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SHAREHOLDER RIGHTS, EQUITABLE TREATMENT AND THE ROLE OF THE STATE

Corporate Governance Report : Azerbaijan

By

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AZERBAIJAN CORPORATE GOVERNANCE REPORT

Introduction Corporate ownership structures

Generally, in Azerbaijan companies are established either as joint stock companies or as limited liability companies.

The establishment and operation of joint stock companies is regulated by the *Civil Code* 2000, the law *On Joint Stock Companies* 1994, the law *On Enterprises* 1994 and the law *On Securities* 1998. Furthermore, there are various regulations passed by the State Securities Committee, which regulate the issue and registration of, and dealings in shares and securities.

A joint stock company is defined as a company whose share capital is divided into shares. In Azerbaijan only joint stock companies are authorised to issue shares. Thus, upon registration at the Ministry of Justice, which acts as the state registration authority for legal entities, the company should register the issue of shares with the State Securities Committee. Unlike joint stock companies, limited liability companies do not issue shares and, therefore, do not register shares at the State Securities Committee.

Generally, under the *Civil Code*, 2000, a joint stock company may be established by any number of persons. However, we note that under the *Civil Code*, 2000, the number of shareholder in a joint-stock company of a closed typed should not exceed the number to be specified by the Cabinet of Ministers but this number has yet to be specified. Should such limit be exceeded, the joint-stock company should be transformed into an open type company within one year and where the company fails to comply with this requirement it may be liquidated upon a court decision being made to that effect.

Other restrictions apply to certain types of joint-stock company, e.g. it is a requirement of banking legislation that a joint stock bank be established by at least three persons. It is likely that this requirement will be maintained in the new law *On Banks and Banking Activities*, a draft of which is, at the time of writing¹, about to be submitted for consideration by the Milli Majlis (National Assembly).

Joint stock companies may be established in two forms²:

- Open type joint stock companies: where shareholders may dispose of their shares without the consent of other shareholders and shares are issued by public subscription.
- Closed type joint companies: where shares are issued to the founders or to a specific group of persons.

¹ March 2002.

² Art. 98.5, *Civil Code* 2000

The joint stock company is the preferred form for the corporatisation of former state enterprises prior to privatisation. In such situations, 15% of all shares of the company are allocated for distribution among employees of the former state enterprise.

Information on the composition of shareholders is, in practice, not publicly available. This is despite the fact that the Ministry of Justice, which carries out the registration of companies, should provide information noted in the state register to applicants. In practice, such applications face delays and the receipt of information cannot be guaranteed.

According to information received from the Ministry of Justice there are currently approximately 3400 joint-stock companies registered in Azerbaijan. In the absence of reliable data, it is hard to give any figures as to aggregate annual turnover, of either open or close type joint stock companies. According to reports of the Ministry for Economic Development, 1278 medium and large enterprises with a total charter capital of AZM 3,510.2 billion manats have been transformed into joint stock companies since the commencement of the privatisation process. Of all privatised joint stock companies 29.8% operate in the agricultural sector, while 18.3% are industrial enterprises.

The Baku Stock Exchange remains the only place where shares (and other securities) of companies can be publicly traded. Information on shares traded on the Exchange (which includes the name of the company, total number of shares, number of shares offered for sale, nominal value and price of the share at the Exchange) is regularly published in various newspapers and can also be obtained from the internet web-site of the Baku Stock Exchange. As of March 27, 2002 there were shares of 48 companies listed on the BSE. The market is extremely illiquid.

There are no tax provisions that consolidate the profits and losses of group companies and large groups of companies are still a rarity in Azerbaijan.

Protection of shareholder rights: the legal and regulatory framework

The principal laws related to shareholder rights are:

- *Law On Joint Stock Companies* (July 12, 1994 with No. 850)
- *Law On Securities* (July 14, 1998 with No. 523-IQ)
- *Civil Code* (2000)
- *Law On Enterprises* (July 1, 1994 with No. 847)
- *Law On the Protection of the Rights of Investors on Securities Markets* (June 16, 2000 with No. 899-IQ)

It is expected that a new law on joint stock companies will be passed to take into account recent provisions stipulated by the new Civil Code.

The company's charter (articles and memorandum of association) and foundation agreement are the principal documents submitted to the Ministry of Justice on incorporation. The Ministry acts as the principal state registration authority. Any amendments to the corporate charter should also be registered at the Ministry of Justice. Amendments made to the charter come into force upon

their state registration. However, legal entities and their founders (participants/shareholders) cannot justify their acts by reference to the non-registration of amendments vis-à-vis obligations to third parties who have relied on such amendments.

Registration of company shares

The following documents should be submitted for the registration of the issue of a company's shares:³

- application for registration;
- copy of resolution on the issue of securities;
- issue prospectus (for open type joint-stock companies);
- copies of establishment documents (charter, foundation agreement, registration certificate);
- form of certificate, if the issue of shares is to be confirmed by a share certificate;
- receipt for payment of state duty, where required;
- where the issue is carried out by prospectus, information on the financial status of the issuer.

Documents for registration should be submitted within 1 month of the date of passing the resolution on making the issue.⁴

The State Securities Committee, which is authorised to carry out the registration of issue of shares, should do so (or reject registration) within 15 days of the date of receipt of documentation for registration.⁵

The following may constitute reasons for the refusal of registration:⁶

- failure to comply with the requirements of the law *On Securities*;
- inclusion of incorrect or falsified information in the issue prospectus;
- where an earlier issue has not been fully taken up;
- breach of other requirements of Azeri law.

Registration of shareholders

Currently, it is believed there are two officially recognised shareholder registrars in Azerbaijan – the National Depository Centre and a private registrar, operating under a licence issued by the State Securities Committee of Azerbaijan.

Two types of entry may be maintained by the registrars:

- emission account (to be opened for a company issuing shares); and
- personal account (to be opened for individual shareholders for the purpose of registering transactions in shares).⁷

³ Art 6.3, law *On Securities* 1998, s. 2.2, *Regulations on the issue and registration of emission securities in the Azerbaijan Republic* 1999

⁴ s. 2.4, *Regulations on issue and registration of emission securities in the Azerbaijan Republic* 1999

⁵ Art. 6.5, law *On Securities* 1998

⁶ *Ibid*, Art. 7

Registration should be carried out within 3 days of the date of application.⁸

For more information on data to be included into application for opening personal accounts see Appendices 1 and 2 hereto.

Transfer of shares

A shareholder in a closed type joint-stock company may dispose of its shares only with the consent of a majority of the other shareholders in the company and subject to notarisation of the transfer. Shareholders in an open type joint-stock company may freely dispose of their shares⁹.

Where, in a joint stock company of a closed type, a shareholder is not given consent to dispose of his shares, such shareholder has the right to require the company to purchase his shares¹⁰. A shareholder of a closed type joint stock company wishing to dispose of his shares must inform the company of his intention¹¹.

Antimonopoly restrictions

The transfer of more than 20% of voting shares is subject to antimonopoly legislation¹² and approval must be obtained from the relevant executive body (i.e. Ministry for Economic Development - MED).¹³

Application for approval of the MED should be made where:¹⁴

- The total balance value of companies involved in the transaction exceeds 75,000 minimum salaries¹⁵;
- The market share of one of the companies concerned exceeds 35%;
- The buyer exercises control over the operations of the seller.

The following documents should be submitted to the MED:¹⁶

- Notarised copies of all establishment documents of the issuer of shares;
- Copies of establishment documents of parties involved in the transaction;
- Share transfer agreement;
- information on the market share of the seller and the buyer in the appropriate sector of Azerbaijan.

⁷ s. 5.2, *Standards for Maintaining the Register of Holders of Securities* 2000

⁸ *Ibid*, s. 10.1

⁹ Art. 10.1, law *On Joint Stock Companies* 1994

¹⁰ *Ibid*, Art. 10.2

¹¹ *Ibid*, Art. 10.3

¹² Art. 17.10, law *On Securities* 1998

¹³ Art. 13-1.1, law *On Anti-monopoly Activity* 1997 (as amended)

¹⁴ *Ibid*, Art. 13-1.2

¹⁵ Currently, 1 minimum salary is AZM 27,500 (or approximately USD 5.70)

¹⁶ *Supra* note 14, Art. 13.2

Unfortunately the law is not clear as to which party should apply for consent, but there have been instances where applications for consent were filed by the issuer of shares.

Furthermore, consent of the MED should also be received where, following a merger of companies, the new entity will have over 35% of the market share or where the merged companies have total assets exceeding 75 thousand minimum salaries.

Specific restrictions exist with respect to the transfer of shares in banks. Permission of the National Bank of the Azerbaijan Republic (NBA) should be received for the transfer of shares to a non-resident. Such permission may be withheld where a transfer will lead to violation of the limits on foreign capital participation in the Azerbaijan bank system. Failure to receive permission will make transfer null and void.¹⁷

Further, consent of the NBA should be received for transfer of over 20% of shares.¹⁸ The NBA has the right to refuse consent where the transferee is 'not creditworthy', where the transfer breaches provisions of the antimonopoly legislation (see ii below), etc.

Dividends

Shareholders are entitled to dividends as declared by the general meeting of the company.¹⁹ Upon resolution of a general meeting of shareholders, dividends may be paid quarterly.

In practice, dividends are not always paid regularly, i.e. shareholders do not always get paid in a timely manner dividends which have been declared.

Irrespective of results of economic operations of a joint-stock company, preference shares guarantee to their owners receipt of fixed amount of dividends as a percentage of nominal value of shares, as well as the pre-emptive right in comparison with other shareholders in receipt of distribution of property upon liquidation of the company, and other rights determined by terms of issue of such preference shares.²⁰ However, no dividends can be declared and paid where net assets of the company are or will, following payment of dividends, fall below the amount of charter capital.²¹

The rights of shareholders to receive a dividend from a company in liquidation are subordinated to those of trade creditors, debts and other obligations to employees and the budget²².

Shareholders may lodge a objections with the State Securities Committee or commence legal proceedings in a court of law in order to protect themselves where dividends have not been paid²³.

Changes to share capital

¹⁷ Law *On Banks and Banking Activity* 1996, Art. 11.3

¹⁸ *Ibid*, Art. 17.2

¹⁹ *Supra* note 10, Art. 9

²⁰ *Supra* note 2, Art. 106.1

²¹ *Ibid*, Art. 106.3

²² *Supra* note 10, Art. 9 and 26

²³ Art. 219, *Administrative Default Code* 2000

The share capital of a joint-stock company can only be changed upon resolution of a general meeting of shareholders. For this purpose, the following information must be included in the notice to shareholders:²⁴

- amount, method and reason for change of share capital;
- draft amendments to the charter to be made because of the change of charter capital;
- value, quantity, total amount of new shares to be issued;
- term for subscription to newly issued shares.

An increase of charter capital is allowed only where the nominal value of shares of previous issues has been fully paid-up.

Charter capital may be decreased either through reduction of the nominal value of shares or by the repurchase of shares.²⁵

A joint-stock company has the right to repurchase its shares for re-issue, issue to employees, or cancellation. Repurchased shares must be re-issued within one year²⁶, otherwise the company should cancel the shares and thus reduce the size of its share capital.

The *Civil Code*, 2000, indirectly addresses the issue of the purchase by company of its own shares. A decrease in the charter capital is permitted only after notice thereof has been sent to all creditors of the company. In such case, creditors have the right to demand the premature performance of the obligations of the company or compensation for damage. A decrease of the charter capital of a company by re-purchase and cancellation is only possible if permitted by the charter of the company²⁷.

Major corporate changes

Shareholder meetings should be held at least once a year.²⁸ As for the location of general meetings, the law is silent. No distinctions are drawn between local and foreign investors with respect to procedures for lodging a notice of general meeting.

Notice of a general meeting should be delivered at least 45 days in advance²⁹ and, although the law is silent as to this, usually also contains an agenda of the general meeting. Shareholders have the right to make changes to the agenda not later than 20 days before the date of the meeting.³⁰

All shareholders are entitled to vote, however holders of preference shares are not entitled to vote unless specified by the charter.³¹ Shareholders are entitled to participate in general meetings either

²⁴ Supra note 10, Art. 17.3

²⁵ Supra note 2, 105.1

²⁶ Supra note 10, Art. 18.4

²⁷ Supra note 2, Art. 105.3

²⁸ Supra note 10, Art. 21.5

²⁹ *Ibid*, Art. 21.2

³⁰ *Ibid*

³¹ *Ibid*, Art. 12.2

in person or through proxies, which should be appointed under a power of attorney.³² Other shareholders and third parties may act as proxies.

Under current requirements, the following threshold for votes is required to pass certain resolutions as noted:³³

- the appointment or removal of directors, the appointment and removal of external auditors, consent to major corporate transactions, transactions with related parties, changes to company business and strategy - 50% of voters participating at the shareholders' meeting;
- the issue of share capital, the issue of new shares, amendments to foundation documents, the liquidation of the company and the opening and closing of branches– 75% of voters participating at the shareholders' meeting.

A quorum at a meeting of shareholders is constituted by the participation of 60% of *shareholders* [sic.] entitled to vote at a general meeting.

In joint-stock banks 75% of voters participating in a general meeting are required to pass certain resolutions e.g. on the appointment of members of the Management Board, Supervisory Board and Finance - Audit Committee.³⁴

Certain matters are in the exclusive competence of the meeting of shareholders. These are as follows:³⁵

- making amendments to the charter and charter capital;
- the appointment and dismissal of members of the management board, supervisory board and audit committee;
- the establishment and dismissal of executive bodies of the company;
- the approval of annual reports, balance sheets, profit and loss accounts, and the distribution of profits and compensation of losses.

Generally notices (at least with respect to announcements published in newspapers) do not contain any information on voting requirements, etc., but refer to the name of the company, address, date and time for the meeting and specify the agenda.

Shareholders can require a shareholders' meeting to be convened. The management board must do so at the request of shareholder(s) holding at least 10% of shares.³⁶ Where the management board fails to comply, a general meeting should be convened by the supervisory board, again within 30 days.³⁷ Should the supervisory board also fail to convene the meeting, shareholder(s) have the right to apply to the courts for an appropriate order.³⁸ There is no record of these provisions having been applied in practice.

³² *Ibid*, Art. 21.4

³³ *Ibid*, Art. 21.1

³⁴ *Supra* note 17, Art. 22.2

³⁵ *Supra* note 2, Art. 107.1

³⁶ *Supra* note 10, Art. 14.1

³⁷ *Ibid*, Art. 14.2

³⁸ *Ibid*, Art. 14.3

Equitable treatment

A joint stock company may have either preference or ordinary shares³⁹ Preference shares may not exceed 25% of a joint-stock company's charter capital⁴⁰ In practice, there is little understanding of the rights attaching to preference and ordinary shares.

The method of voting by shareholders is determined by the charter. Where a shareholder fails to fulfil his obligations as to acquisition or payment of shares, he may be deprived of his voting rights⁴¹.

The law makes no specific reference to preference shareholders with regard to their rights to receive information in respect of general meetings, to demand clarifications from the supervisory board, to table motions or to give comments.

Foreign shareholders

Foreign legal and physical persons, persons without citizenship, foreign states and international organisations ("foreign investors") may participate in the securities market through the listing, sale and purchase of securities and derivatives.

Although there are no explicit restrictions on the participation of foreign capital in companies, in the banking sector a limit for the participation of foreign capital is, in practice, set at 30% of the total charter capital of banks. This limit, according to recent information, may be increased to up to 50%. This has, in the past, been used to prevent foreign persons from establishing a presence in Azerbaijan or investing in Azeri banks.

Also, in the insurance sector, the share of foreign persons should not exceed 49% of the share capital.

Under the law *On the Privatisation of State Property* foreign persons and legal entities may take part in the privatisation of state assets in Azerbaijan. This law defines "foreign investors" as citizens of foreign states, foreign legal entities and their representative offices as well as Azerbaijan legal entities with more than 50% foreign ownership. To participate in the purchase of state property, foreign investors are required to submit a number of privatisation "options" (corresponding to the number of privatisation vouchers). This contrasts with the prior general view that Azerbaijan legal entities, including 100% foreign-owned companies, would not be required to submit privatisation "options" to participate in the privatisation of state property. This is unfortunate, since in effect the requirement that foreigners purchase privatisation "options", widely criticised as discriminatory, has been extended rather than eliminated.

³⁹ Supra note 10, Art. 12 and 18

⁴⁰ Supra note 2, Art. 106.1

⁴¹ Supra note 10, 12.3

There are several state assets where foreign investors have taken a stake or manage the enterprises. One of the largest of these is Garadagh Cement Plant, which was reorganised into an open joint stock company, in which a majority shareholding was acquired by Holderbank Financiere Glaris. Also, Fondel Metal Participations B.V. (Holland) was awarded a contract for management of Azerbaijan Aluminium Joint Stock Company and Barmek (Turkey) entered into a management contract for operating the Baku City Electricity Network.

State as a shareholder

The President of Azerbaijan or the Ministry for Economic Development may limit private share ownership in a privatised entity for the preservation of state security, public health, morals and the rights and interests of individuals. The State may retain a controlling interest (51%) or a substantial one (25.5%) in state property during privatisation. These shares may then be privatised upon further decision of the President or the Ministry for Economic Development⁴².

Violation and abuse of shareholder rights

The following are the most frequent violations of shareholder rights:

1. Failure to notify of the convening of an annual/extraordinary general meeting;
2. Failure to pay declared dividends.

The *Administrative Offences Code* 2000 applies to certain types of violations concerning shareholder rights and imposes the following penalties (currently, for the purpose of calculating fines, the provisional currency unit of AZM 5500⁴³, approximately USD 1.20, is applied)⁴⁴:

- for violation rules on the issue and registration of securities – an official warning or fine of 50 to 70 provisional currency units on the official, and a fine of 150 to 200 provisional currency units on the company⁴⁵;
- for the illegal use of insider information for personal benefit by an employee of a professional participant⁴⁶ in the securities market or disclosure of confidential information to a third party for the purpose of entering into a transaction – an individual may be fined 25 to 30 provisional currency units and company officials may be fined 50 to 70 provisional currency units⁴⁷;
- for violation of rules for, or the illegal refusal to make, or evasion of payment of the value of securities or property, dividends, or interest on securities – officials may be fined 50 to

⁴² *Second State Program for Privatisation of State Property*, Art. 7.2

⁴³ Art. 1 and 2, law *On Provisional Currency Unit* 2000

⁴⁴ The authors are not aware of any cases where such sanctions have been imposed.

⁴⁵ *Supra* note 23, Art. 207

⁴⁶ A 'participant in the securities market' is defined as a legal or physical person licensed to engage in broker or dealer activity, securities management, clearing, depository operations, share registrars

⁴⁷ *Supra* note 23, Art. 212

70 provisional currency units and a company may be fined 150 to 200 provisional currency units⁴⁸;

- for violation of shareholder rights specified in legislation or any form of illegal restriction of shareholder rights – officials may be fined 70 to 90 provisional currency units, and a company may be fined 200 to 250 provisional currency units⁴⁹.

According to press reports, the State Securities Committee has applied sanctions upon companies violating the rights of shareholders, such sanctions being imposed primarily for failure to give notice of a general meeting or failure to make due payment of dividends.

The following may also be of some relevance to such issues as insider dealing:

Professional participants of a securities market may not manipulate prices of securities in the market by presenting false information relating to the price of securities. Although, there is no penalty specified for this particular offence, adoption of relevant sanctions for these actions is expected.

Shareholders are entitled to apply to the State Securities Committee to seek protection for their interests. One of the primary functions of the Committee is to ensure protection of the rights of investors, shareholders and owners of other securities. Upon application by a shareholder, the Committee investigates a particular matter and, where necessary, may take action against a defaulting party. Furthermore, the State Securities Committee can also initiate proceedings for the imposition of administrative penalties against persons who have violated securities legislation designed for the protection of shareholder rights.

In addition, shareholders, where their rights are violated, may apply to the courts in order to protect their interests.

If a judge decides that a case is sufficiently prepared for consideration, he schedules a hearing and gives notice to the parties of the time and place of proceedings. The case should be considered and the decision should be rendered within three (3) months of filing the application with the court. Cases regarding the legality of acts or omissions by a company official should be considered within one (1) month⁵⁰.

When lodging appeals and cassation petitions against the decision of a lower court, the amount of state duty payable is 120% and 150% respectively of the normal state duty.⁵¹ In addition, a plaintiff filing an action for the recovery of material (e.g. financial and/or property) damages incurred as the result of a criminal offence is exempt from payment of state duty.

The following court litigation expenses may apply:

⁴⁸ *Ibid*, Art. 219

⁴⁹ *Ibid*, Art. 220

⁵⁰ *Civil Procedure Code*, article 172.2

⁵¹ *Ibid*, Art. 109.1

- in respect of witnesses, experts, specialists and translators;
- in respect of on-site examinations;
- in respect of a court summons;
- travel and lodging costs in respect of the appearance of the parties and third persons to hearing in court;
- paid to representatives for their assistance;
- paid to attorneys for their assistance;
- incurred in the search for the defendant; and
- in respect of the execution of a court order.

Azeri civil procedure legislation does not directly envisage class actions as such. However, any person may bring an action and conduct litigation through a representative. Any person with the capacity to bring an action can, in general, act as a representative in court.⁵² However, we are not aware of any having been conducted in respect of shareholder claims.

Conclusion **Priorities for improving shareholder rights**

Albeit slowly, shareholders have started to understand their rights as shareholders. This is evidenced by a growing number of applications made to the State Securities Committee to take measures against companies violating shareholder rights. On its part, the State Securities Committee is also active in protecting shareholders. For example, during the second quarter of 2001 the Committee required 24 joint stock companies to eliminate breaches of shareholder rights, while 10 joint stock companies were fined for gross violations. Furthermore, current legislation provides for the dissemination of information on, *inter alia*, measures taken and court orders obtained against parties breaching the rights of investors.

However current corporate law does not set out precise steps to be undertaken in the case of mergers and acquisitions, insider dealing and takeovers. Nor are there any provisions relating to the location of general meetings or to corporate governance at the management board level. It is hoped that the new law on joint stock companies currently being drafted by the State Securities Committee will provide clearer procedures for these matters. It is also certainly hoped that one of the major obstacles to the efficient working of corporate law, namely the odd requirement that a quorum at a shareholders' meeting be 60% of *shareholders entitled to vote* rather than the more logical expectation of 60% of shares being represented, is amended.

⁵² *Ibid*, Art. 69-71

APPLICATION
(for physical persons)

TYPE OF PERSONAL ACCOUNT:	Owner's account	
	Pledgee's account	
	Nominal holder's account	

1. LAST NAME, FIRST NAME, PATRONYMIC OF REGISTERED PERSON _____

2. CITIZENSHIP _____

3. ID _____ No _____
issued on _____

(title of document)

4. REGISTERED ADDRESS _____

5. TELEPHONE(S) _____
(city code) (office) (home)

6. METHOD OF RECEIVING INFORMATION AND EXTRACTS FROM THE REGISTER: _____

7. SIGNATURE SAMPLE:

8. INFORMATION ABOUT AUTHORIZED REPRESENTATIVES OF REGISTERED PERSON:

LAST NAME, FIRST NAME, PATRONYMIC	SAMPLE OF SIGNATURE	ID INFORMATION

An additional application should be submitted by an authorized representative.
The person signing the application bears responsibility for the completeness and correctness of information.
Written notice should be given in the event of any change to the information in this application.

SEAL _____ SIGNATURE: _____

_____ (date)

Normative acts establishing and protecting the rights of shareholders

1.	Law On Joint Stock Companies (July 12, 1994 with No. 850)
2.	Law On Enterprises (July 1, 1994 with No. 847)
3.	Law On Securities (July 14, 1998 with No. 523-IQ)
4.	Civil Code 2000
5.	Administrative Offences Code 2000
6.	Civil Procedure Code 2000
7.	Law On the Protection of the Rights of Investors on Securities Markets (June 16, 2000 with No. 899-IQ)
8.	Standards issued by the State Securities Committee for Maintaining the Register of Holders of Securities, 2000
9.	Rules of the State Securities Committee On the Participation of Foreign Legal and Physical Persons in the Securities Market, 2000
10.	Regulations of the State Securities Committee On the Issue and Registration of Emission Securities on the Territory of the Azerbaijan Republic, 1999