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## *SHAREHOLDER RIGHTS, EQUITABLE TREATMENT AND THE ROLE OF THE STATE*

*Shareholder Rights: Theory and Practice in Armenia*

By

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**EURASIAN CORPORATE GOVERNANCE ROUNDTABLE**

**Shareholder Rights, Equitable Treatment and the Role of the State**

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**SHAREHOLDER RIGHTS: THEORY AND PRACTICE IN ARMENIA**

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## **1. Introduction: Corporate Ownership Structures - Profiles of Shareholders**

This background paper was prepared for the OECD Corporate Governance Roundtable in Kyiv on April 17-18, 2002. It presents the general status of affairs in Armenia with respect to shareholder rights in theory and practice. This paper is based on publicly available data and information received from various institutions such as the Securities Commission of the Republic of Armenia, the Commercial Court of the Republic of Armenia and the Association of Shareholders. This paper also benefited from IFC's corporate governance project in Armenia which included work with more than 500 most active Joint Stock Companies (JSCs), their management and shareholders, government agencies and representatives of different professional communities (lawyers, judges, accountants, auditors and journalists).

The structure of the paper is as follows. First, it presents the common ownership structures and profiles of shareholders in Armenia. Second, it discusses legal and practical implications for the protection of shareholder rights. The paper concludes with recommendations to improve the rights of shareholders. A list of legal acts regulating the rights of shareholders is presented in the appendix to this report.

### *1.1 Corporate Ownership Structures*

There are two types of JSCs in Armenia: companies that have resulted from the privatization of state owned enterprises and newly established companies. Corporate legislation makes a distinction between open JSCs and closed JSCs (the number of shareholders of a closed JSC may not exceed 49).<sup>1</sup> In general, there is a great concentration of ownership in Armenian JSCs – most of the companies have a controlling shareholder which possesses a supermajority of voting shares of a company.

### *1.2 Profiles of Shareholders*

Shareholders of Armenian joint stock companies can be classified as follows:

- **Strategic investors** that have a majority equity position in a local company. Although limited, Armenia has attracted foreign investment such as: Armentel (Armenian telecommunications system) - 90% foreign equity investment; Yerevan Brandy Factory - 100% foreign equity investment by Pernod Ricard (French Spirits Co.); Hotel Yerevan – 100% foreign equity investment by RENCO SPA (Italian Construction Firm); HSBC Bank Armenia – 70% foreign equity by HSBC);
- **Armenian diaspora investment groups** that usually have a controlling position (supermajority) in companies such as: Hotel Armenia – 100% foreign equity investment by AK Development LLC, a US Investment Group; Hotel Ani – 100% foreign equity investment by Ani Investment Group, a US Investment Group;
- **The state – currently represented by Ministries and other state agencies** - is a major corporate player in Armenia. The state owns 100% of 1,635 closed JSCs. The state possesses more than 50% of the shares of 105 companies (out of a total of 129 JSCs) listed on the Armex. In 23 JSCs, the state's share is between 30 and 50%;<sup>2</sup>
- **Local Armenian investment groups** are mainly holding companies. Members of these holding companies are incorporated as closed JSCs or limited liability companies (examples are: SIL Group, Multi Group, Mika Group, Grand Group);

<sup>1</sup> According to data from the National Statistics Service of the Republic of Armenia, there are 3,109 closed and 1,152 open JSCs registered with the State Register of Legal Entities as of January 1, 2002.

<sup>2</sup> The figures are obtained from the Securities Commission of the Republic of Armenia and reflect the situation of January 1, 2002.

- **Foreign institutional investors** have equity stakes in a very limited number of JSCs. These investors usually have a minority position in companies (IFC – 20% equity investment in Hotel Armenia; EBRD – 30% equity investment in the International Commercial Bank);
- **Natural persons** hold a majority position in many companies. These are mainly the insiders (the management and their affiliated persons) of privatized companies;<sup>3</sup>
- **Employees** of privatized companies that automatically became shareholders as a result of the privatization program in Armenia are the most vulnerable minority shareholder groups in Armenia.

## **2. Protection of Shareholder Rights**

### *2.1 Ownership rights*

A fundamental right of shareholders is the registration of ownership of their securities. To secure ownership, article 51 of the Law on Joint Stock Companies (LJSC) provides that a company shall maintain a shareholder register that must be established within 1 month after the state registration of the company. The LJSC permits smaller companies (companies with less than 50 shareholders) to maintain the register or to maintain the register with a specialized organization – the Central Depository of Armenia. Larger companies (with 50 and more shareholders) must hold their register with the Depository.

Despite the law, there are still many companies that have not transferred their registers to the Depository or that have refused to register the shares of minority shareholders. Many companies, especially those that were privatized, have not established registers and frequently the management does not have information on the total number of shareholders and how many shares they hold.

As a rule, the shareholder register is not a public document. Only the company, its shareholders, the Securities Commission and relevant state organs, in cases provided by law, have access to the register. Any registered shareholder and his/her representative have the right to request information regarding personal accounts. When the Board of Directors of a company composes the list of the shareholders eligible to participate in the General Meeting of Shareholders (GMS) (based on the data from the shareholder register), the shareholder or a group of shareholders that own at least 10% of voting shares have the right to familiarize themselves with the entire shareholders list.

Shareholders do not have access to the shareholder register to compile a shareholders list when the Board of Directors refuses to organize an Extraordinary GMS (EGMS). This makes it impossible for minority shareholders to convene a valid EGMS without the consent of the Board of Directors. This also means that shareholders with less than 10% of voting shares can never call an EGMS in Armenia without the consent of the Board of Directors since they have no access to the shareholder register.

### *2.2 Dividends*

Article 49 of the LJSC provides that a company may pay dividends from the net profits (retained earnings) quarterly, semi-annually and annually. The decision to declare and pay annual dividends is vested with the GMS (based on a recommendation from the Board of Directors). The Board of Directors determines the size and the type of payment of dividends (cash or assets). The Board of Directors also determines intermediary dividends. This means that the shareholders (particularly non-controlling) have no tools to force the management (and/or the controlling shareholder) to distribute dividends since only the Board of Directors may submit this issue to the Annual GMS. Another deficiency is the fact that the LJSC does not

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<sup>3</sup> The Survey of Corporate Governance Practices of Open Joint Stock Companies in the Republic of Armenia published in July 2000 by the IFC's Corporate Governance Project indicates that in 70% of sample companies the management holds on average 72% of the shares.

set a maximum deadline for the payment of already declared dividends. The law also does not specifically stipulate that any payment of dividends made while violating the law shall be returned to the company unless the shareholders did not know or could not have known irregularities. In many cases, shareholders do not have a good understanding of legislation which make them more vulnerable under these circumstances.

There are only a few companies which have declared dividends in Armenia. Not too many companies are active and profitable, the management (the controlling shareholder) does not share profits with other shareholders or companies hide profits for tax purposes.

### *2.3 Participation in Major Corporate Changes*

The right to participate in the decision making process of a company through the GMS is another fundamental right of shareholders. Article 67 of the LJSC specifies the exclusive powers of the GMS to decide on issues such as:

- The approval of and amendments to the charter of the company;
- The reorganization and liquidation of the company;
- The election of Board members and the early termination of their powers;
- Determination of a maximum amount of authorized shares;
- Reduction of the size of the charter capital;
- Payment of annual dividends (upon the recommendation of the Board of Directors);
- Approval of large and interested transactions;
- Consolidation and split of shares.

Most of these decisions require a qualified majority of three-quarters of the shareholders that participate in the GMS. For the liquidation of the company and the decrease of the charter capital, the law sets two thresholds – three-quarters of the participants of the GMS need to vote which should represent not less than two-thirds of the total number of voting shares of the company. It is unclear why only these two decisions are based on two thresholds. In contrast, the decision to suspend (waive temporarily) the pre-emptive rights of shareholders requires only a simple majority vote of participants of the GMS. The LJSC does not allow this threshold to be changed with amendments to the charter.<sup>4</sup> At the same time, there are decisions that are very important to the shareholders which can be transferred to the Board of Directors by the charter of the company (e.g. establishment of subsidiary and dependent companies) or which do not fall within the competence of the GMS (the acquisition by the company of its own issued shares, changes in the definition of company's activities).<sup>5</sup> In practice, considering the concentration of ownership in Armenian companies, these decisions are often adopted by the controlling shareholder whereas the minority shareholders are often unable to vote on these issues.<sup>6</sup>

### *2.4 Shareholder Meetings*

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<sup>4</sup> See LJSC, article 68.2 which specifies that the charter may not change the number of votes required for the adoption of any decision by the GMS.

<sup>5</sup> Unless these are set in the charter and there is a need to amend the charter. In this case, the GMS has to vote on the decision.

<sup>6</sup> It is important to note that despite the recent adoption of the LJSC in 2001, it still has inconsistencies with the Civil Code of 1998 with respect to the exclusive powers of the GMS. Article 115.1 of the Civil Code provides that amendments to the charter capital fall within the exclusive competence of the GMS whereas the LJSC, Article 83.1 provides that the GMS may permit the Board of Directors to issue authorized shares and thus increase the charter capital without the consent of the GMS.

Article 37.1 of the LJSC lists the rights that are attached to common shares of a company. Among others, it indicates that the holders of common shares have the right to participate in the GMS with the right to vote on all issues that fall within the competence of the GMS. In addition, article 38.1 of the LJSC provides that the holders of preferred shares do not have voting rights unless the law or the charter of the company provides otherwise. Clauses 3-5 of the same article specify circumstances in which the holders of preferred shares have voting rights. The holders of preferred shares have voting rights when:

- The GMS votes on the reorganization of the company, the liquidation of the company and amendments to the company charter which limit the rights attached to preferred shares of a specified class;
- The company does not pay dividends to preferred shareholders (in this case, the preferred shareholders can vote on all issues put on the agenda of the GMS). However, the holders of preferred shares vote together with common shareholders since the law does not provide for separate voting.

Article 76 of the LJSC gives the right to the holders of voting shares to vote at the GMS by proxy. Powers of the representative must be duly certified by a power of attorney.

The LJSC also gives shareholders the right to vote by proxy during EGMSs.<sup>7</sup> In general, voting by proxy is not used in Armenia because clear procedures to communicate with shareholders (e-mail, fax, other means of communication) and for their user of the voting ballots (proxies) are absent.

### **3. Equitable Treatment of Shareholders**

#### *3.1 Treatment of Minority Shareholders*

Articles 37 and 38 of the LJSC give to holders of shares of the same class (common and preferred) equal rights. These provisions set the ground for the equitable treatment of shareholders. In addition, the law permits the charter to limit: (1) the maximum number of shares of a specified type and class that a single shareholder may possess; (2) the maximum total nominal value of shares of a specified type and class a shareholder may possess and (3) the maximum number of votes that a single shareholder may possess. It is not clear in the law whether the limitation of the maximum number of votes a shareholder may have is the same as the maximum number of the voting shares a shareholder may possess. In this case, if it is meant by the law, a shareholder may have an unlimited number of shares but can vote only with a maximum number of votes set by the limitation in the charter.

The law states that these limitations shall apply equally to all shareholders holding the shares of the same type and class. An example of such a limitation is used by Diagnostika open JSC, a health center in Armenia. The company charter specifies that no shareholder may have shares with a nominal value that represent more than 4% of the company's charter capital *with the exception of the state*.<sup>8</sup>

The limitations can be set by the company charter during the establishment of a company or through amendments to the charter. If the limitation is set during the establishment of the company, it requires a unanimous vote of holders of voting shares that participate in the Constituent Meeting.<sup>9</sup> For the limitation

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<sup>7</sup> It is not permitted to hold Annual GMSs in absentia under the LJSC article 69.1. This means that at least one shareholder or his/her representative must be physically present during the GMS.

<sup>8</sup> The state owns about 34% of shares of Diagnostika open JSC.

<sup>9</sup> The Constituent Meeting has quorum if at least three-quarters of holders of the voting shares were registered. See LJSC article 12.2.

to be introduced through a charter amendment, the LJSC requires the approval of three-quarters of all holders of the voting shares of the company.<sup>10</sup> Since the introduction of limitations require charter amendments and limit shareholder rights, the shareholders who have not participated in the GMS or that have voted against this decision have redemption rights.

### *3.2 Additional Rights of Minority Shareholders*

The LJSC gives minority shareholders additional rights. In particular, article 72.1 of the LJSC grants the holders of at least 2% of voting shares the right to propose a maximum of 2 issues for the agenda of the GMS and the right to propose a number of candidates for the Board of Directors and the Control Committee of the company that equals the maximum number of members of these organs.<sup>11</sup> The Board of Directors in charge of approving the agenda of the GMS, may not change the proposal of the shareholders or refuse their inclusion in the agenda other than on the grounds specified by law. If the Board unlawfully refuses to include the matter on the agenda, these shareholders have the right to appeal that decision to the court. In practice, shareholders (especially the minority shareholders) rarely propose issues for the agenda of the GMS in Armenia.

Similarly, shareholders or a group of shareholders who own at least 10% of voting shares may request the company to convene an EGMS.<sup>12</sup> The law does not allow the company charter to grant this right to shareholders possessing a smaller number of voting shares. The Board of Directors may not change the agenda proposed by the shareholders and can refuse to hold the EGMS only on the grounds set by law. In this case, the shareholders may also appeal the Board's decisions to court. In addition, if the Board refuses to convene the EGMS or does not make a decision on this matter, the shareholders may convene the EGMS and charge the costs to the company. The right to call an EGMS has been used rarely by shareholders in Armenia.

Article 85 of the LJSC gives minority shareholders two possibilities of having a Board representation. Firstly, the holders of at least 10% of voting shares may become members of the Board of Directors or appoint their representative while they are not elected by the shareholders. This is a very controversial provision since it directly violates the "one share - one vote" rule by allowing these shareholders also to vote during the elections at the GMS and thus these shareholders can exercise their voting rights twice. Also, this is not a collective right so that smaller shareholders cannot together put their representative on the Board. This means that a shareholder or a group of shareholders that owns together at least 10% of voting shares cannot use this right.

Secondly, in companies with 500 or more shareholders, Board members should be elected through cumulative voting. Although all members are elected at the same time during the GMS, directors appointed based on the 10% rule are exempted. In Armenia, most Board elections are a formality. Companies that must use cumulative voting rarely comply with the law and only in very rare cases, minority shareholders succeed in putting their representative on the Board.

The corporate governance framework does also not ensure the protection of minority rights when a new person acquires control over the company. In particular, the shareholder who acquires control over the company is not obliged to buy out other shareholders. The right of shareholders to sell shares to third parties and the redemption rights of minority shareholders are not effective due to the absence of

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<sup>10</sup> For other decisions of the GMS regarding the amendments to the charter of the company, the law requires the approval of three-quarters of the holders of voting rights that participate in the particular GMS. See LJSC article 68.

<sup>11</sup> This is a collective right that allows a group of shareholders which possess together 2% of the voting shares to submit a proposal to the agenda of the GMS.

<sup>12</sup> This is also a collective right.

trustworthy valuation procedures and the absence of a stock market in Armenia. In many companies, minority shareholders cannot sell their shares when majority shareholders or other parties are not willing to acquire these shares.

### *3.3 Treatment of Foreign Shareholders*

Local and foreign shareholders receive equal treatment by laws. In practice, foreign investors usually take majority stakes in companies and ensure that their rights are protected against the administrative abuses.

### *3.4 The State as a Shareholder*

The legal status of the State as a shareholder is regulated by the LJSC and privatization legislation.<sup>13</sup> The new LJSC has abolished the concept of “state joint stock companies” thus giving the companies (partly or completely) owned by the state the same status private JSCs have. However, the LJSC still contains several provisions that deal with the state as a shareholder. In particular, article 11.2 of the LJSC provides that the Republic of Armenia can be a shareholder of a company based on the same grounds as natural and legal persons. It does prohibit state agencies and local government agencies to be the shareholders or the founders of a company.<sup>14</sup> The current legal framework does not give the shares that belong to the state a different status from the shares that are held by natural or legal persons. It does give the possibility to introduce “special privileges” for the state as a shareholder through the issuance of preferred shares.

A specific rule (related to increases of the charter capital) is provided by the LJSC for companies that are included in the privatization program.<sup>15</sup> The LJSC refers to privatization legislation to regulate this procedure which still has not been adopted. The purpose of this procedure is to avoid dilution of state shareholdings.<sup>16</sup>

## **4. Violation and Abuse of Shareholder Rights**

The concentration of ownership, inconsistencies in legislation, generally weak enforcement mechanisms and the lack of knowledge of shareholders have contributed to violations of shareholder rights in Armenia. However, many of these irregularities are often not disclosed since outsiders (regulatory organs and shareholder activist groups, if any) and minority shareholders are not able to reveal or understand these violations. Most cases that are brought to courts in Armenia involve other matters such as property rights, employment issues and contractual problems. The following are the most common violations of minority shareholder rights in Armenia:

**Outright theft by company managers/controlling shareholders, asset stripping and self dealing:** these violations were very common during the early years of privatization. As a result, many formerly state owned companies are currently inactive or work at low levels of capacity. Assets were either sold to outsiders directly or transferred to affiliated persons below reasonable market prices. Despite the fact that laws prohibit such transfers, it is very hard to monitor and sanction these transactions. The absence of

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<sup>13</sup> See LJSC article 1.5.

<sup>14</sup> If company shares belong to the state (or the local communities) the state agencies (or the local government agencies) are **the representatives** of the state while the state itself (or the local communities) remains **the shareholder of the company**.

<sup>15</sup> See LJSC article 35.9.

<sup>16</sup> There are several cases reported when companies with state shares issued additional shares and the state was not able to acquire new shares in order to keep the same proportion (and to exercise its pre-emptive rights). As a result, the state's shareholdings were substantially diluted.

proper ownership disclosure mechanisms makes it very difficult to unveil affiliated parties. Corruption and weak enforcement are other “contributors” to this situation. In all cases, the companies themselves and, therefore the minority shareholders often have received only a small portion of the true value of these assets, if any.

**Dilution of minority shareholders:** it is very easy for controlling shareholders to dilute minority shareholders through capital increases. Minority shareholders are often unable to exercise their pre-emptive rights to maintain the same proportion of their shareholdings simply because they are too poor (if they would understand their rights). Even the state, as a shareholder, has been in many instances the “victim” of such capital increases. The situation is moreover exacerbated when the capital increases are done through in-kind contributions which minority shareholders often simply cannot do. In other cases, insiders contribute assets that are not useful or that are overvalued substantially. Another means of dilution that is becoming more “popular” recently is the consolidation of shares. With consolidation, the number of shareholders decreases and the total percentage of the shares owned by minority shareholders significantly decreases as well.

**Transfer of valuable assets of the company through reorganizations:** such violations are becoming more common. In Armenia, in order to make privatized companies more attractive to investors, several companies were reorganized with valuable assets being transferred to an entity with almost no liabilities and the illiquid and useless assets and major liabilities transferred to another entity (or they remained with the company). Very often, minority and non-affiliated shareholders remain with the company with liabilities and useless assets.

**Manipulation of information:** in many Armenian companies, minority shareholders are deprived of any information regarding the company. Often, they have never seen annual financial statements, if any, that must be approved by the GMS. The management and the controlling shareholders often do not provide information regarding the financial plans of the company. Violations are still common in companies that are monitored by the Securities Commission.<sup>17</sup>

**Uneven distribution of company profits:** a few Armenian companies distribute profits as dividends. Mostly, the insiders either hide the real profits to avoid tax liabilities or keep the profits to “reinvest” in the company. In both cases, the insiders often receive more dividends than they are entitled to.

**Violations with respect to the GMS:** many companies have never held a GMS. Because of this, the management of the company (both the Board of Directors and the Executive organ) does whatever it wishes. In many companies, the shareholders (mainly minority employee shareholders) are deprived of exercising any rights that the law attributes to the GMS and the shareholders. Also, violations of procedures regarding the notification of shareholders about the GMS, the agenda of the GMS and the materials that must accompany notifications are very common.

**Violations with respect to the shareholders register:** problems regarding the shareholder register include the absence of the register in many companies, the violation of rules on conducting the register and the limitation of shareholders’ access to the information in the register.

**Insider trading:** due to the absence of capital markets in Armenia and the almost complete absence of any trading in shares, most insider trading takes place informally by managers who buy shares from employees.

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<sup>17</sup> Article 4 of the Law on the Regulation of Securities Market defines the reporting issuers as: (1) JSCs that are listed on the stock exchange; or (2) that have 50 and more shareholders and the net assets of the company exceed the limit set by the Securities Commission.

While there is no fair price discovery in Armenia, managers are able to manipulate employees to sell shares at discounts or to give shares in exchange for a paid position in the company (if any).

One of the weakest aspects of the LJSC is that even though it provides almost all basic shareholder rights, it does not specify the measures and mechanisms for their implementation, protection and sanctioning. This issue is somehow regulated by the Law on the Regulation of Securities Market (LRSM) which gives the Securities Commission sanctioning powers. In particular, chapter XIV of the LRSM is devoted to administrative and civil liability and the powers of the Securities Commission to apply sanctions.

## **5. Enforcement and Legal Redress**

### *5.1 Regulatory Enforcement*

The Armenian judicial system has two types of courts that may deal with disputes involving the violations of shareholder rights: courts of general jurisdiction and commercial courts. Which court has the jurisdiction with respect to a particular dispute depends on the nature of the dispute (whether it relates to entrepreneurial activities or not) and the parties (whether the parties are natural persons or legal entities and individual entrepreneurs).<sup>18</sup> Because of the unpredictability of court decisions, many companies distrust the court system and seek protection elsewhere. One such an alternative is arbitration. However, arbitration is not a valid option for all types of shareholder rights violations and is not used in Armenia.<sup>19</sup> Another mechanism is protection through the Securities Commission. To what extent the Commission can substitute the court remains to be seen in the future since it has been established only recently. The Commission itself has to earn trust. Currently, most disputes are resolved informally.

### *5.2 Access to Legal Redress*

In general, the legal framework regarding the protection of shareholder rights provides the opportunity to go to the court, at least in theory. Under article 38 of the Constitution of Armenia, every person has the right to protect his/her rights and liberties in any manner that is not prohibited by law. At the same time, every person has the right to protect his/her rights and liberties granted by the Constitution and laws by the courts. Provisions of the LJSC and the LRSM regulate corporate governance disputes. In particular, article 68.13 of the LJSC specifies that shareholders have the right to appeal to the court the decisions of the GMS that have been adopted while requirements set by law, other legal acts and the charter were violated. In a few other provisions, the LJSC provides that shareholders have the right to appeal decisions made by the Board of Directors if these are not made in compliance with legislation (the decision to refuse a shareholder proposal for the agenda of the GMS, the decision to refuse to convene the EGMS or the absence of a decision on this issue, etc.). The LJSC is silent about the shareholders' right to appeal other unlawful decisions of the Board of Directors and the Executive organ. In this case, the Civil Code can impose general liability on managers and directors.

Shareholders are also given the right to protect their rights when the management of the company causes losses to the company by acting negligently or against the best interests of the company, i.e. the shareholders. Article 90.5 of the LJSC specifies that the shareholders holding at least 1% of common

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<sup>18</sup> This issue is regulated in detail by the Civil Procedure Code, article 16.1 which gives the jurisdiction over disputes between commercial legal entities (partnerships and corporations) and individual entrepreneurs regarding the entrepreneurial activities to the commercial court. The concept of entrepreneurial activity is defined in article 2 of the Civil Code.

<sup>19</sup> Article 5 of the Law on Arbitration and Arbitration Procedure specifies that arbitration tribunals are permitted to adjudicate proprietary disputes.

shares of the company have the right to go to the court with a request for compensation for the losses caused to the company by the managers who violated their duties of care and loyalty.<sup>20</sup> It is important to note that article 143.1 of the LRSM grants the same right to *any* registered shareholder. In practice, there are no cases brought by shareholders against mismanagement to the court in Armenia.

### *5.3 Self-Regulatory Enforcement*

In order for a company to be listed on the Armenian Stock Exchange - Armex – the company has to have its securities (shares) registered either with the Securities Commission or the stock exchange. The registration requirements for both institutions are the same although it is less expensive to register with the stock exchange. The LRSM<sup>21</sup> and “The Collection of Rules Regulating Securities Markets” (Rulebook)<sup>22</sup> specify the information and documents that a company must submit to the registration body (the Securities Commission or the Armex) in order to register its shares.<sup>23</sup>

The stock exchange has two listing tiers for companies – an upper tier and a lower tier. To facilitate the development of capital markets and the stock exchange in Armenia, the stock exchange has not set listing requirements for lower tier companies. Currently, 129 companies are listed on the lower tier.

For the upper tier, the stock exchange requires:<sup>24</sup>

- Minimum charter capital - AMD 50 million;<sup>25</sup>
- Minimum duration of company activities – 3 years;
- Minimum number of shareholders and shares – 200;
- Minimum number of shares – 5000;
- Minimum annual profitability – the company had profits during the last reporting period (no limitation for lower tier securities).

The stock exchange has set the following requirements for the maintenance of the listing for both tiers:

- Disclosure of annual financial statements (verified by an auditor) and quarterly financial statements (do not need to be verified by an auditor);
- The shareholder register must be maintained with the Central Depository;
- Payment of required fees;
- Informing the exchange in case of violations of any of the listing requirements (for companies listed on the upper tier);
- Other requirements for reporting issuers.

In case of violation of the requirements for the maintenance of stock exchange listing, Armex may impose two sanctions: temporary delisting and permanent delisting. Temporary delisting is applied when:

- The registration of company’s shares is suspended;
- The company did not pay the fees required for the maintenance of the listing;

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<sup>20</sup> This is a collective right.

<sup>21</sup> See articles 9 and 10 of the LRSM.

<sup>22</sup> See article 23.1 of the Rulebook.

<sup>23</sup> Registration with the stock exchange means registration with the Securities Commission but the registration with the Commission still requires that the securities be registered with the stock exchange which is a precondition for listing these shares on the exchange.

<sup>24</sup> No shares are listed on the upper tier as of March 15, 2002.

<sup>25</sup> Approximately USD 87,000.

- The contract between the issuer and the stock exchange has expired.

The Listing and Delisting Rules of the Armenian Stock Exchange provide that a company's shares may be permanently delisted if:

- The registration of shares is cancelled;
- The term of the contract between the issuer and the stock exchange has expired and no new contract was concluded;
- The company applies for permanent delisting;
- The issuer is in the process of liquidation;
- The issuer is bankrupt;
- The contract between the issuer and the stock exchange regarding the maintenance of listing is cancelled;
- During the period that shares were temporarily delisted, the reasons for delisting were not resolved;
- The term of listed securities expired.

So far, no company has been temporarily or permanently delisted from the Armex. Moreover, a mandatory listing for companies with 100 and more shareholders will soon be introduced.<sup>26</sup> Both the listing and sanctioning requirements have very little to do with shareholder rights and self-regulation is almost non-existent in Armenia.

## **6. Shareholder Awareness and Shareholder Associations**

One of the main reasons why the enforcement of shareholder rights and corporate governance in general is undeveloped in Armenia is the passivity of minority shareholders. These shareholders are passive because:

- Most shareholders are not familiar with their rights as shareholders and do not fully understand the corporate governance system;
- It is practically impossible for shareholders to organize themselves because of the costs and the large number and variety of persons involved;<sup>27</sup>
- The free distribution of shares may have fostered a passive attitude among shareholders that tend to be indifferent to the behavior of directors and managers;
- The costs for small individual shareholders to be involved in corporate governance are much greater than their benefits.

However, raising the shareholders' awareness of their basic rights and the development of mechanisms for the protection of these rights are important. To date, only a few corporate governance initiatives have been launched in Armenia. The first and the most influential was IFC's Corporate Governance Project (March 1999 - August 2001). The project played an important role in introducing the concept of corporate governance in Armenia on a large scale. The program worked with the Government, the management and the shareholders of privatized, NGOs, media and institutions for higher education. One of the components of the project was the development and the dissemination of a Corporate Governance Manual which served as a practical guide to many Armenian JSCs. The project also worked with more than 500 most active companies and advocated good corporate governance standards.

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<sup>26</sup> The Rule 51 "Mandatory Listing of Securities" was adopted on February 8, 2002 and will enter into effect after the official publication.

<sup>27</sup> About 118,000 shareholders are registered with the Central Depository as of January 1, 2002.

The second effort - currently the only active project in Armenia - is the Shareholders Association. Despite the fact that some of its employees also work for Government agencies and these agencies actually represent the interests of the state in many JSCs, the Association is active in raising shareholders' awareness of corporate governance.

## **7. Conclusion: Priorities for Improving Shareholder Rights**

The improvement of shareholder rights has two aspects – improvement of legislation and the enforcement of shareholder rights.

Although laws in Armenia contain many provisions that do protect minority shareholders, the following recommendations can be made:

- Minority shareholders are very vulnerable in situations when a new person acquires control over the company. The law could force the new shareholder to offer the existing shareholders to buy their shares at the highest price that this person paid for shares to acquire control;
- The law could better regulate the procedures for GMSs, e.g. voting by proxy;
- Relations within corporate groups should be regulated so that the rights of minority shareholders in subsidiary and dependent companies are better protected;
- Currently, the Government of Armenia is preparing a draft law on non-bank financial institutions which regulates some administrative supervision aspects of their activities. However, a separate law regulating investment and pension funds could be advisable;
- Proper sanctions for violations of shareholder rights could be introduced.

Improving the enforcement of shareholder rights is a difficult and time consuming process. Effective enforcement of shareholder rights requires many measures which are not always related to company law. Enforcement of shareholder rights in Armenia could be improved by:

- Fighting corruption (administrative and judicial);
- Developing capital market infrastructure and institutions such as investment bankers, institutional investors, accountants and securities lawyers, financial press and various NGOs and by raising the awareness of shareholder rights;
- Advising the Government of Armenian and regulators on issues regarding the protection of minority rights in Armenia;
- Raising shareholders' awareness of their rights;
- Dissemination of information regarding shareholder rights and practical problems in Armenia.

**Annex: The Legal and Regulatory Framework Providing for Shareholder Rights**

Laws and other legal acts in effect:

- 1) The Civil Code of the Republic of Armenia of 1998;
- 2) The Civil Procedure Code of the Republic of Armenia of 1998;
- 3) The Law on Joint Stock Companies of 2001;
- 4) The Law on The Regulation of Securities Markets of 2000;
- 5) The Law on Privatization of State Property of 1997;
- 6) The Law on Privatization Program for 2001-2003 of 2000;
- 7) The Law on Arbitration and Arbitration Procedure of 1998;
- 8) The Law on Compulsory Enforcement of Judicial Acts of 1998;
- 9) The Law on Bankruptcy of 1996;
- 10) The Collection of Rules Regulating Securities Markets of 2001;
- 11) The Decision of the Government of the Republic of Armenia N. 351 of 31/10/1996 on the Approval of the Procedure on Conducting the Register of the Holders of Nominal Securities;
- 12) The Decision of the Government of the Republic of Armenia N. 211 of 8/04/1999 on the Regulation of the Procedure of Conducting and Maintaining the Register of the Holders of Nominal Securities;
- 13) The Decision of the Government of the Republic of Armenia N. 21 of 21/10/2000 on the Reorganization of Companies that Have Shares Held by the State Exceeding 50 Percent of the Charter Capital;
- 14) The Listing and Delisting Rules of the Armenian Stock Exchange of 2001.

Laws and other legal acts being drafted:

- 1) Draft Law on Audit;
- 2) Draft Law on Bankruptcy;
- 3) Draft Law on Non-Banking Financial Institutions;
- 4) Draft Law on Arbitration;
- 5) Draft Criminal Code;
- 6) The Regulation of the Securities Commission of the Republic of Armenia on Voting by the Use of Proxies.