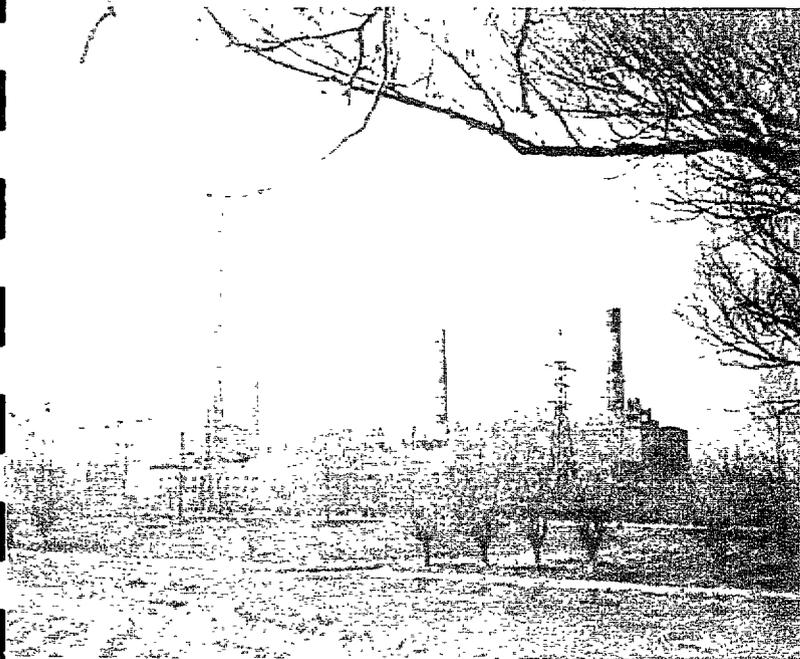
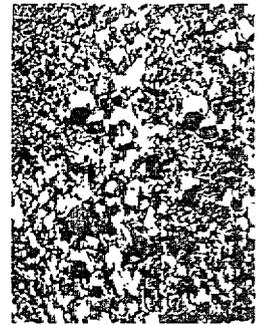


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UKRAINE

**Power Sector Regulatory Reform and Restructuring
Ukraine Local Electricity Companies (LEC's)
Energy Efficiency & Market Reform Project 110-0002
Kiev, Ukraine Tel/Fax: 380 44 244 38 20
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Draft**

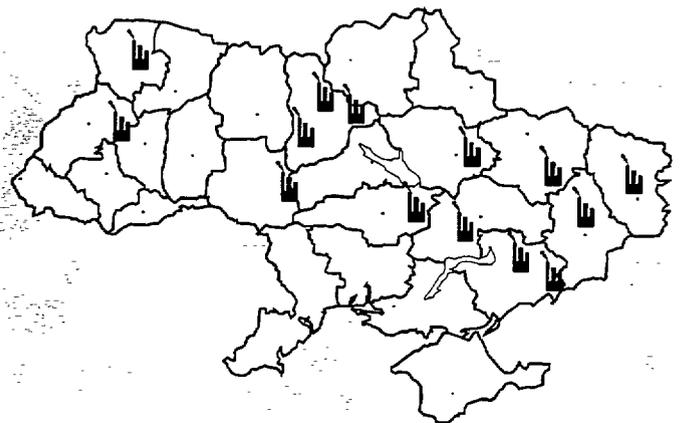


**CORPORATIZATION
GUIDELINES
AND ANALYSIS**

Prepared by:



Price Waterhouse LLP
May 6, 1996



PNACH-480

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May 7, 1996

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 twenty seven local electric companies (referred to hereafter as LECs or Oblenergos). Price Waterhouse LLP (PW) is currently providing consulting assistance to twelve of these newly formed corporations in the regions of Kiev, Vinnistia and Zaparozhia. The purpose of this manual is to assist officials of the Ministry of Energy, currently the 100 % shareholder, and the newly appointed boards of these enterprises, in the critical first steps of their creation. Together these companies account for approximately 46 % of the country's distribution 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 Ukraine Local Electricity Companies (LECs) Energy Efficiency & Market Reform Project 110-0002.

This document entitled "Corporatization Guidelines and Analysis" summarizes our work to date. It is based on a previous manual issued in October 1995 for the four Ukrainian fossil fuel generating companies, under a similar contract for "Power Sector Regulatory Reform and Restructuring Task - Institutional Development Activity : Ref CCN-0002-Q-00-3152-00, Delivery Order No. 4". Our recommendations and research have been shared with the senior officials of the twelve companies on an ongoing basis since April 1995. On August 10, 1995 a government order transformed all the Oblenergos into State Owned Enterprises (giving them minimum independent legal existence, short of becoming a Joint Stock Company). By April 1996, at the date of writing this manual, the status of development in the incorporation process of the companies varied from one region to another. Some had completed their privatization plan and were fully formed Joint Stock Companies with issued shares, ready for sale to their employees. Others had not yet registered their company charter and are still SOEs. This manual is aimed at giving the new directors and the representatives of the Shareholder, information on sound corporate governance practices so that they can positively influence the creation and definition of new corporate institutions within the boundaries authorized by current Ukrainian corporate law. The experience gained throughout 1995 assisting Centrengo, one of the four fossil fuel generating company, in registering a progressive company charter has proven particularly useful in advising the LECs at a similar stage of their corporate development. The text of this manual,

where it changes from the earlier version, draws heavily on this experience.

2. Summary of content : Corporatization Analysis

The underlying principle behind our recommendations stems from a recognition that Ukrainian Company law, judicial institutions and law enforcement are not sufficient to adequately protect shareholders investment. The only way to boost shareholder confidence and attract investment is to adopt a company charter that compensates for the legal vacuum under which corporations operate in Ukraine. Some of the provisions we recommend would never be considered acceptable in the Western world. This is because in those countries, shareholders can rely on a very sophisticated underlying legal context to protect their rights. A liquid capital market guarantees their ultimate and fundamental right to exit their investment as a last resort. Ukrainian companies that hope to attract outside investment must recognize that they have to make extra concessions to reduce the risk shareholders face in the current environment.

Our analysis covers various aspects of corporate governance. The largest section focuses on 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 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. Ukraine's energy policy should however be conducted exclusively at the Government executive level, not by interfering in the management of the Joint Stock Companies with aims that are not strictly commercial¹. Any deviation from that principle jeopardizes the integrity of good corporate governance.

Much attention has been devoted to the organization and composition of the future Supervisory Councils. Current Supervisory Councils do not operate in an optimal way and are not organized to cover the traditional functions attributed to outside directors. 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

¹An example may be the temptation of Governmental authorities (both National and Local) to intervene in the cut-off policies of an Oblenergo towards non-paying customers.

individual Supervisory Council and Executive Board members.

The importance of internal and outside 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 local governments, 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 LECs on the creation of an integrated financial management system and the conversion of their accounting system to international accounting standards. 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 Oblenergos can contemplate issuing shares abroad.

3. Recommendations : Corporatization Guidelines

Our principal recommendations center on adopting 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 LECs adopt eventually is based on the document prepared in July 1995 for the fossil fuel generating company Centrenergo. It 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 Ukrrih Flot, the first large SOE whose shares were 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 was then approved by 11 out of 12 signatories at the Ministry of Energy. Unfortunately, we were not able to persuade this last person to change their mind and Centrenergo had to adopt the more conventional SPF model document. Director Siaber is nevertheless confident that he will eventually get his charter approved, especially if an outside investor can pressure the Ministry into action. If other Company Directors in the industry follow Director Siaber's example, this time may come very soon.

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, normally, 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 (Article 8.2.3.1., Annex A). 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., Annex A 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, Annex A. 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 Annex A).

The decision to declare and distribute dividends should belong to the Supervisory Council (Article 7.1., Annex A.), 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. Article 5.3.1. Annex A., 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., Annex A). 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 Annex A). 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., Annex A). 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. Annex A). 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 Annex A) 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., Annex A). 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., Annex A). 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 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 Centrenergy felt was necessary. (This provision remains in Article 8.2.3.1. of Annex A.). 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., Annex A) concerning the company. The proposed Charter in Annex A 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

The senior Management of Centrenergy is the only Fossil Generating Company to have endorsed most of our recommendations to date. Unfortunately, its Shareholder, Minenergo has so far decided to ignore them. 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. They are the ones who will have to manage the companies according to new commercial principles. They

remain, for the foreseeable future, the representatives of the State and sole owners of these entities. As such, their blessing to the introduction of Western style corporate governance principles, is essential. The Charter for Centrenergo was in the end rejected by the shareholder it was designed to protect, mainly because it looked too unfamiliar. A more sinister interpretation is that the State shareholder representative who opposed the document understood that protecting minority shareholders would limit the rights of the State as a majority shareholders and was not prepared to allow such a loss of control. Such reasoning, of course goes against all the principles of reform which Minenergo is introducing, and we have to hope it was not a conscious decision.

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 cannot be usefully performed without endorsement of change by the owners representatives.

As for the Oblenergos 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. Some LECs are already Joint-Stock companies, others are still State Owned Enterprises. But, as long as the State remains the sole shareholder, amending the existing charters will be a formality and should be actively encouraged. 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 less likely to occur as vested interests will by then be quite 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 realize 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 LECs are potentially very interesting commercial ventures and if the UK experience is anything to go by 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. This is particularly true given the poor protection afforded by corporate law and judicial enforcement.

Ukraine's mass privatization program will probably lead to a significant dilution of ownership rights and the creation of many small investors, since a portion of the Oblenergo shares will probably be auctioned for vouchers to the general public. Individually, small shareholders 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 additional investors, it will be all the more important for the LEC'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.

The electric distribution 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 level of the country's electricity sector.

I. LEC CORPORATIZATION PROCESS

1. Legal Environment

(i) Background

On August 10, 1995, the corporatization of twenty seven Oblenergos was ordered, following the dismantlement on July 1, 1995 of the formerly vertically integrated eight regional electric companies. In practice all LECs were initially legally incorporated into State Owned Enterprises (SOEs), giving them each for the first time individual legal personality. Some have now become State Joint-Stock Companies, others remain SOEs. The more advanced LECs have had their privatization plans approved by the Ministry and are about to issue shares to their employees.

The creation of the LECs 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 regional Energos have been dissolved and their assets and liabilities allocated amongst new commercial companies.

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 serves as a first step in shifting decision making powers from the centralized ministry to independent corporations.

A State Joint Stock Company is a hybrid Joint Stock Companies in which the State owns 75 % or more of the shares of the LECs. In practice, and for the foreseeable future, the State still 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 LECs : (i) Individual assets are grouped together to form an SOE (done for all 27 LECs on August 10, 1995 by Decree). (ii) The SOE is transformed into a State Joint Stock Company. (iii) - optional - The State Joint Stock Company becomes a Private, Open 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. It can equally apply to step (iii), when the shareholders may choose to amend the existing charter at their first annual meeting. The analysis does not focus on the initial charter governing SOEs because it differs so much from usual corporate governance standards and is only intended to

cover the transition phase prior to full corporatization.

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 Bank² 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 Dniiproenergo one of the two hydro-electric generating companies formed in parallel with the four fossil fuel generating companies. A copy of the Charter adopted by Ternopiloblenergo is also included and offers an interesting comparison. All article numbers represented hereafter under this heading correspond to the Dniiproenergo Charter.

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.

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,

² "Corporate Law from Scratch", by Bernard Black, Reinier Kraakman and Jonathan Hay - World Bank conference December 15, 1994

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. In some known instances, this right has already been abused in Ukraine by incumbent managers to dilute outside minority shareholders against their wish. These cautionary tales illustrate the delicate balance which must be found between giving managers enough leeway to conduct their business efficiently and keeping enough controls in the hands of the shareholders to prevent rogue behavior discrediting the entire corporate governance process. The proposed draft charter in Annex A addresses this issue by giving the Executive Board the discretion to issue new shares within the 1/3 rule, but by giving at the same time existing shareholders the automatic right to purchase additional shares at the issue price, in order to prevent any dilution of ownership. See Article 4.2.9 of Annex A and footnote 1 on ex-post participation rights and Article 5.3. of Annex A and footnotes 2, 3 and 4 on issuing new shares. Another article 8.2.5 on Redemption Rights (and footnote 9) gives dissenting shareholders the right to require the company to purchase back their shares at a fair market value if they voted against a decision deemed to "alter the nature of their investment" (further defined in article 8.2.4 and footnote 8).

The SPF document is also deficient in other 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 efficiencies of these large corporations may be undermined by unscrupulous managers. Price Waterhouse strongly recommends to the LEC General Directors that they not follow the SPF model and propose an alternative document modeled in Annex A that would be credible for future private investors.

2. Role of the Executive Board and the Supervisory Council

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 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. Its official role is to monitor the activities of the Executive Board. The first Supervisory Council members are appointed jointly by Minenergo, the Ministry of Economy, the Ministry of Finance and the State Property Fund. Two Oblenergos each had only 5 Supervisory Council members. The Executive Directors indicated that 3 were candidates they had proposed. One LEC had the following mix of Council Members : the Chairman was a representative of Minenergo; one council member was a representative of the SPF, a third came from the town's branch of Prominvest Bank, the Oblenergo's bank; a fourth was an Oblase Council member and the fifth was the Chairman of the Labor Committee of the enterprise. This mix appears to be typical of current practices in the Ukraine electricity sector. These individuals are referred to hereafter as the Council Members. 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 is 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, Khmelnitsky Oblenergo indicated that once they were a fully formed Joint-Stock Company that did not 100 % belong to the Ministry, they wished to do without a Supervisory Council. A similar desire was voiced by the senior executive directors of Dniproenergo Generating Company. 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

In principle, the interests of directors and shareholders are identical. They all want to see the enterprise prosper. This is also true of other stakeholders, such as neighboring communities that depend on the company for employment and stimulation of the local economy, actual employees of the company, customers and suppliers. In practice, there are many instances where the interests of the stakeholders are not perfectly aligned and conflicting goals may create tensions. The goal of corporate governance is to define all these interacting relationships precisely and to spell out clear rules of behavior aimed at always maximizing the value of the enterprise to its investors and therefore at reducing the cost of its capital.

No system of corporate governance in the world is perfect, nor is there a single model to follow. 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, and 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 in Annex A for the LECs is but one example, designed specifically in the context of Ukrainian transition to a market economy and for enterprises that can expect to attract the interest of foreign investors in the near term.

There are, however, two universal criteria which must be met for all corporations 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 always be taken at the lowest possible level of

hierarchy.

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 usually powerful CEO. While Germany and Japan prefer a collegiate two tier management system which favors a more informal and private system of decision making. Annex C contains a selection of recent articles published on Governance in Germany which suggest a shift towards the Anglo-Saxon model (for Daimler and Veba).

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 in Annex A 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 smaller 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 a cost effective way.

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. None of this applies of course as long as the state is the only shareholder.

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. See Annex C to observe how sensitive management is to shareholder approval.

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 instance³. With such strict reporting requirements, the financial results of company operations are much more transparent. The cost of monitoring management is therefore less prohibitive for small investors and they 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 LEC'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

³ See however the articles on Daimler Benz and how even for German companies, increased transparency and financial disclosure is becoming more important.

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 essential, 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 obvious solution.

Historically, many public utilities have tended to be owned by the State in most of the world. This logic has only 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 independently competing and privately owned electric enterprises. Initially, the State will be the only shareholder of the LECs, 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 LEC 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 to 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 LECs. The greatest pressure will come from politicians wishing to prevent LECs from shutting off strategic but non paying customers. These include municipal service organizations such as schools, hospitals, local transport services, etc. Other typical candidates are state owned entities such as military bases. Local enterprises who employ a significant percentage of the workforce are also difficult to shut down without serious social and political ramifications. Liberalizing prices will probably lead to an increase in the price of retail electricity which 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 LECs. 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 LECs, minimize social unrest and reduce electricity 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 efficient allocation of resources in the economy. In the long run, 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 run to manage the transition of the economy as smoothly as possible and provide social safety nets to its more vulnerable constituents. PWG 19⁴ describes in detail how for instance non-paying and non-privileged customers should be dealt with. How else 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 should have a number of rights with which they can exercise control over LEC management. Any proposed Corporate Charter must 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 Annex A. 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 (but this is not a guarantee

⁴See Annex E.

for common shares).

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, 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. But Annex A does provide for Directors to be responsible for more than gross negligence.

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 to the goal of the company, 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 or in other words an inside or an outside 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 words

"President" or "General Director" are used interchangeably to refer to the person appointed as head of the Executive Board. The word "Chairman" seems to be used to refer to the head of the Supervisory Council.

(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 lead 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 LECs 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 raising additional capital 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 LEC's 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 LECs, 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 LECs 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 and regulatory 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

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.

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 shareholders⁵. 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

⁵ See for instance Article 8.3.4.4. of the Annex A on pre-approval of any "self-interested" transactions.

charter as it appears in Annex A, highlights these self-enforcement provisions and bright line rules (relevant paragraphs appear in italics).

(vii) Selection Criteria and Terms of Office

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 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 Council, 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. Such provisions can be elaborated in a separate contractual agreement between the Executive Director and the Company, represented by the Supervisory Council's standing committee on compensation (see viii b below).

(viii) Role of Standing Committees

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 (ie Council Members in Ukraine) to specialize and 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 LEC 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 choose 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 a simple procedure by which they can propose alternative candidates to be included in 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 full 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 LECs, 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. This will probably very soon also be a requirement for listing on the Kiev Stock Exchange or the Moscow Stock Exchange. 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 LEC's currently envisages that they must conduct their business operations in accordance with international accounting standards 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 wholesale electricity market reforms and prevent LECs from abusing their monopoly position in setting retail tariff levels.

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 as 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 has introduced regulations, as several other countries of the Former Soviet Union (FSU) have done, requiring large companies to contract the shareholder registry function to an outside independent organization. This does not mean that the Company should not maintain a parallel set of records, in order to ensure accuracy of both data bases.

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 generating companies, the general public and the government (local and national). 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 LECs should be further researched.

IV. LEGAL & FINANCIAL REPORTING REQUIREMENTS

1. Financial Reporting

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), defined in the electricity distribution and supply license and gradually phased in. These are likely to include the adoption of some international accounting standards and some specific disclosure requirements for the Market Funds Administrator. Finally, "Managerial Accounting" will be the internal records and analysis developed to give management and 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 is recommending, 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. Regulatory reporting requirements are influenced by the longer term interest that consumers be 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 international accounting standards. 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 LECs establish their retail tariffs based on 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 international accounting standards should be adopted. Price Waterhouse is preparing 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 does not need to be minimized. Prudent management practice requires statements to remain conservative, but closer to reality.

2. Disclosure Requirements for Issue of Shares

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 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 corporatization⁶ (LECs appear to be at different stages in this process at the date of writing this manual). 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 proportional 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.

⁶ 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.

(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 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 list appears in Annex G.

(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 requires much more extensive research.

ANNEX A

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

_____, 1996

CHARTER
of the open joint stock company
Oblenergo Company

1. General Provisions

1.1. The open joint stock company Oblenergo Company, hereinafter referred to as the "Company" is founded in accordance with the executive order from the Ministry of Energy of Ukraine dated ----- No xx, by means of restructuring corporatization of the state-owned enterprise Oblenergo.

1.2. The Company is composed of its separate subdivisions, namely: -----

1.3. The Company registered name is as follows:

The open joint stock company - Oblenergo Company, briefly, OCo.

1.4. The address of the initial registered office of the Company is -----

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 "OBLENERGO".
- 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;

4.2.9¹ *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 0,000,000 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 Board². 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.³

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.⁴*

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.⁵*

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:*
 - 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.*⁷ 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 canceled 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 canceled 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.⁸*

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:⁹
- 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.

8.2.9.¹⁰ *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:

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.

8.3.2.5¹¹ *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.

8.3.2.7¹² 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.¹³
- 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.
- 8.3.4.6¹⁴ *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.).*
- 8.3.5.5¹⁵ *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. ABC.
- 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 ½ 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.
- 8.4.10¹⁶ *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.

ABC
President of OJSC "Oblenergo" Company

Annotations to the Charter :

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 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. Cumulative 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 Number 2

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

ANNEX B

PROPOSED CHARTER OF "DNIPROGIDROENERGO"

1. General Provisions

- 1.1 The open joint stock company "DNiPROGiDROENERGO"/llereinafter- 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 "Dniprohidroenergo"

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 "Dniprohidroenergo". 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"¹¹.

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 too be consulted, the process took too long to organize. Unfortunately, the Law on Business association does state: "*approval of contracts made fr 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 werę 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.

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."

REGISTERED BY:

Ternopil City Rada

Registration No.: 00130725

August 10, 1995

Executive Order 282 as of August 10, 1995

APPROVED BY:

Z. Y. Butsyo

Deputy Minister of Energy

CHARTER
of a State Joint Stock Energy Supply Company
TERNOPILBLENERGO

Ternopil

1995

1. General Provisions

- 1.1. The State Joint Stock Energy Supply Company TERNOPILOBLENERGO, hereinafter referred to as the "Company" is founded in accordance with the executive order from the Ministry of Energy of Ukraine dated July 28, 1995 No 134, by means of reorganization of Ternopil Oblast Electricity Network into the state joint stock energy supply company.
- 1.2. The Company full registered name is as follows:

The State Joint Stock Energy Supply Company TERNOPILOBLENERGO, briefly, SJSC TERNOPILOBLENERGO.
- 1.3. The address of the initial registered office of the Company is 2 Energetychna St. 282010 Ternopil Ukraine.

2. Goal and Subject of the Company's Activity

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

-to conduct business and provide services to meet the needs of the economy of Ternopil Oblast and Ukraine as well as their residents and other customers for electricity under the Energomarket conditions in conformity with the licenses;
-to meet economic and social needs of the Company's Shareholders and workers.
- 2.2. The subject of the Company's activity is :
- generation of energy in conformity with the license;
- obtaining energy and providing supplies to the customers;
- conducting commercial and mediatory operations, as specified by the license;
- 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 executes its activity in conformity with the effective legislation of Ukraine and this Charter.
- 3.3. The Company is the legal successor of the Ternopil Oblast Electricity Network.

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 shareholders may include 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. The Shareholders have the right :
- to participate and vote in person or by proxy in the General Meeting of Shareholders;
 - to elect by cumulative vote and be elected to the Company's bodies as specified in Article 8 of this Charter;
 - to participate in the Company's profit distribution;
 - to obtain information about the Company's activity. At the request of its Shareholders, the Company must submit copies of its annual balance sheets, 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. The Chairman of the Executive Board of the Company shall bear personal responsibility for providing the information to the Shareholders and the authenticity of this information.
 - to freely dispose of their shares.
- Shareholders may also have other rights stipulated by the effective legislation.
- 4.3. All Shareholders of the Company must be inscribed in the Company's Share Registry jointly kept by the Company with the Center for Securities Circulation and Accounting of the Ministry of Energy of Ukraine.

- 4.4. The Shareholders have the obligation :
- to adhere to the founding documents of the Company; to execute the decisions of the Company's General Meeting and its other management bodies;
 - not to disclose the commercial secrets and confidential information about the Company's activity;
 - to fulfil other obligations envisaged by the effective legislation.
- 4.5. 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 1,527,204 million KBV. It is the initial authorized capital of the Company.
- 5.2. The Statutory fund is divided into 1,527,204 million common shares, each at the nominal value of 1,000,000 KBV.
- 5.3. The Company has a right to increase or decrease the amount of the authorized capital. The Company's General Meeting of Shareholders may decide with a 75 % majority of voting shares to increase or decrease the amount of authorized capital. The Executive Board may decide to issue new shares in an amount not in excess of 1/3 of the Statutory Fund.
- 5.4. After the Company's outstanding shares are paid up in full, the Company can increase the amount of its authorized capital:
 - by issuing new shares;
 - by increasing the par value of the shares.
- 5.5. The Company can decrease the amount of its authorized capital:
 - by reducing the par value of the shares;
 - by buying out a portion of the shares from the Shareholders with the purpose of the annulment of these shares.

However, the authorized capital cannot be decreased in case of any objection from the Company's creditors.

- 5.6. The decision on the increase/decrease of the statutory fund shall go into effect from the date of their inscription to the State Register.

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.
- 6.2. 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, or to alienate them in favor of other legal entities or physical persons, unless otherwise determined by the acting legislation.

7. Procedure for profit distribution and cost recovery

- 7.1. The Company's income shall be composed of the revenues drawn from its activities less the

material and other related costs and labor costs. The interest on bank loans and debentures as well as the taxes and payments to the state budget envisaged by the effective legislation shall be paid from the Company's balance profit. The net profit of the Company shall remain at the Company's disposal in full. Dividends and other gains from profit on the share of state property shall be used by the Company for the purposes of technical reconstruction, production development, new technologies and replenishment of working assets on the agreement with the Ministry of Energy.

- 7.2 The procedures for sharing the Company's net profit and cost recovery shall be determined by the highest decision making body of the Company in conformity with this Charter and pursuant to the effective legislation of Ukraine.
- 7.3 The Company creates the following funds:
- reserve (insurance) fund;
 - dividend fund;
 - production development fund.
- 7.3.1 The Company's reserve fund shall be created in the amount of at least 25% of the Authorized fund. The reserve fund shall be used for recovery of the expenses related to damage or loss and extra-budgetary expenses. The decision on using the fund can be made by resolution of the highest decision making body of the Company. The reserve fund will be generated by annual deduction of at least 5% of annual net profit of the Company until completion. The fund shall be placed on a separate account with the Company's bank.
- 7.3.2 The dividend fund shall be generated from the net profit of the Company. The budgetary amount of the fund and the amount of deductions per year is determined by the Executive Board and approved by the highest decision making body of the Company. The dividend shall be paid to the Shareholders on the pro rata basis depending on the amount of their stock of Company's shares.
- 7.3.3 The production development fund shall be generated from the net profit of the Company by annual deductions totalling at least 30% of the net profit.

The Company shall make deductions to the industry's centralized funds of the Ministry of Energy of Ukraine, including:

- reserve and investment fund - in the amount of 1.5% of cost of the Company's goods, works and services at the expense of the income remaining after taxes;
- innovation fund in the amount - of 0.7% of actual sales turnover at the expense of the cost of its goods, works and services;
- centralized currency fund - in the amount of 5% of currency revenues remaining after mandatory sale of currency to the state and taxes;
- industry's labor protection fund - in the amount of 0.3% of the actual sales turnover at the expense of the cost of its goods, works and services.

- 7.3.4 The highest decision making body of the Company may decide by resolution whether to create any other funds of the Company.

8. Administrative Bodies of the Company

- 8.1. The institutions of the Company are :
- 8.1.1 the highest decision making body of the Company;
 - 8.1.2 the Supervisory Council;
 - 8.1.3 the Executive Board;
 - 8.1.4 the Revision Commission
- 8.2 The highest decision making body of the Company:
- 8.2.1 The Company's General Meeting of Shareholders shall be the highest decision making body of the Company. Until other shareholders obtain share ownership through the privatization process, the Founder shall be the single share holder and be the highest decision making body of the Company.
 - 8.2.2 The Founder represented by the Ministry of Energy of Ukraine, in the name of the body, is authorized to run the Company by taking decisions on the matters within its competency. The Founder appoints its representatives to the Company's institutions and gives them the relevant powers.
 - 8.2.3 The legal status of the General Meeting and its decisions, order and terms of its convention, shall be determined according to acting legislation and the following provisions :
 - 8.2.4 The Meetings of Shareholders shall have the following powers:
 - to determine the Company's scope of activity, to approve the Company's plans and implementation reports;
 - to determine the Company's organizational structure;
 - to approve and amend the Company's Charter;
 - to elect and recall each member of the Supervisory Board (except the First Supervisory Board);
 - to elect and recall each member of the Executive Board (except the First Executive Board);
 - to appoint the Chairman of the Executive Board (except the First Chairman);
 - to elect and recall the Revision Commission (except the First Revision Commission);
 - to approve the Company's and its subsidiaries, affiliates and representative offices' annual financial statements and reports, as well as the reports from the Revision Commission and the procedure for profit sharing;
 - to determine the cost recovery procedure;
 - to create, reorganize and liquidate the Company's subsidiaries, affiliates and representative offices and other entities and approve their Statutes and Bylaws;
 - to take decisions on property accountability of the officials and other members of the Company;
 - to approve internal documentation of the Company, including company procedures, rules, regulations, etc.
 - to pre-approve self-interest transactions;
 - to determine the remuneration and duties of the key officers of the Company and its subsidiaries, affiliates and representative offices;
 - to make decisions on the Company's termination, to appoint the liquidation commission and approve the liquidation balance.

The highest decision making body of the Company can also discuss all other issues related to the Company's activity.

8.2.5 The General Meeting of Shareholders shall be held in Ukraine and convened no less than annually. Special Meetings are convened in the event of insolvency of the Company, or on the demand of the Shareholders that make on aggregate over 20% of the total Company's shares, and on the demand of the Supervisory Council at any time and for any reason. The notifications on the date and agenda of the Meetings shall be the responsibility of the Executive Board.

8.2.6 Notification of Shareholders .

The 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 .

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. In case the Meeting is not called by the Company's management, but the shareholders that make on aggregate over 20% of the Company's shares, 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.

8.2.7 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.

8.2.8 Proxy Rules

- a. 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.
- b. 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.
- c. 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.
- d. Proxies are valid only for one Meeting and cannot be irrevocable; voting trusts and any other means of ceding voting rights, are prohibited.
- e. 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.
- f. Appointed representatives must exercise their voting rights in the manner specified on the proxy. Voting rights will be exercised by proxy through the open vote procedure.
- g. 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 8.2.6 above.

- h. 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.
- i. The right of any participant of the Meeting to vote by proxy shall be limited to 1 % of the total number of Shareholders. It is recommended that the signatures on proxies should be certified either by the signatory's office or by local authority.

8.2.9 Voting: All decisions in the Shareholders Meeting shall be adopted by 3/4 of present votes, on the matters including:

- (i) the amendment of the Company's Charter;
- (ii) liquidation of the Company;
- (iii) creation of the Company's subsidiaries, affiliates and representative offices, or their liquidation.

All other 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 Board. All votes will be kept confidential, with the exception of voting by proxy.

8.3. The Supervisory Council

8.3.1. The Supervisory Council is the body that protects the interests of the Shareholders and the State by exercising the control over the Company's activity. On gaining ownership of the Company's shares by other shareholders through purchasing of at least 60% of its corporate stock, the first General Meeting may elect the new Supervisory Council and determine its competence.

8.3.2 The Supervisory Council shall consist of 6 members, each of them being a single representative of Ministry of Energy of Ukraine, local branch of a banking institution, State Property Fund of Ukraine, local Rada, Anti-Monopoly Committee of Ukraine, and the Company's staff.

The first Supervisory Council and its Chairman shall be appointed by the Inter-Branch Committee composed of the representatives of the Ministry of Economics of Ukraine, Ministry of Finance of Ukraine and State Property Fund of Ukraine in conformity with the

- acting legislation.
- 8.3.3 The powers of all members of the Supervisory Council , as well as any changes in its composition, shall be confirmed by the highest decision making body of the Company with the exception of the First Supervisory Council.
- 8.3.4. The Supervisory Council :
- subject to the resolution of the highest decision making body of the Company, appoints and concludes the contract with the Chairman of the Executive Board (with the exception of the First Chairman as specified in paragraph 8.4.4 of this Charter).
 - confirms the Chairman's appointment of the members of the Executive Board;
 - pre-approves all transactions with the Company's real property in the equivalent exceeding 10% of the Company's authorized capital;
 - discusses and approves quarterly and monthly reports from the Executive Board and Revision Commission;
 - makes assessments of the activity of the Executive Board related to investment, technical and pricing policies, as well as goods and services standards;
 - initiates, for a due reason, specific audit or inquiry of the Company's activity;
 - takes other actions pertinent to control over the Executive Board activity;
 - submits recommendations on the issues of the Company's activity to an approval of the highest decision making body of the Company;
 - submits recommendation to privatization authorities regarding the specifics of the Company's assets privatization.
- 8.3.5 The Supervisory Council has the right:
- to obtain any information on the Company's activity;
 - to order members of the Executive Board and Company officials to present reports on the specific issues of the Company's activity;
 - to invite outside experts for verification of specific issues of the Company's activity.
- 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 highest decision making body of the Company. Should the performance of the Supervisory Council be found unsatisfactory, its composition may be subject to changes by resolution of the highest decision making body of the Company.
- 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. The decisions of the Supervisory Council are adopted by a simple majority of votes. In case of equality of votes, the Chairman of the Supervisory Council is entitled to a decisive vote. Extraordinary sittings of the Council are convoked at the request of the Chairman or 1/3 of its members.
- 8.4. **The Executive Board**

- 8.4.1. The Board is the executive body of the Company that manages the Company's current activity.
- 8.4.2. The powers of the Executive Board extend to all issues of the Company's activity unless those related to the sole competence of the other institutions of the Company by the effective legislation, this Charter, or the decision of the highest decision making body of the Company. The highest decision making body of the Company may delegate part of its powers to the Supervisory Council.
- 8.4.3. The Board (with the exception of the First Executive Board) is elected for the term of three years. It is accountable to the highest decision making body and the Supervisory Council and provides the implementation of their decisions.
- 8.4.4. The Company's Board consists of 6 members, including:
-The Chairman of the Board - CEO;
- First Vice Chairman and four Vice Chairmen designated to different activities.
The First Chairman of the Board is appointed by the Founder.
The next Chairman of the Board shall be appointed by the highest decision making body of the Company. The list of the other members of the Board shall be submitted by the Chairman to approval from the Supervisory Council. The Chairman of the Supervisory Council completes a contract with the Chairman of the Board on behalf of and by the order from the highest decision making body of the Company. This order shall be in effect at least until the first General Meeting of Shareholders whereby it may be subject to changes.
- 8.4.5 The Chairman of the Board runs the Board's activity. The Chairman is authorized to act on behalf of the Company without the order; he/she is authorized to run the current activity of the Company, implement the decisions of the Company's highest decision making 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.
- 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 Company's highest decision making body and the Chairman.
- 8.4.6 . The sittings of the Company's board are held not less than once a month and are considered authoritative as long as 1/2 of its members are present. The decisions of the Executive Board are adopted by a simple majority of vote. In case of equality of votes, the Chairman of the Executive Board is entitled to a decisive vote.
Extraordinary sittings of the board are convoked at the request of the Chairman or 1/3 of its members.
- 8.4.7. The Chairman issues decrees and other regulating documents concerning the Company's activity on the basis of decisions which were adopted by the Board.
- 8.4.8. The Members of the Executive Board shall bear collective and/or personal responsibility to the Company, its Shareholders and third parties for breach of the acting law or the provisions of this Charter or any damage or loss to the Company resulting from negligence, fraud, incompetence or other guilty actions as specified by the effective legislation.

8.4.9. The Board Members shall by resolution of the Executive Board, appoint a Company Secretary who shall be responsible for maintaining the Shareholders registry), 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 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 highest decision making body.

Verifications are conducted annually or at the demand of the Company's highest decision making body, the Supervisory Council or on the Revision Commission's own initiative or at the demand of the Shareholders who own in total not less than 10 % of the shares.

8.5.2 The Revision Commission reports only to the Company's highest decision making body. The Commission submits verification documents to the Company's highest decision making body and the Supervisory Council.

The Revision Commission is elected by the General Meeting of Shareholders for the period of three years. The results of the vote shall be kept confidential.

The First Commission consists of 3 members appointed by the Founder.

The Revision Commission has the right to invite experts, auditing companies to provide assistance.

8.5.3. The Revision Commission members have the right to take part in Meetings of the Executive Board, with the deliberative voice right.

8.5.4. The Revision Commission completes conclusions on the basis of annual reports and balances. The Company's highest decision making 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 in case 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 operational and accounting records as well as statistical accounting and intrabranh reports and submits them to the state statistical authorities in accordance with the established procedure.

9.2 The first fiscal year begins since 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 be correspondent with the calendar years.

10. Procedure of introducing changes into the Company's Charter

10.1 The right to introduce any changes in the Company's Charter pertains to the sole competence of the highest decision making body of the Company.

10.2 The decisions of the General Meetings of Shareholders on the introduction on the changes in the Company's Charter may be adopted by 3/4 of present votes.

11. Termination of the Company's activity

11.1 The Company's activity may be terminated by its restructuring (takeover, merge, division, separation or transformation) or liquidation.

11.2 In the event of restructuring of the Company, all Company's rights and liabilities in the aggregate shall be passed to its legal successor.

11.3 The Company may be liquidated:

-in case of the Company operating at a loss;

-by the decision of the Company's highest decision making body; or

-by the judgement of the court of law or arbitration;

-in the event of the Company's bankruptcy;

-on the submittal of the regulating bodies in the event of systematical or rough breach of law;

-in other cases stipulated by the effective legislation.

11.4 The liquidation of the Company shall be conducted by the liquidation commission appointed by the highest decision making body of the Company, or, similarly, by the court of law or arbitration in the event of the liquidation at law or by arbitration.

11.4.1 From the date of appointment of the liquidation commission, all management powers shall be passed from the Executive Board to the commission. The commission will announce the the liquidation process commenced and the period of claims application in mass media, particularly including obligatory publication in the official newspapers of Verkhovna Rada and the Cabinet of Ministers of Ukraine.

11.4.2 The Liquidation Commission shall bear liabilities on damage or loss caused to the Company, its Shareholders and third parties that result from the Company's activity.

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 highest decision making body of the Company or to the related court of law or arbitration.

The available Company's funds, including proceeds from sales of the Company's assets, shall be shared between the Shareholders in proportion to the total par value of their shares and in conformity with the law in force.

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.

THIS CHARTER AND THE AMENDMENTS THERETO HAVE BEEN AGREED UPON WITH:

Property and Organizing Structures Department:	Y.S. Zavgorodniy
Power Plants and Heat Networks Department:	O.V. Simonenko
Administration and Labor Incentives Department:	V.M. Korgun
Finance & Credit Department:	G.P. Khaidurova
Economic Department:	E.G. Mishkoriz
Accountancy:	V.Yu. Volianski
Construction/Technical Reconstruction Department:	V.R. Kucher
Fuel & Transportation Department:	Yu.O. Nasedkin
Securities Department:	A.V. Yurchuk
NDC	A.G. Batalov
Attorney's Office:	V.M. Antoniuk

I, State Notary of the First State Notary's Office of the city of Ternopil, hereby confirm authenticity of this photocopy.

Registered No.: 2-13744
Duty Charged: 289,000 KBV

State Notary

Signature

ANNEX C

Shareholder values

YOU expect to hear it from Tony Blair, the leader of Britain's Labour Party. But now it is surfacing in the American political mainstream as well. All over the English-speaking world, and even tentatively in Germany, people are beginning to ask an elementary question. Who do companies belong to, and in whose interest should they be run?

Until recently, most people assumed that firms are the property of their shareholders and should therefore be run in their shareholders' interests. But most people also assumed that the interests of companies and the interests of citizens are broadly aligned. What American or Briton fails to swell with pride when told that American or British firms are earning record profits, boosting productivity and generally becoming more competitive?

Lately the chest-swelling has become a little less automatic. From the White House to the Palace of Westminster the cry goes up that higher profits and productivity are failing to deliver the higher wages and job security they are supposed to. It is important to understand why this line of thinking is emerging now, why it is likely to grow, and why the fashionable "remedy"—to impose on firms a variety of social obligations far beyond that of earning money for their shareholders—is wrongheaded.

Capitalists and gentlemen

Two things have made it tempting in recent years to attack firms for their greed. One is "downsizing". Though people grudgingly accept that firms are entitled to freeze wages and fire workers when times are hard, they cavil at this behaviour when profits are high. In America real wages have been falling in spite of rising profits. And there was an outcry at the beginning of this year when AT&T, one of the world's most successful companies, said it would sack a further 40,000 workers.

It is not just the man in the dole queue who says this is wrong. In Congress last month Bill Clinton asked American firms to put "long-term prosperity ahead of short-term gain" and to share the fruits of increased productivity with their workers. In *The New York Times* Robert Reich, his labour secretary, has accused corporations of abandoning their responsibility to communities and employees. A similar idea lurks behind Mr Blair's advocacy of a (still undefined) "stakeholder society". At least one American senator now wants firms to submit, in parallel with their financial accounts, a formal account of the way in which they are treating the environment, their employees and their community.

The other reason for the unpopularity of big companies is globalisation. As barriers to trade and investment fall, corporations are accused of shopping cynically around the world for the cheapest workers and the laxest tax, labour and environ-



mental regimes. Mr Reich says global electronic capitalism has destroyed the "gentlemanly" investment system under which America's industrial leaders once took care to balance the interests of shareholders, employees and the public at large. He proposes a tax penalty on firms that fail in their responsibility to maintain jobs and neighbourhoods.

This particular idea is astonishing. Mr Reich seeks, in effect, to punish firms that invest in technology rather than workers. It would be hard to think of a better way to make

American workers less productive, and to make American companies less able to compete in the world economy. Compared to that, Mr Clinton's plea to firms to share productivity gains with their workers may sound like simple common sense, perhaps even simple decency. It is neither.

If a firm invests in machines and lays off some workers, where is the case for paying more to the workers who retain their jobs? If anybody has a case for "compensation", it is the workers who have been sacked. The ones who remain need not be working any harder; indeed, their jobs may now be easier. In a sense, they are already privileged. Also, of course, sharing out productivity gains within the firm discourages new employment. Altogether, it is a way of making the winners even better off and the losers even worse off.

A broader point is that the shares of profits and wages in GDP over long runs of years are surprisingly stable. This suggests that raising economy-wide productivity is the surest way to raise wages, and the surest way to raise productivity is to invest. Anything that discourages investment makes societies worse off. Mr Reich complains that, in a global economy, American profits are just as likely to be invested abroad as at home. But the fraction invested abroad is still small. Nor is it the case that American firms building factories overseas are doing so chiefly in search of cheaper labour. They are more often motivated by the need to be closer to growing markets.

On closer inspection, in other words, there is nothing newly irresponsible about the behaviour of American firms. If anything, bosses have got themselves into hot water by discharging their chief responsibility—running the firm as profitably as possible—rather better than they used to. The real reason for the new questioning of their responsibilities is that politicians sniff a wonderful opportunity for buck-passing.

If politicians felt strongly enough about low pay, downsizing or foreign investment, they could reach for direct remedies. But most have the sense to see that such remedies—national pay policy? guaranteed jobs for life? protectionism?—would inflict great economic damage. How much simpler to make it the duty of firms to provide the good things that governments can no longer provide, such as rising incomes, job secu-

rity, and stable and prosperous neighbourhoods.

To the obvious objection—that a firm encumbered with these additional duties is liable to fail in its primary one of efficient wealth creation—advocates of stakeholder capitalism have a stock reply. Look, they say, at the successful versions of capitalism, in Japan and much of continental Europe, in which companies already take on much wider social responsibilities: these economies have often performed better than their Anglo-Saxon counterparts.

The difficulty is that, for the moment at least, this is no longer true. It was fashionable to admire these other capitalisms in the 1980s, when their economies were up and America's was down. Now matters have reversed themselves. This may prove nothing except that all economies are subject to the economic cycle, no matter how they interpret the duties of their firms. But it is a peculiar moment for the English-speaking world to envy the arrangements of Japan and Germany.

Recent events have highlighted the inflexibility of such economies (see pages 21 to 25). Germany's biggest industrial company, Daimler-Benz, has just notched up the biggest peacetime loss in the country's history, and is now trying hard to put profit first. Japan's policy of lifetime employment, always less

comprehensive than portrayed, is eroding fast. In fact there was a lot wrong with these stakeholder economies even in the early 1980s: Germany's was inflexible and short on creativity; Japan's suffered from high underemployment and a tendency to be pro-producer and anti-consumer in all sorts of ways.

The real scandal

Point-scoring comparisons of the different versions of capitalism create caricatures. Only an agitator or an academic could seriously claim that big American and British corporations are fixated exclusively on maximising returns for their shareholders; and even if they were, they would still see the point in paying to have a motivated and loyal workforce.

Arguably, bosses should be more like that caricature. A lot of managers in Anglo-Saxon firms have become detached from the interests of their increasingly dispersed shareholders, most of whom are ordinary citizens, not cigar-puffing plutocrats. These managers are insufficiently accountable to anybody in particular. That is why the next surprising thing you will hear is a lot of bosses enthusiastically embracing the language of stakeholding. And it is why everybody else's interest is to insist, however unfashionably, on shareholder value.

STAKEHOLDER CAPITALISM



Unhappy families

Despite being suddenly championed by the Democrats in America and the Labour Party in Britain, stakeholder capitalism in both Germany and Japan is facing a crop of troubles of its own

WHAT goes under the name of capitalism varies a lot from country to country, even among rich economies. A big difference is in attitudes to public companies; in particular, in views about their duties and responsibilities beyond their obvious objective of producing goods or services. In America and Britain, a public company has traditionally had one overriding goal: to maximise returns to shareholders. In Japan and much of continental Europe, in contrast, firms often accept broader obligations that balance the interests of shareholders against those of other "stakeholders", notably employees, but including also suppliers, customers and the wider "community".

The models of what are popularly known as shareholder and stakeholder capitalism are each something of a caricature; but the caricature is not wildly misleading. It has become fashionable to set them against one another in a sort of capitalist beauty contest. In America and Britain, many voices now assert that stakeholder capitalism is the more attractive. President Clinton and the Labour Party leader, Tony

Blair, have both called on companies to behave with greater social responsibility, Mr Blair explicitly adopting the stakeholder tag. Robert Reich, the American labour secretary, who has written admiringly of German and Japanese capitalism, recently suggested that firms which failed in their responsibility to maintain jobs should pay extra taxes.

In Britain, some businessmen have jumped on to the bandwagon. A report on "Tomorrow's Company", published by the Royal Society for the Arts in 1995 and sponsored by firms such as Cadbury Schweppes, Guinness, Midland Electricity, Unipart and NatWest, asserted that "those companies which will sustain competitive success in the future are those which focus less exclusively on shareholders and financial measures of performance—and instead include all their stakeholder relationships... in the way they think and talk about their purpose and performance."

The oddity of such talk now is that, after two decades of relative underperformance, the American and British economies have for the past decade performed as well as or

better than those of Japan and continental Europe. Moreover, the stakeholder version of capitalism that these evangelists seek so fervently to propagate has itself come under unprecedented strain.

Model economies

Several things differentiate stakeholder from shareholder capitalism. One is near lifetime employment, at least for a significant number of "core" workers. In Germany, the leading example of continental Europe's brand of stakeholder capitalism, this is mainly a matter of convention, although employment law also makes laying off workers harder than in America or Britain. For large redundancies, companies must adopt "social plans" to cushion the blow, as well as consulting works councils, which represent employees. Sometimes companies are forced to choose whom they sack on the basis of age and family situation rather than competence.

Employees also participate directly in German company management. They are represented by law on "supervisory" boards (which oversee lower-tier management boards) of all big public firms. In most firms shareholder representatives hold the balance of power; though occasionally, as in Volkswagen, a car maker in which the state of Lower Saxony owns 16% of the shares, labour representatives do. But even when shareholders decide, the biggest are often banks, insurers or other firms that have broader interests in the firm (they may be creditors or suppliers, for example); they may not behave solely with shareholder interests in mind.

In Japan, lifetime employment is more formal even than in Germany. Following a rigorous selection process, salarymen have traditionally been guaranteed jobs for life. The rest of the workforce (more than half of it, including most women) is less fortunate, likely to be on short-term contracts and at risk of being laid off whenever the economy slows.

Customers and suppliers of Japanese firms are also often bound together into broad groups of firms (the so-called *keiretsu*) in a web of cross-shareholdings that gives each firm some pull over all other firms in the group. These shareholdings, like those in Germany, have tended to be maintained for years. Many German firms, indeed, have a single long-term shareholder. Although this is less often true of Japanese firms, their largest five shareholders typically own a quarter of the equity, compared with perhaps 40% in Germany—but less than 10% in America or Britain. The 21

STAKEHOLDER CAPITALISM

dominant voice in a German firm will often be a bank's; at the heart of every keiretsu, there is also a bank, which owns shares in each firm in the group. Such banks may be a firm's leading lenders too.

To their admirers such characteristics of German and Japanese systems confer on stakeholder capitalism big advantages over shareholder capitalism. Guaranteeing jobs for life gives employees a stronger incentive to take the time and trouble to invest in acquiring skills that are valuable within their firm, but may have only limited value outside it. Workers with less job security have more of an incentive to acquire only the skills that increase their chances of lucrative employment elsewhere. Including employees in a firm's strategic decision-making, as in Germany, is also said to foster a co-operative environment, and to ensure that when difficult decisions such as job cuts have to be taken, they can be carried through with the support of labour as well as capital.

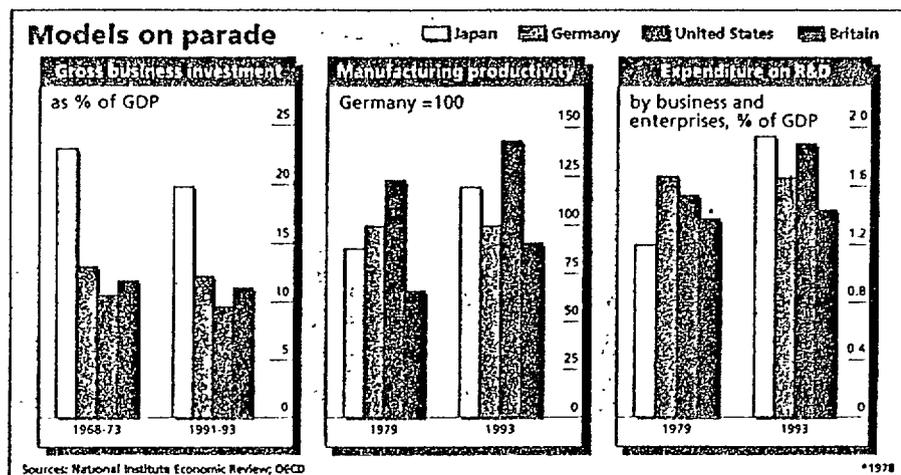
Cross-shareholdings like those in Japan that bind customers and suppliers are also said to encourage investment. They allow better co-ordination of plans than would be possible for stand-alone shareholder firms. Such shareholdings are, moreover, regarded as evidence of a long-term commitment between the parties, which enables each to make investments that will pay off only after several years, confident that they will not find that their customer or supplier has gone elsewhere. And the ability to make long-term investments, particularly in research and development, is also said to be enhanced by the combined role of banks as both lenders and shareholders.

Moreover, the commitment of shareholders, and particularly banks, to a firm gives them a strong incentive to sort out problems as they arise, rather than, as in Britain or America, just selling their shares or accepting hostile takeovers, which are as rare as unicorns in Japan or Germany. The long-termism of banks is also claimed to make them a more reliable source of finance than equity for small and medium-sized firms, which in stakeholder mythology are the most dynamic and innovative actors in an economy; such firms are more common in Germany, notably, than they are in America and Britain.

Capitalism versus capitalism

If believers in the benefits of stakeholder capitalism were right, you might expect its superiority over shareholder capitalism to be reflected in better economic performance. Yet a close look at the evidence suggests that it is not.

At first sight, admirers of stakeholding have an invincible case. The stakeholder models in Germany and Japan emerged during post-war reconstruction. Over the past 40 years, the average annual growth rate of GDP per head has been 3.0% in Ger-



many and 5.5% in Japan, well above Britain's 2.0% and America's 1.7%. Measured in dollars and at market exchange rates, GDP per head in 1994 was \$36,732 in Japan, \$25,512 in America, \$25,133 in Germany, and only \$17,465 in Britain.

These broadbrush numbers mask some big changes, however. Taking only the past 30 years, growth of Japanese GDP per head was still sprightly, averaging 4% a year, but the other countries have converged somewhat: Germany 2.4%, and America and Britain 1.9% each. Over the past decade, the rates have been closer still: Japan averages 2.5%, America 2.2%, Britain 2.0% and Germany 1.9%. In 1995, America's GDP per head grew by an estimated 3.3%, Britain's by 2.6%, Germany's by 2.1% and Japan's by 0.5%—although these differences owe a lot to Japan and Germany having gone into and come out of recession later.

Other data are more intriguing still (see charts). Stakeholding is supposed to produce higher investment. Japan has consistently invested a bigger proportion of its GDP than anywhere else, above 20% since 1960. Between 1960 and 1973, America and Britain lagged behind Germany as well. Since then, however, the differences among these three countries have been tiny compared with the gap between all three and Japan. In the 1980s, Britain invested more of its GDP than any country bar Japan, with America a close third, though German investment has since risen again.

According to Britain's National Institute of Economic and Social Research, manufacturing productivity is highest in America. In 1979, German productivity came next; by 1993, productivity in Japan had surpassed it. And whereas in 1979 manufacturing productivity in Britain was half that of America, two-thirds of Germany's and three-quarters of Japan's, in 1993 it was over 90% of that in Germany and was closing the gap with America and Japan. Between 1960 and 1973, average annual growth of manufacturing productivity was 9.6% in Japan, 5.7% in Germany, 4.1% in Britain and 3.3% in

America; between 1979 and 1994, it was 4.2% in Japan, 4.0% in Britain, 2.5% in America and only 2.2% in Germany.

As for research and development, in 1993 America came within a whisker of investing as big a proportion of GDP in R&D as Japan. Both had raised R&D spending significantly over the previous decade; whereas, as a share of GDP, it had fallen in Germany. Although British spending on R&D still lags behind Germany's, the gap is smaller than it was.

A crunch test of stakeholder capitalism ought to be its effect on employment. As recently as 1981, the stakeholder model seemed clearly superior. Japan had an unemployment rate of only 2.2% and Germany 4.5%, compared with 7.6% in America and 8.3% in Britain. Japan still scores well, with an unemployment rate of 3.1% at the end of 1995—although, as discussed below, this looks less good on closer inspection. However, America (5.6%) and Britain (8.0%), now both outperform Germany (9.9%). True, Germany has had to accommodate millions of workers from the east following unification; but even in western Germany unemployment is now higher than in America or Britain.

The overall impression from these figures is that the stakeholder economies, most notably Japan, certainly outperformed the shareholder ones in the first few decades after the war; but that the gap has narrowed significantly in the past 20 years or so. And in the past decade, the stakeholder models have shown some signs of overtaking the stakeholder ones.

This prompts several questions. Is the stakeholder magic wearing off? Certainly, the outperformance of Japan and Germany ended long before the recent recession. Is stakeholding effective only in periods of rapid growth, such as Japan and Germany enjoyed after the war—and does it crack when put under macroeconomic pressure? Did the superior performance of these economies actually stem from factors that had nothing to do with stakeholding, such as a

huge injection of fresh capital and new factories after the war, and a better-educated workforce?

None of these questions is easily answered. But there is one more significant piece of evidence which suggests that the stakeholding model may no longer be as alluring as its fans in America and Britain claim: it is under serious attack at home.

A bad case of the Benz

In Germany, the commitment to stakeholder capitalism has been taking a beating in recent years for two related reasons: Germany's high costs of production, caused mainly by high labour costs and a strong D-mark, and the pressure to internationalise both production and the raising of capital. German companies have slashed their workforces to cope with recession. Competition from abroad continues to discourage employment within Germany and encourage a build-up of production outside it.

For example, Daimler-Benz, Germany's biggest industrial company, has shed 70,000 jobs (though its profitable car maker, Mercedes, is now hiring again). Grundig, a consumer electronics firm, has just announced 3,000 job losses. Deutsche Telekom plans to lose 60,000 jobs to help ready itself for privatisation. The German employers' federation thinks that, overall, as many as 300,000 jobs have migrated abroad in the past five years.

There is growing political pressure to change employment law to make the German labour market more flexible. German firms are grumbling about the high social costs that have helped to make employment costs so high, notwithstanding German official enthusiasm for the European Union's social chapter, which will spread those costs to the rest of Europe. And it is dawning on most firms that an increasingly global capital market may be more demanding than traditional German capital suppliers. Companies such as Daimler and VEB, an energy, telecoms and chemicals group, are actively promoting the virtues of shareholder value. VEB's chemicals arm has shed a quarter of its workforce and sold or closed two dozen divisions.

Daimler's decision to list its shares on the New York Stock Exchange in 1993 was significant. Part of the price for that was to report its profits under accounting standards similar to America's. These have revealed hefty losses that traditional German accounts could largely have disguised, most recently of DM6 billion in 1995—the biggest peacetime loss of any German firm. This has created pressure for dramatic changes to boost efficiency. The firm has abandoned its policy of diversifying into everything. Jürgen Schrempp, its chairman, has said that "profitability must take precedence over revenues"; to prove it he recently pulled the plug on Fokker, Daimler's loss-

making aircraft subsidiary in Holland.

The German pattern of single dominant shareholders is also changing. Deutsche Bank has allowed its holding in Daimler to fall to 25%. Commerzbank has sold some of its long-term shareholdings. All German investors are now obliged to reveal details of shareholdings bigger than 5% in a company; transparency can encourage divestment.

In Japan as well the stakeholder model has come under pressure. Some *keiretsu* may have begun to unravel; under financial pressure, some partners have recently started to sell their cross-shareholdings. And the lifetime employment of core workers is increasingly under threat. Firms have started to export jobs abroad in response to the strong yen and to fears of protectionist measures against goods made in Japan. A survey in 1994 for the *Nihon Keizai Shimbun*, Japan's leading business daily, revealed that 59% of manufacturers intended to increase overseas production. The Nomura Research Institute predicts that, by 1998, almost 40% of the production of Japan's five major electronics groups will be offshore.

Advocates of shareholder capitalism have also risen up in Japan. Some Japanese companies, led by the Mitsubishi Corporation, its biggest general trading company, are switching their focus to return on equity to bolster financial discipline. This will become more common as pressures grow on the pension system, which has until now accepted low returns on shares in Japanese firms. The ageing of the Japanese population is likely to create a huge demand for cash from the pension system, which will be forthcoming only if firms pay higher dividends. A recent attempt by Japanese insurers to lower payouts to pension funds was met with a threat to shift pension money to foreign fund managers.

Japanese companies are still bending over backwards to protect lifetime employment, however. The first people to bear the brunt of hard times are always women and part-timers, and potential recruits. The graduate unemployment rate, which has risen from 6% in 1992 to 14% last year, is one of the highest in the OECD. But many firms are beginning to get tougher on lifetime employees.

For example, NTT, Japan's telecoms giant, announced in November plans to shed 45,000 jobs, a quarter of its workforce. Nissan, a car maker, is to lay off 7,000 workers. Many firms are moving staff to parts of the business, or to affiliates, where they have less job security. Nippon Steel

has said that 70% of its growth in profits this year will come from such shifts. It is now possible to find male managers serving coffee in firms such as Honda, in place of the usual office ladies.

Above all, Japanese firms are redefining "lifetime employment", pointing out that it applied only to a proportion of workers and whittling down that proportion as much as they can. Japanese banks have introduced a system of "up or out": those who do not make the grade by the age of 40 are sent to run local banks. Toyota has moved some 50-year-old managers from supervisory jobs to "individual work". More desperate firms are introducing "voluntary" early retirement.

Official Japanese unemployment is rising, if slowly. Some big companies are getting tougher with their subcontractors. A government survey of nearly 1,250 subcontractors found that more than two-thirds had been pressed to cut their prices. (The Japanese have a name for the trend: *shitauke ijime*, or "subcontractor bullying".) Small and medium-sized businesses shed nearly 2m jobs in 1989-94, with many businesses going under. There is a growing belief in the country that the shake-out of jobs has barely begun. If the definition of unemployment were expanded to include those willing to work but not actively looking for a job, the rate might rise immediately to 9%—and it looks like going higher still.

The changes in German and Japanese economic performance, together with the switch of emphasis towards shareholder value that many of their firms have made, should give pause for thought to Anglo-American advocates of stakeholder capitalism. It would be deliciously, if sadly, ironic, were Britain and America to shift towards a model just as it was about to be abandoned by its inventors.



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Schrempp cocktail

BERLIN

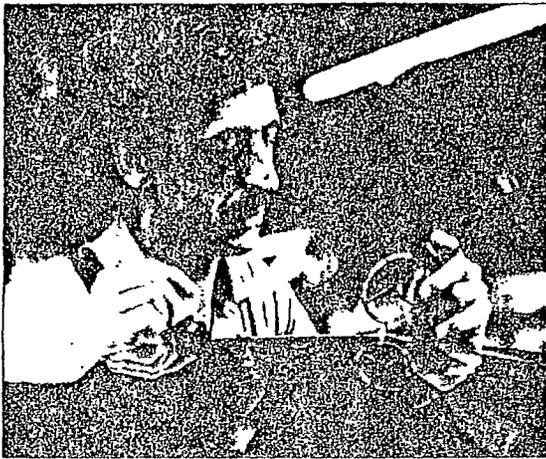
“A DOER, not a thinker. A power player, not a philosopher.” Such is the rhetoric with which the German press has greeted the imminent change of command at Daimler-Benz, Germany’s biggest industrial firm. On May 24th Edzard “the thinker” Reuter will retire as chairman; Jurgen “the doer” Schrempp, former boss of Daimler’s aerospace subsidiary, will take over.

Mr Schrempp does not discourage the impression that he is the antithesis of Mr Reuter, who in the past decade has spent an estimated DM9 billion (\$6.2 billion) transforming Daimler from a car manufacturer into an “integrated technology concern” that includes Europe’s biggest aerospace company and a clutch of other businesses from software to train building. The change was disastrous for Daimler’s profits. Daimler-Benz Aerospace and AEG, the two pillars of the thinker’s diversification, have made combined net losses of DM3 billion in the past three years. Mercedes-Benz accounted for two-thirds of the group’s sales last year but nearly all of its profits.

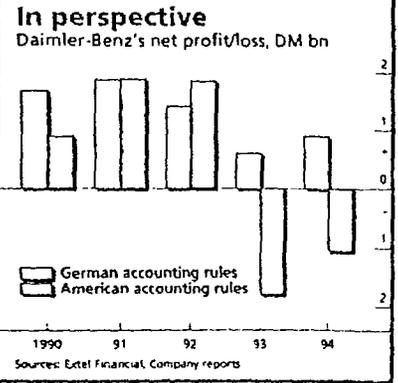
Mr Schrempp is vowing to bury Mr Reuter’s vision and make Daimler “the most profitable enterprise in Germany.” Operations that fail to meet his profit target—said to be a return of 12% on capital—will be dumped. The holding company, which oversees Daimler’s four subsidiaries, will have to meet equally tough criteria.

But Mr Reuter deserves some credit for the company’s current course and Mr Schrempp some blame for its past mistakes. Mr Reuter, after all, broke a German taboo by listing Daimler’s shares in New York last year, exposing the company to the demanding scrutiny of American shareholders. Meanwhile, as boss of the aerospace group, Mr Schrempp was involved in the dubious acquisition in 1993 of Fokker, a money-losing Dutch aircraft maker. And although he trimmed 12% of its workforce last year and closed six plants, the aerospace group may still lose money this year.

Indeed, since he learned last summer that he would get the top job, Mr Schrempp seems to have stepped up the pace of restructuring throughout the



Too much thinking hurts profits



whole group. The recent decision to merge AEG’s undersized rail business with that of ABB Asea Brown Boveri, at a cost to Daimler of \$900m, bears his fingerprints. He is seeking partners for big chunks of the aerospace operation, including Fokker, Dornier (which makes turboprop planes) and MTU, an engine maker. In essence, Daimler is swapping its big stakes in bad businesses for smaller stakes in better businesses.

That will leave Mercedes as one of the few profitable firms that Daimler actually manages. Its boss, Helmut Werner, has boosted productivity and chopped model cycles from 11 years to eight. He is disappointed not to win the chairmanship, and may want a long lead from his new boss. But Mr Schrempp is not one to lurk in the background. If asset sales leave him with little else to do, the temptation to meddle in Mercedes may be overwhelming.

Daimler stalls

BERLIN

IF FRENCH capitalism is in a state of shock, so are those who thought that German industry had emerged from recession fitter than ever. The country's biggest industrial group, Daimler-Benz, had probably hoped that June would be remembered for the novel oval headlights on the newly launched car of its Mercedes-Benz subsidiary. Instead it will be remembered for Daimler's announcement, on June 28th, that it will this year report its first post-war loss. Its share-price immediately fell by 7%.

Daimler had said in April that the strong D-mark would hurt results, especially at its aerospace business, which earns most of its revenues in dollars. It is also complaining, with increasing shrillness, about the stubbornness of the IG Metall trade union, which recently won a pay increase of nearly 4% and a reduction in the working week to 35 hours. The union has refused to consider Mercedes's proposal that Saturday be restored as a normal working day. "I'm not sure they understand the competitive situation," moans one Mercedes board member.

Daimler has just started up new production in lower-cost countries; now it plans for the first time to shift abroad production that is being done in Germany. It is planning charges of "well over DM1 billion" (\$720m) this year to cover the cost of job losses and other restructuring.

However, the announcement is most interesting because Daimler need not have made it. Standard procedure in Germany is to wash away losses by selling assets or releasing hidden reserves. Daimler took DM4.6 billion of restructuring charges in 1993 and 1994, in a far worse economic environment, without reporting a loss under German accounting standards. So why this time?

Part of the answer is that the German firm, whose shares were recently listed on the New York Stock Exchange, is simply

becoming more candid: it is recognising its currency-related losses rather than covering them up. But the loss warning also sends a clear message from Jürgen Schrempp, who became Daimler's boss in May, that he is ready for drastic measures.

His audience includes not just unions but also his managers (Mr Schrempp has already said he will cut 200 people from the firm's head office) and the country's politicians, who are not subsidising the aerospace industry as much as Daimler wants. On the same day that Daimler made its spine-chilling announcement, a committee in Germany's parliament approved financing for the Eurofighter project, in which Daimler has a big stake.



Schrempp studies the books

RECKless pursuits

LIKE the power they supply, Britain's 12 regional electricity companies (RECS) are unremarkable most of the time, but they have the capacity to deliver an occasional shock. The handful of firms now considering buying a REC should handle them with caution.

Takeover speculation hotted up once again on July 6th, after Stephen Littlechild, Britain's electricity regulator, announced a new price regime for electricity distribution. Distribution accounts for around 90% of the RECS' profits. The price controls are tighter than before, but not enough to deter predators.

On July 13th Southern Electric International, a subsidiary of Southern Company, an American power firm based in Georgia, made a hostile £1 billion (\$1.6 billion) bid for South Western Electricity, a REC. As *The Economist* went to press, Trafalgar House, a British conglomerate, was expected to revive its bid for Northern Electric (its £1.2 billion hostile bid lapsed in March, after Mr Littlechild unexpectedly said he would revise his price controls). There is talk of Hanson, another British conglomerate, making a bid; and even of a merger between two RECS.

RECS have clear attractions for predators. They have a stable cash-flow and

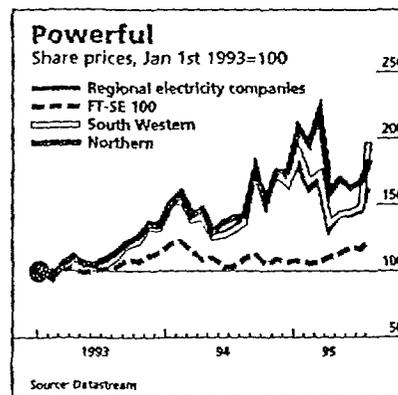
minimal debt (their average debt-to-equity ratio is 15%). Only six years ago, RECS were part of an inefficient state-owned electricity monopoly. Since privatisation in 1990, RECS have on average shed over 13% of their workforce, but the chances are that a company such as Hanson could find more fat to cut.

The problem with buying a REC is likely to come on the revenue side. Britain's electricity market is becoming more competitive. Industrial consumers have recently been allowed to choose between competing electricity suppliers. From 1998 domestic customers will be able to

shop around too. But the bigger threat to prices is regulation.

Mr Littlechild once had a reputation as a hands-off regulator. He pioneered Britain's "RPI-minus-x" style of regulation under which prices are fixed every five years, allowing companies to reap the benefits of efficiency gains in the intervening period. But in March he shattered his image by deciding to tighten regulation only months after his previous price review. He had been shocked by the embarrassingly generous terms of Northern's defence against the bid from Trafalgar. Mr Littlechild may be reluctant to intervene yet again—unless another defence package by a REC shows that he has still been too lenient. But he may nonetheless insist that, if two RECS merge, any efficiency gains are passed on to customers rather than shareholders.

A bigger regulatory risk than Mr Littlechild's ego is the Labour Party. Judging by the polls, Labour is likely to win the next election (which must take place by May 1997). Labour has recently threatened a "windfall tax" on privatised utilities; has also talked about redistributing cash to customers if profits exceed a certain level. This week, Southern Electric International's American bosses expressed their admiration for Britain's hands-off style of regulation. They may have spoken a little too soon.



and their experience with Volkswagen (vw) has boosted the cause

bus phase of development. Last

Changing Values

Satisfying Shareholders Is a Hot New Concept At Some German Firms

Veba AG Embraces Strategy By Closing Weak Units, Laying Off Thousands An Attack on 'Corporatism'

By GREG STEINMETZ

Staff Reporter of THE WALL STREET JOURNAL

Ulrich Hartmann, the chief executive of industrial giant Veba AG, is doing something unheard of in Germany: He's worrying about shareholder value.

He has laid off thousands of workers, fired longtime managers and closed divisions that date back to Veba's beginnings — all in the name of investors. "Our commitment," he said in last year's annual report, "is to create value for you, our shareholders."

The developments at Veba, Germany's fourth-largest company in revenue terms, underscore a trend catching hold in German boardrooms. Mr. Hartmann believes the trend will pick up in Germany if only, he says, because the pursuit of shareholder value is in everyone's interest.



Ulrich Hartmann

"Satisfying the shareholders is the best way to make sure that other stakeholders are served as well," he says. "It does no good when all the jobs are at sick companies."

But the German public — used to a fabled "German model" of management that advocates describe as "capitalism with a human face" — remains deeply suspicious of the alternative way of doing business. "A number of people are left behind," says Norbert Wiczorek, a member of Germany's lower house of parliament and an economic expert with the opposition Social Democratic Party. "That's not the way for Germany."

Mr. Hartmann is one of a new breed of German managers who are enthusiastically embracing the shareholder-value concept. Others are Juergen Dormann at Hoechst AG and Juergen Schrempp at Daimler-Benz AG. During a recent interview, a secretary interrupted the conversation to notify Mr. Schrempp of Daimler's opening stock price. "A year ago, no one in the company knew what the stock price was," he says. Now, he adds, the company keeps stockholders in mind with everything it does.

Driving companies to change are ever-growing capital requirements. Unable to raise enough money in Germany, companies are turning to foreigners. Nearly half the shares of drug companies Hoechst, Bayer AG and Schering AG are owned by non-Germans, who want more than just a dividend check. "There is no German or French or American capital market anymore," says Veba's Mr. Hartmann. "It is a global capital market, and we all have to play by the same rules."

In addition, supporters of shareholder value describe the traditional German approach to business as "corporatism" and say it fosters stagnation and loss of opportunity. They blame it for Germany's sluggish growth and for the highest number of Germans out of work since World War II. Economists say more emphasis on profits might bring job loss in the short term, but produce more jobs over time.

If the Veba example spreads, it could radically alter the way business is done in Germany, the world's third-largest economy. The result would include leaner, more powerful companies that would be tougher foes for U.S. rivals.

Deciding What's Best

The loser, however, would be the German model of business, where executives, banks and labor decide behind closed doors what is best for a company. President Clinton and British Labor Party leader Tony Blair praise the system because it puts the interests of workers, the community and other "stakeholders" on a par with those of shareholders.

Ellen Schneider-Lenne, a management board member of Deutsche Bank, says the emphasis on shareholder value must be viewed critically. She talks about corporate raiders who "squeeze companies dry" and show no regard for workers. Minority shareholders, such as pension funds, are part of the problem, she says, because they sell to the highest bidder.

Deutsche Bank has found itself on the defensive because shareholder-rights groups cite German banks as the No. 1 obstacle to their cause. Banks can — and do — own stock in German firms, and often are the largest shareholders in companies to which they lend. Because of their conflicting roles, they lose sight of shareholder interests, contends Wuerzburg University Prof. Ekkerhardt Wenger, Germany's leading shareholder-rights activist. He was once tossed out of a Deutsche Bank annual meeting after refusing to be silent. "The German system is a cartel with the banks protecting management from market pressures," he says.

Another hurdle is German labor. In a practice known as codetermination, labor representatives sit on German boards, and worker groups have a strong voice in personnel matters. Unions eye the shareholder-value movement with suspicion. "Companies obviously have to earn

Please Turn to Page A10, Column 1

Germans Seek Shareholders Value

Continued From First Page

money," says Michael Denecke of IG Chemie, the union representing German chemical workers. "But profits shouldn't be the only measurement. A company also has obligations to society."

And some German executives openly fear shareholders. SAP AG, a successful software firm, recently adopted antitakeover measures. "Our company would never have achieved its present position if it were guided by outside interests," says Chief Executive Dietmar Hopp.

Over the years, Veba has strayed from tradition. The onetime Prussian utility monopoly still produces power, but it also builds shopping malls, runs a cable-television system and is the country's biggest operator of gasoline stations. With 68 billion marks (\$45.99 billion) in revenue last year, Dusseldorf-based Veba is larger than DuPont Co. or Chevron Corp.

The company's stock price has doubled since 1991, consistently outpacing the German market. Beneficiaries have been international investors. Some 43% of Veba's shares are in foreign hands. Daimler-Benz lists its stock in the U.S., but only 88 American mutual funds hold Daimler shares, compared with 295 Veba owners. FMR Corp.'s Fidelity Investments unit is Veba's largest U.S. investor, according to Morningstar Inc.

Shareholder Uprising

Under Baron Rudolf von Bennigsen, who lorded over Veba for nearly 20 years, shareholder communications meant letting individuals blow off steam at annual meetings. But after the baron's death in 1989 from a lung infection, successor Klaus Piltz faced a shareholder uprising.

There was cause for management concern. Veba, unlike most other German companies, didn't have big shareholders to shield it against hostile-takeover threats. When the government privatized Veba in 1959, it allowed only small retail investors to own the company's stock.

That shareholder structure made it easy for foreign investors to snap up large positions in the company. When the iron-willed baron died, they wanted a return on their investment.

The declaration of war came in the form of a 115-page report by the British brokerage firm S.G. Warburg. The May 1991 report said Veba was worth twice its market capitalization, and was easily the most undervalued company in Germany. Warburg warned that the company was "vulnerable" to a takeover if it didn't act to boost its stock price.

Nicolaus-Juergen Weickart, a Frankfurt lawyer who has taken part in Germany's few but bruising takeover battles, seized on the message. He warned the company that foreign shareholders might sell if Veba ignored their demands. That, in turn, would depress the stock price and make the company more vulnerable to an outsider amassing a big stake. Mr. Weickart declined to comment for this article.

All In the Family

Paying close attention was Veba's Mr. Hartmann. An easygoing executive with a passion for modern art, Mr. Hartmann, 58 years old, had practically grown up at Veba. His father, Alfred, served as a top official at the Ministry of Finance, where he was the baron's boss, and later served on Veba's management board. Ulrich joined Veba following his father's death and served as chief financial officer during the time of Mr. Weickart's attack.

"We took Weickart very seriously," Mr. Hartmann says. "We agreed with the critics that there had to be changes."

Mr. Piltz began to address some of the concerns, but died in an avalanche in a 1993 skiing trip in the Alps at the age of 57. Mr. Hartmann took on the chief executive's job. Aided by Chief Financial Officer Kurt Lauk and a team from Boston Consulting Group of the U.S., he carried on Mr. Piltz's agenda.

In one of his first acts, Mr. Hartmann updated investor-relations efforts. Shareholders not only had someone to talk to when they called Veba, but they also got more information than they ever received from any German company. Mr. Hartmann made personal visits to shareholders in the U.S., Canada and London.

The company's annual report began to give more financial details. In the area of accounting, Veba became one of the first German companies to report earnings according to methods requested by security analysts. Some managers feared it revealed too much to competitors and em-

ployees, but Mr. Hartmann argued there was no other way.

Veba also made sure it could gauge its performance. "It's one thing to talk about shareholder value, but it's another thing when you establish internal systems to measure it," Mr. Lauk says.

Closing Businesses

Operations that failed to measure up would be fixed, sold or closed. Two years ago Veba's Raab Karcher division, founded in 1848 as coal trader, got out of the coal-trading business.

The most significant shake-up came at Veba's chemicals operation, Huels, a consistent money loser in need of a complete overhaul. A new, aggressive management team slashed the work force by 12,000 employees, closed its tire-rubber business and sold its synthetic-rubber operation. The unions grumbled, but — because they were part of the decision-making process — went along with the changes, recognizing the predicament at Huels.

The changes at Veba have since filtered down to the bottom line. Owing to a sharp rebound at Huels, Veba's profit rose 40% last year to two billion marks.

How quickly other German companies follow Veba's lead is another question. Christian Strenger runs DWS, Germany's largest mutual-fund company, and is an outspoken critic of German corporations. He believes German companies have a few years to go before they catch up to U.S. firms in terms of improving shareholder value. But he notes that German companies all but refused to talk to him until a few years ago. Now they call him.

ANNEX D

MINISTRY OF ENERGY AND ELECTRIFICATION OF UKRAINE

EXECUTIVE ORDER

28.07.95

Kiev

No. 134

On creation of State
Joint-Stock Power Supplying
Company "Ternopilenergo"

According to the President Edict, dated the 4th of April 1995, No 282/95 "On restructuring of Power Sector of Ukraine", and to the executive order No.75 of Ministry of Economy, dated 14.06.95, "On editing lists of enterprises subject to corporatization and terms of its implementation" and to the Ministry of Energy executive order No.106, dated 15.06.95 Corporatization Commission of Ternopil Regional Enterprise of Electric Grid(PES) submitted to the Minenergo Report on evaluation of Ternopil PES property state on 01.06.95 and Charter Draft of State Joint-Stock Power Supplying Company "Ternopiloblenergo",

I ORDER:

1. To adopt the Report on evaluation of Ternopil Regional Enterprise of Electric Grid(PES).
2. To create State Joint-Stock Power Supplying Company "Ternopiloblenergo" on the basis of Ternopil Regional Enterprise of Electric Grid and to approve its Charter.
3. To appoint Mr. Maladyka Grigoriy Vasilyovich the Head of the Board - Director of State Joint-Stock Power Supplying Company "Ternopiloblenergo" according to the Contract No.553, dated 13.07.93
4. To Mr. Maladyka G.V. to make state registration of State Joint-Stock Power Supplying Company "Ternopiloblenergo".
5. To consider State Joint-Stock Power Supplying Company "Ternopiloblenergo" as a Legal Successor of Ternopil Regional Enterprise of Electric Grid.
6. To the Corporatization Commission of Ternopil Regional Enterprise of Electric Grid to develop and submit to the Ministry Shares distribution plan for the State Joint-Stock Power Supplying Company "Ternopiloblenergo". This plan should foresee that 100% of the shares should belong to the State. The Commission shall stop its activity from the moment of state registration of the Company.
7. The control upon the execution of this order shall be put on the Department of organisation structure and property forms (Mr.Zavgorodnii)

Minister _____
(Signature)

Sheberstov O.M.

**CERTIFICATE
OF
SECURITIES ISSUE REGISTRATION**

*The Ministry of Finance certifies that the
issue of the shares being accomplished by the
State Joint-Stock Power Supplying Company
"TERNOPILOBLENERGO"*

for the amount of One Trillion Five Hundred Twenty Seven Billion Two
Hundred Four Million krb.

Including :
One Million Five Hundred Twenty Seven Thousand Two Four of Simple
Registered Shares

At value of: One Million krb.

For the amount of: One Trillion Five Hundred Twenty Seven Billion
Two Hundred Four Million krb.

Is inserted into Securities Issue Register

Registration No. 454/1/95

Date of issue: 30 October 1995

The Head of the Department of
Securities and Credit Funds Relations

A.V.Litvin

CERTIFICATE No. 00130725
OF
THE STATE REGISTRATION OF
THE BUSINESS ACTIVITY ENTITY

State Joint-Stock Power Supplying Company

“TERNOPIOBLENERGO”

Ternopil, Energetichna Str.2

(Address)

Issued by : Ternopil City Rada Executive Committee

State Registration Body

Executive Officer: Ya. Savkiv, interim Chief of Economic Department

(Signature)

Stamp

10 August 1995

Issue date

New address information:

1. _____
2. _____
3. _____
4. _____
5. _____

Section V. Placing of shares belonging to the Open Joint-Stock Company which was created on the basis of the state enterprise and put to the G group according to the State Privatisation Program.

Total number of the shares which belong to the state - 1527204

Total nominal value - 1527204000 000 KBV.

Nominal value of the share - 1000 000 KBV.

Open Joint-Stock Company " Ternopiloblenergo"

Way of shares Placing	Placing Term		Shares		Statutory Fund Share, %	
	Beginning	End	Number of shares	Value in KBV,000		
Beneficiary Sale of the Shares: <ul style="list-style-type: none"> • To Company Employees: <ul style="list-style-type: none"> ■ for privatisation vouchers ■ for cash • To people who has the right for Beneficiary purchase of the shares according to: <ul style="list-style-type: none"> • Article 25 of the Law of Ukraine "About privatisation of the property of state enterprises": <ul style="list-style-type: none"> ■ for privatisation vouchers ■ for cash • Edict of the President of Ukraine No.210/93, of 15.06.93 <ul style="list-style-type: none"> ■ for cash 	1 st quarter 1996	2 nd quarter 1996	100500	100500000	6,58 3,29	
	2010 (persons)		50250	50250000		
		1 st quarter 1996	2 nd quarter 1996	21000	21000000	1,38 0,69
		420 (persons)		10500	10500000	
	1 st quarter 1996	1 st quarter 1997	76360	76360000	5.00	
	208 (persons)					
2.Sale of the shares to citizens of Ukraine and commercial mediators on competition basis	1 st quarter 1996	2 nd quarter 1996				

■ for privatisation vouchers 3. Shares belonging to the State	1 st quarter		1268594	1268594000	83,06
Total			1527204	1527204000	100,0

121500 shares with total value 121 500 000 000 KBV. (7,96 % of Statutory Fund) are to be sold to Ukrainian citizens and to commercial mediators

Head of Department

O. Borodavko

Executive officer

V. Verina

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Head of Department

O. Borodavko

Executive officer

V. Verina

"Approved"
by the Head of State Property Fund
(Signature) (Full name)

Stamp

" _____ " _____ 199_

PLAN
of shares placing for open joint-stock company
created through corporatisation

Section 1. Company Requisites

1. Code as to ZKPO 1 0 1 0 1 1 1 3 1 0 1 7 1 2 1 5 1
2. Full and short name for State Joint-Stock Power Supplying Company "Ternopiloblenergo", DAEK "Ternopiloblenergo"-DAEK (in Ukrainian) stands for SJSPSC abbreviation.
3. Legal address 282010, Ternopil, Energetichna Str.2
4. Number and date of state registration: No.282, 10.08.95
5. Current account number and other account numbers of joint-state company, name of the bank and bank requisites: acc. 221001 in Ternopil Branch of Prominvestbank, MFO 338426

Section 2. Description of the business activity

	On 01.01.95	On 01.06.95
1. Roll number of employees (persons)	1995	2010
2. Residual Value, in KBV'000	1865605000	1481799502
3. Retained Earnings, in KBV'000	X	13636000
4. Profit after taxes and duties payments, in KBV'000	X	4160000

5. Main business activities: Power supply to the customers of the region
6. Type of products produced or services rendered: Electric power

Product(service) value: 1855159500 Percentage in general volume of products produced(%): 100

7. Description of Working Capital and Product Sales:

	On 01.01.95	On 01.06.95
Accounts Receivable, KBV'000	184309000	701789000
Accounts Payable, KBV'000	300411000	982699000
Non-sold products value, KBV'000	165143000	669587000

8. Land Tax, in KBV'000: 9 465 000

9. Environment status:

Fines paid for violation of environmental laws, in KBV'000: NO

10. Data on piece of land of joint-stock company: 244 ha., all over the region under transmission lines' poles and under transformer substations.

Section 3. Statutory Fund of the Company

1. Statutory Fund : 1 527 204 000 000 KBV.

2. Nominal Share Value : 1 000 000 KBV.

3. Number of shares : 1 527 204

4. Shares in Statutory Funds of other legal entities :

Name and Legal Status	Legal Address	Total value	Share (%)
-	-	-	-

5. List of the objects which residual value is not included into the Statutory Fund:

Name of object	Residual Value in KBV'000
Housing Fund	25268383

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Head of Department

O. Borodavko

Executive officer

V. Verina

ANNEX E

Law on Business Associations

Text of Law

92SD0024A Kiev HOLOS UKRAYINY in Ukrainian
11 Oct 91 pp 10-14

[Text on Law of the Ukraine on Business Associations under the rubric: "Laws of the Sovereign Republic"]

[Text] This law defines the concepts and forms of business associations, the regulations governing their establishment and activities and the rights and obligations of their copartners and founders.

Section I. General Principles

Paragraph 1. Business associations

This law recognizes as business associations all enterprises, organizations and institutions established on the basis of agreement among legal entities or citizens through the joining of their property and entrepreneurial activity with the aim of making profit.

Business associations include: joint-stock companies, limited liability companies, additional liability companies, full partnerships and limited partnerships.

Business associations are legal entities.

Business associations may engage in any type of entrepreneurial activity that does not violate the laws of the Ukraine.

Business associations may acquire property and personal non-property rights, enter into binding agreements, represent themselves in court, arbitration court and court of referees.

Paragraph 2. Names of business associations

The name of a business association must indicate the form of business association, and in the case of full or limited partnerships—the surnames (names) of the company's copartners, as well as other essential information.

The name of the business association is included in the documents establishing the company.

The company name may indicate the fact that the business association belongs to particular ministries, departments or public organizations. The location of the business association must be in the Ukraine.

Paragraph 3. Founders and copartners of the business association

The founders and copartners of a business association may be enterprises, organizations or institutions, as well as citizens, except in cases specified by the laws of the Ukraine.

Enterprises, organizations and institutions which become members of a business association do not cease to be legal entities.

Foreign citizens, persons without citizenship, foreign legal entities and international organizations may be founders and copartners of business associations on an equal basis with citizens and legal entities of the Ukraine, except in cases defined by the laws of the Ukraine.

Paragraph 4. Founding documents of a business association

A joint stock company, limited liability company or additional liability company are established and act on the basis of a founding agreement and statute, and a full and limited partnership, on the basis of a founding agreement.

The founding documents must include information about the form of business association, the object and purpose of its activity, the identity of the founders and copartners, the name and location, the size and manner of the establishment of the capital fund, the manner of sharing of profits and losses, the composition and competencies of company bodies and their decision-making procedures, including a list of the matters which require unanimity or a specified majority of votes, the procedure for making changes to the founding documents and the procedure for liquidating or reorganizing the business association.

The founding documents must also include the information specified by paragraphs 37, 51, 65, 67 and 76 of this Law.

The absence of this information in the founding documents is a basis for denial of government registration to the business association.

Other conditions may also be included in the founding documents if they do not violate the laws of the Ukraine.

Paragraph 5. Term of activity of a business association

If a business association's founding documents do not indicate the term of its activity, it is considered to have been established for an indefinite term.

Paragraph 6. Government registration of a business association

A business association acquires the rights of a legal entity from the day of its government registration.

Government registration is carried out according to the regulations set out by the Law of the Ukraine: "On enterprises in the Ukrainian SSR."

Business associations which engage in banking activities are registered by the National Bank of the Ukraine according to the manner set out by the Law of the Ukraine on banks and banking activities.

Paragraph 7. Government registration of changes in a business association's founding documents

Changes which have occurred in the founding documents of a business association and which need to be entered into the state register, are subject to government registration according to the regulations set out for government registration of companies.

The business association is obliged to inform within five days the body which carried out the registration about any changes which have been made in the founding documents so that essential changes may be entered into the state register.

Paragraph 8. Consequences of agreements made before registration of a business association

A business association may open a checking or other accounts in a bank, as well as draw up contracts and other agreements only after registration. Agreements made in the name of the business association before it is registered are recognized as made with the business association only on condition of being later confirmed by the business association.

Agreements made by the founders before the business association is registered and not later confirmed by the company are legally binding only on the founders.

Paragraph 9. Branch enterprises, affiliates and agents of a business association

A business association has the right to establish on the territory of the Ukraine and outside its borders affiliates and agents, as well as branch enterprises in accordance with the laws of the Ukraine.

Paragraph 10. Rights of copartners of business associations

Copartners of business associations have the right to:

- a) take part in the management of company affairs in the manner set out in the founding documents, except in cases specified by this Law;
- b) take part in the division of the business association's profits and obtain a share of them (dividend);
- c) withdraw from the business association according to the established procedure;
- d) receive information about the business association's activity. The business association is obliged to make available to the copartner, at his demand, annual accounts, reports about its activity and minutes of meetings.

Copartners may also have other rights, as specified by law and by the business association's founding documents.

Paragraph 11. Obligations of copartners of a business association

The copartners of a business association are obliged to:

- a) act in accord with the business association's founding documents and implement the decisions of general meetings and other management bodies of the business association;
- b) fulfill their obligations to the company, including those related to investment of property, as well as contribute (pay for shares) in the amount and in the manner and by means specified by the founding documents;
- c) keep secret commercial secrets and confidential information about the activity of the business association;
- d) fulfill other obligations if so required by this Law, other laws of the Ukraine or the founding documents.

Paragraph 12. Ownership and property of a business association

A business association is an owner of property:

- transferred to it in ownership by the founders and copartners;
- produced by the business association through its economic activity;
- realized as profit, as well as other property obtained in ways not forbidden by law.

Any risk of accidental destruction of or damage to property belonging to a business association or transferred to it for use is borne by the business association, unless otherwise specified by the founding documents.

Paragraph 13. Investments of copartners and founders of a business association

Investments by a business association's copartners and founders be in the form of buildings, structures, equipment and other material valuables, securities, the right of use of land, water and other natural resources, buildings, structures or equipment, as well as other property rights (including intellectual property), and money, including foreign currency.

The investment, which is evaluated in rubles, constitutes the share of a copartner or founder in the capital fund. The manner in which the investments are evaluated is set out by the business association's founding documents, unless otherwise specified by the laws of the Ukraine.

Paragraph 14. Funds of a business association

In a business association a reserve (insurance) fund is established in an amount set out by the founding documents, but not less than 25 percent of the capital fund, as well as other funds specified by the laws of the Ukraine or the founding documents of the business association.

The amount of the annual contribution to the reserve (insurance) fund is specified by the founding documents, but may not be less than five percent of the net profit.

Paragraph 15. Association Profit

The association profit is formed from receipts from government activities after covering material and similar expenditures for payment of labor. The association pays the interest on bank credit and obligations legally and also taxes mandated by Ukraine as well as other payments into the budget from the balance of the profit. Net income remaining after the designated payments will remain under the association's total disposition. The association, in accordance with established documents, will designate the manner in which this income will be used.

Paragraph 16. Changes in the capital fund

A business association has the right to change (increase or decrease) the amount of its capital fund.

Increase of the capital fund may be take place only after all the copartners have made their full contributions (payment for shares) except in cases specified for by this Law.

Decrease of the capital fund may not take place if there are objections from creditors of the business association.

Decisions of the business association regarding changes in the size of the capital fund take effect on the day these changes are entered into the government register.

Paragraph 17. Controls over the financial activities of a business association

Controls over the financial activity of the business association are carried out by state tax inspection and other government bodies within the limits of their authority, control bodies of the business association and auditing services.

The controls must not disturb the company's normal work regime.

Paragraph 18. Accounting and account books

A business association keeps accounts of the results of its work, maintains statistical account books and makes them available as required to state statistical bodies.

Paragraph 19. Cessation of the activity of a business association

The activity of a business association ceases if the association is reorganized (merging, annexation, division, exclusion, transformation) or liquidated.

Reorganization of a business association takes place at the decision of its highest body.

If a business association is reorganized, the totality of its rights and obligations passes over to its legal successors.

A business association is liquidated:

a) after completion of the term for which it was established, or attainment of the goal set at the time of its creation;

b) by decision of the business association's highest body;

c) on the basis of a decision of a court or an arbitration court;

—at the request of banking bodies in the case of an inability of the business association to pay its debts;

—at the request of bodies controlling the business association's activity in the case of a systematic or serious violation of the law by the business association;

d) for other reasons specified by the founding documents.

Paragraph 20. Liquidation commission

Liquidation of a business association is carried out by a liquidation commission appointed by the business association, and in cases of bankruptcy or the cessation of the business association's activity, by the decision of a court or an arbitration court by a liquidation commission appointed by these bodies.

From the day of appointment of the liquidation commission, authority to manage the affairs of the business association is transferred to the commission. Within three days of its appointment, the liquidation commission publishes information about the business association in official (republican and local) press organs, giving the deadline for creditors to make their claims, evaluates the existing property of the business association, makes settlements with them, takes measures to pay the business association's debts to third parties as well as to its copartners, calculates the liquidation balance and forwards it to the highest body of the business association or the body which appointed the liquidation commission.

Paragraph 21. Division of the funds of the business association at its liquidation

Monetary funds belonging to the business association, including receipts from sales of its property at liquidation, are shared out, after the payment of wages owed to employees of the business association and settlement of obligations to the budget, the banks, owners of shares issued by the company and other creditors, among the copartners of the business association in the manner and according to the conditions stipulated by this Law and the founding documents within six months after the publication of information about its liquidation.

Property transferred to the business association for its use by copartners is returned in its natural form without any payment.

Should disagreements arise regarding the payment of the debts of the business association, the monetary funds will not be divided among the copartners until the disagreement is resolved or until creditors are given the necessary guarantees.

Paragraph 22. Time of cessation of the activity of a business association

The liquidation of a business association is considered completed and the business association is regarded as having ceased its activity from the moment that this fact is entered into the government register.

Paragraph 23. Management of a business association and its executive personnel

Management of a business association is carried out by its bodies, the composition and manner of election (appointment) of which depends on the form of business association.

The executive personnel of the business association are the chairman and members of the executive body, the chairman of the auditing commission, and in business associations in which a company council (overseeing council) is established, the chairman and members of the company council (overseeing council).

Not eligible to be executives of a business association are members of elected bodies of public organizations, members of the military, executives of bodies of the prosecution, court, state security, internal affairs, arbitration court, state notary's office, as well as government bodies called upon to control the activities of the business association. Persons who have been forbidden by the courts to engage in a given type of activity may not be executives of companies which engage in that type of activity. Persons who have criminal records and do not have a pardon for theft, bribe-taking and other mercenary crimes may not assume management positions in business associations or positions entailing financial responsibility.

Executives are liable for harm done by them to the business association, as specified by the laws of the Ukraine.

Executives must not divulge commercial secrets or confidential information and are liable should they be divulged, as specified by the laws of the Ukraine and the founding documents of the business association.

Section II. Specific Types of Business Associations

Chapter I. Joint Stock Company

Paragraph 24. The concept of a joint stock company

A joint stock company is a company which has a capital fund that is divided into a specified number of shares of

equal nominal value and is liable for its obligations only with company property.

The shareholders are liable for the obligations of the company only within the limit of the shares they own.

In cases specified by the statute, shareholders who have not fully paid for their shares are liable for the obligations of the company within the limits of the unpaid sums as well.

The total nominal values of the shares issued constitutes the joint stock company's capital fund, which cannot be less than 100 thousand rubles.

Paragraph 25. The forms of joint stock companies

Joint stock companies include: the public joint stock company, the shares of which may be circulated through public subscription and trading on stock exchanges; and the private joint stock company, the shares of which are divided among the founders and may not be circulated through subscription or be traded on the stock exchange.

A private joint stock company may be reorganized into a public company through the registration of its shares in the manner specified by the law on securities and a stock exchange and by making changes to the company's statute.

Paragraph 26. Founders of a joint stock company

Legal entities and citizens may be founders of a joint stock company.

The founders of a joint stock company make an agreement among themselves which sets out the manner in which they will engage in common activity for the establishment of the joint stock company, and their liability to persons who subscribed for shares and to third parties.

The founders bear a common liability with regard to obligations incurred before the registration of the joint stock company.

In order to establish a joint stock company, the founders must give notice of their intention to establish a joint stock company, carry out a subscription for shares, hold a founding meeting and officially register the joint stock company.

Paragraph 27. Issuing of securities by the joint stock company

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

Paragraph 28. Acquisition of shares

Shares are purchased by the copartners at the time of the establishment of the joint stock company on the basis of an agreement with the company's founders, and in cases when additional shares are issued because of an increase

in the size of the capital fund, on the basis of an agreement with the company.

If not otherwise specified by the company statute, a share may be also be acquired through agreement with its owner or holder for a price agreed upon by the two parties, or for the price which it is worth on the stock market, or through inheritance by a citizen or a legal entity which is a legal successor. The manner in which shares are sold is to be specified in accord with Ukrainian law.

Paragraph 29. Circulation of shares

At the time of the establishment of the joint stock company, shares may be circulated through public subscription (in the case of publicly-owned joint stock companies) or division of all the shares among the founders (in the case of private joint stock companies).

Paragraph 30. Public subscription for shares

Public subscription for shares at the time of the establishment of a joint stock company is organized by the founders. The founders are obliged to be holders of shares amounting to not less than 25 percent of the capital fund for a term of not less than 2 years.

The founders of a joint stock company publish notice of a coming subscription, in which must be indicated the company name, object, aims and terms of activity of the company, the founders, the date of the founding meeting, the projected size of the capital fund, the nominal value of the shares, their number and forms, the privileges and advantages enjoyed by the copartners, the location and the opening and closing dates of the subscription, the form of property being invested by the founders in natural form, the name of the banking institution and the number of the checking account into which the initial investments will be contributed. Upon the decision of the founders, the notice may also include other information. The term of public subscription may not be longer than six months.

Persons who wish to acquire shares must pay to the founders' account not less than 10 percent of the value of the shares for which they have subscribed, after which the founders will issue them a written commitment regarding the sale of the appropriate number of shares.

After the end of the term indicated in the notice, the subscription is suspended. If up to that time, the founders have not succeeded in selling by subscription 60 percent of the shares, the joint stock company is considered not to have been founded. Persons who subscribed for shares are returned the sums or other property invested within 30 days. Liability for the failure to do this is carried in common by the founders.

In the case that subscriptions for shares exceed the size of the capital fund, the founders may decline to accept excess subscriptions. Rejection of subscriptions is done

on the basis of a list of subscribers, beginning at the end of the list. Should the founders not reject the excess subscriptions, the decision regarding acceptance or rejection of the excess subscription is made by the founding meeting. If the founders or the founding meeting reject the excess subscriptions, the sums invested are returned in the manner specified in part four of this paragraph.

Before the day when the founding meeting is called, persons who subscribed for shares must pay, including their previous payment, not less than 30 percent of the nominal value of their shares. As confirmation of their investment, the founders issue temporary certificates.

Paragraph 31. Division of all shares among the founders of a joint stock company

In cases where all the shares of a joint stock company are divided among the founders, the founders must pay, before the date of the founding meeting, not less than 50 percent of the nominal value of the shares.

Paragraph 32. Acquisition by a joint stock company of its own shares

A joint stock company has the right to buy out shares purchased by a shareholder and paid for by him only with funds that are not part of the capital fund, for the purposes of future resale, circulation among employees or annulment. These shares must be sold or annulled within a term of not more than one year. During this period, division of the profit, as well as voting and defining a quorum at general shareholder meetings, is done without taking into account the shares acquired by the joint stock company.

Paragraph 33. Payment for shares

A shareholder is obliged to pay the full value of his shares within the terms set out by the founding meeting, but not later than one year after the registration of the joint stock company.

In the case of failure to pay within the set term, the shareholder, unless otherwise specified by the company statute, is charged interest on the outstanding sum of 10 percent per year for the period of the delay.

In the case of failure to pay within three months after the set term, the joint stock company has the right to sell the shares in the manner established by the company statute.

Paragraph 34. Ban on issuing shares in order to cover losses

A joint stock company is forbidden to issue shares to cover losses linked with its economic activity.

Paragraph 35. Founding meeting of the joint stock company.

The founding meeting of the joint stock company is called within the term indicated in the notice, but not later than two months from the time of the completion of the subscription for shares.

Should this deadline be missed, a person who subscribed to shares has the right to demand the return of the portion of the value of the shares which he has paid for.

The founding meeting of the joint stock company is recognized as valid if it has the participation of persons who subscribed for more than 60 percent of the shares for which a subscription was held.

If because of a lack of a quorum the founding meeting does not take place, another founding meeting is called within two weeks. If again there is a lack of a quorum, the joint stock company is considered nonexistent.

Voting at the founding meeting takes place according to the principle of one share, one vote.

Decisions regarding the establishment of a joint stock company, or its branch enterprises, affiliates and agents, about the election of a joint stock company council (overseeing council) and executive and control bodies of the joint stock company or about granting privileges to the founders at the company's expense must be passed by a majority of $\frac{2}{3}$ of the votes of the persons present at the founding meeting who have subscribed for shares, and other matters, by a simple majority of votes.

Paragraph 36. The mandate of the founding meeting of a joint stock company

The founding meeting of a joint stock company decides the following matters:

- a) passes resolutions about the establishment of the joint stock company and ratifies its statute;
- b) accepts or rejects proposals regarding subscriptions for shares which exceed the number of shares for which the subscription was announced (if a resolution regarding a subscription exceeding the announced subscription is passed, the projected capital fund is appropriately increased);
- c) decreases the size of the capital fund in cases when the full amount indicated in the notice has not been covered by subscriptions for shares within the set term;
- d) elects the council of the joint stock company (overseeing council) and the executive and control body of the joint stock company;
- e) resolves questions related to the acceptance of agreements made by the founders before the establishment of the joint stock company;
- f) defines the privileges granted to the founders;
- g) approves evaluations of the investments made in natural form;
- h) other matters as specified by the founding documents.

Paragraph 37. Content of the joint stock company statute

The statute of the joint stock company must include, in addition to the information mentioned in paragraph 4 of this Law, information about the types of shares being issued, their nominal value, the relationship among various types of shares, the number of shares being purchased by the founders and the consequences of the failure to meet obligations with regard to purchasing shares.

Paragraph 38. Procedure for increasing the size of the capital fund of a joint stock company

A joint stock company has the right to increase the size of its capital fund if all the previously-issued shares are fully paid for at a value not below the nominal value.

The capital fund is enlarged through the issue of new shares, exchange of bonds for shares or increase of the nominal value of the shares.

Subscription for additionally-issued shares takes place in the manner specified by paragraph 30 of this Law. Shareholders have priority in acquiring additionally-issued shares.

An increase of not more than 1/3 in the capital fund of a joint stock company may take place at the decision of the directors if so specified by the statute.

Changes in the statute related to an increase in the size of the capital fund must be registered by the body which registered the company statute after the additionally-issued shares are sold.

A procedure for enlarging the capital fund different from the one presented in this paragraph may be specified by the statutes of banking and insurance institutions which are joint stock companies.

Paragraph 39. Procedure for decreasing the size of the capital fund of a joint stock company

A decision to decrease the size of the capital fund of a joint stock company is made in the same manner as that to enlarge the capital fund.

The size of the capital fund is decreased by decreasing the nominal value of shares or by decreasing the number of shares by purchasing some of the shares from their owners in order to annul these shares.

If a joint stock company decides to decrease the size of the capital fund, shares not remitted for annulment are considered invalid, but not sooner than six months after all shareholders have been notified of this in the manner specified by the statute.

The joint stock company will compensate the share owners for losses related to changes in the capital fund. Disagreements regarding compensation for these losses are settled by a court or an arbitration court.

Paragraph 40. Notice of a general meeting on changes to the capital fund of a joint stock company

The notice regarding the calling of a general meeting to deal with matters related to changes in the capital fund of a joint stock company must include:

- a) the reasons, method and minimal size of the increase or decrease in the size of the capital fund;
- b) a draft of the changes to be made to the company statute in relation to the increase or decrease in the size of the capital fund;
- c) information about the number of shares which are being additionally issued or withdrawn and their total value;
- d) information about the new nominal value of shares;
- e) the rights of shareholders during the supplemental issue of shares or their withdrawal;
- f) the opening and closing dates of the subscription for shares being additionally issued, or of their withdrawal;
- g) the manner in which share owners will be compensated for losses linked with changes to the capital fund.

Paragraph 41. The highest body of a joint stock company

The highest body of a joint stock company is the general meeting of the company. All shareholders have the right to take part in the general meeting, regardless of the number or class of the shares they own. Members of executive bodies who are not shareholders are also allowed to take part in the general meeting with the right of an advisory vote. The shareholders (their representatives) who take part in the general meeting are registered with an indication of the number of votes each one has. This list is signed by the meeting chairman and secretary.

The competence of the general meeting includes:

- a) defining the basic directions of the joint stock company's activity and approving plans and reports about their realization;
- b) making changes to the company's statute;
- c) election and dismissal of members of the joint stock company council (overseeing council);
- d) election and dismissal of members of the executive body and auditing commission;
- e) acceptance of the annual assessments of the activities of the joint stock company, including its branch enterprises, acceptance of the reports and assessments of the auditing commission and the manner in which the profits are shared out, determination of the manner in which losses are to be covered;
- f) establishment, reorganization and liquidation of branch enterprises, affiliates and agents, ratification of their statutes and regulations;
- g) passage of resolutions about imposing property liability on company executives;

h) acceptance of rules of procedure and other internal company documents and determination of the company's organizational structure;

i) resolution of questions regarding the acquisition by the joint stock company of its own shares;

j) definition of the conditions of payment for the work of employees of the joint stock company, its branch enterprises, affiliates and agents;

k) approval of contracts (agreements) made for an amount which exceeds that indicated in the company statute;

l) passage of a resolution concerning the cessation of the company's activity, appointment of a liquidation commission, acceptance of the liquidation balance.

Other matters may be included in the competence of the general meeting by the company statute.

The general meeting is recognized as valid if it has the participation of shareholders who have, in compliance with the company statute, more than 60 percent of the votes.

Paragraph 42. Validity of the decisions of the general meeting of shareholders

On the following matters, decisions of the general meeting of shareholders must be passed by a majority of $\frac{2}{3}$ of the votes of the shareholders taking part in the meeting:

a) change of company statute;

b) passage of a resolution about the cessation of the company's activity;

c) establishment and cessation of the activity of branch enterprises, affiliates and agents of the company.

On other matters, decisions are made by a simple majority of votes of the shareholders taking part in the meeting.

Paragraph 43. Procedure for calling a general shareholder meeting

The holders of inscribed stock give personal notice of the holding of a general shareholder meeting. In addition, general notice of the meeting must be given in the manner specified by the statute, with information about the time and place of the meeting and its agenda. The notice should be issued not less than 45 days before the date of the general meeting.

Any shareholder has the right to make proposals for the agenda of general meeting not later than 40 days before the date of the meeting. Within this term, shareholders who control a total of more than 10 percent of the votes may demand the inclusion of a matter in the meeting agenda.

Before the date of the general meeting, shareholders must be given the possibility of familiarizing themselves with documents related to the meeting agenda.

The general meeting does not have the right to make decisions on matters which are not included in the agenda.

Paragraph 44. Method of voting at the general shareholder meeting

Voting at the general shareholder meeting is done according to the principle of one share, one vote. The company statute may establish the minimal number of shares needed to have the right to vote or a limit to the number of votes which may be had by a single shareholder.

A representative may be permanent or appointed for a certain term. A shareholder has the right to change his representative to the highest body so long as he gives notice of this fact to the executive body of the joint stock company.

Paragraph 45. Frequency at which general meetings are called. Extraordinary meetings

A general shareholder meeting is called not less frequently than once per year, unless otherwise specified by the company statute.

Extraordinary shareholder meetings are called in case of the company's inability to pay its debts and in other circumstances set out in the company statute, and in any other case if so demanded by the general interests of the joint stock company.

Such a meeting must also be called by the executive body at the demand of the shareholder council (overseeing council).

Shareholders who control a total of more than 20 percent of the votes have the right to demand the calling of an extraordinary meeting at any time and for any reason. If within 20 days the directors have not carried out this demand, the shareholders have the right to call such a meeting themselves.

Paragraph 46. The joint stock company council (overseeing council)

Within a joint stock company, a joint stock company council (overseeing council) may be established which is responsible for controlling the activity of the executive body.

The joint stock company council (overseeing council) may be mandated specific functions that are part of the competence of the general meeting by the company statute or by a decision of a general shareholder meeting.

Members of the joint stock company council (overseeing council) may not be members of the executive body.

Paragraph 47. The executive bodies of a joint stock company

The board of directors or another body specified by the company statute is the executive body of the joint stock company and directs its current activities.

The work of the board of directors is headed by the chairman of the board, who is appointed or elected according to the statute of the joint stock company.

The board of directors decides all matters relating to the activity of the joint stock company, except for those which are part of the competence of the general meeting and the joint stock company council (overseeing council). The general meeting may pass a resolution transferring part of its rights to the competence of the board of directors.

The board of directors must report to the general shareholder meeting and the joint stock company council (overseeing council) and see to the implementation of their decisions.

The board of directors acts in the name of the joint stock company within the limits specified by this Law and the joint stock company statute.

The work of the board of directors is headed by the chairman of the board, who is appointed or elected in the manner set out by the joint stock company statute.

Paragraph 48. Chairman and members of the board of directors of a joint stock company

The chairman of the board of directors of a joint stock company has the right to act without special warrant in the name of the company. Other members of the board of directors may also be granted this right in accord with the statute.

The chairman of the company's board of directors sees to it that the minutes of board meetings are recorded.

The minute book must be available at all times to the shareholders. At their demand, signed extracts of the minute book must be provided.

Persons who are employed by the company are permitted to serve as chairman and members of the board of directors.

Paragraph 49. Audit commission of a joint stock company

Control over the financial and economic activity of the board of directors of a joint stock company is carried out by an auditing commission, the members of which are elected from among the shareholders.

The manner in which the auditing commission carries out its activity and the number of its members is approved by the general shareholder meeting in accord with the statute of the joint stock company.

Verification of the financial and economic activity of the board of directors is done by the auditing commission at the request of the general meeting or the joint stock company council (overseeing council), at its own initiative or at the demand of shareholders controlling a total of more than 10 percent of the votes. All materials, accounting or other documents and personal explanations by employees must be provided to the auditing commission of the joint stock company at its demand.

The auditing commission reports the results of its verifications to the general meeting of the joint stock company or to the joint stock company council (overseeing council).

Members of the auditing commission have the right to take part in meetings of the board of directors with an advisory vote.

The auditing commission makes its assessment of annual reports and balances. Without an assessment of the auditing commission, the general shareholder meeting does not have the right to accept the balance.

The auditing commission must demand the calling of an extraordinary general shareholder meeting in the case of an appearance of a threat to the vital interests of the joint stock company or the revelation of misuse by executives.

Chapter 2. Limited Liability Company

Paragraph 50. Concept of a limited liability company

A company that is recognized as a limited liability company is one which has a capital fund divided into parts, the sizes of which are set out by the founding documents.

Copartners of the company are liable within the limits of their investments.

In cases specified by the founding documents, copartners who have not paid their investments in full are liable for the company's obligations also within the limits of the unpaid part of the investment.

Paragraph 51. Particular features of the content of the founding documents of a limited liability company

The founding documents of a limited liability company must include, in addition to the information indicated in paragraph 4 of this Law, information about the size of the share of each of the copartners, and the size, composition and manner of contributing their investments.

Changes in the value of the property contributed as an investment and additional contributions by copartners do not affect the size of their share in the capital fund set out by the founding documents of the company, unless otherwise specified by the founding documents.

Paragraph 52. Capital fund of a limited liability company

In a limited liability company, a capital fund is established, which must be no less than 50 thousand rubles.

Up to the time of registration of the limited liability company, each of the copartners is obliged to invest not less than 30 percent of the investment specified by the founding documents, and the investment is confirmed by documents issued by a banking institution.

Each copartner is obliged to pay his investment in full not later than one year after the company's registration. In the case that this obligation is not met within the set term, the copartner is charged interest of 10 percent per year on the outstanding sum for the period of delay unless otherwise specified by the founding documents.

A copartner of a limited liability company who has paid his investment in full is given a certificate to this effect by the company.

Paragraph 53. Concession of a share (part of it) in the capital fund of a limited liability company

A copartner of a limited liability company may, with the agreement of the other copartners, concede his share (part of it) to one or several other copartners and, if not otherwise specified by the founding documents, also to third parties. The company's copartners have priority in acquiring the share (part of it) of a copartner who is conceding it in proportion to their shares in the company's capital fund or as otherwise agreed among themselves.

The transfer of the share (part of it) to third parties may take place only after full payment of the investment by the copartner who is conceding the share.

In the case of the transfer of a share (part of it) to a third party, a simultaneous transfer occurs of all the rights and obligations belonging to the copartner who conceded the share in full or in part.

The share of a copartner of a limited liability company may be acquired by the company itself after he has paid the investment in full. In this case, the company is obliged to transfer the share to other copartners or to third parties within a term which may not exceed one year. During this period, the division of the profit, as well as voting and the definition of a quorum is done by the highest body without taking into account the share acquired by the company.

Paragraph 54. Payment of the value of property at the time of withdrawal of a copartner from a limited liability company

Should a copartner withdraw from the limited liability company, he is paid the value of a part of the company's property in proportion to his share of the capital fund. The payment is made after acceptance of the report for the year in which he withdrew from the company, within a term of 12 months from his withdrawal. At the demand

of the copartner and with the agreement of the company, the investment may be returned in full or in part in natural form.

The copartner who has withdrawn is paid part of the profit owing to him earned by the company in that year up to the time of his withdrawal. Property contributed by the copartner for use by the company is returned in natural form without any payment.

Paragraph 55. The legal successors (heirs) of a copartner of a limited liability company

In the case of reorganization of a legal entity which is a copartner of a company, or in relation to the death of a citizen who is a copartner of a company, the legal successors (heirs) have a priority right to enter the company.

In the case of a refusal of the legal successor (heir) to enter the limited liability company or a refusal of the company to accept the legal successor (heir), he is given in monetary or natural form the share of the property which belonged to the reorganized or liquidated legal entity (heir), the value of the share being determined on the day of the reorganization or liquidation (death) of the copartner. In this case, the size of the company's capital fund is decreased.

Paragraph 56. Period of coming into effect of decisions regarding decrease of the size of the capital fund of a limited liability company

The decision of a limited liability company about decreasing the size of the capital fund comes into effect not sooner than three months after government registration and publication of this fact in the established manner.

Paragraph 57. Application of recovery against the share of a copartner of a limited liability company

The application of recovery against the share of a copartner of a limited liability company in relation to his personal obligations is not permitted.

Should a copartner have insufficient property to cover his debts, the creditor has the right to demand the company share of the indebted copartner in the manner specified by paragraph 55 of this Law.

Paragraph 58. The highest body of a limited liability company

The highest body of a limited liability company is the copartners' meeting. It is composed of the copartners of the company or representatives appointed by them.

The copartners' representatives may be permanent or appointed for a specific term. A copartner has the right to change his representative to the copartners' meeting at any time so long as he informs the other copartners of this fact.

A copartner of a limited liability company has the right to transfer his meeting mandate to another copartner or representative of another copartner of the company.

Copartners have a number of votes in proportion to the sizes of their shares in the capital fund.

The copartners' meeting elects the chairman of the company.

Paragraph 59. Competence of the meeting of the copartners of a limited liability company

The competence of the meeting of the limited liability company includes, in addition to the matters set out in points a), b), c- b), j-1) of paragraph 41 of this Law:

a) determining the size, form and manner of contribution of additional investments by copartners;

b) resolution of matters related to the acquisition by the company of a copartner's share;

c) exclusion of a copartner from the company.

On the matters set out in points a) and b) of paragraph 41 of this Law, as well as on matters related to the exclusion of a copartner from the company, unanimity of the highest body is required.

On other matters, decisions are made by a simple majority of votes.

Paragraph 60. Decision-making procedure of the meeting of the copartners of a limited liability company

The copartners' meeting is considered valid if it has the participation of copartners (representatives of copartners) controlling a total of more than 60 percent of the votes, and for questions which require unanimity, participation of all copartners.

Members of the executive bodies who are not copartners of the company may take part in meetings with the right of an advisory vote. Copartners who take part in a meeting are registered with an indication of the number of votes each copartner has. This list is signed by the meeting chairman and secretary.

Any copartner of a limited liability company has the right to demand consideration of a matter at the copartners' meeting if he makes his proposal no later than 25 days before the date of the meeting.

In cases specified by the founding documents or by procedural rules approved by the company, resolutions may be passed by the method of questioning. In this case, a draft resolution or question to be voted on is sent to the copartners, who must give their opinion in written form. Within 10 days of the reception of the last reply from the voters, all the copartners must be informed by the chairman about the resolution that has been passed. Resolutions made by means of questioning are regarded as accepted in the absence of rejection by even a single copartner.

The chairman of the company meeting sees to it that the minutes are recorded. The minute book must be available at any time to the company copartners. At their demand, signed extracts from the minute book must be provided.

Paragraph 61. Frequency of calling of meetings of copartners of a limited liability company. Extraordinary meetings

A meeting of the copartners of a limited liability company is called not less than twice per year, unless otherwise specified by the founding documents.

Extraordinary meetings of the copartners are called by the company chairman under circumstances set out in the founding documents, in the case of inability of the company to pay its debts, and in other cases if so required by the general interests of the company, in particular, if a threat arises of a significant decrease in the size of the capital fund.

A meeting of company copartners must also be called at the demand of the executive body.

Company copartners controlling a total of more than 20 percent of votes have the right to demand the calling of extraordinary copartners' meeting at any time and for any reason related to the activity of the company. If the company chairman does not meet such a demand within 25 days, the copartners have the right to call the meeting themselves.

Notice to copartners about the calling of a general meeting of the company is given in the manner specified by the statute and must include the time and place of the meeting and its agenda. The notice must be given not less than 30 days before the date of the general meeting. Any copartner has the right to demand consideration of a matter by the meeting so long as he makes his proposal not later than 25 days before the date of the meeting. Not later than seven days before the general meeting, the company copartners must be given the possibility of familiarizing themselves with documents related to the meeting agenda. Resolutions on matters not included in the agenda may be passed only with the agreement of all the copartners present at the meeting.

Paragraph 62. Executive body of a limited liability company

Within a limited liability company, an executive body is established which is collegial (board of directors) or composed of one person (director). The board of directors is chaired by the general director. Persons who are not copartners of the company may be members of the executive body.

The board of directors (director) deals with all matters related to the company's activity, with the exception of those which are part of the exclusive competence of the copartners' meeting. The copartners' meeting may pass resolutions transferring part of its authority to the competence of the board of directors (director).

The board of directors (director) reports to the copartners' meeting and sees to the implementation of its decisions. The board of directors (director) does not have the right to make decisions which are obligatory to company copartners.

The board of directors (director) acts in the name of the company within the limits set by the present Law and the founding documents.

The general director has the right to act without special warrant in the name of the company. Other members of the board of directors may also be granted this right.

The general director (director) may not also be chairman of the meeting of the company copartners.

Paragraph 63. Control over the activity of the board of directors (director) of the limited liability company

Control over the activity of the board of directors (director) of the limited liability company is carried out by the auditing commission, which is established by a meeting of the company copartners from their own ranks with the number of members specified by the founding documents, but no fewer than three. The members of the board of directors (director) may not be members of the auditing commission.

Verification of the activity of the company's board of directors (director) is done by the auditing commission at the request of the meeting, at its own initiative or at the demand of the company copartners. The auditing commission has the right to demand from the company's executives all essential materials, accounting and other documents and personal explanations.

The auditing commission reports the results of its verifications to the company's highest body.

The auditing commission makes an assessment of annual reports and balances. Without the assessment of the auditing commission, the meeting of the company copartners does not have the right to accept a company balance.

The auditing commission has the right to propose the calling of an extraordinary copartners' meeting if a threat arises to the vital interests of the company or in the case of revelation of misuse by company employees.

Paragraph 64. Exclusion from a limited liability company

A copartner in a limited liability company who systematically fails to fulfill or improperly fulfills his obligations, or by his actions prevents the company from attaining its goals, may be excluded from the company by a resolution passed unanimously by a copartners' meeting. In this case, the copartner involved (his representative) does not take part in the voting.

If a copartner is excluded from the company, the results specified by paragraphs 54 and 55 of this Law apply.

Chapter 3. Additional Liability Company

Paragraph 65. Concept of an additional liability company

A company recognized as an additional liability company is one which has a capital fund divided into parts, the sizes of which are defined by the founding documents. The copartners of the company are liable for its debts with their investments to the capital fund, and in the case that these funds are insufficient, with their own property, in proportion to the investment of each copartner.

The limit of liability of the copartners is specified by the founding documents.

Applicable to an additional liability company are the standards set out in paragraphs 4, 11 and 52-64 of this Law, taking into account the particular features specified by a given paragraph.

Chapter 4. Full Partnership

Paragraph 66. Concept of a full partnership

A company recognized as a full partnership is one of which all the copartners are engaged in common entrepreneurial activity and carry common liability for the company's obligations with all of their property.

Paragraph 67. Content of the founding agreement for a full partnership

The founding agreement for a full partnership must indicate, in addition to the conditions specified by paragraphs 4 and 66 of this Law, the size of the shares of each of the copartners, the size, composition and manner of making contributions, the form of their participation in the affairs of the company.

Paragraph 68. Management of the affairs of a full partnership

Management of the affairs of a full partnership is carried out according to the general agreement of all copartners.

Management of company affairs is carried out either by all the copartners or by one or several of them acting in the name of the company. In the latter case, the extent of the mandate of these copartners is specified by an authorization which must be signed by the rest of the company copartners.

If the founding agreement states that some copartners are given the mandate to manage the company's affairs, it is specified that each of them may act independently in the name of the company. The founding agreement may state that these copartners have the right to carry out any given acts only in common.

Copartners who have been commissioned to manage the affairs of a full partnership are obliged to provide to the

other copartners at their demand complete information about actions carried out in the name and in the interests of the company.

The mandate of a copartner to manage company affairs is fully or partly suspended in the case of cessation of the company's activity, the copartner's rejection of the commission or the cancellation of the commission at the demand of even one of the other copartners.

A copartner who acted in the common interest without a mandate, should his actions not be approved by the other copartners, has the right to demand compensation for his expenses if he can demonstrate that as a result of his actions, the company preserved or acquired property which exceeds in value the expenses incurred by the company.

Paragraph 69. Surrender of a share (part of it) of a partner of a full partnership

The transfer by a partner of a full partnership of his share (part of it) to other copartners of the company or third parties may take place only with the agreement of all the copartners.

With the transfer of a share (part of it) to a third party, there is a simultaneous transfer of the totality of rights and obligations belonging to the copartner who withdrew from the full partnership or surrendered part of his share.

In the case of reorganization of a legal entity which is a copartner of a full partnership, or the death of a citizen who is a copartner of a full partnership, the legal successor (heir) has a priority right to join the company with the agreement of all the other copartners.

The legal successor (heir) bears responsibility for the debts of the copartner to the full partnership and for the debts of the company to third parties which were incurred during the period of the company's activity.

In the case of a refusal of the legal successor (heir) to join the full partnership or a refusal of the company to accept the legal successor (heir), he is paid the value of the share which belongs to the reorganized legal entity (heir), with the value being determined on the day of reorganization (death) of the copartner. In this case, the amount of the company's property, defined in the founding agreement, is suitably decreased.

Paragraph 70. Ban on competition of the copartners of a full partnership with the full partnership

The copartners of a full partnership do not have the right to make agreements in their names and in their interests which are identical to the goals of the activity of the company, or to take part in any companies (except for joint stock companies) which have the same goals of activity as the full partnership.

In the case that a copartner breaches the regulations established by this paragraph, he is obliged to compensate the losses caused by his actions to the company.

Paragraph 71. Withdrawal of a copartner from a full partnership

A copartner of a full partnership which has been established for an indeterminate term may leave the company at any time so long as he gives notice of this fact no less than three months in advance.

Withdrawal from a company which has been established for a set term is allowed only if there are serious reasons and if warning of this fact is given no less than six months in advance.

If upon the withdrawal of a copartner from a full partnership, the company continues to exist, the copartner is paid the value of his investment in accordance with the balance calculated on the day of his withdrawal. At the demand of the partner and with the agreement of the company, the investment may be returned in full or in part in natural form.

The copartner who withdraws is paid the share of the profit owing to him, which was earned by the company during that year. Any property contributed by the copartner for the company's use is returned in natural form without any payment.

Paragraph 72. Exclusion of a copartner from a full partnership

The copartner of a full partnership who systematically fails to carry out or improperly carries out his duties or prevents by his actions the attainment of the company's goals may be excluded from the partnership in the manner specified by the founding documents.

If a copartner of a full partnership is excluded, the results specified by paragraph 71 of this Law apply.

Paragraph 73. Application of recovery against the copartner's share in a full partnership

Application of recovery against the share of a copartner in a full partnership in relation to his own obligations is not permitted. If the copartner has insufficient property to cover his debts, the creditors may demand in the established manner the liquidation of the company or the apportionment of the share of the indebted copartner.

The other copartners have the right, with the aim of maintaining the existence of the company, to apportion the share of the indebted partner in monetary or natural form in accordance with the balance calculated on the day of the copartner's withdrawal from the company.

Paragraph 74. Liability of copartners for the debts of a full partnership

If at the time of liquidation of a full partnership, it is found that the property is insufficient to pay all the

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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 Minerego?

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.

SC = G of JS Co
E of founders
banks
WC
SPF
+ other bodies

to be approved by Min Economy
Finance
SPF

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 10% 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.

Waterhouse

PHONE NO. : +229 6155

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World Bank, Kiev

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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

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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.

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 foregoing 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,

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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.

PLAN FOR NDC SOLVENCY

— March 1996

CHANGED FROM
~~March 1996~~
28 FEB

1 Background

As of 29 February 1996, NDC is insolvent. The past due claims on NDC, including its 8 RDCs, exceed its cash on hand by about Kv200 trill (\$1,100 mil at Kv180,000/\$). Of this amount, only Kv30 trill has been formally presented at NDC's bank. Of this Kv30 trill, about Kv3 trill consists of claims by tax authorities.

Banking regulations give priority to payments due to such tax claims, with the effect that all cash paid into NDC accounts is de facto taken by tax authorities and none goes to other creditors. As a result, NDC now avoids using its cash account by diverting payments through barter arrangements or through the RDCs, both of which cause confusion and distrust.

The effect has been to destroy the reliability of NDC's promises to pay, making it impossible for the World Bank to lend money to or through HXZ, and preventing NDC from objectively administering the payment rules called for in the prospective Energomarket Members Agreement.

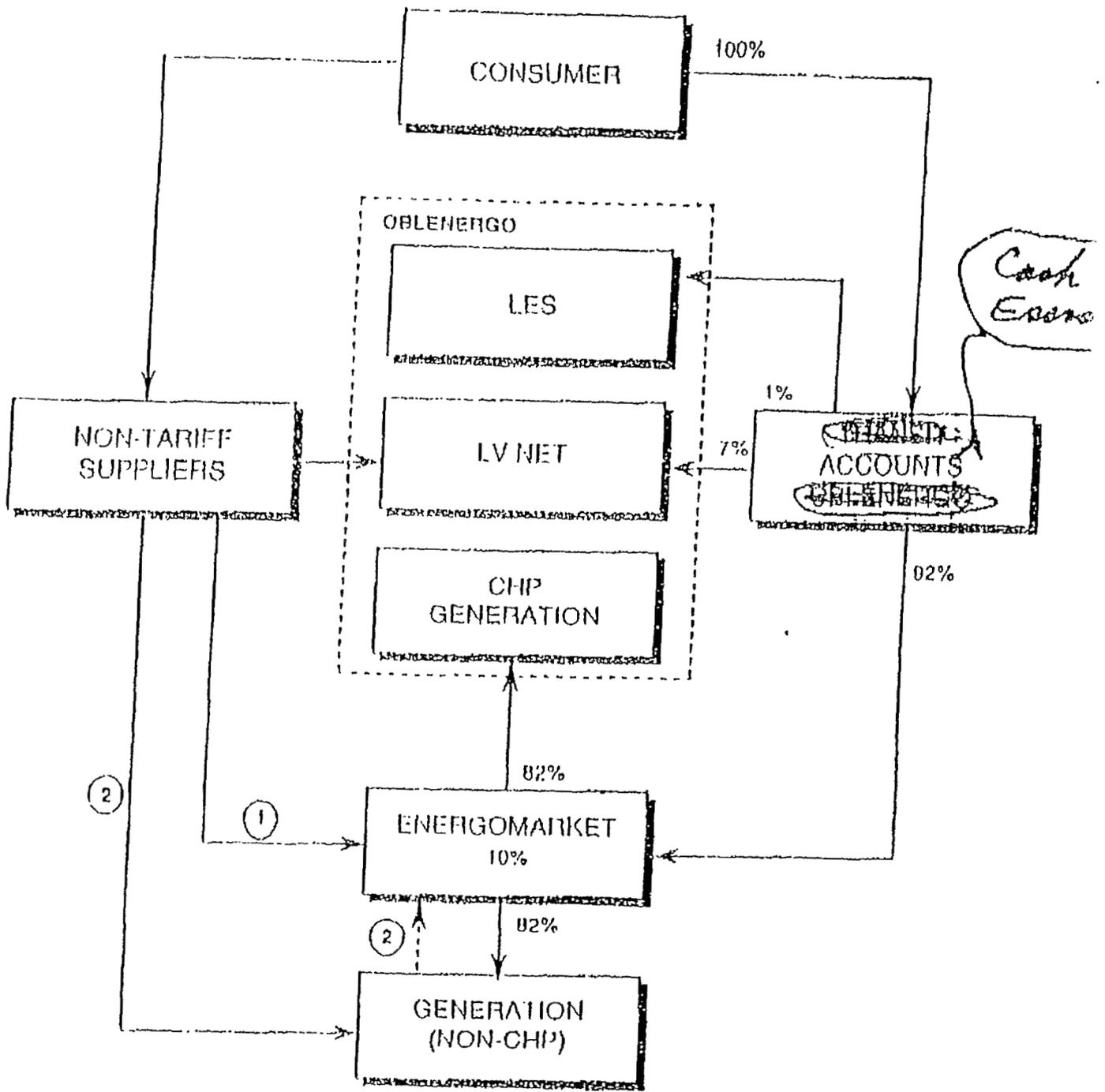
The Kv200 trill owed by NDC is in principle offset by over Kv200 trill of arrears owed to NDC by the oblenergos. These oblenergo arrears arose for two reasons:

- 1.1 The oblenergos are in turn owed a roughly similar amount by their customers, which the oblenergos have so far been unable or unwilling to collect; and
- 1.2 Of the amounts collected, the oblenergos appear to be retaining amounts in excess of what they are entitled to, paying a correspondingly reduced amount to NDC.

As a step toward improving payments to NDC by reducing problem 1.2 above, Hfinergo and the NDC are installing a system by which all cash payments from all retail electricity customers in Ukraine are paid into cash escrow accounts controlled jointly by the National Bank of Ukraine and NDC. While helpful, the escrow accounts will do little to solve the most serious problem, 1.1 above.

At the same time, many of the best electricity customers have taken to purchasing their power through nontariff suppliers as part of barter and offset transactions. These escrow and nontariff payment arrangements are illustrated in Figure J attached.

FIGURE 1 - PROSPECTIVE PAYMENT FLOWS



Cash
Errors

- ① Cash Purchase
- ② Barter and Offset
- % Percent of Regulated Retail Tariff

(Rus = Nick)

These changes are to be accomplished by the oblenergos signing the Energomarket Members Agreement together with a supplementary agreement on escrow accounts and special collections as in Annexes 1 and 2, and in the interim if necessary by amending the existing RDC/oblenergo sale agreements. There would be no NDC agreement to defer collection of oblenergo debts.

- 2.3 NDC+RDCs/Genco energy purchase agreements are to be changed to provide that:
- (1) NDC's energy purchase price is to be set at the NERC-approved generator tariff until the Energomarket Members Agreement ("EMA") becomes effective and the generator licenses are issued at which time the purchase price is to be set according to the Market Rules;
 - (2) NDC's payment obligation is to be limited to applying the available funds according to the EMA funds administration procedure (EMA Annex 5), and under no circumstances can a genco claim additional payment from NDC;
 - (3) Each genco agrees to convert the full amount due to it from NDC+RDCs as of [2 April] 1996 (the "Effective Date") to a promissory note in the form attached as Annex 3;
 - (4) Each genco agrees to take all necessary actions to release all claims filed by it with NDC+RDCs banks within [5] business days after the Effective Date; and
 - (5) Each genco agrees to allow NDC to devote all of NDC's cash proceeds received subsequent to the Effective Date to payment of its remaining overdue obligations, in the amount of approximately \$[6.0] bill, until these amounts are fully paid, a period estimated at [5-10] calendar days (the "Interim Period"). All power purchase payment obligations incurred by NDC during the Interim Period shall be deferred and added to the amount of the Annex 3 note at the end of the Interim Period.

These changes are to be accomplished by the gencos signing the Energomarket Members Agreement together with promissory notes as in Annex 3, and in the interim if necessary by amending the existing power purchase agreements.

- 2.4 NDC must renegotiate its bank loans to extend their maturity so that they can be repaid from a wholesale market price surcharge over a period of time.

3 Required Actions

The arrangements set out above are to be accomplished by the following actions:

3.1 NDC+RDCs must agree with the obligors on amounts due as of the most recent available month end (the "Reference Date"). These amounts would then be updated as of the Effective Date. This requires:

(1) NDC+RDCs should notify each obligor of the total amount due at the Reference Date according to NDC records. Each obligor notifies NDC of the same according to their records. In the event of differences which cannot be resolved by the parties within 10 days, NERC decides.

(2) NERC confirms ~~the applicable~~ ^{a procedure} rule used to determine when a retail customer is in default on its payment obligation (the "Default Rule").

registrar
o This would be the time at which the obligor would be ~~allowed~~ ^{Advised} to suspend service for nonpayment, which may differ by customer class.

o There must be a Default Rule for all customers, even those where suspension of service is actually not allowed.

o For example, the Default Rule could be as simple as: "A customer is in Default if any amount remains unpaid 15 calendar days after the later of (a) the date it was due or (b) [the Effective Date]."

(3) Each obligor must provide NDC's Market Funds Administrator with summary information on those customers who are in Default, including the total number of such customers, the number whose service has been suspended, and the total amount of money due from them at the Reference Date.

3.2 The standard form of NDC power sale agreement, embodying the provisions of sections 2.1 and 2.2 above, is prepared by NDC and approved by the NERC.

3.3 NDC+RDCs notify each of the gencos of the total amount due to them at the Reference date according to NDC records. Each genco notifies NDC of the same according to their records. In the event of differences which

Plan for NDC Solvency
3 March 1996
Page 6

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can not be resolved by the parties within 10 days, NERC decides.

- 3.4 The standard form of NDC power purchase agreement and promissory note, embodying the provisions of section 2.3 above, is prepared by NDC and approved by the NERC.
- 3.5 On the Effective Date designated by the NERC, prospectively on (2 April 1996), the following actions are taken:
- (1) Each oblenergo signs the approved NDC power sale agreement using the figures determined in action 3.1 above;
 - (2) The accounts of all retail customers in Default are transferred to their oblenergo special collections group for special collection action according to Annex 2;
 - (3) Each genco signs the approved NDC power purchase agreement and promissory note using the figures determined in action 3.3 above; and
 - (4) NDC's bank creditors sign the loan rescheduling agreement.
- 3.6 In the days immediately following the Effective Date, all cash collected by NDC will be applied to pay off its remaining creditors. This should take 5-10 days, after which NDC's bank accounts should be free from liens, and NDC can resume trading as a solvent enterprise.

These action should be taken at once, regardless of completion of the Energomarket Members Agreement.

4 Effects

These forbearance and collection arrangements should restore NDC's solvency and gradually end the nonpayments problem in the power sector.

In so doing it should be noted that these collection procedures have the following effects:

- 4.1 The oblenergos are given strong incentives to collect on old debts and to prevent new defaults.
- 4.2 The collection performance of the oblenergos is to be monitored by the NDC's Market Funds Administrator on behalf of the Energomarket Board, which will be empowered to recommend penalties if an oblenergo fails to perform the specified special collection procedures.

- 4.3 The cash escrow accounts give NDC the means to enforce payment proration rules on the oblenergos and to collect any penalties due from them for failure to perform the special collection procedures.
- 4.4 Special collections departments are part of any market-based electricity supply organization, and the early development of these capabilities will add a permanent value to each of the oblenergos.
- 4.5 The collection enforcement mechanism does not require broad curtailment of electricity service to whole oblenergos, so there should be no interference with supply to customers who do pay promptly.
- 4.6 The cost of an oblenergo failure to collect arrears and suspend service to nonpayers will be borne by local customers in the form of an oblenergo-specific surcharge on wholesale electricity prices which will be publicized and provide local pressure on the oblenergos to perform.
- 4.7 The whole process is under NERC supervision to prevent abuse and is to be carried out uniformly nationwide to prevent unfair burdens across regions.

ANNEX 1

CASH ESCROW ACCOUNT CONDITIONS

This annex sets out proposed conditions which the planned cash escrow accounts should fulfill in order to assure that they are ~~effective~~ and yet do not interfere with existing nontariff trading arrangements:

- 1 All existing payment arrears due to oblenergos must flow through the escrow accounts in order to avoid diversion of collected arrears by oblenergos. All such payments are to be in cash only.
- 2 No oblenergo may accept barter goods in direct or indirect payment for power after the Effective Date.
- 3 Fees allowed to each oblenergo from funds paid into its cash escrow accounts are to be based on the fees allowed under their LVNO and LES licenses.
- 4 No fee is to be collected from the oblenergo escrow account for generation costs, since all oblenergo generator output is to be sold to NDC and paid for pursuant to the standard NDC power purchase agreement.
- 5 Each oblenergo retail customer account which violates NBRC's published Default Rules is to be promptly noticed to the NDC's Market Funds Administrator and transferred for special collection action pursuant to Annex 2 hereto. At that time the oblenergo will have no further right to LVNO or LES fees from that customer's payments unless and until the customer is transferred back to the oblenergo according to the special collection procedures.
- 6 NBRC may at any time order an audit by an independent auditor, at the oblenergo's expense, to verify, on a statistical basis, the oblenergo's records of amounts due from and paid by retail customers.
- 7 Nontariff suppliers' customers who have no arrears due to their oblenergo shall be under no obligation to pay into the oblenergo escrow account for energy purchased from their nontariff supplier, whether paid for in cash or in barter goods.
- 8 The use of escrow accounts in no way reduces the oblenergo's financial responsibility for all energy delivered by NDC to the oblenergo's LV

network. Each oblenargo remains fully responsible to either pay directly for such delivered energy or to assure that it is paid for indirectly through offset transfer orders from generators.

These conditions are in addition to those already established for proper administration.

ANNEX 2

SPECIAL COLLECTION PROCEDURES

This annex sets out the proposed special collection procedures to be followed by each oblenargo's Special Collections Group ("SCG"). The procedures are to be approved by NERC and published prior to implementation.

These procedures apply to all retail customer accounts which have violated the NERC-approved Default Rule and have been transferred to special collections pursuant to Annex 1 hereto.

- 1 Each Defaulted retail customer is to be notified at the time it is transferred for special collection and is to be told what to expect if payment is not made within a further 15 day notice period. If the customer is currently purchasing energy from a non-tariff supplier, that supplier is also notified.
- 2 Immediately after the notice period expires, if payment has not been made in full or a satisfactory payment plan (paying no less than current invoices plus interest plus 10% of arrears each month) is agreed:
 - 2.1 Service to the defaulted customer is to be promptly suspended; and
 - 2.2 The SCG is to file a claim against the customer's bank account if this has not already been done.
- 3 If the SCG is prevented by government orders or pressure from effectively suspending service in step 2, the SCG must immediately:
 - 3.1 Apply to NERC to treat the unpaid and accruing amounts as a "default subsidy", to be recovered through default subsidy certificates and charged to an oblenargo-specific Energomarket surcharge over a period of time; and
 - 3.2 Publish a notice of the involuntary continuation of service, the reason for it and the prospective financial effects on the paying customers.

NERC shall then have 10 business days to decide whether or not to grant a default subsidy.

- 3.3 If NERC grants subsidy certificate status, this account is released from special collections, and LVNO and LES service fees are to be paid to the oblenargo from the oblenargo escrow account in the normal way.
- 3.4 If NERC does not grant subsidy status within that time, the oblenargo is at fault and:
- (1) From the Default Date forward, the oblenargo is not to be paid any LVNO or LES fee for serving the Defaulted customer; and
 - (2) Beginning [3] weeks after the Default Date a penalty will be deducted from escrow amounts due to the oblenargo in the amount of 3x the Defaulted customer's LVNO and LES fee, increasing by 1x each week until the oblenargo is paying the full value of the energy being consumed by the Defaulted customer. The proceeds from this penalty are to be applied to the oblenargo's power purchase payment obligation to NDC.
- 4 Any customer failing to perform on an agreed payment plan is to have service immediately suspended until the account is paid in full and acceptable security arrangements are made to prevent a recurrence.
- 5 Customers are to be discharged from special collections only when all arrears have been paid, including interest.
- 6 Full interest charges and penalties as authorized under current law (estimated at [1] % per day) are to be charged to the customers account.
- 7 The SCG may accept payment by Defaulted customers only in cash. Customer barter goods must be converted to cash before payment to the SCG.
- 8 All proceeds collected by the SCG are to go directly to the local RDC escrow account, bypassing the oblenargo escrow account and eliminating any associated fees which would have been due to the oblenargo.
- 9 The SCG is to receive [5] % of all pre-1996 arrears which it collects, plus [3] % of all post-1995 arrears which it collects. These fees will be paid from the RDC escrow account. (For \$1 bill of pre-1996 arrears collected over 36 months, this would mean paying about \$50k/m per oblenargo in total compensation for special collection services.)
- 10 Each SCG is to file weekly an aged receivables reports with the NDC Market Funds Administrator, together with a report of collections and related activities as the Energomarket Board may request. For aging

purposes, customer payments are to be applied first to interest and penalties, then to arrears, oldest first.

- 11 The Energomarket Board may declare any amounts due from a customer whose service has been suspended to be a "Bad Debt" if it remains uncollected after the later of (6) months after default date or (3) months after the Effective Date. This declaration means:

11.1 The Bad Debt amount is removed from the SCG backlog; and

11.2 The Bad Debt amount is added to the oblenargo-specific Energomarket surcharge over a period of time, and this fact is published.

- 12 NDC's auditor and market funds administrator are to monitor the performance of the 27 SCGs. In the event of systematic failure by an SCG to properly report, suspend service or collect payment, the Energomarket Board may recommend to NERC penalties of up to 20% of the oblenargo's supply and LV fee be charged against the oblenargo escrow account until the deficiency is corrected. Proceeds from such penalties shall be applied to reduce the oblenargo-specific surcharge.

The special collection program may be modified at any time by the Energomarket Board with the consent of the NERC, taking due account of incentive payment obligations to the SCGs.

ANNEX 3

GENERATOR FORBEARANCE AGREEMENT

The form of promissory note given by NDC to each generator shall include the following provisions.

This agreement dated _____ is between (Generator) ("Seller") and National Dispatch Center of Ukraine on behalf of itself and its eight subordinate regional dispatch centres ("NDC"):

- 1) NDC hereby acknowledges debt to Seller in the amount of . (. Kv _) . as of [31 March 1996] for electricity purchased on and before that date (the "Debt").
- 2) NDC agrees to repay the Debt as follows:
 - 2.1) Principal is to be paid in 36 equal installments beginning 30 June 1996.
 - 2.2) NDC shall pay Seller Interest at the Bank of Ukraine Interbank Lending Rate, compounded monthly from 1 April 1996 on the then outstanding balance until fully paid.
 - 2.3) Principal and interest are to be paid on the last business day of each month.
 - 2.4) Any amounts not paid when due shall accrue Interest at the rate of 120% of the Interbank Lending Rate.
 - 2.5) In each month after June 1996 until the Debt is fully paid, any amounts received through the special collections procedure (set out in Annex 2), net of associated expenses, shall be applied first to pay that month's interest and principal on all such Debt pro rata among creditors, and second to prepay the next unpaid principal payments, pro rata among creditors.
- 3) NDC agrees to secure repayment of the Debt as follows:

- 3.1) NDC shall unify all wholesale electricity sales now conducted by eight RDCs and the NDC in a unified national electricity settlement system, operated by NDC.
- 3.2) NDC shall pool all daily receipts from wholesale electricity sales, whether as cash or as offsets valued at market prices, and whether collected directly or through escrow accounts. This entire amount, after deduction for obligations to the budget and NDC expenses, shall be available to make scheduled payments on the Debt. The debt service payment take priority over NDC payment for current energy purchases, ancillary services and HV network fees.
- 3.3) If necessary, NDC shall add a surcharge to the wholesale market price sufficient to repay the Debt as scheduled, including any interest on overdue payments each month.

NDC agrees to report the full results of the operation of the unified settlement system to Seller each day.

- 4) In consideration of these arrangements, Seller agrees to:
 - 4.1) Release its block on bank accounts of NDC and the RDCs and to refrain from any further such action against NDC and its affiliates so long as NDC adheres to this agreement.
 - 4.2) Take all practical actions to obtain the release of any blocks on NDC or RDC bank accounts by government authorities resulting from Seller's failure to pay taxes due.
- 5) In the event that Seller circumvents the unified national electricity settlement system, operated by NDC, and sells energy to parties other than NDC, this agreement shall be null and void and NDC shall have no further obligation to Seller to pay any remaining balance on the Debt.

AGREED:

SELLER

NDC

General Director
(Power Plant of Genco)

Director

ANNEX F

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

Supervisory Unit
3.1 Designation. The ~~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 or

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
reliance on 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.

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AUDIT COMMITTEE RESPONSIBILITY AND FUNCTION

MISSION

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.

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Financial Statements and External Auditors

The 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.

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- 1. Review the effect of any important new pronouncements of the accounting profession and other regulatory bodies on the Company's accounting policies and practices.
- 2. Confer with the external auditors any significant proposed changes in basic accounting principles and reporting standards used in the preparation of the Company's financial statements.
- 3. 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.
- 4. Confer 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.
- 5. 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.
- 6. 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.
- 7. 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.
- 8. Report promptly to the Board its deliberations and recommendations.
- 9. 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.

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

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

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ANNEX G

Reporting Requirements for the Public Offering of Securities¹

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.

¹The 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.

VI. The Law of Ukraine "On
Securities and Stock Exchanges"

The Law of Ukraine
on Securities and Stock Exchange.

This law defines conditions and procedure for the issuance securities and also regulates intermediary activity in the process of organization of circulation of securities in the territory of Ukraine.

Chapter 1. SECURITIES, THE PROCEDURE FOR
THEIR ISSUANCE AND CIRCULATION

Section 1. General Provisions

Article 1. The definition of the securities

Securities - monetary documents which testify the right to possess or the relations of a loan, define interrelations between the entity which issued them, and their holders and stipulates, as a rule, payment of revenue in the form of dividend and interest payments as well as the possibility of transfer of the monetary and other rights that result from these documents to other persons (individuals).

Securities can be of two class - registered and bearer. Registered securities, if nothing is provided by this Law or if there is no special indication in such shares that they are not subject to transfer, they are transferred by means of endorsement in full.

Bearer securities circulates without any limits.

Securities can be used for carrying out settlements and also as a mortgage to secure payments and credits.

Renewal of the lost registered securities is carried out by the state bodies, enterprises, institutions and organizations which issued such securities.

Inheritance is carried out in accordance with the civil legislation of Ukraine.

The definitions; special conditions of issuance and circulation of privatization papers are stipulated by the special legislation of Ukraine.

The procedure of circulation of securities issued by the Soviet Union and other Soviet republics and placed in the territory of Ukraine is regulated by this Law, other legislative acts of Ukraine and also by the agreements of Ukraine with the Soviet Union and appropriate Soviet republics.

Article 2. Issuer of securities

The issuer of the securities - legal entity which issues securities and commits itself to perform obligations which result from the conditions of their issuance (hereinafter referred to as issuer).

The issuer must perform all obligations which result in association with issuing securities within terms and procedure stipulated by this Law, other legislative acts of Ukraine and also by the decisions on the issuance of securities.

The rights and obligations regarding securities arise upon transfer of securities by issuer to receiver (purchaser) or to his authorized person.

Article 3. Classes of securities

In accordance with this Law the following kinds of securities can circulate on the territory of Ukraine:

shares;
internal republican and local bonds;
bonds of enterprises;
republican treasury bonds;
saving certificates;
promissory notes.

Section 2. Shares

Article 4. Main characteristics of shares

Share - a security without any time limits of their circulation which testifies the share holding in the charter fund of joint stock company, confirms membership in joint stock company and the right for participation in its management, provides the right to shareholder to receive part of revenue in the form of dividends and as well as the right to participate in distribution of the property upon liquidation of joint stock company after.

Shares can be: registered shares, bearer shares, preference shares and ordinary shares. The citizens, as a rule, enjoy the right to hold registered shares.

The circulation of registered shares is recorded in the stock registration book which is kept by joint stock company. This book should include all data regarding registered shares, including data concerning a shareholder, time of their purchase as well as quantity of shares that every certain shareholder possesses.

The total quantity of bearer shares is recorded in the registration book.

A holder of preference shares has the right in preference to obtain dividends and priority right to participate in distribution of property of joint stock company in the event of its liquidation. Holders of preference shares have no right to take part in management of joint stock company if it is not provided by its charter.

Preference shares may be issued with fixed annually paid dividends in percents according to their nominal value. The amount of dividends paid is established in share by irrespective of the amount of the revenue of joint stock company in the corresponding year. In the event there is no enough revenue of the corresponding year, the dividends on preference shares are paid at the cost of the reserved fund.

If the amount of dividends which are paid to the holders on ordinary shares exceeds the amount of the dividends on the preference shares the shareholders of the latter ones can receive additional payment equivalent to the amount of dividends received by other shareholders.

The total amount of issued preference shares may not exceed 10% of the statute fund of the stock company.

The charter of joint stock company determines the implementation of the right to obtain dividends in preference.

The minimum nominal value of the share may not be less than 50 karbovantsi. The nominal value of the share that exceeds 50 karbovantsi shall be divisible to the minimum value of the share.

Shareholders can receive certificate for total to nominal value of shares.

Share must contain the following requisites: the name of joint stock company, its location, the name of security - "share", its ordinal number, the date of its issuance, class of share, its nominal value, the name of owner of share (for the registered shares), the amount of the charter fund of joint stock company at the date of issuance of shares and the quantity of the shares being issued, the term of payment of dividends and the signature of the chairman of the board of joint stock company or another authorized for it person, the seal of the stock company.

Dividend coupons may be attached to shares.

Dividend coupon must contain the following requisites: the ordinal number of the dividend coupon, the ordinal number of the share on which the dividends are paid, the name of joint stock company and the year of payment of the dividends.

Article 5. The rights granted to Shareholder

Shareholder has the right to receive a share of revenue of joint stock company (dividends), to take part in the management of the stock company (except from holders of registered shares), and also other rights, provided by this Law, other legislative acts of Ukraine, and also by the charter of joint stock company.

Share may not be divided (is indivisible). In the event when several persons are the joint holders of a share all they

are counted as one shareholder and can enjoy their rights through one of them or through common authorized person.

Article 6. The decision on issuance of shares

The decision to issue the shares is made by the founders of joint stock company or by the general meeting of the shareholders of joint stock company.

The decision to issue the shares is recorded in the minutes.

The minutes on the decision to issue the shares must contain the following requisites: the name of the issuer and its location; the amount of the charter fund or the value of the main and working assets of the issuer; the objectives and purpose of its activity; designation of the officials of the issuer; the name of the controlling bodies (auditing firm); data regarding the placing of previously issued for circulation securities; the purpose of their issuance of shares; definition of the categories of the shares; the quantity of the registered stocks and bearer shares; the quantity of the preference shares; the total amount of the emissions and the quantity of the shares; the nominal value of the shares; the quantity of voters; the procedure of the dividend payment; the term and the procedure of the subscription for shares and payment for them; the term of repayment in case of refuse to issue shares; the sequence of the issuance of the shares (when there are different series of their issuance); the procedure of the announcement of their issuance and the procedure of their distribution (placing); the conditions of their disposal; the rights of holders of the preference shares; the priority to buy shares upon new emission.

The minutes, in addition, may contain some other data regarding issuance of shares.

Article 7. Issuance of shares

The amount of issuance of shares by joint stock company is equivalent to the charter fund of joint stock company or to the value of the property of the state enterprise (if it is turned into a joint stock company). Additional issuance of shares is allowed when all previously issued shares are paid in accordance with their value that is not less than their nominal value.

It is prohibited to issue shares to cover losses relating to the economic activity of joint stock company.

Article 8. Purchase of shares

Shares are purchased in karbovantsi and, if it is provided by the charter of joint stock company, in foreign currency or through the transfer of the property. Regardless of the form of

the made deposit the value of a share is expressed in karbovantsi.

Enterprises, institutions and organizations may buy shares for money left at their disposal after they paid taxes and interest on the bank credit.

Shares may be handed to purchaser only after their total value is paid for.

Joint stock company may redeem shares from shareholders which they hold for further resale, distribution between their workers or for cancellation. Such shares should be sold or canceled within one year. Within this period distribution of the dividends, voting, definition of quorum at general meeting of joint stock company is made without taking into account shares purchased by joint stock company.

Article 9. Payment of dividends from shares

Dividends from shares are paid to shareholders according to results of year in the order established by charter of joint stock company, at the cost of the profit that is left at its disposal after all stated by the legislature taxes are paid, other payments to the budget and interest on the bank credit.

Section 3. Bonds

Article 10. Main features of the bonds

Bond - a security which testifies money deposited by holder of the bonds and confirms obligations for refunding of the nominal value of such security within the term established by this security with payment of the fixed percentage (if nothing else is provided by the conditions of the issuance). Bonds of all classes are distributed between enterprises and citizens on a voluntary basis.

The minimum nominal value of the bond can not be less than 50 karbovantsi. The nominal value of the bond that exceeds 50 karbovantsi shall be divisible to the minimum value of the bond.

There are the following classes of the bonds:

- a) bonds of the domestic republican and local loan;
- b) bonds of the enterprises.

The bonds of the enterprises are issued by enterprises of all established by the law forms of ownership, associations of the enterprises, joint stock companies and other companies such bonds do not grant their holders the right of management them.

The conditions of their issuance and distribution of the bonds of the enterprises are determined by this Law, other legislative acts of Ukraine and by the statute of the issuer.

The following classes of the bonds can be issued: registered bonds, bearer bonds, interest bearing bonds, passive bonds, those that circulates freely and bonds with limited circulation.

The bonds of the domestic republican and local loan are issued as bearer bonds.

The passive bonds are defined by the goods (services) under which they are issued.

The bonds of the enterprises shall have the following requisites: the name of the security - "the bond", the name of the firm and the location of the issuer of the bonds; the name of the firm or the name of the buyer (for the registered bonds); the nominal value of the bond; the terms of the repayment, the size and the term of the payment of the dividends (for the interest bearing bonds); the place and the date of their issuance and also the series and the number of the bond; the signature of the manager of the issuer or other authorized for it person, the seal of the issuer.

Coupon for payment of interest may be attached to bond.

Coupon for payment of interest shall have the following data: the ordinal number of the coupon for the payment of interest; the number of the bond on which the interest is paid; the name of the issuer and the year of the payment of interest.

The bonds proposed for open sale with subsequent free circulation (except passive bonds) shall have the coupon.

Article 11. Decision on issuance of the bonds

The decision on the issuance of the bonds of the domestic and local loan is made correspondently by the Cabinet of the Ministers of Ukraine and the local Soviets of Peoples' Deputies.

The issuer, the conditions and the procedure of the distribution of the bonds must be defined by this decision.

The issuer makes the decision on the issuance of bonds and which is recorded in the minutes.

The minutes of the decision on the issuance of bonds of the enterprises shall obligatory include: the name of the firm which issues the bonds and its location; data concerning the statutory fund, economic activity and officials of the issuer; the name of the controlling body (the auditing firm); the data on the distribution (placing) previously issued securities; the purpose of their issuance and their kind (registered bonds or bearer bonds); the total sum of the emission, the quantity and nominal value of the bonds; the number of voters; the procedure of the issuance of the bonds and dividend payments on them; the terms of repayment in case of refusal to issue the bonds; the terms of

sale of the corresponding goods or providing with corresponding service on passive bonds; the procedure of announcement on the issuance and distribution (placing) of the bonds; the procedure of the payment of the bonds.

The minutes shall also include other data regarding the issuance of bonds.

Joint stock companies may issue bonds the total sum of which does not exceed 25% of the amount of the charter fund and only after all issued shares are paid.

The issuance of the bonds of the enterprises for the formation and replenishment of the charter fund of the issuers and also for covering losses relating to the economic activity is not allowed.

Article 12. Purchase of bonds

The citizens may buy the bonds of all kinds at the cost of their own savings.

The enterprises buy the bonds of all classes at the expenses of the funds which they have after they paid taxes and interest on bank credit.

The bonds of all kinds are paid in karbovantsi and in the events established by the conditions of their issuance - in foreign currency. Regardless of the kind of currency which was paid for the bonds their value is expressed in karbovantsi.

Article 13. Payment of dividends from bonds

The dividends on all classes of the bonds are paid in accordance with the condition of their issuance.

The dividends on the passive bonds are not paid. The owner of the passive bonds has the right to buy corresponding goods or services on which these loans were issued.

If the price of the goods exceeds the value of the bonds before the owner obtains goods than the owner is entitled to receive the goods at the price designated on the bond and when the owner receives goods for cheaper price than he or she receives compensation equal to the difference between the value of the bond and the price of the goods.

The dividends from the bonds of the enterprises are paid at the expense of the funds which are left after payments to budget and other obligatory payments.

In the event, issuer fails to perform its obligations or performs obligations not in time which relate to the payments of the dividends from the interest bearing bonds, granting the

rights to buy corresponding goods and services on the passive bonds or repayment of the designated on the bond sum in a definite term compulsory deduction is made from the corresponding sum through court of law or court of arbitration.

The procedure of redemption of bonds of all classes apart from passive bonds is determined upon their issuance.

Article 14. Use of money received from sale of bonds

Money received from sale of bonds of domestic republican and local loans are accordingly allocated to the republican and local budgets, and other funds of the local Soviets of Peoples' Deputies.

Money from allocation of bonds of enterprises are used for the purposes which were determined upon issuance bonds.

Section 4. Treasury bonds of the republic

Article 15. Main features of treasury bonds

Treasury bonds of Ukraine (hereinafter referred to as "treasury bonds) - a kind of bearer securities which are distributed among the population on voluntary basis, testify contribution of money by their holders to the budget and entitle them the right to receive financial income.

There are the following classes of the treasury bonds:

- a) long-term - from 5 up to 10 years;
- b) medium-term - from 1 up to 5 years;
- c) short-term - up to one year.

Article 16. The procedure of issuance of the treasury bonds

Decision regarding issuance of the long-term and medium-term treasury bonds is made by the Cabinet of Ministers of Ukraine.

Decision regarding issuance of the short-term treasury bonds is made by the Ministry of Finance of Ukraine.

The decisions regarding issuance of the treasury bonds shall include conditions of issuance.

The procedure of quotation of selling value of the treasury bonds is established by the Ministry of Finance of Ukraine in accordance with the date of their purchase.

Money received from sale of the treasury bonds are used to cover the current republican budget expenses.

Article 17. Payments of the dividends from the treasury bonds

Payments of the dividends from the treasury bonds and their cancellation are made in accordance with the conditions of their issue approved: by the Cabinet of Ministers of Ukraine regarding the long-term and medium-term bonds - by the Ministry of Finance of Ukraine regarding the short-term obligations.

Section 5. Saving certificates

Article 18. Main features of the saving certificates

Saving certificate - a written certificate of the bank regarding depositing of a certain amount of money, which testifies the right of depositor to receive the deposit and the dividends after expiration the term of the depositing.

Saving certificates can be of the following classes: fixed date saving certificates (at a certain agreed interest for a definite term) or demand saving certificates, registered saving certificates, and bearer saving certificates.

Registered saving certificates do not circulate and their sale (ite) by other persons is not void.

Saving certificates shall have the following requisites: the name of security - "saving certificate", the name of bank which issued the saving certificate and the location of bank, the ordinal number of certificate, the date of its issuance, the total sum of deposit, the term of the withdrawal of deposit (for the fixed date saving certificate), the name of the holder of the saving certificate (for the registered saving certificates); the signature of the manager of bank or another authorized for it person, the seal of bank.

Article 19. Acquirement of saving certificates

Enterprises and citizens shall acquire the certificates for invoices provided by the Article 12 of this Law.

Article 20. Paying up the income from saving certificates

The income from saving certificates shall be paid up upon providing them for payment to the bank which issued such certificates.

In the event the owner of certificate requires the return of funds deposited under the term certificate before term agreed in such certificate, than he shall be paid the reduced per cent the level of which shall be defined upon making a deposit on the basis of contractual terms and conditions.

Section 6. Promissory Notes

Article 21. Main features of promissory notes

The promissory note is a security certifying unconditional monetary obligation of the promisor to pay the holder of promissory note (promisee) defined sum of money upon the term thereof.

The following classes of promissory notes shall be issued: demand, negotiable.

Demand promissory note shall include the following requisites:

- a) nomination - "promissory note" ;
- b) simple and non-conditioned promise to pay the defined sum;
- c) definition of the payment term;
- d) definition of the place where the payment shall be made;
- e) name of the person to whom or under the order of who the payment must be made;
- f) date and place of making the promissory note;
- g) signature of the issuer of promissory note (promisor).

Negotiable promissory note shall also include, except the requisites set forth in points "a", "b" - "g" of third paragraph of this Article, the following:

simple and non-conditioned proposition to pay certain sum; name of the person who has to pay (payer).

The document which does not have any of requisites set up in the third and fourth paragraph of this Article, respectively for the demand and negotiable promissory notes, shall not have the force of demand or negotiable promissory notes, except as in the following cases:

a) promissory note with undetermined term shall be considered as such that is subject to the payment upon its presentation;

b) upon the absence of special definition the place specified near the name of payer (place of making document - for demand promissory note), shall be deemed at the same time the place of payment and the place of residence of the payer (promisor - for demand promissory note);

c) promissory note where the place of its making¹ is not indicated, shall be defined as signed in the place specified near the name of promisor.

The schedule for issuance and circulation of promissory notes shall be defined by the Cabinet of Ministers of Ukraine.

Section 7. Registration and circulation
of securities

Article 22. Registration of the issuance of securities

The issuer shall have the right to issue the shares, bonds of enterprises from the date of registration of such issuance with respective finance body.

If the shares, bonds of enterprises provided for registration are proposed for free sale, i.e. are designated for distribution between legal entities and citizens the circle of who is impossible to define before hand, than the issuer shall be also obligated to submit for registration to the finance body the information on the issuance of these securities.

The procedure for registering the issuance of shares, bonds of enterprises, as well as the information on their issuance shall be defined by the Cabinet of Ministers of Ukraine or under its authority - by the Ministry of Finance of Ukraine.

The registration of the issuance of securities shall be carried out not later than 30 days of submission of an application with all necessary documents.

The finance body which registers the issuance of securities or the information on the issuance of securities shall be obligated to review the compliance of the documents provided by the issuer with requirements of Ukrainian legislation.

Deny for registration may take a place only in the event of the breach of established manner or non-compliance of submitted documents with requirements of legislation.

In the event the registration of the issuance of securities is not carried out in established term or is denied under the reasons which the issuer deems as ungrounded, he may apply to court.

The registration of the issuance of securities or information on the issuance of securities carried out by finance bodies may not be deemed as a guaranty of value of these securities.

General Register for the issuance of securities shall be carried out by the Ministry of Finance of Ukraine.

Article 23. Information on the issuance of shares and bonds of enterprises which are proposed for free sale

Information on the issuance of shares and bonds of enterprises which are proposed for free sale, except the registration, shall be subject to mandatory publication in the media of the Supreme Rada of Ukraine and the Cabinet of Ministers

of Ukraine, and in official issuance of the Stock Exchange not less than 10 days before the beginning of the repayment to securities.

Shares and bonds of enterprises which are proposed for free sale shall be allowed for distribution not less than 30 days after publication of information on their issuance.

In the event of any changes in the information on the issuance of shares, bonds of enterprises which are proposed for free sale, the issuer of securities shall publish the information on changes which took place prior to 30 days period from the day of publication of such information.

The finance body which carries out the registration shall have the right, in the event of disclosure of wrong data in published information on the issuance of shares, bonds of enterprises, to terminate their distribution until the issuer of these securities will not introduce the respective changes to such information.

Article 24. Constant information on the issuer

The issuer shall be obligated, not less than once a year, to inform the public on his economic and financial condition and the results of activity (hereinafter referred to as "annual report").

Annual report shall be published not later than April 1 of the year following the report year, and shall be sent to the holders of registered shares and to the finance body which carries out the registration.

Annual report shall include the following issuer data:

- a) information on the activity results in forgoing year;
- b) information on financial condition certified by the auditor, as well as balances for forgoing year and the auditor report;
- c) main information on additional issuance of securities;
- d) basing of changes in the personnel.

Article 25. Special information on the issuer

The issuer shall be obligated, within two days, to send to the Stock Exchange and to the finance body which carries out the registration, as well as to publish in the official newspaper of the Stock Exchange the information on changes occurred in its economic activity and influence the value of securities or amount of income from such securities, in particular:

- a) changes to the rights for securities;
- b) changes in the personnel;
- c) attachment of bank accounts of the issuer;

d) beginning of the improvement of actions (carrying out the complex of actions directed to the improvement of financial condition of the issuer);

e) reorganization, termination of the issuer's activity;

f) destruction not less than 10% of the issuer's property resulting from extraordinary circumstances;

g) making a claim against the issuer in the amount which does not exceed 10% of the charter fund or the value of fixed and working capital of the issuer;

h) receipt of credit or the issuance of securities in the amount which does not exceed 50% of the charter fund or the value of fixed and working capital of the issuer.

The issuer with respect to publication of wrong information on his activity, which may influence the value of securities or amount of income from such securities, shall be obligated within two working days to take steps for correcting this information.

Article 26. Activity for issuance and circulation of securities

The activity for issuance and circulation of securities, pursuant to this Law, shall be the intermediate activity for issuance and circulation of securities which is carried by banks and joint-stock companies the charter fund of which is formed exclusively at the expense of registered shares, and by other companies (hereinafter referred to as "sellers of securities") carrying out the operations with securities as exclusive type of their activity.

The sellers of securities shall have the right to carry out the following types of activity for issuance and circulation of securities:

a) activity for issuance of securities;

b) commission activity for securities;

c) commercial activity for securities.

The activity for issuance of securities shall be the performance by the seller of securities under authority, on behalf and at the expense of the issuer of obligations on arranging the securities subscription or their realization otherwise. With this respect the seller of securities under agreement with the issuer may take obligations, in the event of incomplete distribution of securities, to redeem from the issuer non-realized securities.

The commission activity for securities shall be sale-purchase of securities carried out by the seller of securities on his behalf under authorization and at the expense of other person.

The commercial activity for securities shall be sale-purchase of securities carried out by the seller of securities

on his behalf under authorization and at the expense of other person.

Article 27. License on carrying out the activity for issuance and circulation of securities

The activity for issuance and circulation of securities as an exclusive activity shall be permitted on the basis of license issued by the Ministry of Finance of Ukraine. The list of documents necessary for obtaining the license on carrying out the activity for issuance and circulation of securities, and the list of information which the seller of securities must submit during the term of this license, shall be defined by the Ministry of Finance of Ukraine.

The license on carrying out all or special (except commission) types of activity may be issued to the sellers of securities who have the charter fund in the amount not less than 5 million karbovanets, and for carrying out the commission activity for securities - not less than 1 million karbovanets.

Upon carrying out the activity for issuance and circulation of securities shall be allowed to carry out the special types of activity related to the issuance of securities, and first of all, the activity for providing the holders of securities with consulting services.

Article 28. Terms and conditions which prohibit the activity for issuance and circulation of securities

The license on carrying out any type of activity for issuance and circulation of securities may not be obtained by the seller of securities who directly or indirectly owns the property of other seller of securities having the value over 10% of the charter fund, including the direct possession - having the value over 5% of the charter fund of other seller.

The seller of securities who has not the license on carrying out any type of activity for issuance and circulation of securities may not directly or indirectly own the property of other seller of securities having the value over 10% of the charter fund, including the direct possession - having the value over 5% of the charter fund of other seller.

If the share of legal entity which does not have the license on carrying out the activity for circulation of securities, or individual in the charter fund of some sellers of securities exceeds 5% for each seller, then those sellers may not sell securities between them.

The seller of securities may not sell:

- a) securities of its own issuance;

b) stocks of that issuer whose property owned by him in the amount of more than 5% of the charter fund.

In accordance with this Article the direct holding of the property shall be possession of share in the charter fund of any company, the indirect holding - possession of share in the charter fund of that company which is a participant of other company.

Article 29. Making agreements with securities

Upon acceptance of the power of attorney for the purchase or sale of securities the seller of securities shall be obligated to provide the person, at the expense of which he is acting, with information related to the rate of securities.

The seller of securities shall be obligated to submit to the Stock Exchange the information on all agreements with securities made by him in terms and in order defined by rules of the Stock Exchange.

The particularities of carrying out the accounting upon the purchase-sale of securities shall be determined by the Ministry of Finance of Ukraine.

Article 30. Requirements for liquidity of sellers of securities

The value of agreements made by the seller of securities with other sellers of securities, but not performed at the moment (opened positions), may not exceed 5 times amount of the own charter fund of the seller of securities.

Value of agreements concluded by vendor of securities with other vendors of securities but not performed at certain date (open positions) may not exceed ten time amount of own charter fund of vendor of securities during carrying out of activities associated with issuance of securities, which is conducted simultaneously with commercial or commission activities associated with securities.

Sale or nominal value of securities, held (in reserve of) by vendor of securities, who carries out activities regarding issuance of securities or commercial activity associated with securities, as well as value of open positions summed up together, simultaneously may not exceed fifteen time amount of charter fund of vendor of securities. Calculations should be based upon highest sale or nominal value.

Article 31. Taxation of income from securities

Income from securities is taxed according to legislation of Ukraine.

Chapter II. STOCK EXCHANGE

Section 8. General Provisions

Article 32. Concept of stock exchange

Stock exchange - a joint stock company, which concentrates demand and offer of securities, facilitate the formation of their market rate and performs its activity according to this Law, other acts of Ukrainian legislation, charter and rules of stock exchange.

Stock exchange may be founded by not less than 20 founders-vendors of securities, who have license to perform commercial and commission activities associated with securities, provided that they contributed to the charter fund not less than 50 000 000 karbovantsi.

Stock exchange obtain the rights of legal entity upon the date of its registration by the Cabinet of Ministers of Ukraine.

Article 34. The Charter and the Rules of Stock Exchange

The charter and the rules of stock exchange are approved by its supreme body.

The charter of stock exchange shall determine:

- a) name and location of stock exchange;
- b) names and locations of founders;
- c) amount of charter fund;
- d) conditions and procedure of acceptance as members and expulsion from members of stock exchange;
- e) rights and obligations of members of stock exchange;
- f) organizational structure of stock exchange;
- g) powers and procedure of formation of management bodies of stock exchange;
- h) procedure and conditions of attending of stock exchange;
- i) procedure and conditions of implementation of sanctions, established by stock exchange;
- j) termination of activities of stock exchange.

Charter may contain other provisions pertaining to establishing and activities of stock exchange.

The rules of stock exchange should provide:

- a) types of agreements, which are concluded at stock exchange;
- b) trading procedure at stock exchange;
- c) conditions of admitting of securities to stock exchange;
- d) conditions and procedure of subscribing for securities which are quoted at stock exchange;
- e) procedure of quotation of prices, stock exchange rate and their publication;

- f) list of securities which are quoted at stock exchange;
- g) obligations of members of stock exchange regarding keeping of records and information, internal schedule of work of commissions of stock exchange, procedure of their operation;
- h) information support system of stock exchange;
- i) types of services provided by stock exchange and fees for them;
- j) rules of payment at stock exchange;
- k) other provisions pertaining to activities of stock exchange.

Article 35. Use of term "stock exchange"

The term "stock exchange" or any which contains words "stock exchange" may be used in company name or in advertisement only by organization which is established according to provisions set forth in Article 34 of this Law.

Article 36. Special conditions of termination of activities of stock exchange

Activities of stock exchange shall be terminated in the event when the number of its members reduced to 10. In the event 10 members are left at stock exchange, its activity shall be terminated if new members are not accepted within six month.

Activities of stock exchange shall be terminated according to legislation of Ukraine on joint stock companies and other kinds of business companies.

Section 9. Protection of property rights of investors

Article 37. Cancellation of agreement on subscribing or purchase of securities

Person, who subscribed for or purchased securities before publication of changes in business activities of issuer which effect value of securities or amount of revenue from them, may within 15 days from the date of publication of such information unilaterally terminate the agreement.

In the event of termination of agreement, issuer must upon requirement of the said person refund his/her expenses and possible losses associated with subscription for or purchase of securities.

In the event of issuer's failure to perform conditions of subscription for securities, issuer must return to subscribers upon their requirements all received from them money with interest for the whole period of their retaining.

The issuer bears responsibility for refunding of losses, caused by improper information regarding securities.

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"

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 stock exchange" from January 1, 1992.

2. To announce that from January 1, 1992 the issue of stocks belonging to work collectives, enterprises and organizations 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 organizations 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

L.KRAVCHUK

the city of Kiev

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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

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 rates) 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 "Ukraina" 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.

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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.