CHAPTER 2

Beyond the Tip of the Iceberg:
Business Disputes in Russia

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Analyses of business litigation in Russia have focused almost exclusively on the final stage, studying how disputes are handled by courts and private arbitration\(^1\) (e.g., Hendley 1998a, 1998b, 1998d; Frye 1997; Hendrix 1997; Halver-son 1996; Pistor 1996). Yet only a tiny portion of disagreements—the proverbial tip of the iceberg—ever ends up in court. Most disagreements drop out along the way, either because they are settled or because the allegedly wronged party decides that the potential costs of proceeding outweigh the potential benefits. In this study, I explore how disputes between trading partners in Russia evolve. The early stages of the process are important because they shape the structure of disputes and bring to light the social and economic factors that influence the decision to move forward. This approach provides a more complete understanding of the role of law, legal actors, and legal institutions at every stage of this process than is possible through detailed analyses of judicial decisions, pleadings, or caseload statistics. It is also helpful in assessing the level and nature of litigation, that is, whether the “right” disputes are being litigated.

I take the conceptual framework developed by Felstiner, Abel, and Sarat (1980–81) as my starting point. They set forth a series of stages through which all disputes proceed: naming, blaming, claiming.\(^2\) Each successive stage raises the stakes for proceedings. While recognizing that the nature of the relationship between the disputants and the anger felt by the party wronged affect the willingness to go forward, they argue that other factors complicate these decisions. More specifically, they identify a set of actors and institutions that tend to either constrain or facilitate the transformational process. Primary among these is law. At every stage, the decision as to whether to continue is affected by the viability of the underlying legal claim. Also important is the accessibility of legal expertise and the willingness of lawyers to pursue the claim (see Eisenberg 1994; Kritzer 1990). Thus, these transformational actors and institutions often act as gatekeepers, sifting out both legally baseless claims and claims viewed as undesirable for other reasons (see generally Ross 1980; Macaulay 1979). The relationship between the parties also affects the shape of the dispute and its duration (Mather and Nygren 1980–81).

The Felstiner-Abel-Sarat framework was, of course, not developed with post-Soviet Russia in mind. It is very much grounded in U.S. experience and is more explicitly concerned with general civil disputes than with business disputes. Yet the basic logic is unaffected by the nature and setting of disputes. In Russia, just as in the United States, the business disputing process is pyramidal in structure, with inchoate injuries at the base and litigation at the apex.\(^3\) Beyond this superficial similarity, the profound differences between the two countries in terms of legal culture, business climate, and institutional environment suggest that the details of the transformational process will diverge sharply. The question I explore is how Russia’s different institutional environment and legal culture affect the disputing process.

The analysis is based primarily on evidence from six in-depth case studies of industrial enterprises, carried out during the first half of 1998. The enterprises were selected from among the 328 enterprises that participated in a 1997 survey.\(^4\) The sample variation of this survey in terms of the size, age, ownership, access to legal expertise, and sector was replicated to the maximum extent possible given the challenge of gaining access.\(^5\) The case-study approach is well-suited to research aimed at understanding an ongoing process. During the several weeks I spent at each of the enterprises, I was able to observe key actors in their day-to-day activities, interview a broad spectrum of managers, and study contracts and other documentary records of agreements.\(^6\) In this study, I focus exclusively on the problem of nonpayment because this is the most common type of business dispute faced by enterprises\(^7\) and because the failure to pay a debt in a timely fashion can objectively be regarded as injuring the seller.\(^8\)

Before turning to the specifics of these case studies, I outline the four stages through which business disputes proceed in Russia. I then apply this framework to the three cases, paying particular attention to explaining the differences among them, not just in the propensity to litigate but also in the role of key actors and institutions. Finally, I assess what these case studies suggest about the role of law in business disputing in Russia and other societies characterized by high levels of uncertainty. The goals are to develop hypotheses that can be tested more systematically and to work toward a theory of law in economic transition.

**Stages of Russian Business Disputes**

Relationships, regardless of their source, often experience difficulties. In some instances, the dissatisfaction is entirely one-sided, and the other side is never made aware of it. In other instances, the problem may be perceived by the party
allegedly wronged as more serious and may be voiced to the other side as a grievance. At that point, several outcomes are possible. The parties to the relationship may find some way of smoothing over the problem quickly, causing no damage to the relationship. Alternatively, the parties may prove incapable of resolving the problem on their own and may turn for help to outsiders, such as mediators, lawyers, or trusted advisers (who may or may not use violence to encourage performance). At some point, the grievance may become so intractable that one side resorts to litigation, though this is certainly not the only possibility for parties who cannot reach an agreement on their own. Litigation ostensibly resolves the dispute by declaring victory for one side. The evolution through these stages is rarely self-conscious.

Applying this logic to Russian business disputes over nonpayment, four basic stages emerge. The first is the injury, which occurs when the buyer fails to pay for goods in a timely fashion. This corresponds to the “naming” stage of the Felstiner-Abel-Sarat framework. Without exception, managers from the six case-study enterprises confirmed the perilous nature of this problem. The survey results buttress these findings. We asked general directors to rank the seriousness of customer arrears on a 0 to 10 scale. Sixty percent of the respondents gave scores of 7 or higher, with one-third giving scores of 10. This clearly indicates the pervasive and critical importance of nonpayment for Russian enterprises (see also Hendley 1998d, 389–90).

A seller that is not paid may decide not to pursue the debt. On the other hand, a seller may notify the buyer of its dissatisfaction and demand payment. By doing so, the seller effectively transforms the injury into a grievance. Key to this transformation are the assignment of blame to the buyer and the seller’s characterization of the injury as a violation of law and punishable. (This stage corresponds to Felstiner-Abel-Sarat’s “blaming” stage.) The grievance may be conveyed in a variety of ways, ranging from a polite reminder to an angry letter threatening to go after penalties. Yet during this stage the disagreement remains localized to the parties; outside advisers typically play no role in the decision. Although the popular press and much of the scholarly literature assigns a prominent role to so-called private enforcers (Volkov 1999; Hay and Shleifer 1998; Hay, Shleifer, and Vishny 1996), it is typically a euphemism for the mafia (or kryshi). I found little evidence for their involvement in enforcing nonpayment contracts.

The seller’s efforts to collect payment on its own may or may not be successful. If unsuccessful, the seller faces a choice as to whether to drop the grievance or to transform it into a legal claim, in the form of a lawsuit or the threat of a lawsuit. This coincides with the “claiming” stage of the Felstiner-Abel-Sarat framework. Business disputes between enterprises are within the jurisdiction of the arbitrazh courts in Russia. Managers sometimes seek the counsel of legal experts before embarking on litigation. These legal experts may work at the enterprise or may be in private practice. Consequently, outsiders may play a role in the decision to ratchet up the disagreement. Once the lawsuit is filed, power is temporarily ceded to the judge, who is also an outsider. At any point, however, the parties can reclaim power by settling the dispute among themselves.

The Felstiner-Abel-Sarat framework concludes with the legal-claim stage. The post-Soviet Russian context, in which few losing defendants pay voluntarily and judgments often languish unenforced, requires an additional stage of collection (see Hendley 2000; Hay and Shleifer 1998). Once again, the seller faces a choice. The seller may take no affirmative action, relying on the buyer to live up to its legal obligation and pay the judgment. Alternatively, it may actively pursue the buyer through either formal or informal means. As with the preceding stage, outsiders of various types are likely to participate in deciding first to transform a legal claim into a collection matter, then how to proceed.

With respect to each of these transformations of the dispute, certain factors tend to affect the decision as to whether or not to proceed. I explore the relative importance of various social, institutional, and cultural factors through the case studies. Of particular interest is the extent to which the economic climate of extreme uncertainty that has characterized post-Soviet Russia colors the decision-making process and, if it does, whether these features are specific to Russia or should be expected in the context of transition.

The Evolution of Disputes in Post-Soviet Russia: Three Patterns

During the first half of 1998, I carried out six in-depth case studies of industrial enterprises in Moscow, Saratov, and Ekaterinburg. Although each enterprise was somewhat idiosyncratic in terms of its production profile and heritage, they all face a similar set of challenges in their struggles to survive. The research revealed three distinct behavioral patterns of how Russian managers deal with nonpayment. These are intended to serve as archetypes of Russian enterprise behavior more generally, though I make no claim that these patterns capture the full range of possible options for enterprises.

Pattern 1: Suspicious Activist. The first pattern involves an aggressive approach to collecting past-due payments and an insistence on being paid with money rather than accepting in-kind payments. It is best illustrated by a Moscow enterprise that produces consumer goods, Moskovskaya Bytovaya Tekhnika (MBT).

MBT began production in 1923, and its trophy cases and walls are jammed with awards bestowed during the Soviet era. It was privatized in February 1993 and is presently an open joint stock company ("Ob aktsionernykx" 1996; Tikhomirov 1996). Most of the stock is held by outsiders, including a 42
percent stake owned by an American consumer goods company; the Moscow city government has retained an equity interest as well. MBT began to experience difficulties in 1994, as foreign consumer goods flooded the Russian market and MBT proved incapable of competing on either price or quality. Since that time, 60 percent of the work force has been laid off, and the enterprise has been teetering on the verge of bankruptcy. Over the past few years, delays in the payment of wages have averaged three months. Prior to 1992, it had a three-person legal department, but the lawyers were laid off. For several years, MBT worked with an outside law firm on a contingency basis. It rehired one of its previous in-house lawyers in May 1996, and she now comprises the legal department. She estimates that about 80 percent of her time is devoted to collections.

Although current production is well below its Soviet-era levels, it continues. MBT’s existence depends on its ability to sell its output. Its customer base is made up of third-party retail outlets throughout Russia. MBT does not have its own stores. It finds most of its customers at trade shows. Like its counterparts throughout the world, MBT works through a system of annual contracts that set the basic terms governing the relationship (see Keating 1997; Kenworthy, Macaulay, and Rogers 1996). These annual contracts are a form developed by MBT—jointly by the sales department and the in-house lawyer. Goods are not shipped solely on the basis of this contract, since it does not provide for price or quantity. Instead, whenever a customer wants to make a purchase, it sends a telegram or fax confirming the quantity desired and agreeing to the prevailing market price. The disjointed nature of the contract and the order makes MBT rather casual about signing contracts. MBT does not view the contract as binding it to anything. At the trade shows and in the sales department of the enterprise, presigned contracts are stacked up, waiting for signatures of customers. Illustrative of this position is the fact that, in 1998, MBT had more than 300 fully executed contracts, but only about 50 active customers.

This somewhat unusual attitude toward contracts is relevant to the disputing process. In truth, the MBT sales department is suspicious from the outset. Due to the absence of credit-rating agencies, the sales director has no way of ensuring the reliability of potential customers. She automatically assumes that new customers are trying to deceive her, and over time she has tried to assess their creditworthiness by requiring them to produce certain standardized documents. By the beginning of 1998, she had largely given up, recognizing that wily customers could forge virtually any document. Customers must earn her trust. She requires full prepayment for the first sale and, thereafter, has set up a sliding scale. Once customers have proven themselves, which generally takes six months of steady activity, she allows them twenty to thirty bank days to pay.

The potential for disputing arises with respect to these customers that are given short-term credit. The suspicion that characterizes MBT’s attitude toward new customers is present here as well. The sales department does not wait until payment is due before it starts sending reminders of the amount owed. As a rule, it sends a telegram a day after shipment, and a letter within a week. The customer may also be called and “reminded of its obligation to pay MBT.” In terms of the disputing framework, we see that MBT is anticipating injury—it assumes that customers will try to squirm out of paying. The letters and phone calls even before payment is due are designed to keep MBT in the forefront of the customer’s consciousness.

Not surprisingly, many customers fail to pay in a timely fashion. This does not make MBT unique, but typical in post-Soviet Russia. Nonpayment has become an epidemic. The decision as to how to respond, that is, whether to transform the injury into a grievance by notifying the customer of its delinquency, is made by the sales director. Neither top management nor the legal department participates in any way. The sales department has a tremendous incentive to pursue nonpayments, because employees receive 15 percent of the amount recovered as wages. The vigorousness of the pursuit depends on the nature of the relationship with the customer. If the customer is reliable, the sales director may “close her eyes” for a week or two. But this is the exception. As a rule, she keeps friendship and work separate. She explains that, while she may be sympathetic to the predicament of customers who cannot pay, and will do her best to arrange terms that they can meet, she will not forgive debt. This is simply a line that cannot be crossed. The usual response to nonpayment is to send out a “warning letter” (pis’mo preduprezhdeniya), thereby moving immediately into the grievance stage. In this letter, MBT cautions that if the customer fails to pay, MBT will begin assessing penalties and will be forced to refer the matter to arbitrazh court, which will result in additional costs to the customer.

When negotiating with recalcitrant customers, MBT insists on monetary payment. In contrast to most Russian enterprises, it has a firm policy against barter. The explanation, according to the sales director, is that MBT lacks the capacity to resell goods received in this way. She argues that MBT would need to have a special department charged with resales in order to make barter worthwhile. If the sales director sees no hope of recovering money, for example, if the customer has ceased operations, then she may take the MBT products back. She also takes goods back when the customer refuses to pay out of dissatisfaction with their quality. She estimates that this outcome is at least as common as pursuing the matter in court.

The next step is to make a legal claim by sending out a letter, threatening to initiate litigation. These letters, known as pretenziya, used to be a mandatory prerequisite to filing a lawsuit. After 1995, they became optional, but many enterprises continue to use them, because they are a good signaling mechanism. At MBT, approximately 30 percent of delinquent customers receive pretenziya.
The remainder settle up with MBT during the injury stage. The sales director forwards the files to the legal department, and the lawyer writes the letter. Once again, it is the sales director that acts as the gatekeeper, deciding which debts to pursue and how vigorously. Even after the pretenzija has been sent, the sales department personnel continue to call the customer seeking payment. After all, it is at the sales department level where personal relationships have been established. Once a lawsuit has been filed, however, the sales director loses control. She admits that she often uses this to pressure customers to pay before it gets to that point.

MBT’s lawyer estimates that sending pretenzija leads to recovery of full payment in 20 percent of cases and almost always prompts some partial payment. Why would a customer pay at this juncture? If liability is indisputable, as it is in most nonpayment cases, then by paying before the case is filed, the customer can escape paying the filing fees and will often be excused from penalties and interest.

Customers who fail to pay their debt within the time set forth in the pretenzija are sued. The lawyer prepares complaints for filing with the arbitrazh court. She enjoys very little discretion. Though management pays lip service to the importance of relationships, MBT rarely forgoes an opportunity to collect out of fear of undermining the trading relationship. Moreover, in contrast to the sales department personnel, who work regularly with their counterparts at customer enterprises, the MBT lawyer has no preexisting relationship with anyone there. It is assumed that legal action will be pursued against any customer who fails to pay. Neither the lawyer nor the sales director could recall any nonpayment case in which upper management had intervened. The process moves forward according to its own inexorable logic. Thus, in contrast to the transformation process described by Felstiner, Abel, and Sarat, the MBT lawyer need not repackage the claim. She only has to write it up. She estimates that, during 1997, she averaged five to seven complaints per month. The complaint is a relatively standard document. As would be expected in a civil law country, there is no need for elaborate argumentation. The lawyer need only cite the relevant sections of the Civil Code. The “demands” include debt, penalties, and interest. For her, the most difficult part of preparing complaints is not the text, but the calculations, since both penalties and interest have to take into account when partial payments were made. Although there is little discretion about filing the case, MBT sometimes forgoes penalties and/or interest if the customer is greatly valued.

She rarely receives a response or answer from the customer. Indeed, in about half of the cases she handled during 1997, the defendant had either gone out of business or was an empty shell. This is also commonplace in post-Soviet Russia. The MBT lawyer thinks that defendants stay away because they fear a scolding from the court due to their “gross violation” of the contract. She wins almost all her cases, but concedes that “this is not because I am such a great lawyer, but because the cases are so clear.”

Although the initiation of the lawsuit would seem to indicate the parties’ desire to cede authority over the dispute to the judge, they can reassert control by reaching a settlement. The arbitrazh judge has to approve the settlement terms, but this is a formality. The details of a case in which the defendant offered to settle with MBT epitomizes the suspicious attitude that colors MBT’s relations with its customers. In this case, the defendant did mount a defense, but even before the hearing commenced, its lawyer proposed settling the case. The defendant’s lawyer, an experienced woman in her sixties, explained that the store was unable to pay its debt because its bank had failed. The MBT lawyer was unsympathetic, noting that the store had freely assumed the risk of dealing with that particular bank. The defendant’s lawyer claimed that the store would soon be coming into some cash and would be able to pay about three-fourths of the debt owed. She cautioned that if MBT did not agree to this settlement and proceeded to judgment, it would never collect. The store owed huge debts to the tax authorities and others that had to be satisfied before any private judgment would be honored. The settlement amounted to an offer to skirt the law and jump the queue.

The lawyer favored accepting the settlement, but lacked the authority to make such a decision. MBT’s general director disagreed. He rejected the offer, deciding that the risk was too great. Because the defendant did not have the money in hand, the settlement would be memorialized in the form of a contract and, if the defendant failed to live up to its promise, MBT would be limited to suing for this lesser amount. Any hope of recovering the penalties or interest it was entitled to under the original contract would be lost. MBT decided that there was little chance the defendant was going to pay either amount and opted to retain the right to sue for the greatest amount possible. When the case was heard on its merits, MBT was awarded the full amount of the debt plus penalties.

At first glance, this might seem like a rational choice for MBT. After all, it had elected to obtain a judgment for an amount in excess of the proposed settlement. Moreover, the defendant had previously promised to pay, and MBT could reasonably have feared that it would again renege. But these concerns have to be weighed against the virtual certainty that MBT would never collect the judgment through the official process. The defendant’s lawyer explained that the store owed everyone money. If MBT had accepted the settlement, then the defendant promised that it would not have to wait until all these secured creditors had been paid. This is, of course, illegal, but not uncommon in Russia. It is fair to assume that if the defendant was offering this deal to MBT, it was likewise offering it to other creditors. This means that any cash that came into the defendant’s hands would probably be siphoned off for these extralegal
purposes, thereby increasing the delay in paying secured creditors. By deciding to push for the full amount owed under the contract, MBT virtually assured that it would never see any money from the defendant.

The final stage of the disputing process is collecting the judgment. When writing about the United States, Felshtiner, Abel, and Sarat did not include this stage, due to an assumption of voluntary compliance. In Russia, many defendants refuse to pay unless they are compelled to do so. MBT’s customers are no exception. The burden is on MBT to get the judgment enforced. At this point, the lawyer hands over responsibility to the head of the finance department, who deals with banks on a regular basis, but has little knowledge of the relevant law. The first step is to obtain a court order (ispobitel’nyi list) and to ask the defendant’s bank to satisfy this court order. In most cases, the defendant’s bank account is empty, and MBT’s court order is attached to the account. If any money comes into the account, the bank is obligated to pay all of the judgments, in accordance with the priority established by law. This operates as a 100 percent confiscation system, which, not surprisingly, encourages debtors to keep their bank accounts empty (see Hendley 1999).

MBT has had no success in having judgments satisfied through these official channels. Yet it has not tried alternative methods, nor has it taken preemptive action to avoid the problem. The law, for example, allows plaintiffs to petition to freeze the property of the defendant when the case is filed or any time thereafter, if it legitimately fears that the assets may disappear. MBT’s lawyer has never filed such a petition, viewing it as a waste of time due to the likelihood of obtaining a favorable ruling by the judge (cf. Hendley, Murrell, and Ryterman 1999, 2001). Similarly, MBT makes no effort to investigate where the defendant is hiding its money. During the Soviet era, enterprises had only one bank account. Now they can have many accounts, and they have taken advantage of this right to shield their assets from creditors. This behavior is certainly not a mystery to MBT. In 1997, it began doing business through a shell company in an effort to avoid having its income confiscated to pay outstanding tax debts and secured creditors (Hendley 1999). MBT has also not forced any of its customers to liquidate fixed assets to satisfy the court judgments, as the law allows.

MBT has played by the rules. When customers fail to pay, it seeks recourse through the law. But MBT’s behavior, though activist, has a rote quality. Undergirding it is an assumption that customers are slippery and will not pay unless hounded. At each stage, the delinquent customer is given an opportunity to pay but, if it fails to do so, MBT relentlessly presses forward. This is how the system has been set up within the enterprise. Those handling nonpayments have remarkably little discretion. At best, the sales director can allow a customer a few weeks of breathing space, but any tendency toward partiality is undercut by the fact that her income is based on the total amount collected. Why is MBT so unconcerned with maintaining cordial relations with its customers? The answer lies in the high turnover of customers, and the recognition that MBT has little to lose by seeking payment. MBT is dealing with the retail market, and there is no limit on the number of possible customers for its goods. If one customer is offended by MBT’s strong-arm tactics, it is not deadly for MBT. Confounding expectations, MBT has no compunctions about renewing relations following litigation. This suggests that MBT finds itself in a world in which litigation is not taken personally, and is rather routine. It also helps explain why MBT does not employ thugs to enforce its contracts.

Playing by the rules has turned out to be something of a double-edged sword for MBT. On the one hand, the sales department has proven capable of squeezing money out of reluctant customers and finds the threat of litigation to be a powerful incentive. Yet once the formal legal process is initiated, MBT is remarkably less successful, at least when measured in terms of amount recovered. One key reason is MBT’s tendency to play it safe. It does not take the initiative by seeking to freeze assets or to uncover hidden assets. In a world in which enterprises routinely hide money from creditors and tax authorities, its lack of assertiveness means that MBT will always be at the back of the line, patiently and futilely waiting for money to appear in its customers’ accounts. The fault lies not with MBT’s lawyer, who chafes at the restrictions placed on her, but with the failure of upper management to give her enough room to maneuver.

Pattern 2: Defensive Dodger. The second pattern involves a defensive approach to collecting past-due payments. It is characterized by a willingness to settle on virtually any terms proposed by delinquent customers and an overpowering fear of damaging its relationship with its customers by being too demanding. It is well represented by a Moscow auto parts plant, Avto-Detalny.

Avto-Detalny began production in 1929 and is housed on the premises of a gigantic electrical equipment plant. At one time, it was a subdivision of this Soviet behemoth, but was split into a separate entity in the late 1970s. It was privatized in September 1994 and is currently an open joint-stock company, with a majority of the stock held by nonemployees. Avto-Detalny’s prospects have declined along with the Russian automobile industry (see generally Jenkyn 1997). During the Soviet era, it had 8,000 employees, but now employs only 1,600 and is usually four months behind in paying those workers who remain. It has a one-person legal department. Until late 1996, it had four lawyers and, though there is authorization to hire three replacements, the salaries proposed have stifled demand for the jobs.

Avto-Detalny manufactures generators. Traditionally, it has sold almost all of its output to assembly plants for Russian cars, trucks, and tractors. At this point, 90 percent of its output is purchased by only four plants. None of these purchasers has money. As a result, Avto-Detalny finds itself locked into what the
stage. But it almost never goes any further, and this letter rarely raises the specter of penalties, even though they are routinely included in Avto-Detaly's form sales contracts.\textsuperscript{38}

Over the past two years, Avto-Detaly has not sent pretenzija or initiated legal action against any assembly plant. In early 1998, the only lawsuit in the offing was one against an intermediary in Tomsk that received cars from GAZ (a large auto assembly plant in Nizhni Novgorod) in payment of a debt to Avto-Detaly. The paper trail indicates that Avto-Detaly wanted to use this intermediary to generate cash to pay its bills to key suppliers and utility companies. It ordered inputs on the assumption that the intermediary would sell the cars and transfer the money directly to its suppliers, but this plan collapsed when the reseller failed to make the transfers in a timely fashion. In response to a pretenzija, the intermediary acknowledged the full amount of its debt to Avto-Detaly, though it disagreed with the calculations of penalties.\textsuperscript{39}

In contrast to MBT, neither the sales director nor the lawyer was responsible for deciding whether or not to initiate litigation. Instead, the assistant general director for economic questions (zamistitel' general'nogo directora po ekonomicheskikh vozrosam), one of the most senior officials within the enterprise, made this decision (and others like it), usually after consulting with the general director.\textsuperscript{40} He avoids the courts whenever possible, believing that litigation inevitably ruptures business relationships. He is pursuing the legal claim against the Tomsk intermediary because Avto-Detaly has nothing to lose. It had no long-standing relationship with this reseller. In fact, he implied that the intermediary had engaged in a fraudulent scheme that included a number of enterprises, thereby absolving Avto-Detaly of bad judgment and leaving it guilty only of bad timing.

Looking beyond this pending case, the reservations of the assistant general director for economic questions about litigation went well beyond a concern over damaging trading relations. He expressed profound skepticism about the capacity of the arbitrazh courts to handle business disputes. He notes that the courts are ill-equipped to deal with multisided barter transactions and that they refuse to enforce oral agreements.\textsuperscript{41} In the current climate, when so many deals are done quickly on the telephone, the courts and the law seem to him to be unresponsive to the needs of Russian business. His firm belief that arbitrazh courts are biased in favor of the big assembly plants, which are often the largest and most politically prominent plants in the towns where they are located, serves as the final nail in the coffin. When I asked him for specific examples of these problems, he related a few third-hand stories, but had no personal experience (either at Avto-Detaly or at any of his previous positions).

This antipathy toward litigation should not be taken to mean that Avto-Detaly has given up on reducing its accounts receivable. The assistant director for economics has been working actively to reduce the assembly plants' current ar-
rears and to forestall additional arrears. For example, in late 1997, he issued an order forbidding barter with ZIL (a large Moscow auto assembly plant). He was under no illusion that this would actually end barter overnight, but hoped that it would serve as a signal to ZIL management that Avto-Detaly was serious about reducing its debt. It worked. Over the next several months, ZIL became more pliant in setting the terms of trade for barter, and its debt was lowered by 40 percent. He is now pursuing similar initiatives with all of Avto-Detaly’s customers.

The central role played by informal mechanisms for resolving nonpayments problems might suggest that the content of the contract is not terribly important for Avto-Detaly. After all, contractual language typically becomes decisive in the context of legal claims (Macaulay 1985, 1963), and Avto-Detaly’s disputes are not allowed to progress to that stage. In reality, however, the enterprise exhibits conflicting behavior. The sales department behaves just as would be expected, paying little attention to the written documents and worrying more about the current state of the relationship with the customer. Avto-Detaly’s lawyer, on the other hand, takes a “strict” approach to contracts. She insists on the most advantageous terms for Avto-Detaly and has included a penalty clause as well as other self-protecting devices in the form sales contract. This often places her in conflict with the sales department, which complains that such terms are unnecessary and even insulting when working with long-term customers. The lawyer rarely bends. Like lawyers everywhere, she contemplates the unforeseen possibility of conflict with long-term customers and counsels that, even if the relationship is good, Avto-Detaly is still well-served by a “strong contract.” The sales department cannot avoid the lawyer, because her signature confirming the legality of the contract is required before it can be concluded.

The sales and legal departments are concerned with different interests of the enterprise. This sort of conflict is perhaps to be expected and, in principle, does not mark Avto-Detaly as unique (see Hillman 1997). The surreal nature of the legal department’s conduct becomes apparent only when we recall Avto-Detaly’s unshakable policy regarding litigation and the pursuit of other aggressive remedies vis-à-vis its long-standing customers. In this, it goes beyond the usual predilection in favor of informal remedies as a first resort exhibited by firms around the world. If Avto-Detaly truly is not prepared to make legal claims against its customers or even to threaten to do so, then the energy put into drafting binding language by the legal department is simply pointless.

Interestingly, the lawyer’s negotiating posture changes dramatically in the context of barter. She adopts a defensive attitude seeking to limit possible claims against the enterprise. She reflexively assumes that Avto-Detaly will be the defendant and reasons from that point of view. For example, the separate form contract for barter transactions lacks a penalty clause. The rationale is that Avto-Detaly is more likely to breach than its counterpart, leaving itself open to claims for penalties. From this, it might be suspected that Avto-Detaly is frequently sued, but it is not. Just as it is generally unwilling to sue its trading partners, they are similarly unwilling to do so. Avto-Detaly has been a defendant in only two cases since 1996. Neither was filed by a trading partner. Instead, the plaintiffs were the Moscow electric company and the state pension fund.42

Looking at Avto-Detaly’s overall disputing strategy, it is indeed characterized by fear, though the fear is more of alienating long-standing customers than of being sued by creditors. Avto-Detaly finds itself in a most unenviable position. The collapse of the Russian automobile industry has left its usual customers with no money. Yet an alternative customer base remains elusive. At the present time, the domestic retail market for auto parts is negligible. Avto-Detaly’s efforts to penetrate foreign (particularly third-world) markets have failed. Its generators cannot be used in cars produced elsewhere without alterations on the production line that would require additional investment beyond its reach. Further complicating matters is the presence of a potent competitor within Russia. Indeed, the Avto-Detaly managers concede that their competitor’s plant, which was built in the waning days of the state, has more modern equipment than they do. The bottom line is that the number of potential customers is small and finite, and Avto-Detaly does not enjoy a monopoly market position. Avto-Detaly is penetrated by an air of dogged resignation—a feeling that only the persistence of long-established relationships and an impasioned survival instinct keep the enterprise afloat. This meekness helps explain why Avto-Detaly is reluctant to turn over its disputes to private enforcers.

Unlike MBT, therefore, litigation is not at all a routine activity for Avto-Detaly, but is a high-stakes game from which it abstains. Although willing to acknowledge the injury caused by nonpayments and to notify customers of their obligations, Avto-Detaly refuses to take the next step of pursuing a legal claim. The risk lies in the termination of relations that it believes to be a natural consequence of litigation, regardless of who wins in court. It follows that decisions about whether to file a lawsuit are seen not as ordinary parts of the duties of the sales director and the lawyer. Instead, the general director and his top lieutenants make these decisions on a case-by-case basis.

Pattern 3: Coercer. The final pattern identified in the course of the six case studies is of the disputing process being used in a combative manner to send a message to current and prospective trading partners that is designed to shape their behavior. Like the first pattern discussed, it involves aggressive pursuit of debts owed, but raises the stakes by pursuing lawsuits that obviously will not yield any sort of meaningful recovery when doing so may affect the interpretation of key aspects of contract law. In other words, the initiator of these lawsuits is playing for the rules rather than the short-term result (Galanter 1974).
It may also involve pushing delinquent customers into bankruptcy. The audience for these coercive tactics is not the enterprises who are directly affected, since they are usually terminally wounded by the interaction, but the remaining customer base.

This behavioral pattern is best reflected by an Ekaterinburg machine-building enterprise, Ekaterinburgskii Mashinostroitel’skiy Zavod (EMZ). It began production in 1933, manufacturing machine tools for metallurgical plants. It became one of the industrial showcases for the Soviet Union. It enjoyed considerable political prominence, with its general directors often going on to successful careers on the national stage. It was privatized in November 1992 and is now an open joint-stock company, with employees holding less than 10 percent of the outstanding shares. It is a participant in a registered financial industrial group. At the close of the Soviet period, it employed 22,000. Layoffs and retirements in the interim have brought that number down to 16,000, and it often lacks sufficient orders to keep even this reduced workforce busy. EMZ’s legal department has seventeen lawyers, which is very large by Russian standards. It has also experienced some post-1992 downsizing. Previously, EMZ had twenty-one lawyers.

In order to understand how disputes are handled by EMZ, we need to distinguish between ordinary disputes and disputes over EMZ’s big-ticket machine tools. Given that the stakes are so different, differences in behavior can be anticipated.

Like the other two case-study enterprises, EMZ struggles with customer arrears. With regard to ordinary disputes, EMZ behaves very much like MBT. It does not ignore nonpayment, regardless of the embedded nature of the relationship with the debtor-customer. It exhibits the same sort of suspiciousness as MBT, sending out reminders even before the debt comes due. If these letters and/or telegrams fail to provoke the desired action, then it ratchets up the pressure by sending out pretensziya, warning that a lawsuit will be filed if the customer fails to respond within twenty days. In fact, even though the law no longer requires it, EMZ’s form sales contract mandates the sending of pretensziya as a prerequisite to filing any lawsuit. Its lawyers believe that this allows for a brief cooling-off period, and they find that a majority of delinquent customers settle up at this point. If they do not, then EMZ shows no compunction about filing suit. Thus, both MBT and EMZ have essentially routinized nonpayments. The dispute moves automatically from injury to grievance to legal claim, stopping only if the debt is paid. The only wiggle room is provided by penalties, which are often forgiven in the course of negotiating settlements.

EMZ’s behavior diverges somewhat from MBT’s in its willingness to accept nonmonetary payments, both at the outset of transactions and in settlement of outstanding debt. Recognizing that few of its customers are flush, EMZ routinely accepts both goods and promissory notes (veksely). These negotiations are handled by the sales department. The lawyers do not participate, except to render an opinion on the legality of the contract. As with Avto-Detaly, the negotiations may be protracted and may end up drawing in many unrelated parties in an effort to find something of value for both sides. For example, in a 1998 case, EMZ resisted accepting the defendant-customer’s goods in satisfaction of the amount owed because it had no use for them, but reached a settlement when the defendant countered by agreeing to offset EMZ’s tax debt.

EMZ’s coercive behavior manifests itself primarily with respect to the sale of its big-ticket machine tools. For all of its domestic customers, this equipment represents a significant capital investment. Prior to 1992, this sort of investment would have been funded by the state, and enterprises would have worked through their ministries to gain approval. EMZ did not have to concern itself with attracting and retaining customers. Now, EMZ competes with foreign companies and receives no significant state subsidies. The persistent decline in production that has characterized the post-Soviet era poses a dilemma for EMZ in that few Russian industrial enterprises have sufficient resources to engage in capital investment. The downturn has been even more profound in the metallurgical sector, which is EMZ’s traditional client base.

When EMZ is negotiating with a potential customer, it has to strike a balance between protecting itself and providing incentives to induce the customer to finalize the transaction. In an ideal world, EMZ would demand full prepayment. But this would be unrealistic. So it routinely sets up a schedule of incremental prepayments. It faces a quandary whenever a customer pays the first few installments and then stops. By that time, EMZ has already begun its production process and incurred costs in excess of the amounts received. Since most machine tools are custom-made, the item cannot easily be sold to another enterprise. EMZ grew tired of losing its initial investment on these contracts and decided to send a message.

A St. Petersburg enterprise contracted with EMZ to manufacture a special piece of equipment. EMZ set up an installment schedule for payment. At first, the customer paid on time, then it failed to keep up with its payment obligations. Reasoning that it had gone too far in the production process to turn back, EMZ finished the job and notified the St. Petersburg entity that the equipment could be picked up upon receipt of payment. Not surprisingly, there was no response from this customer. EMZ’s rejoinder was to file suit in arbitrazh court seeking reimbursement for its expenses in manufacturing the equipment. The customer had paid 30 percent of the amount owed, and EMZ wanted the remaining 70 percent. The case was heard in St. Petersburg.

The legal argument advanced was unlike any other I have encountered in the literally hundreds of case files reviewed in Moscow, Saratov, and Ekaterinburg arbitrazh courts from 1993 to 1997. EMZ relied on a rather obscure provision of the Civil Code which applied to contracts that require buyers to pick
up goods from the supplier. If the buyer fails to do so within a reasonable time, then the seller can either refuse to perform the contract or demand payment from the buyer. EMZ, as seller, demanded payment. In its complaint, EMZ made special note of the fact that the equipment had been produced specially for this customer and could not be sold to anyone else. EMZ lost at trial. In a bizarrely reasoned opinion that contradicted both the evidence and the governing law, the arbitraj judge denied the existence of a contractual relationship between the parties and failed to find any evidence that the customer had been contractually obligated to pick up the equipment from EMZ.

The appellate court reversed. It found that the contract had been with a structural subdivision of the entity originally identified as the defendant and that the defendant had subsequently confirmed the contract. It further found language in the contract specifically requiring the customer to pick up the good. Thus, the court awarded EMZ the full amount requested. But EMZ’s victory turned out to be Pyrrhic. Within a week of the appellate opinion, the St. Petersburg enterprise declared bankruptcy. An external manager has been appointed to run the company. EMZ remains a secured creditor, its managers hold out no hope of seeing any money. The debts to the government, which have to be satisfied first, are in excess of 120 billion rubles (which was about $20 million at the then-prevailing exchange rate).

EMZ was not surprised by this turn of events. Its managers and lawyers had never expected to get anything of value from this St. Petersburg enterprise. Instead, they candidly revealed that their true purpose in pursuing the lawsuit had been to send a signal to other customers that EMZ would no longer tolerate this sort of behavior.

Two factors seem particularly important in explaining the coercive strategy of EMZ: the nature of its customer base and the role of its lawyers. Unlike Avto-Detaly, EMZ does not have a stable and finite set of customers with which it trades on an ongoing basis. By the same token, it is unlike MBT in having a virtually limitless supply of customers that is constantly turning over. Its reality lies somewhere in-between. Its customer base was traditionally made up of the large metallurgical plants within the Soviet Union, but it is now looking beyond these borders. Moreover, EMZ’s capabilities are somewhat unique within the former Soviet Union, which gives it a sense of arrogance in dealing with customers. Though foreign competitors have undercut its uniqueness, it is still better situated to work with customers within the former Soviet Union, due to its greater flexibility on payment issues. Few foreign companies will accept payment in goods or veksely. As a result, EMZ is more willing to be imperious than are the other case-study enterprises.

The central role played by its lawyers in the disputing process also marks EMZ as unusual. EMZ is the only one of the three case studies in which lawyers can truly be seen as transformational agents. In the case described above, for example, the EMZ lawyers repackage a losing nonpayments case into a winner by an inventive use of existing law. This sort of creativity, which is highly valued among lawyers in Anglo-American legal systems, is less appreciated in countries with a civil law legal tradition. In these countries (including Russia), lawyers are typically viewed as technical experts on the law (e.g., Merryman 1985). Managers turn to them for an assessment of whether a contract is legal, not for advice on the business sense of the transaction. The lawyers for MBT and Avto-Detaly fit into this traditional mold. But their counterparts at EMZ break the mold.

Why do lawyers behave differently at EMZ? An obvious explanation might be size, but the continuing peripheral role of the legal department in other very large Russian enterprises renders this argument unconvincing (e.g., Hendley 1998c). Another possible explanation might be the size of the transaction. Perhaps the amount of money involved caused the EMZ lawyers to behave differently. This interpretation is not satisfying. After all, the EMZ lawyers confessed that they never actually expected any monetary recovery from the debtor. Moreover, this case was entirely analogous to the cases discussed with regard to MBT and Avto-Detaly. For all of these enterprises, the cases analyzed herein were considered ordinary nonpayments. Yet the lawyers’ behavior varied.

The EMZ lawyers themselves give credence to internal tradition and the high caliber of the heads of the legal department over the past decades. They explained that EMZ general directors have always accorded great respect to the legal department, even during the Soviet period. One lawyer whose tenure dates back to the early Brezhnev period said with pride of having had tea with a general director who went on to great political prominence under Gorbachev. She could not come up with any logical explanation as to why this general director (and others) preternaturally recognized the importance of lawyers within the enterprise. She and her colleagues attribute it to innate wisdom. This, of course, raises the question of why EMZ was specially blessed with such general directors. The explanation that credits the special qualities of the heads of the legal department is similarly flawed.

Taking as a given that, at some point in history, EMZ did have a general director that valued competent and creative lawyering and that he was able to hire someone to head the legal department who met his standards, it may have sustained this tradition by becoming a beacon within the local law community. When speaking with EMZ current in-house lawyers, I was struck by the pride in the unique heritage of the legal department of EMZ. Without exception, they all said that they had come to work at EMZ because it offered opportunities unavailable elsewhere and provided said training. The current head of the legal department enjoys considerable stature within the Ekaterinburg bar. Evidencing this is his regular participation in the annual year-end exams at the Sverdlovsk Legal Academy.
Explaining the Disputing Process in Russian Enterprises

What explains the variations in how enterprises deal with nonpayment? The common features among the enterprises permit a few possible explanations to be ruled out. All of them began their existence as state-owned enterprises, the only legal organizational option during much of the Soviet era. They share the same path to privatization, and all are currently open joint-stock companies with a majority of their stock held by nonemployees. These qualities are probably not critical.

Inadequacy of Contract Law. Along similar lines, these enterprises all made their decisions as to whether or not to pursue disputes in the same legislative and institutional context. Thus, it is unlikely that there is any statutory or institutional trigger that explains why some enterprises are more activist than others. This conclusion stands in contrast to the existing literature, which identifies the shortcomings of the legal system as a cause of the slow pace of economic reform (e.g., Hay and Shleifer 1998; Eckstein et al. 1998; Ernst et al. 1996; Åslund 1995; McFaul 1995). Some have even gone so far as to contend that Russia lacks contract law or has not codified property rights. The fact that MBT actively uses the law to recover nonpayments indicates that the existing substantive law (e.g., the civil code) is not the problem. This is not to say that Russian contract law is perfect. No law is. Rather, the evidence shows that the law is adequate to the task.

Inadequacy of Arbitrazh Courts. The more common criticism is that the arbitrazh courts are not up to the job, and, consequently, economic actors do not regard litigation as a viable alternative (e.g., Hay and Shleifer 1998; Black and Kraakman 1996; Hay, Shleifer, and Vishny 1996; O’Donnell and Ratnikov 1996; Grief and Kandel 1995). The catalog of failings varies, but usually includes high filing fees, delays, incompetence of judges, and problems with enforcing judgments. To be sure, few enterprise managers would dissent. The drumbeat of complaints about the arbitrazh courts is incessant. But this hardly marks Russian managers as unique. Managers everywhere delight in bemoaning the slow pace and high cost of justice, and in belittling the capacity of judges to understand the subtlety of their legal claims. Indeed, in all of the case-study enterprises, both managers and lawyers were savage in their criticism of the arbitrazh courts. They were particularly frustrated by the difficulties in implementing judgments, which they somewhat unfairly blamed on the courts, even though implementation is technically outside their sphere of responsibility. While legislators finally took action to reform the enforcement system in mid-1997 (see Belousov and Martyanova 1999; Sklovskii 1999), the changes had not yet taken hold in early 1998 when I was doing my research. There can be no doubt that collecting on judgments remained highly problematic, though reliable data on the extent of the problem are lacking.

These shortcomings of the arbitrazh courts may have discouraged some economic actors from using them (e.g., Frye 2001), but surveys of industrial enterprises indicate that they continue to file lawsuits (e.g., Hendley, Murrell, and Ryterman 2001; Johnson, McMillan, and Woodruff 1999). Seventy-two percent of the enterprises we surveyed had filed a lawsuit in arbitrazh court during 1996 (Hendley, Murrell, and Ryterman 1999). When I asked managers at the case-study enterprises why they persisted in using these courts, they were consistently taken aback by the question. In all instances, it was clear that it had never occurred to them to abandon the courts because they were not perfect. The survey data confirm that enterprise lawyers regard the difficulties with implementing judgments as a serious obstacle to using the arbitrazh courts, but that this feeling does not materially affect their willingness to use these courts.

How can the continued use of the arbitrazh courts be explained? A full explanation is beyond the scope of this study and demands additional empirical research, but a few reasons can be suggested. Viewed in comparative terms, the arbitrazh courts are remarkably accessible (e.g., Trubek et al. 1983). As a result, lawsuits may be regarded with less trepidation than in the United States or in Western Europe. Perhaps the question is not “why,” but “why not.” In other words, legal action is a relatively quick and low-cost mechanism for seeking redress. If enforcement is not forthcoming, then the plaintiff chalks it up to experience, but has expended little time and/or effort. If the defendant pays, then all the better.

Lawyers. Greater variation among the enterprises is visible with regard to the role of lawyers. It should be recalled that the Felstiner-Abel-Sarat framework assumes a pivotal role for lawyers. Under their scenario, lawyers routinely act as transformational agents. By listening to clients’ concerns and deciding whether they deserve to be pursued, lawyers serve as gatekeepers to the legal system. Others who have made use of the Felstiner-Abel-Sarat framework in Western contexts have found that contingent fee arrangements and societal perceptions about the sorts of claims that are legitimate affect lawyers’ willingness to take on cases (e.g., Kritzer 1990; Sarat and Felstiner 1986; Griffiths 1986; Macaulay 1979). Lawyers’ involvement also impacts on the substance of the claim. Clients often come to lawyers with a vague sense that they have been somehow wronged and desiring recompense, but unsure of how to proceed. In most Western legal systems, the complexity of the procedural rules and the substantive law renders courts largely inaccessible to laymen. Lawyers, as experts, take this unformed claim and repackage it into a viable cause of action. Lawyers are needed to bridge the chasm.

As the case studies illustrate, lawyers in Russia do not always play this sort of facilitative role in nonpayments disputes. Although these disputes are usually straightforward in terms of the underlying facts, this does not mean that lawyers cannot make a difference. If empowered and inclined to do so, they
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could use the procedural and substantive provisions currently in the law to their advantage. Only at EMZ does the participation of lawyers transform the dispute in any meaningful way. In the case described above, the in-house lawyers used the law creatively to send a signal to customers. Elsewhere, lawyers serve a more technical function. At MBT, for example, the lawyer processes claims against all delinquent customers in a rote fashion. She never veers off the conventional path for seeking nonpayments. She has developed a form document for complaints filed with the arbitrash court and changes only the amount of the debt, penalties, and interest for each new case. In fact, she regards the calculation of these amounts as the most challenging part of drafting the complaint. She never contemplates changing the underlying legal argument. Neither the law nor the norms of practice provide any impetus to do so. Outside the office where pleadings are filed is a sample complaint that provides a template used by most lawyers. This is what judges expect, and they look askance at variation.

The MBT lawyer made an abortive effort to assert her client’s interests more vigorously when she petitioned for both interest and penalties in a February 1998 arbitrash case I observed. The judge asked her to explain why this did not represent a double recovery. The lawyer was visibly shaken. She pointed to the section in MBT’s contract in which both parties specifically agreed that both interest and penalties could be assessed. Her lack of conviction came through, both in terms of her tone of voice and in the substance of the argument. The judge did not rule on the propriety of the request at that hearing, but indicated her skepticism in her body language and her citation to the prevailing rule of thumb in the Moscow arbitrash court that plaintiffs must choose between interest and penalties. Rewriting the petition to bolster the explanation as to why MBT deserved both would not have been terribly difficult, because they are different types of remedies and each speaks to a different loss suffered by MBT. Interest is compensatory, reimbursing MBT for the fact that the defendant had use of the funds well after they were due to MBT. Penalties are, of course, punitive, and they represent a societal choice that, in an effort to improve contractual discipline, delinquent customers in Russia can be penalized for late payment. Rather than making this argument, the MBT lawyer made the choice to ask for only penalties. She did not want to risk angering the judge by pursuing both, even though she agreed that MBT was legally entitled to both.

Thus, at MBT, the lawyer does little more than fill in the blanks on form complaints. She does not chafe at this narrow role. She has responsibility, but no discretion. At the beginning of any sales transaction, she signs off on the legality of the contract and, if the customer fails to pay, she once again becomes involved. She is expected to file lawsuits against any and all customers who fail to pay after being sent a pretenciya. She has an enviable track record at court, but MBT has been less successful in actually collecting on the judgments. At that point, she turns the matter over to the finance department, which also follows the standard practice by seeking payment from the defendant’s bank. The lawyer does not take preemptive action by seeking to freeze the defendant’s assets. She does precisely what is expected. When given an opportunity to be a bit creative, she shrinks from it.

The lawyer at Avto-Detaly shows even less spunk. She cannot initiate litigation or even pursue debtors without the express consent of top management. She has neither responsibility nor discretion. She is reduced to providing opinions as to the legality of contracts.

The explanation for this limited role of lawyers in Russian enterprises is partially historical. Lawyers were peripheral in Soviet-era enterprises, spending most of their time dealing with labor issues. Contracts existed, but their content was mostly determined by the industrial ministries, and could always be trumped by the exigencies of the plan. Contractual disputes were more likely to result from late delivery or quality problems than nonpayment (Shelley 1981–82; Kroll 1988).

With the advent of market reforms, the substance of contracts became contested and payment became critical. These reforms contributed to the growth of interenterprise arrears (see Ickes and Ryterman 1992, 1993). This development might have been expected to increase the profile of lawyers within enterprises. As a rule, it has not. Lawyers continue to be regarded as having a technical expertise but, in contrast to U.S. corporate lawyers, are generally not seen as having useful advice about the underlying business sense of transactions (Hendley, Murrell, and Ryterman, forthcoming). In this, they resemble their counterparts in other civil law systems. Legal education in such systems trains lawyers to think about law in a highly positivistic and technical manner. They are accustomed to rendering narrow opinions about the legality of contracts. The organizational structure supports this role, with the legal department usually made subordinate to the finance department, rather than reporting directly to the chief executive of the company. In none of the three enterprises is the head of the legal department treated with anything approaching the sort of respect and responsibility typically accorded to a general counsel in the U.S. context. The specific role played by lawyers varies among the three case studies, which can be seen as a rational response to market incentives (as discussed below).

Some have argued that the increasingly interconnected nature of the world economy has muted these differences in lawyering styles (e.g., Dezelay and Garth 1996). The globalization process is viewed as having a profound impact on the legal profession, giving rise to a spread of the American style of legal adversarialism (see Kagan 1994). The “carriers” of this new behavior are foreign (often American) investors and their legal teams, who insist on their standards of deal-making and dispute resolution being maintained. We might hypothesize that there is a correlation between the extent of an enterprise’s contact with foreigners and the nontraditional behavior of its lawyers. Along similar
lines, we might look more generally for the new-style behavior to be more prevalent in regions such as Moscow that have had more exposure to foreign influences.

This would lead us to expect MBT's lawyers to be exhibiting innovative legal tactics designed to protect its interests aggressively. MBT, after all, is located in Moscow, and an American consumer goods manufacturer holds a 42 percent stake. Yet MBT is remarkably traditional in the role assigned to its legal department. The single instance in which MBT management took legal action designed to impress its foreign shareholder backfired dreadfully. In late 1997, it filed a lawsuit against a bank that had promised to provide a loan, but had then absconded with the collateral. Its in-house lawyer had not been involved in structuring the loan transaction and was not consulted as to the wisdom of litigating the dispute. She was brought in as a technician to draft the pleadings once top management had decided on its legal theory. MBT lost the case. The trial court ruled that, because the credit contract had not expired, the bank had not breached. This was just nonsense from a practical point of view since the bank was only a shell and was incapable of performing. But MBT's management feared that not pursuing the matter further would make it look foolish, and so it insisted that an appeal be filed in order to save face with the American investor. The decision-making process was micromanaged by top management (much like litigation at Avto-Detaly) and reflected a remarkably poor understanding of what might impress foreigners. In reality, the American investor probably would have advised MBT management to cut its losses and move on. Thus, MBT may occasionally modify its behavior in an effort to please foreigners, but the end result is not movement toward a style of legal practice that is qualitatively different.

Instead, the innovative Western-style legal behavior is exhibited by EMZ, a plant that has no foreign shareholders and is located in a city that was closed to foreigners during the Soviet era. It does have periodic contact with foreigners through joint-venture relationships, but these have never required the attention of the lawyers. Globalization theory, therefore, turns out to be a poor predictor of how lawyers' roles are likely to shift in post-Soviet Russia.

**Competition.** Another marked difference between the three patterns of behavior lies in the market position of the enterprise. MBT sells to retail outlets and has a large, constantly fluctuating set of customers. Its primary competition comes from foreign manufacturers, who offer similar prices and better quality goods. Avto-Detaly is limited to domestic auto assembly plants. There is another Russian enterprise that duplicates its production profile and serves as a potent competitor to provide inputs for these assembly plants. By contrast, EMZ, which also has a circumscribed customer base composed mostly of metallurgical plants, does not feel itself to be hemmed in. It views exporting as a viable alternative. Needless to say, it faces significant competition to produce machine tools on the world market.

These differences have a profound impact on behavior. MBT has routinized the disputing process. The sales department and the legal department carry out their assignments in a rote fashion. Nonpayments move through the system with little regard to the status of the debtor. At best, the head of the sales department might hold back for a week or two. After that, her duty to the enterprise trumps any goodwill she might feel for customers. In addition to feelings of loyalty to her employer, she and her subordinates have a strong material incentive for their allegiance to MBT. They receive 15 percent of all amounts collected from delinquent customers as compensation. Naturally, this encourages them to make their best efforts to recover as much as possible and discourages turning a blind eye. The in-house lawyer has no such contingent fee arrangement, but has no prior relationship with any of MBT's customers and, therefore, no personal motivation to ignore nonpayment.

Given MBT's expectation of high customer turnover, its routinized method of dealing with nonpayment makes good sense. Its sales are sufficiently dispersed that no single customer or affiliated group of customers has any leverage. Management is willing to lose customers by insisting on timely payment and penalizing delinquency because it is confident that others will come along to take their place. For MBT, rapid turnaround of debt is essential to maintaining the cash flow needed for its survival. This also explains why MBT refuses to accept in-kind payments, a policy that sets it apart from most Russian enterprises.

The situation is completely different at Avto-Detaly. With a finite customer base and a direct competitor, Avto-Detaly management is paralyzed by the fear of alienating its remaining customers. The Russian auto industry is more likely to contract than expand, and, consequently, Avto-Detaly cannot count on finding new domestic buyers for its generators. Management is firmly convinced that litigation—either threatened or initiated—will raise the ire of its trading partners and will cause them to move their business elsewhere. Avto-Detaly, therefore, treads lightly, even though its customers consistently fail to pay. Rather than taking the aggressive stance of MBT, Avto-Detaly sees itself as a supplicant and is grateful for any efforts made by its customers. It eagerly accepts in-kind payment, even though this creates new headaches in terms of how to sell the cars and trucks sent in lieu of cash. No one regards the current situation as ideal. The sales director describes barter as a "terrible system that wastes time and causes many problems." Yet Avto-Detaly's position in the middle of the production chain leaves it with few alternatives. To insist on cash payment when it knows that the auto assembly plants are cash-poor is a sure road to bankruptcy. By muddling through on a diet of barter, Avto-Detaly hopes to survive until better times.

On the surface, EMZ's customer base appears to be just as limited as Avto-Detaly's. There are relatively few large metallurgical plants in Russia and even fewer with the resources necessary to purchase new production line equipment.
Like Avto-Detaley, EMZ’s customers rarely pay on time. While EMZ is open to in-kind settlement of arrears, it refuses to behave submissively and to accept whatever crumbs its customers toss its way. Instead, it aggressively asserts its interests in the legal arena. It uses the courts to send a message to potential buyers about the limits of acceptable conduct. EMZ is willing to risk alienating its customers for two reasons. First, management hopes to expand its customer base through exports and believes its machine tools are up to world standards. More important in the short run is its confidence in the uniqueness of its ability to provide for the Russian market. While foreign competitors may be able to manufacture the machine tools needed by Russian metallurgical plants, few are willing to engage in the shenanigans necessary to finance such a purchase in the contemporary Russian context. EMZ is. It deals regularly in bartered goods and promissory notes denominated in both money and goods. Thanks to its position within the industry, EMZ can travel the middle road between the inflexibility of MBT and the excessive pliability of Avto-Detaley.

What emerges from a comparison of the three patterns is a positive correlation between the level of sectoral competition and the willingness to pursue disputes aggressively. In their study of the American automobile industry, Kenworthy, Macaulay, and Rogers (1996) reached similar conclusions. They find that increases in competition tend to give rise to increases in the number of potential disputes as well as the proportion that end up being litigated. They use the concept of competition in a more traditional sense to refer to intersectoral rivalries for market share, taking the existence of alternative customers as a given, as is reasonable in the U.S. marketplace. Their rationale for the positive correlation between competition and litigation is that competition tends to “increase firms’ attention to short-run bottom-line concerns. Firms can less easily afford to forgo opportunities for immediate gain, and their room for maneuver, and ability to sustain the cost of constructing and applying alternative sanctions, are reduced” (633). Thus, when their survival is threatened by the emergence of new competitors, rather than taking the time to develop the relationship of trust needed to support a give-and-take approach to problems with their trading partners, firms fall back on legalistic solutions.

To some extent, the comparison does not hold up. The concerns of the U.S. auto industry are qualitatively different from those facing virtually any Russian manufacturer. Russian managers do not have the luxury of worrying about profitability; they are obsessed by mere survival. Thus, all of the case-study enterprises are preoccupied by short-run bottom-line concerns, irrespective of the level of competition. While the contours of the behavior might seem similar, when we look below the surface, the explanations are radically different. In the Russian context, the driving force is desperation. As desperation increases, enterprises are less likely to push through to litigation and are more likely to settle for whatever they can get.

**Sectoral Uncertainty.** Desperation is also tied to uncertainty, which has emerged as one of the hallmarks of the post-Soviet Russian economy. It exists on both the firm and sectoral level. As the discussion of the three behavioral patterns illustrates, sectoral uncertainty can vary widely, in terms of the sources, the responses, and the consequences for disputing strategies. Once again, we see the importance of the customer base and the underlying relationships with these customers.

As a consumer goods manufacturer, MBT sells mostly to retail stores. It has a large number of customers. The highly unstable nature of the retail marketplace means that the identity of MBT’s customer is constantly changing. This creates a practical problem for MBT. Its sales department has to decide whether new customers are capable of paying. Russia has no credit-rating agencies to which MBT can turn. It is on its own. The head of the sales department has tried a variety of approaches, such as requiring prospective customers to provide documentary proof of their financial stability, and meeting with their representatives in person in order to assess their integrity. Although she still relies on both of these methods, she has grown discouraged about the ability to appreciate the true character of customers prior to working with them. She is also disheartened by the ease with which documentary evidence can now be forged. Whenever possible, she requires prepayment, but consumer goods are not a staple, and she is unwilling to risk losing customers by appearing too demanding at the outset. Given these circumstances, the failure of many of MBT’s customers to pay on time is not surprising. Certainly it comes as no surprise to MBT management. It compensates by aggressively going after customers who renge, and it has pursued this policy by routinizing the disputing process. It sets limits on how far it will go to get value from delinquent customers. In particular, MBT adamantly refuses to accept in-kind payments, insisting on money transfers. It has this luxury because its customers, which are retail establishments, have access to cash.

The uncertainty that envelops Avto-Detaley is more profound. The Russian auto industry is in a deep slump. It has done a poor job of responding to market incentives. It has proven incapable of coping with foreign imports and, though it has attracted some foreign investment, has not put it to good use. These mistakes cannot be laid at Avto-Detaley’s door. Avto-Detaley’s management feels itself to be trapped in a nightmare not of its own making. It believes it can survive only by hanging on to the customers it has, even though these customers fail to live up to their contractual obligations. It responds by working closely with these customers to find some accommodation and does not reject any settlement offer out of hand. Avto-Detaley lives on barter. This is a rational choice, given that its customers are cash-poor.

In contrast to Avto-Detaley, EMZ does not fear for its basic survival. This may be a consequence of the political prominence of the plant in Ekaterinburg...
Conclusion

By exploring how nonpayments disputes proceed, we begin to understand the reasons behind the different behavioral patterns. Law and legal institutions emerge as necessary but not sufficient conditions for pursuing delinquent customers through to litigation. Other factors are clearly more important. In particular, levels of competition and uncertainty have a significant impact on behavior. Where management fears that losing customers will threaten its viability, disputes are resolved informally. Moreover, the negotiations tend to involve top officials, who will go to virtually any length to avoid alienating the customer (even though the customer is in breach). By contrast, where management is unconcerned with specific customers, but is motivated by maintaining its cash flow, the disputing process is highly routinized. Nonpayments are pushed through the system without regard to the nature of the relationship with the delinquent customer. Top officials play almost no role in the process. Instead, low-level managers control the negotiations.

Certain similarities emerge between these findings and what we know about disputing in the United States. In both settings, most disagreements between trading partners do not end up in court. Most are settled long before getting to that point. Yet the reasons why are somewhat different. In the United States, businessmen avoid courts because of the immense costs (both time and money) associated with litigation. No American businessman would contemplate initiating a lawsuit without legal counsel, and, by taking this action, he opens himself up to what can be an exasperating process of discovery. He is also discouraged from going to court by the fear of the consequences to the relationship with the customer. But this fear arises from the adversarial nature of the process, in which parties are forced to make statements and accusations that may wound the other side permanently and make it difficult to resume a good working partnership. By contrast, the Russian legal process is not explicitly adversarial. It does not allow lengthy discovery, nor does it demand legal expertise. Thus, the similarities are largely superficial.

NOTES

Thanks are due to Alla V. Mozgovaya of the Institute of Sociology of the Russian Academy of Sciences who negotiated access to the case-study enterprises and coordinated the survey throughout Russia, to James H. Anderson and Michael Morgalla for research assistance, and to Peter Murrell and Glenn Hendrix for helpful comments on an earlier version of the essay. Financial support for the field research was provided by the National Science Foundation, the National Council for Eurasian and East European Research, and the World Bank.

1. Russia is hardly unique in this regard. The business disputing process in the United States is likewise understudied (e.g., Kenworthy, Macaulay, and Rogers 1996).

2. The Felstiner-Abel-Sarat framework has been criticized on the grounds that it overemphasizes litigation (Conley and O’Barr 1998). In this study, I am interested not only in what propels disputes toward court, but also what prompts managers to settle disputes without resorting to litigation.

3. Illustrating this point are the results of a 1997 survey of 328 Russian enterprises, which reveal that, for every 100 transactions, 24 involve some level of dissatisfaction, i.e., a potential dispute. Of these, 16 are resolved through informal complaints, 7 are resolved through threats of litigation, and only 1 is actually litigated (Hendley 1998d). On business disputing in the United States, see Keating 1997; Kenworthy, Macaulay, and Rogers 1996.

4. In the course of that survey, we asked the general directors whether they might be amenable to having a foreign scholar carry out a case study at their enterprise. We approached only those enterprises that indicated some willingness. This excluded 25 percent (83) of our sample. For details on the composition of the sample and other information about the survey, see Hendley, Murrell, and Ryten 2000.

5. Alla V. Mozgovaya of the Institute of Sociology of the Russian Academy of Sciences in Moscow, who had coordinated the 1997 survey, negotiated initial access for me. I then had to convince management to let me stay. Mozgovaya found that many enterprises were nervous about the presence of a foreigner.

6. I began each case study with a wealth of basic information about the enterprise, thanks to the earlier survey. This greatly expedited my research, as compared with earlier case studies (e.g., Burawoy and Hendley 1992; Hendley 1992).

7. Since 1993, at least 40 percent of the contractual disputes resolved by the arbitral courts have involved nonpayments. For more detail, see Hendley 1998d, 389–90.

8. In this way, I avoid the possibility, raised by Felstiner, Abel, and Sarat (1980–81), of having unperceived injurious experience. The enterprise may choose not to take action, but it cannot escape a recognition of an injury, given the material consequences of nonpayment. I also avoid the criticism sometimes leveled at the Felstiner-Abel-Sarat framework of rushing to judgment on the presence of disputes.
9. The survey results reveal that, at some point over the past two years, 57 percent of enterprises had threatened to force a delinquent customer to pay penalties, or had actually forced payment of penalties (see Hendley, Murrell, and Ryterman 2000). In contrast to U.S. contract law, under which penalties or other punitive damages for nonpayment are usually deemed unenforceable, Russian law follows the European practice of endorsing penalties (Hendley 1998a). A 1992 decree allows for penalties of 0.5 percent per day of the amount owed until it is repaid (Postanovienie 1992).

10. All of the case-study firms had internal security service, but these individuals were not occupied with enforcing nonpayment contracts.

11. The survey results reveal that more than 60 percent of enterprises had taken this action at some point over the past two years (see Hendley, Murrell, and Ryterman 2000).

12. The arbitrazh courts, which are distinct from the courts of general jurisdiction, hear only disputes between legal entities, disputes between legal entities and the state, and bankruptcy claims (see generally Hendley 1998b, 1998d). Alternative dispute resolution in the form of private arbitration is possible, but its use is generally limited to Russian enterprises that have disputes with foreign companies (see Hendrix 1997).

13. Of the surveyed enterprises, 47 percent had consulted outside lawyers, though most (31 percent) did so on an intermittent basis. See generally Hendley, Murrell, and Ryterman forthcoming.

14. The names of the case-study enterprises have been changed in order to preserve their anonymity.

15. MBT privatized via Option 2, which allowed enterprise employees to purchase 49 percent of the capital stock under advantageous terms. For an account of the three options for the privatization of state enterprises, see Åslund 1995.

16. In 1992, MBT had 1,000 employees. By 1997, only 350 remained.

17. The deal struck allowed these lawyers to retain 15 percent of any amount recovered. The current lawyer is highly critical of this arrangement. Even though the fee should have provided them with an incentive to follow through on nonpayments, they did not. Sales department personnel complained that, while they did all the work, the lawyers ended up pocketing all the money.

18. For an analysis of how an analogous transaction might proceed in the United States, see Keating 1997.

19. The only exception is for bankrupt customers, where there is other hope of gaining value from the transaction. This is not a decision that the sales director makes. Instead, the general director and his key vice president decide whether it is prudent to accept these bartered goods.

20. Filing fees, known as gosposhchina, are calculated on the basis of a percentage of the amount claimed in the lawsuit. As a rule, the plaintiff must pay these fees when filing the case, though many arbitrazh courts allow penalties to be delayed until the decision is rendered if the plaintiff is illiquid. In any event, the loser must pay the filing fees at the conclusion of the case.

21. Complaints tend to be short and are almost exclusively devoted to the facts of the dispute. In reviewing hundreds of nonpayment cases brought between 1992 and 1997, I encountered only a handful of complaints that exceeded two pages. Often one of the two pages would be taken up by a list of attached documents (see generally Hendley 1998a). This nondiscursive style is, of course, common in legal systems based on a Continental tradition.

22. Beginning in 1997, the arbitrazh courts refused to award both interest and penalties, regarding such claims as an effort to double dip. In an effort to get around this norm, MBT's form contract included a clause that specifically allowed for both interest and penalties, in which the parties stipulate that they are different remedies.

23. All sales contracts include a penalty clause, allowing for penalties of 0.5 percent per day of the outstanding debt. MBT collected penalties in only 15 percent of delinquent contracts, indicating that penalties are often used as a negotiating tactic.

24. The 1995 APK eliminates the requirement that defendants provide written answers to complaints filed against them. It also allows the case to proceed in the absence of the defendant if there is proof of its receipt of the complaint. Earlier research in the Saratov arbitrazh court, I found a precipitous decline in the incidence of answers. Of the 21 nonpayment case records I reviewed in Saratov in 1996, defendants filed answers in almost half (9 cases or 43 percent). By 1997, my review of 52 such cases uncovered only 12 (23 percent) cases in which answers were filed. In 77 percent of the cases (40) the defendants failed to respond in writing. Indeed, in 42 percent of cases (22), the defendants failed to participate in any way. This reform, which allowed for default judgment, allows the arbitrazh courts to operate more efficiently (see Hendley 1998a).

25. The judge was equally unsympathetic when the defendant's lawyer tried to argue that the failure of the bank absolved them of any "fault" in debt.

26. The priority for payment is established by article 855 of the Russian Civil Code, as modified by a December 1997 decision of the Russian Constitutional Court (Vesnik Konstitutionnogo Suda Rossiiskoi Federatsii, no. 1, 23–31 (1998)). See GK.

27. The complaint asked for both penalties and interest. The judge questioned the MBT lawyer sharply on this point, drawing her attention to the current interpretation of this as double-dipping. The MBT lawyer made a halfhearted effort to defend her position, pointing to the language of the contract, but took out the claim for interest.

28. By "secured creditors," I mean those creditors who have attached their debts to the bank account of the defendant. Government debt is attached to "kartoteka 1," and private debt is attached to "kartoteka 2."

29. This assumption may have been overly optimistic, since compliance is far from assured in the United States, even in nonpayment cases (see generally Kagan 1984).

30. Art. 76, APK. A 1996 informational letter from the Presidium of the Higher Arbitrazh Court clarifies that such claims are given the same priority as the final judgment. The order of payment is established by article 855 of the Civil Code, which means that preexisting claims by the state or other private creditors will be paid first (Vesnik Vyshego Arbitrazhnogo Suda Rossiiskoi Federatsii, no. 10, 126–28, 1996). A petition to freeze assets represents a low-cost mechanism of preventing the defendant from abscording with the assets in the bank account.

31. Upon renewing the relationship, MBT insists on full prepayment for any purchases. The customer must prove its trustworthiness.

32. Avto-Detalny privatized via Option 1 (see Åslund 1995).

33. A second lawyer was working out her probationary period while I was carrying out the case study, but she was not kept on. The permanent lawyer was disdainful of the
probationer’s qualifications, noting that she had obtained her legal education at a correspondence (zaochnoe) school. The probationer was actually a pensioner who had worked her entire career as a lawyer in another large enterprise and was seeking to supplement her pension.

34. This is a Soviet-era title. It is the functional equivalent of vice president. At Avto-Detal, there were five assistant general directors.

35. By comparison, in 1992, Avto-Detal sold 30 percent of its output via barter.

36. For example, of the vehicles provided by ZIL, only 15 percent are likely to be liquid. ZIL is a large Moscow assembly plant and a key Avto-Detal customer.

37. When asked to evaluate the seriousness of customers’ arrears on a 0 to 10 scale as part of our survey, the general director gave a score of 10. He also gave scores of 10 when asked to rank the seriousness of Avto-Detal’s problem with unpaid wages and debts to the tax authorities and energy suppliers. These responses confirm the desperate straits of the enterprise.

38. Like MBT, Avto-Detal’s form contract calls for it to collect 0.5 percent of the outstanding debt per day.

39. The contract (which was drafted by Avto-Detal’s legal department) is ambiguous on whether the intermediary’s obligation to pay Avto-Detal arose when it took possession of the cars or when it actually sold the cars. This determines the starting date for the accrual of penalties.

40. The legal department is subordinate to this assistant director, and he reviews all drafts of legal documents and pleadings, though he is not a lawyer. As I completed the case study in March 1998, he was not yet satisfied with the drafts of the complaint against the Tomsk intermediary, and so the lawsuit had not been filed. Russian law provides a three-year statute of limitations for filing cases involving breach of contract.


42. Both involved nonpayments, and Avto-Detal was found liable to both plaintiffs.

43. EMZ privatized via Option 2.

44. During the last quarter of 1996, 30 percent of EMZ’s employees had a reduced workweek.

45. It was the largest legal department among the 328 enterprises surveyed.

46. Like his counterpart at Avto-Detal, when surveyed, EMZ’s general director gave the problem of customer arrears a 10 on a 0 to 10 scale.

47. On average, it sends out twenty pretenziiya every month.

48. Penalties are included in 80 percent of EMZ’s sales contracts, but are collected from only 3 percent of delinquent customers. Like the other two enterprises, penalties are calculated at 0.5 percent per day of the amount owed, but unlike the others, EMZ usually caps the maximum that can be recovered at some percentage of the value of the contract. The specific percentage varies and is set by the sales department in the course of negotiations.

49. For more on veksley, see Woodruff 1999 and Commander and Mumsen 1998.

50. Unless the contract provides otherwise, Russian law grants jurisdiction to the arbitrazh court closest to the defendant (Art. 25, APK). EMZ does not attempt to shift jurisdiction in its form sales contract, reasoning that few customers would concede their home court advantage.

51. Art. 515, GK.

52. I am not arguing that locale played any role. All three case-study cities are roughly equal in this regard. All have highly regarded legal academies and a large and active private bar.

53. I have elsewhere analyzed the factual basis for the allegations that the arbitrazh cases are prohibitively expensive and subject to excessive delay (Hendley 2000, 1998d). My analysis of the official caseload statistics reveal that these claims are overstated. During the past few years, fewer than 5 percent of cases decided by the arbitrazh courts were not decided within the statutory deadline of two months from the filing date of the case (Hendley 2000, 1998d). In addition, the courts have exhibited flexibility on the payment of up-front filing fees (which are statutorily required to be calculated as a percentage of the amount sought in the lawsuit) by allowing illiquid enterprises to put off paying until judgment is rendered. Of course, the plaintiff has to pay these filing fees if it loses, which ostensibly acts as a check on frivolous litigation (Hendley 2000, 1998a,b,d; Hendrix 1997).

54. See Hendley 1998a, b; Vasill’eva 1997, 1998; Hendrix 1997; and O’Donnell and Ratnikov 1996 for a discussion of how the previous enforcement system was supposed to work and an assessment of the reasons for the dissatisfaction.

55. Asked to evaluate on a scale of 0 to 10 the seriousness of implementation problems as an obstacle to using the arbitrazh courts, more than 60 percent of legal directors surveyed gave this score of 8 or above, clearly demonstrating the universality of the perception of enforcement as a vexatious problem.

56. These insights about the transformative role played by lawyers in the West often serve as the basis for arguments about the lack of access to justice for certain societal groups or categories of claims.

57. One of the émigré lawyers who used to work in a Soviet enterprise with whom Shelley (1981–82, 445) spoke commented that “if there is anyone who needs and benefits from our services, it is the worker at the workplace.” She concluded that in-house lawyers acted as interpreters of law for workers and were often able to help them resolve personal problems (445–53).

58. On the back page of many Russian contracts is a list of approvals needed before the contract can be finalized. Along with the finance department and other enterprise officials, the consent of the legal department is required. Each department is expected to examine the document from its narrow perspective.

59. This observation is not intended as a criticism of the role of lawyers in Russia (or in civil law systems), but rather as an empirical observation of their level of responsibility.

60. Foreign-initiated legal reform programs can also play a role, though the impact may not become apparent for some time. For example, Garth argues that the efforts to reform the Brazilian legal system and legal profession in the 1960s created close ties between legal elites in Brazil and the United States, which help explain the current iteration of reforms.

61. This should not be taken to mean that all aspects of MBT’s operations are highly routinized. For example, the sales director has complete discretion over whether to sell to a given customer, and the decision-making process is individualized.

62. In private conversation, Stewart Macaulay drew my attention to the similar be-
havioral pattern of large credit card companies in the United States. Like MBT, these companies have a large and constantly fluctuating customer base and have great difficulty assessing their creditworthiness. Of course, the U.S. companies have an advantage in being able to rely on credit reports. The basic contours of the disputing strategy are the same. Both pursue debtors aggressively, and both have difficulty collecting on court judgments.

63. Avto-Detail management’s effort to disclaim responsibility for its predicament is somewhat disingenuous. A full analysis of what actions Avto-Detail might have taken to improve matters is beyond the scope of this study.

REFERENCES


