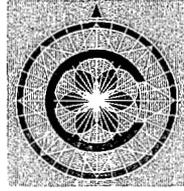


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CHEMONICS INTERNATIONAL INC.



KAZAKSTAN MASS PRIVATIZATION PROJECT

FINAL REPORT

Submitted to:
U.S. Agency for International Development

Submitted by:
Chemonics International Inc.
Ernst & Young

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ACRONYMS

AMC	Anti-monopoly Committee
IC	GKI Information Center
IESC	International Executive Services Corps
IHCC	Inter-ministerial Holding Company Commission
IRA	Independent Registration Agent
JSC	Joint Stock Company
MPP	USAID Mass Privatization Project
NAMI	National Association of Professional Participants in the Securities Market (the independent investment fund association)
NSC	National Securities Commission
OSC	Overseas Strategic Consulting (the USAID public education contractor)
PIF	Privatization Investment Fund
SAL	Structural Adjustment Loan
SPC	State Privatization Committee
SPMC	State Property Management Committee
UNDP	United Nations Development Program

EXECUTIVE SUMMARY

Chemonics International and Ernst & Young began the Mass Privatization project (MPP) almost one year after the U.S. Agency for International Development launched its efforts in support of mass privatization in Kazakstan. By early August 1995, the MPP team had made the following significant achievements:

- Established smooth working relationships with the State Privatization Committee (SPC), State Property Management Committee (SPMC), National Securities Commission (NSC), and other government agencies relevant to enterprise privatization.
- Organized and conducted 16 mass privatization coupon auctions. In addition, the MPP assumed full responsibility for auction preparation activities, such as auction list compilation and company documentation collection.
- Designed the share emission prospectus used by the NSC as the basis for registering share emissions of joint stock companies (JSCs).
- Gained observer status on the Inter-ministerial Holding Company Commission (IHCC) and actively lobbied IHCC members to encourage Cabinet of Ministers decrees on the privatization of remaining state shares.
- Established an independent investment fund association (the National Association of Professional Participants in the Securities Markets—NAMI), which now lobbies the government vigorously on behalf of investment fund interests.
- Designed a strategy for cleaning up the investment fund's shareholder database.

On August 8, 1995, USAID issued a task order to continue the project and complete the mass privatization process in Kazakstan in six key areas: pipeline management, share registration, holding company dissolution, cash auctions, legal analysis, and public outreach and education. Originally slated for six months, ending on February 7, 1996, the task order was extended for an additional three months, ending May 7, 1996. The primary reason for the extension was to capitalize on key government decisions, made in January 1996, which greatly facilitated the mass privatization process.

The MPP has made significant progress in all areas affecting the continued smooth implementation of mass privatization. In spite of delays, by May 7, 1996, the MPP had made substantial progress, often against strong institutional resistance, on the benchmarks that had not been previously achieved. As of May 7, 1996, notable MPP accomplishments included:

Coupon Privatization

- Completed coupon collection, with 85 percent of the population investing at least some of their coupons and 65 percent of all coupons issued invested in privatization funds
- Shares offered at coupon auctions for 59 of the 129 case-by-case enterprises

- Completed coupon auctions with a total of 1,712 companies offered and virtually no collected coupons (0.1 percent) left unspent

Cash Auctions

- Passage by the SPC and registration by the Ministry of Justice of the MPP-drafted regulation governing the sale of state shares at cash auctions
- Initiated cash auctions of state shares with over 700 companies offered by May 7, of which 300 had no state shares remaining after auction
- The SPC identified, trained and licensed over 45 independent, self-financing auction organizing companies
- Recruited and trained MPP regional consultants who support mass privatization-related processes in all of Kazakhstan's 21 oblasts
- Created the most comprehensive database on JSCs with state shares in Kazakhstan, incorporating information collected by four government agencies, including the State Statistical Committee, and the MPP regional consultants

General Privatization Policy

- Participated, at the Cabinet of Ministers level and in the office of the Minister of Justice, in the drafting of the law on privatization, which took effect on January 1, 1996. The MPP participation ensured that the law would not be disruptive to the initiation and implementation of nationwide cash auctions of state shares.
- Advised experts from the United Nations Development Program (UNDP) in the drafting of the 1996-98 Privatization and Restructuring program. The MPP participated actively in drafting of sections pertaining to securities privatization. The MPP also facilitated meetings between representatives of USAID/CAR, the UNDP, and the SPMC on the draft privatization program.

Holding Company Demonopolization

- Review by the IHCC of the majority of holding companies and a policy change in word and deed by the IHCC chairman in favor of increased privatization of holding company subsidiaries

Support of Privatization Investment Funds

- Achieved 75 percent financial self-sufficiency for NAMI
- Established regional NAMI offices and created an analytical center through grant funding
- Drafted industry ethical standards and general preparations for NAMI to act as a self-regulated organization

- Transferred responsibility for NAMI and investment fund-related issues to the Arthur Andersen USAID project

Share Emission Registration

- Removed the emission registration tax, which was the most serious disincentive in the registration process
- Trained and certified, with NSC concurrence, 191 independent registration agents (IRAs)
- Initiated and coordinated a concerted emission registration effort by the MPP, Carana, and Arthur Andersen that led to a more than three-fold increase in the number of companies registered monthly with the NSC

Investment Fund Shareholder Database Clean-up

- Launched a nationwide investment fund shareholder verification campaign with a full-scale television, radio, and print media campaign

Corporate Governance Training

- Trained 28 persons as professional board of directors members
- Completed final draft of corporate governance manual based on course lectures and materials

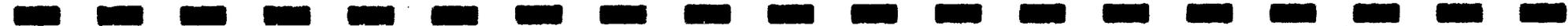
Debt Restructuring

- Published and distributed two iterations of the manual "Out of Court Enterprise Debt Restructuring." The second, user-friendly version, is being sold at cost by NAMI.
- Tested some of the techniques described in the manual, and documented the results in the second version of the manual.

In addition to the above, over the course of the task order, the MPP made significant progress in achieving transfer of responsibility for most project components to local MPP staff. At the close of the task order, the project employed the services of only 3 expatriate consultants and had a local staff, including regional consultants, of over 50 persons.

SECTION I

TABULAR PROGRESS REPORT



Explanatory Notes	Progress			Task / Objectives Description
<p>(Abbreviations: SPC: State Privatization Committee; SPMC: State Property Management Committee; JSC: joint stock company; NSC: National Securities Commission; AMC: Anti-Monopoly Committee; PIF: privatization investment fund; MPP: Mass Privatization Project)</p>	<p>Nov-Dec</p>	<p>Jan-Feb</p>	<p>March-May 7</p>	<p>X - Completed; O - Ongoing</p>
<p><i>Develop and implement cash auctions</i></p>				
<p>Draft regulation for cash sales of the remaining state package of shares</p>	<p>O</p>	<p>X</p>		<p>New, permanent cash auction regulation approved by SPC Feb. 7</p>
<p>Train regional staff of SPC in procedures for implementing cash auctions</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Seminar, at which Deputy Prime Minister Sobolev gave key address, with participation from all 21 terkomns held in February; ongoing on-site assistance provided to Terkomns and organizers</p>
<p>Changes made to auction regulation that allow Dutch auctions with no floor price</p>	<p>O</p>	<p>O</p>	<p>X</p>	<p>Changes approved by SPC in April.</p>
<p><i>Develop cash auction pipeline</i></p>	<p>O</p>	<p>O</p>	<p>O</p>	
<p>Effect transfer of JSCs from SPMC to SPC for cash sale</p>	<p>O</p>	<p>O</p>	<p>X</p>	<p>Joint SPMC/SPC resolution of April 17 transfers over 2,000 JSCs to SPC</p>
<p>Work with Registration Team to ensure that JSCs have registered their emissions</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>The Registration Team gives priority to large companies whose state shares will be offered for cash sale.</p>
<p>Work with Registration Team to provide prospectuses to investors</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Regulation specifically mandates that prospectuses - and additional information - be available to potential auction participants.</p>
<p>Bring as many case-by-case enterprises as possible into mass privatization process</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>5%-10% of state share packets of 59 of the 129 case-by-case enterprises were offered in coupon auctions.</p>
<p>Monitor unauthorized sale of share packages</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Monitoring ongoing; advised SPC to reverse a resolution that would have led to illegal management contract tenders on 69 JSCs in Karaganda Oblast.</p>
<p>Verify and investigate cases of unauthorized share sales</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Ongoing, within MPP staff limitations.</p>
<p>Sell share packages through competitive bidding process</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Dec. 1 - May 7 shares of over 700 JSCs were offered in all of Kazakhstan's 21 oblasts at cash auctions governed by the MPP-drafted auction regulation; all the remaining state shares of more than 300 JSCs were sold.</p>
<p>Regional implementation staff to support regional cash auctions</p>	<p>O</p>	<p>O</p>	<p>X</p>	<p>Hired consultants in the regions who are responsible for 1) consulting and assisting terkomns in auction implementation, 2) JSC share emission registration, 3) MPP database support.</p>
<p>Train the SPC to maintain an information pipeline between the regional centers and the central SPC</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Training SPC central and regional staff in use of MPP database</p>
<p>Assist the State Privatization Committee in running cash auctions</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Conducted a seminar for the SPC and its regional staff on auction procedures; provided on-site auction consultations in 9 oblasts.</p>
<p>Monitor post-auction requirements</p>	<p>O</p>	<p>O</p>	<p>O</p>	<p>Regional staff monitor timely payment for state shares purchased at auctions and relay this information to the MPP database.</p>

Task / Objectives Description	Progress			Explanatory Notes
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(Abbreviations: SPC: State Privatization Committee; SPMC: State Property Management Committee; JSC: joint stock company; NSC: National Securities Commission; AMC: Anti-Monopoly Committee; PIF: privatization investment fund; MPP: Mass Privatization Project)				X - Completed; O - Ongoing
<i>Develop self-financing auction companies</i>				
License auction organizers with the SPC	O	X		Over 45 organizers were licensed with MPP assistance as of Dec. 31; on Jan. 1 simplified rules took effect that allow any organization with a broker/dealer's license from the NSC to organize cash auctions; over 10 cos. are organizing auctions full time.
Conduct open tenders to select winners	O	O	O	Following MPP-organized tenders in Almaty and Jambyl, SPC has replicated the process independently in the regions; an MPP-drafted regulation governing the tenders was passed March 19.
Oversee the work of the winners	O	O	O	On-site consultations with organizers are ongoing.
Transfer this capability to the SPC	O	O	O	Seminar for terkoms included training in organizer oversight.
<i>Support floating selected Companies' Share Packages on Stock Exchange</i>	O	O	O	Coordinating with other USAID securities market projects.
II. Company Preparation				
Review company registration documents to register companies	O	O	O	Coordinated the review of documents of the companies to be offered for cash auctions with the Cash Auctions Team.
Educate companies in regions on registration (Conduct seminars)	O	O	O	16 seminars were conducted in 12 oblasts. Priority given to those oblasts with large numbers of companies with state shares.
Use computer program to track companies for future auctions	O	O	O	Registration database was made a component of the overall MPP database.
<i>Assist National Securities Commission</i>				
Create a database of all JSCs with registered share emissions	O	O	X	MPP staff entered information from over 2,000 JSCs into an MPP-designed database that is now used and maintained by the NSC.
Continue to train NSC staff on registration procedures	O	O	O	Continuing to advise NSC registration staff.
Review company registration documents to register companies	O	O	O	Continuing liaison between JSCs in the regions and the NSC.
Transfer assistance in regulatory drafting to Arthur Andersen project	O	O	X	Initiated and led a joint effort with the Carana and Arthur Andersen USAID projects to register shares of JSCs in the regions.
Resolve re-registration issue	X			On December 30 President Nazarbaev signed an MPP-drafted decree allowing registration by the Ministry of Justice of changes and amendments to charter documents of privatized JSCs without meeting minimum charter capital requirements.

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III. Coupon Auction Pipeline Management				
<i>Preparation of final wave of coupon auctions</i>				
Carry out auction prep for companies on the final wave list, i.e., collecting documents, gathering information	O	X		We installed a special group at the SPC to ensure proper auction preparation and to travel to problem oblasts when necessary.
Bring as many case-by-case enterprises as possible into the mass privatization process	O	X		26 case-by-case enterprises included in the final wave list
Completion of coupon auctions	O	X		Final coupon auction (#22) was held Feb. 1
Minimize the "coupon overhang" problem	O	X		Because of special rules used in the final coupon auction, only 0.2% of all coupons collected by investment funds were unspent.
IV. Legal				
<i>Provide legal support to MPP teams and MPP counterparts</i>				
Analyze all drafts and amendments to the Privatization Law	X			MPP participated in discussions on the "Law on Privatization" with Pepper, Hamilton & Scheets, at the Cabinet of Ministers, and with the Minister of Justice (Law passed Dec. 23, 1995)
Analyze all drafts and amendments to the Privatization Program for 1996-1998	O	X		MPP consulted UNDP privatization consultants on the aspects of the Program affecting securities privatization
Aid SPC and SPMC in interpreting and revising privatization regulations/decrees	O	O	O	Conducted seminars for SPMC staff aimed at interpreting the present legislation of Kazakhstan and at correct drafting of resolutions.
Work with Holding Companies Group to address the legal framework surrounding holding companies	O	O	O	Continued to provide the Interministerial Holding Company Commission with economic and legal analysis of holding companies up for review; provided draft decrees.
Maintain legal database	O	O	O	It is used by MPP team members as well as MPP counterparts
Assist SPC and SPMC in drafting securities market legislation, regulations	O	X		MPP liaised with Arthur Anderson Team, which has primary responsibility, and transferred these issues to AA in February.
Cooperate with USAID commercial law teams on issues pertaining to Mass Privatization	O	O	O	Co-ordinated on regional economic policy and financial industrial groups with IRIS, on Kazakhstan's WTO membership application with Booz-Allen, and on bankruptcy and liquidation issues with the Booz-Allen Bankruptcy Project.
V. Holding Companies				
Compile and review list of companies in holdings	O	O	O	Continued updating of holding company database information.
Develop a priority list of holdings to demonopolize			X	Developed a list of holding companies to be re-reviewed by the Interministerial Commission in order to gain greater privatization than is foreseen in the already passed decrees.

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Work with the Interministerial Commission on Holdings to evaluate holdings	O	O	O	We participated in the Interministerial Commission meetings on holding companies and submitted comments on proposed efforts to segment these companies
Assist with drafting of regulations on demonopolization of holdings	O	O	O	Exerted continuous efforts to speed up the process. Analyzed draft resolutions on segmentation of holdings and submitted our proposals to the Ministers involved in the Commission.
Continue to work with Antimonopoly Committee, and later with the SPMC, to formulate holding policy	O	O	O	The function of preparing policy proposals for the Interministerial Commission was transferred from the AMC to the SPMC in January. Several draft SPMC decrees on holding companies drafted by MPP were adopted without significant change.
<i>Monitor implementation of the signed decrees on holdings</i>	O	O	O	MPP consultants have been given authority by the SPMC to act as its representatives in monitoring decree compliance by holding companies.
Verify that shares of companies subject to mass privatization are auctioned off	O	O	O	MPP regional staff keep track of the sale of holding subsidiaries' shares.
Continue to update the database to reflect the status of each company in the holding	O	O	O	It is continuously updated for new decrees, changes in manpower numbers, etc.
<i>Assist SPC and SPMC with issues/problems as requested</i>	O	O	O	Continuously assisting the departments of SPMC in drafting and clarifying of resolutions
VI. Investment Funds				
<i>Increase transparency between shareholders and funds</i>				
Clean up share registry	O	O	O	
Develop method for cleaning up list	O	X		After Narodny Bank refused to continue cooperating, MPP investigated other possibilities and facilitated a contractual agreement between the SPC, the SPMC Information Center, and the Postal Service.
Design PR campaign for clean-up program	O	O	X	Coordinated with OSC public education contractor on design of TV, radio, and press campaign.
Begin implementation of program	O	O	X	PR campaign was begun April 8 with print advertisements; TV and radio advertisements began April 25. As of May 7, terkoms reported receiving many thousands of shareholder verification forms.
Ensure shareholders receive confirmation of investment	O	X		All citizens who participate in the verification program receive a print-out of their PIF shareholdings; this will be the first confirmation of coupon investments that PIF shareholders receive.
<i>Ensure transparency in auction process for investment funds</i>				
Provide funds with enterprise information/auction list 40 days before auction	O	X		40 days targets are met. The company lists compiled by the Pipeline Team together with the SPC were published in the newspapers before legal deadlines; in addition, the SPC sent companies' financials, to terkoms by E-mail for distribution to PIFs.

Task / Objectives Description	Progress			Explanatory Notes
	Nov-Dec	Jan-Feb	March-May 7	
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<i>Train funds in portfolio management/enterprise restructuring techniques</i>				
Assist Investment Fund Association to reach objectives.				Most support of Assoc. transferred to Arthur Andersen project in February.
Services to funds in portfolio management, restructuring, accounting	O	O	X	2nd, user-friendly, version of debt restructuring manual published; most copies given to Assoc. for subsequent sale to public.
Lobbying for interests of funds	O	X		The team continuously advises Assoc. on legal and other issues concerning investment funds.
Publication of monthly newsletter	O	O		9th - 11th editions published and distributed
Self-sustainability through fee-for-services system	O	X		Assoc. reached 75% self-sufficiency by improving membership fees collection and through successful grant solicitation.
Train independent Board of Directors	O	O	X	Two training seminars for BOD held in November and December; 30 persons were trained. The BOD manual was compiled and, as of May 7, was going through final revisions for publication.
<i>VII. Public Relations/Public Education</i>				
Encourage Policy-maker Support	O	O	O	Reported on MPP activities to policy-makers through OSC's monthly reform publication; established contact with newly-elected parliament; MPP included in working group for Presidential Advisor Utebaev.
Hold forums for addressing questions and concerns	O	O	O	MPP has an ongoing program of speakers on economic, privatization, and policy issues (every second Thursday); the 8 speakers included foreign consultants, ministry representatives, Cabinet of Ministers staff, and academics.
Provide educational materials about the long-term benefits of privatization	O	O	O	Published two books containing legal and technical documents needed for running cash auctions; the books contain information valuable to auction organizers, government staff, and potential auction participants.
Provide Promotional Support for cash auctions	O	O	O	Designed a print, TV, and radio PR campaign with OSC to promote awareness of cash auctions; agreed to continue campaign with specific auction announcements in high-volume newspapers.
<i>VII. Debt Restructuring (objective set by the team)</i>				
Produce manual "Out-of-Court Enterprise Debt Restructuring"	O	O	X	2nd, user-friendly, version was published.
Implement testing of the manual	O	O	O	The manual's methodologies continue to be tested in two real cases.

SECTION II

BENCHMARK REPORT

SECTION II BENCHMARK REPORT

This section describes the team's compliance with the task order performance benchmarks.

The MPP team has completed, and in some cases surpassed, 8 of the 10 task order benchmarks (numbered 1 through 11, skipping number 6 as per the task order). The two benchmarks not achieved (i.e., cash auctioning enterprises representing 40 percent of industrial employment, and reducing inaccuracies in shareholder data lists to 10 percent) were beyond the control of the MPP team.

The MPP team worked closely with both USAID and the Government of Kazakhstan to confront the obstacles that hindered the achievement of these benchmarks, including devising strategies and drafting new regulations to facilitate the mass privatization process. In both cases, the team made substantial progress, and, barring unforeseen circumstances, the benchmarks will soon be achieved as part of a follow-on task order.

We discuss activities below under each of the ten benchmarks.

Benchmark 1: *At least 70 percent of industrial employment will be in majority private hands by the end of the task order. This goal can be met both by including enterprises from holdings, as well as by convincing the GKI/SPF to switch some enterprises from case-by-case to the mass privatization program. (completed)*

Based on the information from the MPP holding companies' database, and confirmed by regional staff participating in the auction process, 70.7 percent of the industrial employment in JSCs subject to mass privatization was in majority private hands as of May 7, 1996. We have therefore achieved this important benchmark.

Benchmark 2: *At least 70 percent of employment of the eligible mass privatization enterprises locked under holding companies will have gone through coupon auctions, and will at a minimum have their remaining shares effectively recalled by the GKI and scheduled for cash auction. (surpassed)*

Based on project information, 82 percent of employment in holding companies under MPP purview had gone through coupon auctions, indicating we have surpassed the original 70 percent goal (this figure has changed since the last benchmark report due to updating of the holding companies' database). The percentage would be even higher if it were not affected by holding companies in the mining sector (67 percent) and the oil and gas sector (39 percent).

Regarding the recall of the remaining state shares by GKI, as of May 7, 1996, 89.5 percent of the employment in holding subsidiaries subject to mass privatization were in JSCs whose shares had been recalled by both Cabinet of Ministers and GKI decrees.

Benchmark 3: *All coupon auctions for the initial (approximately) 1,500 enterprises involved in mass privatization will be completed no later than four months into the task order. (completed, ultimately surpassed)*

As of the last coupon auction (number 21) conducted on January 30 and February 1, 1996, a total of 1,712 enterprises have gone through the coupon auction process. During the first 20 auctions (held within the first four months of the task order) 1,460 companies had been offered. In December 1995, the government agreed to have a very large final auction to significantly exceed the 1,500 target, and to clear up the "coupon overhang." This large auction, during which over 400 companies were offered, achieved both goals. Approximately 99.9 percent of all coupons held by investment funds were used up by the conclusion of the final auction.

In addition, the MPP achieved a major breakthrough in including companies previously under the case-by-case program. By encouraging the government to provide more valuable merchandise for the last auctions, 5 and 10 percent share blocks of 59 companies under the case-by-case program were made available. These offerings partly privatized 46 percent of the 129 case-by-case companies.

Benchmark 4: *At least 40 percent of industrial employment will have gone through cash auctions by the end of the task order. (approaching completion)*

By May 7, 1996, the shares of over 975 JSCs had been offered in cash auctions, representing 20.4 percent of the industrial employment in JSCs engaged in mass privatization. Due to the delay in the passage of key legislation, the first cash auction was not held until December 1995, at which time a total of 44 companies were offered for cash auctions.

Due to extraordinary government and MPP efforts, as well as close USAID and MPP coordination with the World Bank, a total of 322 joint stock companies were offered in January, followed by 164 in February. There are currently over 3,000 companies in the pipeline whose shares have been recalled for cash auction privatization, representing almost 90 percent of industrial employment in JSCs subject to mass privatization. Therefore, while the MPP team was not able to achieve the 40 percent target for industrial employment within the current task order, it will be achieved shortly, if not surpassed, in the follow-on task order recently awarded to the Chemonics consortium.

Benchmark 5: *There will be at least 5-10 self-financed auction companies in existence on a national level, and the SPF will be trained in regulating these entities. (surpassed)*

As of late December 1995, the MPP team had identified and trained 45 self financed, independent auction companies/organizers, greatly exceeding this benchmark. Representatives of 45 companies were given both theoretical and hands-on training in auction procedures in seminars held in August and October 1995. These seminar covered the legal, organizational, and psychological aspects of conducting an auction. All organizers were subsequently licensed by the SPC.

Eleven auction organizers actively participated in the first auction contract tenders, held in December in Almaty and at the Jambyl Privatization terkom. The MPP team provided ongoing assistance during this process. As of January 1, 1996, any entity with a broker/dealer's license from the NSC may compete for auction contracts from the SPC.

Benchmark 6: There was no benchmark 6 for the task order.

Benchmark 7: *There will be at least 50-75 Independent Registration Agents (IRAs) in existence by the conclusion of month four of the task order and the NSC will be trained in regulating these individuals. (surpassed)*

By November 1995, the MPP, with the consent of the NSC, had trained and certified 191 independent registration agents (IRAs), greatly exceeding this benchmark. While the NSC does not officially regulate IRAs, a de facto regulatory mechanism is in place. In the event that an IRA prepares an inadequate or faulty registration statement or prospectus for a company, the NSC will simply not register the shares.

Benchmark 8: *Inaccuracies in the funds' shareholder data lists, which could directly affect the relationship between the funds and shareholders, should not exceed 10 percent. (approaching completion)*

The Investment Fund Data Clean-up program was slow in starting, due initially to the Narodny Bank's ultimate and late decision to not participate in the program. Additional delays were caused by the GKI information center's (IC) difficulties in getting the full database from the Narodny Bank and in translating the database into a readable format. The MPP team has been working with the IC in correcting computer-based errors in the shareholder database (software was designed and implemented which located and consolidated multiple entries for individual shareholders). This work significantly improved the quality of the database, but the majority of inaccuracies caused by changes within the population base (address changes, new passports, marriages, etc.) can only be corrected through a nationwide program that enlists the participation of individual citizens.

The national postal service, through MPP facilitation, has been brought into the program and will serve as the main conduit between individuals and the actual database verification, which will be performed by the IC. In March 1996, the SPC and the postal service entered into a contractual agreement outlining the tasks to be performed by the postal service. On April 8, 1996, the Investment Fund Data Clean-up program was launched with print media advertisements, and a full-scale radio and television public relations campaign began on April 25. As of May 7, 1996, the regional IC offices have reported a high initial volume of responses. It is anticipated that by the end of August 1996, the database cleanup program will be well underway, and the inaccuracies in data lists will be less than 10 percent.

Benchmark 9: *There will be a mechanism in place for allowing all citizens who tendered PICs to investment funds to be able to ascertain what funds they own shares in. (completed)*

One of the main elements of the Investment Fund Data Cleanup program, initiated on April 8, 1996, is that every individual who participates will receive a printout by mail, listing the person's investment fund shareholdings as they are recorded in the database. If the shareholding information is incorrect, the individual will be able to initiate correction procedures at the nearest post office. This program will be ongoing for 12 months.

The MPP has assisted in improving the communication between the various investment funds and the IC by first creating a commission to analyze the issues pertaining to the shareholder registries, and by providing the IC the capability to issue to the largest funds a secured copy of their shareholder registry list on CD-ROM.

Benchmark 10: *The investment fund association will be at least 75 percent self-sustaining, and will be capable of serving as a repository of information for the funds on corporate governance and portfolio management, as well as functioning as a self-regulating organization (SRO) and lobbying agent for the funds' interests.* (completed)

Under the guidance of the MPP, the investment fund association, NAMI, has become more than 75 percent self sustaining. NAMI has achieved this through improving membership fee collection, soliciting subscription sales to their bulletin and other publications, and receiving funding for three grant proposals. NAMI anticipates increased revenues in the future as investment fund financial conditions improve, and information produced by its analytical center is sold for a fee. NAMI currently has a membership of over 100 and has a central office in Almaty as well as in nine regional offices.

NAMI is taking steps toward undertaking self-regulatory activities. The first step was adopting an ethical code for its membership. NAMI representatives are currently researching the methodology necessary to analyze investment fund financial reports for concurrence with current regulations.

The MPP team handed over responsibility for ongoing NAMI technical assistance to Arthur Andersen's Securities Market Institutional Development project on February 8, 1996.

Benchmark 11: *There will be a trained cadre of at least 20-25 individuals who will be serving on at least one Board of Directors apiece.* (completed)

To date, 28 people have been trained in corporate governance to serve on the board of directors of investment fund portfolio companies. About half of the participants of the seminars have already been offered positions and are sitting on boards of directors.

Additional comments: debt restructuring. The MPP team started a debt restructuring project in August 1995. The first stage of this project was to develop a manual on debt restructuring, which was completed in October 1995 (226 pages in Russian and 175 pages in English). The manual has been in high demand; over 35 copies have been distributed. The manual covers the forms and legal issues of out-of-court debt restructuring. A revised, user-friendly debt restructuring manual was recently prepared and published in April 1996. This manual incorporates much of the knowledge and skills the team acquired over the last several months in the provision of actual debt restructuring assistance to a select number of recently privatized companies. The manual is currently being distributed by NAMI.

SECTION III

COMPONENT ACTIVITIES AND RESULTS

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A. Coupon Auctions

A1. Objective

The objective of this component was to complete the coupon auction process for all enterprises involved in the mass privatization program. This would be accomplished by offering the maximum number of companies involved in mass privatization and minimizing the number of collected coupons left unspent by Privatization Investment Funds (PIFs).

A2. Background

On March 5, 1993, the Republic of Kazakstan adopted its second privatization program, which outlined three privatization mechanisms for the years 1993-1995. These were: small-scale privatization for the sale of physical assets and enterprises employing fewer than 200 people, case-by-case privatization for extremely large (more than 5,000 employees) or strategic enterprises, and mass privatization for enterprises with 200-5000 employees.

Mass privatization called for the mandatory corporatization of enterprises and the subsequent sale of 51 percent of their shares through specialized auctions. A key feature of the program was the compulsory use of intermediary PIFs. The PIFs collected privatization investment coupons that had been distributed to the population and used them as currency to purchase shares at coupon auctions.

Coupon books had been issued to an estimated 17 million inhabitants in Kazakstan. City dwellers, who had also received housing coupons, were issued 100 coupons per person, while rural dwellers received 120 coupons per person. Approximately 65 percent of distributed coupons were invested in PIFs by the September 30, 1995 government deadline.

The MPP's work on coupon auctions concentrated on two crucial elements in the pipeline management process: compilation of lists of companies to be offered, and pre-auction preparation of company documentation. Involvement in list preparation allowed maximum influence on the volume and quality of companies offered. Taking over pre-auction preparation allowed the MPP to: a) minimize the number of companies pulled from auctions after publication of auction announcements, b) ensure that company information was correct and provided to the PIFs in a timely manner, and c) ensure that all sales were properly documented.

A3. Key Activities

By August 11, 1995 (when this task order began), 16 coupon auctions had taken place, resulting in the offering of 1,015 enterprises. Four more auctions were held between August and November (numbers 17-20), resulting in the offering of 445 new companies for the first time (including shares of enterprises that had not been sold in previous auctions). During this period, the MPP twice proposed large lists of companies that qualified for mass privatization (the "fourth" and "fifth wave" lists). Both times, SPMC department heads, and ultimately Chairman Kalmurzaev himself, excluded the majority of companies suggested by the MPP, due to

“political” and “strategic” reasons. This exclusion distorted the government’s mass privatization program.

The MPP team was regularly consulted by World Bank missions, particularly in reference to mass privatization initiatives. In early December 1995, the MPP team worked closely with a World Bank mission reviewing the government’s performance on conditionalities to the release of the second tranche of the structural adjustment loan (SAL). The mission (consisting of Bernhard Funk, Klaus Lorch, and Enna Karlova) examined progress on coupon auctions, cash auctions, company list analysis, and holding company dissolution. Before departure, the mission (with MPP and USAID concurrence) informed the government that three privatization-related conditionalities would have to be met before the second tranche of funds would be released. The conditionalities required offering for sale 51 percent or more of the shares of: a) the 121 JSCs scheduled for the 21st coupon auction, b) 416 JSCs previously suggested by MPP for coupon auctions, and c) the JSCs within seven agricultural holding companies.

For categories 2 and 3, the World Bank agreed with the government that JSCs with registered share emissions would be offered at cash auctions, and those whose shares were not registered would be offered at coupon auctions.

To achieve these conditionalities, the SPC and SPMC simultaneously ordered the chairmen of their territorial committees to travel to Almaty for oblast-by-oblast meetings chaired by Mr. Duberman (deputy to Chairman Utepov of the SPC) and Ms. Nikitinskaya (deputy to Chairman Kalmurzaev of the SPMC). During these meetings, lists of companies were reviewed and agreement was reached on the form of sale for each company and on the deadlines for transferring documents and conducting auctions by the terkoms. MPP consultants attended all 21 meetings and recorded the agreements reached in official protocols. The territorial committee chairmen signed the protocols and, in almost all cases, the terms were honored.

As a result of this cooperation with the World Bank mission, the final coupon auction (number 21) was record-breaking. Virtually all offered shares of 413 JSCs, 254 offered for the first time, were sold during this two-day auction (held January 30 and completed on February 1, 1996). A total of 149 investment funds participated, making it an unprecedented auction in all respects. The auction brought the total number of companies offered in coupon privatization to 1,712, thus surpassing the programmed 1,500. The auction was conducted in two parts: first, on January 30 the regular, “highest-bid-wins” auction method was used, and, second, on February 1 the remaining shares were sold using a method of proportional distribution of the shares among the funds that placed bids. This allowed for the complete sale of all shares offered except for those of one JSC, for which no bids were received.

Also significant was that 5-10 percent share blocks of 59 of the 129 case-by-case companies were offered. PIFs had been voicing concerns since the beginning of coupon privatization that the country’s most attractive enterprises were being kept out of mass privatization. The MPP’s efforts to bring case-by-case companies into coupon privatization were first met with skepticism by government officials and PIFs alike, but by the summer of 1995, the government saw the necessity of improving the image of mass privatization by injecting companies with unquestioned value. Thus, by the end of coupon privatization, shares of almost half of the case-by-case enterprises had been offered for coupons.

The final auction was also significant in that it eliminated the “coupon overhang.” Before the final coupon auction, the total number of coupons collected by investment funds, but not used in auctions, was 195.7 million, representing 17.4 percent of all coupons collected (investment

funds had collected a total of 1.126 billion coupons). It was feared that if this number was not reduced significantly, mass privatization would be criticized because millions of coupons would go unused. Before the auction, Deputy Chairman Duberman made clear that this would be the final coupon auction, and any coupons not used by the funds would be worthless. Judging by the result, it is clear that this message was taken seriously by the PIFs. In the final auction, the number of unused coupons was reduced to 1.2 million, representing 0.1 percent of all coupons collected. As a result, 99.9 percent of the coupons handed in by the citizens to the PIFs were utilized in the auction process, making it an unqualified success.

On February 8, one week after the final coupon auction, the MPP organized a press conference with the participation of Chairman Utegov, Deputy Chairman Duberman of the SPC, and Gabit Tolkimbaev, executive director of the National Association of Professional Participants in the Securities Market (NAMI). The three spoke about the final results of the coupon auctions and the prospects for investment funds and their shareholders. The press conference was attended by more than 200 journalists, investment funds, government officials, foreign consultants, and other interested parties. NAMI also provided an update of its activities and services to investment funds, and outlined the role of its regional offices as future points of liaison for PIFs in the regions.

A4. Current Status and Results

The MPP's work on coupon auctions did not end with the final coupon auction. MPP consultants have been policing coupon auction results since the 16th auction, and have determined that there was a small margin of discrepancy between the official auction results and what the MPP team had calculated the results to be. The SPC was highly cooperative with the MPP's efforts to verify the auction results database and provided the MPP with all pertinent documentation.

Reviewing the official transcripts of the 21 auctions was a laborious but ultimately worthwhile effort. Most of the errors identified were determined to be mechanical in nature (data entry mistakes, etc.) and were corrected with no difficulty. There were, however, 25 cases out of the 1,712 company offerings which required more work.

The reason for the discrepancies in the 25 cases was that the companies were offered at more than one auction, and the basic information on the companies was changed between auctions. The SPC auction software allowed changes to be made to company data between auctions, including modifications of charter capital, total number of shares, and nominal share value. Legally, such information cannot be changed without approval from a majority of the company's shareholders. This legislation is designed to protect the percent ownership/control of each shareholder from being altered without the shareholder's consent. In accordance with the MPP review, there is no indication that general shareholder meetings were held in the 25 cases identified. Therefore, the MPP determined that the percent share ownership that PIFs purchased at the time of the auction had to be preserved in the respective company's registries. The MPP provided the SPC with this recommendation and is monitoring this situation until it is resolved. With the resolution of these last few cases, coupon privatization will be completed in Kazakstan, with each coupon and all offered shares fully accounted for.

B. Cash Auctions

B1. Objective

The objective of this activity was to put in place the necessary legal and regulatory framework for open and transparent cash auctions of remaining state shares in former state enterprises, and to begin the nationwide organization and implementation of cash auctions.

B2. Background

In Kazakstan's mass privatization program, the shares of corporatized enterprises were to be dealt with as follows: 10 percent were given to the enterprise's employees in the form of non-voting preferred stock; 51 percent were offered at coupon auctions; and the remaining 39 percent were to be offered at subsequent cash auctions. Before shares can be offered at cash auctions, they must be 1) registered by the NSC and 2) transferred from the SPMC to the SPC.

By August 11, 1995, the MPP had designed the auction procedures and starting price methodology, and had gained SPC and Ministry of Finance approval for their implementation. The next steps were to register both regulations with the Ministry of Justice and define the first group of companies to be offered.

B3. Key Activities

In mid-August, the Ministry of Justice approved the SPC's "Interim Regulation on the Procedure for the Sale of State Share Packets at Open Auctions." The regulation was drafted by the MPP in close cooperation with the SPC and the SPMC, and with input from various other governmental agencies and USAID. The main features of the regulation were:

- The absence of inter-agency auction commissions that significantly slowed down and unnecessarily complicated the auction preparation process
- The option for the SPC to hire self-financing auction organizers to prepare and run auctions for a commission fee to allow for numerous simultaneous auctions and to shift preparation costs to the organizers
- A registration scheme that minimizes opportunities for auction-rigging by allowing participants to register on the day of the auction, thereby guarding their anonymity
- The use of Dutch auctions (in which the price for a lot decreases incrementally from the starting price) with discounted minimum prices to sell state shares that do not sell at the first, English-type, auction
- Strictly defined rights and obligations of the purchaser and the seller (the SPC) that allow for efficient monitoring of post-auction obligations (i.e., payment) and provides for significant sanctions in case a purchaser fails to pay on time

The document was passed as an "interim" regulation, pending the passage of the new Law on Privatization (at which point the regulation would be modified to concur, if only in terminology, with the new law). Nine forms were passed together with the regulation, including registration forms, auction protocols, and sales contracts. These working documents were

designed to simplify adherence to the rules set forth in the regulation and ensured that the deals being closed by the SPC met all legal standards applicable to transactions in Kazakhstan's Civil Code and other relevant legislation.

Also in August, the SPC approved the "Instruction on Determining Minimum Prices for State Share Packets." The document was designed by the MPP cash auctions team, in close, almost daily, cooperation with the SPC, SPMC, and the Ministry of Finance. The instruction is applicable to all state shares regardless of the method of sale or the type of privatization to which the object is subject. The instruction proscribes a simple, asset-based formula that allows for the calculation of the starting price for large quantities of state shares in literally minutes (i.e., social assets, accounts payable, and half of the accounts receivable are subtracted from the JSC's total assets—the result is divided by the total number of shares in order to arrive at the starting price of one share). The passage of this methodology lifted a significant burden from the SPC, which wanted to avoid the necessity of hiring consulting firms to conduct asset valuations to determine starting prices for the shares of each of the thousands of JSCs to be offered in cash privatization.

One of the most notable innovations brought to securities privatization by the MPP's auction methodology was the option for the government to hire self-financing auction organizers to prepare and conduct auctions of state shares. The MPP developed rules for issuing "Licenses for Conducting Work in Destatization and Privatization" that were approved by the SPC in late August. Between August 17, when the first license was issued, and the end of 1995, over 45 licenses were issued to private firms—one of which was from the Czech Republic—wishing to organize cash auctions. During the first two months of licensing, the MPP reviewed all applications and prepared written recommendations to the SPC. By mid-October, the SPC fully assumed the application review function and began independently licensing and regulating auction organizers.

The MPP also drew up a draft regulation that laid out the rules for conducting contract tenders among organizers competing to gain the right to organize an auction of a specific list of companies. The tender is awarded based on an auction procedure, whereby the organizer who offers to prepare and run the auction for the smallest commission fee is awarded the contract by the SPC.

Soon after completing the design of the auction process, the first group of companies to be offered in cash auction was defined. In cooperation with the SPMC, the team generated a list of 90 mass privatization companies that had been offered in coupon auctions and had registered share emissions. The MPP then drafted the resolution, signed by Chairman Kalmurzaev of the SPMC on September 4, 1995, which transferred the remaining state shares of these companies to the SPC for sale at the first mass privatization cash auctions.

Two auction contract tenders were conducted in October to determine the auction organizers for three auction lists. The first tender was held in Almaty at the SPC on October 17. Nine licensed auction organizers participated, and two auction contracts were awarded for commission fees of 1 percent and 0.3 percent of the revenue from the auctions. The second tender was held at the Jambyl Privatization Territorial Committee on October 27. Three licensed auction organizers participated, and the auction contract was awarded to a local Jambyl brokerage firm for a commission fee of 0.3 percent.

During this period, MPP held three seminars and traveled to the regions to ensure that the SPC staff and private auction organizers preparing the first auctions were well-trained in all procedures. Activities and accomplishments included:

- A total of 32 staff members from all 21 newly formed privatization territorial committees attended a MPP seminar on August 22, 1995. Representatives from 82 private organizations from Almaty, six other oblasts, Turkey, and the Czech Republic attended a second seminar on August 24 for potential auction organizers. At both seminars, participants were given copies of the cash auction regulations, the starting price instructions, all form documents approved by Chairman Utepov's order, and other materials clarifying the cash auctions process. MPP staff gave presentations on legal and practical aspects of running cash auctions.
- During both seminars, the participants were trained in the use of MPP-designed software that allows for the calculation of starting prices by simply entering several key figures from a company's balance sheet and charter documents into the program. The software then automatically generates all procedural documentation needed to run the auction (official auction lists, auction results protocols) as well as the forms that the *terkom* or organizer must use to report the auction results to the SPC in Almaty. Seminar participants also received a 235 page hard-cover volume prepared and published by the MPP, containing all recently passed legal documents pertaining to cash auctions as well as instructional materials created by the MPP to explain the auction process.
- The MPP held a special training seminar for auctioneers on October 18 and 19. This was an important program, as professional quality of privatization auctioneers had been low (the legality of auction proceedings requires highly skilled auctioneers; one wrong word from the auctioneer can, for example, violate the anonymity of the participants and thus seriously damage the transparency of the auction). A total of 45 participants attended the auctioneers' seminar and were given both theoretical and hands-on training, covering the legal, organizational, and psychological aspects of conducting an auction. The participants were given detailed introductions to the new cash auction regulations and starting price instructions, as well as training in mock auctions by an experienced and respected auctioneer from Karaganda.
- A working seminar on cash auction procedures was held in Almaty December 6-8, 1995. Two implementation specialists from each SPC and SPMC territorial committee were brought to Almaty for three days of intensive practical hands-on training by the MPP in preparation for the upcoming large wave of nationwide cash auctions. The opening presentation was given by Deputy Prime Minister Viktor V. Sobolev, who had been charged by the Prime Minister with speeding up the sale of state shares at cash auctions. Other speakers included Deputy Chairman Duberman of the Privatization Committee, Commissioner Abai Bisembaev of the NSC, and MPP consultants. A total of 75 SPC and SPMC regional staffers attended the seminar—the main subjects of which were share emission registration, transferring shares for sale from SPMC *terkoms* to SPC *terkoms*, calculation of starting prices, and general auction organization issues.

The first mass privatization cash auctions were conducted in December 1995 by SPC *terkoms* and self-financing auction organizers in several oblasts. Most of the auctions were attended by MPP observers; in general, the auctions were well-organized and conducted with only minor departures from the rules laid out in the cash auction regulation. The experience

gained from these auctions was incorporated in the new, permanent cash auction regulation, which the MPP drafted during December and January in anticipation of the new law on privatization (the MPP's participation in the drafting of the law is described in a later section of this report). In February 1996, the SPC passed the new auction regulations and the Ministry of Justice registered them. The regulation was brought in line with the new privatization law and was signed by Chairman Utepov of the Privatization Committee on February 7, 1996. On February 19, 1996, the Ministry of Justice finished its review of the regulation, found it to be in concurrence with existing legislation, and registered it as having force of law.

To further support cash auction processes and to be in a better position to monitor implementation, the MPP hired nine regional consultants in oblasts determined to be of high priority for the sale of state shares. These oblasts were: Pavlodar, Akmola, Karaganda, Shymkent (South Oblast), Kustanai, Uralsk (West Oblast), Ust-Kamenogorsk (East Oblast), and Almaty city and oblast. In most cases, these regional consultants are responsible for work in two oblasts, one a priority oblast with a large number of JSCs to be sold, and one with fewer JSCs. The main tasks of the regional staff are to provide: a) emission registration consulting to JSCs, b) auction preparation and implementation consulting to the privatization territorial committees, and c) general database information gathering, including reporting on auction results.

The regional consultants were thoroughly trained during a ten-day seminar on a variety of issues, including auction methodology, registration of share emissions, and use of the MPP's JSC database. Successful training completion was based on an oral exam, which ensured that the regional consultants were well-prepared to provide quality consultations on the processes affecting cash auctions in the regions. Currently, an in-house E-mail network has been established that allows direct contact between the MPP regional consultants and the MPP office in Almaty. The mid- to long-term objective is to establish a well-functioning, nationwide information-exchange network that incorporates all 21 of Kazakhstan's oblasts.

By May 7, 1996, cash auctions of state shares were taking place regularly in Kazakhstan, resulting in the offering of the shares of 975 companies, over 300 of which had absolutely no state shares remaining after the cash auction. A total of 3,040 companies are currently in the pipeline for cash privatization, the majority of which will go through cash auctions, with the remainder sold through the stock exchange or tenders.

B4. Current Status and Results

A sales mechanism is worthless without merchandise to sell. The MPP database programmers worked for months with SPMC company inventory specialists to generate a list of all JSCs created from state enterprises.

On April 17, 1996, the SPMC and SPC issued a joint resolution transferring approximately 3,800 JSCs from the SPMC to the SPC. This resolution is highly significant as it provides the SPC the authority to sell all remaining state shares of the companies listed in the resolution's appendix (the list was created based on MPP database information). It is important to note that the actual number of JSCs transferred by this resolution is smaller than 3,800, as the list contained many double entries and liquidated JSCs. As of early May 1996, MPP database programmers were working with the SPC to clean up the list. It is this list, currently comprising 3,040 companies, that will provide the pipeline for cash auctions during the next phase of the mass privatization program.

The next step will be the issuing of a resolution by the SPC delegating the right to offer the JSCs' state shares at auctions to SPC terkoms. It will then be incumbent on the MPP to ensure that the resolution will be implemented quickly, efficiently, and within the framework of the law.

C. Holding Company Demonopolization

C1. Objectives

The main objective of the demonopolization initiative undertaken by the MPP was to break up as many state holding companies as possible, and send their subsidiary enterprises through the mass privatization program and/or another applicable privatization program, including the sale of the remaining state shares at cash auctions.

C2. Background

From 1992 to 1993, the Government of Kazakstan created more than 70 holding companies to preserve the vertical control of sectoral ministries over the vast majority of industrial enterprises in Kazakstan. More than 2,500 enterprises were transferred to holding companies by Presidential as well as Cabinet of Ministers decrees. Following the issuing of these decrees, the State Property Committee (now the State Property Management Committee) issued its resolutions and effectively transferred state assets (state shares, state enterprises, etc.) to holding companies that were incorporated as JSCs, with the state retaining majority control as a shareholder. In some cases, the state assets transferred to holding companies had been included in the holding companies' charter capital. These structures were officially expected to contribute to improving the competitiveness of their subsidiaries as well as to speed up their privatization. In practice, however, holding companies turned out to be vehicles for exercising selective subsidization and administrative control by the former sectoral ministries.

Under pressure from international donors and on the initiative of the Anti-monopoly Committee (AMC), an Inter-ministerial Holding Companies Commission (IHCC), chaired by First Deputy Prime Minister Isingarín, was formed in 1995 to evaluate holding companies and to implement their restructuring and demonopolization. In February 1996, the IHCC was renamed the Working Commission for Analysis and Evaluation of Efficiency of the Activity of Legal Entities. Initially, this group was responsible for drafting demonopolization decrees. In December 1995, due to changes that occurred within the structure of the IHCC, the SPMC became responsible for drafting the decrees.

C3. Key Activities

Since the creation of the IHCC, and during the course of this task order, the MPP and the AMC have carried out economic and structural analyses and drafted decrees on dozens of holding companies. The group also assisted in drafting a number of the Cabinet of Ministers decrees for segmentation of the state holding companies. On numerous occasions, the MPP conducted discussions with specialists of the Economic Policy Division of the Cabinet of Ministers, and with other ministries and agencies, on problems associated with the reorganization of holding companies.

In August 1995, the MPP reached an agreement with SPMC Deputy Chairman Shukputov about close cooperation on drafting decrees on reorganization and demonopolization of holding structures. The MPP also prioritized the list of holding companies for review and

demonopolization to ensure privatization of enterprises with the highest number of employees. In January 1996, when the SPMC became responsible for drafting decrees, the MPP was tasked with the preparation of decrees for those holding companies which had not yet been dissolved.

The MPP team also addressed the issue of holding companies' liabilities, a problem that was frequently discussed during IHCC meetings. In December 1995, the MPP team submitted, through representatives of the U.S. Treasury Department, a debt analysis spreadsheet to the Ministry of Finance. It was expected that the Ministry would use this spreadsheet to begin efforts at solving large debts burdens shared between holding companies and the government.

Prompted by Deputy Prime Minister Isingarín, on January 5, 1996, the government announced that it would completely liquidate its ownership in holding structures. Furthermore, all the decrees on holding companies which had been passed previously were to be reviewed to ensure this goal was met. Needless to say, this was a revolutionary decision. The government's intention was to improve those decrees which were unclear and to refocus those which did not provide for clear-cut privatization. The MPP team has compiled a list of holding companies, whose decrees should be reconsidered and amended to clarify legal and procedural questions regarding the sale of their subsidiaries' state shares.

Since the inception of the demonopolization process, regional monopolies were segmented before being privatized. During the MPP task order, the team worked closely with another contractor, Carana, on the segmentation of regional JSCs. The MPP was involved in drafting the Cabinet of Ministers' decrees on "Munai Onimderi" (oil and gasoline distribution) and "Farmatsia" (pharmaceuticals). In December 1995, the MPP and Carana worked on "Almaty Nan," a large bread holding company. The MPP drafted a joint, open letter with Carana, urging that Almaty Nan be segmented to improve competition for bread products in Almaty. Partly as a result of assistance provided by both teams, significant pressure was placed upon the local bread monopoly to break up into several competing units. As a result, the monopoly ceded to this pressure and will soon call a shareholders' meeting to begin the segmentation process.

Prodded by USAID and World Bank pressure, the government, through the SPMC, adopted decrees on the holding companies "Astyk" (controlling approximately 400 grain and bread processing companies) and "Ken Dala" (controlling over 400 companies providing or supporting agricultural transport services). These decrees transferred the state shares of these companies to the SPC for cash auctions.

C4. Current Status and Results

The MPP is currently assisting the IHCC in drafting decrees on approximately 10 holding companies yet to be reviewed by the commission. In addition, the MPP is lobbying the AMC to seek the revision of the Cabinet of Ministers holding company decrees that do not call for sufficient privatization. The AMC may well prove to be the most valuable and interested ally in the MPP's efforts to convince the commission to reconsider holding company resolutions.

Recently, the MPP stepped up its monitoring of the transfer of the state shares of companies in response to the increased pace of holding company segmentation and privatization of their subsidiaries. The MPP staff are gathering information from the holding companies and SPMC terkoms, which will then be entered into the MPP holding company database. It is this database that allows the MPP to provide the IHCC and other relevant parties with reliable key data on economic performance and impact of the mass privatization process.

D. Support of Privatization Investment Funds

D1. Objective

The objective of this activity was to continue the professional development and support to programming of NAMI.

D2. Background

In early 1995, a number of PIFs recognized the need to create a professional trade association to support their activities. The objective of this organization is to represent the interests of investment funds, promote high professional standards, and engender trust among the population towards PIFs. The result was the creation of NAMI, which was officially formed on January 31, 1995, and registered with the Ministry of Justice on April 28, 1995. NAMI currently has a membership of over 100 funds, with a central office in Almaty and nine regional offices.

D3. Key Activities

Since August 1995, the MPP has assisted NAMI in undertaking a number of projects and activities to benefit its membership, including:

Adoption of an ethical code for its membership. The MPP assisted NAMI in the formulation of an ethical code for its membership to serve as a set of standards to govern and guide the professional behavior of investment fund managers; this ethical code supports a high professional image for the investment fund industry and defends the rights and interests of investors. This code has been adopted by the NAMI membership.

Opening of an analytical center. The MPP assisted in the design and start-up of the analytical center, which was opened in October 1995 with the assistance of grants from the American Legal Consortium and the British Know-How Fund. The center is working toward accomplishing the following objectives:

- Establishing a legal support unit to develop and improve the current legal environment governing the investment fund industry, including a regulation to govern the transformation of PIFs, the Law on Investment Companies, investment fund accounting standards, and instructions governing the registration process for investment funds' emissions prospectuses, among others
- Establishing an information center that collects and analyzes databases of information on PIFs, including the results of coupon auctions, financial data, and PIF portfolios
- Developing training manuals and providing seminars on fund accounting in Almaty and the regions

Conducting training for members. Seminars for NAMI members provided participants with the skills and information necessary to more effectively manage their funds and the enterprises in their portfolios. Seminars included instruction by foreign and local experts in business planning, enterprise valuation, portfolio management, debt restructuring, and industry-specific issues. NAMI also organized hands-on training using specialists in financial

analysis and business planning techniques from the International Executive Service Corps (IESC). The training was provided for a selected group of PIFs and their portfolio companies.

Publication of monthly bulletin. NAMI publishes a monthly newsletter in both Russian and English, which provides updates on legislation affecting the investment fund industry and other policy developments, opinions from experts on privatization and security markets issues, and NAMI activities. This newsletter is available to all members at no cost, and to others for a subscription price. A counterpart consortium grant was recently awarded to NAMI to purchase a high-volume copying machine to ensure continued publication of the bulletin.

In addition, the MPP assisted NAMI in improving its organizational structure, including conducting a three-day training seminar for its board of directors, setting up an internal accounting system, and designing and implementing a plan to develop and improve communications with its regional offices.

Furthermore, under the guidance of the MPP, NAMI achieved its goal of becoming 75 percent self-sustainable. NAMI's accomplished this goal by improving its collection of membership fees, soliciting sales of subscriptions to their bulletin as well as other publications, and receiving funding for three grant proposals. NAMI anticipates increasing revenues in the future as the financial conditions of investment funds improve and sales of information produced by its analytical center are made.

Finally, NAMI is taking steps toward undertaking self-regulatory activities. The first step was the adoption of an ethical code for its membership. NAMI representatives are also currently researching the methodology necessary to analyze investment fund financial reports for concurrence with current regulations.

D4. Current Status and Results

The MPP transferred responsibility for NAMI to the Arthur Andersen USAID project in February 1996. NAMI continues its work and has plans to expand its regional operations considerably.

E. Share Emission Registration

E1. Objective

The objective of this component was to: a) provide consultations and hands-on assistance to JSCs, the NSC, and other government agencies to effect the registration of share emissions for the subsequent sale of JSCs' state share blocks, and b) create a significant cadre of trained self-financing share registration professionals who offer their services to JSCs for a fee.

E2. Background

After a former state enterprise has been corporatized (i.e., registered with the Ministry of Justice as a JSC), it must register its emission of shares with the NSC. Shares not registered with the NSC are not legally tradable. Therefore, registering shares is a prerequisite to selling state share blocks. Unfortunately, JSCs in Kazakstan are given no incentives to register their share emissions. On the contrary, JSCs must pay a 0.5 percent tax on the volume of share emissions registered (the amount of the charter capital), which can be a prohibitive requirement for many

cash-strapped former state enterprises. Furthermore, they face legal sanctions in cases of noncompliance. From the beginning of mass privatization, this tax was the greatest obstacle to the efficient sale of state share blocks.

The MPP's activities in share emission registration began in August 1994, when five MPP staff were placed within the Ministry of Finance (the agency at that time responsible for conducting share registrations). The MPP's five staff members supplemented the three Ministry of Finance employees tasked with share registration, and quickly became experts in reviewing emission registration applications from JSCs. The MPP designed and installed a software package that reduced the average time needed to review an application from 3 hours to 30 minutes. Training seminars were subsequently conducted for regional Ministry of Finance and SPMC staff in both the share registration process and in the use of the computer program. The program is still in use by the NSC today.

The MPP has also authored and published a manual entitled "How to Register Shares," that takes the reader through a step-by-step registration application process; the manual was officially approved by the NSC and continues to be the only manual of its kind in use by JSCs throughout the country.

E3. Key Activities

During this task order, MPP's team of registration specialists traveled repeatedly to almost all of Kazakstan's 21 oblasts, holding seminars for JSCs, giving individual consultations, and preparing registration documents for JSCs. From August 1995 to May 1996, MPP's registration team made a total of 69 trips to Kazakstan's regions, provided individual consultations to 1,225 JSCs and hand-delivered the completed registration documents of 457 JSCs to the NSC. During this time frame, the proportion of registered companies that had been offered at mass privatization coupon auctions rose from 22 to 63 percent.

Without a doubt, the most significant policy development in share emission registration brought about by the MPP during the course of the task order was the September 6, 1995 joint letter. The letter allowed former state enterprises slated for cash auctions to register their emissions without having to pay the 0.5 percent registration tax. Drafted by the MPP and signed by Chairman Utepov of the SPC, Chairman Kalmurzaev of the SPMC, and Chairman Esenbaev of the Ministry of Finance's Tax Inspectorate, the letter stated that former state enterprises subject to privatization would be allowed to register their emission without paying the tax. It also stated that the SPC would pay the tax from the revenue earned in selling the remaining state shares for cash. This breakthrough came after several months of the MPP's lobbying of the agencies that signed the letter, especially the Tax Inspectorate, which was initially reluctant to support the effort. Only after repeated meetings was the MPP able to secure the Tax Inspectorate agreement to sign the letter, thereby effectively removing the most significant obstacle to share emission registration.

In light of the World Bank pressure on Kazakstan's government to privatize a large number of companies before release of the second tranche of the SAL¹, the Prime Minister issued a directive ordering the oblast administration chiefs and the NSC to step up share emission registration to allow for quicker sale of state shares. The MPP seized this opportunity to

¹ See cash auctions section above for details of MPP's cooperation with the World Bank on the SAL.

significantly increase the number of share emission registrations and suggested to USAID/CAR that the contractors with an interest in this process unite.

According to an agreement drawn up by the MPP in November 1995, the Carana Small Scale Privatization project and the Arthur Andersen Securities Market project each seconded three staff members to the MPP registration team. For a period of over three months, the staff worked as MPP team members, traveling to the regions, holding seminars, and preparing registration applications for JSCs. This arrangement had an immediate payoff. In December 1995, emission registrations at the NSC were at an all-time high; over 300 JSCs were registered, whereas the average monthly volume prior to December had been at about 100. The increase in share emission registrations at the NSC was certainly due not only to the joint effort initiated by MPP, but, in large part, to the greater flow of applications to the NSC.

The MPP had realized long ago that its own registration team was not capable of single-handedly registering all the JSCs in Kazakhstan. It therefore planned for the training of a large cadre of independent, self-financing registration agents who could make an income by providing emission registration services to JSCs. Over the course of the task order, the MPP held eight seminars in six cities (Almaty, Karaganda, Ust-Kamenogorsk, Shymkent, Pavlodar, and Kokshetau) at which a total of 191 persons were trained and certified as independent registration agents. This number surpassed the task order benchmark target of 50-75.

The examinations which the participants had to pass for certification were comprehensive in their coverage of joint stock company legislation and the NSC's registration regulations. Not all the participants passed the exams.

E4. Current Status and Results

Now that the joint registration effort is over, the MPP is the only USAID contractor working on registering JSCs' share emissions. The MPP registration team continues to provide services to JSCs, and its regional consultants are now providing consultations and registration assistance to JSCs in all of Kazakhstan's oblasts.

F. Investment Fund Shareholder Database Cleanup

F1. Objective

The objective of this activity was to increase the accuracy of the PIF shareholder database (i.e., reduce the margin of error to less than 10 percent) and to provide the population a chance to confirm their privatization coupon investments.

F2. Background

The investment fund shareholder database was created by the Narodny Bank during the distribution of privatization coupon books to the population. Using a computer program designed by V. Morozov, the staff of the Narodny Bank recorded data on over 15 million coupon investors. The quality of this database came into question, however, due to flaws in the computer program and inadequate quality control measures at the Narodny Bank. Examples of this are provided below:

Flaws in the design of the computer program

- Data on coupon investment was purposely kept separate from investor data. This made it impossible to monitor the accuracy of the number of coupons recorded versus the number of investors, and has made the program substantially more complicated.
- The program could not be read by standard database programs, nor could it be converted easily. As a result, long delays occurred in the distribution of shareholder registries to the PIFs.
- The program could not be updated. Originally, it was foreseen that the database could be automatically updated through agreements with the passport agency and other state agencies; however, this proved to be infeasible.
- The computer program was rolled out too early. Initial entries are believed to have a high percent of inaccuracies.

Inadequate quality control measures at the Narodny Bank. According to the SPMC information center, Narodny Bank staff made the following errors:

- Closing accounts when all coupons were used, effectively removing the individual from the database
- Creating new accounts whenever it was difficult to locate original record (i.e., creating multiple accounts for a single investor)
- Registering multiple individuals with a single passport
- Inaccurately recording names (i.e., registering individuals using only one letter of their name) or using one patronymic (middle name) for multiple investors (e.g., 100 people, both male and female, recorded as having the male patronymic "Ivanovich")

In July 1995, the MPP conducted a survey based on a random sample of coupon investors. The conclusions of the survey were:

- The number of incorrect addresses was between 12 and 20 percent
- The number of errors in addresses in the regions was greater than for urban dwellers
- Seventy percent of investors had at least some minor error in their recorded files
- An estimated 25 percent of investors had sufficient errors in their listing making them inaccessible through the system

The MPP team anticipated that the current percentage of inaccuracies was actually higher due to demographic changes that had taken place since the survey was conducted. USAID decided that measures needed to be taken to improve the quality of the shareholder data registries, and this activity was included within the MPP task order.

F3. Key Activities

The MPP team established a committee to determine the most feasible method to correct the database. The team was composed of the SPMC information center, the SPC, representatives from PIFs and their depositories, and the Narodny Bank.

The only real way to correct the database, such that it would meet the legal requirements for registries as established by the decree on economic partnerships, was to involve the participation of the investors through a national campaign. However, the initial opinion of the SPC was that the only important statistic was the number of coupons received per fund. Even the depositories did not feel that investor data was important, despite evidence of the high percentage of investors that could not be reached. It was only after intensive lobbying and additional documentation on the part of the MPP, clearly demonstrating the disadvantages of this approach coupled with the legal implications of disregarding shareholder data, that the SPC agreed that a nationwide campaign was required to verify and correct the shareholder database. It was determined that the program would have investors correcting or confirming their registry account details at one of 260 Narodny Bank branches throughout the country.

Once the approach was agreed upon, the MPP immediately began drafting an "instruction manual" for Narodny Bank staff. The MPP designed an information sheet for coupon investors to fill out, and modified the coupon registration computer program to allow a worker to make and record changes to the database and to print a summary of coupon investments

In early August 1995, a timeline was approved for the project, including a start date of August 25, 1995. This would have allowed the program to be linked to the close of the coupon collection period. Although the Narodny Bank representatives indicated in writing their concurrence and acceptance of the time line, the Bank's vice president did not allow the program to start at the planned time. The MPP consultants worked with the Narodny Bank to reformulate the plans to expand the program past the close of coupon collection. Several newly defined start dates, however, were not met.

Finally, in late November 1995, the Narodny Bank completely backed out of the program. While it had earlier become clear that the Narodny Bank was unreliable, it was still the most ideal partner for implementing the project due to its participation in the initial coupon disbursement program. The explanation given by the Narodny Bank vice president for backing out of the project was linked to financing: the Bank calculated that it would require \$6 million to conduct the task. This explanation is questionable given that the MPP had previously demonstrated that the Narodny Bank could potentially *earn* up to 10 million tenge in fees from persons verifying their information. A more plausible explanation is that the Narodny Bank was concerned about the potential for negative press if the population saw the degree of errors made by the Bank in the disbursement program.

As early as September 1995, the MPP had begun preparing alternatives to a Narodny Bank-based program. Hence, when Narodny Bank withdrew, the MPP was able to quickly present and secure approval from the SPC and SPMC for an alternative program, involving the national postal service and the SPMC information center. Under the alternative program, which was approved in December 1995, data request forms are made available to the population by publishing them in national newspapers, and providing them at post offices throughout the country. Interested investors fill out and mail an information update/request form to the regional offices of the SPMC information center. Investors provide addresses, passport numbers, current

marital status, etc. The SPMC information center staff compare the form with the database, make adjustments where necessary, and print out a confirmation sheet. The sheet details not only the personal data on the individual, but also a list of their investment decisions. This sheet is then returned to the investor at the address provided.

In the majority of cases, the investor will receive a data print-out, and the process is completed. In a small number of cases, however, the investor will locate a serious error in the information provided. These investors are instructed to take the letter and all relevant documentation to their local post office, which will certify the accuracy of the claim and forward the data to the central SPMC information center in Almaty. All claims that affect the number of shareholders per PIF must be cleared by a special committee made up of state, PIF, and PIF depository representatives.

From November 1995 through May 7, 1996, the MPP team completed the following activities:

- Facilitated the signing of a contract between the SPC and the national postal service, stating that the latter will perform key tasks in the program—from distributing forms to returning information sheets to and confirming claims. The post office is committed to this program, both because of the benefits it provides the country and the positive public relations it creates for the postal service.
- Worked with Overseas Strategic Consulting, the USAID public education contractor, in the design and preparation of the data update application forms, and in the development of a public education campaign on the program, including posters, full-scale television advertisements, and radio and print media materials.
- Printed and distributed 2.8 million data update forms to over 4,000 post office branches.
- Designed a software program to process the applications and ensure data security.
- Identified a mechanism to download and transfer the shareholder database to the regional data centers.
- Prepared a program handbook for permanent and temporary information center staff, and developed a training program to instruct staff in its use and application. The training program is scheduled for late May.

F4. Current Status and Results

The shareholder list verification program officially began on April 8, 1996 with the publication of the information verification forms in the national and regional newspapers. Radio and TV advertisements started on April 25, by which time the forms had reached local post offices throughout Kazakstan. Initial responses have been encouraging, with all terkoms reporting the receipt of forms and visits from interested citizens. The terkoms are responsible for gathering and storing the incoming forms. The verification of the database itself will begin as soon as the SPMC information center completes the verification software, the design of which has been inordinately time-consuming. On average, it takes two weeks to make changes to the program as identified during testing.

In addition to overseeing up to 80 data entry and computer processing persons and coordinating activities with the 20 terkoms and 170 investment funds, the MPP team is providing troubleshooting and quality control assistance as this major effort gets underway. Once a date is confirmed, the MPP team will deliver a full-day seminar for all regional directors of the information center on how to implement the program, using the program handbook as the main instructional tool. This handbook details every aspect of the program, from how to sort forms when they are received, to what to do if a virus wipes out a computer disk. The seminar will also reinforce specific managerial issues in program implementation.

Over time, the importance of improving the level of accuracy in the shareholder database has increased. This program is the first contact that most citizens will have with the mass privatization program since they received their coupons in early 1995.

G. Corporate Governance Training

G1. Objective

The objective of this component was to train a cadre of professional board of director members who know Kazakstani JSC laws and regulations and can represent the interests of JSC shareholders.

G2. Background

The corporatization of thousands of state enterprises in Kazakstan, which took place during a time frame of a few years, did not bring with it an automatic understanding of the rules and regulations governing the operation of a JSC. In fact, many JSC managers, staff, and even shareholders have numerous misconceptions about their rights and obligations. This lack of knowledge is especially detrimental when it comes to shareholders attempting to exercise corporate governance.

In a very short period of time, mass privatization created JSC shareholders in over 160 investment funds with no corporate governance experience. The MPP thus set out to provide detailed training to a group of select individuals who would receive certification as a professional board of director members.

G3. Key Activities

From October through December 1995, the MPP held three in-depth training seminars, each lasting between three and four days. The main lectures were given by MPP staff with additional presentations by representatives of various organizations, including the NSC and the International Executive Service Corps. The main presentations in the seminar were on the following subjects:

- Economic partnerships and joint stock companies
- The goal of a general shareholders' meeting
- The JSC board of directors' role and functions
- Special functions of the board of directors during privatization
- Legal and organizational aspects of contractual relationships within a JSC
- Financial analysis
- Modern enterprise management

- Marketing strategies
- Business planning

A final seminar was held in early December 1995. Investment funds were invited to the first two days of the seminar, which were conducted under the theme of "Corporate Governance: the Work of the Board of Directors of Joint Stock Companies." Twenty-five investment funds participated in the seminar. On December 7, the MPP held a press conference on the series of seminars and publicly awarded 28 participants with certificates of completion.

At the ceremony, the candidates were introduced to invited guests—managers of investment funds and mass media representatives. The graduates obtained sufficient knowledge to be hired by investment funds as representatives of their funds on boards of directors of JSCs. The MPP prepared articles and press releases to announce the availability of the board of director candidates as well as to inform a wide audience about the basics of corporate governance.

G4. Current Status and Results

In early May 1996, the final touches were being made on a manual entitled: "Corporate Governance of Joint Stock Companies," which is a compilation of the major presentations made during the course of the corporate governance training program. This manual has already been used in subsequent seminars organized by the MPP and will be published for wide distribution among JSCs and investment funds.

H. Debt Restructuring

H1. Objectives

The objective of this component was to a) create a user-friendly manual that introduces several out-of-court debt restructuring techniques to JSCs, creditors, and other interested parties, and b) to test the techniques most applicable to privatized JSCs in Kazakstan.

H2. Background

Beginning in early 1995, the MPP conducted a survey of 53 privatized enterprises of various sizes and from various branches of industry in six regions of Kazakstan to determine the effects of mass privatization on the functioning of these companies (i.e., their future viability and the problems they face in the post-privatization period). Consultants interviewed enterprise management about management/operations; production/operations, including quality control and safety issues; sales and marketing; personnel; and relationships with shareholders, in particular with PIFs. The MPP was able to identify a number of trends pertaining to the problems faced by these companies and the subsequent decisions that management have or have not made to ensure the future viability of these enterprises.

Debt, specifically how to manage large liabilities, was quickly and not surprisingly identified as the most endemic problem facing Kazakstan's privatized companies. At the same time, the MPP discovered that little was known about debt restructuring techniques that do not require the intervention of a court of law. At the initiative of the MPP, and with USAID concurrence, the MPP team agreed to prepare a user-friendly manual on out of court debt restructuring.

H3. Key Activities

The first stage of this project entailed the creation of a manual detailing debt restructuring techniques used around the world and explaining how they can be implemented in Kazakhstan. The draft, which was over 200 pages in length, was completed in early October and described financial information collection and the procedures for calculating cash flow that are crucial to the analysis that precedes any debt restructuring. The draft also had a section that described the basic legal framework within which out-of-court debt negotiations and restructuring must take place in Kazakhstan.

Based on the groundwork laid in the draft manual, the MPP began testing the techniques that held the most promise for applicability in Kazakhstan. The goal was not to effect an actual debt restructuring from beginning to end (the time frame of the task order did not allow for this), but rather to test the key elements of the debt restructuring process on privatized JSCs. Over the course of six months, the MPP worked with several companies in defining debt restructuring strategies and moving through the first few stages of the negotiation process. Among the companies assisted were:

- Teploenergooborudovanie, a heating equipment producer that was offered in coupon auctions and for which debt restructuring could lower accounts payable by 34 million tenge (over half a million dollars)
- Eleven companies in the Mangistau oblast that could reduce unpaid balances in the oblast by over a billion tenge (\$15 million) using the "chain method" of mutual debt forgiveness
- The Ust-Kamenogorsk Poultry Factory, which could be awarded a \$3.2 million investment from the Central-Asian American Enterprise Fund over three years (in both equity and loans) if it manages to reduce its \$2.5 million accounts payable out of court

The experience gained from the hands-on work done with the enterprises provided the basis for making final revisions in the manual. In late April, a user-friendly final version of the manual (entitled "Out of Court Enterprise Debt Restructuring") was completed and published. The manual, 125 pages long, contains detailed worksheets that walk the reader through the steps of a debt restructuring and has an expanded legal section that provides crucial advice to anyone planning to conduct an actual debt restructuring.

H4. Current Status and Results

The revised debt restructuring manual was published during the first week of May 1996. On May 21, the MPP held a press conference at the Kazakhstan Press Club to announce the publication of the debt restructuring manual. Over 50 journalists attended and several articles and television and radio announcements resulted from the conference. An estimated 100 copies of the manuals were provided by the MPP to NAMI for subsequent sale at publication cost; they were sold out within two weeks. Currently, the MPP and NAMI are discussing the possibility of providing the proofs to NAMI for a second printing run.

ANNEX A

PRIVATIZATION LAW

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PRIVATIZATION LAW**

**DECREE
HAVING AUTHORITY OF LAW
OF THE PRESIDENT OF THE REPUBLIC OF KAZAKHSTAN
CONCERNING PRIVATIZATION**

The 23rd of December, 1995

In accordance with Article 1 of the Law of the Republic of Kazakhstan, dated December 10, 1993 "Concerning the Temporary Delegation of Additional Authorities to the President of the Republic of Kazakhstan and the Heads of Local Administrations", I issue this Decree:

Chapter 1. General Provisions

Article 1. The Definition of Privatization

Privatization means the sale of the state property to the natural persons, private legal entities and foreign legal entities, this sale is conducted by the state as an owner by means of special procedures, established by the present Decree, or by the order established by the present Decree.

Article 2. Participants of Privatization

1. The seller and the buyer shall be the participants of the process of privatization.
2. Seller means the state body authorized to carry out privatization.
3. Buyer means a physical person, private legal entity or foreign legal entity which purchase assets in the course of privatization.

When Buyer consists of several entities participating on behalf of the Buyer, they act jointly.

4. The following may not be the Buyers in privatization:
 - 1) legal entities in whose charter fund the share of the state exceeds 20 per cent;
 - 2) legal entities which in accordance with legislative acts of the Republic of Kazakhstan or foundation documents have no right to engage in those types of activities the performance whereof is a pre-condition for buying the property at the auction.

5. In the course of selling a state block of shares, the Buyer which is a joint stock company may not acquire more than 25 per cent of shares of the joint stock company if the latter owns shares of the Buyer.

6. The Seller shall have the right to hire an intermediary to organize the process of privatization.

Article 3. Legislation of Concerning Privatization

1. Legislation of the Republic of Kazakhstan concerning privatization shall consist of the present Decree, other legal acts, edicts and regulations of the President of the Republic of Kazakhstan, and the regulations of the Government of the Republic of Kazakhstan.

2. The authorized bodies may issue acts which regulate relations connected with privatization in the cases and within the bounds stipulated by this Decree and other legal acts concerning privatization.

3. Peculiarities of privatizing state-owned agricultural enterprises as well as of property of the state-owned housing facilities, are regulated by special legislation.

Article 4. The Basic Principles of Conducting of Privatization

Publicity, competition, legal successorship, the responsibility of official persons for legality of privatization and reliability of information concerning the property on sale, shall be the basic principles for performance of privatization.

Chapter 2. Property Subject to Privatization

Article 5. Property Subject to Privatization

1. The state property, except for those which are in the exclusive state ownership shall be the property subject to privatization.

2. The following types of the state property shall be subject to privatization:

- 1) state-owned enterprises and institutions (hereinafter - enterprises) as assets and property;
- 2) production and non-production sub-divisions or units of enterprises considered as assets and property, privatization of which does not interrupt the technological process of production;
- 3) property of enterprises;
- 4) stock and shares in charter funds of economic partnerships.

3. State property shall become subject to privatization from the day of the adoption of the decision to privatize the property by State Body Authorized to Manage the State Property.

Article 6. An Enterprise as a Subject of Privatization.

1. An enterprise as property complex subject to privatization includes all types of assets intended for its activities including buildings, constructions, equipment tools, raw materials, finished goods, the rights on the plot of land, the right to claim debts as well as the exclusive rights owned by the enterprise as legal entity.

2. Property of the social and consumer designation may be included into the property complex of the enterprise.

3. The Buyer shall become the legal successor of the rights and obligations of the privatized enterprise, unless otherwise stipulated by this Decree and the buying/selling agreement.

Article 7. Case-by-Case Privatization

1. Particularly large and unique enterprises, the list of which is approved by the Government of the Republic of Kazakhstan shall be privatized on the case-by-case basis.

2. The case-by-case privatization plan shall include the following measures:

- 1) comprehensive analysis of activities and competitiveness of the property subject to privatization;
- 2) evaluation of its assets;
- 3) defining of the size of the state-owned block of shares which is subject to sale;
- 4) proposed system of organizational, structural, technological and other transformations of the property subject to privatization;
- 5) choice of the method of privatization;

3. After the approval of the case-by-case privatization plan by the Government of the Republic of Kazakhstan, its implementation shall be carried out by the Seller.

Article 8. Property of an Enterprise as Property Subject to Privatization

1. Property of an enterprise may be a separate property subject to privatization only in the case of the liquidation of a state-owned enterprise.

2. Sale of the property of a liquidated enterprise shall be carried out exclusively at the auction after the expiry of the deadline established by the legislation for submission of claims by creditors to the enterprise subject to liquidation.

Article 9. Sub-Divisions and Structural Units of Enterprises as Property Subject to Privatization

1. The decision to subtract the structural units and subdivisions of an enterprise and to sell them as independent property subject to privatization may be adopted at any time under the procedure and terms set forth by Article 5 of the present Decree, and in connection with the companies subject to privatization on the case-by-case basis, - by the Government of the Republic of Kazakhstan under the procedure established by the Government of the Republic of Kazakhstan.

2. Subdivisions and Structural units of an enterprise by the moment of privatization must be extracted on the basis of the division balance sheet.

Article 10. Stock and Shares in the Charter Fund of Business Partnerships as Property Subject to Privatization

1. Selling of stock and shares of the state in the economic partnerships must be carried out in compliance with the requirements established by legislation concerning economic partnerships.

2. It shall not be allowed to sell shares the issuance of which is not registered in accordance with the legislation.

Article 11. Privatization and the Rights Connected with the Land

Simultaneously with the privatization of real estate the Buyer shall acquire the ownership of the plot of land in accordance with legislation concerning land. The value of the land plot shall be included into the price of the property subject to privatization.

Chapter 3. Types of Privatization

Article 12. Types of Privatization

1. Privatization shall be carried out in the following forms:

1) auction sales (auction, tender);

2) direct sale;

2. Actions which do not directly lead to selling of state assets, but which stipulate its subsequent sale (transformation of state enterprises into joint stock companies, leasing of state assets or transfer of the latter into trust management with the right to subsequent purchase accordingly by the Lessee or the Trustee manager), shall not be handled as types of privatization, but as its preliminary stages.

Article 13. Types of Auctions and Tenders.

1. Sales shall be held in forms of auctions or tenders. The entity which offered the maximum price at an auction shall be recognized as the winner of the auction. The entity which according to the conclusion of the Tender Commission appointed by the Seller, offered the best terms, shall be recognized as the winner of the tender.

At auctions, proposals shall be made publicly; at tenders the proposals shall be made publicly or in writing in sealed envelopes under the decision of the Seller.

2. Sales, as a rule, must be public, the procedure for their conduct is set forth by Article 14 of the present Decree.

In exceptional cases which impact the State Security, protection of the natural environment, foreign economic position of the Republic of Kazakhstan, defined by the decision of the Government of the Republic of Kazakhstan, a tender may be closed. The procedure for its conduct shall be established by the Government of the Republic of Kazakhstan.

Only entities which comply with the requirements of Article 2 of the present Decree can be participants of the auctions or tenders..

3. Auctions and tenders in which only one participant took part shall be recognized as invalid, except for a third and subsequent sales at which the property subject to privatization may be sold to a single participant which expressed the will to purchase it.

4. Prior to participating in a sale, the Buyer has the right to carry out an audit of the ecological status of the property subject to privatization.

5. Sales relating to selling of state-owned blocks of shares, as a rule, shall take place at a Stock Exchange.

Article 14. The Procedure of Public Sales

1. The notification concerning a sale must be made by the Seller not less than fifteen days prior to this sale; in the case of selling stock and shares of the economic partnerships, - not less than thirty days prior to the sale. The announcement must be published in the national official press in the Kazak and Russian languages. The announcement must contain information concerning the time, place and type of the sale, the property on sale and the procedure for conducting the sale, including information concerning the registration of the participation in the sale, the provisions describing the winner of the auction or tender, as well as information concerning the starting price and the amount of the security deposit.

2. If the Seller will change the terms of the tender, the notice of all the changes must be made by the Seller in accordance with the procedure and within the deadlines established by the first part of the present Article.

Entities which have submitted their applications to participate in a tender prior to the publication of the notice of making changes in its terms and which refuse to participate in it because of the changes, shall have the right to claim the refund of the security deposit and reimbursement of their expenses.

3. The Seller shall have the right to cancel a sale, not less than three days prior to the date of the sale, with the reimbursement of actual damage to the entities which submitted their applications to participate in the sale, except for the cases relating to acts of the force majeure, or for any other reasons beyond the Sellers' control.

4. Participants of a sale shall make the security deposit in the amount, deadlines and procedure indicated in the announcement of holding the sale. If sale does not take place, the security deposits shall be subject to refund. The security deposits shall be also refunded to the entities which participated In a sale but did not win the bid. Entities which in writing refused to participate in a sale, not later than three days prior to their date, will receive back their security deposits.

When concluding a buying/selling agreement with an entity which won the bid, the amount of the security deposit made by the buyer shall be included into the buyers' payments under the buying/selling agreement.

5. The entity which won the bid and the Seller shall sign the protocol on the results of the sale, on the day of the auction or tender.

6. The buying/selling agreement must be signed by the parties not later than 10 days after the completion of the sale.

If the entity which won the sale is evading from signing of the protocol on the results of the sale or the buying/selling agreement shall lose its security deposit and shall be obliged to reimburse to the Seller the losses incurred by the Seller to the extent not covered by the security deposit.

The Seller does not have the right to evade from signing of the protocol on sale results and the buying/selling agreement with the entity which has won the bid, except for the cases where the entity which won a sale does not comply with the provisions of Article 2 of the present Decree.

The terms of the buying/selling agreement must not contradict the terms of the sale.

7. Sale performed in violation of the rules established by legislation may be recognized as invalid by the court under the claim of the interested parties.

Recognition of sales relating to a property subject to privatization as invalid shall include the invalidity of the buying/selling agreement.

8. Special requirements in the course of public sales relating to certain types of property shall be established by the Seller.

9. If a property subject to privatization is not sold within six months after its transfer for sale in accordance with the established procedure, the Seller shall return the property subject to privatization to the body authorized to manage of the state property for adoption of further decisions.

Article 15. Direct Sale

1. Property leased in accordance with the procedure established by Article 16 of the present Decree with the right to subsequent buy-out or transferred for trusted management appropriately to lessee or trustee manager, can be subject to direct sale.

Selling of privatization property to lessees or trusted managers shall only be allowed on the terms of proper observation by them of the relevant agreements.

2. The terms of the buy-out of a property subject to privatization shall be defined in the agreement of the parties, unless they are stipulated on the lease agreement or the agreement on transfer for trusted management.

3. Selling of privatization property to certain investors on the case-by-case bases shall be allowed on stipulated terms, provided the property was not sold in the course of the auctions or tenders.

Article 16. Preliminary Privatization Stages

1. An enterprise which is subject to privatization may be first transformed into a joint stock company under the procedure established by legislation; transferred into trusted management or lease with the right of subsequent buy-out.

2. A trusted manager or lessee shall be elected on the basis of a tender in accordance with Article 13 and 14 of this Decree.

3. Transfer of an enterprise into trusted management or lease shall be documented by appropriate agreement between the Body Authorized by the Government of the Republic of Kazakhstan and the trusted manager or lessee. The agreement must envisage on what terms the enterprise can be transferred into the ownership of the trusted manager of lessee.

4. The provisions of the civil legislation which regulate the relations of trusted management and leasing shall apply to the relevant provisions of the present Decree, except for the cases stipulated by the present Decree.

5. A state-owned block of shares may be transferred into trusted management, on the basis of a tender in accordance with Article 13 and 14 of this Decree.

Chapter 4. The Procedure and Terms of Privatization

Article 17. Process of Preparation of the Property to the Privatization

1. Preparation of the property to the privatization is be carried out by the Seller.

2. In the course of preparing the property to the privatization the Seller shall:

1) evaluation of the property subject to privatization in accordance with the legal act prepared by the Seller and approved by the Government of the Republic of Kazakhstan;

2) prepare the information concerning accounts payable and accounts receivable and obligations connected with the property and presents in pursuance of the Buyer's demand information concerning concluded contracts and agreements of the enterprise subject to privatization, in the cases when an enterprise is subject to privatization as assets or the property subject to privatization is the state-owned block of shares;

3) define the terms, forms and types of privatization conduct, and carry out preparation of its implementation;

4) provide for the safety of the property;

5) take other steps which are required for performance of privatization.

Article 18. Taking into Account the Ecological Requirements in the Course of Case-by-Case Privatization

1. The Seller shall be obliged to present to the Buyer the information concerning ecological conditions of the property subject to privatization on the case-by-case basis.

2. The Buyer shall have the right to examine the ecological conditions of the property subject to privatization..

Article 19. The Procedure of the Payments.

1. Payments under the buying/selling agreement of the property subject to privatization shall be made between the Seller and Buyer.

2. Payment for the purchased property must be made within thirty days from the date of signing the buying/selling agreement.

3. The installment payments shall be allowed only in the cases when the participants of the sale in advance have received the information about the terms of the installment payments.

4. Amount of the initial contribution in the course of selling of the property subject to privatization on an installment basis may be not less than fifteen per cent of the selling price, and the period of the installment plan must not exceed three years.

The rules for execution of monetary obligations shall apply when subsequent amounts are paid under the agreement.

Interest shall be assessed on the outstanding amounts at the rate established by the agreement of the parties, when selling on the installment plan.

5. The properties purchased by the Buyer shall serve as a security for timely payments and the Seller will have the right to claim this property as a security, unless the buying/selling agreement stipulates other type of security.

Article 20. Usage of the Funds Received from Privatization.

Funds received from the selling of the property subject to privatization shall be included to the Revenues of the State Budget, except costs of organizing and conducting the sale, as determined by the Government of the Republic of Kazakhstan.

Article 21. Documentation of the Alteration in the Right of Ownership.

Documentation of the alteration of the right to ownership in respect of a privatized property shall be carried out in the procedure established by the legislation in respect of a privatized property shall be carried out in the procedure established by the legislation of the Republic of Kazakhstan.

Article 22. Supervision of the Implementation of the Buying/Selling Agreement.

1. Subsequent supervision of proper execution of the terms of the buying/selling agreement relating to a privatization property shall be carried out by the Seller.

2. Supervision of implementation of the terms of the agreement shall be carried out until the expiry of the deadlines of their execution by the Buyers where the execution of agreements by those entities must be carried out until the expiry of the deadlines of their execution by the Buyers where the execution of agreements by those entities must be carried out by within certain periods of time (deadlines for implementation of investment programs, periods of retention of the profile or volume of production etc.)

In order to exercise the supervision, the Seller shall have the right to examine the documents related to the execution of buying/selling agreements

Article 23. The Responsibility of Owners of the Privatized Enterprises for the Hazard to the Environment.

1. The liability relating to hazard to the environment and health of the population as a result of business activities preceding the privatization shall be carried by the former owner of privatization property - the State.

2. Apportionment of transfer of liabilities relating to the environment, as well as of ecological risks to the new owner shall only be allowed on the latter's consent.

3. The responsibility for hazard to the natural environment by business activities of the new owner shall be regulated by the legislation of the Republic of Kazakhstan.

Article 24. The Procedure for the Settlement of Disputes

Disputes which arise in the course of privatization shall be settled by the court.

Article 25. Recognition of the Buying/Selling Agreement as Invalid

1. The following shall be the bases for the recognition by court of the buying/selling agreement as invalid:

- 1) selling of the property to an entity which has no right to purchase it;
- 2) granting to the Buyer of illegal privileges and advantages;
- 3) severe violation of the procedure for performing the sales;
- 4) any other bases stipulated by the legislation of the Republic of Kazakhstan.

2. In case of a subsequent alienation by the Buyer of a property subject to privatization prior to the recognition of the buying/selling agreement as invalid its claim back from the Buyer shall be possible in accordance with the rules stipulated in articles 260-262 of the Civil Code of the Republic of Kazakhstan (General part).

3. The statute of limitations in relation to disputes relating to invalidity of purchase and sale agreements shall be six months from the date of their signing, provided the action is filed by the party to the agreement. In the case where action is filed by any other interested entity or the attorney general official, the statute of limitations in disputes shall be six months from the date when the plaintiff found out or should have found out the circumstances which are the basis for recognition of the Agreement as invalid, but not later than three years from the date of signing the agreement.

Article 26. Dissolution of the Buying/selling Agreement

1. The buying/selling agreement relating to a privatization property may be dissolved on the basis and in the procedure stipulated in the Civil Code of the Republic of Kazakhstan.

2. Dissolution of the purchase and sale agreement shall entail the return by the parties of the property which was transferred in accordance with obligations prior to the moment of the dissolution of agreement and reimbursement of losses by the accused party.

Chapter 5. Conclusive and Transitory Provisions

Article 27. The Entering into Force of the Present Decree.

1. The present Decree shall enter into force on the first of January, 1996.

2. The present Decree shall apply to legal relations which arose after the entry into effect of the present Decree, that is from the 1st of January, 1996.

3. New terms of statutes of limitations stipulated in this Decree shall apply to the disputes based on the circumstances which arose after the 1st of January, 1996.

4. Property leased prior to the entry into force of this Decree may be purchased by their lessees, provided that they properly execute the lease agreements for non less than two years.

5. The effect of this Decree shall not apply to lease or trusted management relations without the lessee's or trusted manager's right to subsequent purchase of the enterprise, except for the cases stipulated by the paragraph 4 of this article.

6. The following shall be recognized as invalid as of the date of the entry of the present Decree into force:

1) Law of the Republic of Kazakhstan "Concerning Denationalization and Privatization", dated June 22, 1991 (Bulletin of the Supreme Soviet of the Kazak SSR, 1991, N 27, i. 349; Bulletin of the Supreme Soviet of the Republic of Kazakhstan, 1992, N 6, i. 113; 1993, N 9, i. 218; 1995, N 1-2, i. 20);

2) Decree of the Supreme Soviet of the Kazak SSR "Concerning the Implementation of the Law of the Kazak SSR "Concerning Denationalization and Privatization", dated June 22, 1991, N 27, i.250.

Article 28. Measures of the Implementation of the Present Decree.

The Government of the Republic of Kazakhstan shall:

1. Approve before the 1st of March, 1996:

the list of the enterprises to be privatized on the case-by-case basis;

the procedure for holding closed tenders;

the regulatory legal act to evaluate the property subject of privatization.

2. Bring the decisions of the Government of the Republic of Kazakhstan into conformity with the present Decree.

3. Provide for revision and abolition of the legal acts of the ministries, departments and the state committees which contradict the present Decree.

President of the Republic of Kazakhstan
N. Nazarbaev

ANNEX B

PRIVATIZATION PROGRAM

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PRIVATIZATION PROGRAM

Resolution of the Government of the Republic of Kazakstan
February 27, 1996
#246

On the Program of Privatization and Restructuring of the State Property
in the Republic of Kazakstan for 1996-1998

For the implementation of the Decree of the President of the Republic of Kazakstan "On Privatization" as of December 23, 1995 #2721 which has power of law and in accordance with the Program of Government's Actions for Deepening Reforms in the Republic of Kazakstan for 1996 - 1998, the Government of Kazakstan RESOLVES:

1. To approve the Program of Privatization and Restructuring of the State Property in the Republic of Kazakstan for 1996 - 1998 being attached.

2. For the State Committee for Management of the State Property of the Republic of Kazakstan in conjunction with interested Ministries, state committees, the Almaty and regional Akims (head of administration) -- to submit to the Government up to March 1, 1996 the following documents to be approved:

- List of objects not subject to privatization which are considered an exclusive property of the state;
- List of large and unique objects subject to case-by-case privatization.

3. For the Almaty and regional Akims in conjunction with territorial bodies of the State Committee for Management of the State Property of the Republic of Kazakstan -- to develop and approve the program and schedule of measures for privatization of municipal property within two-months period and on the agreement with the State Committee for Management of the State Property of the Republic of Kazakstan.

A. Kazhegeldin
Prime-Minister of the Republic of Kazakstan

Approved by the Resolution of the Government of the Republic of Kazakstan of February 27, 1996,
#246

PROGRAM
of Privatization and Restructuring of the State Property
in the Republic of Kazakstan for 1996-1998

Introduction

This Program was drafted within the framework of the implementation of the Program of the Government's Actions for Deepening Reforms in the Republic of Kazakstan for 1996-1998 being approved by the Decree of the President of the Republic of Kazakstan as of 13 December 1995 and in accordance with the existing legislation of the Republic of Kazakstan.

In 1991-1995, two programs of destatization and privatization were implemented in the Republic of Kazakstan. The Program of Destatization and Privatization as of June 22, 1991 covered 1991-1992 and its main focus was on sale of retail trade and service facilities, and transfer of state property to employees. The National Program of Destatization and Privatization in the Republic of Kazakstan for 1993-1995 (II Stage) as of March 5, 1993 covered, apart from the small-scale privatization, mass privatization, case-by-case privatization and privatization of agricultural enterprises. For the most part, the objectives outlined in the above programs were implemented.

Under the small-scale privatization, approximately 11 thousands objects were sold, which is about 2/3 of all objects subject to the small-scale privatization. As for objects which form the majority of the small-scale privatization program and are considered to be the most important ones for satisfying the population's needs, specifically objects of retail trade, public catering and services - 84% of them have been privatized.

The mass privatization program has been totally completed. During 22 auctions, shares of more than 1700 enterprises were offered for sale for Privatization Investment Coupons (PICs). Total amount of the charter fund of companies which shares have been sold is amounted to T 1261.5 million.

Under the case-by-case privatization that includes enterprises with more than 5,000 employees, 5 enterprises were sold, 44 were transferred to trusting management. Of them, 12 enterprises - to foreign entities.

Under the privatization of agricultural enterprises, more than 1967 enterprises were sold by the end of 1995. That is 93% of all agricultural enterprises.

As of early 1996, about 60% of charter funds of privatized enterprises were transferred to private owners (excluding the small-scale privatization). 1/3 of shares were sold PICs, 1/3 - for cash, and 1/3 were transferred to employees of enterprises being privatized. At 43% of enterprises more than 50% of private voting stock were transferred to private. Of them, at 29% of enterprises - 80% of shares and more.

The main objective of the presented here the Program of Privatization and Restructuring of State Property in the Republic of Kazakstan for 1996-1998 is to achieve and establish the predominance of the private sector in the economy of the Republic of Kazakstan. This will be obtained by the completion of the privatization process, which will be accompanied by restructuring measures oriented toward objects that remain state-owned. Both these interrelated

processes - privatization and restructuring - will promote establishing effective owners both in private and state sectors.

Program implementation will comply with the principles of openness and transparency of privatization and will be based on market competitive approaches to privatization.

The new owners are expected to take over the rights and responsibilities related to the privatized objects. The all property rights will be guaranteed by the law irrespective of their specific forms.

In the process of developing privatization projects and their implementation, social interests of employees will be constantly taken into account. This will require the compliance of the labor law of the Republic of Kazakstan with current changes in the ownership structure, and also, by inclusion of provisions on social protection of employees of privatized object into tender terms. The need to ensure environment protection and rational use of natural resources should also be taken into account.

Implementation of the present Program will facilitate demonopolization and will lead to changes in economy's structure by the faster development of small and medium-sized businesses and service sphere.

The Program provides for a complex of interrelated measures to complete the privatization process, and on state property restructuring and management which should be coordinated with the corresponding Ministries, state committees, other central and local executive bodies of the Republic of Kazakstan.

I. Completing Privatization Process

The results of the previous privatization stages and the economic reforms implemented in the republic makes the privatization process irrevocable. It's continuation requires the following measures:

- completing, through cash auctions the privatization of state-owned packages of shares in partly privatized enterprises not sold during the II stage within the framework of the small-scale privatization;
- implementation of the case-by-case privatization of state-owned corporations;
- including into the privatization process object that were both not the subject to privatization and that were not privatized during the previous stages;
- drafting privatization plans for selected sectors of the economy;
- promoting formation of the strategic investors in privatized enterprises;
- expanding foreign capital participation in the privatization.

Starting 1996, any privatization of the state property will be carried out only for cash.

Privatization of the state property includes sale of:

- state enterprises or institutions as a whole;
- productive and non-productive parts of enterprises as a whole units (spin-offs). These units will be separated from the enterprises, their balance sheets will be excluded from the enterprises' balance sheets, according to the existing legal procedures;

- enterprise assets in the form of liquidation of state enterprises. This has to be done exclusively at auctions after expiration of the legally established deadline for presenting creditors' claims to the enterprise that is liquidated;
- state-owned stock and shares in charter funds of economic partnerships.

The existing legislation of the Republic of Kazakhstan stipulates two types of privatization:

1. Market sale (auction, tender). Auction sale of state property means the transfer of property rights for an object to a person that offers the highest price during the auction, executed and paid for the purchase according to the established procedure. If additional terms of sale are included (preserving the profile of activities, number of jobs, etc.), those objects will be sold through tenders to entities offering the highest price and comply to the tender terms or offered better terms.

2. Direct sale. Direct sale can be conducted if the pre-privatization measures include lease of the property with the buy-out option, or corporatization with transfer on the tender basis of the state-owned package of shares to a trusting management with the buy-out option.

During the case-by-case privatization, sale to a certain investor under agreed terms may be stipulated. The proposed investor shall be selected on the tender basis.

1. Case-by-case Privatization of State Property Complexes

Enterprises are selected for case-by-case privatization by their large size, unique characteristics, natural or temporary monopoly position. The list of such object will be approved by the Government before March 1, 1996.

The enterprises subject to the case-by-case privatization should be divided into the following categories:

1. Profitable enterprises or enterprises having good potential prospects that do not require special pre-privatization restructuring.
2. Enterprises that need pre-privatization restructuring to ensure their stabilization and demonopolization.

In order to include object into the above categories, by June 30, 1996, state authorities (the State Committee for Management of the State Property of the Republic of Kazakhstan together with the State Committee for Privatization of the Republic of Kazakhstan, the State Antimonopoly Committee, Ministries of Economy and Finance and relevant line ministries) shall carry out evaluation of production and financial condition of enterprises subject to the case-by-case privatization and prepare appropriate proposals. The decision on including object to any of the above categories shall be made by the Government of the Republic of Kazakhstan on the basis of the prepared proposals.

The profitable enterprises or enterprises having good potential prospects are subject to prior corporatization (if it was not carried out during the previous stages of privatization) according to the procedures established by the existing legislation.

It is recommended to sell state shares with the following its distribution:

- no less than 15% of shares shall be subject to public sale at the stock exchange in order to determine their market price;
- no less than 50% of all shares (that provide no less than 1/2 + 1 votes at a general shareholders' meeting) are sold as one block to a certain investor. The investor is selected on a tender basis. Such investor must be the strategic (what means that possesses the controlling interest) and active (what means that should be ready take over the responsibilities for restructuring of the privatized enterprise);
- remaining shares shall be sold through open cash auction through the stock exchange or through brokerage houses.

Privatization of such corporations should comply with the following requirements:

- sales price of shares should not be less than established by the owner;
- in case of open sale favorable conditions should be created for engaging the maximum number of investors in the privatization process;
- in case of the direct stock sale to a certain investor, this investor should be selected on the basis of the enterprise's needs that are included into tender terms.

The enterprises that need pre-privatization restructuring to ensure their financial stabilization and demonopolization can be transformed in the following order:

Step 1. Preliminary diagnosis of the object on the basis of data collection on:

- condition and structure of the property and the property rights (the land plot, real estate, etc.);
- production profile (activities and products);
- production technological level and technical quality of equipment;
- financial and economic situation of the enterprise (financial statements);
- organizational structure and management system of the enterprise;
- major suppliers and customers of the enterprise;
- employment structure and it's dynamics;
- social infrastructure facilities of the enterprise.

Step 2. On the basis of the preliminary diagnosis:

- tender is announced for management groups for trusting management of the whole enterprise (or state-owned package of shares); the terms included in management contract include drafting an enterprise restructuring and its subsequent privatization project by the management company;
- in the case there are no real candidates for trusting management or this type management is not deemed expedient, the decision shall be made to provide the full analysis of the enterprise's status, by engaging special consultants on a competitive basis.

The liquidation and the privatization of the enterprise assets will be considered when it will be recognized that the enterprise is not viable as an economic object.

Such decisions are made by the state body authorized to decide on management and disposal of state property. For joint-stock companies where the state is not the only owner of voting shares, such decisions shall be following to the set up procedures.

Step 3. On the basis of the enterprise's diagnosis, a restructuring project shall be prepared that contains expanded analysis of the enterprise's conditions and recommendations on:

- documentary confirmation of the enterprise's property rights, the number of legal entities subject to separation during reorganization, and distribution of property rights;
- extent of production facilities utilization, proposals on production restructuring (diversification);
- competitive position of technologies and equipment used by the enterprise, recommendations on investment promotion and/or disposal of a part of equipment;
- profitability and liquidity level, structure of the enterprise's liabilities, relation between working assets and liabilities of the enterprise, recommendations on financial restructuring;
- extent of conformity of organization structure of enterprise management to an efficient activity in market conditions, segmentation and reorganization of management system;
- marketing analysis and recommendations on drafting a new marketing strategy;
- changing employment structure during the enterprise's restructuring;
- utilization of social infrastructure facilities (taking out of the balance and transferring to other economic object or local administrations, distribution between spin-offs);
- environmental rehabilitation of production.

Step 4. On the basis of presented projects, the authorized body shall make the decision on pre-privatization restructuring of the object and a type of its case-by-case privatization. Pre-privatization restructuring may include partial implementation of the restructuring project. In such a case, full implementation of the restructuring project becomes the basis for drafting terms of privatization to a certain investor.

The state measures of restructuring particularly large objects include their technologically justified segmentation into separate competitive economic object (spin-offs), and their restructuring with drafting case-by-case privatization plans for each of the spin-offs.

Common procedures of drafting case-by-case privatization plans include:

- determining criteria for selection of auditing and consulting firms during tenders;
- tender selection of financial consultants and auditors;
- selection of project implementation methods;
- evaluation of offers made by certain investors on responsibilities they are ready to assume including proposals on social obligations.

Principal methods of case-by-case privatization projects implementation include:

- tender sale of state property;
- sale to a certain investor on agreed terms;
- open sale of shares;
- concluding management contracts with subsequent privatization;
- preliminary restructuring.

Case-by-case privatization projects may stipulate simultaneous use of several implementation methods. It is useful to combine the open sale of stock and other forms of sale of fragmented packages of shares, with sale of the controlling interest to a certain active investor.

2. Sectorial Privatization Programs

With regard to economic sectors that have special importance for Kazakstan, such as oil and gas industry, power, transport and communications, ferrous and non-ferrous metal industries, diagnosis and analysis will be carried out that will serve as a further basis for forming the optimal ownership structure in these sectors as a whole, and its implementation framework, as well. Based on the results of diagnostics and analysis, and proposals of authorized bodies, the Government of the Republic of Kazakstan will approve sectorial programs of privatization and, if necessary, restructuring programs for state-owned firms.

For each of the above sectors, a special program of case-by-case privatization covering all specific enterprises will be developed, including enterprises that will be privatized by case-by-case methods. This program shall take into account proposals of the relevant ministries, state committees, other central and local executive bodies, and privatized firms, with participation of skilled consultants.

The Government intends to engage in sectorial privatization active investors, including institutional ones (international financial institutions, development banks, bilateral and multilateral investment funds and venture funds) that are capable of providing necessary restructuring of object and inflow of significant financial resources.

When drafting and implementing the sector privatization programs, strict compliance with requirements of competitive environment and with anti-monopoly laws are necessary. It may be done by:

- the sale of object of the same sector to different competing investors;
- the concluding by governmental large order contracts strictly on the tender basis or by dividing specific order contracts between several domestic and/or foreign bidders.

Electric Power Complex

Sectorial program for the electric power complex assumes the restructuring of the sector along with organization of fully independent corporations and their possible subsequent privatization.

In 1996, transformation of the power sector organizational structure will be completed. The sector's structure will include:

- the state regulatory bodies: the State Power Inspection and the State Commission for Electric Power Pricing;
- state enterprises that are not subject to privatization including system and non-system electric power lines, substations, dispatcher control, computer centers and other facilities that ensure integrity and operation of the uniform power network. They include the National Electric Power System Kazakstanenergo that consists of the Joint Dispatcher Control Department of Kazakstan, and inter-regional and interstate electric networks' facilities;
- state enterprises and organizations subject to privatization, and structural units subject to separation and privatization including basic power plants.

Privatization of state property in the electric power sector will be carried out on the basis of a program approved by a special decision of the Government of the Republic of Kazakhstan and prepared by the Ministry of Power and Coal Industries of the Republic of Kazakhstan together with the State Committee for Management of State Property of the Republic of Kazakhstan. Privatization of the electric power sector will be carried out on the case-by-case basis.

In each oblast, state enterprises will be separated from the regional electric power supply systems on the basis of electric power supply networks, and in future, such enterprises will be privatized.

Individual power, and power and heat plants, and central heating enterprises can be privatized after their separation on the basis of the separation of financial statements (balance sheets and income statements).

Depending upon technological and economic expediency, heating supply systems may be transferred by authorized bodies to the power and heat plants.

Production associations (enterprises) that carry out repair and maintenance for the power facilities, and scientific R&D institutes will be transformed into joint-stock companies.

Structural subdivisions that carry out construction, assembly, repair and maintenance, individual power plants, heating supply enterprises, oblast electric power supply enterprises and remaining regional power supply system complexes will be segmented from the regional power supply systems, transformed into joint-stock companies and, later, privatized.

Corporatization and privatization of electric power sector state enterprises will be carried out with mandatory preservation of their profile and possible establishment, under the governmental decision, of a state share of no less than 1/3 of the voting shares of the joint-stock companies.

In certain cases, subject to the decision of the Government of the Republic of Kazakhstan, it is possible to transform into joint-stock companies whole regional power supply systems as uniform property complexes including facilities included in a uniform technological cycle.

For corporatized enterprises, transfer of the state-owned packages of shares to trusting management will be used. For the republican property, managers (individuals or legal entities) shall be identified on the basis of tenders held by the State Committee for Management of State Property together with the Ministry of Power and Coal Industries of the Republic of Kazakhstan; and for municipal property - by authorized local executive bodies with participation of foreign financial consultants.

Social, cultural and household facilities of social importance for a region and the republic as a whole that are included into the balance of power supply systems will be transferred to local executive authorities or to the jurisdiction of oblast Akims according to the procedure established by the Government of the Republic of Kazakhstan. Social, cultural and household facilities necessary to form the social infrastructure of the power supply systems shall be kept on the balance of the relevant power supply systems.

In the coal mining sector, the existing legislation of the Republic of Kazakhstan proclaimed the exclusive state property for subsoil and mineral resources' reserves under mandatory

compliance with the principle that prospecting and extraction will be carried out by the investors who won the tenders for corresponding licenses. Private capital will be engaged in resolving the issues of ensuring financial rehabilitation of coal-mining enterprises on the basis of trust management contracts concluded according to the decisions of the Government of the Republic of Kazakhstan.

Oil, Gas, and Oil Refining Sector

The sector program for oil, gas and oil refining sector will provide for approaches to restructure and privatize of enterprises and organizations that are dealing with oil and gas exploration, prospecting, development, designing and extraction, processing and pipeline transport; sales of oil, gas and their products to consumers.

During 1996-1998, reorganization of national, holding and other state joint-stock companies and large joint-stock companies will be carried out through their segmentation. Social facilities will be separated and transferred to municipal ownership.

Privatization of the oil, gas and oil refining sector will be carried out on the case-by-case basis under the decisions of the Government of the Republic of Kazakhstan, including international tenders conducting. Projects related to prospecting and extraction will be implemented by the investors who will win license tenders for such activities.

Existing pipelines shall remain the state property. The state property of pipelines under construction will be used as a basis for establishing new legal entities with participation of institutional investors, including foreign.

State packages of shares of joint-stock companies established on the basis of oil and gas processing enterprises will be privatized on the tender basis. The state may keep for a certain period of time packages of shares of no less than 1/3 of voting shares. State-owned packages of shares may be given into trusting management on the tender basis.

Terms of tenders for the management contracts and/or purchase of state-owned packages of shares will include:

- ensuring financial rehabilitation of the enterprise;
- drafting, if necessary, a complete restructuring program for the facility that can grant its financial stability;
- long-term funding for complete project implementation;
- ensuring long-term funding for subdivisions that bring low profit or loss, but are necessary for operation of the sector;
- compliance with social and environmental requirements.

While implementing the case-by-case privatization of enterprises, it is necessary to select and to bring to the company a real, active investor (including institutional) who would commit itself to large-scale investments into core and auxiliary facilities.

Small repair, maintenance, geophysical and staff training companies will be privatized separately according to the established procedure through open cash auctions.

In the first half of 1996, privatization of the state joint-stock company "Munai Onimderi" subsidiaries should be completed.

In 1996, the State holding company "Alaugas" will be reorganized with segmentation of a joint-stock company that deals with the gas transportation and wholesale trade. Subdivisions of the SHC "Alaugas", that are engaged in gas retail trade directly to consumers, shall be segmented as independent legal entities according to the regional basis. Depending upon the value of their property and scale of operation, they are subject to transformation into joint-stock companies or limited partnerships with possible preservation of state ownership of 1/3 of enterprise's stocks in charter funds. Remaining part of the charter funds of economic partnerships may be privatized with mandatory selection of a strategic investor, or given into management with subsequent privatization.

During privatization of the pipeline companies of the state holding companies "Kazakstan Munaigas" and "Kazakgas", the state will keep the controlling share which may be later replaced by the "golden share" under the special decision of the Government.

Metallurgy and Mining Sector

Sectorial program of restructuring and privatization of metallurgy and mining sector will provide for the completion of reorganization and breaking into smaller units of national, holding and other state joint-stock companies by excluding from the charter capital state-owned packages of shares.

The main approach to privatization of metallurgical enterprises will be drafting and implementing of individual projects. Submission of the state-owned shares of core joint-stock companies into trusting management on the tender basis will be widely used as a pre-privatization measure.

Terms of tenders for the right of trusting management and/or purchase of the state shares will include:

- ensuring financial rehabilitation of the enterprise;
- drafting, if necessary, a complete restructuring program for the facility that could grant its financial stability;
- long-term funding to complete project implementation;
- production and development of its raw materials' base;
- compliance with social and environmental requirements.

The most important aspect of implementation of metallurgical enterprises' individual privatization projects is the qualified selection of (search for) a real active investor, including institutional, that is capable of large-scale investment into the production and sales of products in the world markets.

Auxiliary and service facilities that are not linked into the basic production cycle will be a subject, if possible, to separation as independent legal entiteis with their subsequent privatization.

For joint-stock companies where more than 1/2 of voting shares have already been privatized, sales of the remaining state stock will be completed under the decision of the

Government of the Republic of Kazakstan through tender with an attempt, if possible, to select an active strategic investor.

For ore mining, the basic principle is preservation of the exclusive ownership of the Republic of Kazakstan for subsoil and mineral resources. Participation of the non-state sector in deposit exploitation will be permitted strictly on the license basis with granting mining concessions or concluding management contracts for mine operation.

Transport and Communications

Program of the transport and communications sector determines approaches to restructuring and privatization of core facilities and infrastructure of land and air transport and communications. The major approach to drafting privatization programs for firms in this sector is preservation of the state ownership of large infrastructure facilities, transfer of small infrastructure facilities to municipal ownership or their possible privatization. The privatization objects are subject to the maximum possible breaking into smaller units that is not preventing them from performing their functions, with creating a large number of private legal object of different profiles.

Land transport

Principal option of segmentation of transport enterprises is separation and independent privatization of core facilities such as goods and passengers carriage, and supporting them service units (repair and procurement). Privatization of core and auxiliary transport sector facilities will be accompanied with privatization of enterprises that provide the population with additional services attached to transport services (terminals, stations with exception of railway stations; public catering enterprises, etc.).

An important part of the program is the separation of state-owned facilities in the form of republican (intricate bus and railway) and municipal enterprises for urban, local and intercity passenger carriage, and enterprises that provide traffic regulation and safety. Large facilities included into the sphere of natural state monopoly or sectors that require temporary state participation in the management will be transformed into joint-stock companies (with the exception of railways) keeping 100% or prevailing state participation in their authorized funds.

Industrial enterprises that produce and repair transport facilities, or produce road construction and repair materials are subject to privatization on the tender basis with preservation of their core profile of activities.

Underutilized railways sections and narrow-gauge lines are also subject to privatization.
Air Transport

The National Joint-Stock Company "Kazakstan Auye Zholy" will be divided into few segments. First of all from the Kazakstans Airlines will be separated the company services that provide general support to air transport operation and are not subject to privatization (air navigation information and meteorological services, medical examination commission, civil aviation academy, training center in Aktiubinsk, etc.).

Next, the new joint-stock company which encompasses aircraft units from different regions will be separated with subsequent privatization. This privatization will be performed on the tender

basis, where potential investors will compete with the alternative air transport development programs. It can not be excluded that a joint venture between competing investors will be established.

Next, airports and air terminals with support surface services shall be also separated from the Kazakstan Airlines and furthermore transformed into the joint-stock company. The controlling interest in the company may be sold through tender or form the basis for establishing a joint venture; in which no less than 1/3 of voting shares will remain state-owned.

Aircraft repair plants will be also a subject to reorganization into joint-stock companies with sale of the controlling interest to investors capable of ensuring development of the national aviation industry. A possible option of their privatization is establishment of joint ventures with participation of foreign legal entities that specialize in aircraft-building.

Communications

From the charter capital of the National Joint-stock Company "Kazaktelecom" will excluded the state-owned packages of established earlier corporations (joint-stock companies or partnerships): "Beset", "Arna-Sprint", "Arna", and "Decatel." The will afterwards sold. The management responsibilities towards state-owned enterprises will be taken away from the "Kazaktelcom." The Institute Kazniicommunication and the Republican Retraining Center will be transformed into the joint-stock companies and privatized according to the established procedures.

Privatization of the Kazaktelecom company is expected to be implemented state-by-stage:

- at the first stage, international tender will be held for transfer of the state block of shares to management of a large investor-operator that will be dealing with maintenance and modernization of the telecommunications network; large international telecommunications companies will be invited to participate in the tender. Individual privatization project will also be drafted, that provides for identification of a strategic owner and open sale of some shares of the Company to the population of the republic.
- at the second stage, shares of the Company will be sold in accordance with the individual privatization project.

The privatization program of the transport and communications sector is expected to be implemented during 1996-1998 including privatization of:

- road transport enterprises and organizations - to be completed in 1996;
- railways and air transport facilities - to be carried out in 1996-1997;
- telecommunications - to be carried out during 1996-1998.

Agricultural Complex

The sector privatization program for agricultural industry will include the system of measures to deepen reforms with the aim to form the effective agricultural production.

The State Committee for Management of State Property of the Republic of Kazakstan together with the Ministry of Agriculture, Academy of Agricultural Science of the Republic of Kazakstan, Committee for Water Resources, Committee for Forestry and other interested central

and local executive bodies of the Republic of Kazakstan will determine and submit for approval to the Government the list of enterprises that will remain in the state ownership.

In the first half of 1996, privatization of the rest state farms and reorganization of the state joint-stock companies will be completed.

Food processing enterprises that have not yet been privatized will be subject to case-by-case privatization, mainly on the tender basis, with the mandatory requirement to create auxiliary production (unit) e.g. package, container, tare, etc.

The group of objects will be determined that are subject to privatization with preservation of the state-owned share of equity including farms that belong to the Academy of Agricultural Science, bloodstock farms, scientific research and development stations, and pilot farms.

Before the end of 1996, the list of object subject to transfer to private associations of water users under trusting management contracts will be prepared together with the Committee of the Republic of Kazakstan on Water Resources and other interested central and local executive bodies.

Forestry facilities subject to privatization during 1996-1998 will be identified together with the Committee of the Republic of Kazakstan for Forestry.

With the aim to expand a network of private farms, procedures will be elaborated for granting employees of state agricultural enterprises, other individuals and legal object the right of long-term land lease and long-term lease with a buy-out option of production premises, agricultural equipment and other property of agricultural enterprises that undergo reorganization and liquidation.

The procedure will be elaborated for granting the right of land to the state agricultural enterprises.

Mechanisms will be developed to ensure property rights of agricultural producers including the right of ownership that provides for execution of land and property pledge as a credit security.

In order to provide post-privatization support to private agricultural producers, necessary equipment and renovation of the out-of-date agricultural machines' fleet, a network of machine technological stations will be created, and leasing of equipment and transport facilities will be widely used.

Health Care, Public Education, Science and Culture

During 1996, preparation will be completed and privatization programs will be initiated for health care, public education and culture facilities.

The program will include division of all state object into two groups: objects subject to privatization and objects that are not subject to privatization. The lists of organizations and institutions that provide state-guaranteed amount of medical and education services, and also, unique and specially important health care, public education, science and culture facilities will be determined, including from the territorial aspect, with participation of relevant ministries. Such

facilities can be privatized only under special decisions of the Government of the Republic of Kazakstan.

On the basis of the above lists, in the first half of 1996, measures will be developed and implemented to privatize research and development organizations, and scientific planning institutes.

Organizations and institutions that are not included into the lists, are subject to privatization and will be the basis for forming private sector in health care, public education, science and culture. Their privatization may be implemented either by creating joint-stock companies with subsequent sale of the state shares, or by tender sales of property complexes to private individuals or legal entities that have an adequate level of professional knowledge or possessing licenses that entitle to carry out activities in corresponding spheres. In case there is no solvent demand for facilities and property complexes, property transfer on the basis of trusting management contracts or property lease with the buy-out option are possible, including to private legal entities.

Terms of tender or address sale of objects may include mixed regime of providing services to the population i.e. ensuring fixed amount of free-of-charge services (which should be larger in case of distant localities) together with paid services.

Large objects must be privatized according to individual projects with prior corporatization, and in case of pre-privatization restructuring - by transfer of the state stock to trusting management with the right of its subsequent buy-out. For sales of state shares of join-stock companies that do not need pre-privatization restructuring, sale of the whole block of shares to a certain investor is recommended.

3. Transformation of Municipal Property

In the first half of 1996, the process of forming municipal property will be carried out in the Republic of Kazakstan. Municipal property will include local treasury and property assigned to municipal legal entities. Lists of legal entities whose property will be transferred from the republican to municipal ownership shall be approved by the Government of the Republic of Kazakstan.

State bodies responsible for possessing, use and disposal of municipal property shall be local executive authorities.

Privatization of the municipal property will be implemented according to special programs drafted by local executive authorities in accordance with provisions of applicable law and the present program.

The municipal property privatization programs must contain lists of state enterprises divided into enterprises that operate on the basis of economic jurisdiction and treasury enterprises, and also, joint-stock companies, the state shares of which was transferred from the republican to municipal ownership. From these enterprises, the group of objects that are not subject to privatization shall be selected. The municipal property subject to privatization is divided into:

- subject to reorganization (or reorganized earlier) into economic partnerships with preservation of the controlling share at the disposal of an authorized body (or a share that gives the right of veto) for a certain period of time; this group includes only municipal legal entities that are producing and supplying electric power and heating, pipeline transport enterprises, gas supply enterprises and public transport;
- subject to privatization without any restrictions.

If restrictions are introduced for privatization of objects, then local executive authorities shall determine objectives, terms and period of preservation of the state share in municipal property.

Fixed state share of economic partnerships may amount, in cases where full control is necessary, to no less than 2/3 of voting shares; in cases where right of veto is necessary - to no less than 1/3 of voting shares.

Under the decision of local executive bodies, municipal facilities subject to privatization will be transferred to territorial privatization committees for subsequent sale. Municipal property will be privatized through sales of the state-owned shares and whole enterprises and enterprise's assets through tenders, or through direct sale in case of transfer of the municipal property to trusting management or lease with the buy-out option.

The principal form of sale of state stock that amounts to less than 1/3 of voting shares of a joint-stock company is auctions or open sale through professional participants of the securities market. State-owned stock that amounts to 1/3+1 or more voting shares are mainly sold in one block through tender, including through professional participants of the securities market.

Local executive bodies can make a decision on case privatization of an object, in this case, sale to a certain investor may be identified as the only form of sale. Selection of the proposed certain investor shall be made on a tender basis. The list of types of municipal property subject to case-by-case privatization is determined by the Government of the Republic of Kazakstan. Decisions on privatization of specific facilities shall be made by local executive authorities.

4. Post-privatization Support to Enterprises

The privatization model adopted by the Republic of Kazakstan requires implementation of integrated post-privatization measures as pre-requisite for better operation of privatized object. It is necessary:

- to develop a system of state activities to ensure access of privatized enterprises to different forms of economic support;
- to ensure access of privatized and other non-state enterprises to all kinds of technical assistance;
- to facilitate processes of developing associations of private economic object including agricultural;
- to provide to managers and leading specialists of the privatized enterprises training in market operation.

5. Activities on Formation and Development of Securities Market

Corporatization of enterprises that was carried out in 1991-1995, the mass privatization and appearance of a large scope of joint-stock companies led to a need to develop a system of activities aimed at development and establishment of the securities market.

The main objective of formation and development of the securities market is its transformation into a permanent mechanism for attracting financial resources to be invested into joint-stock companies.

The development of the securities market is ensured by a complex of measures in most important areas:

1. Creating a network of professional participants of the securities market represented by:

- intermediary firms, dealers and brokers that provide services in securities trade and operate according to the principle of full commercial independence;
- independent registrars and private depositories;
- institutional investors including investment companies, funds, houses, investment banks, trusts, pension funds and insurance companies;
- professional associations of participants of the investment business and securities market;
- companies that provide insurance for securities transactions.

2. Improving the efficiency of stock exchange operations on the basis of:

- selling through stock exchanges a part of the state-owned stock and other securities;
- issue of state securities (bonds, bills of exchange) for stock-exchange sale to interested investors;
- emission of new stock including on the offer of the state shareholder of joint-stock companies (under the decision of the general meetings of shareholders), and their stock-exchange sale.

3. Involving the broad public in securities market transactions by way of:

- open sale of the state -owned stock of attractive enterprises;
- reducing costs of services of professional participants of the securities market through developing competition and expanding amount of securities transactions;
- legal elimination of restrictions on securities transactions for individuals, including control over deleting charter provisions of open joint-stock companies that prohibit free sale of shares by the shareholders;
- introducing free trade with securities issued by the investment privatization funds (IPF) or with securities being in their possession on the secondary markets.

4. State measures to protect interests of securities owners will be aimed at:

- protection of interests of securities' owners by laws and regulations;
- control over compliance with laws and regulations that protect interests of securities' owners by the authorized state bodies.

5. Transformation of IPFs into full-value subjects of the securities market what should enable them to perform the following functions:

- sale of their shares for cash and fulfill their obligations to investors of privatization coupons;
- performance of transactions in the secondary securities market with shares of the privatized enterprises from their portfolio and also, shares emitted by them;
- implementation of active investment policy with regard to joint-stock companies they own.

6. Creating favorable environment for domestic commercial organizations to sell their securities in the international stock market includes:

- entering the maximum possible number of joint-stock companies on a full listing of shares;
- share quotation at the stock exchange;
- connecting stock exchanges to the international securities market;
- sale of a part of the state stock of joint-stock companies to foreign investors including trade in stock exchanges of the world.

II. Restructuring and Execution by the State of its Owner's Functions

1. State Property Management

Implementation of the previous stages' privatization programs presented an issue of clear definition of the state's function as an owner of enterprises which privatization have not yet been completed, and object that are not subject to privatization. For the state-owned facilities, compliance of their institutional management system with market requirements must be achieved.

During 1991-1995, the majority of state enterprises were transformed into joint-stock companies. A part of state-owned packages of shares of these joint-stock companies were privatized through coupon auctions in the mass privatization program, a part - sold through cash auctions that are becoming the principal form of privatization of the state stock as the mass privatization completes. Sale of the state-owned stock of joint-stock companies that were partially privatized during the II stage in the framework of the mass privatization program will be completed in the first half of 1996.

Irrespective of the extend of the state share in the equity of corporations, the state acts as a partner (shareholder) according to legally established forms and executes its shareholder's rights only through its representatives in the management bodies of the economic object.

Efficient execution by the state of its owner's rights must be ensured by a complex of measures in most important areas.

1. Measures to ensure execution of functions of the state participation in the management bodies (general assemblies, supervisory boards, executive boards) of corporations (joint-stock companies, partnerships) where the state stock amounts to more than 1/3 of votes include:

- creating registers of members and candidates to supervisory boards that represent the state participant in economic partnerships (joint-stock companies);

- creating under the State Committee for Management of State Property of the Republic of Kazakhstan a commission on formation and control over supervisory boards of economic partnerships;
- preparing a provision on formation of supervisory boards in corporations (joint-stock companies and partnerships);
- drafting a provision on responsibilities of members of the Board of Directors who act on behalf of the state;
- drafting methodological recommendations on making changes to the charters of economic partnerships (joint-stock companies);
- providing training and retraining to persons who represent the interests of the state in management bodies of corporations (joint-stock companies, partnerships) where the state-owned stock (package of shares) represents more than 1/2 of votes, including utilization of the capacity of international organizations for the purpose.

Entities who represent the interests of the state in management bodies of joint-stock companies or partnerships must regularly report to the owner, who in this case is represented by the authorized governmental body.

2. Activities on creation and introduction of regular monitoring system over the state property during privatization must include:

- creating a full register of state property with regular reflection of the privatization progress;
- creating a register of object being privatized, with annual reflection of the authorized funds' distribution;
- providing for expert analysis of the financial condition of object being privatized on the basis of data provided by the Goskomstat (state statistical committee) and its apparatus and reports of representatives of the state participant in the management bodies of corporations (joint-stock companies and partnerships) where the state-owned stock (package of shares) represents more than 1/2 of votes;
- promoting development of domestic specialized auditing firms whose activities will cover the private sector.

The owner's functions, state management of state enterprises that are not subject to privatization, and monitoring are performed by the governmental bodies authorized by the Government of the Republic of Kazakhstan.

3. State-owned objects that are not subject to privatization or privatization of which requires additional measures may, under the decision of the owner, be transferred to non-state legal entities and individuals including foreign ones to be managed (the trusting management) on the contract basis.

Depending upon the size of state stock and specific objectives, the following types of trusting management contracts may be used:

- for trusting management of a state enterprise that is not subject to privatization;
- for trusting management and restructuring of a joint-stock company where the state stock represents more than 1/2 of votes;

- for trusting management of the state-owned package of shares and restructuring of a joint-stock company where the state stock represents more than 1/2 of votes, and preparing to the sale of the state shares;
- for management of the state-owned package of shares of a joint-stock company where the state stock represents less than 1/3 of votes, and preparing to the sale of the state shares.

The contracts for the trusting management of state property must be concluded in accordance with the following principles:

- publicity and transparency of inviting candidates for the contract conclusion;
- presenting business-plans (management programs) prepared in compliance with the owner's requirements by candidates;
- tender selection of managers;
- control over implementation of contract provisions by managers that is executed by the authorized agency which concluded the contract on the owner's behalf.

4. The following measures on foundation of domestic specialized management companies must be implemented:

- creating conditions for transformation of certain (under the decision of a general meeting of shareholders) holding and other state companies into professional private management companies (groups);
- drafting recommendations and legal basis for establishing and operation of private management companies (groups);
- providing a system of training and retraining of managers and specialists of private management companies (groups);
- promoting foundation of management companies (groups) with participation of foreign managers including potential investors.

2. Restructuring of the State-Owned Object

In implementation of the Program of the Government's Actions for Deepening Reforms in the Republic of Kazakhstan for 1996-1998, all necessary legal and organizational conditions will be created for effective reorganization and liquidation of insolvent enterprises of the state sector including corporations (joint-stock companies and partnerships) where the state stock represents more than 1/2 of votes.

With this objective, the Agency for Reorganization of Enterprises will be created under the State Committee for Management of the State Property of the Republic of Kazakhstan. Main objectives of the Agency are:

- to determine criteria according to which enterprises will be subject to reorganization, sanation and liquidation;
- to make on the basis of the above criteria a list of enterprises that will be subject to reorganization, sanation and liquidation and will be approved by the Government of the Republic of Kazakhstan;
- to draft and introduce a system of measures aimed to prevent insolvency (bankruptcy) of enterprises;

- to elaborate and implement (by itself or with participation of specialized organizations) measures on reorganization, sanation and liquidation of insolvent enterprises;
- to engage external consultants (consulting firms) in drafting and implementation of reorganization, sanation and liquidation programs for specific enterprises;
- to perform functions of the representative of an insolvent enterprise-debtor where required by the bankruptcy procedures;
- to develop, together with interested ministries, other central and local executive bodies and institutions of the Republic of Kazakhstan, curricula and to organize the system of training specialists in insolvency (bankruptcy) issues and contract management.
- to determine the procedure of disposal of the property of insolvent enterprises, with possible participation of specialized organizations;
- to monitor operation of enterprises undergoing reorganization or sanation.

A certain number of large economic objects (mainly, state enterprises) that are characterized by the largest level of accounts payable and at the same time, have special economic or social importance will be subject to restructuring with participation of the Rehabilitation Bank that was created under the World Bank's project. Under this project, the present restructuring program includes implementation of the following measures:

1. Selection of enterprises on the basis of the level of debt to banks, the state budget, suppliers and intermediaries. The decision on the list of such enterprises shall be made by the Government of the Republic of Kazakhstan.

2. Introducing strict limitations for crediting such enterprises. Enterprises will be isolated from the banking system of the Republic of Kazakhstan, the Rehabilitation Bank will assume functions of the only creditor of such enterprises.

3. Each enterprise covered by the program must, together with the owner, present proposals on restructuring with justification of their viability. After the proposals are reviewed by the Rehabilitation Bank of the Republic of Kazakhstan, one of the following two decisions will be made:

- if the restructuring proposals are recognized as justified, a decision is made on drafting the specific restructuring plan including detailed elaboration of its implementation;
- if the enterprise does not prepare restructuring proposals or such proposals are recognized as unjustified (or non-complying with the Rehabilitation Bank's requirements), a decision is made on liquidation of the enterprise.

4. The Approved restructuring plans are implemented with financial support of the Rehabilitation Bank of the Republic of Kazakhstan. Funding will be done stage-by-stage, in connection with implementation of relevant stages of the restructuring plan. If implementation of the restructuring plan is unsatisfactory (does not result in financial rehabilitation of the enterprise), then the enterprise is subject to liquidation.

As enterprises undergoing the program are financially rehabilitated, they will be privatized on a case-by-case basis (except enterprises that are not subject to privatization).

With regard to insolvent state enterprises where their further operation as whole units seems to be unjustified, the authorized body will implement restructuring of the enterprise through one of the following methods:

- segmentation of the enterprise and creating several potentially profitable legal entities;
- merging to an operational legal entity according to the legally established procedure;
- removal of excessive property according to the legally established procedure and sale of such property through tender or its lease with the right of subsequent buy-out;
- liquidation of the enterprise and disposal of its property (priority sale of such property through tender or its lease with the right of subsequent buy-out, transfer to the balance of another state enterprise).

In order to speed up, simplify and provide for wider use of the liquidation procedure in economic practice, it is necessary to ensure favorable conditions for transfer of all authority in liquidation of an enterprise to professional liquidators, legal entities and individuals who specialize in such activities and possess adequate skills.

During restructuring of an enterprise, the property that was not sold due to lack of the solvent demand may be transferred to commercial firms that specialize in the property sales.

Part of property of an enterprise being reorganized may be used for foundation activities on the basis of the state property in order to attract non-state investments, including foreign, effectively utilize property, disengaged during segmentation, sanation and liquidation of enterprises, that was not realized through other methods.

Legal basis will be drafted to regulate specific procedures for declaring bankrupt and liquidation of agricultural enterprises.

ANNEX C

DEBT RESTRUCTURING BOOK

Проект массовой приватизации USAID
Республика Казахстан, г. Алматы, 480091,
Абылай хана 93/95,
комнаты 256, 521, 525,
факс (3272) 620367
тел. (3272) 629261

USAID Mass Privatization Program
Republic of Kazakstan, Almaty,
480091, Abylai Khana 93/95,
Rooms 256, 521, 525
Fax (3272) 620367
Tel. (3272) 629261



**ВНЕСУДЕБНЫЕ ПРОЦЕДУРЫ
РЕСТРУКТУРИРОВАНИЯ
ДОЛГОВ ПРЕДПРИЯТИЙ**

**OUT-OF-COURT
ENTERPRISE DEBT
RESTRUCTURING**

АЛМАТЫ ALMATY

1996

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Редактор: Даниэль Фитцпатрик

Авторы: Пол Макалузо
Даниэль Фитцпатрик
Игорь Мандел
Лайла НазарбековаПереводчики: Марат Бексултанов
Елена Райзер
Лариса Горшкова
Еркен Кульжанбеков
Эльвира ТкачеваКонсультанты: Кеннет П. Чарман
КИМЭП

Тоби Уайт
Туранбанк

Майкл Маллиган
ЮСАИД/Группа Барентс(Киев)

Тодд Джегерсон
ЮСАИД/Корпорация Карана

Харолд Келли
Ротштейн и Шоу

Етьен М. Козинс
ЮСАИД/Группа Барентс(Алматы)

Казкоммерцбанк

Центральноазиатско-
Американский Фонд Поддержки
Предпринимательства**PUBLICATION STAFF:**

Editor: Daniel Fitzpatrick

Authors: Paul Macaluso
Daniel Fitzpatrick
Igor Mandel
Laila NazarbekovaTranslators: Marat Beksultanov
Elena Raizer
Larisa Gorshkova
Erken Kulzhanbekov
Elvira TkachevaContributors: Kenneth P. Charman
KIMEP

Toby Wight
Turanbank

Michael Mulligan
USAID/Barents Group (Kyiv)

Todd Jaegeron
USAID/Carana Corporation

Harold Kelly
Rothstein & Shaw

Etienne M. Cosyns
USAID/Barents Group (Almaty)

Kazkommertsbank

Central-Asian American Enterprise
FundРазработано компаниями Кемоникс
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Note to Readers of the Draft Version of this Manual

In October 1995, the USAID Mass Privatization Project distributed a draft version of this manual to various parties in Almaty for review and comment. This new version takes these comments into account, updates the legal section, and adds additional material regarding debt restructuring methods.

A Word of Caution

The recommendations and analysis in this manual are based on laws that were valid as of March 1, 1996. Due to continued changes in the laws governing commerce in Kazakhstan, the users of this manual should consult legal counsel prior to the commencement of formal debt restructuring negotiations.

Disclaimer

This publication is designed to provide accurate and authoritative information on various legal and business issues in connection with debt restructuring. It is sold with the understanding that the authors, editors, and publishers are not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent, professional person should be sought.

**USAID Mass Privatization
Out - Of - Court
Enterprise Debt Restructuring**

- Section I Introduction**
- Section II Debt Restructuring - Financial
Analysis**
- Section III Debt Restructuring Methods, and
Techniques for Negotiating with
Creditors**
- Section IV Out-Of-Court Debt Restructuring
According to Kazakstani Law**
- Appendix A Balance Sheet Account Listings**
- Appendix B Example Documents for Use in Debt
Restructuring**

Section I

Introduction

“Let us never negotiate out of fear,
but let us never fear to negotiate.”

John F. Kennedy

Introduction

One of the greatest challenges to newly-privatized enterprises is the large debt and back-tax burdens inherited from the previous several years. These arrears restrict company flexibility, discourage outside investment and keep companies beholden to creditors. No one is likely to solve this debt problem other than the enterprises themselves.

This manual provides guidance for an enterprise on how to establish and execute a plan to negotiate its way out of debt. It requires only a basic understanding of finance and economics, some imagination and flexibility, a computer to collect and analyze the required data, and at times, some assistance from professionals.

What is Debt Restructuring?

Debt restructuring is simply preparation for, and execution of, a series of trades between an enterprise and its creditors and debtors. The enterprise is seeking debt concessions, i.e., reduction of amounts, forgiveness of interest, reduction of interest rates, or penalty-free delays in payment. In exchange, it can offer assets (to the extent they are available) such as equity in the enterprise, money, or products. This manual explains how enterprises can assess the availability of such assets, and the extent the enterprise's various cash flow and operational needs will allow it to trade these assets for concessions.

In addition to assets, though, an enterprise has something of particular value to creditors: possible agreements to restructure claims in order to increase likelihood of payment. Various factors, such as the liquidation of the debtor, the absence of proper documentation, or the expiration of a term of limitations can render a claim uncollectable. An indebted enterprise has the power to negotiate new agreements with its creditors that minimize these risks. It can thus offer to renegotiate in exchange for debt concessions.

How to Negotiate a Debt Reduction by Using this Manual

At times, the debt problems of an enterprise can appear overwhelming. Most problems, however, are resolvable if taken one step at a time. Debt restructuring is no exception.

The first step towards debt restructuring is understanding the extent of the enterprise's debt, i.e., amounts, payment dates, interest rates. Likewise, the enterprise should calculate the claims it has against others. A close look at such information can often result in a recalculation of an enterprise's claims at a larger amount. Such work also may reveal opportunities for set-offs of claims and debts. *Tables for calculating such information are found in Section II.*

The next step involves a look towards the future. The enterprise has to make rough predictions as to its future revenues and costs. These types of calculations are critical to a debt restructuring. Such analysis, often referred to as a cash flow analysis, will clarify the enterprise's debt reduction goals. It also will inform the enterprise as to what it can realistically promise to pay its creditors pursuant to new or renegotiated loan agreements. *Tables for calculating this information are also found in Section II.*

Out - of - Court Enterprise Debt Restructuring

After calculating its debts, claims and future cash flow, the enterprise is ready to begin negotiating with creditors. As mentioned above, the enterprise must convince its creditors that it is in their interest to compromise their claims against the enterprise. This can only be done by offering them either assets of the enterprise, or by offering them new arrangements that increase the likelihood of payment. *The various proposals and arrangements that creditors might find attractive are described in Section III of this manual. Section III also contains information on how to persuade creditors to accept these proposals.* It is only by persuading creditors to compromise that an enterprise can restructure its debt.

Throughout this process, the enterprise should be making sure that its negotiations and new debt restructuring arrangements are not subject to challenge either before or after the fact. Section III briefly discusses how to help insulate the enterprise from such challenges and how to discourage aggressive creditors from acting unilaterally by enforcing a claim against the enterprise in court.

To help avoid such challenges, the enterprise must be familiar with its legal rights and obligations. *To this end, Section IV of this manual contains a summary of Kazakstani law on debtor and creditor relations and Appendix B contains model documents for use in debt restructuring arrangements.* Although this material cannot substitute for legal advice from an attorney hired by the enterprise, it will nevertheless instruct both the enterprise and any attorneys or consultants it may hire.

In short, while debt restructuring may initially appear intimidating, it is far less so if taken one step at a time. This manual is designed to take the enterprise through these steps. In the end, the owners and managers of enterprises taking these steps will discover that they have far more influence over their debt situation than they ever thought possible.

Points to Keep in Mind When Reading this Manual

While this manual contains a lot of diverse information regarding debt restructuring, its message comes down to just several points. Keeping the following in mind will assist the reader in understanding this manual and developing an effective restructuring plan:

1. **There is money in the details and the numbers:** The financial sheets in Section II will help the enterprise review its financial situation and will most likely reveal opportunities to increase receivables or question the validity of claims. This has been the case with several enterprises the USAID Mass Privatization team has reviewed.
2. **Do not forget cash flow:** It is the life-line to a debt restructuring foray. Do not make new promises to pay amounts that the enterprise will not be able to afford. Debt restructuring requires trust building. Make and keep reasonable promises to pay, and the trust of the creditors will follow.
3. **Plan to pay taxes:** The government has significant authority to seize property of individuals and enterprises that fail to pay required taxes, and it is increasing its enforcement efforts. As a result, enterprises should account for required tax payments in their debt restructuring plans, or, at the very least, make arrangements with the tax authorities for payment extensions.

4. **Know your creditors:** Figure out what they might want, in terms of assets or increased likelihood of payment. Then give them what they want, in exchange for debt concessions.
5. **Divide and conquer:** Treat creditors or groups of creditors differently based on the strengths of their claims and their importance to the enterprise.
6. **Know when to quit:** At times the financial position of an enterprise will be so poor that it will have no hope of recovery. In this case it should be liquidated. While perhaps painful, such a decision saves all concerned from continued stagnation and further losses. It often will allow a new owner to come and make a fresh start with the assets, management, and workers of the enterprise.
7. **Find a lawyer:** As stated above, the debt restructuring process is a series of trades of new and sometimes complex legal arrangements. If the enterprise were trading computers for the first time, it would certainly seek advice from a computer expert. The same applies for the law. Legal advice in a debt restructuring is critical.

Finally

A successful debt restructuring requires three elements: methods, discipline, and flexibility. This manual provides debt restructuring methods that have been adapted to Kazakhstan's economic and legal environment. The remaining two elements must come from the enterprises themselves: the discipline to collect and analyze the required information, and the flexibility to consider and implement the arrangements and negotiation tactics described in this manual. These latter two qualities will determine the success or failure of a debt restructuring foray.

Good Luck!

Section II

Debt Restructuring -

Financial Analysis

Financial Analysis Introduction

As noted in the introduction to this manual, Section II will take you through the following steps in preparing an out-of-court debt restructuring plan:

Step 1: Determine Whom and How Much Your Company Owes: This step requires you to create a table that will allow you to calculate all the enterprise's outstanding debt, determine how such debt must be repaid over the projection period, and to which creditors.

Step 2: Determine the Amount Owed to Your Company: This step requires you to (a) calculate all the outstanding claims of your enterprise against other entities, and (b) determine the extent that such claims will be repaid during the debt restructuring period.

Step 3: Determine How Much Money Your Company has Available to Pay its Debts: This step will help you to determine your enterprise's expected income and expenses over the period called for in the debt restructuring. The amount that income exceeds expenses is the amount that the company will have as a starting point in determining how to pay its debts. This analysis is crucial to that performed in Steps 4 and 5.

Step 4: Increase the Amount of Money Available to Pay Debts: This step offers you several opportunities to increase net revenues in order to generate more funds for debt payments.

Step 5: Reduce Debt Payments to Attainable Levels: This step explains four options by which you might persuade creditors to allow reduction or deferral of your enterprise's debts. Other alternatives are described in Section III of this manual. These reductions and deferrals will result in a new payment schedule for the enterprise's debts.

Step 6: Plan to Pay Off, New, Reduced Debt Commitments: This step provides you with a model schedule in which the enterprise can allocate and schedule its new, reduced debt payments among first priority and second priority creditors of the enterprise.

In planning these steps you should utilize existing financial data, while accounting for current rules and regulations governing commerce in Kazakstan. You will have to make numerous assumptions about operational and financial matters. The accuracy of these assumptions are critical to the success of the plan, especially in the area of projected revenues for debt service.

Essentially, these steps will guide you through the formulation of a business plan that focuses on meeting obligations to creditors. As a result, information you might obtain from other sources regarding business plan formulation might be helpful here as well.

Each step includes a detailed set of instructions on its purpose, preparation, and relationship to the formulation of a restructuring plan. To illustrate the use of the financial analysis, data from "Troubled Company", a hypothetical enterprise in significant financial trouble, has been inputted into the steps. The financial assumptions that generate the data in these steps follows this introduction.

Out - of - Court Enterprise Debt Restructuring

The successful formulation, negotiation and implementation of a debt restructuring plan will depend on the commitment of all parties involved, particularly the managers and owners of the enterprise. If any one piece of the plan is neglected it may fail overall. This level of commitment starts with the discipline to properly perform the suggested analysis in this section.

Financial Analysis Example--Basic Assumptions

The following is financial information on a hypothetical enterprise named "Troubled Company". This very basic financial information will illustrate the purpose of each restructuring step and provide the reader with a practical example of how the required data is interrelated. Amounts below, and throughout this manual are in thousands of tenge and described in western style notation. For instance, the total assets of Troubled Company before debt restructuring (below) equals one billion, four hundred seventeen million, nine hundred thousand tenge.

Assets (Book Value)

Item	Before Debt Restructuring	After Debt Restructuring	Comments
Cash	400	400	
Products for Sale	50,000	50,000	
Accounts Receivable	817,500	434,500	-290,000 set off -90,000 sold at a 66% discount -3,000 discounted in order to collect 1,000
Inventory	180,000	63,000	117,000 reduced by barter, remainder mortgaged
Equipment	95,000	43,500	51,500 sold or bartered, remainder mortgaged
Land & Buildings	275,000	275,000	All mortgaged
Total Assets	1,417,900	866,400	

Liabilities (Book Value)

Item	Before Debt Restructuring	After Debt Restructuring	Comments
Goods and Services	660,000	275,000	Various portions forgiven, set off, settled by barter, or secured by mortgage
Long Term Loans	40,000	100,000	Secured by mortgage on property
Short Term Loans	100,000	15,000	Portions converted to secured, longer term bank credit
Wages	70,000	0	Settled by barter
Taxes	120,000	147,000	Increased tax obligations stem from Troubled Company having 90,000 in debts forgiven, which is treated as income under the Tax Code.*
Total Liabilities	990,000	537,000	

* This analysis assumes that the tax authorities will treat only the difference between old obligations and new obligations as the amount of forgiven debt. Tax rates are assumed to be 30 percent. As a result, Troubled Company's tax obligations have risen by 27,000 because it had 90,000 in debt forgiven.

Out - of - Court Enterprise Debt Restructuring

Net Worth

Item	Before Debt Restructuring	After Debt Restructuring
Net Worth	427,900	329,500
Net Worth as a Percentage of Total Assets	30%	38%

Other Information

Item	Before Debt Restructuring	After Debt Restructuring
Total Debt Due In Projection Period	905,000	335,000
Amount of Cash to Pay Debts in Projection Period	310,587	366,587
Total Debt during Projection Period to Remain Unpaid	594,413	0

In its debt restructuring, Troubled Company

- will obtain 25,000 by selling nonproductive assets.
- will collect 1,000 in doubtful debts by offering a 66% discount to certain debtors.
- will obtain 30,000 by selling claims worth 90,000 to third parties.
- will reduce its debts by 120,000 through barter.
- will reduce its debts by 290,000 by set off.
- will persuade several creditors to forgive 90,000 in accrued interest and allow a significant amount of payments to be deferred by pledging property to secure these loans in exchange for these concessions.
- will persuade several unsecured creditors to accept promissory notes (allowing for further payment delays) for overdue debts. Troubled Company will persuade these creditors to accept this arrangement by showing them that, unless these debts are postponed, the enterprise would likely be liquidated. Under such circumstances, the creditors would receive only a very small portion of their total claims.

After restructuring, Troubled Company will be a smaller, leaner company, having reduced its debt by 453,000. Further, it will have reduced its debt payment obligations in the near future without incurring additional penalties. Creditors will be better off as well. In the restructuring, many creditors will settle with Troubled Company. Those with claims remaining will improve their ability to collect debts by obtaining promissory notes or pledges of property.

Throughout the debt restructuring, Troubled Company will be careful to meet its tax obligations. Troubled Company's management is aware of the government's broad authority to seize bank accounts and other property in order to collect unpaid taxes.

Note that Troubled Company will have to be careful to meet its rescheduled payment obligations. Otherwise, creditors, especially those with secured claims, will most likely seek to enforce payment very aggressively.

Step 1: Determine Whom, and How Much, Your Company Owes

TABLE 1
List of Creditors - Overdue Payables (In thousands of tenge)

Enterprise:	"Troubled Company"	Debt Balance Date:	PROJECTED FUTURE PAYMENTS											Balance (16)	Comments (17)	
			1/1/96 (1)	Period 1 (9)	Period 2 (10)	Period 3 (11)	Period 4 (12)	Period 5 (13)	Period 6 (14)	Total (15)						
CREDITORS (2)	Principal (3)	Interest (4)	Total (5)	Interest Rate (6)	Date Debt Became Due (7)	Days Overdue (8)	Debt Components	Period 1 (9)	Period 2 (10)	Period 3 (11)	Period 4 (12)	Period 5 (13)	Period 6 (14)	Total (15)	Balance (16)	Comments (17)
First Priority																
Bank 2	30,000	15,000	45,000	85%	11/1/95	61		50,000	50,000	25,000	25,000	20,000	15,000	35,000	10,000	
Bank 3	50,000	30,000	80,000	75%	1/13/95	353		50,000	50,000	25,000	25,000	25,000	20,000	20,000	60,000	
Supplier 1	125,000	50,000	175,000	50%	5/31/95	215		50,000	15,000	30,000	10,000	10,000	65,000	175,000	-	
Tax Inspectorate	80,000	40,000	120,000	30%	11/2/95	60		50,000	65,000	55,000	25,000	55,000	100,000	350,000	70,000	
Total	285,000	135,000	420,000													
Second Priority																
Bank 1	10,000	5,000	15,000	60%	11/1/95	61		10,000	5,000					15,000	-	
Supplier 2	50,000	15,000	65,000	45%	10/31/95	62		30,000	10,000				30,000	60,000	5,000	
Supplier 3	10,000		10,000		11/1/95	61								10,000	-	
Utility	25,000	25,000	50,000		11/2/95	60		25,000						25,000	-	
Wages	70,000	70,000	140,000		3/4/95	303		15,000	15,000	15,000	15,000	10,000		70,000	-	
Supplier 4	15,000	15,000	30,000		6/30/95	185		15,000						15,000	-	
Oil Company	30,000	10,000	40,000	20%	11/6/95	56				20,000			20,000	40,000	-	
Construction Company	45,000	20,000	65,000	35%	9/6/95	117		20,000			35,000			55,000	10,000	
Coal Company	75,000	20,000	95,000	35%	10/8/95	85		20,000	20,000	20,000	20,000	15,000		95,000	-	
Ministry of Energy	35,000	15,000	50,000	30%	1/31/95	335		10,000	10,000	10,000	10,000	10,000		50,000	-	
Transport Company	80,000	40,000	120,000	40%	6/20/95	195						60,000	60,000	120,000	-	
Total	445,000	125,000	570,000					145,000	60,000	65,000	80,000	95,000	110,000	555,000	15,000	
Grand Total	730,000	260,000	990,000					195,000	125,000	120,000	105,000	150,000	210,000	905,000	85,000	

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Step 2: Determine the Amount that Other Companies Owe Your Company

TABLE 2
List of Debtors - Overdue Receivables (in thousands of tenge)

Enterprise	"Troubled Company"	Accounts Receivable Balance Date:														
		1/1/96 (1)														
DEBTORS	Components of Claims			Interest Rate	Consequences of Severed Business Relations		Payment Due Date	Days Overdue	PROJECTED FUTURE PAYMENTS						Total	Comments
	Principal	Interest	Total		Negative	Acceptable			Period 1	Period 2	Period 3	Period 4	Period 5	Period 6		
(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
Customers																
Customer 1	100,000		100,000		100,000		10/12/95	81		20,000		20,000		20,000	60,000	
Customer 2	175,000		175,000			175,000	6/30/95	185	35,000	20,000	35,000	20,000	35,000	20,000	105,000	
Customer 3	90,000		90,000		90,000		1/1/95	365		3,000		30,000		30,000	63,000	
Customer 4	25,000	15,000	40,000	35%	40,000		11/30/95	32	20,000	20,000					40,000	
Total	390,000	15,000	405,000		230,000	175,000			55,000	43,000	35,000	50,000	35,000	50,000	268,000	
Credits Given																
Utility	25,000		25,000			25,000	1/31/95	335								
Coal Company	95,000		95,000			95,000	6/30/95	185								
Total	120,000	-	120,000		-	120,000										
Government Agencies																
Ministry of Energy	50,000	15,000	65,000	30%		65,000	8/30/95	124								
Ministry of Agriculture	120,000		120,000			120,000	7/30/95	155								
Total	170,000	15,000	185,000		-	185,000										
Employees & Officers																
Employee Loans	7,500		7,500		7,500		11/15/95	47			7,500				7,500	
Total	7,500	-	7,500		7,500	-					7,500	-	-	-	7,500	
Other Debtors																
Enterprise X	75,000	25,000	100,000	45%		100,000	10/31/95	62	20,000		20,000		20,000		60,000	
Total	75,000	25,000	100,000		-	100,000			20,000	-	20,000	-	20,000	-	60,000	
Grand Total	762,500	55,000	817,500		237,500	580,000			75,000	43,000	62,500	50,000	55,000	50,000	335,500	

Step 3: Determine How Much Money Your Company Has Available to Pay its Debts

TABLE 3
Cash Flow Analysis (in thousands of tenge)

	PAYMENT PERIOD (I)						Total
	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	
(2) Cash receipts (from ordinary business operations)							
Sales	50,000	52,500	55,125	57,881	60,775	63,814	340,095
Receivables	75,000	43,000	62,500	50,000	55,000	50,000	335,500
Interest	25	25	25	25	25	25	150
Sale of assets		10,000			25,000		35,000
Other			30,000			15,000	45,000
Total	125,025	105,525	147,650	107,906	140,800	128,839	755,745
(3) Payments (from ordinary business operations)							
Cost of sales							
Value added tax (VAT)	5,000	5,250	5,513	5,788	6,078	6,381	34,010
Excise	1,500	1,575	1,654	1,736	1,823	1,914	10,202
Export duties	1,000	1,050	1,103	1,158	1,216	1,276	6,803
Finished goods inventory	5,000	15,550	27,563	12,000	25,500	18,000	103,613
Raw materials	5,000	5,250	5,513	5,788	6,078	6,381	34,010
Handling costs	500	1,040	1,654	889	1,579	1,219	6,881
Production supplies	3,500	3,675	3,859	4,052	4,254	4,467	23,807
Production services	3,500	3,675	3,859	4,052	4,254	4,467	23,807
Wages	5,000	5,000	11,025	5,000	7,500	7,500	41,025
Overhead expenses	20,000	20,000	22,000	17,000	25,000	27,000	131,000
Total	50,000	62,065	83,743	57,463	83,282	78,605	415,158
(4) Free cash flow before capital asset purchases and debt service							
(4) = (2) - (3)	75,025	43,460	63,907	50,443	57,518	50,234	340,587
(5) Capital asset purchases			20,000			10,000	30,000
(6) Free cash available to pay debts							
(6) = (4) - (5)	75,025	43,460	43,907	50,443	57,518	40,234	310,587

Step 4: Try to Increase Amount of Money Available to Pay Debts

Step 4-1: Review Your Company's Capacity to Pay Debt

	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Total
Cash opening balance (1)		10,025	48,485	37,392	87,835	91,353	
+ Cash available to pay debts (see last line in Step 3).	75,025	43,460	43,907	50,443	57,518	40,234	310,587
= Total cash available to pay debts	75,025	53,485	92,392	87,835	145,353	131,587	585,677

Step 4-2: Increase Amount of Money to Pay Debt

Three Suggested Methods (See Notes for Detail)

	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Total
Sale of non-performing assets (2)		10,000				15,000	25,000
+ Collection of discounted receivables (3)					1,000		1,000
+ Sale of claims of the enterprise (4)				30,000			30,000
= Additional cash to pay debts		10,000		30,000	1,000	15,000	56,000
(=) Total cash now available to pay debts	75,025	63,485	92,392	117,835	146,353	146,587	641,677

Step 5: Reduce Required Debt Payments to Attainable Levels

Step 5-1: Review Your Company's Current Debt Payment Requirements

	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Total
Original Payment Schedule							
1st Prior./2d Prior.	1st Prior./2d Prior.	1st Prior./2d Prior.	1st Prior./2d Prior.	1st Prior./2d Prior.	1st Prior./2d Prior.	1st Prior./2d Prior.	1st Prior./2d Prior.
First Priority Debts (from Table 1)	50,000	65,000	55,000	25,000	55,000	100,000	350,000
Second Priority Debts (from Table 1)	145,000	60,000	65,000	80,000	95,000	110,000	555,000

Step 5-2: Decide on and Obtain Arrangements to Reduce Debt and Defer Payments

Reductions in Scheduled Payments as the Result of Debt Restructuring

Debt Restructuring Arrangements

Barter: offering assets to reduce indebtedness. See Table 5-1

First priority debts (REDUCED)
Second priority debts (REDUCED)

Setting off claims. See Table 5-2

First priority debts (REDUCED)
Second priority debts (REDUCED)

Entering into agreements secured by collateral. See Table 5-3

First priority debts (REDUCED & DEFERRED)
Second priority debts (REDUCED & DEFERRED)

Issuing promissory notes. See Table 5-4

First priority debts (DEFERRED)
Second priority debts (DEFERRED)

Total reductions in scheduled payments to first priority creditors

Total reductions in scheduled payments to second priority creditors

	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Total
1st Prior./2d Prior.							
0	0	0	0	0	0	0	0
-15,000	-25,000	-35,000	-15,000	-10,000	-20,000	-120,000	
0	0	0	0	0	0	0	0
-55,000	-30,000	-30,000	-30,000	-85,000	-60,000	-290,000	
0	-50,000	0	-25,000	0	-15,000	-90,000	
-30,000	0	0	0	0	0	-30,000	
0	0	0	0	0	0	0	0
-30,000	-5,000	0	-5,000	0	0	-40,000	
0	-50,000	0	-25,000	0	-15,000	-90,000	
-130,000	-60,000	-65,000	-50,000	-95,000	-80,000	-480,000	

New Payment Schedule after Reductions and Deferrals

Revised Payment Schedule: First Priority Debts	50,000	15,000	55,000	0	55,000	85,000	260,000
Revised Payment Schedule: Second Priority Debts	15,000	0	0	30,000	0	30,000	75,000

TABLE 5-1
Barter - Offering Assets to Reduce Debt

Many enterprises have used barter as a means of exchange. In a debt restructuring context, barter involves the offering of any assets of the enterprise in exchange for debt concessions (e.g. reduction of the amount of debt, interest rate, etc.). An enterprise should not limit its barter offerings to the products of the enterprise. Instead, it should consider any assets - nonproductive fixed assets, natural deposits development rights, etc.- that it owns.

For instance, one debtor enterprise recently handed over control packages of shares of several other enterprises to utilities and various fuel suppliers in exchange for reductions in debts.

When forecasting the financial impact of an exchange of assets for debt concessions, the enterprise should focus on the alternatives, i.e., how much it would receive in cash if it sold the assets, and how much in assets it would receive if it conducted a typical assets-for-assets exchange.

The scheme below illustrates a method for planning and tracking debt reduction by the use of barter transactions.

Creditors	Debt Components			Interest Rate	Existing Debt Situation Repayment Periods						Description	Asset Characteristics	
	Principle	Interest	Total		Period 1	Period 2	Period 3	Period 4	Period 5	Period 6		Balance Sheet Value	Market Value
Second priority													
Oil Company	30,000	10,000	40,000	20%	-	-	20,000	-	-	20,000	Packing equipment	65,000	26,500
Supplier 3	10,000	-	10,000	--	-	10,000	-	-	-	-	Packing materials	8,000	12,000
Wages	70,000	-	70,000	--	15,000	15,000	15,000	15,000	10,000	-	Raw materials	70,000	105,000
Total			120,000		15,000	25,000	35,000	15,000	10,000	20,000			
Creditors	Debt Components			Interest Rate	Debts After Restructuring Repayment Periods						Description	Asset Characteristics	
	Principle	Interest	Total		Period 1	Period 2	Period 3	Period 4	Period 5	Period 6		Balance Sheet Value	Market Value
Second priority													
Oil Company	-	-	-	--	-	-	-	-	-	-	Packing equipment	-	-
Supplier 3	-	-	-	--	-	-	-	-	-	-	Packing materials	-	-
Wages	-	-	-	--	-	-	-	-	-	-	Raw materials	-	-
Total													
Total Reduction of Debts by Barter			120,000		15,000	25,000	35,000	15,000	10,000	20,000			

TABLE 5-3

Conclusion of Agreements Secured by Collateral

Currently in Kazakstan, most creditors are "unsecured". That is, the debtors of most creditors have pledged no collateral which the creditor may take if the loan is not repaid. For various reasons involving the law and general difficulties in enforcing debts in court, these creditors run the risk of receiving little or no repayment of their loans.

Enterprises can take advantage of this creditor "insecurity" and offer to "secure" their outstanding obligations by offering to pledge their assets as collateral in case the payments in connection with the new obligation cannot be made. This increases substantially the likelihood that the creditors will be repaid in full.

In exchange for agreeing to such new arrangements, enterprises can ask creditors to forgive principal and accrued interest, reduce interest rates, or extend repayment periods. See Section III-3 of this manual for more detailed information.

Below is an illustration of how Troubled Company had interest forgiven and payment periods extended by offering to secure various debts through pledges of collateral.

Existing Debt Situation

Creditors	Debt Components		Total	Interest Rate	Value of Collateral	Period 1	Period 2	Period 3	Period 3	Period 5	Period 6	Total	Remaining Debt
	Principal	Interest											
First priority													
Supplier 1	125,000	50,000	175,000	50%		50,000	50,000	25,000	25,000	25,000		175,000	-
Bank 2	30,000	15,000	45,000	85%		-	-	-	-	20,000	15,000	35,000	10,000
Bank 3	50,000	30,000	80,000	75%	40,000*	-	-	-	-	-	20,000	20,000	60,000
Subtotal	205,000	95,000	300,000			50,000	50,000	25,000	25,000	45,000	35,000	230,000	70,000
Second Priority													
Supplier 2	50,000	15,000	65,000	45%		30,000	-	-	-	-	30,000	60,000	5,000
Subtotal	50,000	15,000	65,000			30,000					30,000	60,000	5,000
Total	255,000	110,000	365,000			80,000	50,000	25,000	25,000	45,000	65,000	290,000	75,000

Debts After Restructuring

Creditors	Debt Components		Total	Interest Rate	Value of Collateral	Period 1	Period 2	Period 3	Period 3	Period 5	Period 6	Total	Remaining Debt
	Principal	Interest											
First priority													
Supplier 1	125,000	-	125,000	35%	131,500	50,000		25,000		25,000		100,000	25,000
Bank 2	30,000	-	30,000	45%	40,000					20,000		20,000	10,000
Bank 3	50,000	20,000	70,000	40%	80,000						20,000	20,000	50,000
Subtotal	205,000	20,000	225,000			50,000	-	25,000	-	45,000	20,000	140,000	85,000
Second priority													
Supplier 2	50,000	-	50,000	45%	70,000						30,000	30,000	20,000
Subtotal	50,000	-	50,000			-	-	-	-	-	30,000	30,000	20,000
Total	255,000	20,000	275,000			50,000	-	25,000	-	45,000	50,000	170,000	105,000

First priority debts reduced 75,000
 Second priority debts reduced 15,000
Total debt reduced: 90,000

Reductions in Scheduled Payments of First Priority Debt (deferrals and reductions): - 50,000 - 25,000 - 15,000 90,000
 Reductions in Scheduled Payments of Second Priority Debt (deferrals and reductions): 30,000 - - - - 30,000

* 40,000 worth of assets which had been mortgaged before.

TABLE 5-4
Issuance of Promissory Notes

A promissory note is a unilateral, unconditional obligation to pay a certain sum of money. They have become increasingly popular as a means of demonstrating a claim against an enterprise. In this restructuring method, an enterprise provides its creditors promissory notes to repay current indebtedness. The promissory note represents a new obligation, which will be repaid over a more extended period and, often times, at a lower interest rate. The payment delays obtained by offering the promissory note can allow the enterprise to increase its cash flow, which might lead to a restructuring of the enterprise and perhaps attraction of new investment.

The table below illustrates how Troubled Company, by issuing promissory notes, was able to defer payments and reduce interest rates with regard to obligations to its creditors.

Existing Debt Situation												
Creditors	Debt Components		Total	Interest Rate	Period 1	Period 2	Period 3	Period 3	Period 5	Period 6	Total	Remaining Debt
	Principal	Interest										
Second priority												
Bank 1	10,000	5,000	15,000	60%	10,000	5,000	-	-	-	-	15,000	-
Construction Company	45,000	20,000	65,000	35%	20,000	-	-	35,000	-	-	55,000	10,000
Total	55,000	25,000	80,000		30,000	5,000		35,000			70,000	10,000
Debts After Restructuring												
Creditors	Debt Components		Total	Interest Rate	Period 1	Period 2	Period 3	Period 3	Period 5	Period 6	Total	Remaining Debt
	Principal	Interest										
Second priority												
Bank 1	15,000	-	15,000	60%	-	-	-	10,000	-	-	10,000	5,000
Construction Company	65,000	-	65,000	35%	-	-	-	20,000	-	-	20,000	45,000
Total	80,000	-	80,000		-	-		30,000			30,000	50,000
Total Debts Deferred by Promissory Notes					30,000	5,000		5,000			40,000	
Total Reductions in Scheduled Payments of Second Priority Debt (from deferrals):	40,000											

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Step 6: Plan to Pay Off New, Reduced Debt Commitments

Step 6-1: Plan to Pay Off First Priority Debts As they Come Due

	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Total
Cash available for repayment of first priority debts. See last line of Step 4-2.	75,025	63,485	92,392	117,835	146,353	146,587	
Revised Payment Schedule: First Priority							
- Debts. See last box of Step 5-2.	50,000	15,000	55,000	-	55,000	85,000	260,000
+ Overdue debts from the previous period	-	-	-	-	-	-	-
= First priority debts -- total	50,000	15,000	55,000	-	55,000	85,000	260,000
- Debt payments	50,000	15,000	55,000	-	55,000	85,000	260,000
= Unmet first priority obligations	-	-	-	-	-	-	-

Step 6-2: Plan to Pay Off Second Priority Debts As they Come Due

	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	Total
Cash available for repayment of second priority debts.	25,025	48,485	37,392	117,835	91,353	61,587	
Revised Payment Schedule: Second Priority							
- Debts. See last box of Step 5-2.	15,000	-	-	30,000	-	30,000	75,000
+ Overdue debts from the previous period	-	-	-	-	-	-	-
= Second priority debts -- total	15,000	-	-	30,000	-	30,000	75,000
- Debt payments	15,000	-	-	30,000	-	30,000	75,000
= Unmet second priority obligations	-	-	-	-	-	-	-
Cash Available for next period	10,025	48,485	37,392	87,835	91,353	31,587	

Explanatory Notes to Steps 1-6

NOTES REGARDING ALL TABLES, FIGURES, AND EXPLANATORY TEXT:

- “You” refers to the managers or owners of an enterprise.
- For ease of reference, cells containing formulas or information borrowed from other tables are shaded.
- All obligations and claims of the enterprise that are considered overdue should be inputted into these tables, regardless of whether they are on or off balance sheet.
- Appendix A to this manual lists the applicable balance sheet accounts utilized to record various types of accounts payable and accounts receivable. This listing also reflects the applicable account numbers for reference.

Notes to Step 1 (Table 1)

Step 1 requires you to generate a table that collects information on the debts your company owes.

GENERAL NOTE REGARDING TABLE 1: This table assumes that, for each creditor, there is only one obligation overdue. If you have different obligations with different debt components to the same creditor, these obligations should be listed out separately.

- (1) The information in this table may be for any date, though, it is often the date the enterprise compiled its most recent balance sheet.
- (2) Creditors should be grouped into two categories for purposes of payment: first priority and second priority. You should determine a particular creditor's payment priority by considering the consequences of non-payment on your enterprise's activities.

For example, creditors that continue to supply materials necessary for continued operation should be considered first priority (non-payment of debt could mean cut off of supplies and shut down of the enterprise). Likewise, creditors holding claims that generate large amounts of interest rates should also be considered first priority (non-payment could mean extraordinary growth of debt). Finally, banks (holding secured claims) and the government (for taxes) should also be considered first priority creditors (non-payment could mean enforcement of claims against the enterprise).

Creditors holding claims that are insignificant in amount and have low interest rates, and creditors that no longer supply materials necessary for production activities can be considered second priority.

Of course, Table 1 could be altered to identify additional payment categories for creditors if this will assist you in determining payment priorities.

Finally, while filling in Table 1, you may discover that there are dozens, if not hundreds of creditors. In this case you should only list out the first priority creditors and the largest second priority creditors that account for a significant portion of the unpaid debts (payables)(at least 80%). The remaining 20 % of

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Explanatory Notes to Steps 1-6

the creditors can be labeled "remaining creditors" and lumped together. Nevertheless, you should not ignore the category of "remaining creditors" in your debt restructuring plans, as any one of them have the opportunity to file an action in court or seek a declaration of bankruptcy.

- (3-5) These columns should reflect the basic components of the amount of money due to be paid to the creditor, whether interest is charged or not. If you cannot break down the payables principle and interest, you should put the entire debt balance into the principle column. Note that various laws may affect the amounts owed to creditors. Refer to legal analysis (Section IV-4.2 of this manual) for related information.

While filling in these columns you should closely review the way interest is calculated for each debt. Unlike the situation with receivables, there is no need to calculate every tence of interest accurately and to present the information on the debts to the creditors for consideration (this is the creditor's task). Nevertheless, it is very important to know the amount charged for two reasons:

- if you are certain the creditor will include (or has already included) interest into the total sum of your obligations, it should be calculated and shown in this table;

- if you are not certain whether the creditor will attempt to charge interest you should not record it in this table. You should, however, calculate the interest and keep it in mind in order to be ready for "unexpected" claims by the creditors.

Further, before filling in these columns, you should determine whether your creditor agrees with your calculations. Often times a debtor and creditor will meet, compare records, and sign a statement confirming the amount of indebtedness. During these meetings, you have a good opportunity to convince the creditor to reduce any poorly documented or otherwise questionable claims, such as when the statute of limitations of a claim has apparently expired. See the legal analysis (Section IV-4.1 of this manual) for related information.

- (6) Include in this column the rate of interest being charged on particular debts as of date of the analysis in this table. Include in the comments section of this table (column 17) any information on how interest charges are computed or how penalties are incurred. Note that interest rates may change over certain time periods.
- (7) List here the date the obligation to pay arose. Do not confuse this date with the date the contract was signed. For instance, if you signed a contract on 1/1/96 that required you to pay for goods on 1/6/96, but failed to do so, you should place 1/6/96 in this column.
- (8) The delay in payment here is the difference (in days) between the date when the debt arose and the date in the analysis.
- (9-15) This table calls for projection of payments by the debtor over six periods. Often, and in this case, each period equals one month. Use of other intervals is acceptable if these intervals are of equal length and if they facilitate information gathering and projection.

Payments made during each of these six periods may often times have to account for different payment priorities. For example, a payment to a particular creditor within Period 1 may be considered first priority, while the payment in a subsequent period may be considered second priority, or vice versa.

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Explanatory Notes to Steps 1-6

While filling in these columns, you should project payments as they are coming due, separate and apart from any adjustments that could occur in these schedules due to debt restructuring. For instance, if a payment to a first priority creditor is coming due in a certain payment period, you should recognize it as such regardless of whether you have the financial resources to make the payment or whether you expect to negotiate a payment deferral.

- (16) This column reflects the difference between columns 5 and 15.
- (17) Include in this column all data affecting the necessity and timing of payment. For instance, possibilities of renegotiating with the creditor, its aggressiveness in enforcement of its claim, and the amount of time left before the limitation period on the claim expires.

Notes to Step 2 (Table 2)

Step 2 requires you to generate a table that collects information on debtors of your company.

Note that this table assumes that, for each debtor, there is only one obligation overdue. If your debtors have different obligations with different debt components, these obligations should be listed out separately.

- (1) The information in this table is to be presented as of the same date as that in Table 1.
- (2) List here the name of each debtor having accounts receivable outstanding as of the date of this table. Group the debtors according to your enterprise's major balance sheet categories (e.g., settlements with purchasers and customers, settlements of cash loans or settlements on state budget receivables). Debtor groupings are important for projecting the future timings and amounts of cash collections.

When preparing this listing, you may realize that the current number of debtors is very large. In this case, you should determine if a certain number of the debtors account for a majority of the accounts receivable outstanding (at least 80%). If the debtors included in this 80% category are those most critical to the success of the enterprise, the remaining debtors, who fall into the 20% category, may be grouped as a single figure in a "Settlement with Other Debtors" category. However, the enterprise should not ignore these other receivables when determining how its debt can be restructured because these receivables may represent a substantial amount of actual cash flow over the given analysis period.

- (3-5) These columns should reflect the basic components of the amount of money debtor has to pay the enterprise, whether interest is charged or not. If you cannot break down the receivables' principle and interest, you should put the entire debt balance into the principle column. Note that various laws may affect the amounts owed by debtors. Refer to the legal analysis (Section IV-4.2 of this manual) for related information.

Experience has shown that it sometimes takes a significant effort to calculate the interest charged on each obligation to each creditor. To facilitate this exercise, you should fill out the tables similar to the auxiliary one below. Note that column 2 of the auxiliary table corresponds to Table 2's column 9, and column 6 of the auxiliary table corresponds to Table 2's column 4.

Explanatory Notes to Steps 1-6

	Contract N	The date, on which the obligation arose	number of days day obligation is overdue as of the date ____	Sum according to the Contract	Interest rate according to the Contract	Interest, charged according to the Contract
Debtors and contracts	1	2	3	4	5	6
Debtor A						
Contract A1						
Contract A2						
Debtor B						
Contract B1, etc.						

This analysis often results, to the enterprise's surprise, in an upward adjustment of the interest due the enterprise from its debtors. With increased claims against its debtors, an enterprise has more flexibility in settling the claim for a satisfactory amount.

Finally, before finalizing the numbers in these columns, you should determine whether your debtors agree with your calculations. Often times a debtor and creditor will meet, compare records, and sign a statement confirming the amount of indebtedness. During these meetings, you have a good opportunity to convince the creditor to acknowledge the principle and interest you have calculated.

- (6) Include in this column the rate of interest being charged on particular claims as of date of the analysis in this table. Include in the comments section of this table (column 18) any information on how interest charges are computed or how penalties are incurred. Note that interest rates may change over certain time periods.
- (7-8) Indicate the importance of the debtor to the enterprise's activities in these columns. This information will guide you in determining the extent to which you may wish to jeopardize relations with the debtor in order to obtain payment. The more important the debtor is to your enterprise's activities, the more diplomatic you should be in attempting to obtain payment.

Explanatory Notes to Steps 1-6

- (9) List here the date on which each obligation to pay arose (*be careful not to mix it up with the date of concluding the contract*) with the obligation remaining unfulfilled. For example, a contract requires payment for goods within 15 days of delivery. If the goods were received on the 25th of November, the date of required payment is the 10th of December.
- (10) List here the difference (in days) between the date in column 9, and the date of the analysis.
- (11-17) List here the amounts and dates when the overdue debts to the enterprise are likely to be paid. The source for this information will likely be various promises by and other settlements with the enterprise's debtors. Often, and in this case, the each period equals one month. Use of other intervals is acceptable so long as it facilitates information gathering and projection. They should correspond with the periods in Table 1.
- (18) Include in this section any relevant comments on the accounts receivable scheduled, e.g., special relationships with debtors, special collection provisions, previous credit forgiveness or settlement negotiations. Also include whether any legal obstacles may exist to prevent the enterprise from collecting the debts due (i.e. lack of proper documentation, expiration of the statute of limitations). Refer to the Legal Analysis (Sections IV-4.1 and IV-4.2 of this manual) for related information.

Notes to Step 3 (Table 3)

In Step 3 you need to determine the amount of cash your company currently has to pay its debts. To make this determination, you should create a table similar to the example in Step 3 ("Table 3") which will help you estimate your enterprise's cash receipts and disbursements over the next six periods. A realistic assessment of these receipts and disbursements (referred to as "cash flow") is crucial to a successful debt restructuring. An understanding of projected cash flows will help an enterprise determine how much debt it needs to have restructured and how much it can realistically promise to pay creditors in the future. Estimated figures should be based upon the enterprise's operating results in the past, as well as current market information and trends.

The numbered notes below refer to references in Table 3.

- (1) The date of the analysis and the projected payment periods for this tables should be the same as that for Table 1.
- (2-3) The receipt and disbursement amounts scheduled should represent those anticipated in the ordinary course of business for the enterprise. They should not include the scheduled repayment of any outstanding debt as of the beginning of Period 1.
- (2) **Cash Receipts Assumptions:** Included in this section of the table should be all of the enterprise's expected cash receipts over the next six periods. Sources of cash should be scheduled/projected for each period by major source. Included in this table are examples of the major sources of cash the enterprise could collect during each projected period. The following are guidelines for each major type of cash receipt:

Enterprise Cash Sales

Projected receipts should be based upon the number of cash sale transactions the enterprise expects to complete

Explanatory Notes to Steps 1-6

during each period. Credit sales are not to be included in this section of the table.

Accounts Receivable Collections

Projected cash receipts from outstanding accounts receivable as projected in Table 2.

Interest Income

Incremental cash generated on deposits maintained in bank accounts, if any.

Asset Sale Receipts

Cash receipts generated during a given projection period sale of enterprise assets in the ordinary course of business.

Other Cash Receipts

Cash receipts during each period from sources other than those outlined above.

- (3) **Cash Disbursement Assumptions:** Included in this section of the table should be all of the enterprise's expected cash disbursements over the next six periods. Cash disbursements should be scheduled/projected for each period by major type. Keep in mind that categories of disbursements included here are only recommended but not required (although they are derived from accounting practice). It is important that the table include all types of cash disbursements the enterprise would be expected to make during each projected period.

Sales Related:

- **Value Added Tax (VAT)**
- **Excise Taxes**
- **Export Duties**

Anticipated tax payments in connection with cash and credit sales during each of the designated projection periods.

Inventory - Finished Goods

Projected cost basis of inventory items the enterprise expects to purchase for resale during each period. Note that only items purchased for cash would be included in this section. Enterprise management should consider the existing amount of inventory held and the projected sales for the next six periods when calculating this figure.

Raw Materials

Projected volume of manufacturing materials to be purchased for cash during each of the designated periods. Only items purchased for cash would be included in this section. Enterprise management should consider the existing amount of raw materials held, manufacturing requirements and the projected sales for the next six

Explanatory Notes to Steps 1-6

periods when calculating this figure.

Handling Costs

Cash expenditures in connection with the sale of finished inventory goods, raw materials and related sales costs such as shipping, if applicable.

Production Supplies

Projected amount of supplies to be purchased for cash and utilized by the enterprise in its production process. The projected amount of supplies to be purchased should be based upon the expected volume of sales during the period and the current level of production supplies held.

Production Services

Projected amount of services to be purchased for cash and utilized by the enterprise in their production process. The projected amount of services to be purchased should be based upon the expected volume of sales during the period and the current level of production services already paid for in advance.

Salaries / Wages

Projected employee salaries to be paid in cash during each of the designated periods.

Overhead Expenses

Projected amount of expenses to be incurred and paid in cash, associated with the indirect operations of the business such as office rent, office expenses, employee costs (other than salary and wages) and other costs not directly connected with the volume of production.

- (4) These figures represent the amount of net cash the enterprise is expected to generate during each period after paying the periodic expenses incurred but before the purchase of any capital assets required to operate the business. This figure is calculated to provide the enterprise with the information necessary to determine how much money can be spent on capital assets and how much should be allocated to the repayment of existing debts.
- (5) Capital assets represent equipment, machinery, automobiles or other goods to be purchased and utilized by the enterprise. To the extent the capital asset is paid for in part with cash and the balance is purchased on credit, only the cash payment should be scheduled in this analysis.
- (6) Free cash flow generated from operations and available for the enterprise to pay its outstanding debts, including accounts payable. These cash figures are critical in the development of a debt restructuring plan as this information is required for determining how much and when debt will be scheduled for payment.

Note that the total amount of cash available to pay debt (310,587) is substantially less than the 905,000 in debt that needs to be paid. As a result, the enterprise should take various measures to bridge the gap. These measures are described in Steps 4 and 5.

Explanatory Notes to Steps 1-6

Notes to Step 4

In this step you will consider various options for increasing the amount of money your enterprise has for paying debts. Explanations of these options are discussed in the numbered notes below.

Note that you need not employ these options in any particular order. This decision should be based on the particular opportunities you have to implement these techniques.

- (1) Include here the amount of cash the enterprise has on hand at the beginning of the first projection period. In subsequent periods, "Beginning Cash" will be equal to the ending cash balance from the prior period (the very last line in Step 6).
- (2) Include here incremental cash flow generated from the sale of nonproductive enterprise assets. Nonproductive assets can be defined as assets not utilized by the enterprise in its core business or production assets that are no longer utilized due to permanent changes in production needs or product lines. The enterprise should also consider whether nonproductive assets can be used in barter transactions as a means to eliminate debt.
- (3) Include here payments by debtors resulting from offers to discount the amount owed by debtors in exchange for accelerated payment. This approach is not cost free. Acceptance of discounted payments by creditors may affect future cash flows. Determining the debtors who should receive such discounts, and how much each discount should be, depends on individual circumstances. Nevertheless, you should keep in mind the following in making these decisions:

Regarding the choice of whom to offer discounts:

- choose debtors not likely to pay in the near future;
- choose debtors with whom you want to maintain good relations;
- choose debtors who are likely to resist effectively any judicial actions brought against them to collect the debt.

Regarding how much of a discount to offer:

- consider the desire of the debtor to clear up its own debt situation;
- consider the costs (in both legal fees and potential lost future business) of bringing a judicial collection action against the debtor;
- consider the discount rates *currently being accepted* by other debtors.

You should make it clear to the debtors you approach that, if they refuse to pay at the discounted rate, you will sell these claims to third parties who will likely enforce the claim very aggressively.

- (4) Include here the incremental cash flow generated from the sale of claims the enterprise may have against its debtors. An enterprise should sell its claims against a debtor only after attempting to settle the claim with the debtor at an acceptable discount.

Selling claims has become more common. At least one commercial bank, Kazkommertsbank, has set up a debt clearing site where claims are bought and sold. More opportunities for selling claims should arise soon.

Explanatory Notes to Steps 1-6

Regardless of where sold, these claims will likely sell only at a substantial discount. Experience has so far shown that discounts of five to ten percent are not sufficient to induce a third party to buy a claim against a debtor. Most likely discounts of greater than fifty percent are necessary.

Determining which claims to sell depends on individual circumstances. The following questions should help clarify the decision:

- how well documented is the claim?
- is collection of the claim costly and uncertain?
- are there parties out there that have the opportunity to collect more quickly and effectively than the enterprise?
- can you identify customers of your debtor who may wish to purchase the claim and set off their debts to your debtor at 100 percent?
- can you identify entities that want to influence or take over the debtor?

Notes to Step 5

Here you will consider several methods for reducing or deferring debt of your enterprise in order to reduce required debt payments to attainable and realistic levels.

The four methods mentioned in Step 5 are not the only means of reducing or deferring debt. Other methods are discussed in Section III of this manual. Section III also contains advice on how to persuade creditors to accept such arrangements.

Note that you need not employ these options in any particular order. This decision should be based on the particular opportunities you have to implement these techniques.

Differences in Accounting for the Effects of the Techniques discussed in Step 4 and the effects of the techniques discussed in Step 5. Although the techniques listed in these steps both increase positive cash flow, they do so from opposite ends. Each option in Step 4 leads to an increase in cash inflow regardless of what the income will be spent on. By contrast, each option in Step 5 increases positive cash flow by reducing the amount the company must pay each month to particular creditors. Accordingly, the results of debt restructuring are accounted for differently in Step 5. Namely in Step 5, you must distinguish between reductions in required payments to first priority creditors and reductions in payment to second priority creditors.

Notes to Step 6

In Step 6 you should schedule payments to two tiers of creditors according to their priority level.

Step 6 suggests the allocation of payments among creditors by the following method:

Pay all first priority debts of the current period first, then pay second priority claims. Carry forward any cash that remains to the following period and then repeat the procedure.

Explanatory Notes to Steps 1-6

There are, of course, alternative methods of allocating debt payments. You could choose to pay only first priority creditors for each current period, deferring payment to second priority creditors in order to increase your ability to pay first priority creditors of the next period, etc. Of course, such an approach depends on how long an enterprise will risk continued non-payment of second priority creditors. Step 6 illustrates a general, simplified approach. You should make such allocations based on individual facts and circumstances.

Important Note: The adjusted payment schedule does not assume any changes in tax obligations during the six projected payment periods. After these periods, however, Troubled Company is likely to have increased tax obligations as the result of having its creditors agree to reductions of its debts. You should account for such increases in your debt restructuring plans.

Section III

***Debt Restructuring Methods,
and Techniques for Negotiating
with Creditors***

Debt Restructuring Methods, and Techniques for Negotiating with Creditors

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Debt Restructuring Methods, and Techniques for Negotiating with Creditors

1. Introduction

Section II of this manual describes four methods for reducing or deferring debts: (1) barter, (2) mutual debt cancellation through set-off, (3) renegotiation of non-secured loans into secured loans, and (4) issuance of unsecured promissory notes (with debt concessions) to current creditors. In each case, the enterprise obtains debt concessions by providing its creditors with either (a) assets or (b) arrangements that increase likelihood of eventual payment.

This Section provides more detail on these methods and describes additional approaches to debt restructuring. This Section then describes how an enterprise might stimulate negotiations with its creditors by showing them how debt restructuring benefits them. Further, it describes how to approach creditors and work with them, getting them to sign debt restructuring agreements that will withstand challenges after the fact. Finally, it discusses several techniques that an indebted enterprise might use to minimize concerns regarding debt that would possibly prevent outside parties or current shareholders from making investments in the enterprise.

Legal issues regarding these arrangements and techniques are discussed in more detail in Section IV of this manual. Nevertheless, one very important legal concept should be kept in mind when reading this Section: the priority of payment to creditors if a company is liquidated. With few exceptions, payout upon liquidation will occur in the following order:

1. Administrative costs of liquidation;
2. Compensation for physical injuries caused by the enterprise's operations;
3. Wages of the enterprise's workers;
4. Claims secured by pledges of property ("secured claims");
5. Debts to the government budget;
6. All remaining claims (those of "unsecured creditors").

Under this system, a liquidator pays the claims of the first class in full, then moves to the next. If sufficient money is available to pay that class in full, he does so, and then moves to the next. When insufficient funds remain to pay a class in full, the liquidator pays the creditors in that class proportionally. The creditors in the classes below receive nothing.

The liquidation and creditor payoff analysis in Appendix B-1 of this manual illustrates how this system favors creditors in higher payout classes. In that illustration, the first five classes of Troubled Company's creditors would have received a 100 percent payout if Troubled Company had been liquidated prior to debt restructuring. The last class would have received approximately 30 percent of their original claims.

As will be shown below, the possibility of liquidation is the major factor that frames a debt negotiation effort. Understanding and explaining the payout system to creditors if a liquidation were to occur is an important element in a successful debt restructuring.

2. Debt Restructuring Methods/Arrangements Utilized in Section II

The four methods used by Troubled Company in Section II are explained in more detail below.

- **Barter: The Trading of Assets for Debt Concessions (Section II, Table 5-1):** As mentioned earlier, barter is a common means of exchange among enterprises. In a debt restructuring context, the enterprise gives assets to its creditors in exchange for debt concessions.
 - ⇒ *Questions the enterprise should be asking itself when considering a barter transaction:* (1) Is the asset crucial to current and future operations? (2) Does the enterprise use the asset ineffectively? (3) Is the asset free from the claims of other creditors, i.e., has it been pledged? (4) Is the asset expensive for the enterprise to store and/or maintain? (5) Would the amount of debt reduced by the barter transaction significantly exceed the revenues generated by its sale?
 - ⇒ *Enterprises that may wish to use this approach:* Those with large amounts of tangible, durable assets that are not likely to be sold at an acceptable price in the foreseeable future. Alternatively, those incurring costs for storing or maintaining such assets.
 - ⇒ *Creditors that may be willing to accept this approach:* Those with the ability to use or resell assets that are given in exchange for debt reduction. Alternatively, those that would incur little extra costs for storing such assets.
- **Mutual Debt Cancellation, i.e., Set-Off (Section II, Table 5-2):** Sometimes a comparison of the debts and claims outlined in Section II, Tables 1 and 2 will reveal that the enterprise may have both debts outstanding to, and accounts receivable from, the same entity. In this situation, the enterprise likely has the ability to simultaneously set off the two amounts. Refer to the legal analysis (Section IV-5.1) in this manual for details.
 - ⇒ *Benefits:* Settling debts by set-off is an extremely quick and efficient means of reducing debt. It requires no exchange of money or other tangible assets.
 - ⇒ *Procedures:* A set-off may be performed unilaterally. A debtor can execute a set-off merely by "application", i.e., by informing the other party (preferably through a letter requiring a receipt) of the set-off and reducing the amount owed and the amount claimed. Although this action does not require the agreement of the other party, an enterprise, after making a set-off, may wish to negotiate an agreement with its counter claimant that the set-off was valid. See the legal analysis (Section IV-5.1) in this manual for more detail.
 - ⇒ *Set-Offs with state agencies:* As illustrated by the Troubled Company situation, an enterprise may have claims and debts against a state agency. Here a set-off is allowed so long as the claims are considered similar. More difficult, however, is an attempt to set off debts to one state agency by claims against another. This issue is treated more fully in the legal analysis (Section IV-5.2) in this manual.

- ⇒ *Set off of overdue taxes by reducing claims against the government:* Under current legislation and practice, this is extremely difficult, if not impossible. Enterprises should assume that their tax obligations cannot be reduced through this method. Further, given the broad authority of the government to seize assets for failure to pay taxes, enterprises should account for payments of tax obligations as part of any debt restructuring.
- ⇒ *Enterprises that may wish to use this approach:* Those that have claims against their creditors and those that have both large debts to and claims against the government.
- ⇒ *Creditors that may be willing to accept this approach:* Those having debtors with claims against them.
- **Renegotiation of Existing Loan Agreements with Primary Creditors to Allow for Secured Claims (Section II, Table 5-3):** A loan agreement is “secured” when the debtor specifically promises to pledge some of its property, or property of another, as collateral for the loan.¹ Because the rights of “secured” creditors are greater than those of unsecured creditors, a debtor may be able to offer secured status to its unsecured creditors in exchange for concessions on total debt, interest or payment schedules.
 - ⇒ *Benefits of holding a secured claim:* A creditor holding a secured claim (a) can more easily and quickly enforce its claim than an unsecured creditor and (b) is paid both before the government and unsecured creditors if the debtor is liquidated. The importance of this latter right is illustrated by the Liquidation and Creditor Payout Analysis for Troubled Company (Appendix B-1). *That analysis shows that if Troubled Company had been liquidated without debt restructuring, the single, secured claim against that enterprise would have been paid in full while all unsecured creditors would have received approximately thirty percent of their claims.* An enterprise seeking to renegotiate its debt in this manner should convey these benefits to its unsecured creditors. It should then try to exchange these benefits for debt concessions.
 - ⇒ *Details regarding negotiation of secured claims:* More detail on these claims is offered in the legal analysis (Sections IV-4.4 & 4.5) in this manual. An example of a security agreement is in Appendix B-6. Enterprises should keep in mind that negotiating a secured loan agreement involves complex issues of law that should be handled by competent legal counsel.
 - ⇒ *Enterprises that may wish to use this approach:* Those that have immovable property of some value not yet pledged as collateral.
 - ⇒ *Creditors that may be willing to accept this approach:* Those with unsecured claims that are willing to offer concessions to the debtor for increased likelihood of eventual payment.

¹ Alternatively, a loan can be secured by a guaranty or warranty in which a third party promises to pay the debt of the borrower if it cannot meet its payment obligations.

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- **Issuance of Unsecured Promissory Notes to Current Creditors (Section II, Table -5-4):** A promissory note is a unilateral promise to pay a specified amount of money. These instruments are increasing in popularity as a means of reflecting claims against companies. In a debt restructuring context, the enterprise offers promissory notes as payment for current debt. The promissory notes represent new debt that could allow for a longer time to pay at a lower interest rate. This gives the enterprise greater cash flow that, hopefully, will be used to improve the enterprise's performance.

- ⇒ *Use of unsecured promissory notes (with debt concessions) where opportunities to renegotiate debt into secured claims are not available:* As discussed earlier in this section, an effective means of negotiating debt of unsecured creditors is to offer them greater likelihood of payment, i.e., through secured claims. It is quite likely however, that, for various reasons, the enterprise will not be able to offer all its creditors secured claims and thus will have the challenge of persuading them to accept unsecured promissory notes with debt concessions.
- ⇒ *Benefits for creditors:* Although such recipients of promissory notes against the enterprise remain unsecured creditors, they do receive some rather significant benefits from the transaction. For instance, because promissory notes are designed to be tradable, these creditors could decide to sell the notes to third parties, thereby receiving payment right away. Further, these promissory notes will also not likely be questioned as an actual claim against the enterprise. Because of this latter reason, these promissory notes might be most acceptable to creditors with questionable claims. See the legal analysis, Section IV-4.1, in this manual, for guidance on when claims may be considered questionable.
- ⇒ *Further arguments for persuading creditors to accept the notes:* Where the enterprise is in extreme financial trouble, its management should candidly explain to its creditors that unless such concessions are made, the enterprise is likely to go into bankruptcy or be put into voluntary liquidation by the owners. As shown in the Liquidation and Creditor Payout Analysis (Appendix B-1), these unsecured creditors, who are the last in line to be paid, receive only a fraction of their claims if the debtor enterprise liquidated. The creditors thus lose very little by agreeing to debt concessions when the alternative is liquidation.
- ⇒ *Finally,* as further incentive for creditors to accept these claims, the enterprise could promise to offer these creditors secured claims (this time in exchange for the promissory notes) as soon as some additional, pledgeable property becomes available. The enterprise should also demonstrate how the debt concessions will strengthen the enterprise, thereby resulting in greater likelihood of repayment.
- ⇒ *Enterprises that may wish to use this approach:* Those in obvious financial difficulty (on the verge of bankruptcy or voluntary liquidation) and with little property available to be pledged to secure new loans. Alternatively, those with claims that third parties may wish to buy.

⇒ *Creditors that may be willing to accept this approach:* Those who realize that debt concessions are the only alternative to liquidation of the enterprise. Alternatively, those that are looking to sell their claims against the enterprise in exchange for immediate payment.

3. Additional Debt Restructuring Methods/Arrangements

Like those described above, the following methods involve exchanges between a debtor enterprise and its creditors. In exchange for debt concessions, the enterprise offers either (a) assets, or (b) new arrangements that increase likelihood of payment.

3.1. Offering Assets in Exchange for Debt Concessions

- **Debt-Equity Swaps:** In this arrangement, the creditor forgives debt (i.e., trades its claim, an intangible asset, against the enterprise) for a portion of the enterprise's shares (an intangible asset as well). Rather than an exchange between the creditor and the enterprise, the arrangement is between the creditor and the enterprise's owners, who are giving up a portion of their share ownership in order to improve the financial health of the enterprise. See Section IV-7 of this manual for legal aspects of such an arrangement.

⇒ *Enterprises that may wish to use this approach:* Those with owners willing to give up some control over, and rights to eventual dividends from, the enterprise in exchange for a reduction of the enterprise's debt.

⇒ *Creditors that may be willing to accept this approach:* A creditor or creditors whose claim(s) amount to a large proportion of the debts of the enterprise. In this instance, forgiveness of these debts would be the major factor in determining whether to liquidate or continue operating. Also, creditors seeking to expand their business "down stream" may be interested in this arrangement. For example an oil storage facility forgives debt in a company owning a chain of gas stations in exchange for equity ownership in the chain.

- **Chain-Set Offs:** Like a mutual set-off, a chain set-off involves the trading of claims among enterprises to reduce both payables and receivables. In this case, however, more than two enterprises are involved, with each enterprise owing debts and holding claims in a series. For instance, Enterprise A owes Enterprise B \$100, Enterprise B owes Enterprise C \$100, and Enterprise C owes Enterprise A \$100. While these debts can be canceled, the problem lies in that Enterprise B may not know that Enterprise C is actually a debtor of Enterprise A. The primary obstacle to utilizing the chain method for mutual debt cancellation is building the chain. Rarely does a single enterprise have all of the necessary information regarding its creditors' corresponding creditors or debtors. Furthermore, enterprises have not historically been willing to share this type of information. However, such information is necessary to create a chain set-off.

⇒ *Suggested Approaches:* Enterprises can seek outside consultants for assistance in gathering this information or can attempt to obtain this information on their own. In the latter case, enterprises should request information from their largest suppliers and customers as they are the most likely to be the beginning point for a viable chain.

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⇒ *Enterprises and creditors that may wish to use this approach:* Those operating along a distribution chain with circular characteristics. E.g., Coal producers owe railways, who owe utilities, who owe coal companies.

- **Purchase of Claims followed by Set-Off:** Here, an enterprise purchases a claim from a third party against one of its creditors (hopefully at a discount) and then uses this claim to set off its debt at 100 percent. This is a simpler method than attempting to construct a chain. It requires, however, funds from the enterprise to purchase the claims.

⇒ *Sources of Claims:* Opportunities for enterprises to buy claims against their creditors at a discount are likely to increase over the coming year. The government is considering the sale, hopefully at a discount, of its claims against large energy suppliers (which are creditors to almost everybody). Further, as more and more companies are liquidated, their claims, i.e., receivables, will be sold, most likely at a considerable discount. And, finally, private entities, such as Kazkommertsbank, are establishing debt clearing sites where individuals can purchase and sell claims.

⇒ *Approach:* Enterprises should identify the creditors of their creditors and approach them with an offer to buy the claims at a discount. They should also check with the privately-run, debt clearing sites being developed in Almaty.

⇒ *Enterprises that may wish to use this approach:* Those with some funds available to buy claims against their creditors at a discount.

3.2. Offering Arrangements that Increase Likelihood of Payment in Exchange for Debt Concessions

- **Challenge of Claim followed by Settlement with Promissory Note:** A close review of an enterprise's debts by an attorney is likely to reveal several instances where the claim against the enterprise is of questionable legal validity. For instance, the claim may be so old that it is no longer enforceable in court, or the claim may be unenforceable because the creditor failed to perform properly its part of the obligation (see Section IV-4.1 of this manual). In such cases, the enterprise may wish to bring these problems to the attention of the creditor, and then offer to settle the claim, perhaps through the issuance of a promissory note at a substantial discount.

⇒ *Enterprises that may wish to use this approach:* Those with poorly recorded, questionable, or aging debts.

⇒ *Creditors that may be willing to accept this approach:* Those that would rather settle a questionable claim at a discount than take the claim to court.

- **Use of Bank-Issued Promissory Notes:** As discussed in Section IV-4.3, promissory notes are of particular use to an enterprise because of the ease and certainty with which they can be transferred. It is very likely, however, that a holder of a promissory note has only the status of an unsecured creditor. As the liquidation analysis in Appendix B-1 indicated, unsecured creditors, such as promissory note holders, face a serious risk of non-payment if the enterprise is

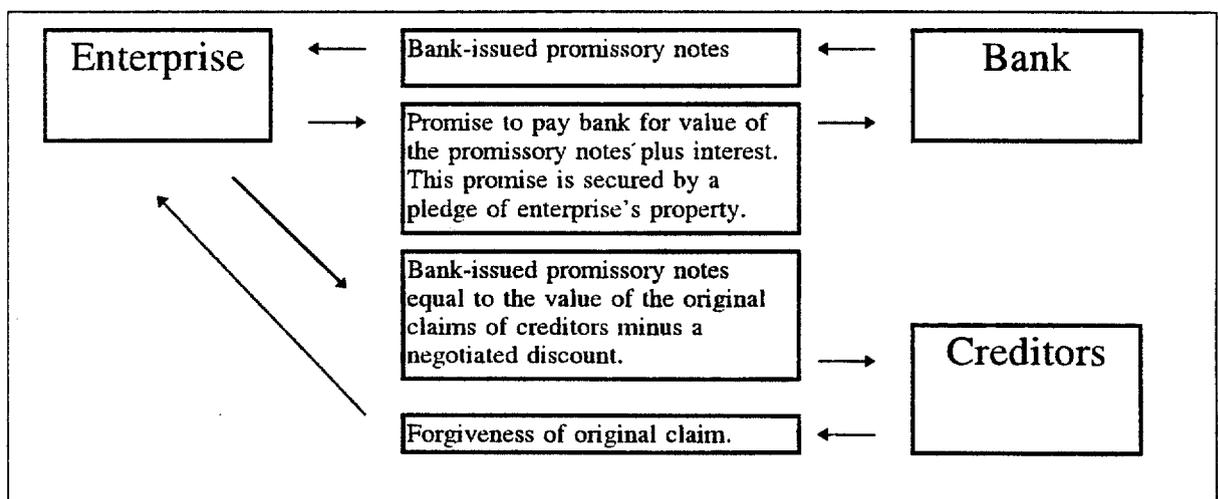
liquidated. Further, such notes may not be easily tradable because of this concern. How, then, can an enterprise reduce the risk and increase tradability of such promissory notes?

⇒ *Use of bank-issued promissory notes:* Enterprises should approach a large financial institution and enter into the following agreement:

1. Enterprise enters into secured loan agreement with Bank at a relatively low interest rate.
2. Rather than money, Bank gives promissory notes to enterprise issued in its name.
3. Enterprise gives Bank-issued promissory notes to creditors in exchange for reduction of debt.
4. Creditors then either trade promissory notes or present them to Bank for payment.
5. Bank gets reimbursed for its payment of creditors by enforcing loan agreement against Enterprise.

In this transaction, which is becoming quite common in Kazakstan, the enterprise essentially replaces its numerous, unsecured creditors with a single, secured creditor, i.e., the bank, which usually offers a loan at an interest rate lower than that charged by the former creditors. The creditors benefit because they have exchanged questionable claims against the enterprise for more certain claims against the bank. The enterprise extracts debt concessions from the creditors for this certainty. The bank makes money by charging interest against the enterprise under the loan agreement. The bank has certainty of payment because its loan is secured.

⇒ Diagram: This arrangement is illustrated below:



⇒ **Note on above arrangement:** This transaction is a relatively complex one. It should be entered into only after close review by the attorneys for both the bank and the enterprise. For an example of an agreement that would finalize

this arrangement, see Appendix B-2. For an example of a mortgage agreement see Appendix B-6.

- ⇒ *Enterprises that may wish to use this approach:* Those with (a) numerous small creditors who are concerned about payment, (b) a pre-existing relationship with a bank with a good reputation, and (c) assets available for use as collateral.
- ⇒ *Creditors that may be willing to accept this approach:* Those that are looking to increase certainty of payment or are interested in obtaining payment quickly (i.e., by selling the promissory notes).

4. Negotiations with Creditors: Increasing their Appreciation of Various Debt Restructuring Methods

The debt restructuring methods described above should give an enterprise at least several arrangements that it could offer its creditors in exchange for debt concessions. But, no matter how well the enterprise packages and offers its arrangements, negotiations will not be successful unless the creditors realize that it is in their interest to grant concessions on debt in exchange for these new arrangements.

Unfortunately, creditors in Kazakstan have tended to show a strong reluctance to compromise on claims. The reasons could be one, or some, of several. Maybe their managers believe that having a large amounts of receivables on their books is a good thing, ignoring the question of whether these receivable have any real value. Maybe some are looking for a bailout by the government. Maybe some are waiting for others to go first and grant the largest concessions. And maybe some are afraid that agreements to a debt concession could expose them to accusations of corruption and self-dealing.

Given this reality, enterprises and IPFs are likely to have to educate their creditors not only as to the value of the debt restructuring arrangements they can offer, but also as to the consequences of failing to accept such arrangements. Enterprises may wish to educate their creditors as to these consequences by thinking about, and then communicating, this risk as described below.

4.1. Creditors as Participants in a Zero-Sum Game

In recent years both government officials and businessmen in many countries have been studying and using "game theory" a theory in social sciences that focuses on strategic decision making. Game theorists describe certain social and business situations as "zero-sum games" where one person's gain is another person's loss. Among friends, zero-sum game could be a chess match (involving two people) or poker (involving several). In both situations, one participant's gain in the game necessarily means a loss to all other participants. In business, this is the situation currently faced by the creditors of insolvent enterprises. If one creditor can maneuver himself into a preferential position, all other creditors, merely by doing nothing, lose out if the creditor is liquidated.

The following, simple example illustrates the "creditors' dilemma". Enterprise X is a company with good facilities and demand for its product. However, it struggles under the following financial burden:

Assets	Liabilities
Total 1000 (liquidation value)	Government 500 (tax arrears)
	Supplier A 500 (unsecured claim)
	Supplier B 500 (unsecured claim)

If no debt restructuring were to occur, and Enterprise X were liquidated, the pay out to the creditors would be:

- Government: 500 (100 % of claim)
- Supplier A: 250 (50% of claim)
- Supplier B: 250 (50% of claim)

But, suppose that, prior to any liquidation, Supplier A and Enterprise A agree to renegotiate their debt whereby Supplier A obtains a secured claim in exchange for a reduction of its total claim from 500 to 400. Supplier B does nothing. Payout upon liquidation would be as follows:

- Supplier A: 400 (secured claim) (80% payout of original claim)
- Government: 500 (tax arrears) (100% payout of original claim)
- Supplier B: 100 (unsecured claim) (20 % payout of original claim)

This exercise illustrates that, where an enterprise is liquidated, the gains of some creditors (by establishing new debt arrangements) necessarily mean losses for other creditors who do nothing if the enterprise is liquidated.

4.2. Explaining Risks to Creditors

An enterprise seeking to convey such risks should perform the liquidation and creditor payout analysis illustrated in Appendix B-1. It should then convey the likely payout upon liquidation to all of its creditors. Further, the managers of such an enterprise should explain to the creditors that the decision to liquidate is the decision of the owners (the shareholders) and is a real possibility unless debt concessions are made. The managers can then offer creditors the various arrangements described in this Section, in exchange for debt concessions. If many creditors accept, then the enterprise will continue operating with most creditors receiving a portion of their claim. If few accept, the company will be liquidated: those creditors that renegotiated their debt will get the same amount as they would have gotten had the company continued operations; those creditors refusing, will get significantly less.

Essentially, the enterprise should characterize its offer as an offer for insurance. Like an insurance company, the enterprise is offering to reduce the risk of others. And like an insurance company, the enterprise will require a premium for this risk reduction. The premium in this case is a concession by the creditor on the claim it has against the enterprise.

For examples of letters conveying such information to creditors, see Appendix B-1.

Note: An enterprise has essentially one opportunity to obtain debt concessions from its creditors by offering them secured creditor status. Before becoming "secured", creditors have reason to fear liquidation and hence will negotiate to avoid this result. Afterwards, these creditors will likely have far less concerns about liquidation and would be willing to act more aggressively if the enterprise fails to meet its new obligations.

Lesson: The enterprise's payment obligations under the new, secured debt arrangements should be realistic and achievable.

5. Negotiations with Creditors: Particular Types

5.1. The Aggressive Creditor

Currently, relatively few creditors attempt to enforce their rights against debtor enterprises through court action. Nevertheless, creditors have at least a theoretical right to obtain a judgment on a claim, execute that judgment, and obtain payment ahead of other creditors. This could possibly start a stampede of court claims that the enterprise will not be able to manage effectively. There are several ways of coping with this risk:

- **Convince the creditor that negotiation, rather than court action, is the best method:** If possible, before the creditor files the court claim, try to demonstrate that the costs of enforcing the claim will eat away at any excess amounts it might gain by a court action. Put such an offer in writing. Keep a copy on file.
- **If the above fails, threaten to file for a declaration of bankruptcy:** Explain to the creditor how the enterprise's filing for bankruptcy will likely prevent the creditor from collecting on its claim for a considerable period of time. See Section IV-10.2 of this manual. Explain to the creditor that this delay will likely result in a smaller payout than by negotiation.
- **If the above fails, fight:** If grounds exist, dispute the claim. Think creatively, though honestly, about claims that the enterprise might have against the creditor. This may force the creditor to back down.
- **If the above fails and:**
 - ⇒ (a) *the creditors' claim is a small one.* Pay off the claim and continue negotiating with remaining creditors.
 - ⇒ (b) *the creditors' claim is significant:* File for bankruptcy and hope for the best. See the discussion on bankruptcy in the legal analysis (Section IV-10) in this manual.

The above difficulties demonstrate why it makes good sense for the enterprise to take the initiative and negotiate before creditors begin to prosecute.

5.2. The Timid Creditor

A more likely obstacle to face an enterprise in its debt restructuring efforts is the timid creditor. A "timid creditor" might be the manager of an enterprise who, while recognizing that the offered debt restructuring arrangement is in his enterprise's

interest, refuses to agree to the deal, fearing accusations that the debt concessions were motivated by bribery or other forms of corruption.

To combat this problem, the debtor should make sure to give the timid creditor as much cover as possible. All benefits that result from agreement and all risks that result from refusal should be well documented and provided to both the timid creditor and his superiors. Further, if other creditors are involved in the restructuring arrangement, this fact should be documented as well. A demonstration that an agreement by the timid creditor is part of a larger deal, might give him sufficient comfort to agree to the restructuring.

5.3. The Tax Authorities

Although it is highly unlikely that the tax authorities will forgive tax obligations, it is possible that they will agree to payment extensions. Extensions on payments can be made for up to a year, though the tax payer will have to pay interest on the obligation during the extension period. Tax payers should apply in writing for tax payment extensions through the head of the applicable tax agency. Reasons for the extension should emphasize the need to arrive at a reasonable payment schedule that would allow the enterprise to meet the obligations of all its priority creditors in order to keep operating.

6. Negotiations with Creditors: Psychological Aspects

Of course, the way a debtor will approach and attempt to finalize a debt restructuring with its creditors will depend on particular circumstances and the personal relationships among the parties. Nevertheless, a few points should be kept in mind:

- **Reestablish Trust:** The creditors may assume that the debtor is in far better financial shape than its management is stating, or that the debtor has fraudulently transferred assets to another enterprise outside the reach of creditors.
 - ⇒ *If this is not the case*, the debtor should allow its creditors access to its records to assure them that the problems of the company are legitimate and not created by fraud.
 - ⇒ *If, in fact, former management had fraudulently transferred assets from the debtor*, the debtor should be candid about this and offer to cooperate with the creditors on prosecuting these individuals and obtaining compensation from these individuals
- **Assure the Creditors that they are Sharing the Burden of the Debt Restructuring:** Resentment against any non-participating creditors, who would not have to sacrifice, could very well cause the creditors to refuse to agree to the restructuring, even if it is in their best interest to do so. Alternatively, some creditors may be suspicious that the debtor enterprise is secretly offering some creditors a better deal.
 - ⇒ The creditor resentment problem can best be avoided by getting the largest creditors to agree to a restructuring. Any smaller, non-participating creditors can be dismissed as unimportant. If a large creditor refuses, try to persuade the creditors that regardless of how others fair, they are better off signing the

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agreement. It may also be helpful to offer the cooperating creditors debt arrangements that give them preferences vis a vis the non-cooperating creditors should the enterprise be liquidated.

- ⇒ The enterprise should tackle the creditor suspicion problem by offering them access to information about the enterprise's finances, including its dealings with other creditors.

7. Finalizing the Debt Restructuring Deal

Having convinced creditors to agree in principle to a reduction and/or deferral of debt, an enterprise will have to finalize these agreements on paper and make sure that this agreement is not challenged after the fact.

7.1. Using Debt Restructuring Agreements

Appendices B-2 and B-3 are sample agreements that creditors may wish to use. Appendix B-2 memorializes a joint agreement between the debtor and all the major creditors in which the debtor gives the creditors promissory notes issued by a bank in exchange for debt reductions. Appendix B-3 is an agreement in which the debtor and each creditor agrees to terminate old obligations and enter new ones, on an individual basis.

It should be noted that the agreement in Appendix B-2, while new to Kazakstan legal practice, is based on a model that has been used very effectively for many years in the United States. The strength of the Appendix B-2 agreement is that it allows the enterprise to deal with all of its major creditors at one time. It also attempts to avoid some of the problems of creditor resentment and mistrust (discussed above) by assuring equal compromises by creditors that go into effect only upon the signatures of all parties.

The Appendix B-3 agreement, by contrast, will serve the needs of enterprises that wish to deal with creditors on a case-by-case basis.

Regardless of choice, with the signatures of its creditors' representatives on either of these documents, the enterprise can be confident that the prior obligations treated by these documents will not be enforceable in court.

7.2. Coping with Success

After an enterprise successfully employs the restructuring methods discussed in this section, it needs to make certain that these arrangements are not challenged by a creditor who feels wrongly-treated. While it is likely that any such challenges under current law is likely to lose, an enterprise may wish to consider the following actions in order to cement its debt restructuring efforts and minimize the likelihood of court actions against it:

- **Create a Record of Negotiations with Creditors:** Offers to creditors should be made in writing. Arrangements among parties should be in writing with the names, titles, and signatures of all parties clearly shown. This will protect successful enterprises from the "creative memories" of creditors after a debt restructuring.
- **Keep the Negotiations Honest:** Do not misrepresent facts in describing the financial condition of the enterprise when negotiating with creditors. Instead,

spend extra time developing strong arguments and offers based on facts that no one could dispute.

- **Offer to Allow Creditors to Review the Enterprise's Records:** Most will not bother to accept the offer. Nevertheless, it will assure all parties that the enterprise is acting honestly with its creditors.
- **Perform an Evaluation of Both the Enterprise's and the Creditors' Status both Before and After Debt Restructuring:** An example of this can be found at the beginning of Section II of this manual. The analysis should demonstrate how both the enterprise and its creditors have improved their positions as a result of the debt restructuring.

7.3. Tax Affects of Debt Reductions

Enterprises moving towards a successful debt restructuring should account for the fact that forgiveness of principle and/or interest by their creditors will be considered taxable income. They should thus budget to pay for additional taxes during the year the debt is forgiven.

- Note: In their debt restructuring, enterprises are likely to convince creditors to cancel old obligations and substitute new ones with the net effect being a reduction of debt. The tax authorities have indicated that they would consider the the *difference* in the amounts between the old obligations and the new obligations as forgiven debt if this is clearly shown to be the case.

⇒ *Suggestion:* The best means of assuring that only the *difference* in the amounts will be treated as forgiven debt is to (a) memorialize in the debt reduction agreements that the substitution of one obligation for another is part of a single debt renegotiation and (b) memorialize that the creditor recognizes this to be the case as well. See the provisions in the agreements in Appendices B-2 and B-3 regarding this issue.

8. Minimizing Shareholder and Outside Party Risk in Investing in a Debt-Ridden Company

For both current shareholders and outside parties, investment in a debt-ridden company is a risky venture. Such investors, as owners, are the last to be paid if the company is liquidated. Further, when creditors of a company hear that further investment in a company is likely, they tend to become less willing to compromise on claims. The techniques described below, the first one for current shareholders, the second for outside investors, are designed to minimize this investment risk.

8.1. Defensive Lending

In this technique, the existing shareholders have funds they wish to invest in the enterprise. Some of these funds will be used to reduce the enterprise's debt. Rather than paying these "debt relief" funds into the enterprise, and then having the enterprise pay off debt, the shareholders should approach some the creditors of the enterprise (beginning with workers and secured creditors) and offer to buy these claims (this could also be done through an intermediary if the shareholders wish to keep their identities secret). By this method, the shareholders become creditors of the enterprise, but choose not to enforce the claim. Their investment in "debt relief" can

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thus be recovered more readily than if they had paid money into the enterprise with the funds afterwards going to creditors.

8.2. Joint Ventures

An outside investor might be interested in an enterprise but is uncomfortable with the enterprise's debt. If it invests directly, it risks losing its investment if its financial contribution is used to pay old debts of the enterprise or if the enterprise is liquidated. How can it limit its risk?

The answer is found in a joint venture arrangement between the enterprise and the investor. The two agree to form a new company -- a joint venture. The enterprise contributes its existing assets as capital, the outside investor contributes funding. The enterprise takes its portion of the shares of the joint venture and essentially becomes a holding company. Its liabilities to its creditors remain. The joint venture starts its existence free of debt.

Creditors of the enterprise still have the right to be repaid. The enterprise, now a holding company, must meet these obligations. Otherwise, it risks action by the creditors who will go after its only asset: the shares in the joint venture. Meanwhile, the only risk faced by the outside investor with regard to the enterprise's debts is the possibility that enterprise's shares in the joint venture may have to be sold to pay the debts of the enterprise.

Note: The above arrangement works to the extent that the assets contributed by the enterprise have not been pledged.

Section IV

Out - of - Court

Debt Restructuring According

to Kazakstani Law

Out-of-Court Debt Restructuring According to Kazakstani Law

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Out-of-Court Debt Restructuring According to Kazakstani Law

1. Introduction

As commercial law develops in Kazakstan, companies and entrepreneurs will increasingly find legal provisions impacting upon their negotiations with their debtors and creditors. For instance, various laws often times affect the amount, if not the existence, of one company's¹ claims against another. They determine the types of claims that have financial priority over others, and determine the remedies a creditor has against a debtor for failure to pay. A company seeking to maximize its success in a debt negotiating session will need to consider these factors in setting its strategy.

The following is an overview of debtor-creditor law in Kazakstan. Although this analysis delves into a considerable level of detail, keep in mind that it remains a general explanation of a complex area of law. The statements below will not apply to all facts and circumstances. **Individuals and legal entities entering into or renegotiating debt or credit commitments should consult professional and competent legal counsel.**

2. Six Key Elements of the Law Governing Debtor-Creditor Relations

Regardless of how closely the users of this manual review the law on debtor-creditor relations, they should keep the following six legal points in mind when planning and executing a debt restructuring/reduction strategy.

1. Set-off, i.e., the full or partial cancellation of cross-demands between two parties (usually initiated unilaterally), is an effective and inexpensive means of reducing debt.
2. Obligations that are overdue but not enforced in court after a certain period of time, may no longer be enforceable through legal action. The current, general time period to bring an action is three years. Some specific claims may have times that are longer or shorter.
3. The law imposes few obstacles to buying and selling claims. By purchasing claims against its creditors (hopefully at a reduced rate), a company can put itself in a position to set-off a significant portion of its own debt.
4. Overdue, unfulfilled obligations earn interest, even when the parties fail to provide for this penalty.
5. Initiation of a bankruptcy case in court does not automatically prohibit creditors from pursuing their claims against the debtor in other courts. Such a prohibition will come if and only after the court decides whether to order liquidation. Such a decision could take far longer than the one month called for in the Bankruptcy Law.
6. The payment order for creditors of a company in liquidation is the following:

¹ The term "company" throughout this discussion will refer to a joint stock company, for which the Out-of-Court Debt Restructuring Manual was specifically designed. Many of the issues in this discussion apply as well to other types of commercial legal entities.

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- ⇒ citizens for their claims for compensation for harm caused to their life and health;
- ⇒ employees for their salaries;
- ⇒ creditors with claims secured by pledged property;
- ⇒ the government for money owed as the result of required payments to the budget and to non-budgetary funds; and
- ⇒ all other creditors in accordance with any other legislative acts.

3. Sources of the Law on Debtor-Creditor Relations

3.1. The Law of Obligations

It is important to remember that, for the most part, the rights of debtors and creditors are based on the Law of Obligations, which is set forth in the Kazakh Civil Code. In most instances, debts stem from agreements between two or more individuals or legal entities. In so doing, one party to the agreement (the debtor) promises to commit for the benefit of the other party (the creditor) certain actions (i.e., to perform work, transfer assets, pay money, etc.) or to refrain from certain action. The creditor has the right to claim from the debtor the fulfillment of its obligations and is obliged to accept it (Civil Code, Art. 268). Some of the more common agreements are between:

- **Customer and Supplier:** The debtor-creditor relationship here often arises when a supplier delivers goods or services to a customer in exchange for a promise to pay.
- **Borrower and Bank:** The debtor-creditor relationship here arises usually when a bank lends an individual or a legal entity money in exchange for a promise to pay the money back with interest. Such agreements are likely to be recorded by formal documents.
- **Employer and Employee:** This debtor-creditor relationship arises when an individual exchanges his labor for a salary. Upon performing work for a company an employee becomes a creditor of the company until it is paid in full.

Debts can also arise through non-contractual relationships, such as when one individual has to pay another to compensate for harm caused. In each of these instances, the law requires the proper fulfillment of the obligation (Civil Code, Art. 272).

Note: The Civil Code came into legal force on March 1, 1995. As to transactions entered into force on or after that date, the Civil Code applies. As to transactions entered into force before that date, however, it appears that pre-Code law governs for obligations that arise before March 1, while the Code governs obligations that arise on or after March 1.²

² Decree No. 269-XIII of the Supreme Soviet of the Republic of Kazakhstan "Concerning the Implementation of the Civil Code of the Republic of Kazakhstan (General Part)" (December 27, 1994).

3.2. Other Applicable Laws

Other laws and rules affecting the rights of debtors and creditors include the Decree on Bankruptcy; the Decree on Economic Partnerships; the Labor Code; the Decree on Banks and Banking; the Civil Procedure Code; the Uniform Law on Bills of Exchange and Promissory Notes ("Uniform Law")³; the Decree on Land; the Decree on Mortgage of Immovable Property; the Decree on State Registration of Immovable Property and Transactions Therewith; the Law on the Procedures of Settlement of Economic Disputes by the Arbitration Court; and the Regulation on Procedure of Settlement of Claims. Many of these laws (i.e., decrees) were recently enacted. Because the legal environment in Kazakstan remains fluid, readers of this manual should consult with their legal counsel to confirm that the laws referenced herein are still in effect.

4. Legal Aspects of Recorded Claims and Debts

The law may affect the total claims and debts that a company may actually have, regardless of the amount it has reflected on its books and records. For instance, a claim (i.e., an accounts receivable) recorded against a company which is left unpaid for several years may no longer be enforceable because the time to enforce the claim has expired, while another claim (i.e., an obligation) may be larger than initially thought because the law may call for the payment of interest on overdue debt even when the parties never mentioned such a requirement.

In reviewing its total claims and debts, a company should ask the following questions when seeking legal advice:

1. Is there an obligation to pay under the law?
2. Do legal provisions affect the amount of those claims and debts that have to be paid?
3. How do guaranties, pledges, and other types of secured transactions affect the rights and obligations of debts and claims involving such provisions?

The answers to the above questions (considered below) may significantly affect a company's projected free cash flow analysis and the compilation of its debt priority and payment analysis.

4.1. Is There an Obligation to Pay?

In assessing its total debts and claims, a company should ask whether each is likely to be considered valid under the law. In most cases, the answer will likely be yes. In some cases, however, a claim may be so lacking in legal support that both sides will come to a conclusion that the claim should be abandoned or at least substantially reduced. When two parties disagree to the validity of a claim, the dispute may have to be resolved in court.

The following questions should be reviewed with competent legal counsel:

³ According to the Decree of the President of August 21, 1995, No. 2418, Kazakstan joined the 1930 International Treaty which established rules for promissory notes.

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- **Was the person who agreed to take on the debt or claim authorized to do so?** Often times, individuals sign documents on behalf of other individuals or legal entities. The authority of such persons must either be (a) clear from the circumstances (e.g., a salesman in retail trade) (Civil Code, Art. 163.1); (b) explicitly granted (*Id.*); or (c) subsequently approved (*Id.*, Art. 165).⁴ An unauthorized signing not subsequently approved will not create an obligation on the part of the legal entity or person for whom the signing was supposedly made (*Id.*, Art. 165).
 - ⇒ *Exception:* When an agreement is entered into or approved by either the supervisory board, the executive board, or the management of a company, the company will be held liable for the resulting obligations even if such action is outside the authority given to any of these bodies (Civil Code, Art. 44.4; Decree on Economic Partnerships, Art. 64).
- **Has the required procedure been followed?** If the transaction value exceeds 25 minimum monthly wages, it should be in writing (Civil Code, Art. 152.1 (2)). Letters, faxes, and other documents which identify the parties and their intent to enter an agreement fulfill this requirement unless otherwise stated by legislation or agreed to by the parties (*Id.*, Art. 152.3). A failure to fulfill such requirements increases the difficulty of proving that a transaction occurred (*Id.*, Art. 153.1), or may result in a declaration of invalidity if other legislation calls for such a result (*Id.*, Art. 153.2). When a transaction is recognized as invalid, each party must return what was received, or, where this is not possible, the equivalent value in money (*Id.*, Art. 157.3).
 - ⇒ *Additional Requirements:* In some instances, the law will require the notarization and/or the registration of the agreement (*Id.*, Art. 154, 155). The consequences of a failure to comply with such requirements may result in the agreement being held invalid, depending on the particular type of agreement and the law governing it.
- **Has the time period for which the creditor may make a claim expired?** A term of limitations is a period of time during which a claim can be brought to court. The appropriate rules regarding such limitation periods are determined by reference to the date on which the time the limitation period began. In general, the old Civil Code alone applies to limitation periods beginning before January 30, 1993. Between that date and February 28, 1995, the rules of the old Civil Code are supplemented by the Basis of the Civil Legislation of the USSR and the Union Republics.⁵ From March 1, 1995 the new Civil Code applies to limitation periods beginning on or after that date. Fortunately, many of the provisions regarding this issue are treated the same by the old and new codes.

⁴ It is likely that a subsequent act by the person or legal entity represented would amount to an approval. For instance, an employee for a company orders a large shipment of goods without authority to do so. The company's subsequent acceptance and use of these goods would likely be considered to be a subsequent approval.

⁵ The Decree of the Supreme Soviet of the Republic of Kazakhstan "On Regulating the Civil Legal Relationship within the Period of Economic Reforms (Jan. 30, 1993) called for the application of the Basis of the Civil Legislation of the USSR and the Union Republics from that date forward.

- ⇒ *Beginning point of limitation period:* Under both the old Civil Code and the new Civil Code, the limitation period begins when the potential claimant learned or should have learned of the violation of the obligation (Old Civil Code, Art. 75; Civil Code, Art. 179).

- ⇒ *General limitations period - - Obligations arising before January 30, 1993:* The general rule under the old Civil Code was that obligations involving natural persons have a three year period of limitation and agreements between legal entities have a limitation period of only one year. (Old Civil Code, Art. 75).

- ⇒ *General limitations period -- Obligations arising after January 30, 1993 and before March 1, 1995:* Both obligations involving natural persons and obligations involving agreements between legal entities have a limitation period of three years (Basis of the Civil Legislation of the USSR and the Union Republics (May 31, 1991)).⁶

- ⇒ *General limitations period -- Obligations arising on or after March 1, 1995:* The new Civil Code provides for a general, three year time period in which a party may seek to enforce an obligation after failure to perform (Civil Code, Art. 178). Although legislation may change the applicable time periods of certain obligations, parties are not allowed to change a limitations period by agreement (Civil Code, Art. 177.2).

- ⇒ *Specific Limitation Periods:*

If the Obligation Arose Before March 1, 1995:	
Claim	Time Period
<ul style="list-style-type: none"> • To levy a forfeit (penalty, fine); • Those stemming from a delivery of goods of improper quality; from a deficiency of an item, that has been sold; and from deficiency of work performed by a contractor. 	Six months (Old Civil Code., Art. 76)

⁶ That this legislation applies to obligations arising during this period was made clear by the Clarification of Mr. Kazhanov, the First Vice-Chairman of the High Court of Arbitration, No. H-3-12/55 (Feb. 28, 1995).

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If the Obligation Arose or Arises On or After March 1, 1995:	
Specific Claim	Time Period
On an obligation pursuant to a bank loan.	Unlimited (Law on Banks and Banking, Art. 37)
Pursuant to a warranty or guaranty and where no expiration date is specifically stated. ⁷	One year from the time the warrantor or guarantor becomes liable for the underlying obligation. (Civil Code, Art. 336).
Pursuant to a warranty or guaranty and where no expiration date is specifically stated and the date the warrantor or guarantor became liable is undetermined. ⁸	Two years from the date of concluding the warranty or guaranty agreement (Civil Code, Art. 336).
On the right of the state to make or amend a tax assessment.	Five years (Tax Code, Art. 148)
On having a transaction ruled invalid on the basis of "malicious agreement" (e.g., a coerced agreement).	One year from the date of the cessation of the violence or threat or from the date when a plaintiff learned or was to learn about any other circumstances which are the basis for the recognition of the transaction as invalid (Civil Code, Art. 162.2).
Arising out of a promissory note or bill of exchange	Either three years, one year, or six months, depending on the circumstances (Uniform Law, Art. 70).
On having a transaction ruled invalid on other bases provided for by Article 159 of the Civil Code.	Ten years (Civil Code, Art. 162.2).
On Labor disputes	Either three months, or one month (Labor Code, Art. 211).

⇒ *Suspension of the Course of the Limitation Period and remaining nuances:* If a party believes that a particular limitation period applies to a claim or obligation, he should check the detailed rules regarding (a) whether the limitation period was at any time suspended and (b) other nuances of their application in Articles 182-187 of the Civil Code.

- **Has the creditor violated the agreement to a substantial degree?** A substantial violation of an agreement is one that causes the other party to be deprived of "something on which it had the right to count when concluding the agreement." Such an act by the creditor provides the debtor with the right to terminate the contract (Civil Code, Arts. 401-03).
- **Did the creditor create circumstances that made fulfillment of the obligation impossible?** If the creditor did not allow the debtor to fulfill its obligations, it is deemed a delaying creditor. During such a delay, fulfillment of obligations may

⁷ Note that the time limits on enforcement of a warranty and guaranty result from specified periods in which these agreements expire. The time limits do not arise from statutes of limitation and hence are not subject to the general provisions thereunder.

⁸ See footnote 7, above.

become impossible. All unfavorable consequences of this default, and the obligation to reimburse the debtor for damages caused by the delay, are imposed on the delaying creditor (Civil Code, Art. 374).

- **Has the creditor consented to and accepted a replacement performance?** Such an action terminates the obligations of the original agreement (Civil Code, Art. 368).
- **Have the parties established a new agreement?** Such an action terminates the obligations of the original agreement (Civil Code, Art. 372).
- **Has the issuance of a legislative act of a state body made fulfillment of the debt or claim impossible?** Such an act terminates the agreement to the extent called for in the legislation. Parties have the right to claim compensation in accordance with the law (Civil Code, Art. 375.1).
- **Has the debtor been declared bankrupt?** In this case the claim against the debtor is terminated (Civil Code, Art. 377). The claim is to be settled by the appropriate liquidation commission in accordance with the applicable legislation. See Section IV-4.4 regarding instances when such debts are secured by warranty or guaranty.
- **Has the creditor been declared bankrupt?** In such instances, the creditor can no longer bring the claim (Civil Code, Art. 377). Instead, the liquidation commission of the bankrupt company will likely be able to sell the claim to a third party who would then be able to enforce it.⁹
- **Do jurisdictional factors make the claim unenforceable in a practical sense?** The debtor and his property may be out of the country. Thus the creditor may have to incur incremental costs to pursue a claim.

Based on the answers to the above questions, the company may wish to categorize the claims/debts as (1) certain, (2) questionable, or (3) not enforceable. This will aid a creditor in determining which claims to pursue, and on which claims to negotiate and possibly compromise. It will aid a debtor in determining which claims it should pay and which claims it should reject or seek a significant reduction.

4.2. What is the Proper Amount of Each Obligation?

Of the claims/debts that are deemed valid, it is important also to analyze the stated amount of each and the components of such amounts, e.g., principle and interest. Often times the law will significantly affect their value. The following questions should be reviewed with competent legal counsel.

⁹ Note on possible legal contradiction: Article 404(3) of the Civil Code states that an agreement "may be amended or dissolved upon the application by one party" upon the "announcement of the other party as bankrupt, in accordance with established procedure." When an agreement is dissolved, according to Code "the obligations of the parties shall cease" (*Id.*, Art. 403.1). This provision could be read as to establish the right of contractual counterparts of bankrupt entities to unilaterally terminate their obligations to these entities. Such a reading, however, would render valueless the property of the bankrupt that consists of receivables and claims against third parties, thereby depriving the creditors of the bankrupt a significant set of assets from which their claims may be settled.

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- **Have the losses of the enterprise been properly valued?** Unless the parties have otherwise agreed, the following rules apply for determining the price of the goods at issue:
 - ⇒ *If the obligation is voluntarily met:* When determining losses, the prices on the date and at the place where the obligation should have been fulfilled shall be taken into account (Civil Code, Arts. 350.3, 385).
 - ⇒ *If the obligation is not met:* The price taken into account is to be that on the date of the filing of the legal action to enforce the debt (*Id.*).
 - ⇒ *The court also has the option of basing the losses on the price on the date of its decision or on the date payment is actually made.*
- **Was part of the obligation met?** A creditor generally has the right to refuse acceptance of an obligation in part (Civil Code, Art. 274). If it does accept it, however, the amount of the debt should be reduced respectively (*Id.* Arts. 367, 368).
- **Did the creditor deliberately or negligently assist in increasing the amount of losses or fail to adopt reasonable measures to reduce losses?** If this occurs, the debtor need not pay the extra, resulting amount (Civil Code, Art. 364).
- **To what extent are consequential losses being claimed?** A debtor is responsible for losses caused by the failure to meet its obligations (Civil Code, Art. 350). Such consequential losses include lost profits unless otherwise provided for by the legislation or agreed to by the parties (*Id.*, Art. 9.4).
- **To what extent is the claim earning interest?** When a debtor fails to pay on time, it becomes additionally responsible for an interest charge on the unpaid portion of the debt. Interest is charged as of the date when payment should have been made.
- **However, interest does not accrue on interest previously charged, i.e., interest is not earned on interest.** The interest rate is either that on (a) the date a legal action was filed; or (b) the date of the court's decision; or (c) the date of the actual payment (Civil Code, Art. 353).
- **Have the funds resulting from partial payment to satisfy an overdue obligation been properly accounted for (applied to the set-off or reduction of the obligation)?** Unless otherwise agreed to by the parties, payments are first applied against collection costs, then interest, then the principle amount due (Civil Code, Art. 282.2).
- **To what extent and how are penalties on unpaid taxes accruing?** The Tax Code provides for the following penalties:
 - ⇒ *For overdue taxes:* an interest rate charge (1.5 times the refinancing rate set by the National Bank on the date the payments were due) for each day of delay (Tax Code, Art. 161).

⇒ *For amounts understated on a return and underpaid and for amounts on a monthly payment understated: One hundred percent of the understated amount (Id., Art. 163).*

4.3. Obligations that are Reflected as Promissory Notes

Increasingly, companies will find that their debts are sometimes reflected in the form of promissory notes. Promissory notes are unilateral obligations to pay a specified amount of money often issued by individuals or companies in exchange for money or products. The primary advantages of promissory notes are tradability and collectibility. A creditor can often easily sell a promissory note. And when the promissory note becomes due, the debtor (issuer) has fewer grounds for refusing to pay than it would otherwise.

The following points should be noted with respect to promissory notes:

- **Standard Form Requirements (Uniform Law, Art. 75):** Unless otherwise noted below, if any of the following elements are missing, the promissory note is invalid.
 1. The term “promissory note” inserted in the body of the instrument and expressed in the language employed in drawing up the instrument;
 2. an unconditional promise to pay a specific sum of money;
 3. a statement of the time of payment (otherwise, payable on demand);
 4. a statement of the place of payment (otherwise, the place where the promissory note was made);
 5. the name of the person to whom or to whose order payment is to be made;
 6. a statement of the date and place where the promissory note was issued (otherwise, the place mentioned beside the name of the person who issues the instrument (Uniform Law, Art. 76));
 7. the signature of the person who issues the instrument.
- **Example of Promissory Note:** See Appendix B-4.
- **Transferring Promissory Notes:** The holder of a promissory note may transfer the instrument to another party by stating so on the back of the note or on a slip attached thereto. This is referred to as an endorsement, which must be unconditional or is otherwise void (Uniform Law, Art. 12).
- **The Crucial Need to Use the Phrase “without recourse” When Endorsing a Promissory Note:** Otherwise, the endorser guarantees both the validity of the note and its payment (Uniform Law, Art. 15).

4.4. Obligations that are Secured by a Forfeit Provision, Pledge, Guaranty, or Warranty

Each of the debts and claims should also be evaluated to determine whether they involve forfeit provisions, pledges, guaranties, or warranties, which in various

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ways, give greater assurances of eventual fulfillment of obligations. Such provisions, which are referred to in this document as security agreements, can significantly affect the rights of creditors against debtors, as well as the rights of creditors amongst each other with respect to payment priority order. It should be noted that security agreements involve rather complex and intricate areas of the law and should be used only with advice of competent legal counsel. They are discussed in general below:

- **General Provisions:**

- ⇒ *The underlying obligation is not affected by the validity of the security agreement attached to the obligation.* The underlying obligation remains valid regardless. However, the invalidity of the underlying agreement will cause the security agreement to become invalid (Civil Code, Art. 292).

- ⇒ *The security agreements should be in writing:* This rule applies regardless of whether the underlying obligation is required to be in writing (Civil Code, Arts. 294, 307, 331, 337).

- **Debts or Claims Secured by Forfeit:** In such an agreement, the debtor is to pay an amount agreed to by the parties if it fails to fulfill its obligation. Such arrangements relieve the creditor of having to prove the amount owed to it and can increase the incentive of the debtor to meet its obligations if the amount of forfeit is significant (Civil Code, Arts. 293-298).

- **Debts or Claims Secured by Pledge:** Such claims result from an agreement in which the creditor can impose claims on the specified, pledged property of the pledgor should the debtor fail to meet its obligations. Further, the pledge-holding creditor has a priority status *vis-a-vis* the government and unsecured creditors, should the debtor be liquidated (Civil Code, Art. 299).

- ⇒ *Types of pledge:* (1) mortgage, in which the pledged property remains in possession (and use) of the pledgor or a third person; and (2) pawning, in which the creditor, i.e., the pledge holder possesses (but does not own) the property which is pledged (*Id.*, Art. 303).

- ⇒ *Property that may be pledged:* The Code allows a debtor to pledge almost all types of property (*Id.*, Art. 301).

- ⇒ *Registration requirements:* If collateralized property is subject to general registration procedures, its pledge is required to be registered as well (*Id.*, Art. 308).¹⁰ The particular agency responsible for the general registration of a given type of property handles the registration of the pledge of the property (*Id.*, Art. 308). Note also that if a pledge holder fails to fulfill the various requirements regarding the registration of its pledge, it will not enjoy the benefits of a pledge holder.

¹⁰ For instance, enterprises, structures, buildings, installations, apartments, transport vehicles, and items used in the exploration of and travel through outer space are subject to registration (Civil Code, Art. 303.1). Securities are subject to registration as well.

- ⇒ *Subsequent pledge*: Property may be pledged more than once, to different creditors though the right of the subsequent pledge holders are subordinate to the pledge holders before them, i.e., the claims of a secondary pledge holder shall be paid through the proceeds from selling of property, that has been pledged, after providing for claims of previous pledge holders (*Id.*, Art. 311). Note that subsequent pledging is lawful if not prohibited by the preceding pledge agreement.
- ⇒ *Imposing claims out of pledged items*: Claims may be imposed by application to court or, where the parties have agreed and where it is allowed by law, by a non-judicial auction.
- ⇒ *Limited protection in the event of debtor's liquidation*: Pledged property, unlike in many other countries, is not segregated from the assets subject to claims of certain other creditors in the event of a debtor's liquidation. Rather, a pledge holder becomes a member of a class of creditors (other pledge holders) that are scheduled to be paid, to the extent of the pledge, after injury claimants and workers, but before the government (i.e., for back taxes), and other unsecured creditors (Civil Code, Art. 51; Bankruptcy Law, Art. 21).
- **Debts or Claims Secured by Warranty**: In an agreement with a warranty, a third party (the warrantor) agrees to be obliged to the creditor for the fulfillment of obligations to the same extent as the debtor, unless otherwise stated by the agreement. The warrantor can be held to its extent of the obligation directly by the creditor (Civil Code, Art. 332).
- **Debts or Claims Secured by Guaranty**: A guaranty resembles a warranty in that a third party (the guarantor) agrees to be obliged to the creditor for the fulfillment of a specified portion of a debtor's obligations. The guarantor shall be liable within the amount indicated in the guaranty. Before a creditor can make a claim against a guarantor, however, it must show that it has taken reasonable measures to have the claim satisfied through the debtor (Civil Code, Art. 332).
- **Rights of Guarantor and Warrantor to Indemnification**: If either must pay the debts of the debtor, they obtain the rights that the creditor had against the debtor that had failed to pay (Civil Code, Art. 334).
- **Precautionary Note on Claims Secured by Warranty or Guaranty in the Event of Liquidation of the Debtor Responsible for the Underlying Obligation**: Language in the Bankruptcy Law and the Civil Code, strongly suggest that a third party's obligations as a warrantor or guarantor terminate upon completion of the liquidation of the underlying debtor (*Id.*, Arts. 336, 377). See Section IV-10.3.

4.5. Debts or Claims Secured by the Mortgage of Immovable Property

At the time this manual was being finalized, the government published the Decree on the Mortgage of Real Estate, the Decree on Land, and the Decree on State Registration of Immovable Property and of Transactions Therewith. In general, the legislation, which supplements the rules regarding pledge under the Civil Code, establishes procedures that provide significant rights to creditors to enforce obligations secured by mortgages. It is thus likely that creditors will be seeking to renegotiate

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current loans with debtors to increase their likelihood of eventual repayment. Some of the major points of the legislation are discussed below. These rules, as well as the general rules regarding pledge (which apply to mortgages of immovables as well), should be reviewed carefully.

- **The Concept of Mortgage:** As stated earlier, a mortgage is a pledge of property which remains in the possession of the pledger or a third person other than the pledge holder.
- **The Property that can be Mortgaged under the Law on Mortgage:** The legislation defines immovable property as land plots, buildings, installations, and any other assets firmly attached to the land. The ultimate test is whether the item may be moved without unreasonable damage to it (Law on Mortgage, Art. 1, par. 6). When a building is mortgaged the rights to the land underneath it must be mortgaged as well (Decree on Land, Art. 58).
- **Entities with the Right to Mortgage:** Owners, as well as permanent and long-term users of immovable property, are allowed to mortgage this property. Though some doubts, based mostly on technical grounds, have arisen as to the rights of permanent and long term users of land to mortgage this property, it appears that this right is available under the Law on Mortgage.
- **Documents Involved in Executing a Mortgage -- Mortgage Agreement:** The Law on Mortgage requires a mortgage agreement, which must state:
 1. the name and address of the pledger and pledge holder and estate warrantor or guarantor, if necessary;
 2. a description of the principal obligation, including its amount and deadlines for its execution;
 3. the list and location of the pledged immovable property;
 4. the type of right the pledger has with regard to the immovable (ownership, right of business authority, etc.).
- **Example of Mortgage Agreement:** See Appendix B-6.
- **Documents Involved in a Mortgage--Mortgage Certificate:** This document certifies the rights of its legal holder to enforce the obligations under the mortgage agreement. The requirements of this document are listed in Article 13 of the law.
- **Obtaining Rights of a Pledge Holder under a Mortgage of an Immovable:** This occurs at the moment when the mortgage agreement is registered with the Ministry of Justice (Law on Mortgage, Art. 6; Law on State Registration, Art. 3.1). Different pledge holders of the same property may obtain these rights by registration as well. The rights of subsequent of the subsequent pledge holders, however, are subordinate to the rights of any prior-registered pledge holders (Civil Code, Art. 311).

⇒ *Cautionary Note on Rights of Pledge Holders in Liquidation--possible dilution by subsequent pledge on property:* Neither the Civil Code's nor the Bankruptcy Law's liquidation provisions explicitly prohibit subsequent pledge holders of a piece of property from treatment on an equal basis as the first pledge holder in a liquidation pay out. To guarantee that their rights are not diluted by subsequent pledge holders in this process, parties entering into mortgage agreements should require that the pledger promise not to re-pledge the property.

5. Remedies For a Creditor or Debtor

After an obligation arises, Kazakstan law provides creditors with several options if an individual or legal entity fails to fulfill an obligation. Both creditors and debtors should keep in mind these options, as they will affect negotiations and may actually be used, should negotiations fail.

5.1. Debt Set-off with Private Parties

When available, set-off is a particularly convenient and effective means of reducing the debt of a company. In a set-off, a company reduces the amount it owes its creditor by the amount the creditor owes the company. Its uses and limitations are described below:

- **General Requirement:** Where parties have "similar" claims against each other, either party may unilaterally reduce its debt by the amount owed by the other party (Civil Code, Art. 370).¹¹ The time of performance for the claims need to be (a) specifically due or (b) payable upon demand of the creditor (*Id.*, 370.3).
- **Definition of "Similar Claims":** Although the Civil Code fails to define "similar" it is safe to say that "similar" claims under the Code include at least those claims that both call for (a) the payment of money, or (b) delivery of the same property.
- **Procedure:** Apparently, a debtor can execute a set-off merely by "application", i.e., by informing the other party (preferably through a letter requiring a receipt) of the set-off and reducing the amount owed and the amount claimed. It would then be the creditor's responsibility to challenge the set-off as unlawful.

⇒ *Consequences of an Unlawful Set-off:* A set-off that fails to comply with the above requirements will simply not be recognized by a court. A debtor refusing to pay a debt on the basis of an unlawful set-off would be as liable as if it had simply refused to pay the debt. To avoid such a result, a debtor after making a set-off may wish to negotiate an agreement with its counter claimant that the set-off was valid.

5.2. Set-off of Debts to a Government Agency by Claims against Another Government Agency

So long as the claims are similar, the opportunity for a lawful set-off will depend on the following factors:

¹¹ Note that there are several minor exceptions to this rule (*Id.*, Art. 370.2).

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- **Both agencies Contracting on Behalf of the Republic of Kazakstan:** Set-off is allowed since the same legal entity (the Government of Kazakstan) is holder of both debt obligation and claim.
- **Both Agencies Contracting on their Own Behalf and Having Authority to Do So: Set-off Not Allowed:** The contract itself should clearly indicate who are the parties. The existence of such authority is usually indicated in the agency's founding legislation. In such a case, the parties (government agencies) are different legal entities and the set-off would not be considered lawful.
- **One Agency Contracting on its Own Behalf and Another Contracting on Behalf of the State: Set-off Not Allowed:** The party to the second contract (the Government of Kazakstan) is not the same as the party to the first contract.

⇒ *Cautionary Note:* The above conclusion stems from principles of representation under Articles 163-171 of the Civil Code. Agencies, however may vigorously oppose the set-off of their claims against an enterprise by debts from another state agency. Companies considering such an action should approach the agencies involved for a confirmation of this act.
- **Other Limitations:** A company may not lawfully set-off debts to the Government of Kazakstan by its claims against state-owned enterprise or a joint stock company whose shares are owned by the state. Such entities are considered to be legal entities separate from the Government of Kazakstan (Civil Code, Art. 44.1). Likewise, a company may not lawfully set-off debts to the Government of Kazakstan by its claims against an oblast level government enterprise. Such entities are considered to be legal entities separate from the Government of Kazakstan (Civil Code, Art. 113).

5.3. Out-of-Court Seizure of Assets

So long as specific legislation does not prohibit the practice, and so long as the parties so agree, a pledge holder can be given the right to obtain and auction the pledged assets (Civil Code, Art. 318). The pledge holder can use the power of the court without resorting to a full case, should the pledgor refuse to release the assets. The sale of these assets should be carried out in accordance with the procedures set forth in Article 312 of the Civil Code. Note however, that upon application of the pledgor, a court has the right to delay the auction of the assets for up to a year (Civil Code, Art. 319).

5.4. Court Action to Enforce a Claim

Court action, though expensive and time consuming, may be the only viable option if out-of-court debt restructuring proves to be ineffective.

5.4.1. Preliminary Note on Effects of New Constitution

Kazakstan's new Constitution does not recognize the Kazakh Arbitration Court as a separate institution. As a result, the Supreme Arbitration Court, and the oblast and Almaty City arbitration courts have been disbanded (Edict on "Measures of Implementation of Part I, Art. 98 of the Constitution" and Edict having the Force of Law on "On the Courts of the Republic of Kazakstan" (Oct. 20, 1995)). They have been replaced by the Collegium on Economic Disputes at the Supreme Court, and

oblast and Almaty City Court levels. These bodies will, for the most part, be staffed by the same judges, and hear the same type of claims, as the arbitration courts.

5.4.2. *Bringing Claims Against Legal and Physical Persons*

Disputes between legal entities are heard by the Collegium on Economic Disputes, within the Supreme Court, and the oblast and Almaty City courts (Law on Courts of the Republic of Kazakstan, Art. 6). Where a natural person is either the plaintiff or the defendant, the appropriate forum is Public Court (Civil Procedure Code, Art. 15). In either forum, a plaintiff is required to pay a fee equal to ten percent of its claim (Law on State Fees, Arts. 3, 4). If the court finds the plaintiff's claims valid, litigation costs, including the state fee, can be redeemed from the defendant (Civil Procedure Code, Arts. 90-95; Law on Procedure of Settlement of Economic Disputes between Business Entities, Art. 60).

5.4.3. *Legal Actions against Governmental Bodies*

The Republic of Kazakstan acts on equal basis with the other participants of relations governed by the civil legislation (Civil Code, Art. 111). Disputes of civil nature with the participation of the Republic of Kazakstan may be settled in court.

- ⇒ *Whether to sue the Republic of Kazakstan in general, or to sue the specific government agency.* The key issue is who actually entered the agreement. If the agency contracted on its own behalf, it should be named as the defendant. If the agency contracted on behalf of the Republic of Kazakstan, the Republic of Kazakstan should be named as the defendant on grounds that the government agency was its representative (see *id.*, Art. 163).
- ⇒ *Subsequent approval in absence of actual authority of the government agency:* If authority of the government agency to act on behalf of the Republic of Kazakstan in the transaction at issue is questionable, the plaintiff should determine whether this contract was subsequently approved through word or by deed. If so, the situation is relatively clear: according to Articles 163 and 165 of the Civil Code, the Republic of Kazakstan is a holder of rights and obligations resulting from the agreement.
- ⇒ *Precautionary note:* Even in countries with well-developed legal systems, suing the government is an often-times complex task peppered with traps for the unwary. Potential plaintiffs should pay special attention to any legal decisions that may provide some guidance in this area.
- **Note:** The above procedures and remedies apply to situations in which the debtor has not entered into bankruptcy proceedings. The rights of debtors and creditors in such proceedings are discussed in Section IV-10.

5.5. **Enforcement of an Obligation Secured by a Mortgage of Immovable Property.**

The Decree on the Mortgage of Immovable Property establishes and clarifies procedures for enforcing obligations secured by mortgages through both judicial and non-judicial processes.

- **Enforcement through Court Action:** If the pledge holder can convince the court that the debtor has not performed its obligation, and that this failure is not

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insignificant, the court will enforce the claim against the pledger (Law on Mortgage, Art. 21, pars. 1 & 2). Enforcement will occur through auction sales according to procedures established by the Civil Procedure Code.

⇒ *Temporary Delay of Enforcement:* For “good reasons” a court *may* allow up to a one year delay in enforcement of the pledge where (a) the pledger is a Kazakstani citizen and the mortgaged property is not associated with entrepreneurial activities and (b) where the mortgaged property is land designated as agricultural (Law on Mortgage, Art. 21.4). Under such conditions, the pledger is liable to the pledge holder for any losses incurred by the pledge holder. But if the pledger and/or the debtor is able to satisfy his pledged obligation during this period, the pledge holder’s right to enforce the pledge expires.

⇒ *Limits on Delays:* They are not allowed if (a) they will cause significant harm to the pledge holder and (b) either party has had a bankruptcy case instituted against it (Law on Mortgage, Art. 21).

⇒ *Termination of Proceedings:* Fulfillment of the obligation that has been secured will terminate the proceedings, so long as it occurs before the property is sold (Law on Mortgage, Art. 22).

- **Enforcement through Non-judicial Proceedings:** Where the parties have so agreed, a pledge holder may enforce its pledge agreement through an auction organized by a private trustee (Law on Mortgage, Arts. 20 & 24). The trustee is appointed pursuant to a provision in the mortgage agreement, or in absence of such a provision, by the pledge holder.

⇒ *Procedures:* The details for holding a non-judicial auction of pledged property are set forth in Articles 24-36 of the Law on Mortgages.

5.6. Enforcement of Tax Obligations

The Decree on Taxes and Other Obligatory Payments to the Budget gives the government significant tax collection authority. Under the Decree, if a taxable entity has not paid the required taxes, the Tax Service may, with the taxpayer’s consent, seize money in the entity’s bank accounts or the bank accounts of the entity’s debtors (Art. 154 (2)). It is understood that the taxpayer gives consent to this action merely by (a) filing and signing a tax return, or (b) failing to appeal against a tax assessment within five banking days.

When funds in these accounts are insufficient to pay the tax, the Tax Service may impose a lien on the property of the entity (Art. 155). If the entity fails to appeal the lien to the Tax Service within five banking days of its imposition, the Tax Service may make a claim on the property subject to the lien (Art. 156) and have it sold at an auction. The proceeds of this sale are used to pay the tax obligation (Art. 157).

6. Legal Aspects of Renegotiating Debt Out of Court

The following points should be of use to both creditors and debtors in their out-of-court negotiations over existing debt.

- **Right to Renegotiate:** Parties are free, by mutual consent, to terminate obligations. This can be done, for instance, by the payment and acceptance of “smart money” (Civil Code, Art. 369); and by the creation of a new obligation that replaces the previous one (“novation”) (*Id.*, Art. 372)
- **Right to Forgive Debt:** A party has the right to exempt unilaterally the other party from its obligations to the first party (“forgiveness of debt”) (*Id.*, Art. 373).
 - ⇒ *Examples of an agreements regarding the above matters.* See Appendices B-2 and B-3.
- **Liberal Right to Transfer a Claim:** Creditors may assign claims through a transaction (Civil Code, Art. 339.1).¹² The consent of the debtor is not required unless otherwise stipulated by law or by the parties’ agreement (*Id.*, Art. 339.2). However, if the debtor is not notified of the transfer and the debtor satisfies its obligation to the first creditor, the obligation is deemed repaid.
 - ⇒ *Same rights transferred unless otherwise stated:* This includes any rights to interest as compensation for unfulfilled obligations (*Id.*, Art. 341).
 - ⇒ *Objections to the claim are transferred as well:* The debtor may raise the same objections to payment as it had against the first creditor at the moment it learned of the transfer (*Id.* Art. 343).
 - ⇒ *Debtor’s right to see documentation of the transfer:* He is not required to pay until this is presented (*Id.*, Art. 342).
 - ⇒ *Form of the transfer:* It must follow the same requirements as the underlying agreement that gave rise to the claim (i.e., if the underlying claim required notarization, the transfer agreement would also require notarization) (*Id.*, Art. 346).
 - ⇒ *Responsibility of first creditor:* If the claim is deemed invalid, the first creditor is liable to the second creditor. If the claim is unfulfilled, the first creditor is not liable unless it assumed a warranty for the payment of the debt (*Id.* Art. 347).
- **Restricted Right to Transfer Debt:** Unlike a creditor’s right to transfer a claim (see bullet point immediately above), a debtor’s right to transfer its debt is very restricted. It is permitted only with the consent of the creditor (Civil Code, Art. 348).
- **Right to Refinance through a Third Party:** For instance, a party owing a debt with high interest rate may find another creditor willing to lend the amount of the debt on more favorable terms. If the debt is past due, use of the third party’s money to pay the debt (plus any penalties and interest) should extinguish the obligation to the first creditor (Civil Code, Art. 368). If all or a portion of the

¹² Some claims, such as that for alimony and for compensation for harm done to life and health, cannot be transferred (Civil Code, Art. 340).

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debt is not yet due, the debtor can most likely use these funds from the new creditor to accelerate payment of the debt.

- **Right to a Tax Deduction for Doubtful Debts Only after Two Years:** A creditor is allowed to deduct from its income loan amounts not collected within two years so long as it had included the expected amount as part of its income previously (Tax Code, Arts. 5(27) and 17).
 - ⇒ *Deduction available to companies on an accrual accounting system only (see Tax Code, Arts. 5 (12) and 17).* But tax payers on a "cash" system get the same tax benefit simply by not reporting as income the amount not paid.
 - ⇒ *Non-recognition by Tax Code to deduct amount of debt actually forgiven:* The Tax Code says nothing about deductions for debts that are not yet two years overdue, but, because of debt renegotiation, will certainly not be paid. A tax payer deducting such debt forgiveness before the end of the two year waiting period thus risks under-paying taxes.
 - ⇒ Note that parties are still free to forgive debt at any time before the two year period expires (Civil Code Art. 373).
- **Tax Affects of Having Debt Reduced:** The Tax Code recognizes this as business income (Tax Code, Art. 11(3)).

7. Legal Aspects of Assets Sales, Debt-Asset and Debt-Equity Swaps in Out-of-Court Debt Restructuring

Sometimes, the only viable method of paying off debts and gaining operating capital may be the sale of less productive assets, or the transfer to the creditor of a share of the assets or equity of the company.

- **The Right of a Company to Sell Assets:** This is inherent in a company's right to its property (see generally, Law on Economic Partnerships). Unless restricted by provisions in the company's charter or other company restrictions, the management of a company has the right to sell assets without shareholder approval.
 - ⇒ *The right of a company to sell pledged assets:* Companies may do so if allowed by their security and loan agreements (Civil Code, Arts. 315 and 327).
 - ⇒ *Tax affects of selling assets:* Proceeds from such sales are considered business income (Tax Code, Art. 11).
- **Debt-Asset Swaps:** This is merely a sale in which the purchaser, rather than paying money, forgives or renegotiates a debt obligation. As stated above the forgiveness of debt must be recorded as income by the debtor (Tax Code, Art. 11).

- **Debt-Equity Swaps:** Here the purchaser again agrees to forgive debt, now in exchange for an equity share in the company. There are two basic ways that such a transaction can be constructed:
 - ⇒ *Shareholders give portion of their shares to a creditor in exchange for creditor's forgiveness or reduction of a claim against the company.* This type of transaction, which is between two or more parties (the shareholders and the creditor) on behalf of a third party, is explicitly recognized by the Civil Code (Art. 391).
 - ⇒ *Company issues new shares:* The general idea here is that the company issues new shares to a creditor in exchange for that creditor's agreement to forgive debt. Such a transaction might develop as follows:
 - Step 1: Company D issues new shares, making sure to offer them first to existing shareholders. Shareholders refuse offer.
 - Step 2: Company D offers to sell shares to Company C, which has a claim against Company D. Company C accepts.
 - Step 3: Company C pays Company D cash and receives shares. Company C is now both a partial owner and a creditor.
 - Step 4: Company D uses cash that was recently received to pay back debt to Company C.
- Result: Company D's debt has been reduced. Company C has changed its status from a creditor to a partial owner of Company D.

8. Suggested Provisions for Increasing Likelihood of Repayment

In almost every debt negotiation, creditors are seeking to increase assurance of eventual payment, either by collection directly or through an eventual sale of the claim. Likelihood of payment, however, because of the less-than-fully-developed legal system in Kazakstan, is somewhat difficult to assess. The following provisions may increase the likelihood of repayment:

- **Pledging Collateral:** Arrangements secured by pledged collateral are discussed in some detail in Section IV-4.4. Although the creditor has the right to a sell a pledged asset to have its claim paid, this right is significantly deluded if the creditor has to apply to court to obtain control over the asset. As a result creditors will have greater security if they can maintain control of an asset. Some possibilities are discussed below:
 - ⇒ *Creditor maintains possession of the asset:* this is called pawning (see Section IV-4.3). Because the debtor loses the right to use the asset, it is not very effective as a means of pledging assets such as buildings or equipment. It could be very effective, however, for pledging property such as securities.
 - ⇒ *Asset is placed in possession of third person; creditor is given right to obtain asset from third person upon a showing of non-payment:* The most likely arrangement is one in which the pledgor places funds in a bank account that could be withdrawn only with consent of the creditor. The creditor would have the right to obtain funds if the debt obligations are not met.

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- **Sale-Lease Back Arrangements:** Because of the limits of pledge holder rights in Kazakhstan, the parties may consider a transaction in which the creditor actually buys the asset. The debtor remains in possession of the asset, but only as a lessee. The rent payments perform the same function as a debt payments. After an agreed amount has been paid, the asset is sold back to the debtor for a nominal amount.
- **Attorneys Fees and Other Debt Collection Charges:** Although the Civil Procedure Code does provide for such cost shifting (Art. 91), making such a provision explicit will help assure that the costs are transferred and warn the debtor as to the consequences of non-payment.
- **Contractual Obligation to Repay the Entire Remaining Debt before its Normal Due Date, if the Debtor Fails to Meet its Payment Obligations:** This creates additional incentives for the debtor to pay on time, and gives the creditor greater leverage in the event of non-payment. Further, if the creditor goes to court to enforce payment on the loan, it can obtain the entire amount due on the loan, as opposed to only the payments that are late.

9. The Need to Memorialize New Debt Agreements on Paper

Although not necessarily required in all instances, parties to new agreements that result from debt restructuring should memorialize their new obligations and rights on paper. The resulting agreement should meet the requirements regarding the form and content of a contract (Civil Code, Arts. 393, 394). For examples of various agreements, see Appendix B.

10. Bankruptcy

At times, the total debts of a company may so exceed its ability to pay them in the ordinary course of business, that either the creditors of a company or the company itself may seek a declaration of bankruptcy. Because this manual focuses on debt negotiations outside a bankruptcy context, the following is only a brief review of how the possibility of bankruptcy proceedings, and the potential results thereof, may affect out-of-court negotiating positions of creditors and debtors.

10.1. Brief Overview

In general, the bankruptcy process is designed to treat companies with significant debts in an orderly and coherent manner.

- If the current financial health of a company is not beyond repair, and its prospects for the future are somewhat bright, it might have its debts restructured (i.e., creditors agree to new debt terms or take a stake in the company) thereby giving it an opportunity to regain financial health.
- If the company is hopelessly insolvent, it may be liquidated (i.e., the assets are sold to pay creditors a defined pro rata share of their claims) thereby freeing up those assets for those who can use them more effectively. And, just as important, the bankruptcy process is designed to treat creditors fairly, in order to encourage them to lend money and extend credit to companies.

Cautionary Note on Bankruptcy Law: The Bankruptcy Law in Kazakhstan is new and untested. Until additional bankruptcy regulations are established and/or until a

jurisprudence of bankruptcy law develops, outcomes of many disputes in bankruptcy will be difficult to predict.

10.2. Effects of Bankruptcy Proceedings on both Debtors and Creditors

The following should be kept in mind by both debtors and creditors in negotiations where a bankruptcy application is an option:

- **The inability of a debtor to meet its obligations within three months after they are due is grounds for a bankruptcy application.** The bankruptcy application may be filed by either the debtor or its creditors. In the latter case, the application must explain why it is impossible for the debtor to meet its obligations (Bankruptcy Law, Art. 5).
- **Filing a bankruptcy application may eventually consolidate all collection efforts against the debtor:** Collection actions in other courts are stopped after the judge declares the debtor bankrupt. This declaration begins liquidation proceedings (Bankruptcy Law, Art. 17.4) where all claims will be heard by a liquidation commission. A decision by the court (with approval of the debtor's creditors) that the debtor should come under external management does not trigger the prohibition against other claims. However, it prevents the execution of judgments during the time period that the debtor is under external management (Bankruptcy, Art. 11.3). The Bankruptcy Law fails to allow for a prohibition on other court collection actions if the company is undergoing rehabilitation.¹³
- **Opportunity for creditors to continue to press their claims after filing of bankruptcy application:** Until the judge makes his decision to declare a company bankrupt, creditors have the right to press claims in other court collection actions.
 - ⇒ *Seeking to delay other collection actions until the bankruptcy judge makes his decision:* In the event of a delay on a decision of bankruptcy, the debtor or its creditors may attempt to have debt collection proceedings in other courts delayed. Upon filing a bankruptcy application, the debtor or its creditors should so notify the judges of all courts in which collection actions against it are being pursued. A request for a delay pending the outcome of the bankruptcy proceedings should include statements and supporting evidence that such a delay will result in lower court costs and more equitable treatment for creditors.
- **A declaration of bankruptcy will suspend the accrual of penalties and interest against the debtor.** It is clear that this suspension applies after the company is declared bankrupt and enters liquidation proceedings (*Id.*, Art. 17.3). The bankruptcy law fails to provide for a suspension of penalties and interest if the company comes under "reorganization procedures" (hereinafter referred to as simply "reorganization").

¹³ Note that a rehabilitation can be pursued under external management (Bankruptcy Law, Art. 13.6). The prohibition on execution of judgments in other courts would thus apparently apply were the rehabilitation conducted under this method.

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- **Filing for bankruptcy will likely result in control of the company being transferred from management of the debtor to a third party.** If a court determines the company to be bankrupt it will be liquidated. Control passes to a liquidation commission who sells the assets to pay off creditors (*Id.*, Art. 18). If a court, prior to its decision on the debtor's bankruptcy, decides to allow for a reorganization instead, control transfers to either a trustee manager (known as reorganization under external management) or a group who will eventually own part of the company in exchange for satisfying the company's debts (known as rehabilitation) (*Id.*, Arts. 12.2 and 13.6).
- **Only property of the bankrupt entity is subject to sale to pay the debts of its creditors.** Property belonging to employees as well as property merely leased or stored by the company is not included in the property subject to sale (*Id.*, Art. 19.4).
- **A bankrupt entity under liquidation may appeal against the decisions of its liquidation commission (*Id.*, Art. 18).** The court that initially declared the debtor bankrupt hears the appeal (*Id.*, 16.1).

10.3. Bankruptcy Provisions that Primarily Affect Creditors

- **If the debtor is declared bankrupt, creditors will have two months after publication of the declaration of bankruptcy to submit claims to the liquidation commission.** Claims after that point are barred (see Bankruptcy Law, Arts. 9, 21.11).
 - **Creditors whose claims were fully or partially disallowed by the liquidation commission can appeal their claims in court.** They have one month to do so, otherwise their claims are barred (Bankruptcy Law, Arts. 21.9, 22.2). The court that initially declared the debtor bankrupt hears the appeal (*Id.*, Art. 16.1).
 - **The administrative costs of bankruptcy will be collected from the debtor's property first, thereby leaving less for creditors (*Id.*, Art. 21.1).**
 - **In a liquidation and in a rehabilitation, creditors' claims will be satisfied by class in the following order:**
 1. Citizens for their claims for compensation for harm caused to their life and health;
 2. Employees for their salaries;
 3. Creditors with claims secured by pledged property;
 4. The government for money owed as the result of required payments to the budget and to non-budgetary funds;
 5. All other creditors in accordance with any other legislative acts.
- ⇒ The Bankruptcy Law does not state that the above priority list governs payouts in a reorganization under external management.

- **Payout Procedures:** The obligations to any creditor group above must be satisfied in full before the next group can be paid (Civil Code, Art 51.2; Bankruptcy Law, Art. 21.7). If the funds are insufficient to fully compensate a particular group during their turn for payment, the members of this group are paid in proportion to the amount of their claims (Civil Code, Art. 51.3; Bankruptcy Law, Art. 21.8). The claims of groups falling below the group that is only partially paid, with few exceptions, will receive no payment at all (Civil Code, Art 51.6). Thus, according to these rules, a creditor with a completely valid claim against a debtor being liquidated, might not be paid in full, or at all, if its claim has a low priority and the funds are insufficient to pay out all creditors.
- **Creditors may attempt to have disallowed the transfers of the bankrupt's property to third parties:**
 - ⇒ *Transactions occurring prior to a declaration of bankruptcy:* The Bankruptcy Law does not describe the consequences of the transaction that occurred within this period. Possibly successful would be an argument that the transaction at issue is invalid under the Civil Code because it was "committed only for appearances without intention to cause any legal consequences" (Art. 160.1). It thus would still remain property of the debtor and would be subject to distribution.
 - ⇒ *Hiding Assets:* An insolvent debtor will not be exempted from its obligations if it has hidden property or transferred it to a third party during the year prior to the commencement of a liquidation process with the view of concealing it from creditors (Civil Code, Art. 56).
 - ⇒ *Transactions occurring after a declaration of bankruptcy:* Such transactions are prohibited (Bankruptcy Law, Art 17.1).
- **Procedures for protecting creditor rights in a reorganization under external management:** The external manager is appointed by the court upon approval by creditors holding 50% of the debt (*Id.*, Art. 11.1). It is unclear as to the right to remove an external manager. Further it is unclear how voting should occur (by creditor, or by debt held by creditor) and whether the creditors have the right to approve the plan. Creditors believing that their interests are being unfairly compromised may appeal to the court (*Id.*, Art. 12.4).
- **In a rehabilitation, the creditors have a preferential right** to become rehabilitation participants and to obtain a part of the company in exchange for a reduction of its debts (*Id.*, Arts. 13.2, 14.2). Other participants are chosen by a competitive bidding process. All participants take on joint and several responsibility for the debts of the debtor unless it is otherwise agreed to in the rehabilitation plan (*Id.*, Art. 13.6).
 - ⇒ *The rehabilitation plan* is adopted by the court upon approval of creditors claiming more than 50% of the debt (*Id.*, Art. 13.7).
 - ⇒ *Creditors believing that in the course of rehabilitation their interests are being unfairly compromised may appeal to the court* (*Id.*, Art. 13.9).

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- **Uncertainty as to the right of unsatisfied creditors to seek claims against third parties to the extent the latter are guarantors or warrantors of the bankrupt's debts:** On one hand, meeting the obligations of the bankrupt when it lacks the means to pay the creditors is exactly the type of circumstance a guaranty or warranty is designed for. On the other hand, the Bankruptcy Law states that "creditors claims unsatisfied for the lack of the liquidated entity's property . . . shall be deemed repaid" (*Id.*, Art. 21.11). Further, the Civil Code states that a "warranty and a guaranty shall cease with the termination of the obligation secured with them" (*Id.*, Art. 336.1). This language suggests strongly that guarantors and warrantors are free of their obligations to secure an obligation of the debtor upon the debtor's liquidation.
- **Creditors may seek relief against the founder of a company on grounds that it caused the bankruptcy:** Normally, the creditors of a company cannot look to the company's founders to satisfy claims (Civil Code, Art. 44.2). Founders are liable though when they are found to have caused the bankruptcy of the company and the legal assets are not sufficient to satisfy the claims of creditors (*Id.*, Art. 44.3).

11. Voluntary Liquidation Under the Civil Code

In addition to its rules under the Bankruptcy Law, Kazakstani law also allows for another method for terminating a company's legal existence: voluntary liquidation. The procedures are far simpler than those employed under the Bankruptcy Law.

- **Concept of Voluntary Liquidation:** Voluntary liquidation is the means by which the owners of an enterprise terminate that enterprise's legal existence. Such a liquidation involves the itemization of the enterprise's assets and debts. The latter must be settled through full payment or partial payment according to law if the assets are insufficient to cover all the enterprise's debts. After such payments are made, the enterprise's existence is terminated by having its name removed from the state register of legal entities.
- **Procedures for Initiating Voluntary Liquidation:** A decision to liquidate a company can be initiated by the board of directors, the company's audit commission, or by the petition of 20 percent of the company's shareholders.
- **The Decision to Liquidate:** Such a decision must be approved by no less than 2/3 of the total number of voting shareholders. A general meeting of shareholders is recognized as competent if more than 50% of the shareholders or their legal representatives, having more than 60% of votes, attend the meeting. The shareholders need not articulate a particular reason for the liquidation.
- **Liquidation Procedures:** After the decision to liquidate, a liquidation commission, appointed by the shareholders, takes control of the company. It begins inventorying assets, publishes notice of the liquidation and informs creditors directly. After a period of no less than two months after public notice, the commission presents for approval of shareholders a liquidation balance sheet detailing all claims and assets. Upon approval by shareholders, payments to creditors begin.

- **Payment Rules:** If the monetary assets of the company are insufficient to satisfy creditors' claims, the commission sells assets of the company through public auction according to procedures established for the execution of court decisions. The commission must pay creditors according to the rules under Article 51 of the Civil Code. Money or assets that remain after payment are given to shareholders.
- **Termination of Legal Existence:** The liquidation of the company is complete and the company is deemed terminated after the appropriate reference is recorded in the state register of legal entities.

12. Conclusions

The successful development and implementation of an out-of-court debt restructuring plan depends upon adherence to rules and regulations governing such efforts. The preceding legal commentary provides the user with a comprehensive foundation and the tools necessary to commence the restructuring exercise from a legal perspective. This section of the manual is based upon current legislation and the civil code. As the market economy in Kazakstan continues to evolve, the laws governing transactions will change as well. The users of this manual should consult legal counsel prior to the commencement of formal restructuring negotiations to ensure the most favorable legal provisions are employed in this exercise.

Appendix A

Account Sheet Balance Listings

Appendix A

Kazakstani Standardized Chart of Accounts

Accounts Receivable and Other Assets, and Debts and Accounts Payable

The following are standard balance sheet accounts that should be utilized to account for the various types of debts and accounts receivable listed in Tables 1 and 2 in Section II of this manual. This listing also reflects the applicable account numbers for reference. Enterprises can utilize these listings to help ascertain what should be included in these tables.

Balance Sheet Accounts Applicable to Table 1, "Enterprise Creditors"

1. *Short-term loans*
 - Account 90 - Short-term bank loans (completely)
2. *Long-term bank loans*
 - Account 92 - Long-term bank loans (completely)
3. *Debts to third parties*
 - Account 94 - Short-term debt (completely)
 - Account 95 - Long-term debt (completely)
 - Account 79 - Settlements with other Debtors and Creditors
 - Account 78 - Settlements with Subsidiaries
4. *Payment for delivery*
 - Account 60 - Settlements with Suppliers and Contractors (completely)
5. *Settlements with the government*
 - Account 67 - Non-budgetary liabilities (completely)
 - Account 68 - Settlements with Budget (completely)
6. *Settlements on social sphere*
 - Account 65 - Personnel and Property Insurance Payable (completely)
 - Account 69 - Social benefits Payable (completely)
7. *Debts to workers and employees*
 - Account 70 - Settlements with personnel on salaries (completely)
 - Account 71 - Settlements with accountable people (completely)
 - Account 73 - Other settlements with personnel (completely)
8. *Other creditors*
 - Account 62 - Settlements with Buyers and Customers (completely)
 - Account 64 - Advances from Customers
 - Account 75-2 - Paid-out income etc. (completely)
 - Account 76 - Settlements with Other Debtors and Creditors
 - Account 78 - Settlements with Subsidiaries
 - Account 79 - Settlements with other Debtors and Creditors
 - Account 97 - Lease Liabilities (completely)

Balance Sheet Accounts Applicable to Table 2, "List of Debtors -- Overdue Receivables"

1. *Products and services*
 - Account 62 - Settlements with Buyers and Customers (completely)