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Brochure on Shareholders Rights

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Preface (Section 1)

As a result of the mass privatization program, millions of Russian citizens have become shareholders, i.e. owners of securities - shares of privatized enterprises or Investment Funds. A person can also become a shareholder buying shares of a privatized enterprise where he works, or of any privatized enterprise for cash or in exchange for vouchers. Throughout the world, investment in stock is considered to be one of the most common. It gives the owner the right to receive his share of overall income in the form of dividends. And not only this. Investing his money in shares of an enterprise, the shareholder acquires a number of rights.

Basic Rights of a Shareholder:

- the right to a share in company net profits;
- the right to information on its performance;
- the right to vote in decision-making on the most important issues of its activities;
- the right to freely dispose of one's share.

How are shareholder rights in Russia observed? certain of these guarantees are fixed in legislative acts, however general legislation in this field leaves much to be desired. The problem of protecting shareholder rights in Russia is rather high on the agenda. Managers of our enterprises are not accustomed to be responsible to the shareholders and to report to them on their performance. Shareholders, in their turn, do not fully realize their rights, connected with shares. Meanwhile the greater part of the Russian population today are shareholders. And now, the success of an enterprise, and each one of us, will depend on how active we are, the knowledge and information we have on hand.

In this pamphlet we tried to digest information about shareholder relations in different countries of the world. It's probable that with the development of shareholder relations in Russia its own model shareholder/management relations will be worked out. But it's useful to use the world practice while developing one's own model.

This brochure will tell you about the rights enjoyed by shareholders, and how these rights can be protected.

NOTE: In the process of work on the brochure the following issue was debated: how should a shareholder be called - "holder of shares (vladelets aktsii) " or"owner of shares " (sobstvennik aktsii). According to J. Hay the combination "owner of shares" should be used in all cases, since it better reflects the essence of the subject. We ask readers of this version to pay attention to this and express their opinion. If the expression "sobstvennik aktsii" which sounds unusual for Russian readers , will be chosen, we suggest to include the following explanation:

In this brochure we deliberately use the phrase "owner(sobstvennik) of a share" and not "holder(vladelets) of a share". According to world practice the notion "owner of a share" includes also, besides the right to own , the right to freely dispose of the security. Many enterprise managers would prefer to consider their shareholders as holders, but not owners. By introducing this new term we wanted to once again remind shareholders of their rights.

Section 2: On shares, shareholders and their rights

In this section, we tried, with the experience of other countries, to reply to the most vital questions on shares and shareholders.

What is a share?

A share is a security, which stipulates the rights to own a share of stock in the charter capital of a joint-stock company.
The rights of a shareholder are divided into:

- **finance rights,**
- **the right to information,**
- **the right to participate in management.**

If you want to receive profit from your investments, it is necessary to insist that the management adheres to these rights. If any of these rights are violated, your chances of making money from your investment in stock could be hurt or taken away completely.

What is a joint stock company?

A joint stock company is a form of organizing large enterprises which attract investments by issuing and selling shares. There are two types of joint stock companies: JSC of a closed type, shares of which may be transfered from one holder to another only with consent of other shareholders, according to the procedure, specified by the charter of the JSC, and of open type, shares of which may be freely bought and sold.
This brochure is dealing mostly with JSC of an open type. Shareholders of closed JSC enjoy many of the rights, mentioned in the brochure but in this case a number of limitations are applicable as well.

What are the most important financial rights for shareholders?

- **The right to dispose of your shares.**

The owner has the right to sell his share or transfer it to another person. This does not require the approval of the AO administration or any other shareholder.

- **The right to receive dividends,** if the annual meeting of shareholders approves this .

- **The right to a share of any assets of a company,** if it is forced to liquidate. If anything is leftover after satisfaction of claims of creditors, suppliers etc.) the remaining assets are distributed between shareholders according to procedure, specified by the charter .

What are the most important rights to information for shareholders?

- **The right to know the business plan of the enterprise.**
- **The right to receive quarterly reports on the company's financial performance.**
- **The right to be notified in advance of annual meetings and extraordinary meetings convened by the corporation.**
- **The right to know the Articles of the Association and all amendments and additions which are introduced into it as well as to have access to any minutes of shareholders meetings as well as to the minutes of meetings of the Board of Directors.**
- **The right to inspect the share register.**

What is the right of a shareholder to participate in management?

At annual meetings, owners of ordinary (voting) shares have the right to vote on the following matters:

- *election of the members of the Board of Directors;*
- *the most important decisions concerning the AO activities;*
- *payment of dividends and their amount;*
- *issue new shares of stock of the company;*
- *use company funds to repurchase shares from stockholders;*

- sale or any form of alienation of a large portion of its assets;

- divide a company , apportion another company or create a daughter company or join it to another company;

- introduce changes an and additions to the company's Articles of association.

How many votes does each shareholder receive?

The basic principle in a joint stock company is: one share - one vote. Therefore, the greater contribution of a shareholder in AO charter capital (the more shares he has), the greater possibility to influence decision-making at the general meeting.

Do shareholders forfeit their right to vote if they cannot attend the annual meeting in person?

In most countries in the world voting can be conducted by "proxy". A shareholder, who for some reason cannot attend a meeting, appoints someone to vote for him. Sometimes, shareholders give their proxies specific voting instructions. In other cases the shareholder gives his proxy discretion to vote for or against each agenda item based on the information provided at the meeting.

Do shareholders have the right to interfere in day to day management?

A company is managed by the administration. The administration - is usually hired personnel, whom the shareholders entrust to manage their company. The shareholders control the management of their administration through their representatives (Board of Directors) and participate in adopting the most important decisions. If the Board of Directors are dissatisfied with their management, they have the right to annul their contract and hire new managers. However, if the business plan proposed by the management has been approved by the Board of Directors and the shareholders' meeting, and the authority of the managers has been affirmed for a certain period

of time, the managers have the power to undertake measures, within the authority they enjoy. In this case shareholders do not have the right to interfere in the day to day management of the company.

What is the role of the Board of Directors?

The members of Board of Directors are elected among shareholders at the annual meetings . They are empowered to represent shareholder interests during the course of a year.
The basic principle of the performance of a company is the division of functions: administration executes day-to-day management, and the Board of Directors monitors its performance and oversees observance of shareholders rights and interests. The Board of Directors should meet at least once a month, and vote on all important business decisions.

The Boards of Directors should not consist solely of members of the administration. It should necessarily included people not employed by JSC, whose only interest is that they are shareholders of the JSC. Board of directors consisting solely of members of administration is like a goat guarding cabbage.

What is an Audit Commission ?

Audit Commission is another tool enabling shareholders to exercise control over activity of management. The Audit commission, like the Board of Directors, is elected among shareholders by shareholders meeting, it also should necessarily include members, materially independent from the management of JSC. The Audit Commission audits all financial documents of the JSC and oversees their availability to shareholders. The Audit Commission chooses independent auditor in order to check financial statements of the JSC. The Audit Commission oversees correctness of maintenance of shareholders register and is empowered to call for urgent shareholder meetings in order to deal with financial matters.

Is the right to receive annual dividends guaranteed?

No. Dividends are declared only if approved by shareholders at their annual meeting.

In some cases, it is in the interests of shareholders not to receive dividends and invest all profits in the reorganization of production or the realization of this or that well-planned project. Good investments can produce higher dividends in the future.

Besides, receiving dividends is only one way to make money from owning stock. Shareholders can also profit by selling their shares to someone else at a price higher than they paid for it.

Every day thousands of shareholders around the world sell and buy shares at a profit through stock markets (securities markets). Stock markets are now beginning to emerge in Russia. If a company is concerned about its future and conducts a wise investment policy, its dividends may be reduced, the price of shares on the stock market will rise. But if the management makes false decisions and mismanages the JSC, the market price of its shares will go down and the shareholders could lose the value of their investment.

Do the rights of shareholders conflict with the interests of workers?

In the long-run, shareholders and workers share a common interest. Both are interested in their company to be competitive in a free market economy and to bring in a profit.

Only competitive, flourishing companies can provide secure jobs and a rise in their incomes.

Only effective, competitive companies can provide high dividends and stock prices to any shareholders.

If the goods of an enterprise are not in demand, it will go bankrupt, which means all workers and shareholders will lose everything. So both shareholders and workers have an interest in persuading managers to conduct a policy, to make their company competitive on the market.

But before some privatized enterprises manage to become successful they will have to go through a difficult period of restructuring. At the stage of restructuring nobody can give any guarantees to the workers or to the shareholders. It's possible that many AO will fight for survival. Both employees and shareholders should be prepared to accept hardships and certain sacrifices.

Why should managers respect shareholders rights?

Managers all over the world protect shareholders rights for the simple reason, that this is in their interest to do so. Periodically enterprises are in need of increasing their charter capital by attracting new investments into production, and consequently new company shareholders. If managers have the reputation of violating the rights of their shareholders, they will find it hard to attract new investors.

The issue of attracting investment for privatized Russian enterprises is on the top of the agenda. It is necessary to restructure production, to have new sources of finance. That is why managers of enterprises should be first of all interested that potential investors would have trust in them. The best way to accomplish this - is a well thought-out investment policy and respectful approach to shareholders, and strict observance of all their rights.

When would a shareholder decide to sell his share ?

A legal right of any shareholder is to sell his shares freely. You need not to ask anybody for approval in order to sell a share. You have a right to decide yourself, how you should act, being guided solely by your own interest. If you feel that the enterprise is going into recession,

just think it would make sense to sell shares of this enterprise and to use the money to purchase shares of another, more promising JSC. Before selling the share obtain as much information as you can on its price. Try to establish the dynamics of change on the market price of shares, what is its current quotation on the stock exchange. If you decide to sell your share, choose the best moment for this, to receive maximum profit. Selling shares may be an efficient way to influence the management.

If you feel that your rights as a shareholder are not observed or that your shares do not bring sufficient return because of incompetent management of the JSC you have the legal right to sell the shares. If many shareholders decide to sell their shares, it will testify that something is wrong in the JSC.

SECTION 3: PRINCIPLES OF MANAGEMENT /SHAREHOLDER RELATIONS

Company managers in countries with a developed market economy usually base their relations with shareholders guided by principles incorporating shareholders rights to the maximum. These principles are:

- more than half of the Board of Directors are materially independent of the AO, whose only interest in the company is as a shareholder;
- all groups of shareholders are represented on the Board of Directors, irrespective of how they acquired their shared;
- shareholders are informed every quarter as to the financial performance of the company;
- financial reports are verified by a professional independent auditor;
- the shareholders register is conducted by an independent registrar, and each shareholder has free access to the register;
- every shareholder has the right to get access the detailed business plan of the JSC;
- shareholders who cannot attend the annual meeting for some reason, can vote by proxy;
- all decisions affecting the use of a significant portion of the company's capital, including the buying or selling of huge blocks of shares, are adopted at the annual shareholders meeting;
- all decisions in which anybody in the administration is materially interested, shall be taken only after approval by the Board of Directors;
-members of the Board of Directors, materially interested in adopting this or that decision, do not participate in the voting on this issue:
- if the company issues new shares, all shareholders have equal rights to acquire them.

Shareholders should try to have these principles included in the Articles of Association of joint stock companies.

SECTION 4: WATCH FOR THESE TRICKS THAT MANAGERS CAN PLAY TO VIOLATE SHAREHOLDERS RIGHTS

Some managers consider privatization of an enterprise as a purely formal act and try to run the enterprise in the same old way. Following are some of the tricks managers most often use to ignore shareholders interests:

- intentional delay of sending notices of annual meetings, so that shareholders will not have the opportunity to arrive on time;
- charging admission fees to annual meetings, although all shareholders have the right to attend annual meetings anyway;
- violations of the rules of procedure: voting by show of hands instead of secret ballot;
- creating "special" classes of shares whose owners will receive more dividends or more votes at the general meeting;
- election of "pocket" Boards of Directors, consisting only of the administration representatives, like director, chief engineer and chief accountant, who "control" themselves;
- using company money to buy back shares of the company stock at cheap prices from shareholders who are uninformed about its real value. Often this happens to workers who own shares;
- issuing new shares and selling them to figure-heads at cheap prices. Shareholders do not have the chance to purchase them;
- illegal sale of company property or goods to friends at cheap prices;
- refusal of managers to register sale-purchase transactions of shares or taking a very high interest rate for the registration, which infringes on the rights of shareholders to disperse their stock;
- include a clause into the Articles of Association of the company, whereby the Board of Directors cannot replace members of the Board;
- attempts to manipulate shareholders votes: exerting pressure on the employees-shareholder in order make them transfer their voting rights to management, including passing the shares into full control by management or by persons, affiliated with the management.

SECTION 5: RUSSIAN LEGISLATION AND OF SHAREHOLDER RIGHTS

(NOTE. THIS IS A DRAFT TEXT. TO BE COMPLETED)

A number of guarantees protecting shareholders rights are envisaged by standard acts. The basic principles of company performance and shareholders rights are fixed in Articles of Association of a joint stock company. The principles of registering shareholders and conducting a company register are stipulated in the Russian Presidential Decree No 1769 "On Measures to Guarantee Shareholders' Rights" of October 27, 1993. Russian legislation fixes the following stipulations:

- General Director reports to the shareholders at the annual meeting on the performance of the company. The annual meeting is held at least once a year;
- the shareholders are informed of the upcoming general meeting at least 45 days in advance;
- the shareholder may vote at the meeting by "proxy";
- joint stock companies having over 1,000 shareholders must have independent registrars conduct the register - banks, investment organizations, depositories or specialized registrars. A registrar cannot refuse to make an entry into the register. Rejection of including a shareholder into the register may be appealed in the company auditing commission, civil court or court of arbitration;
- the managers are obliged to inform shareholders on the payment of dividends and procedures of calculation.

But Russian legislation on shareholder rights is not yet perfect. One of tasks of priority for the new Russian Parliament will be to adopt normative documents , regulating corporate property and corporate relations. It is especially important for the new laws and normative documents, to reflect the following points:
- there should be firm guarantees for small investors that their opinion will be taken into account when decisions are taken by general meetings. Each shareholder should possess the right to vote on all important issues;

- the procedure for voting should be specified in detail, so that opinion of all shareholders would be taken into account;
- the legislation should specify principles for formation of the audit commission, and should guarantee access to information of financial conditions of the JSC for the shareholders and to public;
- it is necessary to include provision for reelection of the Board of Directors annually, the board should be entitled to the right to make decisions on replacement of members of management.

SECTION 6: How can you protect shareholders' rights?

How can a shareholder protect his rights? Here are some suggestions how you can do this.

Attend your annual meeting.

Learn all you can about the performance of the company. The more information you have, the more intelligent will be your vote.

Ask questions to the managers about their business plan and what they are doing to protect shareholder rights.

Consider sponsoring an amendment or an addition to the company's Articles of Association aimed at the protection of shareholder's rights. For example, you could sponsor an amendment requiring that half of the members of the Board of Directors be people materially independent of the company.

Call your local Association for Shareholders' Rights. If one is not yet organized in your region, get in touch with the Moscow Association.

ADDRESS:

The Basic Fields of Performance of the Association for Shareholders' Rights:

- wide dissemination of information on shareholders' rights;
- work with enterprise management to advocate shareholder rights;
- filing lawsuits to the Court of Arbitration against companies systematically violating shareholders' rights;
- public expertise of legislation on shareholders rights;
- providing information on joint stock companies financial performance.

On all matters of violations of shareholder rights call the Association for Shareholders' Rights. They can help you to take action.