murrell, 2002) and more specifically with reference to Russia (Iwasaki, 2007) call for more qualitative and multifaceted approaches to studying the subject of corporate governance. This paper addresses this general gap in the literature by focusing on a case study analysis which simultaneously presents an argument for a degree of generalisation of the uncovered governance-related issues.

4. METHODS
Case study research is an important methodological tool within a range of disciplines in social sciences including business studies (Yin, 2003). In terms of the required philosophical underpinning, this research method is appropriate for a number of perspectives spanning across the qualitative-quantitative continuum. Most frequently however, case study research is considered to be lacking the potential to generalise, a feature which most noticeably curtails the scientific significance of the method. This is particularly true if a piece of research is based on a single case. Nevertheless, an element of generalisability cannot be totally discounted because depending upon the nature of the selected case, a clear positivistic input can be possible (Flyvbjerg, 2004). For example, hypothesis testing and theory development can be conducted on the basis of selecting “the most likely” case which demonstrates a premise to the contrary. This leads to the following consideration: if a proposition is not true for the most likely of scenarios (a critical case), it renders a generalisation to that effect across a number of less likely cases.

The above point vividly demonstrates the power of the method that goes far beyond the presentation of descriptive material to simply serve as an exemplar. On the contrary, a case study methodology allows researchers to make important contribution to critical debates about the applicability of theory to critical contexts.

The case study used for this research is TNK-BP (www.tnk-bp.com) which is a 50-50 joint venture between BP (www.bp.com) and a group of prominent

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5 See Yukos as an example of the largest scale renationalisation (Walsh, 2003) and Inteko as one of the most recent cases (Belton, 2011a).
Russian investors collectively known as the AAR consortium (Alfa Group, Access Industries and Renova, www.AAR.ru). The company is important to the current analysis because it is not primarily owned by the government or a local investor - a typical feature of major companies operating in the oil sector in Russia (Pappe & Drankina, 2007). The venture is also important because in 2003 when the company began its operations, it marked a milestone in terms of the capital size committed by a single foreign investor to Russia (“BP signs..”, 2003). BP, previously known as British Petroleum, invested $6.8 billion in return for a 50% share in the vertically integrated oil company which subsequently grew to become one of the world's largest privately owned entities (www.bp.com). The Russian government then headed by President Putin was very supportive of the deal which had the potential to set the example and promote the safety of the investment climate in the country to the global investor (Olcott, 2004). Thus, the success of the deal was an important matter to the government as well as the shareholders. Furthermore, BP invested 40,000 man hours examining due diligence covering operational, technical, legal and environmental aspects of the project. On this basis, analysts predicted a good future for the company due to the technical and managerial expertise contributed by BP, the administrative leverage offered by the Russian investors and the full commitment of both parties reinforced by the moratorium prohibiting sales of respective stakes until 2008. Thus the venture was very much the exemplification of successful value creation combining solid operational capabilities with reliable availability of the necessary licences which are required for the development of the country’s natural resources.

This article proceeds with the analysis of key corporate disputes which have been reported in Western and Russian media covering the nature of the conflicts, aspects of the dispute resolution and the analysis of the outcomes set in the context of corresponding literature.

5. CASE 1: TNK-BP IN CONFLICT WITH THE RUSSIAN GOVERNMENT

5.1 Definition of the “Critical Case”

Further to Putin’s presidency, the Russian government vigorously pursued the

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6 In addition to other printed sources of information such as company press releases, and professional reports, this article draws on newspaper accounts of corporate events. There has been a considerable level of research using newspaper archives because they ‘incorporate a number of facets concerning a country’s social, political and economic history’ (Gatos et al., 2000, p. 77). The Moscow Times is the preferred source of such information in the context of this study because the newspaper has substantial experience on reporting corporate events in Russia and has been used as a leading source of data in previous corporate governance related studies in the country (Fox & Heller, 2000).
agenda of obtaining majority stakes in significant oil projects in the country (Pappe & Drankina, 2007; Olcott, 2004). This happened in part, due to substantial increases of the crude oil price in international markets for the period between 1999 and 2006. Previously, international oil firms obtained developmental licenses on favourable terms due to the rapidly declining Russian economy of the 1990s coupled with and in some ways related to the significant drop in the price of oil at that time. Then, production sharing agreements (PSA) made it possible to convince sceptical foreign companies to invest in Russia by offering substantial discounts on the value of underlying assets (Black et al., 2000). As the country emerged from its most vulnerable stage of transition, the bargaining power shifted in favour of the Russian government, which was keen to redress the balance, particularly within the strategic sectors (Olcott, 2004). However, additional legal protection offered by the PSAs and the unwillingness of the international majors to lose control over key assets made the task of renegotiating the terms a convoluted process with the Russian government resorting to the selective application of law (Miles, 2006).

The Kovytka gas field is one of the largest deposits of natural gas in Eastern Siberia. TNK-BP inherited the Kovytka licence which TNK owners obtained in 1992, a time when such licenses were granted on obscure, non-transparent terms. Sixteen years later, the license to develop the massive gas field became a $3 billion asset joint venture. Further to the formulation of the policy towards strategic assets, the government officials declared their intention to develop such fields with state companies having a majority stake. Understandably, TNK-BP was reluctant to surrender the substantial value locked in the project to Gazprom – a state-run monopoly. At the same time, the government needed to treat the venture with caution because in addition to its strong local representation (the AAR group), TNK-BP carried the status of a flagship project; its fate was a barometer of the investment climate in the country. The “critical case” is thus revealed in the context of the situation when the interests of the Russian government and private investors (both local oligarchs and foreign majors) clash:

*If the Russian government is prepared to use a heavy-handed approach in renegotiating the terms of the flagship investment project, it will not hesitate to use the same approach with respect to lower profile deals with weaker local representation but equivalent profit-making potential.*

### 5.2 Enforcement Techniques

The Russian government put significant pressure on TNK-BP demanding that the latter surrendered control of the Kovytka gas field over to Gazprom. The Natural Resources Minister, Yury Trutnev referred to TNK-BP as the worst violator of licence terms (Kim, 2006). In addition to sending powerful messages radiating from the Natural Resources Ministry and aimed at the board of directors of TNK-BP and its shareholders, the company was further pressurised by means of publicly expressed concerns over its formal adherence to the terms of the licence agreement.
The Kovytka licence, as per the 1992 licence agreement, required the holding company to produce a minimum of 9 billion cubic meters (bcm) of gas. TNK-BP failed on this condition because the originally intended exports of gas to China were blocked by the pipeline monopoly, Gazprom. The local markets however, were not big enough to justify the level of production to above 2.5 bcm of gas.

In this regard, the media often cited comments made by international observers relating to the mounting pressure on TNK-BP. One such informed observer, Robert Amsterdam, an international lawyer for Khodorkovsky (an imprisoned oligarch), described the situation in the following terms:

“BP is not in Siberia. It’s not in a concentration camp. But it is hostage to a Kremlin points system where political points are required to protect your investment as there’s no rule of law” (Kim, 2006, p.1).

The board of directors of TNK-BP responded by suggesting that the talks of the licence withdrawal have been highly exaggerated by the media and was never communicated to the company by individuals with the corresponding authority. In addition to this, the media centre of the company kept emphasising the need for the rule of law in the country if sustainable investment flows were to materialise. From the BP’s side of the venture, the answer to the mounting pressure manifested itself in terms of subtle yet consistent messages about the necessity of the clear rules and warned about the dangers of selective application of law. In addition to this, BP speculated about possible joint projects with the state-run companies (Kim, 2006). Concordantly, the TNK representatives were better positioned to negotiate with high-ranking government officials regarding the terms of possible resolution of the conflict. However, the effectiveness of the administrative powers of the AAR consortium was severely curtailed by their necessary political allegiance to the government (Olcott, 2004).

As the conflict progressed, the Prosecutor General’s Office kept issuing warnings about a possible licence withdrawal and eventually, a criminal investigation was opened in respect to Rospan International, a TNK-BP subsidiary. This coincided with charges of industrial espionage, a $150.4m back tax claim and office raids which interrupted the work of the TNK-BP head office in Russia (Belton, 2006b; Elder, 2006a; Elder, 2006b).

5.3 Dispute Resolution

TNK-BP succumbed to pressure and made the decision to sell its stake in Kovytka to Gazprom. In 2007, the sums which were initially quoted ranged from $700m to $900m. However, the arrangement was stalled by the disagreement over the exact price. The negotiating process lasted until 2010 when Rusia Petroleum, the TNK-BP subsidiary which held the Kovytka Licence, filed for bankruptcy and the asset
was finally sold to Gazprom for a price of $770m in March 2011 (Belton, 2011b).

It is clear from the perspective of BP’s management that the Russian partners (the AAR consortium) did not fulfil the task of protecting the company’s interests against the much anticipated attacks from the government. In this regard, BP once again questioned their selection of partner in the Russian context. However, this task is not as straightforward as one might initially assume. Partnering with the Russian government may be problematic for a shareholder wealth-oriented company. This is because the state-owned companies in Russia are highly inefficient and may overburden private investors with significant expenditures relating to politically-motivated projects. Conversely, partnering with a group of Russian oligarchs carries significant risks of skewed incentives and inferior bargaining power in comparison to state-owned enterprises.

In this respect, the biggest obstacle to BP’s development in the Russian context is the difficulty of partnering with a shareholder who is wealth-oriented and has absolute authority. In addition to this, the Anglo-Saxon tradition has a very low degree of tolerance towards uncertainty created by the lack of rule of law. This fact makes key decision makers unable to achieve any constructive equilibrium in their encounters with powerful stakeholders. The analysis of the selected conflict demonstrates that the nature of the government interventions contradicts the principles set forth by Khan (2006) and Hendley (2006) relating to the concept of the rule of law and more importantly, shows that BP is unable to utilise the existing power structures in the country in the way that the legal vacuum contributes to the advantage of its profit-making agenda.

With regard to the previously mentioned agency-linked conundrum (oligarch-manager-shareholder-government), the following table summarises three systemic deficiencies which increase the government’s bargaining position in relation to the existing corporate contracts.

<table>
<thead>
<tr>
<th>Nature of malpractice</th>
<th>Related quote from case study material</th>
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<tr>
<td>The list of strategic assets can be redrawn and the ensuing redress of state ownership will be applied retrospectively.</td>
<td>“The manipulation of prices for oil and gas assets by way of pressure from state regulatory agencies has become part of the standard mechanism for the transfer of property and ownership in Russia” (Vedomosti, 2007)</td>
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7 This was vividly demonstrated by the failed Sidanko deal between Interros and BP (Kranz, 1999).

8 The Yukos bankruptcy was believed by many to have been orchestrated by the government as a response to the political ambitions of its CEO, Khodorkovsky (“Russian tycoon”, 2005).
Nature of malpractice | Related quote from case study material
---|---
Environmental laws do not apply equally to state owned firms since they have not experienced the equivalent intensity of probes and enquiries as has been the case in relation to private entities. | “This is the case because of three basic factors constantly at play in Russia’s energy sector: significant state ownership, a general lack of transparency and serious concerns over the fair and consistent application of the law”, (“These signals..”, 2006).

Certain laws are impossible to comply with due to their ambiguity, volume or complexity. | “The company has previously faced threats that the government will revoke Kovykta drilling licenses unless it coordinates the field’s development with Gazprom”...

“The oil and gas business is such a tricky business that you can always find faults if you want to” (Kim, 2006).

This corporate dispute clearly demonstrates that the significant investment projects in Russia are at risk of being adversely affected by the economic and political ambitions of government officials who will target the most successful ventures by means of manufactured allegations for the benefit of the administrative elite. In this respect, even the most powerful oligarchs and multinational companies will not be in a position to represent the interests effectively because as this case demonstrates, it is the government who possesses superior enforcement capabilities and administrative resources. As such, it is possible to conclude that the vast majority of oligarchs in contemporary Russia need to display a degree of political allegiance with the state, a condition which severely restricts their economic independence and thus, the capability to represent private companies’ interests in the highest echelons of power.

6. CASE 2: CONFLICT BETWEEN TNK AND BP

6.1 Definition of the “Critical Case”

In 2008, the “lock-in” clause of the TNK-BP shareholder agreement expired. This meant that BP and AAR could from then on exercise the option of selling their respective stakes in the company. However, due to the financial success and future potential of the venture, neither party had any intention/incentives to sell out.

Concordantly, the Russian government was increasing pressure on all major oil companies to concede majority stakes in large projects to state-run firms “These signals..”, 2008). According to numerous market analysts, it was time for BP to amend the partnership by replacing private shareholders with a more powerful state company, with Gazprom and Rosneft being the most obvious candidates. The shareholders representing TNK however supported the agenda of international expansion which would differentiate the risks in the first instance (particularly
political) and more importantly, help TNK-BP develop into a global company capable of competing with BP itself (“Russian stakeholders..”, 2008). Naturally, this fundamental clash of interests evolved into a prolonged corporate dispute between BP and the representatives of the AAR consortium.

BP is a highly experienced company when faced with the task of protecting its interests on foreign territory. It does so by accumulating a critical mass of loyal people working at its foreign subsidiaries, developing sophisticated communication strategies, committing substantial financial resources and lastly, by ensuring the jurisdiction of international arbitration. However, the consortium has the advantage of being internal to the domestic infrastructure in this conflict. BP was meticulously careful at the selection stage of its business partners for its Russian operations and with respect to TNK-BP, it was successful in identifying the most influential, commercially-oriented and ambitious individuals (“Gazprom warned..”, 2008). In this regard, this dispute between the commercial partners represents a critical case whereby in the absence of the government’s involvement, the following proposition can be addressed:

If the Russian oligarch investors are capable of successfully exerting pressure over one of the most resourceful and experienced multinational corporations, then foreign investors with weaker capabilities than BP may not be able to adequately represent their interests in relatively similar conflicts.

6.2 Enforcement Techniques

As per the initial shareholder agreement, BP nominated the CEO of TNK-BP and held the majority of seats on the board of directors\(^9\). Thus, despite the 50% ownership, the Russian investors did not have the corresponding level of control and representation. This is in contrast to the view of proportionate representation of capital and thus, contradicts some of the main principles set forth in the UK Corporate Governance Code (2010). The necessity of this deviation from the “Western” standards could be justified by arguing BP’s managerial supremacy and otherwise unfettered powers of the Russian kleptocrats. However, the board structure appeared unsustainable beyond the first stage of partnership when the interests were broadly aligned through the agenda of recouping the initial investment on the part of both parties.

Beyond the initial stage of the project, the conflict of interests became more prominent. Whenever the Russian partners proposed projects aimed at international expansion, the BP-dominated board prevented such initiatives from taking place. Each time BP voted down such proposals, the sense of injustice developed further

\(^9\) At the time of this conflict, 5 out of 9 board members of TNK-BP were nominated by BP (“AAR threatens..”, 2008).
in the minds of the AAR executives. This feeling must have been amplified by the success of the venture and the expiry of the “lock-in” clause in the shareholder agreement. Frustrated by the lack of dialogue, the Russian investors proposed to replace the CEO of TNK-BP, Robert Dudley. This initiative also failed due to the BP-nominated majority on the board (Elder, 2008c). The AAR responded by issuing a statement that it would “seek other legal means to limit BP’s influence on the company” (“BP to sue”, 2008).

In order to exert pressure on BP, AAR resorted to what has been termed as “corporate raiding”, which in the Russian context frequently amounts to the use of state agencies as a tool for gaining control over corporate assets (Settles, 2009). In this particular conflict, the Federal Migration Service refused to renew work permits to the company’s 148 expatriate workers (Elder, 2008c). This coincided with a court claim by an opaque minority shareholder, Tetlis that the company (TNK-BP) employed too many foreigners who earned disproportionately higher salaries than their Russian counterparts. Tetlis was reported to be linked to the Alfa group and thus, was likely acting on behalf of the AAR consortium. The fact that the dialogue between the two major shareholders failed was further exemplified by the absence of quorum at the 2008 AGM (“Russian stakeholders”, 2008). BP responded to the pressure by bringing the “campaign of harassment by the state agency” to the attention of the press.

6.3 Dispute Resolution

In 2009, BP conceded to the pressure and the terms of the TNK-BP shareholder agreement were renegotiated in favour of the Russian shareholders. The board structure was amended and currently conforms to the equal representation principle. The board was further strengthened by the appointments of three high-profile independent directors (www.tnk-bp.com). As a function of these concessions by BP, the problems with the Federal Migration Service and the minority shareholder (Tetlis) subsided. Moreover, Robert Dudley (the CEO of TNK-BP) was replaced by a Russian-speaking executive.

This conflict created a more balanced board of directors with an improved decision making capacity, albeit achieved through the questionable interventions of the state agency which were apparently acting on behalf of the Russian investors. The agency theory (Jensen & Meckling, 1976) warns about the likelihood of the original conflict which clearly stemmed from the misaligned interests of the corporate partners. In the British context, a strong stock market prevents this

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10 This practice is widespread in the Russian context where foreign firms often reward expatriate workers with a significantly higher remuneration package to compensate for the difficult living environment in the country (Hollinshead, 2007).
imbalance through the “voice” actions of the institutional investors which in this case would have strongly demanded technical adherence to the principles set forth in the UK Corporate Governance Code (2010). In Russia, where the capital markets are underdeveloped, and ownership structure is highly concentrated, such a correcting mechanism is practically absent and in the short to medium term is replaced with administrative levers available to large private investors. Thus, the case of TNK-BP demonstrates that the large private investors in Russia are capable of challenging international corporate giants. However, despite the crudeness of the administrative levers method in the conflicts involving high-profile oligarchs, this does not necessarily result in lasting damage to the corporate governance landscape and there may be a positive element to the much criticised “state capture” scenario (Hanson & Teague, 2005). The analysis of this case reveals that the bargaining power of a multinational if matched by that of oligarchs may lead to a constructive negotiating process which in this instance, produced a more balanced board structure and thus a more sustainable business model.

7. CASE 3: BP AND THE RUSSIAN GOVERNMENT IN CONFLICT WITH TNK

7.1 Definition of the “Critical Case”

Further to the conflict described above, BP continued looking for ways of partnering up with a large state company. The biggest Russian oil majors were also keen to merge their assets with the international corporation as a way of raising international profile and legitimising their own asset base and operations. For Rosneft, this was a particularly important task due to the long-lasting negative legacy of the non-transparent renationalisation of the assets previously held by the now bankrupt Yukos company (“Yukos haunts”, 2010). In order to disassociate itself from such a legacy, Rosneft welcomed a share swap with a willing multinational corporation.

The Gulf of Mexico disaster severely damaged BP’s reputation and stock value (Bergin, 2011). This development meant that the executives at BP were under pressure to divert attention of the anxious stock market to a significant positive project in a bid to reverse the struggling company’s fortunes. Partnering with Rosneft was seen as a strategically important move which would ensure a less painful recovery from the US environmental disaster by securing access to an enormous oil field in the Arctic. In this respect, the interests of BP and Rosneft were perfectly aligned with Rosneft gaining from the share swap and BP profiting from the renewal of its asset base (Amos, 2011a). Thus in January 2011, the two companies announced of their intention to jointly develop the field in the Arctic’s Kara Sea containing approximately 100 billion barrels of oil. The deal included a share swap of 5% of

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11 This is approximately equivalent to the amount of oil deposited in the North Sea at the pre-exploration stage.
BP for 9.5% of Rosneft (Amos, 2011b). If the arrangement materialised, it would have represented the highest level of integration with the two companies having respective representation on each others’ boards.

However, from the perspective of TNK-BP, the deal was seen in contradiction to the company’s interests (TNK-BP, 2011). Moreover, the deal was in violation of the existing shareholder agreement according to which TNK-BP had the right of first refusal relating to all projects undertaken by BP in Russia. The new board of TNK-BP, with the exception of BP-nominated directors, supported partnering with Rosneft which in turn, saw the joint venture as a less favourable partner than BP itself. As a result, it is possible to formulate the “critical case” in the following terms:

If TNK succeeds in preventing the illegal partnership between BP and Rosneft, then there are circumstances under which the Russian government is likely to be mindful of the legality of the arrangements in question despite their potential to attract substantial revenue.

### 7.2 Enforcement Techniques

The AAR consortium sued BP in a London-based arbitration court\(^\text{12}\) which had no choice but to rule in favour of the Russian oligarchs issuing an injunction on the share swap and the development deal between BP and Rosneft (Amos, 2011c). Analysts had previously predicted such an outcome wondering why BP was not more careful in its due diligence arrangements. However, in addition to arguing that the deal between BP and Rosneft would not harm the long-term prospects of TNK-BP, BP banked on the Russian government acting as a deterrent against AAR pressing for the annulment of the deal as it was strongly considered to be in the interests of the state. Previous experiences showed that the oligarchs are no match to the administrative powers of the state and thus would not wish to openly challenge the government by questioning the legality of the deal. This is precisely where BP may have been mistaken in its deliberations. Protected by the letter of the law and the publicity of international arbitration, the AAR consortium challenged the partnership. The Russian administrative elite expressed their surprise at the actions of the oligarchs, but were keen to distance themselves from the ongoing dispute between BP and TNK-BP which, by then, developed its own identity through the more balanced board of directors (Amos, 2011c). BP had no other choice but to buy the Russian shareholders out of the company.

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\(^{12}\) The London-based arbitration court operated under the Swedish law as per the shareholder agreement which stipulated the jurisdiction under which the disputes between the parties are to be resolved.
The AAR consortium was thus in an ideal bargaining position which the oligarchs intended to exploit through the valuation of their stake in TNK-BP ranging between $35 and $40 billion. BP however, was not prepared to pay more than $32 billion, an offer that was turned down by the AAR shareholders (Amos, 2011c).

As a measure of last resort, BP initiated a crude informational campaign and suggested that it was the AAR consortium who refused to partner up with Rosneft. In a controversial statement released by BP on 12 March 2011, the following was stated:

“At a TNK-BP board meeting in Paris today a proposal by BP’s nominated directors which would have allowed TNK-BP to hold initial discussions with Rosneft about pursuing the Arctic opportunity, was rejected by Alfa, Access and Renova (AAR”).

TNK-BP vigorously argued against such claims and in turn, responded with its own media campaign accusing BP of a lack of effort in attempting to resolve the conflict to the mutual benefit of the parties involved (TNK-BP, 2011).

7.3 Dispute Resolution

Due to the court’s involvement, the share swap agreement could not be finalised and eventually, the partnership between BP and Rosneft was cancelled. Although the parties in question continued suggesting that alternative arrangements could still be made, to date, no concrete announcements have been issued. Both AAR and BP unwillingly reaffirmed their commitment to TNK-BP, despite the ongoing disagreement about the future strategic direction of the company. BP continues regarding the venture as its Russian subsidiary, whereas the AAR shareholders consistently insist on the agenda of international expansion.

This conflict clearly demonstrates that the Russian government will not always intervene in corporate affairs even when the commercial interests of the state companies are at stake. In this regard, the way this corporate dispute was handled demonstrates an additional level of uncertainty that the multinational organisations have to cope with in the Russian context. The uncertainty comes from the difficulties associated with predicting the exact incentives of the key stakeholders. These incentives may erratically shift from commercially-oriented to politically-determined ones.

8. CONCLUSION

The analysis of the above cases unravels some details in the way multinational companies operate in the Russian context. Administrative levers and state capture (Hanson & Teague, 2005) have been shown to have a significant presence in conflicts involving key oligarchs, multinationals and the state. It is clear that these extrajudicial
practices erode the rule of law and create the image of ubiquitous corruption. However, in the course of transition, these practices are inevitable (Shleifer & Treisman, 2005) and as we have demonstrated, it should not be automatically tagged as a pervasive deficiency of the corporate governance environment in Russia. This is the product of both systems. In this respect, we agree with Kuznetsov and Kuznetsova (2003) who explained the origins of institutional deficiencies in terms of the weak capacity of the state at an earlier stage of Russia’s transition. Secondly, the analysed cases demonstrate that although the Russian government does process superior administrative resources, it will not always prevail in conflicts with private capital. This is particularly true in cases where the opposing party may resort to international arbitration and extensive publicity.

Furthermore, having considered the oligarch-manager-government-shareholder conundrum in the context of the equal stake partnership between BP and the group of Russian investors, two extreme interpretations of the corporate conduct may be proposed.

The first view is very much consistent with the existing literature and highlights the obvious deficiencies of the Russian corporate climate. Here, attention is focused on the selective application of law by both government officials and large private investors. Corrupt state agencies are used as an instrument for renegotiating terms of existing agreements and make such efforts possible by pressing charges against apparently unprotected multinationals. The only means of protection available for international companies is the absolute legitimacy, which in the context of convoluted and arbitrary rules is almost impossible to attain (Settles, 2009). It is this view that draws the ongoing academic discussion in the domain of “the rule of law” (Hendley, 2009; Khan, 2006). As the analysis of the first dispute shows, the proposed solutions here relate to the reinforcement of the power and independence of the judiciary, transparency and clarity of the legislature, enforcement capabilities and perhaps more importantly, the culture of legal compliance (Hendley, 2006). These are currently considered to be crucial reforms for new market-oriented economies which according to some academics should have been given priority over the privatisation reform (Black & Tarassova, 2002).

The second view highlights the discrepancies and deviations from the international corporate governance standards which might initially occur due to the inferior bargaining power of the local governments and investors. TNK-BP has suffered from massive discounts of key assets, large gaps in pay between local and expatriate experts, violation of the shareholder agreement, and disproportionate representation of capital. These are the concrete examples of bad corporate governance which cannot produce a sustainable partnership regardless of the deficiencies of the context and infrastructure. In this regard, multinational companies may create a good enough reason for the local stakeholders to resort to corporate malpractice, a response which, if creates a more adequate corporate governance structure, might be reasonably justifiable.
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