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**UKRAINE**

**Power Sector Regulatory Reform and Restructuring**

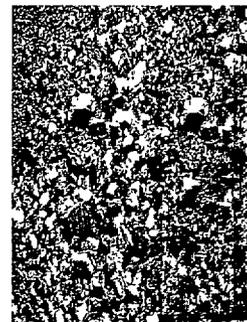
**Task - Institutional Development Activity**

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**CORPORATIZATION**

**GUIDELINES**

**AND**

**ANALYSIS**

**Prepared by:**



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# CORPORATIZATION GUIDELINES AND ANALYSIS



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## EXECUTIVE SUMMARY AND RECOMMENDATIONS

### 1. Introduction to Power Sector Reform in Ukraine

The Ukrainian government is currently introducing far reaching market reforms to its electricity sector. They involve the vertical disintegration of the formerly centralized structure; the creation of independent, commercial corporations at the generation and distribution level and extensive regulatory and institutional reforms. The World Bank is providing general policy advice to the Ministry of Energy and has secured the financial assistance of a number of donor agencies to provide foreign technical assistance for the implementation of this complex program. This study comes in the context of the legal formation and corporate organization of four fossil fuel electric generating companies (FGCs), namely : Centrenergo, Donbassenergo, Dniprenergo and Zaxhidenergo. It is aimed at assisting the Ministry of Energy and newly appointed General Directors in the critical first steps of their foundation. Together these companies account for approximately 60 % of the country's generating capacity.

The funding was provided by the Energy Division of the United States Agency for International Development and was performed by Price Waterhouse LLP, as a sub-contractor to Hagler Bailly Inc, under a contract issued for the "Power Sector Regulatory Reform and Restructuring Task - Institutional Development Activity"<sup>1</sup>.

This document entitled "Corporatization Guidelines and Analysis" summarizes our work to date. Our recommendations and research have been shared with the senior officials of the four companies on an ongoing basis since January 1995. By August 1995 all four companies had been incorporated. Our research was aimed at giving the new directors information on sound corporate governance practices so that they could positively influence the creation and definition of new corporate institutions within the boundaries authorized by current Ukrainian corporate law.

### 2. Summary of content : Corporatization Analysis

Our analysis covers the respective roles and responsibilities of executive and non-executive directors. Ukrainian law makes a two tier management system, similar to German companies, the most appropriate structure. We describe the implications of having the State as a single

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<sup>1</sup> See deliverable defined under paragraph 3.1.1.1.6 of the Draft Work Plan dated January 4, 1995 prepared by RCG/Hagler Bailly, for the United States Agency for International Development, Contract Reference: CCN-0002-Q-00-3152-00, Delivery Order No. 4. Please note hereafter that subsequent footnotes refer to paragraph numbers of this document unless otherwise specified.

shareholder as opposed to multiple private equity ownership. The State has a responsibility to manage a smooth transition to a market economy and may be tempted to interfere directly in the management of the new independent generating and distribution companies. Any energy policy should however be conducted exclusively at the executive level, not indirectly, by interfering in the management of the Joint Stock Companies with aims that are not strictly commercial. Any deviation from that principle would jeopardize the integrity of good corporate governance.

Much attention has been devoted to the organization and composition of the future Supervisory Councils. The importance and respective roles of various standing committees are described in detail as well as suggested corporate governance practices relating to the most effective use of non-executive directors. These include encouraging between the two tiers of management, a relationship based on collaboration and consensus, rather than confrontation. This can be done by introducing internal procedures that promote the sharing of information and open debate.

The concepts of fiduciary responsibilities of directors to shareholders as they are known in the West are introduced and explained. Additional advice and training needs to be provided to individual Supervisory Council members as soon as they have been appointed.

The importance of in-house and independent audit is explained and differentiated. We describe the function of the corporate secretary and the importance of maintaining the integrity of the shareholder registry. We also briefly list other possible stakeholders, likely to influence management decisions, such as employees, members of the local community, electricity end users, etc.

A final section deals with legal and financial reporting and current disclosure requirements for the listing of shares on the Ukrainian Stock Exchange. Under the same contract, Price Waterhouse is also advising the FGCs on the creation of an integrated financial management system and the conversion of their accounting system to internationally accepted accounting principles. Introducing these changes will be necessary before contemplating any outside financing. Further research on the practical feasibility and additional requirements for raising private capital, specially from foreign sources, still needs to be performed. For instance, it has been a requirement for listing on the New York Stock Exchange since 1978 to have an internal audit committee made up of at least four non-executive Directors. Our recommendations include creating such a committee, but there are many other requirements, much more difficult to implement, that must be met before any of the FGCs can contemplate such a step.

### 3. Recommendations : Corporatization Guidelines

Our principal recommendations have centered on the drafting of a transparent corporate charter guaranteeing accountability of the various institutions and maximum minority shareholder protection through various self-enforcement mechanisms. Following the principle of subsidiarity, decisions are delegated to the lowest possible level. This increased flexibility in the decision

making process is compensated by strict reporting mechanisms, the clear definition of different levels of authority and the empowerment of each higher institution to take various ex-post measures against the lower level body which directly reports to it, if it is deemed necessary. Our recommendations recognize that shareholder rights are vulnerable in the current Ukrainian environment. Legal redress and illiquid financial markets do not afford the usual guarantees a Western investor can expect. This is why we have included a series of far reaching measures designed to give shareholders various options in case they feel management (or a controlling shareholder) is not acting in their best interest.

Some of our recommendations are summarized below. The full text of the proposed charter is included in Annex A. Provisions specifically designed to emphasize shareholder rights appear in italics. Article numbers mentioned hereafter refer to the proposed Charter.

The charter we recommend that all the FGCs adopt eventually has been reviewed for consistency with Ukrainian law by Ms. Svetlana Golikova, a Ukrainian lawyer. Ms. Golikova is the corporate lawyer who incorporated the Joint Stock Shipping Company Ukrriich Flot, the first large SOE to be sold to members of the public in Ukraine. The draft was then further reviewed by the international law firm Latham & Watkins and their Ukrainian counterpart Victor Kovalenko of the law firm Grischenko Paliashvili & Partners. Director Siaber of Centrenergo proposed some additional modifications and endorsed its final version. It has currently been approved by 11 out of 12 signatories at the Ministry of Energy. It has also inspired the drafting of the Charter submitted by the Founders of the future Energomarket Joint Stock Company.

In general, all day to day decisions should belong to the Executive Board. the Supervisory Council should only interfere in a limited number of pre-defined situations. Shareholders should, in general, not be involved in this process. This is mainly because making decisions conditional upon shareholder approval, makes the process very cumbersome. Usually, Shareholders meet only once a year to appoint the Council members who in turn appoint the Executive Board members (both Centrenergo (Article 8.2.3.1.) and Zaxhidenergo follow this pattern). That is how shareholders normally exercise control on the management of the company. The Supervisory Council is in turn allowed to remove the Executive Board members and is thereby made accountable for their performance. Under exceptional circumstances however, Shareholders must be able to interfere directly. Article 8.2.4. of Centrenergo's Charter gives them the automatic rights to pre-approve decisions that could either "transform the nature of their investment or involve a substantial risk of abuse". A certain number of such decisions are listed as falling automatically into that category. A group of shareholders can also call an extraordinary meeting of shareholders if they feel that such a decision has or is about to be taken. Article 8.2.9 extends that right to individual Council Members and the Revision Commission. Adding items to the agenda of a meeting of shareholders (such as proposing a candidate to the Supervisory Council or to the position of Chairman of the Executive Board) is also a relatively simple procedure for any Shareholders.

The decision to issue new shares belongs to the Shareholders (as prescribed by the Ukrainian law on Business Association). But within reasonable limits (1/3 of the statutory fund), the Shareholders should be able to delegate this function to the Executive Board (subject to Supervisory Council veto). This gives the Company the flexibility to take advantage with short notice of market conditions in order to raise private capital. In Russia, the first public share offerings in October 1994, were significantly hindered and delayed by the need to first hold shareholder meetings to authorize any sales. (see Article 5.3.1. of Centrenergo Charter. This recommendation was also adopted by Zaxhidenergo.).

The decision to declare and distribute dividends should belong to the Supervisory Council (Article 7.1.), but only if the company is solvent, as determined by internationally accepted accounting principles.

The concept of "treasury shares" does not exist per se under Ukrainian law. Centrenergo's charter, Article 5.3.1., mentions them expressly and provides that they will have no voting rights as long as they are owned by the Company. The same is true for authorized but un-issued shares (Article 6.1.). This prevents management from exercising in their favor voting rights of shares that appear to belong to no one, as has reportedly been the case sometimes in Russia.

Shareholders should have ex-post participation rights to prevent dilution of ownership at less than market price and redemption rights in cases where a decision defined in the above mentioned Article 8.2.4. was approved by a majority of shareholders, but the individual shareholder dissented. This means that even where a majority of shareholders controls the assembly, minority shareholders always have the right to either exit their investment at a fair price or a guarantee to buy additional shares to maintain their proportional ownership, also at a fair price. (see Articles 4.2.9. and 8.2.5. of Centrenergo's charter). These are examples of shareholder rights that go beyond what is common in publicly quoted companies in the West. As mentioned earlier, these provisions are intended to compensate for other mechanisms usually available to investors but absent in Ukraine for the time being, such as a liquid financial market and a reliable judicial system.

In principle, the sale and purchase of the shares of an open joint stock company should be unrestricted (see Article 4.3.8.) However, if the Company sells a quantity of shares sufficient to shift the control to a group of shareholders (or a single shareholder), then the other shareholders should pre-approve the sale. (Article 5.3.3. of Centrenergo Charter). Ukrainian securities laws do not otherwise yet provide for the public disclosure of the intention to accumulate (through secondary trading), a controlling portion of the shares of a public company. Article 5.3.3. is designed to prevent management from shifting shareholder control to avoid their annual review and protect their position.

So called "Self Interested Transactions" (defined in Article 8.3.4.3. of the charter and also included in Zaxhidenergo's Charter) should be approved by non interested Council Members. This should make it difficult for high company officials to personally benefit from their position at the expense of the company and its shareholders without all parties involved knowing about it.

Minority Shareholders should have the right to appoint Council Members yearly under a system of proportional representation (Article 8.3.2.5.). Members should be re-elected each year. The procedures for submitting Council Member candidates at each General Meeting of Shareholders should be simple and open to all concerned (Article 8.3.2.7.). This provision makes Council Members directly and annually accountable to the Shareholders. If the Shareholders are not happy with their performance, they can be removed, with or without cause. Executive Board members in turn are appointed by the Supervisory Council members. The Chairman of the Executive Board, in Centrenergo's charter is confirmed by the Shareholders for a period of three years. This is a concession to the tradeoff between yearly accountability and stability in the leadership of the company which the Director of Centrenergo felt was necessary (Article 8.2.3.1.). Other Executive Directors are appointed and removed at the discretion of the Supervisory Council, subject to the suggestion of the Chairman of the Executive Board.

Shareholders must have the right to access all "material information" (Article 8.3.4.2.) concerning the company. The Centrenergo Charter lists documents which the Company must make available to Shareholders. All copies are to be provided for no more than the actual cost of reproduction (Article 4.2.6.). Members of the Supervisory Council should not have to rely exclusively on information prepared by the Executive Board to make their decisions. They should have the necessary power to conduct their own independent investigations. (Article 8.3.5.1.).

The charter has built in fiduciary duties of loyalty, care and attention for Supervisory Council Members (Article 8.3.4.6.) and Executive Board Members (Article 8.4.10). Under Ukrainian law, they are currently only responsible in case of gross negligence.

The Charter provides for Standing Committees to be appointed at the Supervisory Council level. An annex gives an example of by-laws adopted by a large US utility, Pacificorp, for a Personnel and Remuneration Committee, a Finance Committee and an Audit Committee. We recommend also the formation of a Nomination Committee, an Executive Committee, a Coordination Committee and a Corporate Governance Committee.

The actual text in Annex A contains many more practical recommendations. For instance the logistics of holding a shareholder meeting are described in great detail, specifying notice requirements, quorum rules, conditions for proxy voting, vote counting, etc.

#### 4. Lessons Learned and Concluding Statements

Centrenergo is the only FGC to have endorsed most of our recommendation. At the time of writing, the Charter has not yet received all the approvals necessary for registration and it is not clear that it will be accepted without significant alterations. Zaxhidenergo has adopted a more traditional charter, but, encouragingly, did incorporate some of our recommendations into the text. Dniproenergo and Donbassenergo did not solicit our advice in the corporatization process.

This qualified result suggests that some lessons can be learned to help future similar technical assistance projects achieve a higher rate of success. In particular, it seems that not enough time, resources and explicit attention, was devoted to ministry officials. Corporate Governance training and corporatization assistance in the current Scope of Work were all exclusively targeted at the newly appointed General Directors. They are the ones who will have to manage the companies according to new commercial principles. But the ministry officials remain, for the foreseeable future, the representatives of the State and sole owner of these entities. As such, their blessing to the introduction of Western style corporate governance principles, was essential. The Charter for Centrenergo may yet be rejected by the shareholders it is designed to protect, mainly because it looks so unfamiliar. As for Donbassenergo and Dniproenergo, their management were acting quite rationally, in the short term, when they refused to subject themselves to the straight jacket implied by strict accountability to shareholders.

We therefore suggest that any future corporatization assistance in FSU countries target shareholders and founders more specifically. Management should not be overlooked, since their collaboration is essential for the implementation of the new system. But that work can come after the owners have endorsed the changes.

As for the FGCs in Ukraine, technical assistance will be provided on an ongoing basis for the foreseeable future. The advisors should continue to explain to all concerned the benefits of adopting our recommendations. As long as the State remains the sole shareholder, amending the existing charters will be a formality and should be actively encouraged for Donbassenergo, Dniproenergo and Zaxhidenergo. Similar steps should be considered for the Local Electricity Supply companies. As soon as the privatization process begins, a formal special shareholder meeting will have to be convened and a 75 % majority must agree to the changes. If management and employees control a sufficient amount of shares, change will be unlikely to occur as vested interests will by then be deeply entrenched. This has been a pattern familiar in post-privatization Russia, where abuse of the rights of shareholders is sadly commonplace.

Applying sound corporate governance will attract cheaper capital. In the Former Soviet Union, remarkably few large companies seem to understand how much of a first mover's advantage they would have by acknowledging this before the others. International investors are looking at Ukraine with a mixture of curiosity, growing interest and wariness. The FGCs are very large corporations and should eventually become prime investment targets. The adoption of a strong

corporate charter protecting minority shareholder rights should help to distinguish them from other former State Owned Enterprises. Given similar business prospects, investors interested in the energy sector in the Former Soviet Union, will prefer a company dedicated to guaranteeing shareholder rights.

Ukraine's mass privatization program will probably lead to a significant dilution of ownership rights and the creation of many small investors. Individually, they cannot exercise much pressure on management. As a result, corporate governance enforcement will have to rely less on the direct monitoring of the boards and more on strict financial disclosure requirements. Small shareholders must have access to transparent and accurate financial statements so that they can easily make the decision to hold on to their investment or sell their shares. In the Ukraine, until capital markets become more liquid and sophisticated, in order to attract investors, it will be all the more important for the FGC's to make their financial statements transparent and ensure that all material information is released in a reliable and timely fashion.

The managerial and accounting reforms we recommend will contribute to better management decisions and more credible relationships with the investment communities. In addition, the management of the FGCs should be given assistance on producing their first annual and quarterly financial statements for the public.

The four generating companies have a pivotal role to play. They are leading the way in the reform of the Energy sector and of the economy of Ukraine in general. They are being closely watched by other company directors and will provide useful examples for the entire country in this difficult period of reform. Adopting sound corporate governance principles and setting new standards for corporate management will have an impact far broader than just at the individual level of these four companies.

## I. FGC CORPORATIZATION PROCESS

### 1. Legal Environment

#### (i) Background

On March 17, 1995, the President of Ukraine ordered the corporatization of four Fossil Generating power Companies (the "FGCs"), to be completed by August 4, 1995. In practice, by August 31, all FGCs had been legally incorporated into Joint Stock Companies by ministerial decree. Together they own 14 power plants with an aggregate capacity of almost 30,000 MWs, or about 60 % of current total Ukrainian electricity generating capacity.

The creation of the FGCs is part of a comprehensive reform program, coordinated by the World Bank, which aims to introduce a competitive market environment for the generation and distribution of electricity in Ukraine. The old vertically integrated Energos are being dissolved and their assets and liabilities allocated amongst new commercial companies.

The Presidential Decrees of March 17, 1995<sup>2</sup> (one for each future FGC) ordered that in the period prior to incorporation as Joint Stock Companies, the assets associated with power generation formerly belonging to the regional Energos, become part of one of four new "State Owned Enterprises" (SOEs) : Centrenergo, Donbassenergo, Dniproenergo and Zaxhidenergo. An SOE is a legal structure inherited from the Soviet regime and has little in common with the modern limited liability corporation. An SOE is, however, a separate legal entity and served during the interim period of March to September 1995 as a first step in shifting decision making powers from the centralized ministry to independent corporations.

All four newly formed SOEs are now "State Joint Stock Companies". These are hybrid "Joint Stock Companies" in which the State owns 75 % or more of the shares. In practice, and for the foreseeable future, the State owns 100 % of the shares. State Joint Stock Companies are subject to the Ukrainian law on Business Association dated October 1, 1991 which governs also all privately owned businesses.

If or when the State sells more than 25 % of the issued shares, the Companies will become "Joint Stock Companies". They will be "open", which means that Shareholders will be free to dispose of their shares freely. The shares will probably be listed on the Stock Exchange of Ukraine. None of this will involve a change to their current legal status, governed by the Law on Business Association. There are therefore up to three identifiable stages in the legal formation of the FGCs : (i) Individual assets are grouped together to form an SOE. (ii) The SOE is transformed

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<sup>2</sup> See for instance the "Plan for Donbassenergo", adopted by the Deputy Minister of Energy of Ukraine, Mr. Sheberstov on April 3, 1995 (annex C)

into a State Joint Stock Company. (iii) - optional - The State Joint Stock Company becomes a Private Joint Stock Company. Each step requires (or will be the opportunity to adopt) a new corporate charter. This study focuses on step (ii) the "corporatization" process that transforms an SOE into a State Joint Stock Company. The analysis did not focus on the initial charter governing SOEs because it differed so much from usual corporate governance standards and only covered the transition phase ending in September, 1995.

Our recommendations for this corporatization process are based on the application of generally accepted corporate governance standards, a careful review of Ukrainian corporate law and the experience to date of neighboring countries. In addition, a study conducted recently in Russia by the World Bank<sup>3</sup> and co-financed by USAID, offered useful recommendations for corporate governance in a similar environment to the one faced by Ukraine today. The analysis highlights the importance for corporate governance, of introducing self-enforcement mechanisms in countries characterized by rudimentary corporate laws, an absence of prior case history on which to base judgments, generally poor law enforcement and widespread corruption.

(ii) The SPF Standard Charter

The Ukrainian State Property Fund has prepared a standard corporate charter that all SOEs are supposed to use as a model in the Corporatization or Privatization process. A detailed critical evaluation of this document appears in Annex B, along with a copy of the model, used by Dniprogidroenergo one of the two hydro-electric generating companies formed in parallel with the four fossil fuel generating companies.

The SPF standard charter contains several major deficiencies. It is not focused on protecting shareholder rights and too often gives management the benefit of the doubt in their decision making process. The two general comments are that the drafting is sloppy and imprecise (some provisions are not relevant, some are ambiguous, others are simply missing) and that the Charter lists rights and obligations already required under Ukrainian law. Many of these are archaic provisions inherited from the communist days. See Article 7 for a typical example. It specifies the various reserve funds and exact percentage of allocation to which net profit should be paid to. Decisions on how much should be reinvested in the company, how much distributed to shareholders, how much paid to the various social institutions owned by the company, etc., should best be left to managerial discretion. At the very least, they do not need to appear in the body of the Charter, since they are any way legal requirements under current Ukrainian law. The day the law is changed to give management more flexibility in their financial decisions, a General Meeting of Shareholders and a 75 % majority vote will be needed to amend the Charter.

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<sup>3</sup> "Corporate Law from Scratch", by Bernard Black, Reinier Kraakman and Jonathan Hay - World Bank conference December 15, 1994

There are many more specific criticisms to this model document. For instance, the goal of the company is not focused on maximizing shareholder value, but, as a remnant of the Soviet system, on "meeting the requirements of the national economy...". Article 3.11., mentions that all staff remuneration must be based on the pay scale of civil servants. Another paragraph goes on to stipulate that a 1.5 % tax should be paid to the Government. The members of the Executive Board and of the Supervisory Council are both appointed and removed by the Shareholders. The Supervisory Council is supposed to "oversee the activities of the Executive Board" and the "Executive Board is responsible for day to day operations". Large transactions must be specifically approved by the Council. But since the Supervisory Council does not appoint the Executive Board members, it is not really accountable for their results. All the Council members are supposed to do is to monitor the performance of the Board and report their findings annually to the shareholders. If corporate governance is to be effective, it is important not only to define the rights and responsibilities of each level of corporate institutions, but also to give them the means to enforce their role. The Supervisory Council defined in the SPF model charter is no more than a paper tiger.

Another criticism, is that management is not given much leeway in terms of increasing the share capital, as this is left to the exclusive competence of the Shareholders. The Ukrainian law on Business Association does not mention the concept of "authorized, but un-issued" shares. It does however allow an increase of up to 1/3 of the statutory capital to be decided by the directors (at the Supervisory Council or Executive Board level), as long as the Charter provides this right explicitly.

The document is also deficient in its omissions. In its definition of shareholders, in Article 4, the Charter forgets to mention individuals who acquire shares through secondary trading. Minority shareholders have no guarantee of being represented at either the Council or Board level, since there are no provisions for any form of proportional representation (through cumulative voting for instance). Article 8 gives a long list of shareholder rights that are almost verbatim from the Law on Business Associations. Others imply shareholder intervention at a level of detail that is not reasonable. The General Meeting of shareholders is for instance required to adopt internal procedures and organizational charts, but omits to provide an automatic mechanism requiring shareholder intervention for strategic decisions that can alter the nature of their investment.

There are no provisions detailing the logistics of holding the meetings. Notice requirements, quorum conditions, rules for proxy voting are never mentioned. The law is silent on most of these matters and, as has been seen in Russia, the SPF charter gives management the potential to hold secret or extremely inconvenient meetings, change the agenda at the last minute, trick uneducated shareholders into granting unlimited voting rights to the management, etc.

There is no mention of how "self-interested transactions", between company officials and the company should be dealt with. Nor is the level of responsibility of directors to the company and its shareholders defined. Annex B lists in greater detail many more issues raised by the SPF

Standard Charter.

In short, the possibilities for quite legally ignoring shareholder rights is huge. This means that economic efficiency of these large corporations may be undermined by unscrupulous managers. Price Waterhouse strongly recommended to the FGC General Directors that they not follow the SPF model and proposed an alternative document that would be credible for future private investors.

## 2. Role and Importance of the Establishment Board<sup>4</sup>

The purpose of the Establishment Board was to act on behalf of the owner or Founder (*i.e.*, the State) in the creation of the new Company. Its members were chosen by Minenergo from representatives of the Founder, the main banking institution servicing the enterprise, the appropriate state privatization body and the workers collective. The criteria for their selection should have been a clear understanding of their role as representatives of the interest of the State as sole owner and Founder and of the interests of future private shareholders. Price Waterhouse was not involved in their selection and was never a part of their deliberations. Their role is now all but over, since the corporatization process was completed in August 1995.

The Establishment Board had two months to prepare for the Founder two important documents : (i) a valuation of the assets of the property based on book value, from which the starting capital is derived, and (ii) a draft company charter. Our analysis focuses exclusively on the draft charter. It is worth noting, however, that the method used to value the assets of the FGCs bears little relationship to the market values of the underlying business concerns. In terms of the drafting the Corporate Charter, it is important to recognize that the vested interests of the management are in theory different from those of the Founder, represented by the members of the Establishment Board. In particular, management may not be an active proponent of increased accountability of their own actions or of self-enforcement mechanisms designed to protect the interests of minority shareholders against larger shareholders, management or Directors. It seems in practice that the Establishment Board was little more than a rubber stamp committee. The draft charter was prepared by the management of the FGCs and the valuation performed by their accounting department.

## 3. Role of the Executive Board and the Supervisory Council<sup>5</sup>

Ukrainian law provides for a two tier management system similar to the one existing in Germany. Day to day operations in theory remain at the executive level (the Executive Board) and broad

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<sup>4</sup> 3.1.1.3 - Criteria for Establishment Board Members

<sup>5</sup> 3.1.1.1 - Specifications designed to recruit future members

supervision is conducted by outside directors (the Supervisory Council).

After incorporation the Supervisory Council replaces the Establishment Board in representing the interests of the owners. Their official role is to monitor the activities of the Executive Board. The first Supervisory Council members may be chosen from the same pool as the members of the Establishment Board. These individuals are referred to hereafter as the Council Members. The Founder submits a list of candidates to the Ministry of Finance and Economics and to the State Property Fund a couple of weeks before final registration takes place. As far as we know, this process has not yet taken place. After the initial corporatization process, the role of the Supervisory Council is regulated by the Regulation on Supervisory Council adopted by the Cabinet of Ministers on July 19, 1993, the Law on Business Association of October 1, 1991 and the Charter of the Company.

The Executive Board is composed of representatives from management and according to the Law on Business Association are responsible for the day to day operations of the Company. It is useful to bear in mind that Supervisory Councils are by no means mandatory under the Ukrainian legal system. A company may choose to have only an Executive Board. For instance, Dniproenergo FGC has already expressed a preference for this option. However, the general practice and State Property Fund model Charter seem to favor large corporations adopting a two tier management system.

## II. CORPORATE GOVERNANCE PRINCIPLES

### 1. The purpose of Corporate Governance

Ultimately, the goal of corporate governance is to maximize the value of the enterprise to its investors and therefore to reduce the cost of capital. Good corporate governance can achieve this goal by providing a smooth and predictable framework for operating the business.

No system of corporate governance in the world is perfect. Successful industrial countries such as the USA, Germany, Japan, the UK and France each have their own typical style for organizing companies. Ukraine can usefully learn from all these models, but no one is clearly better than any other. This is because they have each resulted from an evolutionary process, very closely linked to each country's customs, culture, history and legal traditions. We hope that this study will help the reader to understand the tradeoffs linked to the formation of a large public corporation. Our recommendations are designed to achieve a specific result, the protection of shareholder rights, which in turn should lead to an efficiently managed corporation. There are many ways to achieve this result and the Charter we propose for the FGCs is but one example.

There are, however, two universal criteria which must be met for a corporation to function effectively. The first is **dynamism** : a company must continually adapt in an ever more competitive environment. This means that management must be able to drive the business

forward without undue governmental and bureaucratic interference, fear of litigation, or fear of displacement. To ensure this flexibility of operations, we have applied the principle of subsidiarity in the proposed Charter, allowing each decision to be taken at the lowest possible level.

The second is **accountability** : the greater the freedom of action allowed, the more important vigilant supervision becomes. Each institution within a company (shareholders meeting, Supervisory Council, Executive Board, Independent Auditors, etc.) has a precisely defined role and is responsible for performing a function. Success or failure can then be measured, sanctioned or rewarded against stated objectives. Accountability is meant to guarantee certain standards of competence and behavior. In case of crisis, the system must be able to take appropriate remedial action.

What differs in each country is the balance of power vested in the Supervisory Council Members and Executive Directors (to use Ukrainian terminology - see section 3 (i) on definitions for equivalent words used in other countries). Each country also has its own approach for shareholder oversight of the Supervisory Council and Supervisory Council oversight of the Executive Board. For example, the Anglo-Saxon systems favor an open and more transparent and confrontational approach, under the leadership of a powerful CEO. While Germany and Japan prefer a collegiate two tier management system which favors a more informal and private system of decision making.

In countries like Ukraine, it would be relatively more important to emphasize self-enforcement mechanisms, which reduce the need to rely on a fully developed legal system, a (non-existent) history of legal precedent, or reliable law enforcement.

Each institution of a corporation needs to be analyzed separately, in order to understand its role and purpose within the corporate governance system. We have listed them individually and explored how they should interact with one another. Our recommendations on the drafting of the Corporate Charter are based on this analysis.

## 2. Shareholders

### (i) Role of Shareholders

The shareholders' meeting is always the highest decision-making body in any corporation. The shareholders are the owners and it is to them and their designated representatives that Council Members, Executive Directors, employees and outside consultants ultimately report. In the private sector, the owners (whether they are proprietors, institutional investors or a large and anonymous pool of private shareholders) usually set, as a clear priority : to maximize the return on investment, within a certain level of risk. For publicly traded companies, market forces ensure that only those companies that achieve this objective will get access to needed capital.

In extreme cases, when corporate assets are not put to the most efficient use, the corporation may be subject to a hostile take over. Share prices act like an approval rating. Shareholders who are unhappy with the performance of the company or the management may exercise their primary right to exit their investment by selling their shares. Eventually, this causes downward pressure on the share price. If management does not modify its performance, share prices may become cheap enough for an outsider to decide to buy a majority stake in the company, and launch a hostile takeover bid. The new majority owner would then be in a position to force a change of Directors and officers and alter major corporate policy. Managers know, therefore, that to keep their jobs, they must please their shareholders. Share price movements can have an even more direct impact on management behavior when their compensation is linked in some way to the financial performance of the company or to stock prices.

The effectiveness of this mechanism in influencing management behavior in favor of shareholder's interests depends on the existence of a reasonably efficient and liquid capital market. Ukraine is not yet at this stage in its reform process. But the principle remains valid and may start having an effect as soon as a significant proportion of the shares are no longer in the hands of the State.

In other countries, such as Germany and Japan where capital markets have historically not been as developed as in Anglo-Saxon countries, investors have mitigated their investment risk by monitoring management more closely and by having more representatives on the Boards of Directors. A disadvantage with this approach is that monitoring management is expensive and time consuming. This level of effort can usually only be justified by large institutional investors. Ukraine's mass privatization program will probably lead to a significant dilution of ownership rights, with many small investors who individually are not able to bear such costs. In the United States, where historically there have also been many small investors, the system has adapted by insisting on more stringent financial disclosure rules than Germany, for instance. With such strict reporting requirements, the financial results of company operations are much more transparent. Small investors therefore find the cost of monitoring management less prohibitive and find it easier to exercise their right of exit (ie the right to dispose of their shares). In the Ukraine, until capital markets become more liquid and sophisticated, in order to attract investors, it will be all the more important for the FGC's to make their financial statements transparent and ensure that all material information is released in a reliable and timely fashion.

#### (ii) The State as a Shareholder

When the State is the only shareholder (or holds a controlling stake) the message from owners to Managers may be less straightforward. The State holds assets for two different kinds of reasons: (1) as a tool to carry out specific government policies or (2) and more simply, as a privileged source of funds. Where public utilities are concerned, the argument in favor of State ownership has often been made. The logic seems compelling. The services provided by public utilities are unique, and close substitutes are generally not available. They are natural

monopolies; operating most effectively when they are the only seller in the marketplace, they avoid an unnecessary and wasteful duplication of facilities. To prevent monopolistic pricing and to guarantee equal access to all potential customers, State ownership and control seems to be an easy solution.

Historically, many public utilities tended to be owned by the State in most of the world. This logic has recently been challenged in countries such as the United Kingdom, Australia, Chile and Argentina. Most economists agree today that utilities are not always the natural monopolies they appeared to be; that even if they are, State ownership may not be the best way to prevent monopolistic pricing; that on the contrary, consumers may be better served by privately owned, competing service providers, closely monitored by an independent regulatory body.

The Ukrainian Power Restructuring Program is setting up a framework for private ownership. Initially, the State will be the only shareholder of the FGCs, but the intention is to attract private investors in order to finance future capital investments, including urgently needed rehabilitation of existing facilities. The message to future FGC Managers should therefore be unambiguous : maximize the company's profitability, within the prevailing legislative and regulatory framework. It is only by giving Managers a clear mandate to operate their company under purely commercial principles that it will be possible to measure their performance objectively and hold them accountable for the results.

This will not be easy. There are many interest groups that will try to influence the resolve of the State as owner of the FGCs. These groups include the employees, who may lose their job security and subsidized social programs; the neighboring communities, who may suffer from pollution resulting from lower than present environmental standards caused by stricter concern with cost; and the consumers, who want a reliable supply of energy at a reasonable price. This last group is particularly likely to jeopardize the government's resolve to let market forces dictate operations in the electricity industry. Ukrainian consumers (industrial and private) have never paid for their electricity at its true cost of supply. Liberalizing prices is likely to cause much hardship to members of the population who can least afford it. All these stakeholders have interests that conflict with those of other groups and even more so with those of any private owner.

The State, though, is a special kind of owner and the government has a duty as a responsible and accountable political body to address the concerns of all these constituents. There are two reasons, however, why the State should not attempt to solve these issues through its control of the management of the FGCs. Instead, where necessary, the State should use its broader executive powers.

First, it would be impossible to require the newly appointed Directors to maximize the profitability of the FGCs, minimize social unrest, address environmental issues and reduce prices. These objectives are contradictory and sometimes mutually exclusive and it would become

impossible to measure the success of a management team based on such criteria. Second and perhaps most importantly, the ultimate purpose of all these reforms is to optimize the cost of capital and the allocation of resources in the economy. Eventually, when this is achieved, it will be in the best interest of all the constituents and stakeholders the State is responsible for.

By using its executive powers however, the government should attempt in the short term to manage the transition of the economy as smoothly as possible and provide social safety nets to its more vulnerable constituents. How this should be done, is beyond the scope of this analysis and although we do not wish to minimize the issues at stake, our only point is that they should not be addressed by influencing the decisions of the Executive Directors and Council Members. Rather, the companies should strive to maximize profits subject to legislative and regulatory constraints, imposed by the State, including for instance : environmental laws; labor laws; consumer laws; anti-monopoly regulations and tax laws.

### (iii) Rights of Shareholders

Shareholders have a number of rights with which they can exercise control over FGC management. These include :

The right to vote : Shareholders can participate annually at the general meeting and vote in particular on the composition of the Supervisory Council and Executive Board (unless Shareholders delegate this function to the Supervisory Council as recommended in our draft Charter. See Section III.3.iii, below, on Council Members).

The right to fair and equal treatment of shares of the same class : one share = one vote. (Preferential shares may have no voting powers).

The right to sell or transfer shares : Shareholders can sell or transfer their stock without prior approval or unreasonable cost and procedures, if they are not satisfied with the return on their investment. In a market economy, this drives the price of the shares down and increases companies' cost of financing (*i.e.* cost of capital). Inversely of course, a successful company will see its share price increase and find raising new equity a cheaper way to finance future growth.

The right to dividends : Shareholders are entitled to receive dividends.

The right to information : Shareholders are entitled to obtain all relevant information concerning the enterprise in a timely and regular basis.

The right to sue : In the US for instance, Shareholders have the right to sue their Council Members and Executive Directors (to use Ukrainian terminology) to enforce loyalty and adherence to the Company Charter, if for instance they think corporate assets are being wasted or if they suspect management wrong doing. They may sue on behalf of all the other shareholders in a class action suit or on behalf of the corporation in a derivative suit. Ukraine will probably have to develop the legislative framework for such actions in the near future.

The right to limit liability to the initial investment : A Shareholder is not personally responsible for the liabilities of the Company he/she has invested in. The most a creditor can lay claim to is the value of the Company's net equity. The personal property of shareholders cannot be

included. This limits the amount of money an investor may lose (the downside potential). The amount of money an investor may gain because the value of his or her shares has increased (the upside potential) is, however, unlimited.

The right to residual ownership of the corporation in case of liquidation : Shareholders are entitled to the proceeds resulting from liquidation of a company after all obligations have been met.

The right to amend the Charter : Shareholders can vote on important matters such as capital increases, changes of goal, liquidation, acquisitions and any other issue that may alter the nature of their initial investment.

### 3. Directors : Members of the Supervisory Council and the Executive Board

#### (i) Definition

The use of the word "Director" may be ambiguous. In its broad definition, in the U.S., it may loosely refer to any Member of the Board of Directors, composed of a mixture of Executive Directors (or Managing Directors) and Non-Executive Directors (or non-Managing Directors). In Ukraine, the equivalent broad definition would refer to both Members of the Executive Board and of the Supervisory Council.

In order to avoid confusion, the word "Director" has in general not been used alone, especially in reference to the Ukrainian system. When referring to the US system, a Director is a member of the Board of Directors and may be an Executive or a Non-Executive Director. When referring to the Ukrainian system, we call members of the Supervisory Council, "Council Members" and members of the Executive Board, "Executive Directors". This terminology is consistently used in the Charter in Annex A. In Ukraine, the Law on Business Association, Article 46, specifies that Members of the Supervisory Council may not also be Members of the Executive Board. A "Director" in Ukraine is therefore either a member of the Supervisory Council or of the Executive Board and one should specify which. The word "President" or "General Director" are used interchangeably to refer to the person appointed by the Presidential Decree of March 17 1995, to head each of the four FGCs and become the Chairman of the Executive Board.

#### (ii) Respective Role of Council Members and Executive Directors

The Law on Business Association (Article 46) simply states that the Supervisory Council is responsible for "controlling the activities of the Executive Board" and that it may be delegated functions which the law mentions to be of the competence of the general shareholder meeting. Article 47 goes on to mention that the Executive Board "decides all matters relating to the activity of the company, except those that are specifically reserved to the meeting of shareholders or the Supervisory Council."

This is a typical pattern of governance where the Executive Directors leads the action, and the

Council Members supervise and monitor. Although the responsibilities appear to be clearly delineated by law, in practice, many details need to be spelled out more clearly in the Company Charter.

The relationship between Executive Directors and Council Members should not be conflictual but collaborative. Although tensions can arise from time to time, it is intended that the proposed model will permit management to function in a consensual environment. Oversight through Standing Committees (see paragraph viii of this section) as well as full Supervisory Council meetings must be allowed to be performed with independent judgment, but also with the recognition that the Executive Board has the primary responsibility for initiating and implementing the corporation's objectives and policies. A literal interpretation of Article 46 should be avoided. The law says that the Supervisory Council "controls" the Executive Board. The idea is not that Council Members should be the policemen monitoring the Executive Directors on behalf of the Shareholders. In fact, if that were their function, then the law does not give them enough powers to enforce it meaningfully.

Instead, the purpose of having a two tier management system (as in Ukraine : Council Members and Executive Directors), or the two types of Executive and non-Executive Directors of a one tier management system (as in the U.S.), is to provide an appropriate decision-making process. The goal is to avoid errors in corporate strategy as much as possible and, where errors do occur, to correct them quickly. The focus should therefore be on the respective roles of the Executive Board and Supervisory Council as defined by the internal procedures of the company.

Some large corporations in the United States have been leading the way in using their non-Executive Directors as an invaluable resource and provide interesting examples of how corporate attitudes can be influenced in a constructive fashion. The key to their philosophy is to increase debates, communication and sharing of information and encourage decisions based on broad consensus. Useful examples include General Motors, Home Depot, Lockheed, IBM, Westinghouse and Time Warner.

### (iii) Role of non-Executive Directors

Most large corporations in the world have non-Executive Directors. The primary reason has been mentioned earlier. Shareholders rely on them to monitor what the Executive Directors are doing and to ensure that their interests are protected. Their independence and non involvement in day to day operations is supposed to guarantee a certain level of objectivity. A minimum (but not sufficient) role of a non-Executive Director is to provide ex-post control and monitor the past performance of the company. If the Executive Directors are incompetent or dishonest, they should not be able to continue undetected for any significant period of time. We recommend that the Council Members should appoint the members of the Executive Board and be allowed to remove them if their performance is unsatisfactory. The Law on Business Association formerly gives this responsibility to the Meeting of Shareholders, but also adds that the Shareholders may

choose to delegate any of their rights to the Supervisory Council. We believe this solution is better, because if things go wrong the Supervisory Council should be clearly responsible for replacing management and acknowledging that the Council Members may have failed in their task of monitoring the performance of the Company and its Executive Directors and preventing errors from being committed. The Council Members should not be given the excuse to say that the Shareholders chose the Executive Directors and got what they deserved.

A second reason for having non-Executive Directors is that some decisions have a serious potential to see a divergence of interests between Executive Directors and Shareholders. Some clear examples include the selection of key senior company officials, the level of remuneration of the Executive Directors and the audit of the internal procedures. In the US, Members of the Board of Directors organize themselves into "Standing Committees", responsible for various specific tasks. The Selection Committee, the Remuneration Committee and the Audit Committee are all examples of traditional groups formed exclusively of non-Executive Directors, in order precisely to avoid any possible conflict of interest and ensure objectivity of the decisions. An Executive Committee is usually made up of both Executive and non-Executive Directors in order to share information and together review strategic decisions and corporate policy. Sub-section (viii) deals with Standing Committees specifically.

(iv) Internal Corporate Guidelines for non-Executive Directors

The minimal and traditional role for non-Executive Directors described above, ignores the much greater potential they have to participate in the governance of a corporation. Having a group of experienced independent professionals at their disposal should help Executive Directors develop strategy and make better decisions, not just ensure that past failures are made public. The large US corporations that make the most of their non-Executive Directors do so by actively involving them in the decision making process. We recommend that the FGCs also organize their internal rules to ensure that the relationship between the Members of the Executive Board and the Supervisory Council is one of constructive cooperation, not confrontation. The following paragraphs were written with Supervisory Council Members in mind. But the paragraphs on selection criteria, debate and compensation apply also to Executive Directors. It is assumed that Executive Directors work full time for their companies and that the paragraph on time is therefore irrelevant and that they have unrestricted access to company information.

a) Selection Criteria

The first rule should be that Council Members be chosen for their expertise and broad business perspective. They can only contribute positively to the decision making process if they are considered experts in their field and their opinion is widely respected. Areas of expertise could include finance, law, engineering, experience in international utility deregulation, Western management or marketing techniques, etc. Specialists should be considered for Membership of the Supervisory Council to optimize the quality of the debates. Together, the Council Members should represent a broad and deep pool of

knowledge and experience that can help the company and the Executive Directors make the right decisions.

b) Encourage Debate

The internal procedures governing activities of the Supervisory Council should be designed to encourage debate. Some companies in the US do not elect a chairman for the meeting, but for each proposal that comes to the attention of the board, a Council Member is specifically appointed to lead a constructive debate and critique the proposal. That way criticism is not only accepted; it becomes institutionalized and expected. All strategic decisions and important corporate policies are exposed to the same stringent process. Just like politics at the national level, the process ensures that decisions are open and transparent and that they have been constructively debated. An internal policy should also ensure that large shareholders, Council Members and Executive Directors meet regularly, either informally or formally to exchange information and develop consensus on current issues, particularly with respect to capital markets and to propose candidates for nomination to the Executive Board or Supervisory Council. In the long term, such rules encourage stability and reduce the likelihood of convulsive and contentious change.

c) Access to Information

If Council Members are to contribute meaningfully to the decision making process, they must have unrestricted access to information on the corporation. This means that they should not have to rely solely on prepared packages from the Executive Directors before starting a Council meeting. Such packages are of course necessary and must be encouraged. But Council Members also should be empowered to make their own investigation and obtain independent professional council if necessary. For instance, they should be free to request information from any employee. In order to foster the formation of independent opinion, Council Members should also be required to visit each of the FGC's power plants and other significant business units, at least once a year, and interview first hand employees and Managers.

d) Time

In order to be effective, Council Members must devote time to their Company. Non-executive Directors are not supposed to be full time employees. But the idea that a director's obligation is fulfilled by only attending four board meetings a year for a few hours each, followed by a good meal should be abolished from modern corporate governance. For companies of the size and complexity of the future FGCs, a minimum of 10 full board meetings a year and numerous committees and partial meetings should be expected.

e) Compensation

Finally, the company must compensate their Council Members adequately. That is the only way that the shareholders are going to ensure that they get quality service from their

Council Members. Aligning the interests of the Council Members with that of the shareholders is fairly straight forward. Compensation packages have been developed in the West to help non-Executive Directors take a longer term view of the company and worry less about their immediate job security. They should be given company shares and options to purchase more on favorable terms if the company achieves certain financial goals or the share price reaches a certain level. The Council Members should feel that their reputation and their income are linked to the fate of their company. They should believe that their own personal fortunes hinge on their ability to create value through their services. Future research on incentive compensation schemes for both non-Executive and Executive Directors as well as other senior staff of the FGCs needs to be conducted.

(v) Other influencing factors

There are some other factors which influence Council Members' and Executive Directors' behavior and which shareholders should keep in mind in terms of corporate governance :

Fear of losing their job : shareholders vote on the composition of the Supervisory Council and (indirectly) the Executive Board.

Fear of lawsuit : Council Members and Executive Directors are bound to follow the governing laws and respect their fiduciary duties to the shareholders and the corporation.

Fear of governmental intervention : arbitrary action by the State may impact business decisions.

Fear of competition : the prosperity of the enterprise and the success of Executive and non-Executive Directors depend on how well they do relative to their competitors. The discipline of the market is the strongest motivator to ensure that Directors are always doing their best for the corporation and its owners.

Fear of adverse publicity in the media : this may prompt self-restraint above and beyond strict legal requirements.

Fear of labor unrest : again, this may explain conservative decisions which go beyond legal obligations.

Cultural norms : each country has its own particularities and expected standards of conduct.

(vi) Fiduciary Responsibilities of Council Members and Executive Directors<sup>6</sup>

Under the proposed Ukrainian system both Council Members and Executive Directors should have the same stringent standards of conduct applied to them. They include a duty of loyalty, care and attention to the company and the shareholders. The Courts may, however, with time, establish different standards of responsibility for Members of the Executive Board and the Supervisory Council. In this sub-section on fiduciary responsibility, the term Director is used broadly and refers to both Council Members and Executive Directors.

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<sup>6</sup> 3.1.1.1.5. second point : Fiduciary Duties of Directors

a) Duty of loyalty

While performing their function (which is to promote the interest of the owners and the corporation), the Directors have a duty of loyalty and of care. **The duty of loyalty** of a Director means that the interest of the corporation and its shareholders must always prevail over his own individual interest. This implies that he may not personally gain from his position and must abstain from voting and from quorum calculation requirements in any board decision which may concern him personally. Specifically, any conflict of interest should be fully disclosed to other board Members. While considering a transaction on behalf of the corporation, which would personally benefit one of its Directors, the voting Members also have a duty of fairness : the proposed transaction must be at least as favorable as one available from other sources. The duty of loyalty also means that any business opportunity coming to a Director's attention by virtue of his position must first be reported to the corporation. Finally, all information that a Director may obtain while performing his functions must be presumed confidential.

b) Duty of care and attention

**The duty of care** implies a certain standard of conduct. A Director must always act in good faith and in a manner he reasonably believes to be in the best interests of the corporation. He must perform his duties with such care *"as an ordinarily prudent person in a like position would use under similar circumstances"*. The exact meaning of these words has evolved over time in the United States and Western Europe. The standards expected of Directors have increased, and it will take time for the courts of this country to define where Ukrainian Directors stand. In the US, courts apply the *"business judgment rule"*, which is designed to let Directors run businesses without having to worry about shareholders with the benefit of hindsight suing them for mistakes. Judges recognize that making a profit invariably implies evaluating risks and that decisions may later prove to be erroneous. Directors are therefore not expected ever to make mistakes, but to *have a reasonable basis for believing that the action authorized was lawful and legitimate*.

With the duty of care, comes the **duty of attention**. A Director has a duty to participate actively in the oversight of the company activities. This implies for instance regular attendance to meetings, the review of information and documentation sufficient for him to make informed judgements. If a Director feels that he has not been given enough time to form an opinion or that he has not gotten sufficient information, it is his duty to request that the decision be delayed. If the board decides to ignore his request, the dissenting Director should have his objection recorded in the minutes of the meeting, abstain from voting and depending on the seriousness of the circumstances, consider resigning. Relying on prepared information does not violate the duty of attention, as long as the Director reasonably believes the person presenting the information to be reliable and competent. If the Director has knowledge that causes this reliance to be unwarranted, he would no longer be considered to be acting in good faith.

c) Fiduciary Duties in Practice

Fiduciary duties serve a very important role in corporate governance for US and UK companies by defining certain expected standards of conduct. These standards have been set after hundreds of years of judicial interpretation. The reality is that in countries such as Ukraine, judicial interpretation is unavailable and there is no shared cultural understanding to take its place. The result is that defining fiduciary duties will be of little practical help to protect shareholders in the short term. They do nevertheless serve a useful purpose today in defining expected standards of behavior for Council Members and Executive Directors and in inculcating a culture of duty to shareholders.

But it is more realistic in the short term to rely on so called "bright line rules", rather than broad standards, to define proper and improper behavior for Council Members and Executive Directors. This has been done extensively in the proposed Corporate Charter. We require non-interested Council Members to approve many decisions in order to protect minority shareholders from potential opportunistic exploitation of the company's resources by Executive Directors, Council Members or controlling shareholders<sup>7</sup>. The idea is that shareholders, sometimes with a qualified majority vote, and/or the Council Members, should monitor important decisions (precisely defined in the Charter) to check that they do potentially increase the value of the company and are not simply designed to transfer wealth from the company to interested parties. The annotated version of our proposed charter is enclosed in Annex A, highlights these self-enforcement provisions and bright line rules (relevant paragraphs appear in italics).

(vii) Selection Criteria and Terms of Office<sup>8</sup>

We have already mentioned that Council Members should be primarily chosen because of their general business perspective and technical expertise and ability to contribute constructively to corporate decisions. They should also have a sufficient amount of time to devote to the affairs of the company. This implies that they should not cumulate too many other Directorships and other full or part time occupations. In general, an effective Director should combine strength of character, integrity, an inquiring and independent mind, practical wisdom and mature judgment.

One of our principle recommendations is that Council Members be elected each year by the General Meeting of Shareholders, for one year, on the basis of a cumulative vote. The principle of cumulative voting is particularly important to protect minority shareholders, as it provides some element of proportional representation which does not exist if each vote is distributed

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<sup>7</sup> See for instance Article 8.3.4.4. of the PW proposed draft Corporate Charter on pre-approval of any "self-interested" transactions.

<sup>8</sup> 3.1.1.1.1. sixth and seventh point : Recommended length of term of board Members and conditions of removal

amongst as many candidates as there are positions to be filled. Instead each vote is in effect multiplied by the number of future Council Members and the shareholder can use the total number of votes on as many candidates as he likes. This way, minority shareholders may, without controlling 50 % of the company ensure that they are represented at the Supervisory Board, by using all their votes for instance on a single candidate.

Another important recommendation is that the shareholders be allowed to remove the entire Council without cause, or individual Council Members with cause. Cause for removing individual Council Members should be interpreted restrictively as it could otherwise potentially nullify the effect of cumulative voting by allowing a majority shareholder to remove a Council Member elected by a minority shareholder. But clear causes for individual removal include physical incapacity (certified medically), death, personal bankruptcy, resignation and conflict of interest. Some companies limit the maximum age a Council Member may reach before he must retire (70 seems to be the norm).

As far as the Executive Board is concerned, the proposed charter recommends that the Supervisory Council (through the Nomination Committee - see sub-section (viii) on Standing Committees) appoint members of the Executive Board for longer periods than the members of the Supervisory Council. Three years appears to be an acceptable compromise between accountability and the need for stability in the leadership of the company and long term planning needs. A system of rotation of terms of office would further ensure stability : one third of the board is initially elected for one year, one third for two years and only one third for the full three year period; thereafter, each year, one third of the board is appointed for three years. This does not mean however that the Supervisory Council cannot terminate the employment of any member of the Executive Board at any time with or without due cause. A severance arrangement can be contractually arranged in advance which would provide to compensate any senior executive removed before the expiry of his term of office. Such compensation would not be paid in case of willful and continued failure of an executive to devote his full business time and efforts to the business affairs of the Company or if he has been grossly negligent in the conduct of his corporate duties.

#### (viii) Role of Standing Committees<sup>9</sup>

##### The need for Standing Committees :

Standing Committees were mentioned briefly above. It is common practice in the West, for Boards of large companies to divide themselves into specialist committees that report to the full board in order to perform certain tasks. This enables individual Directors to specialize and

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<sup>9</sup> 3.1.1.1.1. third and fifth points : Definition of Standing Committees and proposed operational rules and procedures

contribute to the firm some of their specific strength and expertise. The roles, responsibilities and internal procedures of each Standing Committee are defined in the Company's by-Laws, adopted by the Shareholders' Meeting with a simple majority.

#### Different types of Standing Committees

We specifically recommend that the FGC Supervisory Councils form the following Committees.

a) **Nomination Committee**

The Nomination Committee identifies candidates for senior management positions. The Ukrainian Law on Business Association mentions that Members of the Executive Board, the company's most senior Managers, should be elected by the General Meeting of Shareholders (Article 41 (d)). This is unfortunate, because it shifts responsibility for choosing the right Executive Directors from the Supervisory Council back to the Shareholders. If the Executive Directors do a bad job, the Supervisory Council cannot be directly blamed. Article 46, second paragraph does add however that the General Meeting of Shareholders may chose to delegate to the Supervisory Council some specific functions that are of their competence. Therefore, it is possible for the Charter to specify that the Supervisory Council shall be responsible for electing the Executive Board Members. This is one of our recommendations. It makes the Council Members directly accountable for their choice of Executive Directors. That does not mean to say that Shareholders and existing Executive Directors should not be able to give their input to these important decisions. Submission of alternative candidates for nomination should in fact be actively encouraged in the same spirit of collaborative decision making discussed above. The eventual appointments, should be made by the full Supervisory Council, with a simple majority vote. The Chairman of the Executive Board should continue to be confirmed at the annual shareholder's meeting. The Nomination Committee should propose one candidate. Shareholders should have an easy procedure by which they can add alternative candidates to the agenda of the Annual Meeting of Shareholders.

In between Annual Meetings of Shareholders the Nomination Committee should also propose to the full board, interim Directors to the Supervisory Council in case of vacancy of one of the directorships.

b) **Personnel and Remuneration Committee**

The Personnel and Remuneration Committee is responsible for analyzing remuneration levels for the Executive Directors and other senior company officials and generally the pay policy of the firm. Special incentive compensation schemes can be developed and proposed. Final decisions should also be taken by the full Council, with a simple majority vote. Remuneration of the Supervisory Council members should remain the sole prerogative of the Annual Meeting of Shareholders. The Personnel and Remuneration Committee should however be allowed to submit recommendations and studies to the

shareholders.

c) Executive Committee

The Executive Committee is usually given most of the powers of the full Council and is convened when the Supervisory Council is not in session or if it is not practical to convene the full board. Sometimes decisions must either be taken in a hurry or have already been agreed in principle on a previous meeting of the Council Members and only the implementation needs to be approved. Some companies make more use of their Executive Committee than others : some meet very exceptionally; others use them on a regular basis as operational and planning committees.

d) The Audit Committee

The Audit Committee (sometimes called the "Audit and Compliance Committee") fulfills a very important function. All companies should perform two kinds of audits, internal and external. The internal audit committee's main purpose is to provide shareholders some reassurance about the effectiveness and integrity of the systems of financial control and information. It is a means of providing both internal and external auditors with a privileged and private forum in which to express doubts and concerns even (and perhaps especially) about Company procedures or top management; and a way of getting the Council Members closer to the business. **The internal audit department** reports directly to the audit committee (and not to the Executive Directors in order to avoid conflicts of interest and to preserve independence of judgment) and monitors whether Company policies and procedures are complied with, assets are safeguarded, and transactions are executed in accordance with appropriate corporate authorization and recorded in a manner which permits management to meet its responsibilities for the preparation of financial statements.

An internal audit function very similar to that conducted in Western style businesses is common practice in large State Owned Enterprises of the Former Soviet Union. The **audit committee** of the future FGCs, should be formed by at least four non-Executive Directors from the Supervisory Council. Since 1978, it has been one of the conditions for listing under the New York Stock Exchange that four "independent" Directors of the Board (broadly defined as not being employees of the company) form an internal audit committee. The selection criteria of the audit committee Members is primarily an inquiring attitude, objectivity, judgement and a sound understanding of the company's business. Audit committee Members do not necessarily need to possess special financial reporting expertise. However, a financial background on the part of at least one Member is probably helpful. An audit committee charter should be written, defining clearly the committee's responsibilities. In general the terms of reference include at least the following :

- Recommending the independent auditors;
- Reviewing the scope of the external audit;

- Reviewing the results of the external audit with the auditors;
- Reviewing the results of the internal audit with the internal auditors;
- Reviewing the adequacy of the companies' accounting policies, practices, and systems of controls;
- Reviewing the adequacy of the internal audit.

The head of internal audit department has the responsibility to examine and evaluate the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities. This person reports to the internal audit committee. The audit committee should be satisfied with the scope and performance of the work done by the internal audit department. The head of the internal audit department should have direct and unrestricted access to the audit committee on a regular basis and should meet privately with the audit committee at least annually. The audit committee should review the appointment or dismissal of the head of the internal audit department. The purpose, authority and responsibility of the internal audit department should be defined in a formal charter, which should be reviewed by the audit committee. As soon as these individuals have been identified, future help in drafting this document shall be provided.

e) Coordination Committee

A fifth Coordination Committee could be envisioned given the two tier management system proposed under the Ukrainian system, to provide a formal link between the Supervisory Council and the Executive Board. Its Members would come equally from both boards and their role would be to ensure that information flows freely between management and shareholder representatives.

f) Other Committees

Other Committees can be imagined for specific purposes. A Committee on Corporate Governance, designed to concentrate on good corporate governance practices for the Company is a good idea in the initial years of corporatization, until all players become more familiar with the concepts. A Corporate Governance Committee (or if it does not exist, the Nomination Committee) could also make recommendations to the full board regarding the memberships and functions of the Standing Committees and their structure. Monitoring possible conflicts of interest and reviewing the outside activities of Executive Directors and Council Members will also probably be necessary. Some companies in the West also have a "Pricing and Finance Committees" that deal with all matters relating to the raising of capital and issuing of new securities.

(ix) Standing Committees Operational Rules and Procedures

Examples of Operational Rules and Procedures adopted by the Board of Directors of Pacificorp

for their standard committees are included in Annex E. Pacificorp is the third largest electric utility in the West of the United States. An example of the by-law providing for the creation of the standing committees is also presented in Annex E.

#### 4. Independent Auditor

By definition, internal audits lack independence and all companies whose shares are publicly traded in the West require that their financial statements be audited independently. One of the conditions of operation of the license issued to future FGC's currently envisages that they must conduct their business operations in accordance with internationally accepted accounting practices and any other guidelines specified by the National Electricity Regulatory Commission. This is necessary, not only to attract future outside investors or creditors, but also to ensure the success of the electricity bidding rules designed to guarantee a fair and competitive environment for the supply of electricity.

An Independent Audit is a series of procedures followed by an experienced independent, professional accountant, to test, on a selective basis, transactions and internal controls in effect, all with a view to forming an opinion on the fairness of the presentation of the financial statements for a specified period. The responsibility of the independent auditor is to design the audit to provide reasonable (but not absolute) assurance of detecting errors and irregularities that are material to the financial statements. The independent accountant's resulting opinion on the financial statements is expressed in the audit report. As part of the audit, the independent accountant reads the company's entire annual report, but is not required to perform any additional procedures to corroborate the information outside the financial statements. If reading the annual report reveals any material inconsistency or other apparent misstatements or omissions of fact, the independent accountant will discuss the matter with the Executive Board and the Audit Committee of the Supervisory Council.

The independent accountant is also required to report significant deficiencies in the internal control structure to the Supervisory Council (or the Audit Committee). These deficiencies involve matters which in his opinion could have a significantly adverse effect on the organization's ability to record, process, summarize and report financial statement information.

Ultimately, the Executive Board of the Company, not the independent external auditor, has the primary responsibility for the preparation and integrity of the consolidated financial statements and all other information included in the Annual Report. The internal Audit Committee has primary responsibility for maintaining direct lines of communication among the Supervisory Council, the independent accountant and the internal audit department.

#### 5. Corporate Secretary

Each corporation must have a corporate secretary, specially appointed by the Supervisory Council

to be responsible for maintaining the minute books and records (other than financial records) of the company and to ensure compliance with all procedural requirements imposed on the company by applicable laws, the articles of the company's charter and any other internal rules set up by the Executive Board and Supervisory Council. The final important function of a company secretary is to maintain up to date a registry of shareholders. As long as the State is the only shareholder, this will not be a particularly important function. But if the State decides to sell some of its shares, or issue some new ones to outside investors, keeping an up to date record of the registry becomes a strategic task.

The Ukrainian government may introduce legislation, as several other countries of the Former Soviet Union (FSU) have done, that when a company has a certain number of employees or shareholders, the company share registry must be kept by an independent third party. Until this issue is decided, the FGCs should appoint someone responsible for creating and up dating the share registry.

#### 6. Other Stake Holders

As briefly mentioned in the section on having the State as only shareholder, other stake holders may include the employees (present and past) and their dependents, the workers collective, the bankers, other creditors, the suppliers, the general public and the closer neighboring communities. It is necessary to take the needs of these groups into account whenever the law requires it or whenever it makes good business sense. In particular, labor laws in the countries of the FSU appear specially complex and often cumbersome. The extent to which they will influence the management and corporate governance of the future FGCs must be further researched<sup>10</sup>.

### IV. LEGAL & FINANCIAL REPORTING REQUIREMENTS

#### 1. Financial Reporting<sup>11</sup>

Financial records are kept for three broad different purposes and audiences. First "Statutory Accounting" is what companies have always done to comply with dozens of Ukrainian governmental agencies, administrations and tax authorities. Second, "Regulatory Accounting" will be performed in conformity with instructions laid out by the NERC (National Electric Regulatory Commission) and defined in the electricity generation license. These are likely to include the adoption of some internationally accepted accounting standards. Finally, "Managerial Accounting" will be the internal records and analysis developed to give management and

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<sup>10</sup>To be coordinated with Latham & Watkins

<sup>11</sup> 3.1.1.1.5 first point - Need to have 2 parallel systems for tax purposes and to comply with terms of the license and to raise international capital covered under 3.1.2.1.2

investors the best possible up to date knowledge of the company's financial situation.

The data used to compile these three sets of books will be the same of course. A good integrated financial management system, such as the one Price Waterhouse has conceived, would automatically generate all three. The focus of each of these three audiences explains the subtle different reporting requirements each one may have. For tax purposes for instance, the company's interest is, within authorized legal boundaries, to minimize yearly recorded profits. In practice this will for instance mean recording revenues only when actually collected and not when generated, as accrual accounting would demand.

The regulatory authorities on the other hand need to protect consumers and ensure that the generating companies are providing a safe supply of electricity at a reasonable cost. Regulatory reporting requirements are influenced by this longer term interest in the "prudence, safety and sufficiency" of operations and the need to determine that consumers are charged a fair price for their electricity. The rules required under the licenses have not yet been finalized but are likely to include the adoption of a certain number of internationally accepted accounting principles. Apart from accrual accounting, the new rules will probably include more detailed record keeping for different cost units, so that the regulator can be satisfied that the FGCs are bidding their generating units at close to marginal cost.

Accounting for internal management purposes will be even more detailed and operations oriented than regulatory accounting. In order to reflect the current economic reality as closely as possible and to attract private financing, all internationally accounting standards should be adopted. Price Waterhouse has prepared an accounting manual and new chart of accounts designed to facilitate this transition. Accounting training courses financed by USAID complement the work done so far. Reports generated for internal purposes can be infinitely varied in their time focus and level of detail. They are not subject to any legal requirements and their purpose is solely to contribute to sound management and investment decisions. Contrary to tax purposes, revenue generation is not minimized but prudent management practice requires statements to remain conservative.

## 2. Disclosure Requirements for Issue of Shares<sup>12</sup>

Although the legal framework in this area is still rudimentary, all the basic capital markets institutions and laws are present in Ukraine. The disclosure requirements for the issue of securities (shares, bonds and debentures) are subject to the Securities & Securities Exchange Law of June 1991. The relevant implementing regulation was adopted by the Ministry of Finance on November 23, 1993 and is entitled : On Procedures for Registering Shares of Open Joint Stock Companies formed from State Enterprises in the Process of Privatization and for Providing

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<sup>12</sup> 3.1.1.1.5. third point : Sale of equity

Information Regarding the Offering, otherwise known as the "Joint Stock Company Order".

(i) Pre-qualifying conditions :

State Owned Enterprises which have not yet been transformed into Joint Stock Companies are not allowed to carry out public offerings of shares. Furthermore, an existing Joint Stock Company may only increase its charter fund if all previously issued shares have been paid in full at a price which is not less than their nominal value. This is presumably assumed to be the case at the date of corporatization<sup>13</sup>, which for the FGCs took place before September 1, 1995. Finally, open Joint Stock Companies are only allowed to make public offerings of shares and may not offer shares for private placement. The issuance of debentures and bonds on the other hand may be carried out by both open and closed joint stock companies, by public offering or private placement. Existing shareholders of an open Joint Stock Company may be granted preferential share purchase rights.

(ii) Relevant Institutions :

The issuance of securities is principally regulated by the Ministry of Finance at the national level and local financial governmental bodies (the "Registering Bodies") at the regional level. The Securities Commission of the Cabinet of Ministers currently reports to the Ministry of Finance, but there are plans to create an independent self-regulated Securities and Exchange Commission, modeled on the SEC of the United States. A Stock-Exchange has been in existence since 1991. Its Governing Council regularly issues economic and financial criteria which issuers must fulfill in order to be allowed to list their securities on the Exchange.

(iii) Basic Requirements for Offering Shares to the Public : The Prospectus

A public offering is defined as an offer to sell securities to an "undetermined group" of potential investors, whether corporate or individual. The term "undetermined group" is not defined under Ukrainian law and the distinction between a public offering and private placement is therefore nebulous. All public offerings must be accompanied by a Prospectus which contains all information necessary for investors to obtain "a fair assessment of the issuer's financial

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<sup>13</sup> As opposed to the date at which the shares are offered to the public for sale through public auction in the context of the mass privatization program. Further research on this technical point is necessary.

condition". The Issuer and underwriter (if one is used) are both responsible for the accuracy of the information in the prospectus, but the Issuer bears primary liability for damages incurred by investors as a result of misleading or inaccurate information, which influences the ability of an investor to evaluate fairly the securities being offered. In particular, the Joint Stock Company Order provides that "information regarding the issuance of shares must be accurate and must permit the potential investor to assess the economic and financial status of the issuer." The Order also prohibits the publication of any information which cannot be confirmed by documents or substantiated by an audit. The information which must be contained in the Prospectus is regulated by the Ministry of Finance. A summary appears in Annex F.

(iv) Listing on the Stock Exchange

The terms and conditions for listing on the Stock Exchange are defined by the Governing Council and regularly amended. Criteria for listing include the size of the issuer's charter fund, the number of shareholders, the nominal value of the shares, the ratio of net profit to total assets, the minimum rate of return, etc. For more detail, refer to Annex F on various reporting requirements. Listings can be "official" if the issuer meets all or most of the conditions or "unofficial". There are three types of security categories :

K1 : are securities of issuers who meet certain economic and financial criteria and who file regular reports concerning their activities with the Governing Council;  
K2 : are securities of issuers who meet most but not all of economic and financial criteria. They are also required to file regular reports;  
K3 : are the unofficial securities of issuers who do not comply with the criteria;

(v) Foreign Participation in Ukrainian Share Subscriptions

The Ukrainian foreign investment legislation permits foreign investors to purchase shares and other securities in Ukrainian enterprises subject to Ukrainian currency regulations (which are notoriously complex and contradictory). The securities legislation also does not impose restrictions on the sale outside of Ukraine of securities issued by Ukrainian entities. However the proceeds of such a sale would also be subject to regulation by the National Bank of Ukraine under the currency regulations. Furthermore, the Ukrainian enterprise would have to comply with the disclosure requirements of the country where the securities were issued. This area obviously will require much more extensive research.

Authorized by  
O.M. Sheberstov  
Minister of Energy of Ukraine

\_\_\_\_\_, 1995

**CHARTER**  
**of the open joint stock company**  
**Centrenergo Generating Company**

Kiev

## **1. General Provisions**

- 1.1. The open joint stock company "CENTRENERGO" Generating Company, hereinafter referred to as the "Company" is founded in accordance with the executive order from the Ministry of Energy of Ukraine dated March 17, 1995 No 49, by means of restructuring corporatization of the state-owned enterprise "CENTRENERGO" in conformity with the Decree of the President of Ukraine No 244/94 as of May 21, 1994 "On measures about market transitions in the energy system of Ukraine" and the Decree of the President of Ukraine No 834/94 as of December 30, 1994 "On the amendments to the Decree of the President of Ukraine No 699 as of November 26, 1994".
- 1.2. The Company is composed of its separate subdivisions, namely: Uglegorsk, Zmiev and Tripolye thermal power plants.
- 1.3. The Company registered name is as follows:  
  
The open joint stock company - CENTRENERGO Generating Company, briefly, OJSC CENTRENERGO.
- 1.4. The address of the initial registered office of the Company is Square Ivan Franko, No. 5, Kiev 252001, Ukraine.

## **2. Goal and Subject of the Company's Activity**

- 2.1. The goal of the Company's activity is :

- To conduct business in Ukraine as a public service company providing its services to residents and other customers which is involved in the manufacturing, production, purchasing and sale ( wholesale or retail), leasing, dealing in, transmission, and distribution of:

- (i) power, light, energy and heat in the form of electricity or otherwise,
- (ii) by-products thereof and
- (iii) appliances, facilities and equipment for use in connection therewith.

- to make profits;

- to meet social and economic needs of the Company's Shareholders and the need of the Ukrainian economy for power, heat, services, etc.

- 2.2. The subject of the Company's activity is :
- generation, purchase and sale of electricity and heat, including the acquisition (by construction, purchase, lease, or otherwise);
  - use, maintenance and operation, of electric power plants;
  - conducting commercial operations and mediatory activities;
  - disposal of power plants, dams, substations, office buildings, service buildings, transmission lines, distribution lines, and all other buildings, machinery, property (real, personal or mixed) and facilities (including water power and other sites), and all fixtures, equipments and appliances, necessary, appropriate, incidental or convenient for its corporate purposes;
  - foreign trade activities;
  - public services;
  - other activity not prohibited by the law of Ukraine.

### **3. Legal Status of the Company**

- 3.1. The Company is a legal person since the date of its state registration.
- 3.2. The Company shall execute its activity in conformity with the laws of Ukraine and this Charter.
- 3.3 The Company is the legal successor of the State Owned Enterprise "CENTRENERGO".
- 3.4 The property of the Company consists of its basic funds and working assets and all other assets, indicated in the Company's opening balance sheet.
- 3.5 The Company is the owner of:
- 3.5.1 the property passed from its Founder (as defined hereinafter) and participants in its ownership;
  - 3.5.2 received income;
  - 3.5.3 products manufactured by the Company in the course of its operation; and
  - 3.5.4 all other property obtained on the basis allowed by the present law.
- 3.6 The Company undertakes the responsibility for risks of casual loss or damage of property that is the Company's property or the property passed into its ownership. The Company owns, uses and disposes of its property in conformity with its goal and permitted activities.
- 3.7 The Company shall possess and may exercise all of the powers and privileges granted

by law and this Charter, together with any powers and privileges incidental thereto, in so far as such powers and privileges are necessary or convenient to the conduct, promotion or attainment of the Company's goals set forth in Article 2 of this Charter.

- 3.8 Subject to Article 2 of this Charter and the laws of Ukraine, the Company shall have the power to:
- 3.8.1 exist in perpetuity, unless and until the winding up and dissolution of the Company by the Shareholders pursuant to the terms of this Charter;
  - 3.8.2 wind up and dissolve in the manner provided in this Charter;
  - 3.8.3 have a corporate seal, trademark and logo registered with the Chamber of Industry and Trade;
  - 3.8.4 sue and defend itself in a court of law, arbitral proceedings, administrative proceedings (including but not limited to proceedings in front of the National Electricity Regulatory Commission and the Anti-Monopoly Commission);
  - 3.8.5 enter into contracts and other legally binding agreements, including but not limited to, contracts for the sale of electricity, construction contracts, insurance contracts, storage contracts, trade commission contracts and loan agreements;
  - 3.8.6 acquire, own, hold, lease, improve, employ use and otherwise deal in and with real and personal property or any interest therein;
  - 3.8.7 sell, convey, lease, exchange, transfer, mortgage, pledge or otherwise dispose of any of the property, real or personal, of the Company, including but not limited to, the means of production and other assets of material value;
  - 3.8.8 maintain settlement, hard currency and other accounts in the banks;
  - 3.8.9 appoint such officers and agents as the business of the Company requires and to pay provide such officers with suitable compensation;
  - 3.8.10 adopt, amend and repeal this Charter or any of its terms;
  - 3.8.11 conduct its business, carry on its operations in connection therewith, and have offices and exercise its powers within, and outside of, Ukraine;
  - 3.8.12 to found associations and enter into associations with any other entity for any transaction or undertaking which the Company would have the power to conduct by itself;
  - 3.8.13 to create divisions, subsidiaries, affiliates, regional branches and offices within, and outside of, the Republic of Ukraine, and to allot to such entities main funds and working assets of the Company;
  - 3.8.14 lend money for its corporate purposes, invest and reinvest its funds and take, hold and deal with real and moveable property as security for payment of funds so loaned or invested;
  - 3.8.15 incur liabilities and obligations, including the borrowing of money, and secure such obligations by mortgage, pledge or other encumbrance;
  - 3.8.16 to increase its capital through the issue of additional equity shares, including both common and preferred stock and to enact stock splits; and

3.8.17 to take any other lawful actions in furtherance of its stated goal.

#### 4. The Company's Founder and Shareholders

4.1. Definition of Founder, First Shareholder and Subsequent Shareholders (such shareholders hereinafter referred to as the "Shareholders"):

4.1.1. The Company's Founder is the State in the name of the Ministry of Energy of Ukraine. After the registration of the Company, the Founder shall have no legal rights in the Company, other than those rights it enjoys in its capacity as a Shareholder of the Company. Notwithstanding other provisions of this Charter, if the state continues to own all shares of the Company, then the Founder shall have the exclusive right to determine any increases or decreases in the Statutory Fund, and any issuance or repurchase of shares.

4.1.2. The First Shareholder is the State Property Fund, representing the State in the ownership of shares.

4.1.3. Subsequent Shareholders are the physical persons and legal entities and government bodies who lawfully obtain ownership of the Company's shares.

4.2. The Shareholders have the right, subject to the laws of Ukraine:

4.2.1 to be inscribed in the Company's Share Registry;

4.2.2 to participate and vote in person or by proxy in the General Meetings and Special Meetings of Shareholders;

4.2.3 to cast *one and only one vote for every one share of common stock and preferred stock* (if the terms of issuance of such preferred stock so provides) that they own;

4.2.4 *to elect by cumulative vote* and to stand for election to the Supervisory Council, and to elect the Revision Commission and to the other administrative bodies of the Company;

4.2.5 to participate in the Company's profit and dividend distributions, if any, in accordance with the terms of this Charter and the class of stock which such Shareholder owns;

4.2.6 to obtain information about the Company's activity; at the request of its Shareholders, the Company must submit copies of its annual balance sheets and other officially reported documents, Company's reports, and minutes of all meetings, for their first-hand view; photocopies will be provided at the Shareholder's request without unreasonable delay and subject to the Shareholder paying no more than the actual cost of their reproduction;

4.2.7 to obtain a share of the residual property of the Company proportional to the amount of shares of that class of shares held by each Shareholder in case of liquidation, but in accordance with the terms of the class of stock which such Shareholder owns;

4.2.8 to freely dispose of the ownership of their shares;

4.2.9<sup>1</sup> *after new shares are issued, and within 30 days of the close of the new subscription, to elect to buy at the same price as the initial offering price an amount of shares equal or less to the amount necessary to maintain the proportional ownership the Shareholder had prior to the issue; if the new subscription required a Shareholder vote authorizing*

*it, the participation right is limited to those Shareholders who did not vote to approve the issuance; the calculation as to the number of shares such prior Shareholder is entitled to purchase in order to retain its proportional interest in the Company shall be made after the expiry of the 30 day period provided above and simultaneously with the adjustment to the share of all other Shareholders exercising such a right of purchase.*

- 4.3. The Shareholders have the obligation:
  - 4.3.1 to adhere to the founding documents of the Company, this Charter and all other governing documents of the Company;
  - 4.3.2 to execute the decisions of the Company's General Meeting and its other management bodies;
  - 4.3.3 not to disclose the commercial secrets and confidential information about the Company's activity which they acquire in their capacity as Shareholders; and
  - 4.3.4 to fulfill any other obligations required of them pursuant to the laws of Ukraine.
- 4.4. The Shareholders are financially responsible for the Company's obligations within the limit of their shares, and they shall not bear any further responsibility for any financial losses, responsibilities, liabilities or obligations of the Company.

## **5. Statutory Fund of the Company**

- 5.1. The Statutory Fund of the Company equals 8,557 billion KBV. This is the initial authorized capital of the Company.
- 5.2. The Statutory fund is divided into \_\_\_\_\_ common shares, each at the nominal and fully issued value of \_\_\_\_\_ KBV. Each common share will be entitled to one vote. Other classes of shares may be authorized and issued by vote of Shareholders having 75 % or more of the voting shares represented at a duly constituted Meeting of the Shareholders. The terms of issuance of such shares shall specify the voting and financial rights of such shares, but in no event shall such shares be ascribed more than one vote per share.
- 5.3.1 *The Company's General Meeting of Shareholders may decide with a 75 % majority of voting shares represented at a duly constituted Meeting of the Shareholders to increase or decrease the amount of authorized capital. However, the Company may not issue shares to cover losses linked with its economic activity. The Supervisory Council may decide to issue new shares in an amount not in excess of 33 % of the Statutory Fund, subject to existing Shareholders' participation rights described in Article 4.2.9. The Supervisory Council may delegate this power to the Executive Board<sup>2</sup>. A decision of the Shareholders to decrease the authorized capital may, at the election of the Shareholders, be carried out by either a decrease in the nominal value of such shares or an offer to repurchase outstanding shares. Upon any such repurchase of shares by the*

*Company, those share shall be deemed invalid and will no longer carry any voting or financial rights, and the Statutory Fund shall be reduced to reflect this fact.<sup>3</sup>*

- 5.3.2 *If the newly-issued or reissued shares are sold by the Company to a Supervisory Council Member (a "Council Member"), a member of the Executive Board (a "Board Member"), key employee or Shareholder holding 20% or more of the outstanding shares (voting and/or non-voting), the transaction will be considered a "Self-Interested Transaction" as defined in article 8.3.4.3. and will require a unanimous approval by non-interested Council Members as well as a simple majority vote of all non-interested Shareholders if the amount of shares sold exceeds 5 % of all outstanding voting shares.*
- 5.3.3 *If the newly-issued or reissued shares are voting shares, and either (1) such shares sold equal 20 % or more of all previously outstanding voting shares and are sold to one single Shareholder or group of Shareholders, or (2) such sale, in whole or part, gives any individual or group of Shareholders more than a total of 20 % of the outstanding voting shares, the sale will require the approval by a simple majority of outstanding voting shares represented at a duly constituted Meeting of the Shareholders, excluding shares held by the proposed acquirer of the new shares.<sup>4</sup>*

## **6. Shares of the Company**

- 6.1. The Company initially issues shares in an amount equal to its Statutory Fund and registers them according to the procedure envisaged by the acting legislation. If such shares are not purchased within one year of the issuance, then those share shall be deemed invalid and will no longer carry any voting or financial rights, and the Statutory Fund shall be reduced to reflect this fact. *Prior to the sale of any such shares, the Company may not exercise any of the voting or financial rights associated with such shares.<sup>5</sup>*
- 6.2. With the exception envisaged in item 6.3. of this Charter, the Shareholders of the Company have the right to dispose of the Company's shares in any way without any restrictions, in particular to sell them to other persons, to alienate them in favor of other legal entities or physical persons.
- 6.3. The Founder, who initially owns 100 % of the Company's shares, cannot alienate his shares before the decision on the Company's property privatization is taken.
- 6.4. After the decision on the Company's privatization property is taken the Founder shall hand over its shares to the state body of privatization in the order determined by the Ministry of Finance of Ukraine and the State Property Fund of Ukraine. Simultaneously with such transfer, the privatization body shall assume and thereafter bear all the responsibilities and obligations in its capacity as the Company's shareholder.

## **7. Procedure for Profit Distribution and Cost Recovery**

7.1. *The Supervisory Council decides by resolution whether to declare a dividend out of any net annual profit if the Council Members, in consultation with an internationally recognized banking, law or auditing firm, determine, in accordance with generally accepted accounting principles, that:*<sup>6</sup>

7.1.1 the Company will be able to satisfy its liabilities as they become due in the ordinary course of business; and

7.1.2 the realizable market value of the assets of the Company will not be less than the sums of its actual total liabilities.

7.2 The Company shall establish a reserve fund of not less than 25 % of the Statutory Fund, and shall establish such other funds as are required by the laws of the Ukraine. Payments to the reserve fund must equal or exceed 10 % of the annual net profit of the Company until such time as the reserve fund equals not less than 25% of the Statutory Fund. In the event that the reserve fund does not equal 25 % of the Statutory Fund five years after the establishment of the Company, then payments to the reserve fund shall increase to 20% of the annual net profit of the Company until the minimum reserve requirement is satisfied.

## **8. Administrative Bodies of the Company**

8.1. The institutions of the Company are:

8.1.1 General Meeting of the Shareholders;

8.1.2 Special Meeting of the Shareholders;

8.1.3 the Supervisory Council;

8.1.4 the Executive Board; and

8.1.5 the Revision Commission.

8.2 Meetings of Shareholders:

8.2.1 The Shareholders, as constituted at the General Meeting or a Special Meeting (each, a "Meeting"), constitute the highest decision making body of the Company;

8.2.2 Until other Shareholders obtain share ownership through the privatization process, the Founder shall be the single shareholder and be the highest decision making body of the Company. The Founder, in the name of the Shareholders, is authorized to manage State property and run the Company by taking decisions on the matters within its competence.

8.2.3 The legal status of the General Meeting and its decisions, order and terms of its convention, and the legal status of the Special Meetings and its order and term of its convention, shall be determined according to applicable law:

8.2.3.1 Meetings of Shareholders shall be held in Ukraine. General Meetings shall be convened every first Monday of the month of March. If that day shall be a legal holiday, the General Meeting shall be held on the next business day. At

the General Meeting the Shareholders vote on approving the Company's financial statements, annual report from the Supervisory Council and votes to appoint, renew or replace (with or without due cause) each member of the Supervisory Council and Revision Commission, the compensation of the Supervisory Council and such other matters specified by the laws of Ukraine, including the requirements of paragraphs 41 and 42 of Article 1 of the Law on Business Associations. *The President, being the Chairman of the Executive Board, is appointed by the Supervisory Council prior to such General Meeting, and is confirmed (or not, as the case may be) by the Shareholders every third year and at the time of initial appointment of such President.* Unless indicated to the contrary by the Shareholders by vote at the General Meeting (or at a Special Meeting), *the Shareholders delegate their right to appoint the other Board Members to the Supervisory Council.*<sup>7</sup> All other issues shall be discussed at Special Meetings of Shareholders, which can be convened at any time during the year, including at a time immediately prior or subsequent to the General Meeting, subject to proper notification of Shareholders.

8.2.3.2 Notification: For General Meetings, Shareholders shall be deemed notified if the date and place of the Meeting are published in three major national newspapers at least 45 days in advance and is not scheduled on a different date than the one defined in Article 8.2.3.1. For all Special Meetings and General Meetings scheduled on different dates, all Shareholders must be notified of the date, place and agenda of the Meeting. Notice will be considered duly given if the Company publishes all information in three leading national newspapers at least 45 days before the date and sends a least 45 days in advance the same information by postal mail, hand delivery or telefax, to each Shareholder individually at the address of such Shareholder registered with the Company. In case the Meeting is not called by the Company's management, the Company shall nevertheless bear all the costs related to notification of all Shareholders and shall make available to the organizers of such a Meeting a current list of Shareholders and their addresses. The Company may take all reasonable notification actions, and incur reasonable expenses, to ensure attendance of a Quorum (as defined hereafter) at any Meeting of the Company.

8.2.3.3 Quorum: More than 60 % of all voting shares must be present or represented for the Meeting to be valid. If the capital required is not represented at the Meeting, a second Meeting shall be called and held not later than one month after the first. The same rules concerning quorum representation and voting requirements shall apply to the second Meeting and any subsequent meeting held thereafter until a minimum quorum is achieved. The Meeting shall be dissolved within one hour of being convened if the quorum is not met.

8.2.3.4 Voting: Except where otherwise provided for by the laws of Ukraine or by this Charter, all decisions will be taken by a simple majority of the voting shares present or represented. In the case of equality of votes, the Chairman of the

Meeting, elected before every Meeting, shall be entitled to a second or tie-breaking vote. *Votes will be counted by a Counting Commission, appointed at the beginning of each Meeting by the Supervisory Council. All votes will be kept confidential.* Where voting rights are exercised by a representative holding a valid proxy power the Counting Commission shall verify that the proxy is authentic and that the proxy holder voted in accordance with the instructions contained in the proxy, but shall in all other respects keep confidential such proxies. Where voting rights are exercised in relation to a transaction described in articles 8.2.4.1 to 8.2.4.7 and 4.2.9 giving non-approving Shareholders participation or redemption rights as defined in article 4.2.9, the Counting Commission shall not disclose any voting results except at the request of the dissenting Shareholders in connection with such Shareholder's exercise of such rights they have under Sections 4.4.9 and 8.2.5. Voting for the Council Members shall be based on the principle of cumulative voting as defined in Article 8.3.2.5 below.

8.2.3.5 Proxy Rules

- Shareholders may cast their votes either personally or by proxy. Any solicitation of proxy shall state the proposals to be voted upon, with provisions to allow the Shareholder to vote yes, no or to abstain.
- In case the matter to be voted upon is the reappointment of a slate of Council Members for the Supervisory Council, the proxy solicitation shall allow the Shareholder to vote for the entire slate or by individual. The proxy form shall include the names of all candidates known to the Supervisory Council 30 days prior to notification of the Shareholders of a General Meeting (see Article 8.3.2.6).
- *The proxy may not be open-ended* and leave any discretion to the proxy holder, save to decide upon matters incidental to the conduct of the meeting.
- *Proxies are valid only for one Meeting and cannot be irrevocable*; voting trusts and any other means of ceding voting rights, are prohibited.
- At the date, time and place of the convened Meeting, all duly appointed Shareholder representatives must show original signed proxy documents to the Counting Commission.
- *Appointed representatives must exercise their voting rights in the manner specified on the proxy.* The Counting Commission is responsible for ensuring compliance. Votes exercised by proxy will be kept confidential.
- Signatures on proxies are presumed valid. If the Chairman of the Meeting, the Counting Commission or any Shareholder representing 10 % of the votes, has reasonable doubts concerning the validity of a proxy, he can call for a notarially certified copy of the proxy which must be produced within seven days of being so requested or the vote or votes cast by such proxy shall be disregarded. The Company shall pay for the cost of obtaining such a notarized document. If the cancelled vote or votes do not affect quorum or majority requirements, the decision will be unaffected. If the quorum or majority requirements are not met because of the cancelled vote or

- votes, then the Shareholder's decision will be declared null and void by the Counting Commission and the Supervisory Council shall reconvene a new General Meeting following the notification rules set out in Article 8.2.3.2 above.
- The proxy document shall be in writing, signed by the registered Shareholder or the Shareholder's duly authorized representative if the Shareholder is a corporation.
- 8.2.4. *The Shareholders must authorize any transaction that transforms the nature of the Company or involves a substantial risk of abuse for Shareholders. A majority of the Council Members or any Shareholder holding or representing more than 20 % of the votes, may call for a Shareholder vote on any transaction that it believes will transform the nature of the Company or poses a substantial risk of abuse to the Shareholders. The following types of transactions are assumed to be within the exclusive competence of the Shareholders:*<sup>8</sup>
- 8.2.4.1 *a merger or other business combination involving the Company and one or more other companies, except where such merger or business combination relates solely to the Company and one of its wholly-owned subsidiaries;*
  - 8.2.4.2 *a liquidation of the Company;*
  - 8.2.4.3 *a transformation of the Company into a legal entity of another type;*
  - 8.2.4.4 *a sale of assets, directly or through subsidiaries, equal to at least 33 % of the book value of the Company's assets (excluding assets sold in the regular course of business such as electricity);*
  - 8.2.4.5 *a purchase of assets or other transaction that will result in the Company owning, directly or through subsidiaries, additional assets equal to at least 33 % of the book value of the Company's assets;*
  - 8.2.4.6 *a purchase or sale of asset involving between 15 % and 33 % of Company's value, that has not been unanimously approved by all the members of the Supervisory Council; and*
  - 8.2.4.7 *a "self-interested" transaction as defined in article 8.3.4.4 below (which requires approval by a majority of non-interested Shareholders).*
  - 8.2.4.8 *Book value calculated in 8.2.4.4, 8.2.4.5 and 8.2.4.6 above will be adjusted for inflation.*
- 8.2.5. Redemption Rights:<sup>2</sup>
- 8.2.5.1 *Any Shareholder who does not vote in favor of any transaction referred to in Section 8.2.4. above may demand payment by the Company of the fair market value of his shares, as determined with the assistance of an internationally recognized banking, law or auditing firm appointed by the Supervisory Council, estimated without regard to value added (or decreased) by the transaction or dissemination of information about the transaction. This right of redemption must be exercised within 30 days of the vote by the Meeting of Shareholders.*
  - 8.2.5.2 *The fair market value shall mean the price at which a seller, who is fully informed about the value of the property and is not obligated to sell the property, would be willing to sell, and which a buyer, who is fully informed*

*about the value of the property and is not obligated to buy the property, would be willing to buy.*

- 8.2.5.3 *The determination of fair market value shall be made with the assistance of an internationally recognized law, banking or auditing firm appointed by the Supervisory Council.*
- 8.2.5.4 *If the property to be valued is publicly traded common stock or other securities, the person or persons making the decision shall consider, in making their valuation, the market price of the common stock or other securities over a period of time of no less than 2 weeks prior to the date of the decision as to fair market value, but only to the extent that he (or they) decide that the market price of common stock or other securities is a reliable measure of its value. If the property to be valued is stock of the Company, the "value" of a share is to be understood as a pro rata claim on the underlying value of corporate assets, as these are presently organized and managed. In setting a price for this value, the person (persons) making the decision may also consider the capital of the Company, the price that a willing, fully-informed buyer would be willing to pay for all, or a controlling portion of, the Company's shares, and other factors that they consider important.*
- 8.2.7 The General Meeting of Shareholders shall determine the payments to remunerate the labor of the key Company officials, its subsidiaries, branches and representative offices. Salary levels are proposed by a Remuneration Commission appointed from the Supervisory Council and made up of independent Council Members.
- 8.2.8. The Shareholders may also consider all other issues related to the Company's activity.
- 8.2.9.<sup>10</sup> *Each of the Council Members, the Revision Commission and any number of Shareholders representing jointly not less than 20 % of the voting shares of the Company have equal authority to call a Special Meeting of Shareholders. Any such entity may submit an agenda item for such a Meeting 40 days prior to such schedule Meeting.*

### **8.3. The Supervisory Council**

- 8.3.1. Until the first General Meeting of Shareholders is held, the Supervisory Council is the body that protects the interests of the Shareholders and the State. Its election and activity order and questions within its competence are determined in conformity with the laws of Ukraine and by articles 8.3.2 to 8.3.11 of this Charter.
- 8.3.2.1 The Supervisory Council shall consist of no less than 7 and no more than 12 members. The initial Supervisory Council may, until the first General Meeting of Shareholders is held have less than 7 members.
- 8.3.2.2 Each member shall be "independent" - that is, free of any relationship which would interfere with the exercise of his independent judgment. A Council Member may not also serve on the Executive Board (and vice versa).

8.3.2.3 The first Council Members are:

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8.3.2.4 At the first Meeting to be convened after the initial sale of state owned shares, the Shareholders shall review the composition of the Supervisory Council.

8.3.2.5<sup>11</sup> *The Council Members are elected jointly for one year, following a rule of cumulative voting. Each share of voting stock is attributed one vote per position to be filled. The total number of votes for each share therefore equals the total number of Council Members to be elected. Any number of the votes allowed for each share of voting stock may then be assigned to one or more candidates. Each year all members of the Supervisory Council must be re-confirmed in their position by the Shareholders. They may be replaced with or without due cause.*

8.3.2.7<sup>12</sup> *Notwithstanding Section 8.2.9, any Shareholder representing more than 5 % of the votes may present a candidate for election at the General Meeting of Shareholders. This candidate must either be identified and made known to the Chairman of the Meeting at least half an hour before the beginning of the General Meeting; or be made known to the Supervisory Council at least 30 days before notification of the General Meeting is sent to the Shareholders (defined in Article 8.2.3.2). In such a case, the Company shall include the name of the proposed candidates in the official agenda and universal proxy ballot form sent to all Shareholders (see 8.2.3.5 on proxy rules).*

8.3.3. The first Council Members are appointed by a joint commission of the Ministry of Economy of Ukraine and the State Property Fund, according to the laws then in effect.

8.3.4. Responsibilities of the Supervisory Council:

8.3.4.1 The Supervisory Council appoints the members of the Executive Board and supervises its activity, subject to the Shareholders' veto and their right to discontinue the delegation to the Supervisory Council of the Shareholders' power to appoint the Executive Board. The Chairman of the Executive Board must be approved by the Shareholders at the General Meeting.

8.3.4.2 The Supervisory Council shall review the financial statements, audits, reports and annual statement prior to submitting such items for Shareholder approval. However, *the Supervisory Council may not withhold from the Shareholders any material information concerning the Company.*

8.3.4.3 *The Supervisory Council must pre-approve any "self-interested" transaction. A "self-interested" transaction is defined as any transaction in which one party is the Company and the other is either a member of the Supervisory Council, a Shareholder representing more than 5 % of the outstanding shares (whether*

*voting, non-voting or a combination thereof), a member of the Executive Board or a senior Company official or is a company or third party in which one such interested party and/or his immediate family members owns, directly or indirectly an interest of greater than 5 %. The interested party must disclose his/her interest to the Company before the transaction takes place and if he/she is a member of the Supervisory Council, will be excluded from the quorum and vote calculations, authorizing/denying the transaction. Non-interested Council Members may only approve the transaction if the consideration for any property or services transferred by the Company, as determined by an internationally recognized accounting firm, equals or exceeds the market value of the property or services, and the consideration paid by the Company in exchange for property or services does not exceed the market value of the property or services.<sup>13</sup>*

- 8.3.4.4 The Supervisory Council must pre-approve any purchase or sale of asset involving between 15 and 33 % of the Company's value.
- 8.3.4.5 The Supervisory Council shall elect a Chairman from its Members.
- 8.3.4.6<sup>14</sup> *The Council Members will exercise due diligence in their duties of supervision over the activities of the Executive Board. The Council Members owe a duty of loyalty to the Shareholders and a duty to act with due care in the best interests of the Company. Pursuant to the duty of loyalty, a Council Member (i) shall not take advantage of any business opportunity falling within the sphere of the Company's goal and activities without notifying the Supervisory Council and receiving approval from a majority of non-interested Council Members and (ii) shall disclose all material information relating to the Company when it proposes to issue or repurchase Company stock or debt (in the form of bonds or similar instruments).*
- 8.3.4.7 *The Supervisory Council organizes working commissions made up of its members to deal specifically with internal audits of the Company, remuneration and selection of key Board Members. Other working commissions may be set up on an ad hoc basis.*
- 8.3.5. Rights of the Supervisory Council:
- 8.3.5.1 The Supervisory Council has the right to obtain any information on the Company's activity. It can order members of the Executive Board, Company officials and members of the Revision Commission to appear in front of the Supervisory Council for hearings or to present reports.
- 8.3.5.2 Any Council Member may attend a meeting of the Executive Board but may not vote.
- 8.3.5.3 The Supervisory Council may order the Revision Commission to conduct specific inquiries.
- 8.3.5.4 *The Supervisory Council shall convene Special Meetings of Shareholders whenever required by law, this Charter, or in order to protect Shareholders interests (see Article 8.2.4.).*

- 8.3.5.5<sup>15</sup> *Within the authorized capital limit (that is, within 33% of the Statutory Fund), the Supervisory Council may decide to issue new shares. The Supervisory Council decides the amount of the issue, the timing and the offering price subject to the provisions of Articles 5.3.1, 5.3.2 and 5.3.3. The offering price must not be less than fair market value, as determined by the Supervisory Council in consultation with a firm of internationally recognized accountants.*
- 8.3.6. The Supervisory Council has no right to interfere with the ordinary operational activity of the Company's Executive Board.
- 8.3.7. The Supervisory Council presents an annual report to the General Meeting of Shareholders (or to the Founder until the first General Meeting is held).
- 8.3.8. Meetings of the Supervisory Council: The sittings of the Supervisory Council are held not less than once per quarter and are considered valid as long as no less than 2/3 of its members are present or represented within half an hour of the appointed time. All Council Members must be notified in writing at least 3 days in advance. If all the members are present or represented at a meeting they can validly waive the notice requirements. Extraordinary sittings of the Supervisory Council are convoked at the request of the Chairman or 1/3 of its members. A Council Member may appoint a representative to attend a Supervisory Council meeting and to vote and deliberate on matters in such Council Member's place, so long as such a representative is also a Council Member. Such a delegation of authority can not be granted for more than one Supervisory Council meeting at a time, and may only be made by a Council Member twice within any 12 month period.
- 8.3.9 The decisions of the Supervisory Council are adopted by a simple majority of votes, unless the law or this Charter requires otherwise. In case of equality of votes, the Chairman of the Supervisory Council is entitled to a decisive vote.
- 8.3.10 A vacancy in the Supervisory Council may be filled by a resolution of the remaining members until a Shareholder's Meeting is held.
- 8.3.11 Remuneration for the Council Members is voted by the Shareholders at the General Meeting.

#### 8.4. **The Executive Board**

- 8.4.1. The Executive Board is the executive body of the Company that manages the Company's current activity.
- 8.4.2. Subject to Section 8.3.4.1, all powers of the Executive Board are delegated by the Shareholders.
- 8.4.3. The Board is appointed by the Supervisory Council subject to Shareholder veto. The Chairman is appointed by the Shareholders at the General Meeting.
- 8.4.4. The Company's Board consists of at least 3 members and no more than 12. The first Chairman of the Board, who is also the Company's President is Mr. Nickolai Syaber.
- 8.4.5.1 The Chairman of the Board runs the Board's activity. The Chairman is

authorized to act on behalf of the Company; he/she is authorized to run the current activity of the Company, implement the decisions of the Company's highest body and Supervisory Council, represent the Company in its relations to other physical persons and legal entities, to conduct negotiations and complete agreements on behalf of the Company and arrange for the minutes.

- 8.4.5.2 Issues of authority, terms of activity and material maintenance of the Chairman of the Board are determined in the contract which is completed between the Shareholders and the Chairman.
- 8.4.6. The First Deputy Chairman assists the Chairman in exercising his power, replaces him in case he is absent, performs the decisions of the Company's Shareholders and Supervisory Council.
- 8.4.7. The sittings of the Company's Executive Board are held not less than once a month and are considered authoritative as long as 1/2 of its members are present or represented, within half an hour of the appointed time. All members must be notified in writing at least 3 days in advance. All Board Members can validly waive the notice of the meeting. Extraordinary sittings of the Executive Board are convoked at the request of the Chairman or 1/3 of its members.
- 8.4.8. The decisions of the Executive Board are adopted by a simple majority of votes, unless the law or this Charter requires otherwise. In case of equality of votes, the Chairman of the Executive Board is entitled to a decisive vote.
- 8.4.9. The Chairman issues decrees and other regulating documents concerning the Company's activity on the basis of decisions which were adopted by the Executive Board.
- 8.4.10<sup>16</sup> *The Board Members owe a duty of loyalty to the Shareholders and a duty to act with due care in the best interests of the Company. Pursuant to the duty of loyalty, a Board Member (i) shall not take advantage of any business opportunity falling within the sphere of the Company's goal and activities without notifying the Supervisory Council and receiving approval from a majority of non-interested Supervisory Council Members and (ii) shall disclose all substantial information relating to the Company when it proposes to issue or repurchase Company stock or debt (in the form of bonds or similar instruments).*
- 8.4.11 *Conflict of Interest: If a Board Member has an interest in any corporation or enterprise or activity which the Company is involved in a business relationship, he/she must disclose this interest to the other members of the Executive Board and the Supervisory Council and shall be excluded from the quorum and vote calculations of any decision involving the Company and this other corporation or third party as per Article 8.3.4.3. above.*
- 8.4.12 Company Secretary:  
The Board Members shall by resolution of the Executive Board, appoint a Company Secretary who shall be responsible for maintaining the Shareholders registry (unless a

licensed professional agent is used), minute books and records (other than the financial records) of the Company and ensure compliance with all procedural requirements imposed on the Company by applicable laws and this Charter.

#### **8.5. The Revision Commission**

- 8.5.1.1 Verification of the economic/financial activity of the Company, its subsidiaries, affiliates and representation offices is exercised by the Revision Commission which is approved by the Shareholders.
- 8.5.1.2 Verifications are conducted annually or at the demand of the Revision Commission's own initiative or at the demand of the Shareholders who own in total not less than 10 % of the voting shares.
- 8.5.2.1 The Revision Commission reports only to the Shareholders as constituted at a Meeting. The Commission submits verification documents to the Shareholders as constituted at a Meeting and the Supervisory Council. The first Commission comprises of three members, until the first Meeting.
- 8.5.2.2 The Revision Commission has the right to invite experts, auditing companies to provide assistance. The Revision Commission and its duly appointed agents shall have unrestricted access to the premises of the Company, its books, records and correspondence.
- 8.5.3. The Revision Commission members have the right to take part in Meetings of the Executive Board, with the right to deliberate on issues.
- 8.5.4. The Revision Commission completes conclusions on the basis of annual reports and balances. The Company's highest body can only approve the financial statements if the Revision Commission's conclusions are included.
- 8.5.5. The Revision Commission shall demand a Special Meeting of the Shareholders or a Supervisory Council sitting if its investigations reveal a threat to the interests of the Company, or it has revealed abuses or misconduct on the part of Company officials.

#### **9. Accounting and Reporting**

- 9.1 The Company keeps operation and accounting records as well as statistical accounting and submits them to the state statistical authorities in accordance with the established procedure.
- 9.2 The first fiscal year begins at the date of the Company's registration and ends on the 31st day of December of the same calendar year. The next fiscal years shall correspond to the calendar year.
- 9.3 The Company's activity shall be exercised in conformity with the goal of the Company and any Company plans developed by the Supervisory Council and/or Executive Board.

#### **10. Procedure of Introducing Changes into the Company's Charter**

- 10.1 The right to introduce any changes in the Company's Charter is within the exclusive competence of the Shareholders.
- 10.2 Any revisions to the Charter must be approved by Shareholders representing 75 % or more of the voting shares present at a duly constituted Meeting of the Shareholders.
- 11. Suspension of the Company's Activity**
- 11.1 The Company's activity may be terminated by its restructuring (takeover, merger into another entity, or similar transformation) or liquidation.
- 11.2 In the event of such restructuring of the Company, all Company's rights and liabilities of the Company shall be passed to its legal successor.
- 11.3 The Company may be liquidated:
- 11.3.1. by a decision of the Company's Shareholders by approval of Shareholders representing 75 % or more of the voting shares present at a duly constituted Meeting of the Shareholders; or
- 11.3.2. by the judgement of a court of law or arbitration.
- 11.4 The Liquidation Commission:
- 11.4.1. The liquidation of the Company shall be conducted by the Liquidation Commission appointed by the Shareholders, or, similarly, by the court of law or arbitration in the event of liquidation decided by a court of law or by arbitration.
- 11.4.2. From the date of appointment of the Liquidation Commission, all management powers shall be transferred from the Executive Board to the Liquidation Commission. The Liquidation Commission will announce the commencement of the liquidation process and the period of time during which application claims may be filed against the Company, in a leading official newspaper.
- 11.5 The Liquidation Commission evaluates the available assets of the Company, identifies its debtors and creditors and provides settlements with them, undertakes actions to pay out the Company's debt to the third persons and Shareholders, completes the liquidation balance and presents it to the Shareholders or to the relevant court of law or arbitration. The Company's assets and funds, including proceeds from sales of the Company's assets, shall be shared between the Shareholders in accordance with the preference order for distribution of assets established, in proportion to their respective holdings within a particular class of stock, and in conformity with applicable law.
- 11.6 The liquidation of the Company shall be deemed completed and the Company terminated from the date of corresponding entry made in the State Register.

N.O. Syaber  
President of OJSC "CENTRENERGO" Generating Company

1. Provides shareholders with an ex-post participation right to purchase shares at the same terms and conditions as new purchasers, thereby preventing dilution of ownership for minority shareholders as long as they can afford to pay the market price.
2. The decision to issue new shares belongs to the shareholders. But within a reasonable limit (1/3 of the statutory fund), the shareholders delegate this function to the Executive Board. This gives the company flexibility to take advantage with short notice of market conditions in order to raise private equity.
3. Treasury shares have no voting rights and the management cannot use them to further their own interests.
4. If the Company sells a quantity of shares sufficient to to shift the control to a group of shareholders, then the other shareholders must approve the sale.
5. Authorized and un-issued shares do not carry voting rights.
6. The Company may pay a dividend only if it can afford it, according to International Accounting Standards.
7. Executive Board Member appointments are delegated by the Shareholders to the Supervisory Council Members. This makes Council Members more accountable to Shareholders on how the Company is managed. The President of the Company is elected for 3 years.
8. If the nature of the Shareholder's investment can be altered by a decision or if there is a substantial risk of abuse, the decision must be approved by the General Meeting of Shareholders (simple majority). the Supervisory Council or 20 % of the vote of shareholders can call a meeting of Shareholders. Article 8.2.4 follows with a list of decisions which are presumed to fall under the category of either significantly altering the nature of the investment or presenting a significant risk of abuse for Shareholders.
9. Redemption rights for dissenting minority Shareholders who feel that their investment is jeopardized by a decision of the majority of Shareholders. They can insist that the Company indemnify them.
10. Shareholders can rely on knowledge that important issues will automatically be brought to their attention.
11. Council Members are accountable to Shareholders yearly. Cummulative voting ensures a measure of proportional representation for minority shareholders.
12. Right to submit candidates for election at the Supervisory Council.

13. Any "Self-Interested" transactions and situations where conflicts of interest exist must be specially approved by non interested Council Members.

14. Defines fiduciary duties of care, loyalty and attention for Council Members..

15. See footnote Number2

16. Defines fiduciary duties of care, loyalty and attention for Executive Directors.

## PROPOSED CHARTER OF "DNIPROGIDROENERGO"

### 1. General Provisions

- 1.1 The open joint stock company "DNiPROGiDROENERGO"/hereinafter-Company/is founded in accordance with the decision of the Ministry of Energy of Ukraine dated " " 199 N\_\_\_\_ by means of restructuring of state-owned enterprise/SOE/ "DNiPROGiDROENERGO" is an open joint stock company in conformity with the Decree of the President of Ukraine dated May 21, 1994 N 244/94 "On measures about market transitions in the energy system of Ukraine".
- 1.2 The name of the open joint stock company: Open joint stock company "DNiPROGiDROENERGO" abbreviated form- open joint stock company "DNiPROGiDROENERGO"
- 1.3 The location of the company - Kiev oblast, town of Vyshgorod, 255240.

### 2. Goals of the Company's Activity

- 2.1 Goals of the company's activity: to meet the requirements of the national economy in production output, work and services on the basis of the received profit and to satisfy the economical and social interests of its shareholders.
- 2.2 The matter of activity of the company is the production of electric energy; the increase of technical level of production output; maintenance of equipment, premises and constructions; consumer services; commercial and intermediary activity; foreign economic activity; performance of other activity allowed by the present law of Ukraine.

### 3. Legal Status of the Company

- 3.1 The Company is a legal person since the date of its state registration.
- 3.2 The Company executes its activity in conformity with the present law of Ukraine and this Charter.
- 3.3 The Company is a legal successor of SOE "DNiPROGiDROENERGO".

3.4 The property of the Company is consisting of its basic funds and working assets and the other values as well, indicated in the Company's balance.

3.5 The Company is the owner of:

- The property passed from its founder and participants into its ownership;
- Received income;
- The other property obtained on the basis allowed by the present law.

The Company undertakes the responsibility for risks of casual loss or damage of property that is the Company's property or the property passed into its ownership. The Company owns, uses and disposes of its property in conformity with the aim of its activity.

3.6 The Company has the right to sell and to hand over free of charge, exchange and lease to the other legal and physical persons the means of production and the other material values, use or alienate them by other means if it is adequate to the present law and his Charter.

3.7 The Company has its own balance, settlement and hard currency accounts and some other accounts in the banks; trademark and logo adopted by the Executive Board and registered within the Chamber of Trade and industry; seal with its name.

3.8 The Company has the right to conclude agreements/contracts, namely: contracts of purchase, turnkey contracts, property insurance contracts, storage contracts, trade commission contracts, etc., to gain the property and personal non-property rights, to bear obligations, to appear for the defense in court, in court of arbitration, etc.

3.9 The Company has the right, in the established law order:

- To issue securities;
- To found the associations and to enter associations with the other subjects of business activity;
- To create on the territory of Ukraine and beyond its boundaries the regional branches, representative offices and subsidiaries;
- To act in the other ways adequately to the present law.

3.10 The Company may allot its subsidiaries, branches and representative offices main funds and working assets that belong to the Company. The management over its activity is performed by the persons appointed by the Executive Board.

3.11 Making decisions on its staff remuneration and creating the consumer and alienation funds within the Company's fixed assets, the Company acts according

to the law norms established for the state entities until the decision to sell the Company's shares is taken.

#### 4. The Company's Founder and Shareholders

4.1 The Company's founder is the state in the name of the Ministry of Energy of Ukraine. The Company's stockholders (participants) are:

- The State in the name of the body authorized to manage the State property (if 100% of shares belong to the State);
- Workers collective of enterprise with buy-out of State property according to the alternative privatization plan;
- The privatization body, upon receiving shares from the founder, according to the decision made on the Company's property privatization;
- The legal persons of different forms of property and physical persons of Ukraine and other countries that obtain ownership of the Company's shares through privatization process and subsequent secondary securities markets.

4.2 The Shareholders (participants) have the right:

- To participate in the General Meeting of Stockholders;
- To elect and be elected to the Supervisory Council, the Revision Commission and to the other Company's bodies as defined in Art. 8.3.1 of this Charter;
- To participate in the Company's management in order defined by the present Charter;
- To participate in the Company's profit distribution and be entitled to its share (dividends);
- To obtain information about the Company's activity; at the request of its member, the Company must submit copies of its annual balance sheets, Company's reports, and minutes of all meetings, for his first-hand view;
- To obtain a share of the property of the Company proportional to the amount of shares held by each one;
- To freely transfer to ownership of their shares in the order defined by the present law and this Charter;

When new shares are issued, existing Shareholders have the priority right to subscribe to a proportion equal to their current holdings.

The participants can have some other rights envisaged by the present law.

4.3 The Company's Stockholders have:

- To keep to the founding documents of the Company;
- To execute the decisions of the Company's General Meetings and its other management bodies;
- Not to disclose the commercial secrets and confidential information about the Company's activity;
- To carry out other duties envisaged by the law of the Ukraine;
- To deduct 1.5 % of the production cost from the net profit to the branch fund in order to finance branch programs and the activity of the central apparatus of the Ministry of Ukraine as a body authorized to manage State property and coordinate energy complex of Ukraine.

4.4 The Shareholders are financially responsible for the Company's obligations within the limit of their shares.

## 5. Statutory Fund of the Company

5.1 The Statutory fund of the Company equals to \_\_\_\_\_KBV.

5.2 The Statutory fund is divided into \_\_\_\_\_common shares, each at the nominal value of 25 000 KBV.

5.3 The Company has the right to change (increase or decrease) the statutory fund.

5.4 The Statutory fund after complete payment of all previously issued shares can be increased by:

- issuing and selling new shares in accordance with the current legislation, for additional money or material deposits;
- increasing the nominal value of the issued shares.

The decision to increase the Statutory fund is passed by the highest body of the Company..

5.5 The Statutory fund can be decreased in agreement with the Company's creditors through:

- Reducing the nominal value of the issued shares;
- Canceling shares bought back by the Company from the Shareholders.

The decision to decrease the Statutory fund is made by the Company's highest body.

5.6 The decision on changing the size of the Statutory fund comes into power after the changes are amended into the State register.

## **6. The Company's Shares**

6.1 The Company issues shares in an amount equal to its Statutory fund and registers them according to the procedure envisaged by the acting legislation.

6.2 With an exception envisaged in item 6.3 of this Charter, the Shareholders of the Company have the right to dispose of the Company's shares in any way without any restrictions, in particular to sell them to other persons, to alienate them in favor of other legal entities or physical persons, in case there is nothing else determined by the acting legislation.

6.3 The founder who owns 100% of the Company's shares, cannot alienate his shares before the decision on the Company's property privatization is taken.

6.4 After the decision on the Company's privatization property is taken, the founder hands over its shares to the State body of privatization in the order determined by the Ministry of Finance of Ukraine and the State Property Fund of Ukraine. Simultaneously, the privatization body bears all the responsibilities and obligations of the Company's shareholder.

## **7. The Profit Distribution and Expenses Cover Procedure**

7.1 The Company's profit is formed by the deductions from the business activity for covering material and other expenses including labor remuneration. The interest rates and obligations payments, taxes and other payments to the budget envisaged by acting legislation are made from the Company's balance profit. When all the mentioned above payments are made, the net profit is at the Company's disposal.

7.2 The net profit distribution and covering losses procedure is determined by the highest Company's body.

7.3 The Company creates:

- The reserve (insurance) fund;
- The dividends fund;
- The production development fund;
- The consumer and social fund.

7.3.1 The Company's reserve fund equals \_\_\_\_\_ KBV, that means 25 % of the Company's Statutory fund. The reserve fund is used for covering of expenses related to losses and incidental expenses. The decision to use the fund's means is made by the highest body of the Company. The reserve fund is created by means of annual deductions in the amount of 5 % of the Company's net profit (income) to make a necessary sum. The funds means enter a special account within the banking office and is not used in any other way.

7.3.2 The dividend fund is formed from the Company's net profit (income). The amount of planned and deducted quarterly or annually sum of this fund is determined by the Company's highest body.

The means from this fund are paid to the Stockholders proportionally to a total cost of their shares. The payment of dividends is made quarterly until 25th of the next month after each quarter by entering the Shareholders accounts or otherwise in conformity with the Company's highest body decision.

The extra charging and dividends payment to a share owned by State are made quarterly according to the Decree of Cabinet Ministers of Ukraine dated April 30, 1993, N44-94. "About dividends payments (profit's share) by the subjects of business activity created with the participation of State entities and other organizations".

7.3.3 The development production fund is formed by the deductions from the net profit.

7.3.4 The social development fund is formed by the deductions from the net profit.

## **8. Administrative Bodies of the Company**

8.1 The Company is managed by:

- The Company's highest body according to Art. 8.2 of this Charter;
- The Supervisory Council;
- The Executive Board;
- The Revision Commission.

8.2 The Company's highest body

8.2.1 The General Meeting is the Company's highest body.

8.2.2 Until other Shareholders obtain share ownership rights through the privatization process, Founder shall be single share holder and be the Company's highest body.

The Founder, in the name of the body is authorized to manage State property, run the Company by taking decisions on the matters within its competency.

8.2.3 The legal status of the General Meeting and its decisions, order and terms of its convention, are determined according to acting legislation and this Charter.

8.2.4 Within the Company's highest body competence is:

- To set up key directions of the Company's activity, approve its plans and reports about their fulfillment;
- To set up organizational structure of the Company;
- To approve the Charter and to introduce the changes and amendments;
- To elect or recall, with or without due cause, members of the Supervisory Council (with the exception of cases envisaged in item 8.3.1);
- To elect the Chairman of the Executive Board;
- To elect or recall the members of the Board and the Company's Revision Commission (except the cases envisaged in item 8.4.4);
- To adopt annual results of the Company's activity including its subsidiaries, reports and conclusions of the Revision Commission, profit distribution order;
- To determine the procedures of covering losses;
- To create, reorganize and liquidate subsidiaries, representative offices and branches; to adopt their Charters and regulations;
- To adopt decisions on property responsibility of the Company's officials;
- To adopt procedure rules and other internal documents of the Company;
- To set up organizational structure of the Company;
- To take decisions on purchase of the Company's own shares;
- To approve agreements, calculated for the sum exceeding the Statutory Fund by 5 times;
- To determine the payments to remunerate the labor of the Company's officials, its subsidiaries and branches, representative offices;
- To adopt decisions on suspending the Company's activity, appoint liquidation commission, adopt liquidation balance.

The Company's highest body may deal with the other questions concerning Company's activity.

8.3 The Supervisory Council

8.3.1 Until the first General Meeting of Shareholders is held, which is convened after the decision being made to start the privatization of the Company's property,

the Supervisory Council is the body that manages the Company's Executive Board activity in order to protect the interests of Shareholders and the State. its election and activity order, questions within its competence are determined in the conformity with the "Regulations about the Supervisory Council" adopted by the order of the Cabinet of Ministers of the Ukraine dated July 19, 1993, N556, and by items 8.3.2-8.3.9 of this Charter.

The first General Meetings of Shareholders, convened after the decision being adopted about the privatization of Company's property, elect a new Supervisory Council and determine its competence.

8.3.2. The Supervisory Council consists of 5 members. it has as its members:

- from the "Minenergo" of Ukraine : 1 person
- from Vyshgorod branch of "Prominvestbank" of Ukraine : 1 person
- from "Dniprogidroenergo" : 1 person
- from the State Property Fund of Ukraine : 1 person
- from Vyshgorod district rada of people's deputies of Kiev oblast (local parliament): 1 person

8.3.3 The Supervisory Council staff and its substitutions are adopted by current joint commission of the Ministry of Economy of Ukraine and the State Property Fund by the Founder's presenting.

8.3.4 The Supervisory Council:

- Adopts the membership of the Company's officials by the Chairman's presenting;
- Approve transactions of the Company's fixed property the cost of which is not exceeding 50% of the Statutory Fund;
- Adopts annual and quarter reports which are submitted by the Executive Board and the Revision Commission;
- Makes analyses of the Board's acts concerning the Company's management and its investment;
- Technical and price policy, goods nomenclature support and services;
- In case of necessity initiates the conduction of extra revisions and auditors checks of financial and business activity of the Company;
- Presents to the Founder suggestions on the matters of the Company's activity;
- Executes other acts pertaining the supervision of the Company's activity;
- Submits to the privatization bodies suggestions concerning the peculiarities of the Company's property privatization.

8.3.5 The Supervisory Council have the right:

- To obtain information about Company's activity;
- To hear the reports of the Board, the Company's officials on specific matters of their activity;
- To stop the power of the members of the Board adopted before;
- To invite the experts for analyses of specific matters of the Company's activity.

8.3.6 The Supervisory Council have no right to interfere in the current Company's activity.

8.3.7 The Supervisory Council presents its annual report to the Founder and reports to the first General Meeting of Shareholders that convened after the decision on the Company's property privatization is made. in the case when the work of the Supervisory Council is admitted to be unsatisfactory, the Founder submits to constantly working commission of the Ministry of Economy of Ukraine, Ministry of Finance and the State Property Fund the proposals about changes within its membership.

8.3.8 The extra-ordinary meetings are held quarterly and are considered legal if the have 2/3 quorum. The decisions of the Supervisory Council are accepted by a simple majority of votes. in the case of equality of votes, the Chairman of the Meeting is entitled to a decisive vote. The extraordinary meetings are convened at the request of the Chairman of the Supervisory Council, of 1/3 of its members or the Company's Executive Board.

8.3.9 The Supervisory Council members are the Company's officials and bear the responsibility within its competence. Remuneration of the duties of the member of the Supervisory Council equals to 6 minimal salaries to the Chairman and 4 to the other members of the Board, a supplemental annual bonus equals to 10% of the Chairman's bonus received in the established order.

8.4 The Company's Executive Board

8.4.1 The Executive Board is the executive body that manages the Company's current activity.

8.4.2 All the matters related to the Company's activity are within the Board's competency, besides those related to the competency of the other Company's body determined by acting legislation, this Charter or by the decision of the highest body of the Company. The highest body of the Company can make a decision to delegate its authority to the competence of the Executive Board.

8.4.3 The Board is elected for 3 years and it should report its activity to the highest body and to the Supervisory Council of the Company. The Executive Board organizes the execution of its decisions.

8.4.4 The Executive Board of the Company consists of 7 members. The first Chairman of the Board is Potashink Semen izrailovich. The next candidate's nomination is adopted by the Supervisory Council considering Founder's presenting.

Such order of forming the personal membership of the Company's Executive Board is in power until the first General Meeting of Shareholders takes place and determines the new order.

8.4.5 The Chairman of the Executive Board executes its power over the Board's activity. The Chairman of the Board has the right to act in the name of the Company without any instructions, he is authorized to tackle current Company's affairs, to execute the decision of the Company's highest body and the Supervisory Council, to represent the Company in its relations with the other physical and legal persons, negotiate and conclude agreements in the name of the Company, to organize someone to record the minutes. The highest body of the Company signs a contract that covers issues concerning competency, activity conditions and salary of the Chairman.

8.4.6 The Company Board's meetings are held once in a month and become legal if 1/2 of its members are present. The Board's decisions are taken by a simple majority of votes. in the case of equality of votes, the Chairman's vote is decisive. The extra-ordinary meetings are convened at the Chairman's or 1/3 of its members request.

8.4.7 On the basis of the decisions made by the Board, the Chairman.....

## ANNEX B : COMMENTS ON THE PROPOSED CHARTER FOR "Dniprogidroenergo"

### I. General Comments

The charter of a company should be kept as short, general and simple as possible. There is no reason for the charter to list rights that are already granted under Ukrainian law. The Charter can not create legal rights that contradict existing and future laws, so listing of rights is superfluous and will only promote confusion because some rights will be omitted or because the law will change but the charter will not. As an example, shareholders rights should simply refer to "all rights mandated by Ukrainian Law".

Another advice to keep in mind is to organize sections logically and keep related topics together. The following specific comments follow the proposed outline of the Hydro-power Company charter.

### II. Specific Comments

Hereafter, the numbering of paragraphs follows exactly the numbering of articles of the Charter of the Open Joint Stock Company "Dniprogidroenergo". Direct quotes appear in italics.

#### 2. Goals of the Company's Activity

Section III of this corporatization plan describes at length that the fundamental principle of good corporate governance is the formulation of a clear goal by the company owners, which the managers and directors can then be held accountable for achieving.

The proposed text reads as follows :

*"2.1. The goals of the company's activity is to meet the requirements of the national economy in production output, works and services on the basis of the received profit and to satisfy the economical and social interest of its shareholders.*

*2.2. The matter of activity of the company is the production of electric energy; the increase of technical level of production output; maintenance of equipment, premises and constructions; consumer services; commercial and intermediary activity; foreign economic activity; performance of the other activity allowed by the present law of Ukraine."*

Does this fit the requirements of a clear goal for management ?

- 2.1. "The requirements of the national economy in production output, works and services" are typical concerns of the State as a sole shareholder, but would be irrelevant to private investors. Future private shareholders are also unlikely to reach a consensus on their "social interests".

It would therefore be wise to narrow the goals of the company's activity to the following :

*"to satisfy the economic interest of its shareholders."*

It should be noted that it is unnecessary to specify that company activities must be conducted "on the basis of the received profits". This matter does not directly concern the "goal" of the company, which must anyway always "be allowed by the present law of Ukraine." (see general comment on listing rights granted by the law).

- 2.2. The "matter of activity of the company" should be kept as broad as possible, so that the future Gencos can easily adapt to a changing environment, which is difficult to predict today . For instance, they should not be constrained by the current wording of the licenses under which Gencos will operate initially (restricting Gencos exclusively to power generation activities). As an example, the POTOMAC ELECTRIC POWER COMPANY has the following broad purpose :

(A) To manufacture, produce, generate, buy, sell, lease, deal in, transmit and distribute (i) power, light, energy and heat in the form of electricity or otherwise, (ii) by-products thereof and (iii) appliances, facilities and equipment for use in connection therewith;

(B) To acquire (by construction, purchase, condemnation, lease or otherwise), use, maintain, operate, deal in and dispose of, power plants, dams, substations, office buildings, service buildings, transmission lines, distribution lines, and all other buildings, machinery, property (real, personal or mixed) and facilities (including water power and other sites), and all fixtures, equipments and appliances, necessary, appropriate, incidental or convenient for its corporate purposes; and

(C) To conduct business as a public service company, which business is briefly described as the purchase, manufacture, generation, transmission, distribution and sale, both at wholesale and at retail, of electricity or other power or energy for light, heat and power purposes in the District of Columbia, the Commonwealth of Virginia, the State of Maryland and elsewhere.

3. The legal status of the Company

3.11. *says staff remuneration must be decided according to the law established for the state entities.*

If indeed the law fixes remuneration for state entities, then it is not necessary to mention it in the Charter (see general comment on listing of rights). Eventually, the Genco managers will want to be able to introduce some financial incentives in the remuneration of its key staff. When the law does allow that to happen, it would be a shame if the Company Charter expressly prohibited this option.

4. The Company's founder and shareholders

4.1. lists who the shareholders are. The last paragraph says : *the legal persons of different forms of property and physical persons of Ukraine and other countries that obtain ownership of the Company's shares through privatization process and subsequent secondary securities markets.* This general "catch all" statements forgets to include the owners of newly issued shares, ie beyond the privatization process.

Rather than listing the State, the workers collective, the privatization body and the legal persons [...] as shareholders, it may be simpler to define shareholders generically in the following way :

4.1. The shareholders are the physical persons and legal entities who obtain ownership of the Company's shares through the privatization process, the issue of new shares and subsequent secondary securities markets.

4.2. to 4.4. then proceeds to list the rights and obligations of shareholders as defined in the law on open joint stock companies. As mentioned earlier, listing rights which are provided for by legislation is counterproductive. We suggest that these paragraphs simply be removed.

One paragraph includes the following : *To deduct 1.5 % of the production cost from the net profit to the branch fund in order to finance branch programs and the activity of the central apparatus of the Ministry of Ukraine as a body authorized to manage state property and coordinate energy complex of Ukraine.*

This particular provision is a form of tax imposed on the Gencos. This is a good example of the State as sole shareholder mixing up its roles. Taxation matters must not be dealt with at the Charter level, but in separate laws and regulations. This paragraph in particular should be deleted.

5. Statutory Fund of the Company

The issue of how the statutory capital of the Gencos is going to be increased in order to attract new investors is probably one of the most critical for the future growth of the Gencos. Article 5.4. stipulates that *the decision to increase the statutory fund is passed by the highest body of the Company* (ie the general meeting of shareholders). Article 38 of the Law on Business Associations allows the decision to increase the capital by up to 1/3 to be taken by the Directors, if so specified by the Statute. The law does not say whether this decision should be taken at the executive or supervisory level. In the US such decisions are taken by the full board, including both managing and non-managing directors. 90 % of all board members of publicly quoted companies in the US are non-managing directors, so in practice, the decision to issue new shares is taken by outside directors, under the strong influence of the CEO.

Under the Anglo-Saxon system of company law, the statutory capital can have different characteristics. First a certain amount is "authorized" in the Statute. Within the authorized amount, some shares may be "issued" and others "non-issued". The issued ones belong to shareholders, the non-issued ones are considered treasury shares and belong to the company. It is the non-issued authorized shares which the Directors can sell at any time without shareholder approval. Finally, issued shares can be "fully paid" or "partially paid", allowing shareholders to contribute their equity investment in the company in pre-determined stages.

Attracting outside investors is a complex process in the best of cases. In the US, Directors can issue new shares within the "authorized" capital limit without prior consulting with the shareholders. This flexibility is important because Directors must be able to react to market opportunities (see section on "dynamism" as a fundamental corporate governance characteristic). Many uncertainties make it inappropriate for every public offering to be decided through a meeting of shareholders. Timing is crucial and so is the amount and pricing of an issue. Recent experiences in Russia with public offerings, highlighted the importance of providing a mechanism for Directors to respond quickly to changing market conditions for public offerings. Requiring each change in the number of shares to be offered to be approved by the shareholders has demanded a lengthy process which has made it more difficult for enterprises to raise needed capital quickly.

Unfortunately, the Law on Business Associations does not deal in such detail with issuing new shares. However, article 38 does provide the basis for giving the Directors some discretion in this important matter. The Statutory Fund can be described as "authorized", "issued", "fully paid" shares. The 1/3 additional capital the directors can decide to increase the capital by, can be described as "authorized", "non-issued" shares.

Article 5.4 could therefore read as follows :

"The statutory fund after complete payment of previously issued shares can be increased by :

- issuing and selling new shares in accordance with relevant legislation, for additional money or material deposits;
- increasing the nominal value of the issued shares.

The decision to increase the statutory fund is passed by the highest body of the Company if the increase is more than one third, otherwise the decision is made by the Supervisory Council after consultation with the Executive Board."

6. Shares of the Company

[no comments]

7. Procedure of profit distribution and covering costs

All the provisions from 7.1. to 7.3.4. are extremely restrictive and seem to only repeat current legal requirements. As mentioned earlier, it is understood that Directors must act within the law. Actually listing current rights and obligations in the Charter is not recommended since they are bound to change with time. An alternative, simpler and shorter wording for this section could be the following :

- "The Supervisory Board, may by resolution, declare a dividend out of any net annual profit if the directors are satisfied that :
  - 7.1. the Company will be able to satisfy its liabilities as they become due in the ordinary course of business;
  - 7.2. the realizable value of the assets of the Company will not be less than the sums of its total liabilities;

This should ensure at a minimum that dividends are not declared if the company is technically bankrupt or if its cash flow could become negative as a result of such a payment. As much as possible, the directors should have the discretion ("dynamism" aspect of corporate governance) to allocate funds as best serves the interest of the corporation. Some special funds may have been earmarked by legislation for the time being. These, the Directors will have to respect. But decisions on new investments, acquisitions and dividend payments are best left to their discretion. The shareholders of course monitor these decisions by supporting management or not at the annual general meeting of shareholders and exercising their other rights listed in section III.

8. Administrative Bodies of the Company - Title could be changed to " The Institutions of the Company", since the general meeting of shareholders for instance, is not an "administrative body".

8.1. *The Company is managed by :...*

We suggest alternatively, "The Institutions of the Company are :

- The General Meeting of the Shareholders
- The Supervisory Council
- The Executive Board
- The Audit Commission

8.2.2 *The Founder, in the name of the body authorized to manage state property, runs the Company by taking decisions on the matters within its competency.*

It may be useful in this paragraph to add a word to the effect that as long as the State is the only shareholder, the Company shall be run for commercial purposes, with a view to maximizing the return on investment (see section 2.2.1.1. of the issues of the State as a sole shareholder).

For instance : "The Founder, in the name of the body authorized to manage state property, runs the Company by taking decisions on matters within its competency, with a view to maximizing the value of the Company, within the current laws, regulations and Company Charter."

8.2.3. *The legal status of the General Meeting and its decisions, order and terms of its convention are determined according to acting legislation and this Charter;*

Thanks to this paragraph, most of article 8.2.4. can be excluded (see section on listing legislative rights). Article 41 of the law on business association clearly stipulates that the General Meeting of shareholders has all the rights and can discuss anything. Expressly included are :

- *to set up key directions of the Company's activity, approve its plans and reports about their fulfillment (art. 41(a));*
- *to set up organizational structure of the Company; (art. 41(h))*

- *to approve the Charter and to introduce the changes and amendments; (art 41(b))*
- *to adopt annual results of the Company 's activity including its subsidiaries, reports and conclusions of the Revision Commission, profit distribution order; (41(e))*
- *to create, reorganize and liquidate subsidiaries, representative offices and branches; to adopt their Charters and regulations; (art. 41(f))*
- *to adopt decisions on property responsibility of the Company 's officials (art. 41(g))* [NB this particular provision is difficult to understand. Maybe the Russian or Ukrainian original text is clearer.]
- *to adopt procedure rules and other internal documents of the Company (art. 41(h))*

Other items should be treated differently

- *to elect and recall with or without due cause members of the Supervisory Council (with the exception envisaged in item 8.3.1.);* This right is included in Article 41(c), but should nevertheless be included in the Charter because it adds that members of the supervisory council may be recalled *with or without due cause*. This is an important addition which gives shareholders more influence in the exercise of their power and on how the corporation is run. The following sections include the rights to elect the Chairman of the Executive Board, the other members and the Company's Revision Commission :
  - *to elect the Chairman of the Executive Board;*
  - *to elect and recall the members of the Board and the Company 's Revision Commission (except in cases envisaged in item 8.4.4.)*
 For these sections it would also be useful to add that these appointees can all be dismissed "with or without due cause"<sup>11</sup>.

In practice, the appointment of the Chairman and other members of the Executive Board, should be made through the Supervisory Council and only confirmed by the shareholders meeting. This is the work of the important Selection Committee, composed of outside directors, mentioned in Section III of this paper. This does not mean to say that shareholders cannot challenge the proposed nominations by submitting alternative candidates. On the contrary, the opportunity to do so is an important element of corporate governance. This can be done by introducing new items to the agenda, as permitted by article 43 paragraph 2.

- *to approve agreements, calculated for the sum exceeding the Statutory fund by 5 times; (article 41(k)).* Getting shareholders approval, even for big contracts may be too cumbersome to be practical. Business opportunity must not be lost because, while shareholders had first to be consulted, the process took too long to organize. Unfortunately, the Law on Business association does state: "*approval of contracts made for an amount which exceeds that indicated in the company charter is of the competence of the general meeting of shareholders*".

However just saying this amount is 5 times the Statutory Fund is dangerous and arbitrary. In general, it is best to use a multiple of the book value of the Company's fixed assets which is a slightly more relevant figure. The idea is that Shareholders should only interfere with the running of the Company if the nature of their investment is substantially affected. This would be the case for instance if the Directors were considering an investment that would double the generating capacity for instance.

- *to determine the payments to remunerate the labor of the Company's officials, its subsidiaries and branches, representative offices;*

This provision is very important for corporate governance and should not be changed. It should be noted however that in practice the ground work could be done by the Remuneration Commission of the Supervisory Council, with shareholders confirming their findings or if necessary, proposing modifications. In such a case, it would not be necessary to introduce a new line item to the agenda, as voting on the remuneration of key officers would automatically be included in each annual meeting.

- *The Company's highest body may deal with the other questions concerning Company 's activity;* This last section could be reworded in the following way : "The Shareholders' Meeting may deal with any other question concerning the Company's activity, if not limited by law and this Charter".

These comments apply to the text as proposed for the Hydro-power company. The Genco charters should however include some other very important provisions. The Law on Business Association very briefly mentions rules concerning notification of shareholders, quorum requirements, voting and proxy rules. Under Anglo-Saxon law, the mechanics of these procedures would be described in the company "By-

Laws", a document attached to the "Memorandum of Incorporation". The Charter under Ukrainian law is supposed to be a more comprehensive and detailed document, encompassing both the memorandum and the by laws. The following text is the suggested amendment to the Genco charter, and is an excerpt of Annex C. It ignores the fact that for the time being the State is the only shareholder, on the assumption that this is a temporary situation.

Notification : For Annual General Meetings, Shareholders shall be deemed notified if the date and place of the meeting are published in three major national newspapers at least 21 days in advance and is not scheduled on a different date than the one defined in Article 8.2.3.1. For all Special Meetings and General Meetings scheduled on different dates, all shareholders must be notified of the date, place and agenda of the meeting. Notice will be considered duly given if the Company publishes all information in three leading national newspapers at least 21 days before the date and sends a least 21 days in advance the same information by postal mail, hand delivery or telefax, to each shareholder individually. In case the Meeting is not called by the Company's management, the Company shall nevertheless bear all the costs related to notification of all shareholders and shall make available to the organizers of such a Meeting a current list of shareholders and their addresses.

Quorum : More than 60 % of all shareholders must be present or represented for the Meeting to be valid. If the capital required is not represented at the Meeting, a second Meeting shall be called and held not later than one month after the first. The same rules concerning quorum representation and voting requirements shall apply to the second meeting and any subsequent meeting held thereafter until a minimum quorum is achieved. The Meeting shall be dissolved within one hour of being convened if the quorum is not met.

Voting : Except where otherwise provided for by the laws of Ukraine or by this Charter, all decisions will be taken by a simple majority of the shares present or represented. In the case of equality of votes, the Chairman of the Meeting, elected before every Meeting, shall be entitled to a second or casting vote. Votes will be counted by a Counting Commission, appointed at the beginning of each Meeting by the Supervisory Board. All votes will be confidential unless they are exercised by a representative holding a valid proxy power or relate to a transaction described in articles 8.2.4.1 to 8.2.4.7 and 4.2.9 giving non-approving shareholders an ex-post participation or redemption right as defined in article 4.2.9. Voting of the Directors of the Supervisory Council shall be based on the principle of cumulative voting as defined in Article 8.3.2.5 below.

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Proxy Rules :

- Shareholders may cast their votes either personally or by proxy. Any solicitation of proxy must state the proposals to be voted upon, with provisions to allow the shareholder to vote yes, no or to abstain.
- In case the matter to be voted upon is the reappointment of a slate of directors for the Supervisory Council, the proxy solicitation shall allow the shareholder to vote for the entire slate or by individual. The proxy form shall include the names of all candidates known to the Supervisory Council 30 days prior to notification of the Shareholders of a General Meeting (see Article 8.3.2.7).
- The proxy may not be open-ended and leave any discretion to the proxy holder, save to decide upon matters incidental to the conduct of the meeting.
- Proxies are valid only for one Meeting and cannot be irrevocable.
- At the date, time and place of the convened Meeting, all duly appointed shareholder representatives must show original signed proxy documents to the Counting Commission.
- Appointed representatives must exercise their voting rights in the manner specified on the proxy. The Counting Commission is responsible for ensuring compliance. Votes exercised by proxy will not be confidential.
- Signatures on proxies are presumed valid. If the Chairman of the Meeting, the Counting Commission or any shareholder representing 10 % of the votes, has reasonable doubts concerning the validity of a proxy, he can call for a notarially certified copy of the proxy which must be produced within seven days of being so requested or the vote or votes cast by such proxy shall be disregarded. The Company shall pay for the cost of obtaining such a notarized document. If the cancelled vote or votes do not affect quorum or majority requirements, the decision will be unaffected. If the quorum or majority requirements are not met because of the cancelled vote or votes, then the Shareholder's decision will be declared null and void by the Counting Commission and the Supervisory Council shall reconvene a new General Meeting following the notification rules set out in Article 8.2.3.2 above.
- The proxy document shall be in writing, signed by the registered shareholder or the shareholder's duly authorized representative if the Shareholder is a corporation.

Note that these provisions have been kept to their barest and simplest form and could be made significantly more detailed in an annex to the Charter. In practice, the power of a corporation generally lies with whoever controls the proxy process. Under Ukrainian law, that is the Executive Board. This is not something that needs to be modified. It must only be kept in mind that it must be realistically possible for other interested parties such as outside directors and significant shareholders to influence the voting process. In particular, getting access to the current list of shareholders, in order to notify them of a disagreement with

management, or to call an extraordinary meeting of shareholders, or introducing an item to the agenda, must be guaranteed and protected.

### 8.3. *The Supervisory Council*

8.3.1. contains a reference to Regulations about the Supervisory Council, adopted by the Cabinet of Ministers of the Ukraine and dated July 19, 1993. This document contains worrying provisions in terms of corporate governance. Article 4 of the Regulation stipulates that the composition of the first Council is decided jointly by the Ministry of Economy, of Finance and the SPF. Article 12 seems to suggest that thereafter, the Supervisory Council submits annual reports to the Shareholders. If the shareholders are not satisfied with the work of the Supervisory Council, they must "submit proposals to the commission [that is the corporatization commission composed of representatives of the ministry of economy, finance and SPF, referred to as the "Establishment Board in Section II] as to changes in its composition". This would mean that the State and not the shareholders would ultimately always decide who the members of the Supervisory Council should be.

The Law on Business Association expressly gives this right to shareholders, and the proposed hydro-power charter confirms this (see Article 41(c) and discussion above on the virtue of being able to dismiss members with or without due cause). It seems therefore that the Regulation on the Supervisory Council contradicts an Act of Parliament and is therefore probably invalid. Maybe, it is intended to be in force only during the transitional phase between the corporatization and the first meeting of shareholders, but that is not how it reads, at least not in the literal sense. Whichever way, this matter should be clarified and if necessary a new Regulation on Supervisory Boards should be proposed for adoption by the Cabinet of Ministers.

### 8.3.2. *The Supervisory Council consists of 5 members*

The Charter should not be so restrictive. It is better to fix a maximum, 12 being probably optimal according to international standards for a large corporation such as a Genco. It may not be possible to find 12 suitable candidates immediately, for each of the Gencos, but this should not affect the drafting of the Charter. The text of the Hydro-power plant goes on to list exactly who shall be appointed from where. Again this is counterproductive. The Charter should not worry itself with such details liable to change. The law may require certain people to come from pre-determined groups such as bankers, suppliers, representatives of the State, etc.. This also does not need to be repeated in the text of the Charter. At most, the Charter can perhaps mention who shall be the first non-executive Directors. A further step in the scope of work defined for the Team 3 advisors includes helping the Genco's identify and recruit suitable candidates to this position.

8.3.4. *The Supervisory Council.*

- *adopts the Chairman of the Executive Board by the Founders presenting (except for the Chairman of the Board according to item 8.4.4. of this Charter.)* The Translation can obviously be improved, but this line contradicts a similar statement appearing under article 8.2.4., listing shareholders rights and expressly mentioning that the annual general meeting of shareholders would appoint the Chairman of the Executive Board. What this section should say is probably the following : "submits for approval by the General Meeting of Shareholders a candidate to the position of Chairman of the Executive Board (except 8.4.4.)."
- *adopts the membership of the Company 's officials by the Chairman 's presenting;*
- *approve transactions of the Company 's fixed property the cost of which is not exceeding 50 % of the Statutory Fund.* The comment on this section is the same as the one appearing for the General Meeting of Shareholders. Fixing the limit at 50 % of the Statutory Fund is arbitrary. If the Supervisory Council is to be the ultimate decision making body, it is much better to have it as a multiple of the book value of the company's assets.
- *adopts annual and quarter reports which are submitted by the Board of Directors and the Revision Commission;* Should be "approves" rather than "adopts" the reports. The Charter should add that if the Council decides not to approve a report, such a decision will be put forward at the next shareholders meeting and may be the subject of an extraordinary shareholders meeting if warranted by the seriousness of the circumstances.
- *makes analysis of the Board 's acts concerning the Company 's management and its investment.*
- *technical and price policy, goods nomenclature support and services;* This may be considered involvement in day to day operations and should probably be confined to the Executive Board.
- *in case of necessity initiates the conduction of extra revisions and auditors checks of financial and business activity of the Company;*
- *presents to the Founder suggestions on the matter of the Company's activity;* This section should refer to the shareholders, not the founder.
- *execute other acts pertaining the supervision of the Company 's activity;*
- *submit to the privatization bodies suggestions concerning the peculiarities of the Company's property privatization.*

The following is a proposed amendment to this entire section on the responsibilities of the Supervisory Council :

8.3.4. Responsibilities of the Supervisory Council

- 8.3.4.1 The Supervisory Council appoints, subject to Shareholder veto, the members of the Executive Board and supervises its activity. The Chairman of the Executive Board must be approved by the Shareholders at the Annual Meeting.
- 8.3.4.2 The Supervisory Council pre-approves all matters submitted to a vote of the Shareholders.
- 8.3.4.3 The Supervisory Council may delegate to the Executive Board any function not specifically reserved by law or this Charter to the Shareholders or the Supervisory Council.
- 8.3.4.4 The Supervisory Council must pre-approve any "self-interested" transaction. A "self-interested" transaction is defined as any transaction in which one party is the Company and the other is either a member of the Supervisory Council, a Shareholder representing more than 5 % of the outstanding shares, a member of the Executive Board or a senior Company official or is a company or third party in which one such interested party owns an interest. The interested party must disclose his/her interest to the Company before the transaction takes place and if he/she is a member of the Supervisory Board, will be excluded from the quorum and vote calculations, authorizing the transaction. Non-interested Directors may only approve the transaction if the consideration for any property or services transferred by the Company equals or exceeds the market value of the property or services, and the consideration paid by the Company in exchange for property or services does not exceed the market value of the property or services.
- 8.3.4.5 The Supervisory Council must pre-approve any purchase or sale of asset involving between 25 and 50 % of a Company's value.
- 8.3.4.6 The Supervisory Council elect a Chairman from its Members.
- 8.3.4.7 The Supervisory Council Members will exercise due diligence in their duties of supervision over the activities of the Executive Board. They are responsible, jointly or individually, as the case may be, towards the Company, the Shareholders and third parties in case of negligence, fraud or incompetent behavior. They owe a duty of loyalty to the Shareholders and a duty to act with due care in the best interest of the Company.
- 8.3.4.8 The Supervisory Council organizes working commissions made up of its members to deal specifically with internal audit of the Company, remuneration and selection of key officers. Other working commission may be set up on an ad hoc basis.
- 8.3.5. *The rights of the Supervisory Council:* A more complete list of rights is proposed  
in our draft model :

- 8.3.5. Rights of the Supervisory Council :
- 8.3.5.1 The Supervisory Council has the right to obtain any information on the Company's activity. It can order members of the Executive Board, Company officials and Members of the Revision Commission to appear in front of the Supervisory Council for hearings or to present reports.
- 8.3.5.2 Any member of the Supervisory Council may attend a meeting of the Executive Board but may not vote.
- 8.3.5.3 The Supervisory Council may order the Revision Commission to conduct specific inquiries.
- 8.3.5.4 The Supervisory Council convenes Special Meetings of Shareholders whenever required by law, this Charter, or in order to protect Shareholders interests (see Article 8.2.4.).
- 8.3.5.5 Within the authorized capital limit, the Supervisory Council may decide to issue new shares. The Supervisory Council decides the amount of the issue, the timing and the offering price subject to the provisions of Articles 5.3.1, 5.3.2 and 5.3.3. The offering price must not be less than fair market value, as determined by the Supervisory Council.
- 8.3.6. The Supervisory Council has no right to interfere with the operational activity of the Company's Executive Board.
- 8.3.7. The Supervisory Council presents an annual report to the Meeting of Shareholders or to the Founder until the first meeting is held.
- 8.3.8. Meetings of the Supervisory Council : The sittings of the Supervisory Council are held not less than once per quarter and are considered valid as long as no less than 2/3 or its members are present or represented within half an hour of the appointed time. All members must be notified in writing at least 3 days in advance. If all the members are present or represented at a meeting they can validly waive the notice requirements. Extraordinary sittings of the board are convoked at the request of the Chairman or 1/3 of its members.
- 8.3.10 The decisions of the Supervisory Council are adopted by a simple majority of votes, unless the law or this Charter requires otherwise. In case of equality of votes, the Chairman of the Supervisory Council is entitled to a decisive vote.
- 8.3.11 A vacancy in the Supervisory Council may be filled by a resolution of the remaining members until a shareholder's meeting is held.
- 8.3.12 Remuneration for the duties of the members of the Supervisory Council are voted by the Shareholders at the Annual General Meeting.
- 8.3.7. *Deals with changing the Supervisory Council members if their work is unsatisfactory.* This paragraph mentions again, as does the Regulation on Supervisory Councils the role of the ministries of Finance, Economics and SPF in appointing new members. It is important for this role to

revert very clearly to the General Meeting of Shareholders, and not remain in the hands of the State.

8.3.8. We suggest the following wording :

"Meetings of the Supervisory Council" : The sittings of the Supervisory Council are held not less than one per quarter and are considered valid as long as no less than 2/3 of its members are present or represented within half an hour of the appointed time. All members must be notified in writing at least 3 days in advance. If all the members are present or represented at a meeting they can validly waive the notice requirements. Extraordinary sittings of the board are convoked at the request of the Chairman or 1/3 of its members.

A vacancy in the Supervisory Council may be filled by a resolution of the Supervisory Council until a shareholders' meeting is held.:

8.3.9 Experience in Eastern Europe has shown that for the Supervisory Council to have any meaningful role, it is very important to provide adequate remuneration of its members. The current proposal of a fixed 6 or 4 minimum salaries is again an arbitrary rule which does not leave a lot of room for manoeuvre. A future detailed analysis of what is possible in the Ukrainian context should be conducted in order to provide the basis for more specific recommendations. Such a study should also cover the issue of remuneration of the Executive Board members and other key company officers.

#### *8.4. The Executive Board*

##### *8.4.3. The Board is elected for 3 years [...].*

It may be interesting to consider rotating appointments for the sake of continuity. For instance, one third of the board would be initially elected for one year, one third for two years and one third for three years. Thereafter, each year, one third of the board would be reelected for three years. (This contrasts with our recommendation that the members of the Supervisory Council be elected each year for one year under a system of cumulative voting, at each annual shareholders meeting.)

8.4.4. Replace the word "Founder" with "General Meeting of Shareholders". The shareholders should make the ultimate decision on the composition of the members of the board, although the Supervisory Council, through the Nomination Commission should propose candidates.

The following sections should be added :

##### "Responsibility of the Directors" :

(i) The Directors are responsible, jointly or individually as the case may be, towards the Company, the Shareholders and third parties, for any violation of

any applicable laws, of any articles of this Statute or any fault committed in their administration and management of the Company.

(ii) The Directors are personally liable to any damage incurred or loss caused to the Company, its Shareholders and third parties through fraudulent, negligent or incompetent behavior."

The wording of this section may need some more refining in order to strike the correct balance between accountability of management and the need not to deter good people from taking on such responsibilities. The Business Judgment Rule which has been developed by the Courts in the West could be explicitly inserted in the Charter for instance. Alternatively, it could be included in a contractual agreement between the directors and the Company.

"Duty of the Directors :

The Directors owe a duty of loyalty to the Shareholders and a duty to act with due care in the best interest of the Company.

Conflict of Interest :

If a member of the Executive Board has an interest in any corporation or third party with which the Company is involved in a business relationship, he/she must disclose this interest to the other members of the Board and shall be excluded from the quorum and vote calculations of any decision involving the Company and this other corporation or third party. We have proposed extensive safeguard provisions in our draft charter dealing with "self-interested transactions".

Company Secretary :

The Directors shall by resolution of the Board, appoint a Company Secretary who shall be responsible for maintaining the shareholders registry (unless a licensed professional agent is used), minute books and records (other than the financial records) of the Company and to ensure compliance with all procedural requirements imposed on the Company by applicable laws and this Statute."

Adopted :  
**Deputy Minister of Energy of Ukraine**  
 03.04.95 **O.M.Sheberstov**

**Plan**  
**of measures for creation of state joint stock company**  
**"DONBASSENERGO"**

Measures	Person responsible	Terms	Etc.
1. Adoption of Charter of State enterprise "Donbassenergo"	Director of Energo	05.04.95	
2. Registration of Charter of " Donbassenergo" in local Rada	Director of Energo	17.04.95	
3. Submitting of offers about members list of Commission on Corporatization of entity	Director of Energo	17.04.95	
4. Issue of order about memberslist of Commission on Corporatization of state enterprise "Donbassenergo"	Department of forms of properties and organizational structures	24.04.95	
5. Issue of order about members list of Commission on inventa rization of entity	Director of Energo	25.04.95	
6. Conduction of auditing check of "Donbassenergo"	Director of Energo	15.05.95	
7. Conduction of inventrization of property of "Donbassenergo"	Director of Energo	15.05.95	
8. Preparentment of act of assessment of value of property, Charter Draft, plan of selling of shares of oopen joint stock company "Donbassenergo"	Commission on Corporatization of enterprise "Donbassenergo"	20.06.95	
9. Adoption of act of assessment of property ,issue of order about creation of JSC "Donbassenergo", submittance of offers on members list of Observation Board, agreement on shares selling plan	Minenergo	27.06.95	JSC "Donbassenergo"

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10.Registration of open JSC

Director of JSC  
"Donbassenergo"

04.07.95

Head of the Department of forms of properties  
and organizational structures

signature

J.S.Zavgorodny.

THE LAW OF UKRAINE  
ON BUSINESS ASSOCIATIONS

(with included changes and supplements in accordance to the laws of Ukraine

No. 2692-12 of October 14, 1992,

No. 3709-12 of December 16, 1993,

No. 3710-12 of December 16, 1993, and

the Decree of the Cabinet of Ministers of Ukraine

No. 24-92 of December 31, 1992)

(Explanation business associations officially registered before the Law "On Introduction of Changes and Supplements to the Law of Ukraine "On Business Associations" (3709-12) came into force should not to reregister in accordance to the Resolution of the Verkhovna Rada of Ukraine No. 3711-12 of December 16, 1993)

This Law determines the concept and kinds of business associations, regulations as to their establishment and activity, as well as the rights and duties of their participants and founders.

Part 1

GENERAL PROVISIONS

Article 1. Business associations.

This law herewith determines enterprises, organizations and establishments founded on the basis of agreement of legal entities and citizens, through the unification of their assets and entrepreneurial activity with an aim to gain profit as business associations.

Business associations are joint stock companies, limited partnerships, companies with additional liability, full associations, and member associations.

The associations are legal entities.

The associations can carry any entrepreneurial activity that dose not contradict with Ukrainian legislation.

Business associations can enjoy property and individual non-property rights, make commitments, speak in a court, arbitration tribunal... and court of arbitration on their own

behalf.

Article 2. The name of the associations.

The name of the association should include the specification of the kind of the association; for full and member associations - surnames (naming) of participants of the associations, as well as other necessary identifications.

The constituent documents should include the name of the association.

The name of the association should not indicate correspondent ministers, departments and public organizations under which jurisdictions the associations act.

The residence (location) of the association should be with in the territory of Ukraine.

Article 3. Founders and participants of the association.

(The first and the second paragraphs are suspend in accordance to the Decree of the Cabinet of Ministers of Ukraine No. 24-12 as to the right of state enterprises to be

The associations is obliged to inform in five day term the body which registered it on changes in constituent documents to introduce necessary changes into the state register.

Article 8. Consequences on agreements made before the registration of the association.

The association can open settlement and other accounts in banks, as well as conclude agreements and other contracts only after its registration. The agreements made on behalf of the association before the moment of registration are considered as those made with the association on condition of their further adoption.

The agreements made by the founders before the moment of the registration of the association and not approved afterwards have legal consequences only for the founders

Article 9. Subsidiary enterprises, branches and representatives of the association.

The association has the right to create its branches and representatives on the territory of Ukraine and beyond its borders in accordance to the current legislation of Ukraine.

Article 10. Rights of the participants of the association.

The participants of the association have the right

a) to take part in management of the association within the limits determined by the constituency documents with exception foreseen by this Law;

b) to take part in division of profit of the association and to receive their share (dividends);

c) to leave the association in an established order;

d) to get an information on association activity. The association is obliged to provide annual balance sheets, activity reports of the association, and minutes of the assemblies on request of the participant of the association.

The participants can also enjoy other rights foreseen by the legislation and constituent documents of the association.

Article 11. Duties of the participants of the association.

The participants are obliged

a) to follow the constituent documents of the association and to implement the decisions of general assemblies and other management bodies of the association;

b) to carry out their duties before the association including those that are connected with ownership participation, as well as to make contributions (to pay the shares) in amount, order and by means foreseen by the constituent documents;

c) not to divulge commercial secrets and confidential information on association activity;

d) to carry other responsibilities if it foreseen by this Law, other legislative acts of Ukraine and constituent documents.

Article 12. Property assets of the association.

The association is the owner of

- the property assigned to it by the founders and participants;

- the products produced by the association in the result of business activity;

- the gained profit;

- and other assets acquired by means not prohibited by law.

Article 19. Discontinuation of association's activity.

Discontinuation of the activity of the association takes place by means of its reorganization (merging, acquisition, split, separation, and conversion) or liquidation.

Reorganization of the association takes place on decision of the highest body of the association.

On the reorganization of the association, all rights and duties of the association transfer to its successors.

The association is liquidated

a) on expiring of the term of its activity, or after fulfillment the aim of its foundation;

b) on decision of the highest body of the association;

c) on the ground of the decision of court or arbitration tribunal on application of bodies that conduct the control over the activity of the association in case of its systematic or gross violation of the legislation;

d) on the ground of the decision of arbitration court in order established by the Law of Ukraine "On Bankruptcy";

e) on other grounds foreseen by the constituent documents.

Article 20. Committee on liquidation.

The liquidation of the association is carried out by an appointed committee on liquidation, in case of bankruptcy and discontinuance of activity of the association on the decision of the court or arbitration tribunal - by committee on liquidation appointed by above mentioned bodies.

The committee on liquidation takes all the authority in management of the association from the day of its appointment. The committee on liquidation in three day term from the moment of its appointment should publish the information on the association in one of the official (republican or local) newspapers with indication of the term of submitting creditors' claims, evaluates the assets of the association, finds its creditors and debtors and settle the accounts with them, takes measures to pay debts of the association to the third parties, as well as to its participants, makes liquidation balance sheet and submits it the highest body of the association or to the body appointed by the committee on liquidation.

Article 21. Division of association's costs on its liquidation.

The association's money supply including the gains on selling of its assets on the liquidation, after settling the accounts with the hired staff and execution the obligations before the budget, banks, owners of bonds issued by the association, and other creditors, are divided between the participants in the order and under conditions foreseen by this Law and constituent documents in six month term after the publication of the information on its liquidation.

The assets assigned to the association by the participants should be returned in a natural form without any compensation.

In case of disagreement on payments of debts of the association, the money supply is not allocated for division between the participants till the settlement of disagreement or till the creditors receive necessary guarantees.

Article 22. Time of discontinuation of association's activity.

The liquidation of the association is considered not finished, and the association - as that suspended its activity, from the moment of written note in the state

foreseen by the legislation on securities and stock exchange, and through the introduction of changes into the statutory of the association.

Article 26. Founders of the joint stock company.

Any legal entity and separate citizen can be a founder of the joint stock company.

The founders of joint stock company make an agreement which defines the order of their joint activity on establishment of joint stock company, accountancy before individuals subscribed for shares and third parties.

The founders carry joint responsibility for the commitments made before the registration of joint stock company.

For the establishment of joint stock company the founders should make announcement about their intention to establish a joint stock company, to open a subscription for shares, to conduct constituent assembly and state registration of the joint stock company.

Article 27. Issue of securities of joint stock company.

The joint stock company has the right to issue bonds and other securities in accordance to the legislation of Ukraine on securities and stock exchange.

Article 28. Purchase of shares.

Shares are purchased by the participants on establishment of joint stock company on the basis of agreement with its founders, and on case of additional issue of shares with the aim to increase the equity fund - with the association.

If otherwise is not foreseen by the statutory of the association, share can be purchased on the basis of agreement with its owner or holder on a price determined by sides or on a price in stock exchange, as well as in order of succession of citizens or succession of rights of legal entities. The order of sale of shares is determined in accordance to the legislation of Ukraine.

Article 29. Distribution of shares.

On establishment of joint stock company the shares can be distributed by means of open subscription (for public joint companies) or division of all shares between the founders (for limited partnerships).

Article 30. Open subscription to shares.

The open subscription to shares on establishment of joint stock company is organized by the founders. The founders in all cases are obliged to be the holders of shares in the amount not less than 25% of equity fund and for the term not less than 2 years.

The founders of joint stock company publish an announcement on next open subscription, where should be indicated the name of the firm, object, aim and terms of the association's activity, the composition of founders, date of conducting constituent assemblies, an expected amount of equity fund, nominal value of shares, their number and kinds, advantages and privileges of the founders, place of conducting, the beginning and end of subscription term, structure of assets that is assigned by the founders in a natural form, identification of bank institution and accountant number where to should be allocated initial contributions. According to the decision of the founders the announcement can include other identifications as well. The

the loses.

The joint stock company is prohibited to issue shares with the aim to cover loses that are in consequence of its business activity.

Article 35. Constituent assemblies of joint stock company.

The constituent assemblies of joint stock company are called on term mentioned in the announcement, but not later than 2 months from the moment of discontinuance of subscription to shares.

If the term was exceeded, an individual subscribed to share has the right to demand the returning of paid value of the share.

The constituent assembly of joint stock company is considered competent if individuals who subscribed to 60% of shares take part in it.

If the constituent assembly was not hold because of absence of quorum, during next two weeks the constituent assembly should be called again. If the repeated calling of assembly failed to gather quorum, the joint stock company is considered not to be established.

The voting at constituent assembly is carried out on the principle one share, one vote.

The decision on establishment of joint stock company, its subsidiary enterprises, branches and representatives, on election of the council of joint stock company (observation council), executive and controlling bodies of joint stock company, and on giving privileges to the founders at the account of joint stock company should be supported by the majority of 3/4 votes of individuals present at the constituent assembly, who subscribed to shares, as to other issues - by simple majority of votes.

Article 36. Competence of constituent assemblies of joint stock company.

The constituent assemblies of the joint stock company can decide on the following issues

a) to adopt the decision on establishment of joint stock company and adoption of its statutory;

b) to adopt or decline the proposal for subscription for shares that exceed the number of shares to which it was announced the subscription (in case of adoption of the decision on subscription, that exceeds the amount to which it was announced the subscription, the equity fund is increasing correspondingly);

c) to reduce the equity fund when the subscription to shares did not cover all the necessary sum mentioned in the announcement within the established term;

d) to elect the council of joint stock company (observation council), executive and controlling body of joint stock company;

e) to confirm the agreements made by the founders before the establishment of joint stock company;

f) to determine privileges for the founders;

g) to approve the evaluation of contributions assigned in natural form;

h) other issues in accordance to the constituent documents.

Article 37. The content of statutory of joint stock company.

The statutory of joint stock company, except of identifications mentioned in the article 4 of this Law,

- f) date of beginning or end of subscription to shares that are additionally issued or annulled;
- g) order of reimbursement of losses to the owners of shares that are connected with changes in equity fund.

Article 41. The highest body of joint stock company.

The highest body of the joint stock company is general assembly of the association. All share holders have the right to take part in general assembly disregard the number and kind of shares they hold. Members of executive bodies who are not share holders can take part in general assembly with a deliberative vote. Share holders (their representatives) taking part in general assembly should be registered with notifying the number of votes each participant has. This list should be signed by the chairman and secretary of assembly.

The competence of general assembly is

- a) to define main directions of joint stock activity, to approve its plans and reports on their fulfillment;
- b) to introduce changes into statutory of the association;
- c) to elect and recall members of the council of joint stock company (observance council);
- d) to elect and recall members of executive body and revision commission;
- e) to approve annual results of joint stock activity including its subsidiaries, to approve reports and conclusions of revision commission, and order of division of profit, to define the order of covering of losses;
- f) to establish, re-organize and liquidate subsidiary enterprises, branches and representatives, to ratify their statutes and resolutions;
- g) to decide to draw for the proportional responsibility of association's officials;
- h) to approve procedure rules and other internal documents of association, to define the structure of association;
- j) to decide on purchasing by joint stock company of its own shares;
- i) to determine conditions of payments of wages of joint stock officials, and officials of its subsidiary enterprises, branches and representatives;
- k) to ratify agreements (treaties) made on sum that exceeds the amount determined by statutory of association;
- l) to adopt the decision on discontinuance of association activity, appointment of committee of liquidation, to approve liquidation balance.

The statutory of the association can also presume other issues of competence of general assembly

The general assembly is recognized as competent when share holders who have more than 60% of votes in accordance to the statutory of the association take part in it.

Article 42. Competence of general assembly's decisions.

The decisions of general assemblies of share holders should be adopted by the majority of 3/4 votes of share holders who take part in assembly on the following issues

- a) change of association's statutory;
- b) adoption of decisions on discontinuance of association activity;
- c) establishment and discontinuance of activity of subsidiary enterprises, branches and representatives of association.

The rest of issues are decided by simple majority of share holders who take part in assembly.

Article 47. Executive bodies of joint stock company.

The executive body of joint stock company which direct its current activity, is a management or other body foreseen by the statutory.

The work of management board is supervised by a chairman of board, who is appointed or elected in accordance to the statutory of joint stock company.

The management board solves all issues connected with association's activity except those are under the competence of general assembly and council of joint stock company (observation council). The general assembly can make a decision to transfer part of its competencies to the management board.

The management board accounts to the general assembly of share holders and to the council of joint stock company (observation council) and executes their decisions.

The management board acts on behalf of joint stock company within the limits foreseen by this Law and the statutory of joint stock company.

The chairman of management board supervise the work of management board, who is appointed or elected in accordance to the statutory of joint stock company.

Article 48. Chairman and members of management board of joint stock company.

The chairman of management board of joint stock company has the right to act on behalf of association without a authorization. Other members of management board can be given this right, as well, in accordance to the statutory.

The chairman of management board of association organizes the keeping of minutes of sittings of the board. The minutes book should be always on disposal to every share holder at any time. Certified extracts from the minutes should be provided on their request.

The chairman and members of management board can be individuals who are in labor relations with the association.

Article 49. Revision committee of joint stock company.

Control over financial and business activity of management board of joint stock company is carried out by revision committee which is elected among the share holders.

The order of activity of revision committee and its quantitative structure should be confirmed by general assembly of share holders in accordance to the statutory of association.

Revision of financial and business activity of management board is carried out by revision committee on authority of general assembly, council of joint stock company (observation council), and on its own initiative or on request of share holders who own in total more than 10% of votes. The revision committees of joint stock company can obtain all the documents, accounting or any other documentation, and personal explanations of the officials on its demand.

The revision committee reports on results of conducted reviews to the general assembly of joint stock company or to the council of the association (observation council).

The members of revision committee have the right to take part at the sittings of the management board with a deliberative vote.

The revision committee presents conclusions on annual reports and balance sheets. The general assembly of share

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the equity fund of the association or in any other agreed order.

The concession of the share (part of it) to the third party is possible only after full payment of the contribution by the participant who cedes it.

On concession of the share (part of it) to the third party takes place simultaneous transfer of rights and duties of its successor who ceded it completely or partially.

The share of the participant of limited partnership after his full payment of contribution can be purchased by the association itself. In this case the association is obliged to transfer the share to other participants or third parties within the term that does not exceed one year. During this period the division of profit, as well as voting and determination of quorum in the highest body are carried out without taking into account the share purchased by the association.

Article 54. Payment of assets value on the leaving of the participant the limited partnership.

The limited partnership on the leaving of the participant should pay the value of the part of association's assets proportionally to his share in equity fund. The payment takes place after adoption of annual report for the year he left, and within 12 months from the day of his leaving. On request of the participant and on agreement with the association the contribution can be reimbursed fully or partially in the natural form.

The participants who left the association is paid his share in the income gained by the association in the given year before the moment of his leaving. The assets assigned by the participant to the association for use only should be returned in the natural form without compensation.

Article 55. Successors (beneficiaries) of the participant of limited partnership.

The successors (beneficiaries) enjoy the priority right to joint the association in case of re-organization of legal entity of the participant of the association or death of the citizen, participant of the association.

In case of decline of the successor (beneficiary) to joint the limited partnership or on decline of the association to accept the successor (beneficiary) the latter is given the share in assets in the form of money or property that belonged to re-organized or liquidated legal entity (beneficiary), the value of which is determined by the day of re-organization or liquidation (death) of the participant. In this cases the amount of equity fund of the association should be reduced.

Article 56. The term in which the decision on reduction of equity fund of limited partnership come into force.

The decision of limited partnership on reduction of its equity fund comes into force no sooner than 3 months after state registration and publication of the fact in the established order.

Article 57. Proceeding for recovery of the share of limited partnership participant.

Proceeding for recovery of the share of limited partnership participant for his personal commitments is not allowed. In case of insufficiency of participant's property for covering his debts, the creditors have the right to demand the separation of the share of participant-in-debt in order foreseen by the article 5 of this Law.

Extraordinary assembly.

The assembly of limited partnership participants is called not less than twice a year if otherwise is not foreseen by the constituent documents.

The extraordinary assembly is called by the head of the association on the circumstances mentioned in the constituent documents, in case of non-solvency of the association, as well as in any other case when the interests of the association as a whole demand it, particularly if there is a danger of drastic reduction of equity fund.

The assembly of partnership's participants should be also called on demand of executive body.

The participants of the association who own in total more than 20% of votes have the right to demand the calling of an extraordinary assembly of participants at any time and on any reason concerning the association's activity. If in 25 days the head of the partnership have not fulfilled the above mentioned demand, they have the right to call the assembly themselves.

The participants should be informed on the holding of the assembly of the association in a way foreseen by the statutory notifying the time, place and agenda of the assembly. The announcement should be made not less than 30 days before the calling the general assembly. Any of the association's participants have the right to demand the consideration of the issue on assembly of the participants under condition he came forward with it not later than 25 days before the beginning of the assembly. Not later than 7 days before the general assembly the participants of the association should be given an opportunity to get acquainted .. with the documents that are included into the agenda of the assembly. The decisions on issues not included into agenda can be made only on agreement of all of the participants present on the association.

Article 62. Executive body of limited partnership.

Within the limited partnership it is created the executive body collegial (board of directors) or one-member (director). The board of directors is headed by general director. The members of the executive body can be individuals who are not participants of the association.

The board of directors (director) decides on all issues of partnership's activity except for issues that are under exclusive competence of assembly of the participants. The assembly of association's participants can make a decision to transfer part of its authorities to the competence of the board of directors (director).

The board of directors is accountable to the assembly of the participants and ensure the implementation of its decisions. The board of directors (directors) has no right to make decisions obligatory for the participants of the association.

The board of directors (director) acts on behalf of the partnership within the limits determined by this Law and the statutory documents.

The general director has the right to act on behalf of the partnership without warrant. Other members of the board of directors can also be given such right.

The general director (director) can not be the head of the assembly of association's assembly at the same time.

Article 63. Control over the activity of the board of directors (director) of limited partnership.

The control over the activity of the board of directors (director) of limited partnership is carried out by the revision committee which is established by the assembly of the association's participants out of their ranks, in number foreseen by the constituent documents, but not less than 3 persons. The members

participants or by one or several of them who act on behalf of the association. In the latter case the amount of authorities of the participants is determined by the authorization signed by the rest of the participants of the association.

If the constituent agreement determines several participants who are authorized to manage the association it is foreseen that each of them can act on behalf of the partnership independently. The constituent agreement can also point out that those participants can take certain actions only jointly.

The participants who are authorized to manage the full association are obliged to provide the rest of the participants on their demand the complete information on actions that are performed on behalf and for

the sake of the association.

The authority of the participant to manage the association is fully or partially canceled along with discontinuance of the activity of the association itself in connection with the refusal of the participant

form the authorities or cancellation of the authorization on demand at least of one of the rest of the participants.

The participant who acted for the common welfare not having the authority, in cases when his actions were not approved by the rest of the participants, has the right to demand form the association to cover the expenses, under the condition that it is proved that as the result of his actions the association preserved or gained assets the value of which exceeds the expenses taken by the association.

Article 69. Concession of the share (its part) of the participant of full partnership.

The concession of the share (its part) by the participant of the full partnership to other participants of this association or to third parties can be carried out only on agreement by all of the participants.

With the concession of the share (its part) to the third party the transfer of all the number of the rights and commitments of the former participant who left the association or ceded the part of his/her share takes place simultaneously.

On the re-organization of the legal entity, the participant of the full partnership, or death of the citizen, the participant of the full partnership, his/her successor (legatee) enjoys the priority in becoming the participant of the association on agreement of the rest of the participants.

The successor (legatee) carries the responsibility for debts of the participant to the full partnership, as well as debts of the association to the third parties appeared in result of activity of the association.

In case of refusal of successor (legatee) to joint the full partnership or of association's refusal to accept the successor (legatee), he/she is paid the value of the share that belongs to re-organized legal entity (successor) the amount of which is determined on the day of re-organization (death) of the participant. In such cases the amount of the association's assets determined by the constituent documents is reducing.

Article 70. On prohibition the participants of full partnership to compete with full partnership.

The participants of the full partnership has no right to make agreements on their behalf and in their interests, that are similar with the aims of activity of the association, as well as to take part in any associations (except joint stock companies) which has aim homogeneous ...with the one their own full partnership.

In case of violation regulations established by this article, the participants of the full partnership are obliged to

assets of the association .

If there are two or more participants with full responsibility within the partnership, they carry out joint responsibility for the debts of the association.

Article 75. The content of constituent agreement of mix partnership.

The constituent agreement on mix partnership must include in addition to conditions foreseen by the article 4 of this Law the amount of shares of each of the participant with full responsibility, amount, kind and order of making contributions, as well as form of their participation in association's activity.

As to the investors, only total amount of their shares in the assets of the association, as well as the amount, kind and order of making their contributions are notified in the constituent agreement.

Article 77. Application of the norms for full partnership to mix partnership.

The norms of the articles 67 - 74 are applicable to the mix association taking into account the peculiarities foreseen by the article 78 - 83 of this Law.

Article 78. Join of investor the mix partnership.

The investor can join the mix partnership making contribution in money or in assets.

Article 79. Rights of investors of mix partnership.

The investors of mix partnership have the right

- to act on behalf of the mix partnership only having the authorization and within its limits;
- to demand the priority in returning of their contributions (before the participants with full responsibility) in case of liquidation of the association;
- to demand annual reports and balance sheets, as well as the guarantee of the possibility to review them as to their correctness.

Article 80. Obligations of mix partnership investors .

The investors of the mix partnership are obliged to make contributions and additional payments in the amount, though the means and in the order foreseen by the constituent documents.

The total amount of shares of the investors should not exceed 50 % of the assets of the association mentioned in the constituent documents.

On the moment of the registration of the mix partnership each investor should pay not less than 25% of their contributions.

Article 81. Management of mix partnership.

The management of the mix partnership is carried out only by the participants with full responsibility.

The mix partnership where there is only one participant with full responsibility, the management can be carried out by this participant on his own.

The investors has no right to interfere with the activity of the participants with full responsibility in management of the mix partnership.

Article 82. Responsibility of investor of mix partnership.

If the investor of the mix partnership settles an agreement on behalf and within the interests of the association without correspondent authorization for it, than in case of approve of his actions by the mix partnership he together with participants with full responsibility answers to the creditors in accordance to the agreement with all his/her property, which can be preceded for recovery in accordance to the legislation.

If the approval is not received, the investor is responsible to the third party alone with all of his/ her property, which can be preceded for recovery in accordance to the legislation.

The investor of the mix partnership is responsible for the

1-702-351-0342

Effective June 15, 1993

DECREE OF THE PRESIDENT OF UKRAINE  
ON THE CORPORATIZATION OF ENTERPRISES

With the view to reforming the administration of the state-owned sector of the economy, to increase the responsibility of state-owned enterprises for the results of economic activity and to prepare such enterprises for privatization, I hereby RESOLVE:

1. That corporatization is the transformation of state enterprises, closed joint stock companies in which more than 75% of the charter fund is owned by the state, as well as industrial and scientific-production associations, the legal status of which was not brought into conformity with applicable legislation prior hereto (hereinafter referred to collectively as "enterprises"), into open joint stock companies.

Enterprises with a book value of capital assets estimated as of January 1, 1993 of not less than 20 million karbovanets shall be subject to corporatization.

This Decree shall not apply to enterprises which are not subject to privatization according to applicable law; to enterprises with respect to which a decision has been taken to privatize; to natural monopolies; and to the enterprises which are subject to Decree of the Cabinet of Ministers of Ukraine No. 51, dated May 17, 1993, "On the Particulars of Privatization of Property in the Agroindustrial Complex" and Decree of the Cabinet of Ministers of Ukraine No. 57, dated May 20, 1993, "On the Privatization of Complete Property Complexes of State-Owned Enterprises and the Leased Structural Subdivisions Thereof".

2. That the founders of open joint stock companies which shall be established pursuant hereto on the basis of state-owned property from the side of the Ukrainian State shall be the ministries and other bodies of the state executive branch which are subordinate to the Cabinet of Ministers of Ukraine and which are authorized to manage such property.

= SPF  
or Ministry

3. To recommend to the organs authorized to manage communal property to carry out corporatization according to this Decree.

4. That members of the supervisory councils of the open joint stock companies formed hereunder, shall consist of representatives of the joint stock company, the founders, the banking institution of the company, the workers' collective and representatives of the privatization body, each of which shall be approved by the Ministry of Economics of Ukraine, the Ministry of Finance of Ukraine and the State Property Fund of Ukraine. Representatives of other bodies and organizations may also be members of the supervisory council of the company. The authority of the supervising council of the open joint stock company shall be determined by the Regulations of the Supervisory Council.

to be approved by Min Economy  
Finance  
SPF  
SC = E of JS Co  
E of founders  
banks  
WC  
SPF  
+ other bodies

5. That the founders of the open joint stock company shall impose the obligations of the chairman of the management of the joint stock company upon the director of the enterprise subject to corporatization.

Upon the nomination of the chairman of the management, the supervisory council shall approve the members of the management of the joint stock company from the officers of the enterprise subject to corporatization.

6. That the Cabinet of Ministers of Ukraine shall:

- within one week approve the Regulations on the procedure for the corporatization of enterprises;

- within one month approve the Regulations of the Supervising Council.

7. That the organs authorized to manage state property together with the Ministry of Statistics of Ukraine shall, within one month, submit to the Ministry of Economics of Ukraine the list of enterprises subject to corporatization and the schedule thereof. Within two weeks on the receipt of the above mentioned documents the Ministry of Economics of Ukraine shall submit the drafts of the agreed upon documents for the approval of the Cabinet of Ministers of Ukraine.

The Ministry of Statistics of Ukraine together with the Ministry of Economics of Ukraine shall, within ten days, approve the appropriate form for creating the lists of enterprises subject to corporatization.

8. That the founders of open joint stock companies shall, upon the decision to privatize the open joint stock companies, transfer the shares of such companies to the state privatization organs according to the procedure determined by the Ministry of Finance of Ukraine and the State Property Fund of Ukraine.

9. That during the privatization of the enterprises which were corporatized in accordance with the schedule set forth in Article 7 hereof the directors, the deputy directors and the chief specialists of such enterprises as well as the directors of their structural subdivisions shall have the right to acquire additional shares of the company at nominal value and with a one year deferral of payment up to a total amount of 5% of the charter fund of the company after the acquisition of shares by employees of the company on preferential terms. The deferral of payment for the shares will be granted on the condition that at least 30% of the value of the acquired shares has been contributed.

10. That the responsibility for implementing corporatization shall be placed on the ministers and on the heads of the other organs of the state executive branch which are subordinate to the Cabinet of Ministers of Ukraine.

11. That supervision over the implementation of this Decree shall be carried out by the Cabinet of Ministers of Ukraine.

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12. That this Decree shall come into force as of the date of its execution.

The City of Kyiv  
June 15, 1993

President of Ukraine  
L. Kravchuk

98

RESOLUTION NO. 508  
OF THE CABINET OF MINISTERS OF UKRAINE

ON THE APPROVAL OF THE REGULATIONS  
ON THE PROCEDURE FOR CORPORATIZING ENTERPRISES

In order to implement the Decree of the President of Ukraine of June 15, 1993 "On the Corporatization of Enterprises", the Cabinet of Ministers of Ukraine hereby resolves:

To approve the attached "Regulations On the Procedure for Corporatizing Enterprises".

July 5, 1993

Prime Minister of Ukraine  
L. KUCHMA

Minister of the Cabinet of Ministers of Ukraine  
V. PUSTOVOITENKO

REGULATIONS  
ON THE PROCEDURE FOR CORPORATIZING ENTERPRISES

1. These regulations set forth the procedure for corporatizing state enterprises, closed joint stock companies in which more than 75% of the charter fund is owned by the state, as well as industrial and scientific-production associations, the legal status of which was not brought into conformity with applicable legislation prior hereto (hereinafter referred to as "enterprises").

2. Within a two week period from the commencement of corporatization, as described in Article 7 of the Decree of the President of Ukraine "On the Corporatization of Enterprises" dated June 15, 1993, the director of the enterprise shall submit proposals to the founder of the open joint-stock company (hereinafter referred to as the "founder") on the individual members of the corporatization commission (hereinafter referred to as the "Commission"), which shall include representatives of the Founder, the banking institution servicing the enterprise, the appropriate state privatization body and the workers collective of the corporatizing enterprise. In the event of the corporatization of monopolist enterprises, the Commission shall include a representative from the Anti-Monopoly Committee. The Commission may also include representatives of other bodies and organizations.

The Founder shall approve the members of the Commission within a one week period. The members of the Commission shall preserve their positions and average wages per month for the duration of the period of work in the Commission.

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3. The chairman of the Commission shall organize the work of the Commission and shall be personally liable for its activity.

4. A Commission meeting shall be deemed legally convened if not less than two thirds of its members are present.

5. Decisions taken by the Commission shall be adopted by a simple majority. In the event of a tie in the voting, the chairman shall have the casting vote. A Commission member who does not agree with a decision adopted by the Commission, may submit his comments in writing and such written comments shall be entered into the minutes.

6. The minutes of the Commission meeting shall be prepared within three (3) days and signed by the chairman of the Commission.

7. The administration of the corporatizing enterprise shall be obliged to provide the Commission all necessary accounting, statistical and other data within the time period specified therefor.

8. The Commission shall have the right to enlist experts, auditors, consultants and other companies. Payment for the services of such experts and consultants shall be carried out by the corporatizing enterprise.

9. The Commission shall be responsible for the accurate preparation of documentation and the authenticity of data used by the Commission.

10. The Commission, within a two-month period, shall prepare and transfer to the Founder an act on the valuation of the entire property complex of the corporatizing Enterprise and a draft charter of the open joint-stock company, prepared in accordance with the Law of Ukraine "On Economic Associations".

11. Within a one week period, the Founder shall review and confirm the act on the valuation of the entire property complex of the corporatizing enterprise and shall, within a ten-day period take a decision on the establishment of an open joint-stock company and confirm its charter. In the event of a disparity between the forgoing documents and the requirements of these Regulations or other applicable legislative acts, the Founder shall make all necessary amendments and additions to such documents.

At the same time, the Founder shall submit to the Ministry of Finance, the Ministry of the Economy and the State Property Fund his proposals as to the members of the supervising council of the open joint-stock company.

12. Within one week after the approval of the charter, the director of the corporatizing enterprise, pursuant to a power of attorney from the Founder, shall submit an application together with the decision to establish an open joint-stock company and its charter to the state bodies that register subjects of

commercial activity. No state registration fee or other payments shall be due and payable in connection with the foregoing.

13. The Ministry of Economy, the Ministry of Finance and the State Property Fund shall, within a two week period, confirm the members of the supervising council of the open joint-stock company.

14. The structural subdivisions (units) of enterprises and associations whose legal status was not brought into conformity with applicable legislation may be re-organized in the process of the corporatization into separate enterprises, including open joint-stock companies, pursuant to a decision of the Founder.

15. From the date of the registration of the open joint-stock company the assets and liabilities of the enterprise and its structural subdivisions (units) shall be transferred to the open joint-stock company. The joint-stock company shall become the legal successor to all of the rights and obligations of the corporatized enterprise.

16. The charter fund of open joint-stock companies established according hereto shall be determined in accordance with the existing Methods for the calculation of the value of objects of privatization and leasing.

17. The registration of the issuance of shares and information concerning their issuance shall be conducted in accordance with the procedure specified by the Ministry of Finance. The cost incurred in connection with the issuance of the shares of an open joint-stock company shall be for the account of the company.

18. Disputes arising in the process of the corporatization of enterprises shall be resolved in accordance with applicable law.

19. The corporatization Commission shall be deemed liquidated from the date of the registration of the open joint-stock company.

7 pages in all for JCP.

3

10.Registration of open JSC

Director of JSC  
"Donbassenergo"

04.07.95

Head of the Department of forms of properties  
and organizational structures

signature

J.S.Zavgorodny.

MINISTRY  
FOR ELECTRICITY AND ELECTRIFICATION OF UKRAINE

EXECUTIVE ORDER

March 17, 1995

Kiev

No 49

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Creation of Centrenergo  
State Enterprise

In the follow-up of the Decree No 244/94 of the President of Ukraine of May 21, 1994, "On Measures on Market Reform in the Electric Power Industry of Ukraine" and of the Resolution No 816-p of the Cabinet of Ministers of Ukraine dated November 2, 1994, and aiming at the creation of a state joint stock generating company,

I ORDER:

1. To reorganize the Zmiev, Uglegorsk and Tripolye TPPs into separate (structural) divisions to appear as the base for the Centrenergo State Enterprise to be set up since April 1, 1995, with the residential address of 5 I. Franko Square, Kiev, 252001.
2. To recognize Donbassenergo as a successor to the Zmiev, Uglegorsk and Tripolye TPPs.
3. To vest Syaber, Nikolai Alekseevich, with the responsibility of an interim director of the Centrenergo State Enterprise.
4. For Personnel and Social Issues Department (Mishkoriz):
  - 4.1 To prepare materials on termination of contracts with the managers of the state enterprises referred to in Item 1 of this Executive Order.
  - 4.2 To submit proposals before April 1, 1995, on a challenging director for Centrenergo and prepare documents for signing a related contract.
5. For Mr. Syaber, the Interim Director of the Centrenergo State Enterprise: to approve, within the two-week period, a statute of the enterprise and take necessary measures to have it registered at given bodies.

March 31

6. For the Donbassenergo Electricity Association (Mitryukovsky), the Kievenergo Association (Kirichenko), Kharkovenergo Association (Navrotsky) and Centrenergo Enterprise (Syaber): to prepare and approve, within a two-week period, measures on providing the newly created enterprise with offices equipped with furniture, office equipment, typewriters, computers, copiers and communication means and transfer related services, structural divisions and staff from the Donbassenergo Association to the Donbassenergo Enterprise to ensure functioning of the thermal power plants. Staff and production divisions should be manned within the bounds of the existing number of employees.

7. For the Donbassenergo Electricity Association (Mitryukovsky), the Kievenergo Association (Kirichenko), Kharkovenergo Association (Navrotsky) and the Centrenergo Enterprise (Syaber): to prepare and approve, before April 10, 1995, distribution balances and transfer deeds/acceptance records for the facilities.

*evaluation for Central Bank*  
8. For the Centrenergo Enterprise (Syaber): to submit, before April 10, 1995, to the Economic Department of Minenergo, a feasibility study for 1995 (within the range of the electricity balance stated for the Donbassenergo, Kievenergo and Kharkovenergo Electricity Associations) in order to introduce changes to the settlement balance of feasibility and cost indices for Minenergo to be considered in making up the 1995 plan of economic and social development of Ukraine. ?

*Genio*  
9. For the Economic Department (Trafimov), the National Dispatch Center (Batalov, Svetelik) and the management of the newly created Enterprise and the National Electricity Regulation Commission: to identify a procedure for the formation and approval of electricity tariffs and submit, before April 15, 1995, to the Minenergo management, a scheme of mutual payments for the electric power generated and supplied.

10. For the Finance /Credit Department (Khaidurova): to identify, before April 25, 1995, a procedure for entering taxes to the budget.

11. For the Accounting/Reporting Department (Volyansky), the Finance/Credit Department (Khaidurova): to provide methodological supervision of reporting and information to be prepared by the newly created enterprise for Minenergo in conformity with the distribution balance approved.

12. For the Organizational Management/Labor Stimulation Department (Korgun): to identify, before April 15, 1995, a procedure for remuneration of labor employed by the newly created enterprise.

13. For the Kievenergo Electricity Association (Kirichenko): to support financially and materially the activities of the Centrenergo Enterprise during the period of the latter's formation.

14. For the National Despatch Center (batalov, Kolesnikov): to maintain the existing information system for the period that the Centrenergo Enterprise be formed. To propose, together with the Centrenergo Enterprise, improvements in the existing system, if necessary.

15. For the Ownership Forms/Organizational Structures Department (Zavgorodny) and the Centrenergo State Enterprise (Syaber):

15.1 To submit to me for approval, within the two-week period, an action plan for setting up a joint stock company - Centrenergo - according to the terms set out by the Resolution No 816-p of the Cabinet of Ministers of Ukraine dated November 2, 1994.

15.2 To introduce given changes to the composition of Minenergo of Ukraine.

16. To assign Mr. A.N.Sheberstov, Deputy Minister, to be responsible for the execution of this Executive Order.

V.M.Semenyuk,  
Minister

tor or directors are present at the meeting of the Board of Directors or a committee thereof which authorizes, approves or ratifies such contract or transaction or because his, her or their votes are counted for such purpose, if: the fact of such relationship or interest is disclosed or known to the Board of Directors or committee which authorizes, approves or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors; or the fact of such relationship or interest is disclosed or known to the shareholders entitled to vote and they authorize, approve or ratify such contract, transaction or determination by vote or written consent; or the contract or transaction is fair and reasonable to the corporation.

(b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or a committee thereof which authorizes or ratifies such contract or transaction.

(c) None of the provisions of this section shall invalidate any contract or transaction which would otherwise be valid under applicable law.

2.13 Removal. All or any number of the directors may be removed, with or without cause, at a meeting called expressly for that purpose, by a vote of the holders of a majority of the shares entitled to vote at an election of directors.

2.14 Resignation. Any director may resign by delivering his or her resignation to the corporation at its principal office or to the President or Secretary. Such resignation shall be effective on receipt unless it is specified to be effective at some other time or upon the happening of some other event.

### ARTICLE III

#### COMMITTEES

3.1 Designation. The <sup>Supervisory Unit</sup> ~~Board of Directors~~ may designate from among its members an executive committee and/or one or more other committees. The designation of a committee, and the delegation of authority to it, shall not operate to relieve the Board of Directors, or any member thereof, of any responsibility imposed by law. No member of any committee shall continue to be a member thereof after ceasing to be a director of the corporation. The Board of Directors shall have the power at any time to increase or decrease the number of members of any committee, to fill vacancies thereon, to change any member thereof and to change the functions or terminate the existence thereof.

3.2 Powers. During the interval between meetings of the Board of Directors, and subject to such limitations as may be imposed by resolution of the Board of Directors, the executive committee may have and may exercise all the authority of the Board of Directors in the management of the corporation. Any other committee shall have such authority of the Board of Directors as the Board of Directors shall delegate to it by resolution. Notwithstanding the foregoing, neither the executive committee nor any other committee shall have the authority of the Board of Directors in reference to amending the Articles of Incorporation; adopting a plan of merger or consolidation; recommending to the shareholders the sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all the property and assets of the corporation otherwise than in the usual regular course of its business; recommending to the shareholders a voluntary dissolution of the corporation or a revocation thereof; or amending the Bylaws of the corporation.

3.3 Procedures; Meetings; Quorum.

(a) The Board of Directors shall appoint a chairman from among the members of a committee and shall appoint a secretary who may, but need not, be a member of the committee. The chairman shall preside at all committee meetings and the secretary of the committee shall keep a record of its acts and proceedings.

(b) Regular meetings of a committee, of which no notice shall be necessary, shall be held on such days and at such places as shall be fixed by resolution adopted by the committee. Special meetings of a committee shall be called at the request of the President or of any member of the committee, and shall be held upon such notice as is required by these Bylaws for special meetings of the Board of Directors, provided that notice by word of mouth or telephone shall be sufficient if received in the city where the meeting is to be held not later than the day immediately preceding the day of the meeting. A waiver of notice of a meeting, signed by the person or persons entitled to such notice, whether before or after the event stated therein, shall be deemed equivalent to the giving of such notice.

(c) Attendance of any member of a committee at a meeting shall constitute a waiver of notice of the meeting. A majority of the committee, from time to time, shall be necessary to constitute a quorum for the transaction of any business, and the act of a majority of the members present at a meeting at which a quorum is present shall be the act of the committee. Members of a committee may hold a meeting of such committee by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting

can hear each other, and participation in such a meeting shall constitute presence in person at the meeting.

(d) Any action which may be taken at a meeting of a committee may be taken without a meeting if a consent in writing setting forth the actions so taken shall be signed by all members of the committee entitled to vote with respect to the subject matter thereof. The action shall be effective on the date when the last signature is placed on the consent or at such earlier time as is set forth therein. The consent shall have the same effect as a unanimous vote of the committee.

(e) The Board of Directors may vote to the members of any committee a reasonable fee as compensation for attendance at meetings of the committee.

#### ARTICLE IV

##### OFFICERS

4.1 Number. The officers of the corporation shall be a President and Secretary. Such other officers and assistant officers as may be deemed necessary may be elected or appointed by the Board of Directors and shall have such powers and duties as may be prescribed by the Board of Directors. Any two or more offices may be held by the same person.

4.2 Election and Term of Office. The officers of the corporation shall be elected annually by the Board of Directors at the first meeting of the Board of Directors held after the annual meeting of the shareholders. If the election of officers shall not be held at the meeting, it shall be held as soon thereafter as is convenient. Each officer shall hold office until a successor shall have been duly elected and shall have qualified or until the officer's death, resignation or removal in the manner hereinafter provided.

4.3 Removal. Any officer or agent elected or appointed by the Board of Directors may be removed by the Board of Directors whenever in its judgment the best interests of the corporation would be served thereby, but removal shall be without prejudice to the contract rights, if any, of the person so removed. Election or appointment of an officer or agent shall not of itself create contract rights.

4.4 Vacancies. A vacancy in any office because of death, resignation, removal, disqualification or otherwise may be filled by the Board of Directors for the unexpired portion of the term.

## PERSONNEL COMMITTEE

RESOLVED, that pursuant to Section 3.12 of the Bylaws of the Company, there is hereby established the Personnel Committee of the Board of Directors, which shall be composed of not less than three members of the Board of Directors who shall not be officers or full-time employees of the Company; and further

RESOLVED, that the members of the Personnel Committee shall be appointed by the Board of Directors as soon as practicable after its election in each year, and one of the members shall be designated chairman by the Board of Directors; and further

RESOLVED, that the Personnel Committee shall review periodically the Company's policies relating to employee compensation and benefits, and shall review and assess the effectiveness of the Company's plans in implementing those policies; and further

RESOLVED, that, for the purpose of fulfilling its other responsibilities hereunder, the Personnel Committee shall review the Company's executive staffing plan for meeting present and future leadership needs of the Company; and further

RESOLVED, that the Personnel Committee shall review the following matters for the purpose of making recommendations to the Board of Directors with respect thereto:

1. Candidates for election as officers of the Company;
2. Compensation plans for officers; and
3. Salary level of the Chief Executive Officer.

and further

RESOLVED, that the Personnel Committee shall review the salary levels of the Chief Executive Officers of \_\_\_\_\_ for the purpose of making recommendations to the respective boards of those subsidiaries with respect thereto; and further

RESOLVED, that the Personnel Committee shall review and approve the following matters:

1. Major changes in management organization structure;
2. Salary levels, performance targets and incentive awards for officers;
3. Merit program and salary range adjustments for senior management other than officers;

4. incentive plans for employees; and
5. changes in policies relating to employee insurance and like benefits.

; and further

RESOLVED, that the Personnel Committee shall administer compensation plans as authorized by the Board of Directors in said plans or otherwise; and further

RESOLVED, that the Personnel Committee shall report its activities to the Board of Directors at least annually and at other meetings as may be appropriate; and further

RESOLVED, that the Personnel Committee shall report on executive compensation to shareholders pursuant to the proxy solicitation rules of the Securities and Exchange Commission; and further

RESOLVED, that the Personnel Committee shall have such authority and responsibility for other matters as shall be delegated to such Committee from time to time by action of this Board with respect to such matters; and further

RESOLVED, that the foregoing resolutions shall supersede the resolutions adopted by the Board of Directors on

## Finance Committee Resolutions

RESOLVED, that pursuant to Section 3.12 of the Bylaws of the Company there is hereby established the Finance Committee of the Board of Directors, which shall be composed of the Chairman of the Board and not less than two other members of the Board of Directors; and further

RESOLVED, that the members of the Finance Committee shall be appointed by the Board of Directors as soon as practicable after its election in each year, and one of the members shall be designated chairman by the Board of Directors; and further

RESOLVED, that the Finance Committee shall have all the power of the Board of Directors to approve the final terms of and authorize the offering, issuance and sale by the Company of its stock, bonds, notes and other evidences of ownership or indebtedness to the extent delegated to such Committee by action of this Board with respect to each such offering, issuance and sale and to the extent permitted by the Oregon Business Corporation Act at the date of such delegation; and further

RESOLVED, that upon the delegation to the Finance Committee of such authority with respect to the offering, issuance and sale by the Company of its stock, bonds, notes and other evidences of ownership or indebtedness, the Finance Committee shall have all the power of the Board of Directors to further delegate such authority to an officer or officers of the Company to the extent permitted by the Oregon Business Corporation Act; and further

RESOLVED, that the Finance Committee shall regularly consult with, and may request reports from, the appropriate officers of the Company concerning the Company's requirements for capital, the condition of the capital markets, the most appropriate means of obtaining additional capital as needed from time to time, the capital structure of the Company, the Company's dividend policy, the financial and investment aspects of the Company's employee benefit plans and such other finance-related matters as the Committee shall determine; and further

RESOLVED, that the Finance Committee shall report to the Board of Directors periodically, and at least quarterly, on matters presented to and considered by the Finance Committee, action taken by it on such matters, any recommendations the Committee may deem appropriate, and such other

pects of the financing activities of the Company as the  
Finance Committee deems significant; and further

RESOLVED, that the Finance Committee shall have such  
authority and responsibility for other matters as shall be  
delegated to such Committee from time to time by action of  
the Board with respect to such matters; and further

RESOLVED, that the foregoing resolutions shall supersede the  
resolutions adopted by the Board of Directors on January 11,  
1989 with respect to the same subject matter; provided that  
nothing herein shall affect the validity of actions taken in  
accordance with such resolutions adopted January 11, 1989.

## AUDIT COMMITTEE

RESOLVED, that pursuant to Section 3.12 of the Bylaws of the Company there is hereby established the Audit Committee of the Board of Directors which shall be composed of not less than three members of the Board of Directors who are independent of the management of the Company and are free of any relationship that in the opinion of the Board of Directors would interfere with the exercise of independent judgment as a member of the Audit Committee; and further

RESOLVED, that the members of the Audit Committee shall be appointed by the Board of Directors as soon as practicable after its election in each year, and one of the members shall be designated chair by the Board of Directors; and further

RESOLVED, that the duties of the Audit Committee shall be as contained in Audit Committee Responsibility and Function as attached hereto as Exhibit A; and further

RESOLVED, that the Audit Committee shall have such authority and responsibility for other matters as shall be delegated to such Committee from time to time by action of this Board with respect to such matters; and further

RESOLVED, that the foregoing resolutions supersede the resolutions regarding the Audit Committee adopted November 17, 1993.

AUDIT COMMITTEE RESPONSIBILITY AND FUNCTIONMISSION

The mission of the Audit Committee of the Board of Directors (the "Board") of the "Company") shall be to assist the Board in fulfilling its responsibilities by overseeing and reporting to the Board with respect to the general policies and practices of the Company (and the subsidiaries of the Company included in the consolidated financial statements of the Company) relating to accounting, reporting practices, adequacy of internal controls, quality and integrity of financial reporting, and such other matters as may be assigned by the Board. The Audit Committee shall maintain free and open communication with the Board, the external auditors, the internal auditors, management and the audit committees of each business unit having such a committee. In carrying out its mission, the Audit Committee shall have discretion to initiate such investigations as it shall deem necessary and shall have standing authority to employ special counsel or experts in circumstances when it determines that necessary resources cannot be provided by regular support staff.

Composition

The Audit Committee of the Board shall consist of three or more directors appointed by the Board who are independent of the management of the Company and are free of any relationship that in the opinion of the Board could interfere with the exercise of independent judgment as a member of the Audit Committee.

Role

The Audit Committee of the Board shall coordinate and act as the audit committee for all of the Company's operations, including subsidiary companies, unless such subsidiary has a board of directors which has at least three independent directors who function as an audit committee for that subsidiary. Where such an independent audit committee exists, then the Audit Committee of the Board shall receive and review reports from the subsidiary audit committee and coordinate its activities.

Meetings

Regular meetings of the Audit Committee shall be held no less frequently than quarterly, on a schedule to be adopted by the Audit Committee. Special meetings of the Audit Committee for any purpose may be held when called by the Chair or any member.

Financial Statements and External Auditors

The Audit Committee shall:

- a) Consider the proposed scope of the external auditors' work for the current year, consider any proposed nonaudit functions to be performed, review the audit plan and review the prior year's audit fee and the current year's fee estimate. The Committee's review should include an understanding of the factors considered by the external auditors in determining the audit scope, including:
  - 1) Industry and business risks characteristics of the Company;
  - 2) External reporting requirements;
  - 3) Materiality of the various segments of the Company's consolidated and non-consolidated activities;
  - 4) Quality of internal accounting controls;
  - 5) Extent of involvement of internal auditors in the audit examination; and
  - 6) Other areas to be covered during the audit engagement.
- (b) Receive and consider any recommendations of management regarding the external auditors to be retained for the following year, including management's evaluation of factors relating to the independence of the auditors, and submit a recommendation to the Board.
- (c) Review with management and the external auditors, before publication, the annual financial statements (including special year end entries, footnotes, management's discussion and analysis of financial condition and results of operations, and any special disclosure problems) to be included in the annual report to shareholders, the annual 10-K report to the SEC or similar publicly filed documents, proxy material, and any disputes (resolved or unresolved) between management and the external auditors that arose in connection with the preparation and audit of the financial statements; review the Company's process of assessing the risk of fraudulent financial reporting and monitoring compliance with established codes of corporate conduct; and review significant adjustments proposed by the external auditors.
- (d) Review those reports (or summaries of such reports) issued by the external auditors or the internal auditors, relating to audits in which a material weakness is disclosed or identified and management's responses thereto.
- (e) Review with management, the external auditors and the internal auditors, the Company's general policies and procedures with respect to internal auditing, accounting and financial controls and the adequacy of such policies and procedures.

Review the effect of any important new pronouncements of the accounting profession and other regulatory bodies on the Company's accounting policies and practices.

Review with the external auditors any significant proposed changes in the basic accounting principles and reporting standards used in the preparation of the Company's financial statements.

Review all reports of audits or reviews of the Company (or summaries of such reports) issued by regulatory or taxing authorities that could have a material impact on the Company, or how its businesses are conducted.

Review with the external auditors, internal auditors and with the Company's management the extent to which recommended significant changes or improvements in financial and accounting practices have been implemented.

(a) Receive reports in executive session from the engagement partner of the external auditor, which reports shall, in part, comment on the capabilities of the internal auditing groups and the Company's management.

(b) Receive reports in executive session from management and the internal auditors, which reports shall, in part, review any concerns with respect to the external auditors and the external audit process.

Meet regularly with the Company's General Counsel to review legal matters that may have an impact on the Company's financial statements, and other legal matters as appropriate.

(c) Report promptly to the Board its deliberations and recommendations.

(d) Receive and consider reports of peer reviews of the external auditors.

#### Internal Auditors

(a) The Audit Committee will annually review the audit plan covering the proposed activities of the Internal Audit Department and, as applicable, internal audit groups of any business units coordinated with the audit plan of the external auditors.

(b) The Audit Committee will review, in summary form, the results of peer reviews of the Internal Audit Department performed periodically by consultants approved by the Audit Committee, and peer reviews of the internal audit groups of any business units performed by the PacifiCorp Internal Audit Department.

(c) The Audit Committee will receive reports, at least annually, from the manager of the Internal Audit Department covering activities, staffing, procedures for selection of audits and other relevant information.

1 The chairs of any audit committees of the business units, the manager  
2 the Internal Audit Department, and the engagement  
3 rner of the external auditor will report at each regular meeting of  
4 e Audit Committee regarding the identification of any material  
5 addresses, problems, or significant events. Every incident of theft,  
6 fraudulent activity or illegal conduct by Company personnel shall be  
7 reported to the Audit Committee, without regard to the financial  
8 materiality of such incident.

9 The Audit Committee will review and concur in the appointment,  
10 placement, reassignment, or dismissal of the manager of the  
11 Internal Audit Department.

## **ANNEX F : Reporting Requirements for the Public Offering of Securities<sup>1</sup>**

### **1. Summary Prospectus Requirements**

The Ministry of Finance regulations require that a prospectus include information which permits the investor to obtain a fair assessment of the issuer's financial condition. A prospectus for a public offering carried out by an existing open joint stock company which is increasing its charter fund must contain the following information.

- a description of the issuer : its name, principal place of business, date of incorporation and principal business activities.
- an audited balance sheet and income statement for the previous three completed fiscal years (or for each completed fiscal year since incorporation in the event an issuer has been in existence for less than three years).
- an audited balance sheet as of the last completed quarter of the fiscal year in which the decision to issue the securities was taken and a summary of the issuer's charter fund.
- any material events which occurred during the previous three fiscal years which may reflect on the financial condition of the issuer.
- the number of employees, including information regarding the education , qualifications and length of service of the issuer's management;
- a summary of the issuer's production, sales, research and development activities and investments (such information to be certified by a qualified auditing firm).
- background information regarding the planned issuance : the date on which the decision to issue the securities was taken, the type and categories of securities to issued, any specific rights or privileges to be afforded holders of he securities to be issued, the purposes for which the proceeds of the offering are to be utilized, the location at which the offered securities may be purchased and the commencement and termination date of the offering.
- the name of the underwriter (if there is one) and the steps to be taken in the event of an over or under subscription.
- the anticipated rate of return of the equity securities being offered.
- with respect to debt and interest bearing securities, the interest rate and repayment terms.

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<sup>1</sup>The information in this annex comes from an article published by Borys Sobolev, Deputy Minister of Finance of Ukraine, entitled "Public and Private Equity Financing in Ukraine", written for the Capital Markets in Ukraine conference organized by the OECD in Paris in June 1995.

- a summary of the types and quantity of previously issued securities.
- the number of registered shares previously issued by the issuer, including the number of shares held by management.

## **2. Summary Reporting Requirements under the Securities Legislation**

The Ukrainian securities legislation provides that an issuer of publicly traded securities is required to provide an annual report to all shareholders and to the relevant Registering Body. Such annual report must contain the following :

- information on the issuer's economic performance for the previous fiscal year.
- audited financial statements for the previous fiscal year.
- information with respect to any securities issued during the previous fiscal year.
- information regarding any changes in the management of the issuer.

The Ukrainian securities legislation also requires an issuer of publicly traded securities to provide to the Exchange and to the relevant Registering Body and to publish in the bulletin of the Exchange, *any material information which could have an impact on the price of its publicly traded securities*. Such information is to be provided within two days of arising and includes :

- changes in any rights granted to the securities.
- changes in the issuer's management.
- attachment of issuer's bank accounts.
- commencement of bankruptcy or other similar proceedings against the issuer.
- the reorganization, suspension or termination of the issuer's activities.
- the loss of 10 % of more of the issuer's assets as a result of extraordinary circumstances.
- the filing of a claim against the issuer in an amount which exceeds 10 % of its charter fund or 10 % of the value of the issuer's fixed and circulating assets.
- the incurrence by the issuer of a debt obligation or issuance of securities in an amount exceeding 50 % of the charter fund or 10 % of the value of fixed and circulating assets of the issuer.

## **3. Summary Reporting Requirements under the Exchange's Regulations**

An issuer of securities which are to be officially quoted on the Exchange is required under the regulations of the Exchange :

- to provide the Exchange with a report summarizing the results of each general and extraordinary shareholders meeting.
- to provide the Exchange with information regarding any amendment to the issuer's charter and any internal corporate decision regarding the listed securities.
- to agree with the Exchange on a schedule for offering and subscription with respect to securities to be offered on the Exchange by the issuer, including any provisions for preferred rights with respect to the offered securities.
- to agree with the Exchange on the technical procedures regarding operations involving the listed securities (e.g. payment of interest or dividends).
- to inform the Exchange of any events which may materially affect the quoted price of the issuer's securities or affect the issuer's financial situation.
- to provide the Exchange with copies of all official notices or publications distributed or planned to be distributed by the issuer.
- to notify the Governing Council of any change regarding the appointment of intermediaries for carrying out the payment of interest or dividends to holders of the issuer's listed securities; the payment of dividends, interest or redemption of securities must be carried out free of charge for the holders of the securities.
- periodically to inform the Exchange of the total number of voting shares issued and outstanding.
- to publish in the official bulletin of the Exchange information concerning all issuances of securities.

The issuer would also be required to comply with all reporting requirements under the securities legislation as summarized in Section 2 above.

#### **4. Documents to Apply and Obtain Permission for Quotation**

An application requesting that a security be quoted on the Exchange is submitted by the issuer or its designated attorney. The application is reviewed by the Governing Council which must, within 30 days of submission of the application, either accept or reject the securities for official quotation on the Exchange or request that the issuer provide additional information.

The Governing Council may reject an application if it reasonably believes that official quotation of the security would harm the interests of the securities market and investors.

In addition to the application, the issuer is required to submit the following documents to the Governing Council :

- a notarized copy of the issuer's charter.
- a copy of the certificate (decision) evidencing the registration of the issuer as a legal entity.
- a copy of the document evidencing the granting of a state registration number to the security being issued.
- a copy of the prospectus which was registered with the Ministry of Finance.
- an audited balance sheet and profit and loss statement for the last three fiscal years (or for each completed fiscal year if the issuer has been in existence for less than three years).
- a balance sheet as of the end of the last financial quarter occurring prior to the adoption of the decision by the issuer to list the security on the Exchange.
- a list of shareholders holding at least 5 percent of the total number of voting shares.
- information regarding the percentage ownership of the issuer by the issuer's employees.
- information regarding the percentage ownership of the issuer by the issuer's management.
- other documents as may be required.

L A W

OF THE UKRAINIAN SOVIET SOCIALIST REPUBLIC

ON SECURITIES AND STOCK EXCHANGE

This Law specifies the terms and procedure of securities issue, as well as regulates the intermediary activities in circulation of securities in the territory of the Ukrainian SSR.

Section 1. SECURITIES, THEIR ISSUE AND CIRCULATION

Chapter 1. General provisions

Article 1. Notion of securities

Securities are the monetary documents which certify the right to possession or relations of loan, define the interrelations between the person who issued securities and their owner, also provide the payment of income as dividends or interests and the transfer of monetary and other rights, proceeding from these documents, to other persons.

Securities may be registered or bearer ones. Registered securities are transferred through full endorsement certifying the transfer of rights to securities to another person unless specified otherwise by this Law or specially underscored that such securities shall not be transferred.

Bearer securities are circulated in a free manner.

Securities may be used for settlements, payments and credits.

The lost registered securities are restored by state organs, enterprises and establishments which had issued them.

Securities may be inherited pursuant to the civil legislation of the Ukrainian SSR.

Circulation of securities issued by the USSR, other Union Republics and functioning in the Ukrainian SSR, is regulated by this Law, other legislative acts of the Ukrainian SSR and the corresponding Republics.

Article 2. Emitter of securities

Emitter of securities is the legal entity who, on his own

behalf, issues securities and undertakes to fulfill the commitments proceeding from the terms of such issue (hereinafter referred to as emitter).

Emitter shall fulfill all the commitments, proceeding from the issue of securities, in terms and order prescribed by this Law, other legal acts of the Ukrainian SSR, the decisions on securities issue.

The rights and duties concerning securities appear from the moment of their transfer by the emitter or his authorized person to the recipient (buyer) or his authorized agent.

### Article 3. Types of securities

Pursuant to this Law, the following types of securities may be issued and circulated in the Ukrainian SSR:

- stocks;
- Republican and local bonds;
- bonds of enterprises;
- treasury bonds;
- savings certificates;
- bills.

### Chapter 2. Stocks

#### Article 4. Basic features of stocks

Stocks are the securities without the fixed term of circulation which prove the share in statutory fund of a joint-stock company and the right to take part in its management, also provide stockholders with the right to receive a part of profit in the form of dividends, to participate in division of property in the event of dissolution of joint-stock company.

Stocks may be registered, bearer, preference and ordinary ones. Citizens, as a rule, may be the holders of registered stocks.

The registered stock circulation is fixed in the stock registration book kept by joint-stock company. It should contain information concerning each registered stock, its holder, the date of its purchase and the number of such actions belonging to each stockholder.

As to bearer stocks, only their total number is indicated

in the book.

Preference stocks give the holders the preferential right to receive dividends and to the priority in the division of property in the event of dissolution of a joint stock company. The holders of registered stocks have no right to take part in management of their joint-stock company unless specified otherwise by its statute.

Registered stocks may be issued with annually paid dividend with fixed interest on their nominal cost. Payment of dividends is made in the amount indicated in stocks irrespective of the amount of profit the company obtained over an applicable year. Provided such annual profit is too low, the payment of registered stock dividends is made from reserve fund.

Provided the amount of ordinary stock dividends exceeds that of registered stock ones, the holders of the latter may receive additional payments until the amount of the dividends paid to them reach that received by other stockholders.

Registered stocks cannot be issued in the amount exceeding 10 % of statutory fund of a joint-stock company.

Preferential right to receive dividends are prescribed by the statute of a joint-stock company.

Minimal nominal cost of a stock shall not be less than 50 roubles. Nominal cost of a stock exceeding 50 roubles shall be divisible by the minimal cost of a stock.

Stockholders may receive the certificate equalling the total nominal cost of stocks.

Stock shall contain the following: name of joint-stock company and its location, securities type - "stock", its serial number, date of issue, type of stock, its nominal cost, holder's name (for registered stocks), the size of the joint-company's statutory fund on the day of stock issue, also the number of stocks being issued, dividend payment terms, signature of the joint-company board or another authorized person, stamp of joint-stock company.

The stock may be supplemented with the coupon sheet for payment of dividends.

The dividend payment coupon shall contain the following: coupon serial number, serial number of dividend stock, name of joint-stock, name of joint-stock company and the year of dividend payment.

#### Article 5. Stockholder's rights

Stockholder has the right to receive a part of the joint-stock profit (dividends), to take part in the company's management, also other rights specified by this Law, other legislative acts of the Ukrainian SSR and the statute of joint-stock company.

Stock is indivisible. If one stock belongs to several persons all of them are recognized as its holders and may exercise their rights through one of them or their common representative.

#### Article 6. Taking the decision of stock issue

The decision on stock issue is taken by founders of joint-stock company or by general meetings of stockholders.

Such a decision is registered in protocol.

The following entries should be made in protocol: name of emitter and his location; size of statutory fund or the cost of the emitter's fixed and current assets; goals and subject of his activities; information about the emitter's officials; name of the auditing organization; information on previously issued securities; stock issue purpose, specification of stock categories; number of registered and bearer stocks; number of preference stocks; total amount of emission and number of stocks; nominal cost of stocks; number of voters; dividend payment procedure; terms and procedure of subscription for stocks and payment for them; the period of return of money in case of refusal to issue stocks; sequence of issue of stocks (if they are issued in series); procedure of making the stock issue and distribution known to public; conditions of stock possession; rights of holders of registered stocks; preferential right to acquire stocks of new emission.

The protocol may contain some other data on stock issue.

#### Article 7. Issue of stocks

Stock issue by joint-stock company is effected in the amount of the company's statutory fund or the entire cost of the state enterprise property (if such an enterprise is transformed into a joint-stock company). Additional issue is permitted only if all previously issued stocks have been fully paid at the cost not less than the nominal one.

It is prohibited to issue stocks for covering the losses sustained as a result of business activities of joint-stock company.

#### Article 8. Acquisition of stocks

Stocks are paid in roubles or, if so prescribed by the statute of joint-stock company, also in foreign currency or through property transfer. Regardless of the form of deposit, the stock cost is expressed in roubles.

Enterprises and establishments may acquire stocks using the money remaining at their disposal after payment of taxes and bank credit interest.

Stocks may be given to recipient (buyer) only after full payment of their cost.

Joint-stock company may redeem stocks from their holder for further resale, distribution among its members or annulment. Such stocks should be realized or annuled within the period not exceeding one year. During this period, profit distribution, voting and determination of quorum at general meetings of stockholders are conducted without allowing for the stocks purchased by joint-stock company.

#### Article 9. Stock income payment

Stock dividends are paid on annual basis as fixed by the joint-stock company statute from the profit remaining after taxation, credit interest payments and other deductions to state budget.

### Chapter 3. Bonds

#### Article 10. Basic features of bonds

Bond is a type of securities proving that the bond owner really deposited his money and confirming the liability to compensate him for the nominal cost of the bond in the fixed period of time with payment of fixed interest (unless specified otherwise by the issue terms). Bonds of all kinds are distributed among enterprises, establishments and citizens on a voluntary basis.

Minimal nominal cost of bond shall not be less than 50 roubles. The nominal cost over 50 % should be divisible by minimal cost of a bond.

The following bonds are issued:

- a) Republican and local bonds;
- b) bonds of enterprises.

Bonds of enterprises are issued by the enterprises of all forms of property, industrial amalgamations, joint-stock and other companies; such bonds do not provide their owners with the right to take part in management.

The terms of issue and distribution of the said enterprises are defined by this Law, other legislative acts of the Ukrainian SSR and the emitter's statute.

Bonds are used as registered and coupon, interest and interest-free (target-oriented) ones and may circulate in a free or limited manner.

The Republican and local bonds are issued as coupon ones.

An essential feature of interest-free bonds is that they should indicate the goods (services) for which they are issued.

Bonds of enterprises shall indicate the following: name of securities - "bond"; firm name and location of emitter; name or firm name of buyer (for registered bonds); nominal cost of bond; terms of redemption, amount and terms of interest payment (for interest bonds); place and date of issue, also the bond series and number; signature of emitter or another authorized person, emitter's stamp.

Bond may be supplemented with coupon sheet for interest payment.

Such coupon shall contain the following: coupon serial number; number of interest bond; emitter's name and the year of interest payment.

The bonds intended for open sale with the following free circulation (excluding interest-free bonds) shall have coupon sheet.

#### Article 11. Taking the decision on bond issue

The decision on issuing the Republican and local bonds is taken, respectively, by the Cabinet of Ministers of the Ukrainian SSR and local Soviets of People's Deputies.

Such a decision must indicate the emitter, terms of emission and distribution of bonds.

The decision on issuing the bonds of enterprises is taken by the emitter and registered in protocol.

Such protocol shall indicate: firm name and location of the emitter; data on the emitter's statutory fund, business activities and officials; name of the auditing organization; data on distribution of the previously issued securities; purpose of issue and type of bonds (registered or coupon); total amount of emission; number and nominal cost of bonds; number of voters; procedure of issue of bonds and bond interest payments; period of return of money in case of refusal to issue bonds; periods of the sale of goods or rendering services in accordance with interest-free bonds; procedure of making the bond issue and distribution known to public; bond redemption particulars.

The protocol may also contain other data on bond emission.

Joint-stock companies may issue bonds in the amount not exceeding 25 % of their statutory fund and only after all issued stocks have been fully paid.

It is prohibited to issue the bonds of enterprises to set up and replenish the emitter's statutory fund and also to compensate for the losses caused by their business activity.

#### Article 12. Acquisition of bonds

The bonds of all types are acquired by citizens only at their own expense.

Enterprises may acquire the bonds of all types only using the money remaining at their disposal after payment of taxes and bank credit interest.

The bonds of all types are paid in roubles and, if specified so by the terms of their issue, in foreign currency. Irrespective of the currency in which bonds are paid, their cost is expressed in roubles.

#### Article 13. Bond income payment

The income obtained due to using the bonds of all types is paid pursuant to the terms of their issue.

The interest-free (target) bond income is not paid. The holder of interest-free bond enjoys the right to acquire the goods

and services for which the bonds were issued.

Provided, prior to acquisition of goods, their price is higher than the cost of bond, the holder receives the goods at the price indicated in the bond, while if the said price is lower, he receives the difference between the bond cost and the goods price.

As to the bonds of enterprises, the incomes are paid from the money remaining after settlements with budget and making other compulsory payments.

In the event of nonfulfillment or untimely fulfillment by issuer of his commitments on payment of interest bond income, on giving the right to acquire the goods or services in accordance with interest-free bonds or on redemption of the sum indicated in bond in a fixed period of time, the pertinent sums are collected by court or arbitration.

Redemption of all types of bonds, excluding the interest-free ones, is specified before their issue.

Article 14. Use of the monetary means obtained from  
the sale of bonds

The monetary means obtained from the sale of Republican and local bonds are deducted, respectively, to the Republican local budgets and the budgets of local Soviets of People's Deputies.

The monetary means obtained due to distribution of the bonds of enterprises are used for the purposes defined before their emission.

Chapter 4. Treasury bonds of the Republic

Article 15. Basic features of treasury bonds

The treasury bonds of the Ukrainian SSR (hereinafter called "treasury bonds") are a type of bearer securities distributed among citizens on a voluntary basis, proving the fact that their holders really made deposits to budget and giving the right to obtain financial income.

The following are the types of treasury bonds:

- a) long-term - from 5 to 10 years;
- b) medium-term - from 1 to 5 years;
- c) short-term - to 1 year.

#### Article 16. Issue of treasury bonds

The decision on emission of long-term and medium-term treasury bonds is taken by the Cabinet of Ministers of the Ukrainian SSR.

The decision of emission of short-term treasury bonds is taken by the Ministry of Finance of the Ukrainian SSR.

The order of fixing the selling value of treasury bonds is prescribed by the Cabinet of Ministers of the Ukrainian SSR allowing for the date of their purchase.

The money obtained from the sale of treasury bonds are used to cover the current expenses of the Republican budget.

#### Article 17. Payment of treasury bond income

Payment of treasury bond income and redemption of such bonds are effected pursuant to the terms of their issue approved by: the Cabinet of Ministers of the Ukrainian SSR as regards long-, and medium-term treasury bonds, the Ministry of Finance of the Ukrainian SSR as regards short-term bonds.

#### Chapter 5. Savings certificates

##### Article 18. Basic features of savings certificates

Savings certificate is the written bank warrant on depositing the money proving the depositor's right to receive his deposit and interest on it upon termination of a fixed period of time.

Savings certificates may be the time (at certain interest for a certain period of time) or demand, registered and bearer ones.

Registered certificates are not subject to circulation while their sale (alienation) to other persons is considered as invalid.

Savings certificates should contain the following: name of security - "savings certificate", name and location of the bank which issued certificate; serial number of certificate, date of issue, amount of deposit, the period of deposit withdrawal (for time certificate), name of certificate holder (for registered certificate); signature of bank manager or another authorized person, bank stamp.

Article 19. Acquisition of savings certificates

Enterprises and citizens acquire the certificates using the monetary means specified in Article 12 of this Law.

Article 20. Payment of savings certificate income

Savings certificate income is paid when such certificates are given to the bank which issued them.

If a certificate holder demands to get back the deposited money pursuant to the time certificate before the date fixed in it, such a holder is paid a lower interest where level is defined on agreed terms when making the deposit.

Chapter 6. Bills

Article 21. Basic features of bills

Bill is a type of securities certifying the unconditional monetary liability of bill giver to pay a certain sum of money to bill holder in a fixed period of time.

Exchange and ordinary bills are issued.

Ordinary bill specifies the following:

- a) name - "bill";
- b) simple and unconditional liability to pay the fixed amount of money;
- c) payment term;
- d) place at which payment is to be made;
- e) name of the person or his agent to whom the payment should be made;
- f) date and place of the bill drawing up;
- g) bill giver's signature.

In addition to the data specified in paragraphs "a", "c" - "g" of this Article, the exchange bill also contains:

- simple and unconditional proposal to pay a certain sum of money;
- name of the person who should pay (payer).

The document without any of the particulars specified in parts three and four of this Article, concerning ordinary and exchange bills, has no legal force of such bills excluding the following cases:

a) the bill not indicating the payment term is considered as the one to be paid on presentation;

b) if not specially defined, the place specified next to the name of payer (the place of bill drawing up - for ordinary bill) is regarded as the place of payment and, at the same time, the place of payer's residence (bill giver - for ordinary bill);

c) the bill not specifying the place of its drawing up is considered as having been signed at the place indicated next to the giver's name.

Procedure of bills issue and circulation is fixed by the Cabinet of Ministers of the Ukrainian SSR.

## Chapter 7. Registration and circulation of securities

### Article 22. Securities issue registration

Emitter has the right to issue the bonds of enterprises and stocks from the moment of registration of such issue by financial organs.

Provided the bonds of enterprises and stocks submitted for registration are proposed for open sale, that is, intended for distribution among legal entities and citizens who cannot be specified beforehand, the emitter should provide the financial organ with relevant information concerning the issue of such securities.

Procedure of issue of the bonds of enterprises and stocks, as well as provision of the said information is fixed by the Cabinet of Ministers of the Ukrainian SSR or, on its instructions, by the Ministry of Finances of the Ukrainian SSR.

The said registration shall be made not later than 30 days from the moment of making the official request with all necessary documents enclosed.

The financial organ which registers securities or information about their issue shall check the correspondence of the emitter's documents to the law of the Ukrainian SSR.

Rejection of registration may take place only given the violation of the fixed procedure or noncorrespondence of the emitter's documents to legal requirements.

If such registration was not made in the fixed period of time or it was rejected for the reasons regarded by emitter as

ungrounded, he may apply to court.

The said registration or information shall not be considered as the guarantee of value of such securities.

Securities issue register is kept by the Ministry of Finance of the Ukrainian SSR.

Article 23. Information on the issue of stocks and bonds of enterprises intended for open sale

Information on the issue of enterprises bonds and stocks for open sale shall be registered and published in the press organs of the Supreme Soviet and Cabinet of Ministers of the Ukrainian SSR and official bulletin of stock exchange not later than 10 days before subscription for these securities.

The said bonds and stocks are permitted for distribution not before than 30 days after publishing the announcement about their issue.

Should any changes appear in the said information, the emitter of said stocks and bond shall make these changes public within the period of 30 days from the day of publishing such information.

In case of finding any unreliable data in the said information, the registering financial organ has the right to suspend the distribution of enterprises bonds and stocks until the emitter of these securities corrects his information.

Article 24. Regular information about emitter

At least once a year, emitter shall inform the public about his economic and financial state of affairs and the results of his activity (hereinafter called "annual report").

Annual report should be published by April 1 of the year following the year of account and send to holders of registered stocks and registrating financial organ.

Annual report must provide:

- a) economic results for the previous year;
- b) data on financial position attested by auditor, also the balances for the previous year and auditor's report;
- c) data on additionally issued securities;
- d) justification of changes in emitter's staff.

Article 25. Special information about emitter

Emitter shall, within two days, notify the financial organ and stock exchange, also publish in the stock newspaper the information about all changes which occurred in his business activities and affect the cost of securities or related income, namely:

- a) changes in rights to securities;
- b) staff changes;
- c) arrest of emitter's bank accounts;
- d) actions being taken to improve the emitter's financial position ;
- e) reorganization, suspension or termination of the emitter's activities;
- f) destruction of at least 10 % of emitter's property caused by force majeure;
- g) bringing a suit against the emitter in the amount exceeding 10 % of the statutory fund or the total cost of fixed and current assets;
- h) receiving the credit or emission of securities exceeding 50 % of the statutory fund or the total cost of fixed and current assets.

In case of publishing unreliable (false) data about himself which may affect the cost of securities or related income, the emitter shall correct such data within the space of two days.

Article 26. Activity on issue and circulation of securities

This Law specifies that the activity on issue and circulation of securities is the relevant intermediary activity conducted by banks and joint-stock companies whose statutory fund has been set up exclusively from registered stocks and other companies (hereinafter called "sellers of securities") for whom operations with securities is their main activity.

Sellers may execute the following operations on issue and circulation of securities:

- a) issue of securities;
- b) commission activity related to securities;
- c) commercial activity related to securities.

The securities issue activity implies the fulfillment, on

the instructions, on behalf and at the expense of emitter, of the duties by the seller connected with subscription for securities or their realization in another manner. In doing so, the seller, given the emitter's consent, may undertake to redeem the unrealized emitter's securities in the event of their incomplete distribution.

The commission activity is the sale-purchase of securities being effected by the securities seller on his own behalf, on the instructions and at the expense of another person.

The commission activity is also the sale-purchase of securities being effected by the securities seller on his own behalf and at his own expense.

Article 27. Permission to conduct the activity connected  
to securities

The activity concerning the issue and circulation of securities, as the exclusive activity, may be conducted given the permission provided by the Ministry of Finance of the Ukrainian SSR. The list of documents necessary for getting the said permission, as well as the scope of information to be provided by the securities seller during the term of validity of the said permission are defined by the Ministry of Finance of the Ukrainian SSR.

The permission for conducting all or certain types (excluding the commission) of activity connected with securities may be given to the sellers who have the statutory fund not less than 5 mln. roubles, while that for commission activity - at least 1 mln. roubles.

When conducting the exclusive activity on issue and circulation of securities; it is permitted to carry out certain kinds of activity related to securities circulation, in the first place, giving consultations to holders of securities.

Article 28. Conditions under which it is prohibited to  
conduct the activity related to securities  
issue and circulation

The permission for conducting any type of activity related to securities issue and circulation is not given to the securities seller who directly or indirectly possesses the property

of another seller whose cost exceeds 10 % of statutory fund, and directly - not over 5 % of statutory fund of that another seller.

The seller of securities who has the permission for the said activity shall not directly or indirectly possess the another seller's property whose cost is above 10 % of the latter's statutory fund, and indirectly - not over 5 % of the latter's statutory fund.

If the share of legal entity having no permission for activity related to securities circulation or that of a citizen in statutory fund of several securities sellers exceeds 5 % concerning each seller's part of fund, such sellers cannot carry on the trade of securities between each other.

The securities seller has no right to conduct the trade of:

- a) securities of his own issue;
- b) stocks of the emitter in whose property the seller's share (direct or indirect) is above 5 % of statutory fund.

Pursuant to this Article, direct possession of property is the possession of a part of statutory fund of any joint-stock company, while indirect possession is the possession of a part of statutory fund of such company which is a participant in another company.

#### Article 29. Agreements on securities

When charged with the sale or purchase of securities, the seller shall provide the person at whose expense he acts the information on the rate of securities.

The seller also should inform the stock exchange about all agreements on securities concluded by him in terms and orders pursuant to the stock exchange rules.

Book-keeping procedure related to purchase and sale of securities is fixed by the Ministry of Finance of the Ukrainian SSR.

#### Article 30. Liquidity requirements to security sellers

The cost of agreements concluded between securities sellers but not fulfilled by a given moment (open positions) shall not exceed the fivefold size of the seller's statutory fund.

When conducting the activity on securities issue simultaneously with commercial or commission activities, the cost of agreements concluded between the sellers but not fulfilled by a

given moment (open positions) shall not exceed the tenfold size of the seller's statutory fund.

The selling or nominal price of securities possessed by the seller engaged in the issue of securities or commission activity, as well as the value of open positions, taken together, shall not exceed the fifteenfold size of the seller's statutory fund. Computation should be based on the highest selling or nominal price.

#### Article 31. Taxation of securities income

Securities income taxation is conducted pursuant to the law of the Ukrainian SSR.

### Section II. STOCK EXCHANGE

#### Chapter 8. General provisions

#### Article 32. Concept of stock exchange

Stock exchange is legally registered permanently functioning market, at which the trade of securities is carried on.

#### Article 33. Legal status of stock exchange

Stock exchange is a joint-stock company which forms the demand for securities, promotes the formation of their exchange rate and conducts its activity pursuant to this Law, other legal acts of the UkrSSR, its own statute and regulations.

Stock exchange may be set up by not less than 20 founders-sellers of securities who have permission for conducting the commercial and commission activities related to securities provided they, altogether, deposited at least 50 mln. roubles into the exchange statutory fund.

Stock exchange turns into a legal entity from the moment of its registration by the Cabinet of Ministers of the Ukrainian SSR.

#### Article 34. Stock exchange statute and regulations

The stock exchange statute and regulations are fixed and approved by its highest management body.

The stock exchange statute specifies the following:

- a) stock exchange name and location;
- b) name and location of the founders;
- c) size of statutory fund;
- d) terms and procedure of admittance to stock exchange membership and expulsion from it;
- e) rights and duties of stock exchange members;
- f) structure of stock exchange;
- g) competence of stock exchange management bodies and their competence;
- h) terms and procedure of attendance of stock exchange;
- i) employment of sanctions fixed by stock exchange;
- j) procedure of stock exchange dissolution.

The statute may contain other provisions concerning the stock exchange establishment and work.

The stock exchange regulations concern the following:

- a) types of agreements concluded at stock exchange;
- b) procedure of trade at stock exchange;
- c) terms of securities access to stock exchange;
- d) formation of prices, their rates and publication;
- e) subscription for securities used at stock exchange;
- f) list of securities used at stock exchange;
- g) duties of stock exchange members concerning accounting and information, work of stock exchange commissions;
- h) information support of stock exchange;
- i) services rendered by stock exchange; their cost;
- j) settlements at stock exchange;
- k) other relevant provisions.

#### Article 35. Use of "stock exchange" name

The "stock exchange" name or the one containing the words "stock exchange" may be used in advertisements or its firm name only by the organization set up pursuant to Article 34 of this Law.

#### Article 36. Special terms concerning termination of stock exchange activity

The activity of stock exchange is terminated if the number of its members becomes less than 10. If this is 10, the activity

is terminated provided the new members were not admitted within the period of six months.

The stock exchange activity is terminated pursuant to the UkrSSR legislation on joint-stock and other business societies.

#### Chapter 9. Protection of proprietary rights of investors

##### Article 37. Annulment of agreement on purchase of securities or subscription for them

The person who subscribed for securities or bought them prior to publication of information on changes in business activity of the emitter affecting the securities cost or income may unilaterally annul the agreement within 15 days after publication.

In case of annulment, the emitter, if the said person demands so, shall compensate for all losses and possible damages related to subscription for securities and purchase of them.

In the event of nonfulfillment of subscription terms, the emitter shall return to subscribers, if they wish so, all the money received from them and pay penalty for the entire period of keeping the money.

The emitter shall indemnify for the damages caused by unreliable information about securities.

#### Chapter 10. State control over the issue and circulation of securities

##### Article 38. State organs exercising the control over the issue and circulation of securities

The control over the issue and circulation of securities is exercised by the Ministry of Finance of the Ukrainian SSR and local financial bodies,

The Ukrainian SSR Ministry of Finance appoints its representatives at stock exchange. They exercise the control over observance of the stock exchange statute and regulations and have the right to take part in the work of stock exchange management bodies.

##### Article 39. Sanctions employed by financial organs

The following sanctions may be used by financial bodies

given the nonobservance of provisions specified in the permissions for the issue and circulation of securities, also in the stock exchange statute and regulations:

- a) make warnings;
- b) suspend subscription for securities and their sale for one year;
- c) suspend, for a certain period of time, the conclusion of agreements on the issue and circulation of securities;
- d) cancel the permission for securities issue and circulation in case of repeated sanctions fixed in items a-c of this Article.

The UkrSSR Ministry of Finance may suspend the activity of stock exchange in case it violates the statute and demand to put it into compliance with the statute and regulations of stock exchange.

#### Article 40. Appeals against the actions of financial organs

All complaints about the actions of financial organs related to their control over the issue and circulation of securities are considered by a higher financial organ.

The decisions of financial organs may be appealed in court or arbitration.

#### Article 41. International agreements

Provided an international agreement of the Ukrainian SSR fixes the rules other than those specified in the Ukrainian SSR law on securities and stock exchange, the rules of such international agreement shall be applied.

Chairman of the Supreme Soviet  
of the Ukrainian SSR  
the city of Kiev  
June 18, 1991  
N 1204-XII

L.KRAVCHUK

R E S O L U T I O N

OF THE SUPREME SOVIET OF THE UKRAINIAN SSR

On enactment of the Law of the Ukrainian SSR  
"On securities and stock exchange"

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The Supreme Soviet of the Ukrainian Soviet Socialist  
Republic r e s o l v e s :

1. To enact the Law of the Ukrainian SSR "On securities and  
and stock exchange" from January 1, 1992.

2. To announce that from January 1, 1992 the issue of  
stocks belonging to work collectives, enterprises and organiza-  
tions is terminated. All stocks belonging to work collectives,  
organizations and enterprises emitted prior to Enactment of this  
Law may circulate for five years starting from January 1, 1992  
pursuant to the terms of their issue.

Before the end of the said period, the enterprises and orga-  
nizations which issued such stocks shall buy them or replace them  
with other securities specified by this Law.

3. The Cabinet of Ministers of the Ukrainian SSR shall:

- by October 1, 1991 fix the procedure of registration of  
securities issue and the information concerning securities, as  
well as the procedure of issue and circulation of bills;

- take all due measures for adequate issue of securities in  
the Republic;

- organize the training of specialists, both in the Republic  
and abroad, to work at stock exchange and with securities.

Chairman of the Supreme Soviet  
of the Ukrainian SSR  
the city of Kiev  
June 18, 1991  
N 1202-XII

L.KRAVCHUK

Approved

by the DECREE  
of April 29, 1994 No. 277  
Kiev

Concept for Functioning and Development of Securities  
Market in Ukraine

1. GENERAL PROVISIONS

The market of securities is a multifunctional system, which facilitates accumulation of capitals for investment into industrial and social sectors, restructuring of the economy, positive dynamics of the social structure of the society, increase of citizens' well-being by way of ownership and free disposal of securities, acceptance of market relations by the population.

In Ukraine, the securities market is at the formation stage. The Ukrainian Stock Exchange (USE) and its Central Securities Depository, the electronic (paperless) circulation system, the network of branches and broker offices all over the country, has been in existence for over two years. The number of financial intermediary parties outside the Exchange grows; as well as the number of issuing entities which registered issue of their securities at the Ministry of Finance, and the total volume of their issue.

At the same time, further development of the national securities market is restricted by a number of objective and subjective factors, in part, by the crisis conditions in the economy, by discrepancies between the existing legislative basis and the realities of social life, the inadequate state regulation of the market, psychological unpreparedness of the population for operations with securities etc.

Ukraine will be unable to overcome the economic crisis without creation of the developed securities market. To that end, a number of urgent measures are necessary to be taken, which will be aimed at accelerating the privatization processes, issuing the state securities, amending the effective legislation with respective acts, establishing the state bodies for management and supervision over functioning of the securities market.

2. Requirements of Modern International Standards

The international practice proves it that the securities market unavoidably evolves from chaotic and fragmentary stage to uniformity, centralization, and state regulation. This is characteristic for the entire system of market relations - both within one country and in international financial and economic relations.

The principal features and principles of functioning of such market are its uniformity, centralization, transparency, utilization of electronic systems of securities circulation.

The majority of countries implement these principles in accordance with recommendations of the "Group of Thirty" - an international organization of independent experts, which develops standards for financial markets.

The model for the securities market organization, according to the "Group of Thirty" recommendations, envisages the following

- broad-scale utilization of standard codes (ISIN codes) for sales and deliveries of securities;
- strict compliance with the listing requirements (admission of securities for quotation);
- openness of information about companies whose securities

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are quoted at the stock exchange; these companies are obligated to provide such information;

- determining and publication of data on the securities rates, abiding by the principle of parity of investors;
- preventing emergence of unorganized parallel markets undermining liquidity of the centralized market;
- reliability of the stock exchange market, through timely and safe delivery of securities, and monetary payments for them, via the system which is active at the moment that the agreement is concluded.

With the view of undisputable advantages of the centralized market and the possibilities it provides to national banks for entering the international financial system, it is this system that East European and Baltic countries, China and Vietnam selected.

### 3. The Basis for the Securities Market Formation in Ukraine

Ukraine has a unique opportunity to avoid the trial-and-error way which other countries had to cover in their development, and to start building its securities market immediately, by the best European and international models. For this, the organizational, material, technical and practical prerequisites have been created in the country.

The Ukrainian Stock Exchange - a joint-stock company which, together with its affiliates and broker offices assists legal entities and private individuals in realizing their rights to buy and sell securities throughout the country, is operational. The USE gradually reorganizes its structure and the basis for activities, passing from the principle of a joint-stock partnership to that of a free association. In future, this will allow any company, enterprise, securities trader, which/who satisfy certain requirements, to become member of the Exchange.

Under the Exchange, the Central Securities Depository was created, and an electronic circulation system, in the form of computerized account entries, was introduced. This provides for their functioning as the national securities quotation and circulation system; allows to render assistance to the state enterprises undergoing incorporation and privatization. On the privatization stage, large state-owned enterprises undergoing incorporation (part of their property remaining in the state ownership), make the initial placement of their stock through the USE.

The principal elements of the centralized securities circulation system will be

the USE as the single place for quotation (determining the raters) of securities, accepted for circulation and quotation at the exchange;

- the single Central Securities Depository under the USE, which ensures circulation of securities in the form of computerized account entries, and operates in the framework of the uniform software of the "Exchange - Depository - Clearing Bank" system;
- the single clearing bank, which is created on the basis of the "Ukraine" Joint-Stock Bank in order to ensure

settlements by agreements concluded for purchase and sale of securities, payment of dividends etc.;

- broker offices (brokers), broker banks, which are registered with the USE and are partners in the Central Depository and the Clearing Bank;

- bank, investment funds and companies, trust partnerships, other traders in securities which are not the USE brokers, but which became partners in the Central Depository and the Clearing Bank;

- issuing entities, the securities of which are accepted for circulation and quotation at the USE, and which are partners in the Central Depository.

The supreme Exchange Committee, which exercises control over, and regulates the activities of, all the elements of the centralized securities circulation, determines the procedures and rules for operations with securities, and agreements in connection with such papers.

Formation in Ukraine of the centralized stock market will bring about a significant economic effect and, at the same time, will inhibit development of negative processes in the economic, political, and social spheres. The centralized stock market is the lever by which economic, as well as political and social relations are regulated. As regards macroeconomics, it allows the state authorities to receive the current data about the general market balance, and to directly control its status, and prevent emergence of crisis situations. Stability of the market enhances trust on part of the population toward securities, facilitates attraction of foreign investments; the existence of the single quotation center creates conditions for the healthy competition between traders, and preserves guarantees for investors and issuing entities.

#### 4. Securities and Operations with Them at the Stock Exchange

Only those securities shall be admitted for purchase-and-sale operations at the stock exchange and the market outside, which are determined by the effective legislation.

Securities quoted at the Ukrainian Stock Exchange, are divided into three groups.

The first group encompasses securities issued by entities with a high economic potential, highly efficient and financially stable companies. The issuing entity is responsible for the economic and legal information it provides.

The second group encompasses securities issued by entities the economic potential of which is estimated as sufficient for admitting them to official quotation. In that case the issuing entity may provide the minimal information, which needs to be provided for the stock market.

The second group is composed of securities which were not admitted, or their issuing entities did not request any official quotation. In this case, the USE is not responsible for verity of information about such securities.

This system of quotation allows to ensure a certain safety level for investors, transparency of the securities market; to effectively compare demand and offer, to maintain clearing processes.

Physical securities (papers), both inscribed and drawn for bearer, as well as securities in the de-materialized form, drawn for bearer, are accepted for quotation at the USE and for storage and accounting at the Central Depository. The materialized form of the securities circulation will be preserved for the transitory period.

The electronic system of securities circulation has a

number of significant advantages the full safety of their storage, reduction of the period for settlement, the possibility for introduction of standard accounting routine. It allows, without incurring extra material expenditures, to conduct any operations with securities new issues, increase of the stock nominal value, combinations of securities at merger of joint-stock partnerships, their assimilation etc. The principal features of the system are reliability, low cost, rapidity of issuing and circulation of the securities.

The for-bearer form of securities simplifies their accounting, and the procedure for concluding agreements. At any moment the issuing entity, which chose that form, may receive from the Central Depository the complete list of holders of its securities. At the same time, inscribed stock is quoted, as is stipulated by the applicable law. Quotation of securities at the USE is conducted by way of fixing their rate is determined by comparison of demand and offer at a certain moment, and remains unchanged in the period between the tenders. In the future, continuous quotation of the most active securities may be introduced.

Agreements are concluded according to the principle "delivery against payment", which ensures interaction of the USE, the Central Depository, and the Clearing Bank. This principle ensures the highest safety level, as it excludes situations when one of the parties to the agreement may retain both the securities, and the funds paid for them. Constant control over accounting balances (the sum of securities issued equals the sum of securities in the registers; the sum of securities in each of the registers at the Central Depository equals the sum of securities at clients' accounts) allows to exclude "double accounting".

The electronic system of securities circulation allows to follow each stage of movement of securities and funds, for each agreement, - from bank orders and agreements between market brokers, to standardized settlements. All tenders are held on the date of tender - T, and agreements are completed within the T+4 temporal limits. In the future, transition to the T+4 temporal limits will be made, which corresponds to the recommendations by the "Group of Thirty".

In the course of the state privatization program, the USE will give preference for admission for tenders, acceptance for accounting, storage, and for operations in the de-materialized form at the Central Depository, to the privatization papers (certificates), stock and bonds of corporate enterprises for assessing the real value of property to be privatized.

The intermediary between the issuing entity and the investor at the stock exchange market is a broker. The broker acts as a contractor who/which ensures equality of all clients, and equal conditions for them. The broker is fully responsible for correct and timely fulfillment of clients' orders

##### 5. Securities Market Outside the Exchange

Alongside the centralized stock exchange market, the outside securities market functions in Ukraine. Its infrastructure is composed of investment funds, investment companies, trust partnerships, holding companies, insurance companies, other legal entities which, in accordance with the Law of Ukraine "On Securities and the Stock Exchange" may conduct intermediary, commission and commercial operations with securities; and also auditing and consulting organizations. Independent financial intermediaries may form associations and other unions in order to coordinate their work, conduct joint activities, protect their interests etc.

The securities market outside the exchange is not an alternative to the stock exchange market, but complements and expands it, both at the secondary and, what is especially important, at the primary level. The primary placement of various companies' securities may be effected by way of pre-payment, open sales or auctions.

After the USE passes on to the principle of free association, any financial intermediary will be able to become a member of the stock exchange, and by doing so to expand the sphere of its activities, and have the possibility to access the electronic securities circulation system.

Dealers in securities, if they wish, may be partners in the Central Securities Depository under the Ukrainian Stock Exchange. Membership in the Depository will help them regulate all agreements outside the stock exchange at primary placement of their securities, at operations with the papers of open investment funds, re-delivery between depositors etc., and also will provide for settlements of the "delivery against payment" type.

The securities market is based on mutual trust and respect of all its participants, on uniform rules of professional and ethical behaviour, uniform terminology.

#### 6. Principles for Realization of the National Stock Market Functions.

All subjects at the Ukrainian stock market advertise securities as one of the effective and dependable ways for investment, and increase of incomes. Necessary financing is provided for respective information, advertising, educational and training activities.

The securities market performs important social and economic functions. Accumulation of monetary units currently in circulation (with utilization of the stock market potentials) facilitates stabilization of the budget, and financial status of the state as a whole, creates conditions for penetration of Ukrainian enterprises' securities into the international stock market, and attraction of foreign investments to the Ukrainian economy.

Organization of the Ukrainian stock market by the centralized model, application of the European-standard software, will allow to adapt, in a fast and natural manner, the Ukrainian market to international requirements, to create conditions for foreign investors, which would be similar to those existing in the West; it will help the domestic entrepreneurs to enter the international financial world.

For quotation of foreign securities on the Ukrainian market, the USE utilizes the admission system (listing) for those securities, which meets the international standards, with account to applicable laws and the state of the national market.

The single system, which includes the national Stock Exchange, the Depository, and the Clearing Bank and the network of the USE local branches, is intended to create conditions for development of various financial structures, including investment funds, investment companies, trust partnerships, holding companies, insurance companies, consulting firms, auditing organizations, independent brokers offices.

#### 7. Information Hardware Support for the Stock Market

The securities electronic circulation in Ukraine is based on hardware and software functioning at the USE and the Central Depository. The Stock Exchange utilizes the highly efficient computerized system of the IBM AS/400 class which

provides for quotation of more than 1500 bonds and shares of stock, performing 15000 operations daily.

The system software, elaborated by the Association of French Stock Exchanges, is adapted for the specific conditions. The programs envisage selling securities under certain identification codes. One machine module works during the period when the fixing mode is maintained at the Exchange.

The same computerized system is used to support the work of the Central Securities Depository. The single computer network provides for constant supervision of the market and the accounts at the Depository, allowing brokers to effectively transfer their orders to the market.

In the future, it is planned to connect all branches, brokers offices of the USE, and members of the Central Depository, by the single computerized information network, which will encompass the entire territory of Ukraine. For this, the up-to-date means of communication and data processing, including satellite communication, will be utilized.