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SHAREHOLDER RIGHTS, EQUITABLE TREATMENT AND THE ROLE OF THE STATE

*Structures of corporate ownership/categories of shareholders in
Kyrgyz Republic*

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INTRODUCTION

Structures of corporate ownership/categories of shareholders

Please describe structures of corporate ownership in your country. Is there any tendencies related to the development of corporate groups? Is there any special connecting links between financial institutions and corporate groups?

The structure of corporate ownership of joint stock companies of the Kyrgyz Republic shall consist of the following corporate groups:

- investment funds created in the form of open joint stock companies;
- commercial banks;
- employees of companies;
- foreign investors;
- management of companies;
- state.

Investment funds

Almost all investment funds of the Kyrgyz Republic were founded in the period of carrying out of mass “coupon” privatization¹, when citizens exchanged their privatization coupons into shares of investment funds. Investment funds, in their turn, exchanged them into shares of enterprises through coupon auctions. With a little exception, investment funds did not directly attract monetary funds from population. Assets, which are owned by investment funds today, were generated during the privatization period.

As of January 1, 2002 the Republic has 14 investment funds, which net assets amount to 40 million soms (in accordance with official rate 47.93 Kyrgyz soms are equal to 1 US dollar as of March 1, 2002). As a rule, investment funds are not currently acquiring shares of enterprises and are working with state treasury bills (STB). Only several big investment funds, such as a joint stock company (JSC) «Oshinvest», JSC «Kyrgyzinvest», JSC «Bereke-invest», hold significant shares in the capital of certain enterprises and actively affect their policy.

Commercial banks

During the privatization period, banks took part in coupon auctions, where they acquired shares of companies, however, after termination of coupon privatization in 1997 and financial crisis in 1998 they practically stopped acquiring shares and at the moment their shares in companies are not significant.

Employees of joint stock companies

Employees of many joint stock companies created on the basis of privatized enterprises hold a significant share in the share capital, which sometimes amounts to 40% and more. It is connected with the fact that upon privatization of enterprises the State Property Fund of the Kyrgyz Republic was selling in average 20-25% of shares to the benefit of labor collective of enterprise, and small blocks of shares, as a rule up to 5% of shares, was transferred free of charge. Remaining shares were sold through money and coupon auctions.

Foreign investors:

¹ Coupon privatization in the Republic was carried out from 1992 to 1997 and stipulated the receipt by citizens of privatization coupons, which they had the right to exchange into shares of joint stock companies. It was possible to acquire not more than 25 per cent of shares of certain enterprise for privatization coupons (Decree N VII-159 of the President of KR, dated May 3, 1996).

As of January 1, 2002 the total amount of foreign investments into corporate securities of issuers of the Kyrgyz Republic amounted to 3,119.0 mln. soms, including from CIS countries– 84.9 mln. soms, from distant foreign countries - 3,034.1 mln soms. It's necessary to note that foreign investors own majority shareholdings in certain companies, which play significant role in the Republic's economy. Among them Reemtsma, a manufacture of tobacco products, and Vimm-Bill-Dann, a manufacturer of dairy products and juices.

Management of companies:

Members of executive body of majority of companies of the Kyrgyz Republic hold big blocks of shares. Moreover, they often own majority shareholdings. In doing so, companies, where managers have **majority holdings, do not** obtain additional funds by way of issuing new shares. Rights of shareholders' of such companies are often breached. At the same time, provisions of charters of said companies do not contain norms, which comply with good practices of corporate governance. Changes are not made to such charters in order to improve the structure of corporate management of the companies, since their managers strongly oppose thereto.

State:

The State is holding a share in the charter capital of about 200 open joint stock companies. In many companies, the State owns majority shareholding. Some companies are monopolists at the market of goods and services of Kyrgystan. In 19 of such joint stock companies the State owns up to 20%, in 8 JSC – up to 30%, in 10 – up to 40%, and in 20 – up to 50%².

PROTECTION OF SHAREHOLDERS' RIGHTS

Does the system of corporate management protect shareholders' rights?

•) **Rights of ownership (titles)**

Do main shareholders' rights include the right to protect the methods of registration of ownership, transfer or transportation of shares? Is it practicably applicable? Are there any legal limits or practical barriers in respect thereof?

In accordance with Article 60 of the Law of the Kyrgyz Republic "On companies", a joint stock company shall be obligated to ensure the maintenance and keeping of the shareholders' register in a strict compliance with legislation of the Kyrgyz Republic not later than one month of the moment of state registration of the joint stock company.

In accordance with legislation of the Kyrgyz Republic, a joint stock company having more than 50 shareholders and/or company, which shares are listed at the Kyrgyz Stock Exchange, must involve an independent registrar in order to keep and maintain the register of shareholders. Independent registrars shall be licensed by the State Committee on Securities Market of the Government of the Kyrgyz Republic.

The State Committee shall establish strict requirements towards independent registrars and in case of breach of the procedure for maintaining the register of shareholders, which caused the damage to shareholders, may cancel the registrar's license. The procedure for maintenance and keeping the shareholders' register shall be regulated by Article 50 of the Law of the Kyrgyz Republic «On Securities Market», Article 60 of the Law of the Kyrgyz Republic "On Companies", and

² In accordance with data provided by the State Committee on Securities Market as of January 1, 2001.

Regulations “On Procedure for Maintenance and Keeping of the Register of Holders of Issuing Securities in the Kyrgyz Republic” approved by the State Committee on Securities Market.

Due to such strict requirements and proper legislative regulation of issues of maintenance and keeping of the shareholders’ registers, just few cases of illegal deprivation of shareholders of their shares have been recorded. Single cases of breaches of the shareholders’ rights to register their titles to shares have been registered during the period of privatisation when respective legislation had serious omissions.

The alienation of shares by a shareholder shall not be limited by methods (ways) of transfer thereof. Therefore, in accordance with Article 60 of the Law of the Kyrgyz Republic “On Companies”, a shareholder shall have the right to sell, will or alienate his shares in any other way. In order to transfer his shares to another person, it is necessary to address to the independent registrar maintaining the register of joint stock company for the purpose of registration of transfer of title to securities. The registrar shall be obligated to register such transfer during 3 days of the moment of addressing thereto or refuse to register the same by providing respective motivation. In case of refusal, decision of independent registrar may be appealed before the State Committee on Securities Market or court. The transfer order shall be a document on the basis of which respective changes shall be made to the shareholders’ register in connection with alienation by shareholder of his shares. Such transfer order must determine the transaction on the basis of which the transfer of shares takes place.

When considering issues of alienation by shareholders of their shares, it is necessary to notice that in accordance with paragraph of the Decree No. VII № 121 of President of the Kyrgyz Republic “On Measures for Further Development of Organized Market of Securities” dated May 10, shares of open joint stock companies may be sold only by brokers and dealers through stock exchanges.

Shareholder of closed joint stock company wishing to sell his shares must offer to other founders of the company or to the company itself to buy up such shares, if otherwise is not provided by constituent documents. If none of the shareholders exercise his preemptive right during five days of the moment of notifying thereon or during other term stipulated by the company’s charter, the joint stock company itself shall have the right to acquire said shares under price agreed upon with the owner thereof. If the joint stock company refuses to acquire the shares or upon the failure to agree thereupon or failure to obtain an answer during one month of the day of sending of appropriate request, the shares may be transferred to any third party.

b) Dividends

Do main shareholders’ rights include the right to obtain a part of the company’s profit? Is it practicably applicable? Are there any legal limits or practical barriers in respect thereof?

Decision on the amount of dividends and procedure for their payment shall be made at the general shareholders’ meeting on the basis of at least of 2/3 of votes of the total number of shareholders. Once the amount of dividends has been established and the date of starting of their payment by the company has been determined, the date of making of a list of persons having the right to obtain the dividends shall be defined. In accordance with the law, the right to obtain dividends shall be given to persons acquired the shares not later than 30 days prior to the date of payment thereof.

Legislation of the Kyrgyz Republic shall specify the following procedure for distribution of dividends: at first, fixed dividends on privilege shares, which are established by the company when issuing such shares, must be paid out; then remaining funds shall be used for the payment of dividends on common shares.

Legislation of the Kyrgyz Republic shall establish a mandatory requirement to a joint stock company to pay out dividends to shareholders if the company is profitable in that respective period. Therefore, Article 70 of the Law of the Kyrgyz Republic "On Companies" shall establish that a joint stock company must direct at least 25% of net profit of the company to the payment of dividends. With a rare exception, the company shall comply with the law and direct only a part of profit for the payment of dividends, however, it happens that the general shareholders' meeting makes a decision not to direct any part of profit for the purpose of payment of dividends. Such decision shall breach the rights of shareholders to obtain dividends and any shareholder may appeal against such decision before the court. Certain cases, when shareholders appealed to a court against decision of the general shareholders to refuse to pay out the dividends, have been registered in the Republic.

If it is stipulated by the charter, the company may pay out dividends in the form of shares (capitalization of profit) (Article 70 of the Law of the Kyrgyz Republic "On Companies"). Given the fact that legislation does not contain any direct ban, the company often pays out dividends in the form of goods produced thereby.

When considering issues of payment of dividends, it is necessary to stress that the absence of funds of the company in the period of payment of dividends, which fact leads to payment delays, shall be a frequent problem in terms of payment thereof. However, it is rare when shareholders apply to a court for the purpose to make the company to pay out declared but outstanding dividends.

c) Participation in significant corporate changes

Do main shareholders' rights include the right to participate in decisions related to fundamental corporate changes? What are such changes? Is it practicably applicable? Are there any legal limits or practical barriers in respect thereof?

The general shareholders meeting shall be competent to make decision on the following fundamental issues:

- changes to the company's charter and approval of its restated and amended version;
- increase or decrease of the share capital;
- procedure for distribution of profit obtained by the company (payment of dividends);
- reorganization of the company (merger with another company, joining, split, and segregation);
- decision to liquidate the company;

Decision in respect of aforesaid issues shall be made at the general shareholders' meeting by at least 2/3 of votes of the total number of shareholders.

Charters of majority of companies, which are developed in accordance with a typical charter of the open joint stock company (approved by the Resolution • 433 of the Government of the Kyrgyz Republic dated July 26, 1997), shall stipulate that the general shareholders' meeting shall make decision to alienate or acquire the property, which value exceeds the company's assets to 20%.

Legislation of the Kyrgyz Republic shall establish that resolution of issues, which are assigned to the competence of the general shareholders' meeting, may not be included into a competence of the executive body of the company. In connection therewith, in practice such decisions shall be made at the general shareholders' meeting. It is also connected with the fact that state bodies carrying out state registration and re-registration of legal entities, as well as issues of securities, do not register any changes, which result in aforesaid corporate measures, if the decision thereon has been not made at the general shareholders' meeting.

d) Shareholders meeting and access to information

Do main shareholders' rights include the right of fruitful participation and voting at the shareholders' meeting? What are such changes? Is it practicably applicable? Are there any legal limits or practical barriers in respect thereof?

The right of shareholders to participate in and to vote at the shareholders' meeting shall be established in Article 61 of the Law of the Kyrgyz Republic "On Companies". Holders of common shares shall have the right to vote at the general shareholders' meeting. Holders of privileged shares shall not have the right to vote at the shareholders' meetings, except owners of cumulative privilege shares, if such shares are issued in accordance with the charter of the company. Holders of cumulative privileged shares shall have the voting rights only if the company did not pay dividends for the previous year and this right is invalidated of the moment of full payment of dividends to such shareholders.

Legislation does not clearly determine the issue of division of privileged shares into cumulative privileged and privileged shares. If the norm established by paragraph 5 and 6 of Article 59 of the Law of the Kyrgyz Republic «On Companies» is taken into account, it is evident that dividends must be paid out on privileged shares and, therefore, it is not necessary to transfer voting rights regarding such shares, but if the charter does not state that the company has cumulative privileged shares, then the company, in the case it cannot pay out the dividends, must provide the shareholders owing such shares with the right to participate in the voting with the voting right. However, in practice joint stock companies stipulate only the issue of privilege shares, but in doing so they sometimes do not pay dividends to such shareholders (motivating it by the absence of profit). In its turn, this fact results in the low demand of privilege shares at the market of securities.

The right of shareholders – owners of common shares to participate in the general shareholders' meeting shall not be limited neither by legislation nor by companies themselves. The practice of corporate management suppose that the participation of shareholder in the general shareholders' meeting must not be considered only from the point of view of their presence and voting at the general shareholders' meeting. It should be considered from the point of view of influence of the shareholder on the policy of company's activities through decisions made at the general shareholders' meeting. The full right to participate in the determination of agenda of the general shareholders' meeting shall be one of important mechanisms of such influence. By now, legislation had serious omissions in this sphere. The Law of the Kyrgyz Republic «On Companies» does not contain norms specifying the procedure for determination of agenda that lead to the fact that such agenda of the general shareholders' meeting was made either by executive body of the company and/or a shareholder (shareholders) owning majoring shareholding. For the purpose of avoidance of omissions in legislation regulating the issues of holding shareholders' meeting, the State Committee on Securities Market approved the Rules on Holding General Shareholders' Meetings in Joint Stock Companies of the Kyrgyz Republic (Resolution No. 7 dated January 24, 2002 •7). Besides, such rules, which were developed jointly by the Center of Corporate Development and professional participants of securities market, shall, *inter alia*, establish a clear procedure for making agenda of the general shareholders' meeting by shareholders themselves.

OBJECTIVE (EQUITABLE) TREATMENT OF SHAREHOLDERS

Does the system of corporate management ensure the objective treatment of all shareholders? Is it practicably applicable? Are there any legal limits or practical barriers in respect thereof?

•) Treatment of minority shareholders

In general, legislation shall not divide shareholders into minority and majority ones, however the Law of the Kyrgyz Republic "On Companies" stipulates additional rights of shareholders owning more than 10% of shares. Therefore, Article 66 shall specify the possibility of shareholders owning 10% of shares and

more to require the audit of finance and business activities of the company to be conducted by the audit committee or independent auditor. Holders of 20% of shares and more shall have the right to initiate the convening of the extraordinary shareholders' meeting. Charters of companies, which are developed in accordance with a typical charter of the open joint stock company, stipulate that shareholders owning 5% of shares and more shall have the right to submit proposals to make agenda of the general shareholders' meeting. However, in doing so it's necessary to note that minority shareholders may combine their blocks of shares and together have the number of shares required by legislation.

The norm established by Article 61 of the Law of the Kyrgyz Republic "On Companies" shall acknowledge property and non-property rights of shareholders regardless the number of shares owned thereby. Even if shareholder owns one share, he may apply to a court in order to appeal any decision of a governing body of the company, in the event such decision breaches his rights.

The biggest problem of the shareholder shall be in obtaining the information on the company's activities, as well as corporate information, and this problem is related either to shareholders owning small blocks of shares or those owning bigger block of shares, unless they or their representatives are members of executive body of the company.

Annual report on the company's activities enclosed with accounting balance shall be the main information, which could be obtained by shareholders in accordance with legislation, but many companies refuse to provide even this type of information. Besides, unfortunately, all joint stock companies ignore their duty to publish annual reports in mass media.

The Law of the Kyrgyz Republic "On Companies" and the Law of the Kyrgyz Republic "On Securities Market" shall be the principal laws regulating the issues of disclosure of information by the company. Articles 44 and 51 of the Law of the Kyrgyz Republic "On Securities Market" shall stipulate the list of information which is subject to disclosure by the issuer, as well as the procedure for disclosing such information, but it is related only relations between the issue and the State Committee on Securities Market. In terms of disclosure of corporate information to interested parties, the Law of the Kyrgyz Republic "On Companies" regulates this issue only through several norms:

- paragraph 5 of Article 56 regulates the issue of disclosure to the company's shareholders of information on the procedure and ways to increase the share capital of the company upon expected increase thereof;
- paragraph 5 of Article 60 establishes the right of shareholder to obtain an excerpt form the register of shareholders for the purpose of confirmation his title to shares;
- paragraph 2 of Article 61 establishes the right of shareholder to obtain the information on the company's activities, including the right to review accounting data and other documentation in the order stipulated by the charter;
- Article 64 establishes the right of shareholder to obtain the notice on holding the general shareholders meeting;
- paragraph 2 of Article 65 establishes the right of shareholder to review the annual report, balance sheet and loss and profit statement at the annual general shareholders' meeting;

In addition to the aforesaid norms, Article 140 of the Civil Code of the Kyrgyz Republic establishes the duty of the company to publish the annual report, balance sheet and loss and profit statement for open public.

b) Treatment of foreign shareholders

How does it apply towards minority shareholders?

It's necessary to note that in accordance with legislation of the Kyrgyz Republic, foreign shareholders shall have the equal rights with local ones. However, sometimes certain joint stock companies require themselves the official legalization of powers of attorney issued by foreign shareholders to their authorized representatives in order to take part in the meeting and it creates certain difficulties for said shareholders.

It is also necessary to stress that if representatives of foreign shareholder are not members of governing bodies (are not members of board of directors or executive body), then it will be difficult for such shareholder to obtain the information on the company's activities. However, those foreign shareholders, which own majority shareholding, shall not have any barriers to exercise their rights.

Only from the end of 2000, enterprises of the Kyrgyz Republic started their transfer to the International Standards of Financial Reporting - 2001 (ISFR-2001), but majority of the companies still use local accounting principles, which do not comply with ISFR. The latter fact creates additional difficulties for foreign shareholders.

Companies of the Kyrgyz Republic have a big number of foreign shareholders that previously were citizens of Kyrgystan, however due to different reasons they emigrated to Russia, Germany and Israel. As a rule, they own small blocks of shares. Distant location of shareholders negatively affects either exercise of their rights in particular or activities of the company as a whole. Today, it happens that the general shareholders' meetings of certain companies cannot make a decision on changes to the charter or increase of share capital, since there are not enough votes to approve thereof. Several joint stock companies generated dividends, but shareholders do not address to the company to obtain thereof.

c) State as a shareholder

Does the State have the same rights as other shareholders do? Do the State's shares have a special status?

Article 168 of the Civil Code of the Kyrgyz Republic establishes equal legal rights either for the State or other subjects of civil legal relations, if otherwise is not stipulated by law. Theoretically, the State shall have similar rights as other shareholders have, however paragraph 3 of Article 74 of the Law of Kyrgyz Republic "On Companies" sets forth that a joint stock company created on the basis of state enterprise must comply with requirements of applicable Law, as well as legislation on privatization of state enterprises in the Kyrgyz Republic and additional regulations issued by the State Property Fund, until the State Property Funds has stopped to be a shareholder of the company.

In such a case, the norm of the Law of Kyrgyz Republic "On Companies" shall establish the privilege status of the State as a shareholder, since the state body of management of the state property may affect activities of the company, where it owns a share of the charter capital through decisions such state body makes from time to time. Therefore, within such privilege right, until March of 2001 the State Property Fund used the Instruction "On the Procedure for Segmentation of Property at State Enterprise (amalgamations) and Joint Stock Companies, where the State Owns at least 20% of Shareholding Interest of the Charter Capital". Such Instruction allowed the Fund to segregate assets of joint stock companies into the State's ownership. It was done in the State's interests, but often damaged shareholders' rights. When the Instruction was cancelled, such practice was terminated towards joint stock companies, where the State Property Fund had majority shareholding. It is also necessary to note that legislation of Kyrgyz Republic does not establish the mandatory requirement to big shareholders interested in transactions not to participate in voting upon making decision regarding such transaction. This is used by the State or big shareholders when making decision at general shareholders' meetings regarding the segregation of a part of assets of joint stock companies, where they own majority shareholdings.

VIOLATION OR ABUSE OF SHAREHOLDERS' RIGHTS

What are the most frequent violations of shareholders' rights? What sanctions does the legal system establish? How many sanctions were applied for the last five years? What are the results? Have companies that violated shareholders' rights been punished as a result?

Frequent violations (breaches) of shareholders' rights shall be as follows:

- Not publishing annual report, balance sheet and loss and profit statement in mass media.
- Breaching procedure for holding general shareholders' meeting.
- Breaching procedure for providing shareholders with information which is subject to disclosure pursuant to legislation of the Kyrgyz Republic that also determines the procedure for disclosing the same.
- Making transactions with interested parties and affiliated entities of the company (due to imperfection of legislation in terms of regulation of issues related to making such transactions).
- Breaching shareholders' preemptive rights to acquire additional shares.
- Taking out of assets by shareholders of the company owning major shareholding interest.

Not publishing annual report, balance sheet and loss and profit statement by the company in mass media, as it is required by the norm set forth in Article 140 of the Civil Code, shall result, in accordance with Article 328 of the Code of Administrative Responsibility of the Kyrgyz Republic, in charging the officer of infringing company with a penalty in the amount of 20 - 50 minimum wages (minimum wage is equal to 100 soms or 2 US dollars). The problem of not publishing annual report and accompanying materials shall not be mainly connected with the fact that joint stock companies do not want to publish such information – sometimes they do not have enough funds to publish them. It's cheaper for the officer to pay the penalty than for the company to pay 3 or 10 times more for the publication of said materials. In connection therewith, the Center on Corporate Development carries out annual campaign related to free publishing of annual reports in its newspaper "Corporate Herald".

There is also a problem in respect of the content of annual reports to be published by the companies. Legislation of the Kyrgyz Republic regulating activities of business subjects does not establish requirements regarding the content of annual report of the company, and as a result each company publishes very short text of such report in order to minimize costs. Article 44 of the Law of Kyrgyz Republic "On Securities Market" establishes requirements to the annual report of the company, which has to present it to the State Committee on Securities Market annually. In our opinion, legislation has to be amended as to state that the annual report to be published must contain at least the information which the company submits to the State Committee on Securities Market.

Breaching the procedure for holding general shareholders' meeting (today the number of such breaches is decreased). Article 337 of the Code on Administrative Responsibility of the Kyrgyz Republic says that an officer of the company-infringer may subject to a penalty in the amount of 15 - 50 minimum wages.

Main breaches of the procedure for holding general shareholders' meetings:

- the company has not involved an independent registrar to hold general shareholders' meeting. Any joint stock company, which has more than 3 shareholders, must enter into agreement with independent registrar to hold general shareholders' meeting;
- the company does not publish the information on holding general shareholders' meeting. Article 64 of the Law of the Kyrgyz Republic "On Companies" states that open joint stock company not later than

20 days, and closed joint stock company not later than 10 days prior to holding the general shareholders' meeting, must publish the information on holding such meeting in mass media;

- the company does not provide shareholders with information on issues considered at the general shareholders' meeting;
- breach of the procedure for providing shareholder with information on planned increase or decrease of the charter capital of the company. Article 337 of the Code on Administrative Responsibility of the Kyrgyz Republic says that the officer of company – infringer may be subject to administrative penalty in the amount of 20 - 50 minimum wages. Also, it is necessary to note that legal practice recorded the case when on the basis of shareholders' claim regarding the breach of the procedure for notifying shareholders, the court invalidated the issue of shares made by one of the companies of the Kyrgyz Republic.

Breaching shareholders' preemptive rights to acquire additional shares. Legislation of the Kyrgyz Republic establishes the right of the company to stipulate in its charter preemptive rights to acquire additional shares of the company. However, said legislation does not contain norms specifying general requirements to exercise such preemptive right to shares of joint stock companies. In its turn, such situation leads to the fact that shareholders may not use their preemptive rights to acquire shares of open joint stock company, and officers of the company and big shareholders use such inability in their interests.

Making of transactions in their interests and with interested parties. Article 68 of the Law of Kyrgyz Republic "On Companies" says that officers must obtain a consent of the board of directors and management to make a transaction where they have certain interest, if:

- such officer is an owner, creditor or signed a labor agreement with main suppliers of goods and services to the company, or is a major buyer of goods or receiver of services respectively sold or provided by the company;
- he is a owner, creditor or signed a labor agreement with individual or legal entity, which is fully or partially created on the basis of the company's property or has the right to obtain profit from the disposal of the same.

From the first view it is evident that the notion "financial interests of officer" determined by said Law is very limited and do not correspond to the meaning of such term used in the whole world. In dosing so, norms of the Law do not regulate the procedure for making transaction where shareholders owning big blocks of shares have certain interests.

Legislation of the Kyrgyz Republic, other than that regulating banking activities, operations of investment funds, as well as bankruptcy procedures, does not establish the notion "affiliated entities" and does not fully explains the notion "interest in the transaction". In its turn, this gives the large opportunity for machinations of officers of companies, as well as for big shareholders. At the same time, Article 68 of the Law of Kyrgyz Republic "On Companies" does not establish the responsibility of officer for damages to be caused to the company by transaction where the company's officer has certain interests. The responsibility shall be enforceable only in the case when said transaction leads to a compulsory liquidation of the company. It is very important to note that legislator does not limit the voting right of the member of management or board of directors interested in the transaction when making decision by the management or board of directors on providing consent to make thereof.

Certainly, in theory it is possible, in accordance with Article 195 of the Civil Code of the Kyrgyz Republic, to try to invalidate the transaction, where an officer had certain interests, through a court on the basis of failure to perform procedures established by the Law of Kyrgyz Republic "On Companies", however it is a really problematic case.

Paragraph 3 of Article 88 of the Civil Code of the Kyrgyz Republic establishes that a person, who pursuant to the law or constituent documents of legal entity, acts on the latter's behalf, must act in the interests of such legal entity in a faire and logic way. Said person must, if it is required by founders (participants, members) of the legal entity, since otherwise is not provided by law or agreement, compensate damages caused to the legal entity thereby. Therefore, if transaction with said interests entails damages to the company, shareholders shall have the right to require the compensation of damages from the head of executive body of the company. However, the norm determines property responsibility only with respect to the manager (head), and not regarding other officers. Article 67 of the Law of Kyrgyz Republic "On Companies" establishes that the board of directors of the company shall make answerable guilty officers of the company to the extent of their property, however legislation of Kyrgyz Republic does not define in which cases and upon which circumstances the board of directors acts so. In connection therewith, the officers may not be practically brought to property responsibility for transactions, where they had certain interests.

Such problem is solved in a better way by a draft of the Law of Kyrgyz Republic "On Joint Stock Companies" (it was submitted for consideration by the Parliament in April 2001). Therefore, Article 75 set forth that persons interested in company's making any particular transaction shall be officers of the company, shareholder (shareholders) owning together with its affiliated person (persons) 20% or more of voting shares of the company, as well as members of their families if they:

- are deemed a party to such transaction or participate in it as a representative or agent;
- own 20% or more of voting shares (interest, stocks) of the legal entity being a party to the transaction or participating in it as a representative or agent;
- are officers of the legal entity being a party to the transaction or participating in it as a representative or agent.

Article 77 of this draft of law establishes that the decision to make a transaction, where there is certain interest of other person, shall be approved by majority of votes of members of board of directors not interested therein. In doing so, an interested person shall bear responsibility before the company in the amount of damages caused to the company thereby. In case, several persons are made answerable, their responsibility to the company shall be joint and several (Article 78 of the draft law).

Certainly, already today, prior to approving the draft law "On Joint Stock Companies", the company may use its regulations, if the company includes them into the charter thereof. However, legislation of the Kyrgyz Republic says that if provisions of the charter contradict to the Law, the norms of the Law shall prevail.

LEGAL CONCILIATION AND LEGAL COMPENSATION (REDRESS)

Are all shareholders able to get effective compensation for the breach of their rights?

In accordance with paragraph 2 of Article 61 of the Law of Kyrgyz Republic "On Companies", any shareholder, regardless of number of shares he owns, shall have the right to appeal against decisions made by the company. In doing so, he may appeal against decisions either made by general shareholders' meeting or any other governing body thereof. As a rule, if legislative norms or provisions of the charter expressly regulate disputable issue or breach of shareholders' right is evident, the rights of shareholders

will be reinstated. The shareholder may seek for legal remedies by applying to the State Committee on Securities Market of the Government of the Kyrgyz Republic, and the Procurator's Office of the Kyrgyz Republic. However, subject to many imperfections in legislation and charter of companies, the reinstatement of rights of shareholders requires to apply to a court. Issues related to protection of non-property rights of shareholders do not require from shareholders to invest significant financial resources, but in case of protection of shareholders' rights within a property-related dispute, a shareholder, when submitting the claim, shall as a rule pay out the state duty in the amount of 10% of the claim value. Legal expenditures such as state duty shall be additional costs and lead to the fact that shareholders do not apply to a court to protect their rights, which have been breached.

Within its activities, the Center on Corporate Development provides shareholders with free consultations regarding legislation regulating corporate relations, including issues related to the protection of shareholders' rights. From 1998 to 2002, more than 2,000 shareholders addressed to the Center on Corporate Development to obtain respective assistance. Shareholders obtained and are obtaining assistance in terms of preparation of applications to be sent to the State Committee on Securities Market, as well as claims to be submitted to courts regarding the breach of shareholders' rights.

What authorities can be approached by shareholders in order to require the compensation? What powers do such authorities have? Does any arbitration procedure exist in connection therewith?

The State Committee on Securities Market shall be a principal authority taking direct control over securities market (in accordance with legislation of the Kyrgyz Republic, a share shall be deemed as a security). Shareholders shall also have the right to seek for protection of their rights before a general court, and if such shareholder is a legal entity, he may apply to arbitration panel.

Within its powers, the State Committee on Securities Market may issue an instruction binding the companies to bring the breaching officers to administrative responsibility, postpone the validity and invalidate the license of breaching professional participant of securities market (independent registrar, broker, stock exchange), if their actions resulted in breaching shareholders' rights.

Courts usually consider property disputes among shareholders and companies. Shareholders shall apply to a court when companies fail to pay due dividends, breach of preemptive rights to shares, and shall appeal to a court against decisions made by the company in breach of the procedure for holding general shareholders' meeting.

Legislation of the Kyrgyz Republic has no direct ban to use the procedure out-of-court consideration of disputes, however the legislative basis for conducting such arbitration tribunal is absent at the moment. Today, within the Program "On Corporate Governance and Reform of Enterprises", the Kyrgyz Republic, with participation of the Center on Corporate Development, has developed a draft Law of the Kyrgyz Republic "On Arbitration Tribunal in the Kyrgyz Republic" (approved by the Legal Consulting Commission and submitted to a further approval by the Government). Such legislative draft, *inter alia*, stipulates the validity and effect of decisions of international and foreign courts of arbitration. The adoption of this Law shall allow to settle civil disputes through arbitration tribunal.

•) Use of rights for regulating purposes

Administrative responsibility for breaching shareholders' rights (Code on Administrative Responsibility of the Kyrgyz Republic):

- Article 328. Breach of investor's rights to obtain full and objective information on securities.
- Article 330. Unfair use of official information.

- Article 333. Breach of procedure for public sale (subscription) of securities.
- Article 334. Breach of rules of maintenance of register of securities holders.
- Article 337. Breach of procedure for holding general shareholders' meeting.
- Article 338. Breach of rules of entering into, formalizing and registering of operations with securities.

Property responsibility of persons for breaching shareholders' rights:

Articles 88 of the Civil Code of the Kyrgyz Republic and Articles 67 and 68 of the Law of Kyrgyz Republic "On Companies" shall regulate the issues of making officers of the company answerable to the extent of the property they own. Article 67 of the Law of Kyrgyz Republic "On Companies" states that property responsibility may be laid on the company's officers by the board of directors. Article 68 of the Law of Kyrgyz Republic "On Companies" states that property responsibility may be laid on the company's officers by the court, and in the event of compulsory liquidation, breaching officers of the company shall bear property responsibility before creditors for company's obligations, if the company lacks the property to pay off its obligations.

It is also necessary to note that if annual report, balance sheet, loss and profit statement or interim financial report materially distort the financial condition of the company, then in accordance with Article 68 of the Law of Kyrgyz Republic "On Companies", officers of the company, who signed said documents, shall bear joint and several responsibility before third parties (including shareholders), which were materially damaged as a result.

Paragraph 3 of Article 88 of the Civil Code of the Kyrgyz Republic establishes that the head of executive body must compensate damages caused to the company, if shareholders of legal entity require so, since the law or agreement do not provide otherwise.

b) Mechanisms of self-regulation

Mechanisms of self-regulation in the form of actions taken within legislative norms by participants of the corporate relations market independently without interference of the State, are not sufficiently developed and do not significantly affect the quality of corporate interrelations. It is possible to note one thing, in particular, the potential development of sector of out-of-court settlement of disputes (through arbitration tribunal). Analysis of such ability, its strengths and weaknesses is possible after approving respective legislation.

• Access to legal (court) compensation (redress) and its influence

Issues related to protection of non-property rights of shareholders do not require from shareholders significant financial resources (expenditures vary from 10 to 100 soms), but in case of protection of shareholders' rights within a property-related dispute, a shareholder, when submitting the claim, shall as a rule pay out the state duty in the amount of 10% of the claim value. Legal expenditures such as state duty shall be additional costs and lead to the fact that shareholders do not apply to a court to protect their rights, which have been breached

**AWARENESS OF SHAREHOLDERS AND SHAREHOLDERS'
ASSOCIATIONS**

Are shareholders enough informed on their rights? To what extent do they use their rights? Is there any shareholders' associations? Are they influential and to what extent?

When considering this issue it is necessary to take into account the limited time of existence of market relations in the Kyrgyz Republic. First joint stock companies started emerging in after collapse of the USSR, while developed countries has already recorded hundreds of years of expertise in terms of creation of JSC. Passivity of majority of Kyrgyz citizens, who hold small blocks of shares, is explained by the fact that the possession of shares does not provide them with significant income. At the same time, high level of education of Kyrgyz population, which was obtained in Soviet times, allows ordinary shareholders to orient in legislation and to apply its norms. However, ordinary shareholders and majority of citizens of the Republic do not have practice of protection of their rights through legal proceedings. It is connected with distrust towards legal system created in the past Soviet times.

From 1997 to 2000, within the period of implementation of the Program "On Corporate Governance and Reform of Enterprises, a particular attention was drawn to increase the level of knowledge of ordinary shareholders. It affected the quantity of applications of shareholders submitted to respective state bodies in order to seek for protection of their rights, which were breached. It is necessary to note that one of the main reasons of development of the draft Law of the Kyrgyz Republic "On Joint Stock Companies" in 1999 was a submission of the big number of applications of shareholders, where they stressed on imperfections of legislation of the Kyrgyz Republic, in particular, in the Law of the Kyrgyz Republic "On Companies". It lead to the fact that the Government of the Kyrgyz Republic has developed and adopted the Typical charter of joint stock company excluding a lot of imperfections present in legislation of the Kyrgyz Republic in respect of issues of corporate management. After adopting of Typical charter of joint stock company by the Government of the Kyrgyz Republic in 1997, more than 500 open joint stock companies restated their charters in accordance with said Typical Charter. Positive moment of implementation of norms of the Typical Charter consisted in the fact that its provisions contained express division of powers of each governing body of the company and procedure for making decisions thereby. Introduction of title of Secretary of JSC, which was responsible for direct connection of the company with its shareholders in terms of shareholders' rights, constituted a serious positive step necessary to develop further corporate management filed. It is appropriate to underline that majority of Russian analysts only now believe that it is necessary to introduce the Secretary's title in JSC operating in the Russian Federations. Model of the Typical Charter shall stipulate significantly improved corporate structure in comparison with that defined by the Law of the Kyrgyz Republic "On Companies". However, it should be pointed out that certain norms of aforesaid Typical Charter contradicted to the norms of the Law and it negatively affected the use by companies of provisions of the Typical Charter. Another negative factor was in absence of shareholder's expertise in terms of creation of sound systems of corporate management that result in the fact that JSC simply copied the Typical Charter without making any practical changes and without adapting it in accordance with specifics of their activities.

Within the Program "On Corporate Governance and Reform of Enterprises", the Center on Corporate Development provided shareholders with significant consulting support. More than 2,000 shareholders addressed to the Center regarding corporate governance issues during the term of program implementation. At first, shareholders obtained answers to their questions. Today, the Center on Corporate Development assist either by providing consultations or helping shareholders to make applications to be submitted to the State Committee on Securities Market, as well as to make claims to be applied to courts in respect of protection of shareholders' rights. Therefore, the Center on Corporate Development assisted shareholders in making more than 100 applications for submitting them to courts and other state authorities in order to protect shareholders' rights, which were therefore breached.

There are several shareholders' associations acting in the Republic. They are: Association of Brokers and Dealers of the Kyrgyz Republic and Association of Investment Funds. Only institutional investors can be their members. There are no associations of shareholders holding small blocks of shares in the Republic.

The Center on Corporate Development is currently considering the issue of creation of the Association of Investors' Protection. One of the directions of work of such Association would be a protection of shareholders' rights in court, regulation of conflicts between companies and their shareholders, assistance in development of local acts on companies subject to generally recognized standards of corporate governance, and promotion of independent directors system among joint stock companies.

CONCLUSIONS:

Priorities in strengthening shareholders' rights

What are the main measures to strengthen shareholders' rights in your opinion?

In general, existing corporate structure of joint stock companies of the Kyrgyz Republic protects shareholders' rights to register their titles to shares and transfer (alienate) the same, however there are problems related to disclosure to shareholders of information on activities of the company, affiliated persons, and transactions with interests of certain persons/entities. Practically, shareholders are not protected from damages, which could be caused to the company by transactions with interested persons and activities of management in its interests.

In connection therewith, we believe that it is necessary to act as follows:

1. The Parliament of the Kyrgyz Republic should adopt the Law "On Joint Stock Companies".
2. The Parliament of the Kyrgyz Republic should to carry out additional work at and adopt the Law "On Arbitration Tribunals in the Kyrgyz Republic".
3. It is necessary to create associations of shareholders, which main activities will be in explanatory work among shareholders, settlement of conflicts among the companies and shareholders, protection of interests of shareholders before the State Committee on Securities Market and courts, development of changes and amendments in legislation of the Kyrgyz Republic aimed at improvement of corporate governance in the Kyrgyz Republic, and increase of level of shareholders' knowledge.
4. To increase powers of board of directors of the company.
5. To introduce the International Standards of Financial Reporting in joint stock companies.
6. To intensify requirements for reports submitted by public joint stock companies.
7. To establish efficient system of protection of shareholders' rights when making transactions, where officers and shareholders have certain interests.

ENCLOSURE:

Legal and regulating frameworks to guarantee performance of shareholders' rights

Please, determine principal legal acts specifying and protecting shareholders' rights. Also, please point out whether are there any pending significant laws or legal acts?

Laws:

Law of the Kyrgyz Republic «•n Companies»
Law of the Kyrgyz Republic «•n Securities Market»
Law of the Kyrgyz Republic «•n Banks and Banking Activities»
Law of the Kyrgyz Republic «•n Investment Funds»

Decrees:

Decree No. 121 of the President of the Kyrgyz Republic «•n Measures for Further Development of Organized Market of Securities» dated May 10, 1999.

Decree No. •• •323 of the President of the Kyrgyz Republic «•n Creation of Sustainable System of Corporate Governance in the Kyrgyz Republic» dated October 22, 1998.

Resolutions of the Parliament the Kyrgyz Republic:

Resolution •276 of the Parliament the Kyrgyz Republic “On Approval of Provisions on Procedure and Conditions of Transfer of Title to Manage Public Block of Shares in Joint Stock Companies and other Businesses» dated July 12, 1995, and Resolution No. 99 “On Transfer of State Enterprises into Administrative Management” dated March 11, 1996.

Resolution №433 of the Parliament the Kyrgyz Republic “On Measures to Introduce Principles of Corporate Governance in the Kyrgyz Republic” dated July 26, 1997.

Normative acts of the State Committee on Securities Market:

Rules “On Holding of General Shareholders’ Meetings in JSC of the Kyrgyz Republic” dated January 24, 2002.

Regulations “On Introduction and Maintenance of Registers of Holders of Registered Securities in the Kyrgyz Republic” dated April 30, 1998.

Temporary Rules of Trade of Securities in the Kyrgyz Republic dated July 12, 1999.

Regulations “On Procedure for Disclosure of Information on Significant Facts (events and measures) Related to Finance and Business Activities of the Issuer of Securities” dated December 30, 1998.

Regulations “On Conversion of Shares when Reorganizing JSC” dated November 6, 2001.

Typical contract to be made between JSC and chairman of the board of directors dated December 11, 2001.

Regulations “On Transactions Made with the Use of Insider Information” dated August 2, 2001.

Drafts of normative legislative acts:

Draft of the Law of the Kyrgyz Republic “On Joint Stock Companies”

- Excludes imperfections in the procedure for creation of agenda of general shareholders’ meeting.
- Excludes imperfections in the procedure for initiating and holding of extraordinary shareholders’ meeting.
- Introduces the term “affiliated person”.
- Establishes the procedure for making transactions where officers of the companies, as well as big shareholders and their affiliated persons, have certain interests.
- Determines the procedure for exercise by shareholders of their preemptive right to additionally issued shares of the company.
- Establishes minimum amount of information the company must provide to a shareholder, as well as determines the procedure for its notification to shareholders;
- Determines the term when the company must pay out dividends to shareholders.
- Establishes the list of questions, which should be considered at the general shareholders’ meeting with mandatory participation of shareholders owning privilege shares of the company in the voting process.
- Establishes the right of shareholders owning privilege shares to vote at the general shareholders’ meeting with respect to all issues of its competence beginning from the meeting next to the annual general shareholders’ meeting where no decision on the payment of dividends has been made or where the decision to pay partial dividends on privilege shares has been made. The right of shareholders owning cumulative privilege shares to participate in the general shareholders’ meeting shall be terminated from the moment of full payment of all dividends generated on said shares.
- Significantly increases the rights of shareholders and board of directors.

We believe that your work will be very useful for Eurasian Corporate Governance Round Table. Materials will be circulated among its participants, put on OECD web-site and included into Eurasian Comparative Overview of Progress of Corporate Governance.