



3rd Meeting of the Eurasian Corporate Governance Roundtable



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

Case Study: Describing a typical shareholder meeting in Eurasia

By

Mr. Tolon Toichubaev
Chairman, Corporate Technologies Center
Kyrgyz Republic, Bishkek

hosted by
Securities and Stock Market State Commission of Ukraine
State Property Fund of Ukraine
PFTS

with the support of
The Government of Japan



**The Global
Corporate
Governance
Forum**

1. Profile of joint stock companies in Kyrgyz Republic

As of 1 March 2002, the State Commission on Securities Market registered the following issues of shares:

- 257 closed joint stock companies;
- 1,212 open joint stock companies.

As of 1 January 2002, capitalization according to the nominal value of the shares issued by joint stock companies amounted to 20,386 million soms (425 million US dollars). There are about 400 – 500 thousand shareholders in Kyrgyz Republic.

2. Corporate ownership structure

The following groups own considerable shares in the charter funds of joint stock companies:

- employees of joint stock companies;
- management;
- foreign investors;
- state;
- investment funds.

Such distribution in the ownership structure of joint stock company was set up as result of privatization carried out by the Republic within the period from 1991 until 1997. The majority of the joint stock companies was privatized according to the following procedures: a part of the shares held by the state in the amount not exceeding 5 percent was transferred on free of charge basis, and a part of the shares not exceeding 30 percent in some cases was transferred to the worker collectives. Not more than 25 percent of shares were put up for coupon auctions, and remaining shares were sold via cash auctions.

Employees of joint stock companies

In the majority of the joint stock companies established on the basis of privatized enterprises, the employees own the considerable portions in the charter funds amounting in some cases to 25 – 40 percent of the charter funds.

Management of companies

In the most number of the joint stock companies of Kyrgyz Republic, the members of the executive bodies of the companies own large blocks of shares in the companies. The managers of executive bodies quite often own controlling blocks of shares.

Investment funds

As of 1 January 2001, 14 investment funds were operating in the Republic. As a rule, currently, the funds do not acquire the shares of the companies, however, the shares of many companies of the Republic acquired during privatization constitute integral part of their assets.

Foreign investors

As of 1 January 2002, the total volume of foreign investment into the corporate securities of the issuers of Kyrgyz Republic amount to 3,119.0 million soms, including the investors from CIS countries – 84.9 million soms, and the investors of non CIS and Baltic countries – 3,034.1 million soms.

State

The state owns the controlling blocks of the shares in the companies occupying monopolistic position at the goods and services market of Kyrgyzstan, as well as in a number of the companies of strategic significance for the Republic. There are a few enterprises in which the state owns not more than 10 percent of the charter funds.

3. Normative acts governing the procedures for holding general shareholders' meetings

- The Civil Code of the Kyrgyz Republic;
- The Law of KR "On Business Partnerships and Companies";
- The Rules of holding general shareholders' meetings in joint stock companies of Kyrgyz Republic approved by the State Commission on Securities Market.

Holding general shareholders' meetings in commercial banks is governed by the acts referred to above, however, taking into consideration the requirements established by the legislation regulating banking activities.

4. General Shareholders' Meeting

Types of general shareholders' meetings:

Company is obligated to hold annual general shareholders' meeting on the annual basis, however, not later than by 1 April of a year succeeding a year under report.

Extraordinary general meeting is held at any time according to the initiative of shareholders owning 20 and more percent of voting shares in company, board of directors, management, audit commission, and auditor of company.

In both cases, quorum at general shareholders' meeting should be composed of more than 60 percent of votes out of total amount of voting shares in company. In case quorum is not assembled at the first shareholders' meeting, then another meeting should be convened within one month period, such meeting shall be valid and effective if the shareholders owning more than 40 percent of votes out of total amount of voting shares of company participate in such meeting.

Persons entitled to participate with voting rights in the activities of meeting

Shareholders owning common shares as well as their representatives authorized to vote according to power of attorney executed pursuant to legislation of Kyrgyz Republic are entitled to vote at general shareholders' meeting. Owners of preferred shares shall not be entitled to vote at shareholders' meetings, except for the owners of cumulative preferred shares if such shares have been issued according to the charter of company. Owners of cumulative preferred shares are entitled to vote only in case company has not paid up

dividends for the previous shareholders' meeting, and such right expires from the moment of full payment of dividends to such shareholders. However, in practice, the preferred cumulative shares were not issued in the Republic.

Notification of shareholders regarding forthcoming general shareholders' meeting

Shareholders are notified by notice mailed to them or by announcement in printed mass media regarding forthcoming meeting with the agenda specified.

Notices regarding forthcoming general shareholders' meeting are mailed to shareholders according to data recorded in the shareholder register.

Announcements in printed mass media should be published at least 20 days prior to meetings of open joint stock companies, and at least 10 days prior to meetings of closed joint stock companies.

Notice and announcement should contain agenda of general meeting, data regarding date and place of general meeting, as well as information indicating where and how materials regarding forthcoming shareholders' meeting may be obtained.

It is worth noting that legislation of Kyrgyz Republic provides for opportunity of invalidation of resolutions made at general shareholders' meetings, if company fails to meet the requirements in respect of notifying shareholders regarding forthcoming meeting, particularly, pursuant to paragraph 4 of Article 64 of LKR "On Business Partnerships and Companies", in the event of shorter term or failure to make notice regarding convening meeting, resolution made at such meeting shall have legal force if unanimously approved at such meeting.

Procedures for arrangement of agenda of general shareholders' meeting

As far as participation of shareholders in arrangement of agenda is concerned, it is necessary to note that until recently, legislation used to have significant gap in such area. LKR "On Business Partnerships and Companies" does not contain provisions establishing the procedures for arrangement of agenda, as result of it, either executive body of company with shareholder (shareholders) owning controlling block of shares or shareholder (shareholders) owning controlling block of shares arrange agenda. Charters of large joint stock companies establish the right for shareholders owning 5 and more percent of shares submit proposals to agenda of general shareholders' meeting, however, there is no procedures for implementation of such right. The State Commission on Securities Market developed and approved Rules of holding general shareholders' meetings in joint stock companies of Kyrgyz Republic. The rules, inter alia, establish the procedures for arrangement of agenda of general shareholders' meeting specifying that shareholders, members of board of directors, management, audit commission not later than 30 days after expiration of a financial year are entitled to submit not more than one proposal to agenda of annual general shareholders' meeting and nominate not more than one candidate into board of directors, executive body and audit commission of company.

Proposals submitted by the persons referred to above are considered by board of directors of company, it shall be entitled to decline the proposals submitted to agenda, however, only in cases specified in the Rules.

Holding extraordinary general shareholders' meeting

Prior to approval in January of this year of the Rules of holding general shareholders' meetings in joint stock companies of Kyrgyz Republic, it was problematic to hold extraordinary shareholders' meeting under the initiative of shareholders owning 20 percent of

shares, since the procedures for holding such meetings were not specified, and if management was opposed to holding such meeting, such meeting was not held. Currently, the procedures for its holding are specified in the Rules referred to above, and the problem has been eliminated.

Extraordinary general meeting is held on the basis of the resolution of Board of directors according to its initiative, the initiative of audit commission, the initiative of the company's auditor, the initiative of management, the request of shareholder (shareholders) owning at least 20 percent of shares in company with voting rights.

Board of directors is not entitled to change agenda proposed by initiators of holding extraordinary shareholders' meeting.

In the event, board of directors declines to hold general shareholders' meeting or fails to hold it within terms established in the rules, shareholders shall have the right to convene the general shareholders' meeting by their own.

Competence of general shareholders' meeting

Exclusive competence of general shareholders' meeting shall include the following issues:

- 1) amendments to the charter;
- 2) changes (increase or reduction) of the amount of charter fund of joint stock company;
- 3) consolidation and splitting of earlier issued shares, issuance of additional shares;
- 4) procedures for raising loans on debentures;
- 5) election of board of directors, executive bodies of company, board of directors of company without supervisory council, members of audit commission and (or) auditor of company, as well as early termination of their powers and authorities;
- 6) approval of annual results of activities of company, reports of executive bodies of company, and conclusions of audit commission;
- 7) approval of internal rules of procedure of company, amendments to it;
- 8) liquidation and reorganization of company, appointment of liquidation commission, approval of liquidation balance sheet;
- 9) procedures for exchange of other securities of joint stock company into shares;
- 10) approval of procedures for distribution of profit and covering losses;
- 11) Issues included by the Law or the charter of company to the exclusive competence of general shareholders' meeting may not be delegated to executive bodies of company.

5) Violation of the procedures for holding general shareholders' meeting

Major violations of the procedures for holding general shareholders' meeting:

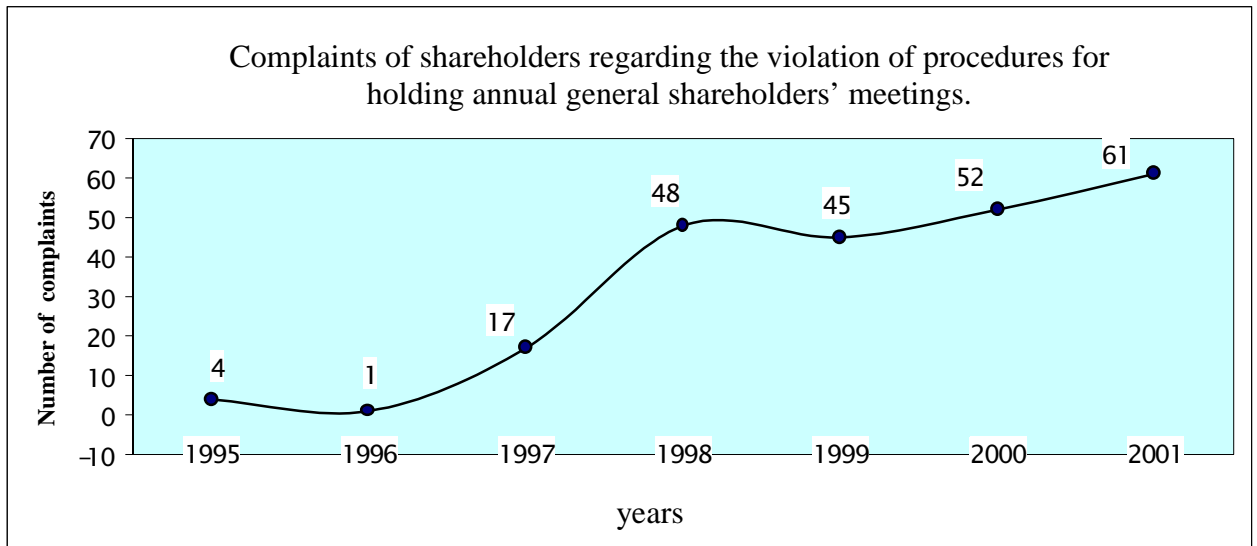
- failure by company to engage independent registrar to general shareholders' meeting
– any joint stock company having more than 10 shareholders is obligated to enter into

agreement regarding holding general shareholders' meeting with independent registrar;

- failure to publish in printed mass media and/or failure to send to shareholders information in respect of holding general shareholders' meeting;
- failure to provide shareholders with information on issues transacted at general shareholders' meeting;
- violation of the procedures for providing shareholder with information regarding forthcoming increase or reduction of the charter fund of the company.

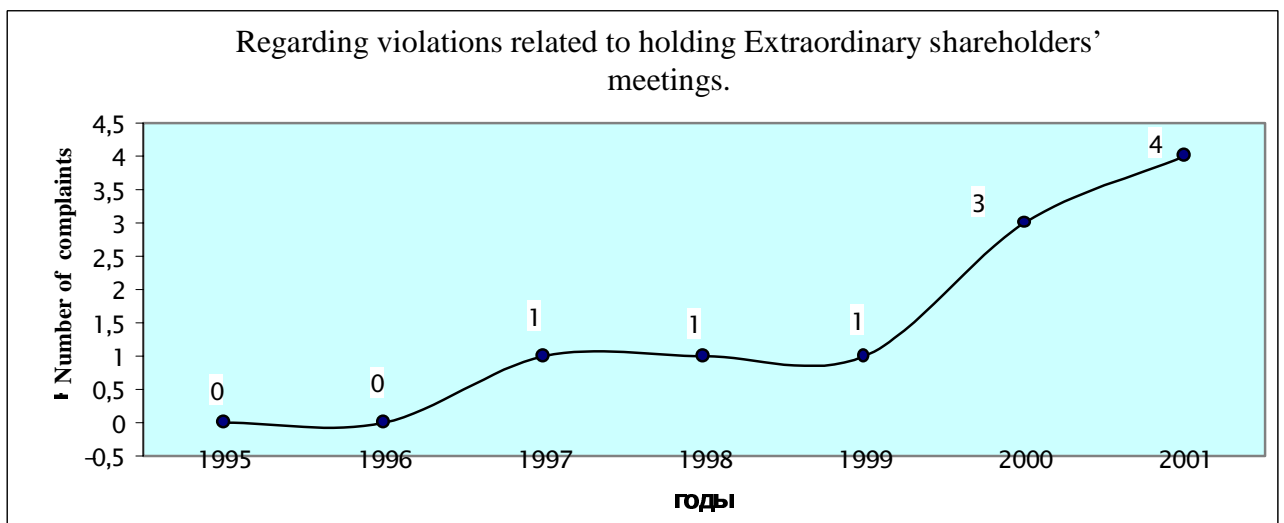
Indicators of revealed violations of the procedures for holding general shareholders' meetings

1995	1996	1997	1998	1999	2000	2000
4	1	17	48	45	52	61



Indicators of revealed violations of holding extraordinary shareholders' meetings

1995	1996	1997	1998	1999	2000	2001
0	0	1	1	1	3	4



years

Authorities to which shareholders may apply seeking protection of infringed rights

In the event of breach of the procedures for holding general shareholders' meeting, shareholders may apply to the State Securities Commission with the Government of Kyrgyz Republic in respect of securities market or directly to court.

Subject to the fact that Article 61 of LKR "On Business Partnerships and Companies" establish the right of shareholders to appeal in court the resolutions made by company, in practice cases were registered when shareholders submitted to courts application seeking invalidation of resolutions made at general shareholders' meetings held with violation of the procedures established by legislation and charter.

In the event of breach of the procedures for holding general shareholders' meeting, the State Commission within scope of its powers and authorities may issue instructions mandatory for fulfillment by companies and impose administrative liability upon officials at fault for violations, suspend and terminate license of independent registrar at fault, if its actions resulted in infringement of the rights of shareholders.

Pursuant to Article 337 of the Code of Kyrgyz Republic on administrative liability, the State Commission may impose upon breaching official of company administrative penalty in the amount from 15 to 50 minimal amounts of salary.

6. Problems associated with holding general shareholders' meetings in Kyrgyz Republic

Inactivity of shareholders

When considering this problem, it is necessary to take into account the fact that the history of joint stock companies in Kyrgyzstan amounts to only a little more than 10 years. Certainly, it is possible to introduce on the legislative level experience of developed countries amounting to several centuries. However, it is very difficult to change mentality of people who lived most of their lives during the times when the state owned everything. At the same time, we may not ignore the fact that majority of shareholders owns minority blocks of shares and do not obtain significant profit as result of such ownership, it means they loose any interest in respect of enforcement of their rights.

Gaps and contradictions in legislation governing corporate relations

Legislation of Kyrgyz Republic contains rules establishing the rights of shareholders, however, at the same time it lacks rules establishing the requirements as to manner of enforcement of such rights by shareholders.

Consequently, Article 61 of LKR "On Business Partnerships and Companies", inter alia, establishes the right of shareholder to participate in management of joint stock company in the manner provided for in the charter of company, however, at the same time, Article 64 of the Law referred to above (the article regulates the procedures for holding general shareholders' meeting) does not contain the requirements in respect of the procedures for the following:

- arrangement of agenda of general shareholders' meeting;
- holding extraordinary general shareholders' meeting;
- making resolutions at general shareholders' meeting in respect of considerable transactions with conflict of interests of significant shareholders;
- providing shareholders with information and materials in respect of issues subject to consideration at general shareholders' meeting;
- consideration of issues which should be considered at general shareholders' meeting with mandatory participation in voting of shareholders owning preferred shares of company.

Upon adoption of the Law of Kyrgyz Republic "On Joint Stock Companies", the majority of gaps and contradictions in legislation governing corporate relations has been eliminated. Such draft law is currently being considered by the Parliament of Kyrgyz Republic, and it will be adopted in the nearest future.