MODEL LEGISLATIVE PROVISIONS FOR CIS MEMBER STATES ON THE PROTECTION OF INVESTOR RIGHTS IN SECURITIES MARKETS

(English version of the official Russian text. The Russian version is the only official version)
The project’s aim is to develop model legislative provisions and explanatory notes on investor protection for CIS member states. In the project, legal experts, representatives of national parliaments of CIS member states and the Interparliamentary Assembly of the CIS work together with CILC experts. The European Bank for Reconstruction and Development (EBRD) has selected CILC for the project. The project began in February 2003.
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Part I. General Provisions

Article 1. The Legal Status and the Scope of the Model Provisions

1. The articles of the Model Legislative Provisions for CIS Member States on the Protection of Investor Rights in Securities Markets (hereinafter the “Model Provisions”) are recommendations and may be included in national legislation of CIS member states and be used as guidance while drafting or amending legislation.

The Model Provisions regulate all types of joint stock companies unless the specific article stipulates otherwise.

The Model Provisions have been drafted as separate articles. Although the articles and sections of the Model Provisions are related, each section (and sometimes even each article) can be used in isolation from other articles. Separate articles of the Model Provisions can be incorporated in legislation of CIS member states on investor protection.

The Model Provisions have been drafted as guidelines and recommendations to improve and develop legislation of CIS member states. The introduction of the Model Provisions to national legislation of CIS member states will contribute to a considerable degree of harmonization of investor protection regimes throughout the CIS.

The Model Provisions are developed on the basis of internationally recognized standards, principles, directives, recommendations, guidelines and other documents developed by organizations such as the Organization for Economic Cooperation and Development (OECD), the European Union (EU), the European Bank for Reconstruction and Development (EBRD) and the International Association of Securities Commissions (IOSCO). The Model Provisions also take into account the developmental aspects of capital markets in CIS member states.

The Model Provisions are recommended for different categories of companies. As a rule, most Model Provisions relate to companies whose shares and other securities are listed on organized securities markets. In some CIS member states, there are many open joint stock companies (in other member states – public companies) that have a large number of small individual shareholders. In these
companies, the investor protection regime closely follows the regime designed for listed companies with certain exceptions. Furthermore, in some CIS member states, there are also closed joint stock companies (in other member states – closely held companies), where the protection of investors has a more limited scope. Thus, the Model Provisions relate to all categories of companies unless otherwise indicated in an article.

2. The Model Provisions regulate the following aspects of the protection of investors as defined in Clause 2.21 of Article 2 of the Model Provisions:

1.1. The rights and duties of shareholders, as well as the special rights of the state as a shareholder;
1.2. The role of the General Meeting of Shareholders in protecting shareholders’ rights;
1.3. The duties and liabilities of directors and managers related to the protection of investors’ rights;
1.4. Investor protection in special circumstances;
1.5. Ensuring transparency of the company’s operations (financial reporting and accounting requirements for the protection of investors);
1.6. The protection of the rights of security holders in securities markets;
1.7. The protection of investors’ rights during the issue and trade of securities;
1.8. Standards of conduct for professional investors in securities markets to protect retail investors; and
1.9. Investor compensation mechanisms to protect retail investors’ rights.

Investors can be protected through a myriad of laws including commercial, corporate, securities, bankruptcy, tax and accounting legislation. Thus, the Model Provisions relate to different parts of legislation and should not be viewed as a single coherent law. Given the complexity of legislation and the scope of the project, the Model Provisions presented in this working document focus on areas that have been shown to create the most problems in practice and that require special regulatory attention in CIS member states.

The Model Provisions do not regulate all issues exhaustively and comprehensively, but hope to contribute to the discussion on the protection of investors and the development of more comprehensive legal solutions by the national legislature of CIS member states. In many cases, the
Model Provisions regulate issues which, as a rule, in most jurisdictions are a matter of separate legislation instead of one or several articles that are provided by the Model Provisions. This includes legislation that regulates control and related party transactions, the organization of the General Meeting of Shareholders, the reorganization and liquidation of joint stock companies, rules of conduct of professional investors and compensation schemes. The issues that are covered by the Model Provisions are relevant both within the context of international markets and markets in CIS member states, although the national legislature of CIS member states may choose a different approach to the regulation of these and other issues.

The Model Provisions pay special attention to the rights and obligations of the most common group of investors – the shareholders. A distinction is made between ordinary shareholders (individuals and legal entities) and the state as a shareholder. The Model Provisions also make a distinction between “standard shareholders’ rights” and “shareholders’ rights in extraordinary circumstances.” Many issues that are regulated by the Model Provisions are new to most CIS member states. The Model Provisions also often present a different approach to existing regulations to strengthen the rights of investors, for example, with the introduction of mandatory external audits and consolidated financial reporting requirements.

The regulation of duties and liabilities of directors and managers of joint stock companies is another aspect of investor protection. Directors and managers are expected to protect and utilize capital in the best interest of investors. Since the interests of these “agents” may deviate from the interests of investors, the Model Provisions pay special attention to the liability and accountability of directors and managers.

In addition to the rights of shareholders, and the duties and liabilities of directors and managers, the Model Provisions focus on the rights of owners of securities other than shareholders, such as bondholders. To provide additional protection to investors, the Model Provisions give bondholders new governance and information rights.

The regulation of professional market participants and especially their relationships with retail investors is important as well. To improve investors’ confidence in securities markets of CIS member states and to develop the trust of small (individual) investors in securities dealers and brokers, the Model Provisions propose the development of standards of conduct for professional market participants.
Finally, the Model Provisions propose the development of special compensation mechanisms to restore losses when professional market participants violate investors’ rights.

Article 2. Definitions

1. For the purposes of the Model Provisions, the following terms are defined:

2.1. Affiliated Persons (affiliates, affiliated parties): An “affiliate” of a specified person or entity refers to one who, directly or indirectly, either controls, is controlled by or is under common control with, the specified person or entity.

2.2. Annual Report: A document that shall be provided to the company’s shareholders and other interested parties prior to the Annual Meeting of Shareholders. It includes a balance sheet, an income statement and other annual financial statements in a manner required by accounting legislation. In addition to historic information, it should also include a special section on the corporate governance standards that have been adopted by the company and the future plans of the company.

2.3. Audit Committee: A committee of the Board of Directors that oversees the company’s financial reporting, risk management and internal audit processes.

2.4. Authorized Shares: The maximum number of shares of any type and class a company may issue in addition to already issued shares. The number of authorized shares shall be specified in the charter of the company.

2.5. Board of Directors: The governing body of the company responsible for the strategic direction of the company and for overseeing the management. In the Model Provisions, the term “Board of Directors” is also used for a Supervisory Board in a two-tier system of board organization.

2.6. Book Value: The value of a company’s assets according to a company’s accounting records.

2.7. Charter Capital: The total nominal value of all shares issued by the company.

2.8. Class of Shares: A group of shares of the same type that confer identical rights upon their holders. The Model Provisions propose that classes of shares are used only with respect to preferred shares.
2.9. **Company or Joint Stock Company:** A legal entity whose charter capital is divided into a defined number of shares.

2.10. **Consolidation of Shares:** The process of converting two or more shares of the same type and class into one share of that same type and class.

2.11. **Control:** The ability to control daily activities of the company, elect the majority of members of the Board of Directors or to have a direct or indirect ownership of 30% and more of voting shares.

2.12. **Convertible Security:** A bond, preferred share, or another company security that is exchangeable for a company share.

2.13. **Cumulative Voting:** Voting during which each voting share grants its owner such a number of votes that is equal to the number of directors to be elected. The shareholder may give all his votes to one candidate or may distribute them among the candidates.

2.14. **Disclosure of Information:** The methods used to ensure the access of parties to information, irrespective of the purposes for obtaining such information, according to the procedure that guarantees that one can obtain and receive such information.

2.15. **Dividends:** A company’s profit that is distributed proportionally to shareholders in accordance with the rights set forth for each type and class of shares.

2.16. **Executive Bodies:** A single person (the General Director) or a collective body (the Executive Board) responsible for the day-to-day management of a company’s operations.

2.17. **Market Value (of a company’s securities and/or assets):** The price that a (an informed) buyer would pay and a (an informed) seller would accept on the open market assuming a reasonable time for the transaction to take place.

2.18. **Golden Share:** A special right of the government to participate in the governance of the company.

2.19. **Governing Bodies:** Bodies that are involved in the governance of the company. Such bodies are: the General Meeting of Shareholders, the Board of Directors, and the General Director and/or the Executive Board.

2.20. **Independent Director:** A director who has no material relationship with the company, its controlling shareholders and managers, that may give rise to conflicts of interests that affect his judgment.
2.21. **Investors:** Creditors and individuals or legal entities that invest in equity (shares) – i.e., shareholders – or debt (bonds) – i.e., bondholders.

2.22. **Issuance:** Legally determined steps necessary to place securities.

2.23. **Issue** (language used in a Russian context): The securities of the company which confer upon their holders identical rights.

2.24. **Nominal Value:** The value of a share, bond, or any other security stipulated by such security.

2.25. **Non-Executive Director:** A member of a company’s Board of Directors who has no executive function in the company.

2.26. **Participating Shareholder:** A shareholder with voting rights who is present at the General Meeting of Shareholders in person, through a representative or by sending a voting ballot.

2.27. **Placement:** The acquisition of securities by the initial owners.

2.28. **Power of Attorney:** An authorization by a shareholder that gives another person the right to vote the shareholder’s shares. A power of attorney also refers to the document granting this authority.

2.29. **Pre-Emptive Rights:** The right of shareholders to maintain their proportion of ownership in a company by buying shares and convertible securities in a share issue before they are made available to other persons.

2.30. **Preferred Shares:** A generally non-voting share, which entitles its holder to special privileges such as a defined priority dividend and liquidation quota.

2.31. **Quorum of the General Meeting of Shareholders:** The minimum percentage of votes of participating shareholders necessary in order for a decision to be legally effective.

2.32. **Quorum of the Meeting of the Board of Directors:** The minimum number of directors that shall be present at a meeting of the Board of Directors in order for a decision to be legally effective.

2.33. **Record Date:** The date on which a person must own shares to be eligible to vote at General Meetings of Shareholders, and/or receive dividends (also defined as the Ex-Dividend Date).

2.34. **Redemption Rights:** The right of a shareholder to request the company to repurchase his shares, which arises in particular circumstances. This is different
from the share buyback of shares as defined in Clause 2.36 of Article 2 of the Model Provisions when the company voluntarily purchases its own shares.

2.35. **Representation:** The transfer to another person of the right of a shareholder to vote his shares.

2.36. **Share Buyback:** The repurchase of a company's own shares upon the company’s decision.

2.37. **Shareholder List:** A list of shareholders and other persons who may participate in a General Meeting of Shareholders or receive dividends. Shareholder lists are compiled on the record date.

2.38. **Split of Shares:** The process of converting one share of the specific type and class into a two or more shares of the same type and class.

2.39. **Standard Voting:** A method of shareholder voting in which shareholders cast all their votes for or against each item put to vote (e.g., an individual candidate nominated for the Board of Directors).

2.40. **Subscription:** An agreement between the company and the subscriber to purchase newly issued securities.

2.41. **Type of Shares:** A method for distinguishing shares depending on the attached rights. There are two types of shares – common and preferred shares.

2.42. **Voting Ballot:** A document used to vote.

2.43. **Voting Shares:** A share that entitles its owner to vote at the General Meeting of Shareholders on issues specified by law or the company’s charter. Common shares always grant voting rights. Preferred shares are voting shares when these shares provide such rights on all agenda items (if dividends are not fully paid) or on certain items (e.g., the reorganization of the company).

Terms used in the Model Provisions are defined differently in various countries’ legislation and regulations. For example, the term “book value” may differ from country to country depending on how it is defined in national accounting legislation. To avoid differing interpretations of the same terms, this Article provides definitions only for the purposes of the Model Provisions.

It shall be noted also that some terms in the Model Provisions are copied from other Model Laws approved by the CIS Interparliamentary Assembly. To define other terms, well-known sources were used. Some terms are used in their short form since their full definition is too extensive to be included.
in the Model Provisions. For example, the term “affiliated person” contains several specific situations when affiliation exists. The term “independent directors” as a rule is defined by listing criteria that directors need to comply with to be considered independent. For example, the International Finance Corporation of the World Bank Group stipulates that an independent director is a director who:

- Is not, and has not been employed by the company or any of its related parties at any time during the past five years;
- Is not, and has not been affiliated with a company that acts as an advisor or consultant to the company or its related parties, nor is not and has not himself acted in such capacity at any time during the past five years;
- Is not, and has not been affiliated with any significant customer or supplier of the company or its related parties (i.e., a company that makes payments to, or receives payments from, the company for property or services in an amount which, in any single fiscal year, exceeds the greater of US $ _______, or 2% of such other company’s consolidated gross revenues) at any time during the past five years;
- Does not currently have, nor has he had any personal service contracts with the company, its related parties, or its senior management at any time during the past five years;
- Is not affiliated with any non-profit organization that receives significant funding from the company or its related parties;
- Does not receive, and has not received any additional remuneration from the company apart from a director’s remuneration, nor participates in the company’s share option or performance-related payment plans, nor is a participant of the company’s pension plan;
- His director’s remuneration does not constitute a significant portion of his annual income;
- Is not employed as an executive officer of another company where any of the company’s executives serve on that company’s Supervisory Board;
- Is not a member of the immediate family of any individual who is, or has been at any time during the past five years, employed by the company or its related parties as an executive officer;
- Is not, nor has been at any time during the past five years, affiliated with or employed by a present or former External Auditor of the company or Auditor of any related party;
- Is not a controlling person of the company (or member of a group of individuals and/or entities that collectively exercise effective control over the company) or such person’s brother, sister, parent, grandparent, child, cousin, aunt, uncle, nephew, or niece, or a spouse, widow, in-law, heir, legatee, and successor of any of the foregoing (or any trust or similar arrangement of which any such persons or a combination thereof are the sole beneficiaries), or the executor, administrator, or personal representative of any person described in this paragraph who is deceased or legally incompetent; and
- Has not served on the Supervisory Board for more than ten years.

The term “market value” often consists of the product’s or service’s value that has been established on an open market and of the so-called “fair value” that theoretically exists when there is no open market for such products or services. In the Model Provisions, the “market value” includes both aspects.
Part II. Investor Protection at the Level of Company Law

Section 1. Shareholder Rights

Article 3. Voting Rights

1. Each common share provides one vote to its holder.

The “one share – one vote” principle applicable to common shares is fundamental to many modern corporate governance systems. It aims to ensure that the voting rights of shareholders are aligned proportionally with their cash flow rights. This principle is either recognized by most Western jurisdictions or promoted by institutional investors and shareholder associations. Legal instruments that deviate from the principle include: voting caps, multiple voting rights attached to shares, a required minimum percentage of shares that must be acquired before voting rights can be exercised and non-voting shares. These instruments are discussed below. Cumulative voting to elect directors is not a deviation from the principle since the number of votes that can be exercised in the process is linked to the number of shares of a shareholder.

The principle of equal voting rights applies only if legislation determines that common shares of a company have the same nominal value. This ensures that the voting power of shareholders corresponds to their contribution to the charter capital of the company.

2. Only law may stipulate the limitation on the maximum number of common shares that a single shareholder may own.

As mentioned above, legal mechanisms such as voting caps and multiple voting rights deviate from the “one share – one vote” principle. Through such mechanisms, cash flow rights are separated from voting (governance) rights. This may lead to a situation where an investor can have a controlling position in the company with a relatively small equity investment. For example, a ten percent equity investment may result in the ownership of 80 percent of the voting rights in the company. Voting caps, on the other hand, reduce the number of votes a shareholder can exercise. A shareholder with 40 percent of voting shares, for example, may only exercise a maximum of 30 percent of voting shares when such a limitation is in place.
Deviations from the “one share – one vote” principle can create governance problems. For example, how is a limitation on voting shares introduced in a company where individual shareholders already own more shares than the proposed maximum?

At the same time, some deviations may help bring about positive results. One example is the limitation of the number of common shares a shareholder can own. This limitation can be useful for the creation of a dispersed ownership of companies and the development of capital markets in CIS member states. The exact percentage to be set as a maximum depends on the characteristics of financial markets in CIS member states, such as the number of shareholders most companies have, the volume of trading on the stock exchange and the concentration of ownership in the market.

As already noted, voting caps and limitations on the maximum number of common shares a shareholder can own can create obstacles for investors and, therefore, should be used with the greatest care. The Model Provisions only recommend the possibility of limiting the maximum number (amount) of common shares. Such a limitation should be stipulated only by law and not by the charter of the company or other internal documents and only be used for particular important companies. In addition, stringent disclosure requirements should accompany the limitation and they should apply equally to all shareholders owning common shares. This recommendation contrasts with legislation of some CIS member states, which provides for voting caps as well as limitations that can be introduced by the charter of the company (e.g., the Law on Joint Stock Companies of the Russian Federation, Article 11, Clause 3). Although comparable provisions can be found in some Western countries, the Model Provisions do not consider these suitable to CIS member states at present, given that many companies in these states were created by the privatization of former state-owned enterprises.

3. **The rights attached to a share are indivisible. Any agreement providing solely for the transfer of a voting right, or any other right attached to a share, shall be void.**

4. **Shareholders may conclude agreements related to the exercise of the right to vote. Such agreements may not require the shareholder to vote in any of the following ways:**

   4.1. **To always follow the instructions of the company or any of its governing bodies;**
   4.2. **To always approve the proposals of the company or any of its governing bodies;**
   and
4.3. To vote in a specified manner or abstain from voting in exchange for obtaining special advantages.

Voting agreements between shareholders owning cumulatively more than ten percent of voting shares shall be disclosed in a manner specified by the securities market regulator.

Voting against the requirements of the voting agreements does not render the vote invalid.

Shareholder agreements are important instruments that enable collective actions among shareholders. For example, they enable minority shareholders to exercise collective rights (e.g., obtaining a certain percentage of voting shares necessary to call an Extraordinary Meeting of Shareholders or to request an extraordinary audit). The situation is more complex, however, if agreements are concluded between shareholders and the company or one of its governing bodies. In these circumstances, shareholders may be “locked-in” into a particular kind of behavior in a variety of ways. They may be obliged to always vote in favor of proposals of a director or manager or to always follow instructions of the management in matters relating to essential shareholder rights (e.g., the right to sell shares and the right to receive dividends). Thus, the regulation of shareholder agreements aims to prevent the misuse of shareholder agreements by majority (controlling) shareholders and management.

It is also important to underline that shareholder agreements cannot substitute (or contradict) the founding documents of the company. Shareholder agreements are civil contracts and are, in principle, not subject to disclosure requirements. Founding documents (commonly the charter of the company) are mandatory by law and subject to public disclosure at registration and when this is required by company and securities legislation. Because of the corporate governance implications of shareholder agreements, the Model Provisions recommend some form of disclosure with regard to agreements covering a relatively significant number of votes (e.g., disclosure to the securities market regulator and shareholders).

At the same time, because of the civil law nature of shareholder agreements, the validity of votes cast should not be influenced by a shareholder’s breach of the shareholder agreement. In case of a breach of the agreement, the parties to the agreement are entitled to seek civil rather than company law remedies.
5. *Each share of a particular class and type confers identical rights upon its owner.*

The 2004 OECD Principles of Corporate Governance state that “the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders.” They go further to stipulate that “all shareholders of the same series or a class should be treated equally.” The Model Provisions fully concur with this principle and seek to re-enforce its application in legislation of CIS member states.

6. *Preferred shares grant voting rights to their owners only in cases specified by law.*

*Preferred shares of a specific class grant voting rights when the General Meeting of Shareholders makes a decision on:*

6.1. The reorganization of the company;
6.2. The liquidation of the company; and
6.3. Any amendments to the charter of the company that limit the rights of shareholders of that specific class of preferred shares.

*Preferred shares of a specific class grant voting rights on all items put to vote at the General Meeting of Shareholders following the Meeting that made the decision not to pay dividends or to pay partial dividends on preferred shares of that class. If the charter of the company provides for the accumulation of unpaid dividends on a class of preferred shares, such preferred shares shall be defined as cumulative. For cumulative preferred shares, the voting rights attached to these shares cease to exist from the moment when all accumulated dividends are fully paid. For non-cumulative preferred shares, the voting rights attached to these shares cease to exist from the moment a decision is made to pay dividends in full for the given year.*

*When preferred shares of a specific class grant voting rights, each preferred share grants its owner votes in proportion to the nominal value of a common share.*

The Model Provisions follow the principle that preferred shares should not carry voting rights. Preferred shares are financing instruments that grant their owners priority dividends and/or liquidation
quota. To have these preferential rights, the owners do not have governance/voting rights. Common shareholders do not have priority rights. When preferred shares are treated as voting shares, preferred shareholders obtain additional rights at the expense of common shareholders. Preferred shareholders with voting rights, for example, can dominate the General Meeting of Shareholders and can ensure that dividends are paid to preferred shareholders only. Although some Western jurisdictions permit preferred voting shares, they are primarily permitted because of tradition and because the risks of preferred voting shares are counterbalanced by other legal mechanisms that prevent the abuse of this instrument. For the transition economy setting, the Model Provisions take the position that a strict general prohibition of preferred voting shares would be preferable.

To protect investors, it might be necessary that laws of CIS member states grant voting rights to holders of preferred shares in specific circumstances:

- When shareholders approve the reorganization or liquidation of the company, or amendments to the charter of the company that limit the rights of a class of preferred shareholders, preferred shareholders who are affected by these decisions should be entitled to vote separately on these items on the agenda of the General Meeting of Shareholders; or
- When a class of preferred shareholders has not received full dividends for the preceding year, preferred shareholders who are affected by the decision not to declare dividends should be entitled to vote separately on all items on the agenda of the General Meeting of Shareholders. The types of dividends a class of preferred shares is entitled to receive (cumulative or non-cumulative) determine when voting rights cease to exist. For cumulative dividends, the voting rights of preferred shareholders cease to exist after the full payment of all accumulated dividends. For holders of preferred shares with the right to non-cumulative dividends, voting rights cease to exist when the first full payment of dividends is made.

Another important aspect related to voting rights attached to preferred shares is the number of votes they grant to their owners. Since the Model Provisions propose that preferred shares bear no voting rights unless certain circumstances occur, voting rights are granted only as a means to protect investors in specific situations. The nominal value of preferred shares of a particular class can be different from the nominal value of common shares. In this case, the holders of a specific class of preferred shares should be entitled to vote in proportion to their contribution to the charter capital of the company.
In some jurisdictions, special types of shares are “employee shares.” These shares are distributed to employees of the company, and special rights and limitations can be attached. In general, employee shares are used to align the interests of employees and management of the company. Employee shares are often used as long-term investments in a company’s human capital. The economic benefits of employee shares could be realized through a class of preferred shares that do not have voting rights and that have a restricted transferability.

7. **When preferred shares of a specific class grant voting rights according to Clause 6.3 of Article 3 of the Model Provisions, a decision of the General Meeting of Shareholders is valid only if the required majority for this class of shareholders has voted in favor of such a decision (“voting by class”).**

The Model Provisions propose that the laws of CIS member states stipulate voting by class when the General Meeting of Shareholders votes on amendments to the charter of the company or any other items that limit the rights of a class of preferred shareholders. This ensures that preferred shareholders can protect their rights. Voting by class is already provided by some CIS member states (e.g., the Law on Joint Stock Companies of the Russian Federation, Article 32, Clause 2).

**Article 4. Pre-Emptive Rights**

1. **Whenever the company issues additional shares, shareholders are entitled to acquire these securities on a pre-emptive basis pro rata to the percentage of the charter capital represented by their shares.**

   *If the Board of Directors issues additional shares that have been authorized by the charter of the company, the persons included in the shareholder register as of the date of this decision shall have pre-emptive rights. The Board of Directors shall notify the persons in the shareholder register about their pre-emptive rights not later than five days after the decision is made in the same manner as the notification for the General Meeting of Shareholders.*

2. **Shareholders shall be given a period of at least 21 days to exercise their pre-emptive rights unless the charter of the company provides for a longer period.**
Pre-emptive rights are fundamental to the protection of shareholder rights. They aim to ensure that all shareholders of the same class are treated equally and that they have the opportunity to purchase new shares when the company increases its charter capital with a share issue. Thus, pre-emptive rights are instrumental in protecting shareholders from the dilution of their ownership because they provide shareholders an opportunity to maintain the same percentage of voting shares they owned prior to the share issue.

Pre-emptive rights of shareholders cannot be detached from shares and are only transferable together with the shares. This means that a shareholder cannot transfer his pre-emptive rights to another shareholder or other person while he owns the shares. However, some Western countries, the Netherlands and Germany for example, allow a shareholder to transfer his claim to new shares when pre-emptive rights are exercised.

Article 4, Clause 1, Paragraph 2 of the Model Provisions is applicable only in CIS member states where laws allow the Board of Directors to issue shares that are authorized by the charter of the company. Since it is not necessary to hold a General Meeting of Shareholders once the charter of the company has authorized the Board of Directors to issue authorized shares, special attention should be paid to the notification of shareholders to enable them to exercise pre-emptive rights. Disclosure requirements are also important to ensure that shareholders are informed about the Board of Directors’ decision to issue authorized shares. The Model Provisions provide that shareholders are given sufficient time (a minimum of 21 days unless the charter of the company provides for a longer period) to exercise pre-emptive rights.

3. **If the company issues additional preferred shares of a specific class, shareholders of this class shall be allowed to exercise their pre-emptive rights before other shareholders.**

When the charter capital is increased by issuing shares of a class of preferred shares, shareholders of that class of preferred shares should be entitled to acquire new shares before other shareholders exercise their pre-emptive rights. This will ensure that investors are able to maintain the same percentage of preferred shares they owned prior to the share issue.
4. **Pre-emptive rights may not be restricted or withdrawn by the charter of the company. However, the General Meeting of Shareholders may decide to restrict pre-emptive rights for the specific share issue by a three-fourths majority of outstanding voting shares. The Board of Directors shall be required to present to the General Meeting of Shareholders a written report indicating the reasons for the restriction of pre-emptive rights.**

Although the Model Provisions propose that investors be able to exercise pre-emptive rights whenever the company issues additional shares for consideration, there should be an option for shareholders to waive this right. This may be necessary, for example, to facilitate investments from foreign and domestic (strategic) investors who seek a minimum controlling stake in the company. The supermajority voting requirement aims to ensure that a majority of shareholders is protected. The requirement of the Board of Directors to inform shareholders about the rationale and consequences of the decision to waive pre-emptive rights gives shareholders the opportunity to understand the decision. Accordingly, the written report should be distributed together with the notice of the General Meeting of Shareholders. It shall be noted that depending on the development level of each country, ownership structure and other factors, the possibility of such a waiver could be prohibited. In some CIS member states, the waiver of pre-emptive rights may be abused. In particular, it could be used to squeeze-out minority shareholders. Thus, the legislature should carefully consider all the cons and pros of waiving pre-emptive rights.

In the European Union it is possible for the Board of Directors to issue additional shares without pre-emptive rights when this is authorized by the General Meeting of Shareholders. The Model Provisions take the position, however, that this rule of Article 29 of the Second EU Company Law Directive may be not suitable for CIS member states because of the lack of developed shareholder activism and robust judicial enforcement.

5. **The securities market regulator shall not register the share issue if the company does not comply with Article 4, Clauses 1 – 4 of the Model Provisions. When shareholders have not been informed about their pre-emptive rights or when shares have been issued without providing shareholders with pre-emptive rights, the registration of the share issue can be challenged in the courts.**

The Model Provisions recommend that legislation in CIS member states impose liability on companies to ensure that shareholders can exercise pre-emptive rights. Shareholders whose pre-emptive rights have
been violated should be entitled to claim compensation for losses from the company. The company may hold its directors and/or managers liable for these losses. Shareholders can also be protected with securities regulations when companies are “reporting issuers.” The regulator should verify whether pre-emptive rights have been observed and should refuse the registration of the securities issue when the company has violated pre-emptive rights. However, since the regulator may not have a supervisory role in all cases, shareholders should be able to seek another remedy through the courts.

6. **Article 4 of the Model Provisions applies also to instances when convertible securities and options to acquire shares are issued. However, Clauses 1 to 5 of Article 4 of the Model Provisions are not applicable to instances of conversion of securities or the exercise of option rights.**

As mentioned earlier, pre-emptive rights protect shareholders against the dilution of their shareholdings. The Model Provisions propose pre-emptive rights for instances when the company issues convertible securities or stock options of the company. When these securities are converted into shares, the charter capital will be changed and shareholdings of existing shareholders can be diluted.

The Model Provisions propose that laws should not provide pre-emptive rights to shareholders when securities are converted or when stock options are exercised. The holders of these securities and stock options have already had the opportunity to exercise their pre-emptive rights when convertible securities or stock options were issued.

**Article 5. Dividends**

1. **The Annual Meeting of Shareholders shall decide whether to declare annual dividends. The Board of Directors can declare interim dividends, on a quarterly or semi-annual basis, if the charter of the company provides this.**

The right to receive dividends and to participate in the profits of the company is a fundamental right of shareholders. Most Western jurisdictions recognize annual and interim dividends. Interim dividends can be declared quarterly and semi-annually if stipulated by the charter of the company.
The Model Provisions propose that annual dividends be declared by the General Meeting of Shareholders as part of its decision to distribute the profits and losses of the company. The laws of CIS member states could entrust the Board of Directors with the decision to declare interim dividends.

2. **Shareholders who are entitled to participate in the Annual Meeting of Shareholders that declares a dividend shall have the right to receive annual dividends. For interim dividends, the ex-dividend date shall be set by the Board of Directors and cannot be earlier than the date of the Board's decision. The ex-dividend date shall be disclosed as required by securities legislation.**

**Shareholders who purchase shares after the ex-dividend date but prior to the date when dividends are declared shall not be entitled to receive dividends unless a shareholder who was included in the shareholder list on the ex-dividend date transfers this right to these shareholders.**

The Model Provisions provide two rules to determine whether shareholders have the right to receive dividends:

- For annual dividends, the Model Provisions propose that the ex-dividend date coincide with the record date of the Annual Meeting of Shareholders; and
- For interim dividends, the Model Provisions propose that the Board of Directors set the ex-dividend date. The ex-dividend date should not be earlier than the date when the decision is made.

The requirement to communicate to the market the ex-dividend date as part of a company’s disclosure regime for reporting material events should be in place as well.

The Model Provisions also stipulate that the right to receive dividends remain with the shareholder who is entitled to receive dividends on the ex-dividend date. However, the right to receive dividends may be transferred when shares are sold, which is a practice common in Western markets.

3. **Annual dividends declared on common shares shall be paid only from the net profits for the fiscal year for which the dividends are accounted, and from any retained earnings from previous years. For interim dividends, the following conditions shall apply:**
3.1. *Interim accounts shall be drawn up by the executive bodies that shall demonstrate that sufficient funds are available for the distribution of interim dividends; and*

3.2. *The amount of interim dividends may not exceed the total profit made since the end of the most recent fiscal year for which the annual accounts have been drawn up and the retained earnings from previous years.*

*Dividends on preferred shares can also be paid out of a special fund established by the company for the payment of dividends.*

The Model Provisions propose that interim and annual dividends be paid out of the net profits of the company to protect the rights of creditors. The definition of net profits is usually determined by national accounting legislation. Retained earnings or undistributed profit could also be available for distribution. The definition of “distributable profit” used here is consistent with the definition of the Second EU Company Law Directive. The Model Provisions also require companies to prepare interim accounts to show that there are sufficient financial resources available for the distribution of interim dividends. Additional funds could be available when dividends are paid on preferred shares – the company may decide to allocate money to a special fund, which can only be used to pay dividends to the owners of preferred shares.

4. *The amount of declared dividends shall not exceed the amount recommended by the Board of Directors.*

As a rule, the Board of Directors recommends the amount of dividends to be declared by the General Meeting of Shareholders. The Board of Directors is the body of the company that is responsible for setting the company’s strategy in the best interests of the company and its shareholders. Thus, the Board of Directors should also be responsible for making the decision how to utilize and distribute the net profits of the company. Shareholders should not have the right to increase the amount of dividends proposed by the Board of Directors.

5. *Approved dividends shall be paid with no delay but not later than 60 days after their approval unless the charter of the company requires a shorter period.*
It is essential that the company pay dividends within a relatively short period. To avoid situations where companies do not pay dividends or pay dividends very late (after one year), the Model Provisions propose that laws of CIS member states require approved dividends to be paid with no delay and, in any case, not later than 60 days after the dividends are approved unless the charter of the company requires a shorter period.

When the company does not pay declared dividends on time, interest on dividends is commonly accrued under the rules of the Civil Codes of CIS member states. However, CIS member states may also stipulate this explicitly in the laws regulating the protection of investors. In addition, the charter of the company may state that interest be paid to shareholders when dividends are paid late.

6. **The company shall approve dividends on preferred shares before it can approve dividends on common shares. If the company has issued more than one class of preferred shares, the dividends shall be paid in accordance with the priority for the payment of dividends for each class of preferred shares as specified by the charter of the company.**

   The Model Provisions recognize that preferred shareholders are entitled to receive dividends before common shareholders. This is one of the privileges attached to preferred shares. If the company has issued several classes of preferred shares, the charter of the company should specify the priority of payment of dividends for each class of preferred shares. If the company has cumulative and non-cumulative preferred shares, the Model Provisions propose that dividends on non-cumulative preferred shares be paid only after the payment of all accumulated dividends on cumulative preferred shares. When the charter of the company does not provide for a priority order of dividend payments on a class of preferred shares, the Model Provisions propose that dividends on these shares be paid prior to the payment of dividends on common shares.

7. **The company may not declare dividends when:**

   7.1. **The charter capital has not been fully paid;**
   7.2. **The company has not redeemed all shares upon the request of shareholders when the company is required by law to do so;**
7.3. *The company is bankrupt or will become bankrupt as a result of the dividend payment by the company; and*

7.4. *The value of the net assets of the company is, or as a result of dividend payment, will become less than the sum of the charter capital, the reserve fund and the positive difference between the liquidation value and the nominal value of all classes of preferred shares.*

The distribution of dividends also has implications for the rights of creditors. To strike a balance between the interests of shareholders and creditors, the Model Provisions propose that laws of CIS member states introduce limitations on the declaration of dividends based on the availability of assets and the creditworthiness of the company.

8. *Dividends which have been paid contrary to the rules specified by Article 5 of the Model Provisions have to be returned to the company by the shareholder when the company proves that the shareholder knew that he was not entitled to receive dividends or could not have been unaware thereof in view of the circumstances.*

The Model Provisions recommend that the laws of CIS member states specify a rule similar to that of the Second EU Company Law Directive. According to this rule, dividends should be returned by shareholders who have received dividends if the company proves that these shareholders knew that they were not entitled to receive dividends or could not have been unaware that dividends were distributed in violation of legal requirements.

Similar rules may be applied to other distributions to shareholders to avoid the violation of the interests of creditors.

**Article 6. Redemption Rights**

1. *Shareholders have the right to request the redemption of their shares at a price determined by an independent appraiser if they vote against or do not take part in the voting on the following issues during a General Meeting of Shareholders:*

   1.1. *Reorganization of the company;*
1.2. **Major transactions;**

1.3. **Amendments to the charter of the company that restrict the rights of shareholders;** and

1.4. **Restriction of, or withdrawal from pre-emptive rights.**

Redemption rights give shareholders the opportunity to have their shares redeemed by the company in special circumstances provided they act in a certain manner. This is especially important in transition economies where capital markets are not liquid and shareholders cannot voice their disagreement by selling their shares (“voting with their feet”). Buyers for shares are often not available and minority shareholders can be at the mercy of managers affiliated with controlling shareholders. Thus, redemption rights give shareholders an alternative mechanism to exit the company.

The Model Provisions propose that laws of CIS member states clearly identify the circumstances when redemption rights can be exercised. Decisions on the following issues should trigger redemption rights: reorganization, major transactions, amendments to the charter of the company that restrict the rights of shareholders and the limitation of pre-emptive rights. These decisions may substantially affect the rights of shareholders and their investment in the company. Thus, shareholders who disagree should be provided with the opportunity to have their shares redeemed by the company.

According to the Model Provisions, the procedural guarantees for approving related party transactions (see Article 30 of the Model Provisions) should be sufficient to protect minority shareholders. Shareholders should not have redemption rights when the General Meeting of Shareholders votes on related party transactions. Redemption rights, however, should be available to shareholders when the General Meeting of Shareholders votes on any major transaction, including major transactions that meet the requirements of a related party transaction.

2. **When the agenda of the General Meeting of Shareholders includes one of the items listed in Clause 1 of Article 6 of the Model Provisions, shareholders shall be notified of their redemption right with the notice for the General Meeting of Shareholders. The notice shall also include the redemption price and the procedure for the redemption of shares.**
3. The redemption price shall be approved by the Board of Directors and cannot be less than the market value of shares as determined by an independent appraiser. The shareholder requesting the redemption can challenge the decisions of the Board of Directors in the courts not later than 3 months from the date when the decision triggering redemption rights was made.

4. Shareholders can exercise their redemption rights within a period which may not be less than 60 days following the decision of the General Meeting of Shareholders that give shareholders the right to exercise redemption rights. During this period, shareholders can send a written request to the company to have their shares redeemed. The company shall redeem the shares within 30 days after the end of the period during which shareholders could exercise redemption rights.

The Model Provisions propose that shareholders be duly informed about their right to redeem shares. The notice of the General Meeting of Shareholders that approves a decision that can trigger redemption rights should include information about the redemption right of shareholders, including the redemption price the shareholders will receive if they exercise redemption rights and the procedure for exercising redemption rights.

The Model Provisions propose that the redemption price be determined by the Board of Directors. The redemption price should not be less than the market value of the shares as determined by an independent appraiser. When determining the market value of shares, the independent appraiser should not consider any financial consequences that may arise from the exercise of redemption rights. It is also important to provide shareholders who redeem shares with the right to challenge the decision of the Board of Directors on the redemption price. This may be done before shareholders vote on items that may trigger redemption rights. In this case, the courts should decide on the redemption price.

The Model Provisions also propose that shareholders have the right to submit a written request to the company to have their shares redeemed within 60 days after the General Meeting of Shareholders has approved the decision that gives shareholders the right to exercise their redemption rights. The shareholders’ request should include the information on the address (location) of the shareholder who is demanding the redemption of shares and the number, type and class of shares the shareholder seeks to redeem.
The Model Provisions also propose that the company redeem shares within 30 days following the end of the period during which shareholders could exercise redemption rights.

5. **The company shall have no right to redeem shares when:**

   5.1. **The nominal value of the outstanding shares after the redemption will be less than 90 percent of the charter capital;**
   5.2. **The charter capital is not fully paid;**
   5.3. **The company is bankrupt or will become bankrupt as a result of the redemption;**
   5.4. **The value of the net assets of the company is or, as a result of the redemption, will become less than the sum of the charter capital, the reserve fund and the positive difference between the liquidation value and the nominal value of all classes of preferred shares.**

The redemption of shares may be so costly for the company that it may have to file for bankruptcy or be liquidated. The redemption of shares may also weaken the protection of creditors since it involves a repayment to shareholders of (part) of the creditors’ investment. The Model Provisions therefore propose that the laws of CIS member states introduce certain limitations as listed in Clause 5 of Article 6 of the Model Provisions.

6. **When more than ten percent of outstanding shares are submitted for redemption, the company should redeem the shares pro rata to the number of shares submitted for redemption by each shareholder.**

To protect shareholders who redeem shares, the Model Provisions propose that when the redemption of more than ten percent of outstanding shares is requested, the company should redeem the shares in proportion to the number of shares that has been submitted for redemption by each shareholder.

**Article 7. Access to Information**

1. **Each shareholder shall be entitled to examine and obtain a copy of the documents to which shareholders have access by law during the business hours of the company in a manner stipulated by the charter of the company or its by-laws. The company shall not**
require any payments for documents in excess of the costs incurred by the company to produce these documents.

To be able to make informed decisions about their investment in the company as well as to monitor management, investors should have access to information about the activities of the company. The Model Provisions propose that laws of CIS member states determine the list of documents to which shareholders should have access. This list should include as a minimum:

- **Company documentation** including the charter of the company, amendments to the charter or a new version of the charter; the certificate of state registration; documents that verify the ownership title of the company to its assets; and the by-laws and other internal company documents;

- **Financial information** including annual reports; annual accounts and financial statements; and reports of the Revision Commission, the External Auditor and state and municipal financial control agencies;

- **Documents relating to General Meetings of Shareholders and other governing bodies** including the minutes of General Meetings of Shareholders, the Revision Commission, the Board of Directors and the Counting Commission; voting ballots and proxies for General Meetings of Shareholders (or copies of these); and lists of persons entitled to participate in General Meetings of Shareholders, or who are entitled to receive dividends, and any other lists prepared by the company for exercising shareholder rights; and

- **Other information** including prospectuses; reports on the activities of the company submitted to state agencies; lists of affiliated parties of the company; reports of independent appraisers; and other documents specified by legislation, the charter of the company and its by-laws.

The Model Provisions propose that companies provide shareholders the opportunity to familiarize themselves with the documents and to obtain a copy of the documents at costs that do not exceed the costs of producing copies of these documents.

To balance the rights of shareholders and the costs for companies associated with information rights, the Model Provisions propose that documents should be available for examination during the normal business hours of the company. Companies may consider adopting a by-law to regulate what information can be freely obtained and the terms of its availability. The charter of the company could
establish that particular documents would be accessible to shareholders even if this is not required by legislation.

In Western countries, companies are required to disclose certain information and provide shareholders access to particular documents of the company. These countries also have special registries for documents in place that are open to the public (including creditors). The First EU Company Law Directive also regulates the disclosure of information. However, since information in registries is regulated by registration (and public information) law, the Model Provisions restrict themselves to the right of shareholders to information that can be obtained from the company.

It is also important to note that in developed Western countries modern information technologies are more and more widely used in governance of a company. In particular, the Winter Report, the OECD Principles of Corporate Governance and other documents (including the Russian Code of Corporate Conduct) recommend that legislation permit and facilitate the use of electronic means of communication to disclose company information.

2. The company may require a shareholder to give advance notice for the inspection within a period that is not longer than three days prior to the date of the intended inspection.

3. The company shall provide a shareholder with the opportunity to examine or obtain a copy of the documents to which the shareholder has access by law or by the charter of the company within three days of the date the company received the request from the shareholder.

4. If the company does not allow the shareholder to examine the documents, the shareholder may challenge the decision of the company in the courts.

To facilitate shareholders’ access to information, the Model Provisions propose that laws of CIS member states regulate the procedure for requesting and receiving information and documents. These include a notice requirement for shareholders and a requirement for companies to provide information within a period of three days. Shareholders should also have the right to challenge a decision of a company in the courts when an inspection has been refused or when a copy of documents was not
provided on time. In such a case, the court may order the company to provide the requested information.

Information rights of shareholders may be limited based on the confidentiality of information as specified by Article 18 of the Model Provisions.

Article 8. Extraordinary Audit Upon the Request of Shareholders

1. A shareholder (or group of shareholders) owning shares which represent at least ten percent of the charter capital of the company or a smaller percentage specified by the charter of the company shall have the right to request an extraordinary audit of the financial and economic activities of the company by an independent auditor if significant doubts in reliability of the results of financial and economic activities exist.

The Model Provisions propose that laws of the CIS member states provide shareholders or a group of shareholders owning shares that represent at least ten percent of the charter capital the right to request an independent external audit of the financial and economic activities of the company unless the charter of the company provides for a lower percentage. At the same time, there should be sufficient reason to doubt that the results of financial and economic activities of the company presented by management are not reliable.

2. Upon the written request of shareholders specified in Clause 1 of Article 8 of the Model Provisions, the Board of Directors shall appoint an independent auditor within 60 days of the request or a shorter period specified by the charter of the company. If the Board of Directors does not appoint an independent auditor within 60 days of the request, the shareholder can challenge the decision in the courts. The shareholders have the right to propose an independent auditor to the Board of Directors or to request that the courts appoint an auditor other than the one proposed by the Board of Directors.

3. The company shall cover the costs of the extraordinary audit.

To protect the company from unreasonable requests for an external audit by shareholders, the Model Provisions propose that any request be directed to the company. This will give the company’s Board of
Directors and managers the possibility to either provide information that would be sufficient to satisfy the need for such an extraordinary audit or to justify why an extraordinary audit is not needed. The period within which the company engages an independent auditor should be sufficient and reasonable. This period should not be so lengthy that it is impossible for the shareholders who request the extraordinary audit to protect their rights. The Model Provisions propose that a maximum period of 60 days or a shorter period, specified by the charter of the company, be observed by the Board of Directors to appoint an independent auditor.

If the Board of Directors fails to appoint an auditor within this period, the shareholder(s) should be permitted to request that the courts decide this issue. Shareholders should be able also to raise an objection to the extraordinary audit performed by the auditor who is appointed by the company. Shareholders should have the right to request that the company or the courts appoint an independent auditor. The costs associated with the extraordinary audit should be borne by the company to protect minority shareholders’ rights.

Legislation of CIS member states may also stipulate the right of a shareholder (or a group of shareholders) owning a specified percentage of voting shares to request perform extraordinary audit of company’s financial and economic activities on his own account. In this case, the invited auditor shall have full access to required information to perform an audit. At the same time, to protect the company from spending resources to respond to excessive requests for extraordinary audits, legislation may limit the number of such extraordinary audit requests submitted by the same shareholder.

4. **The independent auditor shall report its findings of the extraordinary audit to the Board of Directors within 30 days after the start of the audit. The Board of Directors shall communicate the report of the independent auditor to all shareholders in the same manner as shareholders are notified of the General Meeting of Shareholders and not later than 21 days after the Board of Directors has received the report.**

**Article 9. Extraordinary Meeting of Shareholders Upon the Request of Shareholders**

1. **A shareholder (or group of shareholders) owning at least ten percent of voting shares of the company or a lower percentage specified by the charter of the company, has the right to request the Board of Directors to hold an Extraordinary Meeting of Shareholders**
to discuss and vote on items that have been put forward by the requesting shareholder(s) which fall within the authority of the General Meeting of Shareholders.

2. The agenda of the Extraordinary Meeting of Shareholders cannot be changed without the consent of the requesting shareholder(s). When the agenda of the Extraordinary Meeting of Shareholders includes the election of members of the Board of Directors by cumulative voting, the holders of at least two percent of the voting shares shall have the right to nominate candidates for the Board of Directors.

The Board of Directors is obliged in principle to convene an Extraordinary Meeting of Shareholders when the law (e.g., major transactions, related party transactions, a significant loss of charter capital) requires such a meeting. In addition, the right to request an Extraordinary Meeting of Shareholders is an important right of minority shareholders. It entitles a shareholder (or group of shareholders) owning at least ten percent of voting shares to request that the Board of Directors hold a Meeting. This right could also be given to the holders of a smaller percentage of voting shares if the charter of the company stipulates this.

The requesting shareholder(s) should be allowed to propose items for the agenda of the Extraordinary Meeting of Shareholders and should be assured that the agenda of the meeting cannot be changed without his (their) consent. Meanwhile, the Board of Directors should ensure that the agenda meets the legal requirements by providing the requesting shareholder(s) the opportunity to amend their proposal.

The Model Provisions propose that one group of shareholders (holding a minimum percentage of voting shares) should not be entitled to propose items for the agenda of the Extraordinary Meeting of Shareholders that will be held upon the request of another group of shareholder(s). An exception to this rule should be the election of members of the Board of Directors by cumulative voting. If other shareholders are not allowed to propose candidates to the Board of Directors, the candidates that are proposed by the requesting shareholder(s) are automatically elected to the Board of Directors since cumulative voting guarantees that the candidates who receive the most votes are elected to the Board of Directors. The Model Provisions recommend that the Board of Directors inform the shareholders about the consequences when they do not nominate candidates. However, legislation of CIS member states may stipulate the right of a shareholder (or group of shareholders) owning at least ten percent of voting shares to propose issues to the agenda of the Extraordinary Meeting of Shareholders initiated by
another shareholder (or group of shareholders) owning at least ten percent of voting shares. This will allow the company to save costs on the organization of Meetings. In this case, procedures for proposing items to the agenda of the Meeting and the notification of shareholders of the final agenda should be in place.

3. The Board of Directors shall make the decision to hold the Extraordinary Meeting of Shareholders with the agenda proposed by the requesting shareholders within 14 days after the request. The Extraordinary Meeting of Shareholders shall be held not later than 40 days after the receipt of the request. If the agenda of the proposed Extraordinary Meeting of Shareholders includes the election of directors by cumulative voting, the Extraordinary Meeting of Shareholders shall be held not later than 60 days after the receipt of the request.

The Board of Directors shall notify the shareholders entitled to participate in the Extraordinary Meeting of Shareholders in the same manner in which shareholders are notified of the General Meeting of Shareholders, and not later than 14 days before the Extraordinary Meeting of Shareholders is held.

If the agenda of the Extraordinary Meeting of Shareholders includes the election of directors by cumulative voting, the shareholders shall be notified of the Extraordinary Meeting of Shareholders not later than 40 days before the Meeting is held. During the 14 days after the receipt of the notice, any shareholder (or group of shareholders) owning at least two percent of voting shares shall have the right to nominate candidates for the Board of Directors. The procedure for the nomination of members of the Board of Directors to be elected during the Extraordinary Meeting of Shareholders shall be the same as the procedure for nominating candidates during the General Meeting of Shareholders.

At least 14 days before the Extraordinary Meeting of Shareholders is held, the Board of Directors shall notify all shareholders of the final list of candidates for the Board of Directors in the same manner in which shareholders are notified of the Extraordinary Meeting of Shareholders.
The Model Provisions propose that laws of CIS member states contain procedures for Extraordinary Meetings of Shareholders. The Board of Directors should be given sufficient time to meet and decide on the organization of the Meeting. However, Extraordinary Meetings of Shareholders are often held to decide on urgent matters. The Model Provisions therefore propose that the Board of Directors make a decision on the organization of an Extraordinary Meeting of Shareholders within 14 days after the request for the Meeting has been received by the company. The Extraordinary Meeting of Shareholders should be held not later than 40 days after the receipt of the request.

If the agenda includes the election of directors by cumulative voting, the Extraordinary Meeting of Shareholders should be held not later than 60 days after the receipt of the request. This enables shareholders owning at least two percent of the voting shares to nominate candidates for the Board of Directors. The procedure for the nomination of directors should be identical to the procedures used for the nomination of candidates to be elected during the General Meeting of Shareholders. The procedures should also provide sufficient time for the distribution of voting ballots and the notification of shareholders about the final list of candidates. The shareholders should be notified at least 14 days before the Meeting is held.

4. **The written request to hold an Extraordinary Meeting of Shareholders shall state the agenda items, the wording of the decisions proposed by the requesting shareholder(s) and be signed by the requesting shareholder(s). The request shall also specify the reasons for convening the Extraordinary Meeting of Shareholders.**

5. **The Board of Directors shall not hold the Extraordinary Meeting of Shareholders only if any of the following grounds exist:**

   5.1. **The requesting shareholder(s) does not own the percentage of shares specified in Clause 1 of Article 9 of the Model Provisions;**

   5.2. **None of the proposed agenda items falls under the authority of the General Meeting of Shareholders;**

   5.3. **The written request to hold the Extraordinary Meeting of Shareholders does not meet the requirements of Clause 4 of Article 9 of the Model Provisions; and**

   5.4. **The law and/or the charter of the company do not allow shareholders to propose the items specified in the request.**
The Model Provisions propose that laws of CIS member states require that the request to hold an Extraordinary Meeting of Shareholders be submitted in writing and include minimum information such as the items for the agenda, the decisions the Meeting is requested to adopt and the reasons for calling the Meeting. All requesting shareholders or their representatives should sign the request.

To protect shareholders from a Board of Directors’ abuse of power, the Board should only have the authority not to hold an Extraordinary Meeting of Shareholders when the criteria specified by law are met.

To protect minority shareholders when the charter of the company prohibits shareholders from proposing certain agenda items, the law should specify which agenda items can be proposed only by the Board of Directors according to the charter of the company.

6. **If the Board of Directors does not make a decision within the specified period or does not hold the Extraordinary Meeting of Shareholders, the requesting shareholders can challenge the company’s actions (inaction) in the courts. The court may order the Board of Directors to convene the Extraordinary Meeting of Shareholders or allow the requesting shareholder(s) to convene the Meeting on behalf of the company.**

Shareholders should be protected from Boards of Directors that refuse to hold the Extraordinary Meeting of Shareholders or that do not decide on the shareholders’ request. The Model Provisions propose that the requesting shareholder(s) should be able to submit to the court a request that orders the Board of Directors to convene the Extraordinary Meeting of Shareholders. The courts’ role in this instance is important as they examine the Board’s grounds for refusal, if any. By empowering one group of shareholders to challenge the decision of the Board of Directors in the courts, different groups of shareholders are prevented from holding Extraordinary Meetings of Shareholders concurrently.

7. **The costs of the Extraordinary Meeting of Shareholders shall be borne by the company.**

The Model Provisions propose that the company bear the costs of Extraordinary Meetings of Shareholders to protect the rights of shareholders that have requested the meeting. The procedural rules
for exercising the right to request the holding of the Extraordinary Meeting of Shareholders should be sufficient to protect the company from shareholders who seek to misuse this right.

**Article 10. Cumulative Voting**

1. *The charter of the company may provide for cumulative voting to elect members of the Board of Directors of the company. If members of the Board of Directors are elected by cumulative voting, any decision of the General Meeting of Shareholders on the early termination of the directors’ authority may be approved only with regard to all members of the Board of Directors.*

2. *When the charter of the company provides for cumulative voting, the shareholder having the right to vote shall be entitled to use the votes attached to his shares, multiplied by the number of members that will be elected. The shareholder may give all his votes to one candidate or may distribute them among the candidates. The election of all candidates shall be held simultaneously. The votes given to each candidate shall be calculated separately. The candidates who have received the greatest number of votes shall be deemed elected.*

Cumulative voting is a mechanism that enables shareholders to elect collectively their representative for a position on the Board of Directors. Despite the recent changes in the Russian Law on Joint Stock Companies which make cumulative voting mandatory for all joint stock companies, the Model Provisions propose that cumulative voting be optional for companies. Cumulative voting requires a dispersed ownership structure of a company, a relatively large Board of Directors and the ability of shareholders to organize themselves and understand the voting system. There are costs associated with cumulative voting and the system is generally not well understood. The election of a minority representative can also divide the Board of Directors. Although cumulative voting is used in Anglo-Saxon countries, recent trends show that its usage is rapidly declining.

Although it would be technically possible to design a cumulative voting system that allows shareholders to dismiss a member of the Board of Directors (e.g., the Canadian system), the Model Provisions propose that the individual dismissal of a director should not be used in CIS member states. The system
is difficult to administer and requires a supermajority of the votes present at the General Meeting of Shareholders.

It is important to note that other mechanisms allow minority shareholder representation on the Board of Directors. Often, strategic investors require that charter provisions allow them to appoint one or several of their representatives to the Board. Legislation of CIS member states may provide for such a possibility. To protect other shareholder rights, the total number of appointed directors should be limited.
Section 2. Rights of the State as a Shareholder

**Article 11. Rights of the State as a Shareholder**

1. The state as a shareholder has the same rights as any other shareholder owning the same types and classes of shares.

2. The state may hold a Golden Share in companies with strategic importance as defined by law.

3. Golden Shares may only provide for the following special rights:

   3.1. The right to approve transactions as defined by the charter of the company except for transactions that are carried out in the ordinary course of business;

   3.2. The right to approve the following decisions of the General Meeting of Shareholders:

      3.2.1. Reorganization of the company;
      3.2.2. Liquidation of the company; and
      3.2.3. Increase of the charter capital of the company;

   3.3. The right to appoint a member of the Board of Directors; and

   3.4. The right to stop the acquisition of control within one month after the acquisition has been announced.

4. Decisions of the General Meeting of Shareholders specified in Clauses 3.1 and 3.2 of Article 11 of the Model Provisions enter into effect only after their approval by the state body authorized to exercise the rights attached to the Golden Share.

5. Special rights attached to Golden Shares may only be exercised to protect the rights and lawful interests of the state, to ensure its security or to protect the rights and lawful interests of citizens. The exercise of special rights attached to Golden Shares may be appealed in the courts.
Balancing the interests of private investors and the state as a shareholder is of great importance to CIS member states. In principle, as mentioned earlier, shareholders should be treated equally regardless of whether the shareholder is a private person, a legal entity or the state. However, the Model Provisions recognize that the state should be allowed to maintain a greater influence in companies in the interest of the public. In CIS member states, for example, Golden Shares are useful instruments for governments to maintain a controlling position in strategic companies during the transition process. Company law rather than privatization law should regulate these rules. Legislation in many Western countries also gives special rights to the state. For example, the European Court of Justice recently confirmed the legality of Golden Shares in several cases. Although Golden Shares were declared void in some cases, the European Court upheld the concept of the Golden Shares when certain requirements are met.

Golden Shares deviate from the principle that shareholders of the same type and class are treated equally and they should be used carefully. The Model Provisions therefore propose that special rights of the state under a Golden Share arrangement be limited to the circumstances specified in Clause 3 of Article 11 of the Model Provisions. Golden Shares give investors some certainty since they allow investors to anticipate the rights the state can exercise.

Procedures for exercising special rights attached to Golden Shares are commonly regulated in detail in special legislation. In particular, legislation shall regulate not only procedures for approving a company’s decisions specified in Clauses 3.1 and 3.2 of Article 11 of Model Provisions but also procedures for appointing directors as specified in Clause 3.3 of Article 11 of Model Provisions, as well as the procedure and consequences for vetoing the acquisition of control.
Section 3. Shareholder Duties

Article 12. Shareholders’ Limited Liability

1. A shareholder is not liable for the obligations of the company and he only bears the risk of losses to the extent of the nominal value of his shares.

2. Only laws can provide exceptions to the rule specified in Clause 1 of Article 12 of the Model Provisions.

3. Shareholders who have not paid their shares in full, bear joint and several liability for the obligations of the company to the extent of the unpaid part of their shares.

It is a well-established principle that a shareholder of a joint stock company is not responsible for the debts of the company. The limited liability principle protects investors from losses of the company and it limits the risk associated with their investment to the value of the shares they own. Different jurisdictions provide legal certainty and encourage equity investments with exceptions to the principle of limited liability of shareholders in particular circumstances. The founding documents of a company should not determine whether exceptions to the limited liability of shareholders are allowed. In civil law countries, only legislation can provide for these exceptions. Articles 15 and 16 of the Model Provisions below suggest the regulation of two exceptions to the limited liability principle. The limited liability principle is based on the assumption that a shareholder has fully paid his shares.

The liability stipulated in Clause 3 of Article 12 of the Model Provisions terminates when the charter capital is decreased in accordance with the requirements of Clause 6 of Article 13 of the Model Provisions.

Article 13. Duty to Pay Up the Shares

1. A shareholder is obliged to pay to the company the full consideration for the shares that were issued to him. A shareholder cannot be relieved of this obligation, including through a set-off of claims against the company.
2. Shares can be paid in cash or in property, property rights, or other rights with a monetary equivalent (contribution in kind). The form in which the consideration shall be paid during the foundation of company is determined by the founders agreement, or by the decision to place shares when additional shares are issued. The contribution in kind shall be subject to the appraisal regime established by Article 14 of the Model Provisions.

3. Shareholders shall pay a minimum of 50 percent of the full amount of the cash consideration prior to the state registration of the company. Shareholders shall pay the remaining part within a period of not more than one year of the state registration of the company, unless the charter of the company provides a shorter period. When additional shares are issued, they shall be paid for in full prior to the registration of the results of the share issue.

4. Contributions in kind shall be paid in full prior to the registration of the company at its formation or at the registration of the results of a share issue in case of an additional share issue.

5. Shares that are not paid in full do not grant voting rights to their holders unless otherwise provided by the charter of the company. The charter of the company may provide for fractional votes of partly paid shares.

6. If the shares are not paid in full within the period provided by Clause 3 of Article 13 of the Model Provisions, the ownership of the shares corresponding to the unpaid amount passes to the company followed by writing off of such shares from the shareholder's account upon the instruction from the company in accordance with requirements of legislation.

7. The charter of the company or the founders agreement can authorize the company to claim interest or compensation for losses for the failure of a shareholder to pay for the shares.
The most important (and often the only) duty of the shareholder is to pay the shares fully when they are issued. A shareholder has many rights once his shares are fully paid. In many jurisdictions, a shareholder does not enjoy the right to vote until the full payment of his shares, unless the charter of the company provides otherwise. Clause 5 of Article 13 of the Model Provisions proposes a flexible system that gives holders of partly paid shares fractional votes.

It is important to note that the prohibition for an off-set that is provided by Clause 1 of Article 13 of the Model Provisions does not prevent the company from carrying out debt-and-equity swaps. In this case, the debt will have to be treated as a contribution in kind and is subject to the appraisal requirements of Article of 14 of the Model Provisions.

Most laws of CIS member states allow shareholders to pay only a minimum portion of the consideration at the formation of the company. It helps companies to start activities and facilitates the creation of new companies. Given the public nature of a joint stock company, it is essential that the interests of the founders are balanced with the interests of creditors and other stakeholders of the company. In addition to the protection established in Article 12, Clause 3 of the Model Provisions, shareholders are therefore required to pay in the full consideration within a given period, typically one year. This period should not be longer as it maintains a situation in which the legal capital of the company is not completely formed (the legal capital is one of the guarantees to protect creditors’ interests). Shareholders should always fully pay shares in cash and/or in kind when additional shares are issued. The state registration body and/or the Securities Commission should verify whether a joint stock company complies with this requirement.

The company should have carefully defined authorities when shareholders delay the payment of shares. In most jurisdictions, the shareholder loses the unpaid amount of shares and can incur liability for losses or interest if the charter of the company provides this. It is a matter of policy whether legislation or the charter of the company determine that shareholders pay interest when they delay the payment of shares. It is also a policy choice whether a shareholder is held automatically liable for losses or interests when the period set by law or the charter of the company expires or, for example, whether the company is required to issue a notice to the shareholder prior to the end of the period.
Article 14. Appraisal of Contributions in Kind

1. Contributions in kind shall be subject to a monetary appraisal carried out by the founders of the company at its formation, or by the Board of Directors when the company issues additional shares.

2. The appraisal shall describe the value of the contributions in kind during the six months preceding the share placement at the company formation, or as of the day of the placement, when the company issues additional shares.

3. The appraisal shall be accompanied by the report of an independent appraiser appointed by the founders at the company formation or the Board of Directors when the company issues additional shares. The independent appraiser's report shall include:

3.1. The nominal value of shares that will be wholly or partly paid with the contributions in kind;
3.2. A description of the contributions in kind (including each of the assets it is comprised of and the amount to be paid in cash), if any;
3.3. The method and the date of the appraisal of the contributions in kind;
3.4. A conclusion on how the appraised value and the nominal value of shares correspond; and
3.5. Information on the independent appraiser.

4. The monetary value resulting from the appraisal by the company’s founders or the Board of Directors, respectively, cannot be higher than the value that is determined by the independent appraiser.

5. The appraisal and the independent appraiser's report shall be disclosed in accordance with requirements of legislation.

6. An independent appraiser's report shall not be required when:

6.1. The value of the contribution in kind is below […]; and
6.2. **The contribution in kind consists of shares or other securities convertible into shares, which have been subject to a public offering and when these securities have been included in the quotation lists of stock exchanges.**

7. **The company founders and the Board of Directors, respectively, shall be held liable within a period of three years after the registration of the company or after the share issue when the assets representing the contributions in kind do not have the value stated in the appraisal at the time of the registration.**

An independent appraisal of contributions in kind is an important guarantee to protect investors. To leave the determination of the value of contributions in kind entirely in the hands of directors and founders might lead to an undervaluation or overvaluation of the shareholders’ investment or to other forms of abuse. Therefore, the Model Provisions emphasize the importance of the independent appraiser’s report in determining the fair monetary value of contributions in kind. This approach is consistent with Western regulation and, more specifically, with the Second EU Company Law Directive.

The Model Provisions propose that the independent appraiser’s report be required as a rule except when a functioning market pricing mechanism exists or when the national legislator excludes “small” contributions in law that meet a certain threshold. Similarly, the Model Provisions propose that laws provide minimum requirements of an appraiser’s report and require its disclosure.

**Article 15. Subsidiary Liability in Case of Bankruptcy**

1. **If a company’s insolvency is intentionally caused by acts (or failure to act) of a shareholder or another person who has the right to give mandatory instructions to the company or otherwise has the opportunity to determine its actions, such shareholder or another person, shall be subject to subsidiary liability for the company’s obligations.**

The limited liability of shareholders, as indicated above, is a fundamental principle of the modern corporation where ownership is separated from “corporate control.” Because major/controlling shareholders may influence the decisions of the company and determine its direction, an exemption from the general limited liability rule of shareholders could be justified. Major/controlling shareholders can abuse their power in pursuit of their own interest and violate the interests of the minority
shareholders and the creditors of the company. Many jurisdictions therefore provide for some form of liability of controlling shareholders. This is provided in addition to provisions of major share interest disclosure (discussed in Article 17 of the Model Provisions) or the requirement for the presence of non-executive directors on the Board of Directors to act on behalf of minority shareholders (see also paragraphs 35 and 36 of the OECD General Principles of Company Law for Transition Economies).

The limited liability of shareholders stimulates (foreign and domestic) investment and risk-taking, which are important for the development of markets of CIS member states. Thus, it is particularly important to carefully define the boundaries of the exemption that is regulated by the Model Provisions.

First, the proposed liability relates to persons who have the right to give mandatory instructions or who otherwise can determine the actions of the company. This right arises by virtue of their majority ownership or is the result of special rights that are provided by the charter of the company or a contract with the company.

Second, the liability is triggered only when the actions (or omissions to act) of a controlling shareholder or another person have led to the company’s bankruptcy. Although different jurisdictions allow for different grounds for liability, e.g., enduring negative influence on the company’s business policy, the Model Provisions recommend to consider bankruptcy as a ground for subsidiary liability.

Third, the liability is triggered only when persons specified in Clause 1 of Article 15 of the Model Provisions have caused bankruptcy intentionally and when they have acted with the express purpose of defrauding the company’s creditors by causing the company’s insolvency.

A fourth limitation of the liability is that it is subsidiary, i.e., the shareholder is held liable only when the funds of the company are insufficient to satisfy its debts.

**Article 16. Liability of a Parent Company**

1. **A parent company that has the right to give mandatory instructions to a subsidiary based on a contract with the subsidiary or the charter of the subsidiary, shall be jointly and severally liable with the subsidiary for obligations following from the implementation of these instructions.**
2. **Shareholders of the subsidiary have the right to claim damages caused to the subsidiary by the fault of the parent company. The parent company shall only be liable when the parent company used its right to give instructions to the subsidiary knowing that the execution of the instruction will result into losses for the subsidiary.**

Parent companies can be a special type of controlling shareholders. In addition to the standard company law mechanisms of control provided by share ownership, companies can have additional opportunities to influence the decision-making of their subsidiaries. A number of jurisdictions, including the Russian Federation, allow a parent company to give mandatory instructions to a subsidiary when this is provided by the charter of the subsidiary or by a contract between the parent company and the subsidiary. This enables a group of business entities to realize important advantages – separate legal entities and limited liability combined with the possibility for joint or coordinated economic activities. On the other hand, it creates possibilities for abuse of the subsidiary’s creditors or other (minority) shareholders’ interest. These can include the misuse of assets, the undercapitalization of the subsidiary, or ultimately, defrauding creditors and minority shareholders due to the insolvency of the subsidiary.

For this reason, different jurisdictions give subsidiaries’ creditors and shareholders additional protection. The Model Provisions propose that CIS member states provide for two exemptions from the principle of the limited liability of parent companies to protect creditors of subsidiaries.

First, when a parent company has the right to give mandatory instructions, a key justification for its limited liability is absent, namely the separation of control from risk, and there are no grounds to burden creditors at the expense of controlling shareholders. At the same time, it is important not to discourage investors (parent companies) by extending their liability as a matter of principle. Therefore, the proposal provides for additional liability of the parent company only when the right to give mandatory instructions to the subsidiary is provided by the charter of the company or a contract.

Second, similar grounds for extending the parent company’s liability occur when its instructions directly and deliberately caused insolvency of the subsidiary (see Article 15 of the Model Provisions).

The Model Provisions are based on the principle that shareholders can act against the parent when damages are caused to the subsidiary. To protect shareholders of the subsidiary, the Model Provisions do not envisage a percentage of the capital that must be owned by shareholders in order to act
against the company. In a similar effort not to discourage investment through the establishment of subsidiaries, the Model Provisions limit the liability of a parent company where damages are caused by a deliberate abuse of the right to give mandatory instructions to a subsidiary.

**Article 17. Duty to Disclose a Controlling Interest**

1. **When an individual or legal entity directly or indirectly acquires or disposes of shares of a listed company and when, following that acquisition or disposal, the percentage of voting rights held by that person or legal entity in a listed company reaches, exceeds or falls below 10%, 20%, 33%, 50% and 66%, such person or legal entity shall notify the company and the securities market regulator at the same time within seven calendar days after changes occur in the percentage of voting rights an individual or a legal entity holds.**

The disclosure of the ownership structure of a listed company is essential to ensure that interested parties are informed who the controlling and minority shareholders are. It is also important that a company disclose the ownership of shares to enforce procedural rules for control transactions and related party transactions. However, when shares of the company are traded on the stock market, the company often does not know who its shareholders are since the beneficial owners of shares may not be registered in the shareholder register. The Model Provisions propose, therefore, that the laws of CIS member states require that beneficial owners disclose their ownership in a listed company when certain thresholds of investment in that company are reached. The controlling shareholder should notify the company and the regulatory authority at the same time.

The laws should require the disclosure of voting power once the acquisition of shares exceeds the 10%, 20%, 33%, 50% and 66% thresholds. National legislation of CIS member states may stipulate a lower threshold, e.g., 5%. The disclosure requirements should also apply when an individual or a legal entity decreases the participation in the company by disposing of voting shares.

This disclosure requirement should be triggered not only when a single person owns the voting shares, but also in the following cases:
- Voting rights are held by persons or entities in their own names on behalf of another person or entity;
- Voting rights are held by a company controlled by that person or entity;
- Voting rights are held and used by a third party with whom that person or entity has concluded a written agreement which obliges them to adopt a lasting common policy towards the management of the company in question;
- Voting rights are held by a person or entity or other persons or entities mentioned above who is/are entitled to acquire these rights on his/their own initiative as a result of a formal agreement. In these cases, the company and the regulator shall be notified on the date of the agreement; and
- Voting rights are held which are attached to shares deposited with that person or entity which that person or entity can exercise at its discretion in the absence of specific instructions from the holders.

It shall be noted the rule set forth in this Clause about the disclosure to the securities market regulator should be required only if information is considered to be public in accordance with the requirements of national legislation. Otherwise, it is necessary to provide alternative mechanisms for information disclosure to make information available to all investors. Publication in media or the disclosure to the organizer of trade in securities could be such alternatives.

The described disclosure obligation is consistent with the requirements of the EU Directive 2001/34/EC of 28 May 2001 on the admission of securities to an official stock exchange listing and on information to be published on those securities.

2. **A person who is obliged to disclose his shareholdings in accordance with the requirements of Clause 1 of Article 17 of the Model Provisions can exercise the voting rights attached to these shares only if he has fulfilled these disclosure requirements.**

To enforce the requirements of Clause 1 of Article 17 of the Model Provisions, it is important to provide for sanctions when investors do not comply with the disclosure requirements. The Model Provisions propose, therefore, that voting rights attached to shares cannot be exercised unless the owners have fulfilled the disclosure requirements.
Article 18. Other Shareholder Duties

1. A shareholder, having access by law, the charter or the by-laws of the company to confidential information and documents, shall not disclose the information and documents other than to exercise the rights to which he is entitled by law. If a shareholder violates this obligation and causes damages to the company, he shall be liable to the company for these damages.

2. Other duties can be imposed upon shareholders only by law.

The main duty of shareholders is to pay shares fully. Contrary to investors in “personal companies” such as a limited liability company or a partnership, shareholders, as a rule do not have additional duties. Only legislation should be able to introduce other duties of shareholders.

Shareholders have an additional duty to protect confidential information and documents. It should be noted that Article 18 of the Model Provisions does not regulate the use of insider information. Legislation and a company’s internal documents should establish criteria for the confidentiality of information. Shareholders should use confidential information only in good faith when they exercise their rights. Shareholders should be held liable if they cause damages to the company as a result of the disclosure of confidential information.
Section 4. General Meeting of Shareholders

Article 19. Proxy Voting

1. Each owner of voting shares is entitled to participate in the General Meeting of Shareholders personally or through a representative.

Participation in General Meetings of Shareholders is an essential right of shareholders. Since not all shareholders are in the position or are willing to prepare for and participate in General Meetings of Shareholders, shareholders should be permitted to participate through a representative.

2. The right of the shareholder representative to participate in General Meetings of Shareholders shall be accompanied by a duly authorized power of attorney. The power of attorney shall be in writing and shall be provided to the company at the time of registration for the General Meeting of Shareholders.

The shareholder has the right to change his representative or cancel the power of attorney at any time and to participate in General Meetings of Shareholders in person.

The Model Provisions propose that a power of attorney grant the right of representation. The power of attorney should be duly issued in accordance with national legislation. Notarization could be one but not necessarily the only verification method. The power of attorney should be submitted to the company for the registration for the General Meeting of Shareholders for which it is issued. This ensures that the company is informed about the representation of shareholders.

The power of attorney should be revocable at any time. A shareholder should also be able to change a representative, change the instructions he has given to the representative, cancel the power of attorney and personally participate in the General Meeting of Shareholders.

3. When a member of the governing bodies of a company or any other person acting on behalf of the company offers in public or to a shareholder (or group of shareholders) holding at least two percent of voting shares, to be a shareholder's representative, or invites shareholders to nominate a representative, the following rules shall apply:
3.1. The power of attorney shall be valid only for one General Meeting of Shareholders and any rescheduled or repeat meeting with the same agenda;

3.2. The power of attorney may be revoked at any time by the shareholder. Any changes in the power of attorney shall be effective as of the moment the company is notified by the shareholder;

3.3. The invitation to grant the power of attorney shall be in writing and include at least the following information:

   3.3.1. The agenda of the General Meeting of Shareholders;
   3.3.2. The decisions of the General Meeting of Shareholders as proposed by the governing bodies of the company;
   3.3.3. The invitation to the shareholder to give voting instructions to the representative; and
   3.3.4. Information on how the representative will vote if shareholders do not provide for voting instructions.

The body responsible for registering shareholders and their representatives for the General Meeting of Shareholders shall verify whether the rules specified in Clause 3 of Article 19 of the Model Provisions are observed.

Clause 3 of Article 19 of the Model Provisions regulates a power of attorney that has been solicited from all shareholders or a shareholder (or group of shareholders) owning two or more percent of voting shares of the company. Any offer extended through the media or any general announcement targeting an unlimited number of shareholders would qualify as a public offer. However, the offer could be extended to a single large shareholder or a group of shareholders that holds a certain percentage of voting shares. The threshold of two percent is connected with the shareholder’s right to propose items to the agenda of the General Meeting of Shareholders. If national legislation of CIS member states provides for a higher threshold for proposing agenda items, the threshold in Clause 3 of Article 19 of the Model Provisions could be changed accordingly.

Clause 3 of Article 19 of the Model Provisions regulates offers for representation by a member of the company’s governing bodies or any other person acting on behalf of the company. By including any
other person who acts on behalf of the company, an additional layer of protection is built into the Model Provisions to ensure that shareholders are protected, especially employee shareholders.

In addition, the requirements of Clause 3 of Article 19 of the Model Provisions seek to maximize information disclosure with respect to the transfer of voting rights.

The Model Provisions propose that legislation of CIS member states require that the offeror provide evidence that the requirements for shareholder representation have been met. These should be verified by the body that is responsible for registering shareholders and their representatives for the General Meeting of Shareholders.

4. **The shareholder representative is obliged to vote according to the instructions of the shareholder as indicated in the power of attorney.**

The representative should be obliged to act strictly in accordance with the instructions of the shareholder. However, legislation of CIS member states may stipulate that the representative may depart from shareholder instructions in particular circumstances. This could be possible when new circumstances arise after the power of attorney has been granted and when the interests of the shareholder are better served if the representative votes differently. In this case, the representative should inform the shareholder as soon as possible and he should be liable for damages he has caused to the shareholder by voting differently.

5. **Any person with a dispositive capacity may be a shareholder representative at the General Meeting of Shareholders.**

The Model Provisions propose that legislation of CIS member states specify who can be a shareholder representative. This can be regulated with company laws or Civil Code provisions that regulate representation relations.

In some jurisdictions, members of the company’s governing bodies are specifically prohibited from serving as shareholder representatives to prevent them from making decisions that are not in the interest of shareholders. However, Clause 3 of Article 19 of the Model Provisions should provide sufficient protection for shareholders since it covers representation offers.
1. The shareholders shall be notified of the Annual Meeting of Shareholders at least 21 days before the Meeting unless the law and the charter of the company require a longer period. When the agenda of the Meeting includes the reorganization of the company, the shareholders shall be notified not fewer than 40 days prior to the Meeting.

2. The period of notification for a General Meeting of Shareholders specified in Clause 1 of Article 20 of the Model Provisions may be shortened or waived when all shareholders notify the Board of Directors in writing that they agree with such notification period.

The Model Provisions propose that legislation of CIS member states ensure that shareholders are provided with information about the General Meeting of Shareholders well in advance of the meeting. Shareholders need sufficient time to decide how they will vote on each agenda item and to engage in collective action with other shareholders, if needed. The Model Provisions propose that the notification period cannot be fewer than 21 days before the Annual Meeting of Shareholders is held. A longer notification period of at least 40 days is required when the General Meeting of Shareholders decides on the reorganization of the company. Legislation of CIS member states and/or the charter of the company may require a longer period.

It may not be necessary for shareholders of all joint stock companies (especially with a small number of shareholders) to have a long notification period. To have a shorter notification period specified by Clause 1 of Article 20 of the Model Provisions or to waive the requirement to have any, the written consent of shareholders should be required.

3. The notice of the General Meeting of Shareholders shall be announced in an official gazette where information on commercial legal entities is published, and sent by registered mail unless the charter of the company provides for another method of notification. The charter of the company may provide for additional methods of notification.

As a rule, the Model Provisions propose that the notice of the General Meeting of Shareholders be published in an official gazette that publishes information on commercial legal entities and sent by
registered mail unless the charter of the company provides otherwise. In CIS member states without an official gazette, printed media with a certain minimum distribution and geographic reach can be required. The charter of the company should stipulate the name of the printed media that will be used to publish the notice. In addition, the charter of the company may provide for another method of notification such as hand delivery (for small companies or companies with employee shareholders) or publication in a newspaper.

4. **The notice of the General Meeting Shareholders shall include at least the following information:**

4.1. **Full name of the company;**
4.2. **Form of the General Meeting of Shareholders (physical presence or written consent);**
4.3. **Date, time and place of the General Meeting of Shareholders;**
4.4. **Agenda;**
4.5. **Wording of the decisions to be made;**
4.6. **Record date for shareholders to determine who has the right to participate in the General Meeting of Shareholders; and**
4.7. **A list of documents and the procedure for examining these documents.**

The Model Provisions propose that the notice include the minimum information necessary to enable shareholders to participate in the General Meeting of Shareholders. The charter of the company may expand this list and may require additional information to be included in the notice for the General Meeting of Shareholders. For example, if the agenda includes items which trigger redemption or preemptive rights, the notice might include additional information.

5. **The following information and documents shall be available to shareholders prior and during the General Meeting of Shareholders:**

5.1. **The annual report and annual financial statements;**
5.2. **Information on the candidates for the governing bodies if they are to be elected at the General Meeting of Shareholders; and**
5.3. **Additional information required by law or the charter of the company.**
The company shall ensure that shareholders receive full information regarding the agenda items.

6. The information and documents specified in Clause 5 of Article 20 of the Model Provisions shall be available to shareholders at least 21 days before the General Meeting of Shareholders or 40 days if the agenda includes the reorganization of the company, unless the charter of the company provides for a longer period. The information and documents shall also be available during the General Meeting of Shareholders.

All information shall be available at least at the premises of the company (where the executive bodies of the company are located) and at the location where the General Meeting of Shareholders is held. The charter of the company may provide that the information for the General Meeting of Shareholders also be available to shareholders in other locations.

Information should be available to enable shareholders to make informed decisions during the General Meeting of Shareholders. As a minimum, the Model Provisions propose that the annual report and annual financial statements and information regarding candidates standing for election be available prior to the General Meeting of Shareholders. The charter of the company can specify additional information and documents that should be available to shareholders.

The Model Provisions also propose that information and documents be available to shareholders at least 21 days prior to the General Meeting of Shareholders as well as during the Meeting. The charter of the company may provide for a longer period. The Model Provisions propose a notification period of at least 40 days when the agenda of the General Meeting of Shareholders includes the reorganization of the company.

Information for the General Meeting of Shareholders should also be available at the location of the company’s executive bodies and other locations as specified in company’s charter.
**Article 21. Additional Information That Can Be Requested During the General Meeting of Shareholders**

1. *Any shareholder is entitled to request from members of the governing bodies of the company additional information during the General Meeting of Shareholders to make informed decisions on each agenda item. The charter of the company may provide that these requests shall be addressed to the company in writing before the General Meeting of Shareholders.*

A shareholder’s right to information would be incomplete if it would not allow the shareholder to receive information that may shed more light on items on the agenda of the General Meeting of Shareholders. Shareholders usually obtain information from representatives of the company’s governing during the Meeting. The charter of the company and its by-laws can specify the procedure that allows shareholders to ask questions and obtain information during the General Meeting of Shareholders. The chairman of the Meeting should be entitled to limit the number of questions/requests per person or to limit the time that can be spent on answers/requests if this is stipulated in the company’s internal documents.

2. *Members of the governing bodies of the company can refuse to give the requested information only when:*

   2.1. *This information may cause serious damage to the company; or*
   2.2. *The company is obliged by law to keep this information confidential.*

The right of shareholders that is provided by Clause 1 of Article 21 of the Model Provisions should be provided while balancing a company’s legal obligations to keep information confidential and the duty of directors and managers to protect the company.

3. *The minutes of the General Meeting of Shareholders shall record whether the governing bodies have provided information to any requesting shareholder or on what grounds the information has not been provided. The shareholder may challenge the decision of the governing bodies in the courts within 30 days after the General Meeting of Shareholders.*
Information that has been provided to the requesting shareholder shall be available to all shareholders.

To enforce shareholders’ right to information, laws should provide recourse to the courts. Since the grounds of refusal to provide information may be interpreted broadly and to the disadvantage of shareholders by the governing bodies, the requesting shareholders should be allowed to have the courts review the lawfulness of the refusal. This should be done within no more than 30 days after the General Meeting of Shareholders to avoid the possibility of abuse. As a result of the appeal, the courts may find that the refusal was not lawful and order that the requested information be provided to shareholders. To ensure that all shareholders are treated equally and that no preference is given to some shareholders, the requested information should be disclosed to all shareholders on equal terms.

Judicial supervision is a post facto control measure. In many instances, it has retroactive effect on the decision that was made by shareholders in violation of legal requirements. Thus, the national legislator should consider whether a judicial decision that grants the shareholders access to information could be a ground to invalidate the decision of the General Meeting of Shareholders.

Article 22. Location of General Meetings of Shareholders

The General Meeting of Shareholders shall take place where the company’s executive bodies are located unless the charter of the company provides for another location.

The location of General Meetings of Shareholders should be accessible to shareholders. The Model Provisions therefore propose that Meetings take place at the company’s premises – where its executive bodies are located. The charter of the company, however, can provide for another location.

Article 23. Right to Appeal Decisions of General Meetings of Shareholders

1. Any decision of a General Meeting of Shareholders may be challenged in the courts by shareholders when the requirements of legislation or the charter and other internal documents of the company have been violated.
The Model Provisions propose that legislation of CIS member states provide that shareholders can challenge decisions made by the General Meeting of Shareholders when the requirements of the law, the charter and internal documents of the company have been violated.

Decisions made in violation of these requirements should not be automatically invalid. Only the courts may determine whether the decision is invalid.

2. A shareholder who voted against a decision of the General Meeting of Shareholders or who did not participate in the General Meeting of Shareholders has the right to challenge the validity of that decision in the courts.

The Model Provisions propose that the laws of CIS member states stipulate that any shareholder may challenge the validity of decisions by the General Meeting of Shareholders in the courts when he voted against or did not participate in the General Meeting of Shareholders. In contrast, shareholders who have voted in favor of the decision automatically waive their right to challenge the decision of the General Meeting of Shareholders in the courts.

CIS member states may also authorize the courts to invalidate a decision of the General Meeting of Shareholders even when shareholders have not challenged these. This could be possible only when during another judicial proceeding one of the parties relies on the decision that was made by the General Meeting of Shareholders that violated legislation, the charter and/or other internal documents of the company. The courts, for example, could invalidate a decision that was made on an item that was not included in the agenda of the General Meeting of Shareholders or a decision that does not fall under the authority of the General Meeting of Shareholders.

3. If a shareholder challenges a decision of the General Meeting of Shareholders in the courts, this shall be done within two months after the shareholder knew or should have known of the decision, but not longer than four months after the General Meeting of Shareholders.

To avoid uncertainty over the validity of a decision of the General Meeting of Shareholders during an extended period, the Model Provisions propose that laws of CIS member states provide for a short
period within which decisions can be challenged in the courts. The Model Provisions propose that a maximum period of four months be provided to a shareholder to file a court claim.

4. **Upon the request of the company, the courts may order the shareholder to compensate the company for expenses incurred in defending a legally unfounded claim by a shareholder.**

To ensure that shareholders do not abuse their right to file claims in the courts, the Model Provisions propose that the laws of CIS member states provide that the courts may order the shareholder to compensate the company for the expenses incurred in defending a legally unfounded shareholder claim. Articles 42 – 44 of the draft Fifth EU Company Law Directive provide a similar provision.

5. **In reviewing the decision of the General Meeting of Shareholders, the courts may leave the decision intact even when the decision is in violation of Article 23 of the Model Provisions and when:**

   5.1. **The violations are not significant; and**
   5.2. **The shareholders suffered no damage as a result of the decision.**

The Model Provisions propose that the courts can leave a decision of the General Meeting of Shareholders intact when the violations of Article 23 of the Model Provisions are insignificant or when the shareholder has not suffered any damage as a result of the decision. The following violations could be considered significant:

- The General Meeting of Shareholders was not convened on time by the body responsible for holding the Meeting;
- The shareholders were not notified or the notification did not contain the information required by law, the charter and internal documents of the company;
- A shareholder was not allowed to attend the General Meeting of Shareholders;
- Shareholders were not granted access to documents for the General Meeting of Shareholders in accordance with the requirements set forth by law, the charter and internal documents of the company;
- A request for information has not been answered without lawful reason;
• A decision was made on an item that was not included in the agenda of the General Meeting of Shareholders;
• A decision was made on an agenda item that does not fall within the authority of the General Meeting of Shareholders; and
• Voting procedures of the General Meeting of Shareholders were materially violated.

In these cases, a violation should be considered to be a significant violation even when the voting power of the claimant is limited.
Section 5. Duties and Liabilities of Directors and Managers

Article 24. Duties of Directors and Managers

1. A director or a manager of the company has a duty to the company to perform his functions in good faith, in the reasonable belief that he is acting with the care and attention that a prudent person in a similar position would take under equal circumstances.

2. A director or a manager has a duty to act fairly and loyally to the company and to act in the best interest of the company.

An important mechanism for protecting shareholder rights is the establishment of clear and comprehensive standards for the behavior of directors and managers. These standards serve as guidelines in formulating what shareholders can expect in terms of directors’ and managers’ behavior. Directors and managers can be held liable when these standards have been violated and when losses to the company have been caused as a result (see Article 25 of the Model Provisions).

A general standard for duties of directors and managers is particularly difficult to define, as it depends on the issue in question, the company’s circumstances, the industry and other factors. The definition of standards is an area in which judicial interpretation is important.

Clause 1 of Article 24 of the Model Provisions formulates the general standard of care and professionalism expected of directors and managers. Although some of the concepts used can be interpreted subjectively (e.g., reasonable belief), the rule is intended to provide guidance for making a judgment in particular situations. This may mean that directors and managers must act honestly, not cause the company to act in any unlawful way, refrain from being passive, regularly attend and actively participate in directors’ meetings or demand these when it is necessary.

Another fundamental duty of directors and managers is the duty of loyalty to the company and its shareholders. This means that the interests of the company (typically defined as the interests of all its shareholders, and not as the interests of the majority shareholders as is often the practice) should prevail over the individual interest of a director or manager when the possibility of a conflict of interests exists.
Similarly, directors and managers should not use their position within the company to make personal profit or gain personal advantage. Expressions of this duty are based on other duties and rules that in most jurisdictions are the subject of separate regulation. They include the following duties and regulations/rules:

- The duty not to compete with the company;
- The regulation of related party transactions;
- The rules on determining directors’ remuneration and executive compensation; and
- The duty to keep particular information confidential. This includes the duty to keep such information confidential for a specific period after the end of a term in office.

**Article 25. Liability of Directors and Managers**

1. A director or a manager of a company is liable for any losses caused to the company when he violates any obligation arising from law and the charter of the company.

2. A director or manager shall be relieved of liability if he:

   2.1. Voted against the decision of the governing body which led to losses to the company; or
   2.2. Did not take part in the voting of the governing body; or
   2.3. In case of inaction, can prove that he made reasonable steps to initiate a decision of the governing body to prevent losses to the company.

3. A director or manager shall not be held liable for losses arising from making a business decision, if he:

   3.1. Does not have a personal interest in the decision; and
   3.2. Believes he is reasonably well informed about the grounds of the decision under the circumstances; and
   3.3. Has reasonable grounds to believe that the decision is made in the best interest of the company and its shareholders.
Directors and managers can be held liable when standards of behavior are in place. It is important to consider the following before directors and managers are held liable: First, directors and managers should be held liable for losses only when they act in contradiction to what their duties and obligations prescribe and when they cause losses to the company. This is an important remedy for the company and its shareholders to control the actions of self-serving or incompetent directors and managers. Second, care should be taken that the standards are not excessively unforgiving so that directors and managers are unfairly disciplined (for example, for downturns in the economy they cannot control). Competent individuals may be discouraged from being a director or manager due to fear of excessive liability when reasonable standards are not in place, especially in the absence of directors and officers’ liability insurance.

Article 25 of the Model Provisions, therefore, contains a number of criteria for the liability for losses:

- It exempts directors and managers who, as members of a collective body, did not vote or voted against a decision; and
- It gives directors and managers the freedom to make business judgments. That means that the actions or decisions of directors and managers will not be sanctioned when, with hindsight, they were a mistake and that there are no grounds to suspect that they had any personal interest in the matter, that they took all actions possible to be informed of the situation and that they were acting in the best interests of the company and its shareholders.

**Article 26. Derivative Suits**

1. **A shareholder (or group of shareholders) owning at least one percent of the company’s voting shares at the time of filing a claim in the courts has the right to file the claim on behalf of the company to seek the liability of a member of the company’s Board of Directors as stipulated in Clause 1 of Article 25 of the Model Provisions.**

2. **A shareholder (or group of shareholders) owning at least one percent of the company’s voting shares at the time of submitting the request to the Board of Directors has the right to request the Board of Directors to seek compensation in the courts from the members of the company’s executive bodies if such managers can be held liable according to Clause 1 of Article 25 of the Model Provisions. The shareholder can file a**
claim in the courts on behalf of the company when the Board of Directors does not file a claim in the courts within six months after the shareholder submitted the request to the Board of Directors.

The Model Provisions stipulate that a shareholder can seek compensation in the courts on behalf of the company for losses caused by members of the company’s governing bodies. The following conditions should be met in order to claim compensation in the courts for losses caused by directors of the company:

- The member of the Board of Directors caused losses to the company;
- The member of the Board of Directors can be held liable according to Clause 1 of Article 25 of the Model Provisions;
- A causal relationship exists between the conduct of the member of the Board of Directors and the losses caused to the company; and
- The shareholder (or group of shareholders) owns at least one percent of the company’s voting shares at the time the claim is filed in the courts.

The Model Provisions stipulate that a shareholder can seek compensation in the courts on behalf of the company for losses caused by members of the company’s executive bodies only after the shareholder has requested the Board of Directors to file the claim on behalf of the company in the courts. If the Board of Directors does not file the claim within six months, the shareholder (or group of shareholders) should have the right to file the claim in the courts on behalf of the company.

The procedure for suing directors is different from the procedure for suing managers because the Board of Directors cannot file a claim against itself for losses caused by directors. To sue managers, the Board of Directors should be first given the opportunity to settle disputes internally before a shareholder can seek compensation in the courts.

In all instances, the Model Provisions propose that directors and managers be sued on behalf of the company and not in the name of the shareholder(s) who file a claim.

3. The company shall bear the costs of a court claim under Article 26 of the Model Provisions unless the courts determine that the claim of the shareholder(s) was legally
unfounded and the claiming shareholder has acted in bad faith, in which case the costs shall be borne by the shareholder(s).

The Model Provisions propose that the company bear the litigation costs when the Board of Directors or a shareholder seeks compensation for losses in the courts on behalf of the company. To prevent shareholders from imposing litigation costs on the company without legal grounds, the Model Provisions also propose that the shareholder be held liable for the costs when the courts determine that the shareholder’s claim was unfounded and that he acted in bad faith. The courts may also hold the claimant liable for the losses caused to the company by such a claim.
Section 6. Protection of Investor Rights in Special Circumstances

Article 27. Acquisition of Control

1. A person shall be required to notify a listed company of his intention to acquire shares of the company when this acquisition added to any existing holdings of this person and any persons acting in concert with him, would result in direct or indirect control of 30 or more percent of voting shares of the company. The company shall be notified at least 30 days before the acquisition.

The Board of Directors shall notify all shareholders of the company within ten days after the company has been notified by the intended acquirer, who shall bear the costs for the notification of the shareholders. Shareholders are notified following the procedures for notifying shareholders of the General Meeting of Shareholders of the company.

The Model Provisions propose that any transaction that may lead to direct or indirect control of 30 or more percent of voting shares of a listed company is a control transaction. The acquisition of a smaller percentage of shares with voting rights is also a control transaction when the acquirer and his affiliates already own voting shares of that company and when the combined percentage of voting shares is 30 percent or more as a result the acquisition of shares. Since the Model Provisions propose that preferred shares are non-voting shares unless particular circumstances arise, control transactions as defined by Article 27 of the Model Provisions, as a rule, refer to the acquisition of common shares.

The Model Provisions propose that the rules for the acquisition of control specified in Article 27 of the Model Provisions apply only to companies listed on a stock exchange. However, due to the limited number of listed companies and relatively undeveloped capital markets in CIS member states, the law may provide that the rules on acquisition of control should be applied only to companies with a dispersed ownership, such as companies with more than 1,000 shareholders.

Control over a listed company may be realized either through the direct purchase of shares from an individual shareholder or a group of shareholders (block acquisition), a tender offer or through regular transactions on the stock exchange.
Control of a listed company could be acquired through a direct purchase of shares from a single shareholder or a group of shareholders (block acquisition) and through a voluntary bid for shares on the market (voluntary bid).

The Model Provisions propose that a shareholder notify the company of his intention to acquire control of the company at least 30 days before the acquisition. This notice should allow the shareholders and the governing bodies of the company to consider and react to the upcoming acquisition. Further, the Board of Directors should notify the company’s shareholders of the intended acquisition with the procedures that are used for notifying shareholders of the General Meeting of Shareholders. The acquirer and his affiliated parties should bear the costs for the notification of shareholders.

2. **A person who has acquired control over the company in accordance with Clause 1 of Article 27 of the Model Provisions (“a controlling shareholder”) shall be required to offer to purchase the outstanding common shares of the company’s shareholders (“a mandatory offer”) within 30 days of the acquisition for a price determined according to Clause 4 of Article 27 of the Model Provisions. A shareholder may accept the mandatory offer by notifying the company in writing in 30 days after the receipt of the offer.**

The acquisition of control of a company can significantly change the position of minority shareholders. To offer existing shareholders an opportunity to sell their shares when significant changes in ownership occur, the Model Provisions propose that legislation of CIS member states require that the controlling shareholder offers to purchase the shares of all shareholders. This offer should be made within 30 days after the acquisition of control took place.

It is important that shareholders receive a fair price for their shares. There are different methods used to determine what a “fair” or “equitable” price is. This issue is discussed in Clause 4 of Article 27 of the Model Provisions.

The mandatory offer as provided by the Model Provisions is consistent with the Thirteenth EU Company Law Directive and the City Code for Takeovers and Mergers of Great Britain.

3. **When a controlling shareholder has acquired control over the company as a result of a public offer that has already been made to all shareholders for all their common shares**
according to the requirements of a law ("a voluntary offer"), the requirements of Clause 2 of Article 27 of the Model Provisions shall not apply.

If control has been acquired through a voluntary public offer to all shareholders for all their voting shares, the controlling shareholder is not obliged to make a mandatory offer as required by Clause 2 of Article 27 of the Model Provisions. The voluntary offer, referred to in this Clause, is also called a "tender offer." Clause 3 of Article 27 of the Model Provisions provides for this exception because shareholders already have had the opportunity to sell their shares to the controlling shareholder when the voluntary offer was made. Thus, the assumption is made that shareholders have already decided to retain their shares in the company. Usually, securities legislation specifies in detail the rules for tender offers. The Model Provisions do not regulate tender offers any further.

4. The highest price paid for the same securities by the controlling shareholder or by persons acting together with him over a period of six to twelve months prior to the offer referred to in Clause 2 Article 27 of the Model Provisions shall be the equitable price.

Legislation of CIS member states should specifically regulate the price of a mandatory offer after the acquisition of control. As a rule, it should be equitable. In particular, the price is equitable when it equals the highest price paid by the controlling shareholder. In this case, all shareholders whether they sell or retain shares during the voluntary offer or the mandatory offer, share a control premium. Depending on national legislation, the equitable price can be determined over a period of six to twelve months preceding the acquisition of control.

In addition, legislation may authorize the securities markets authorities to adjust the price referred to in Clause 4 of Article 27 of the Model Provisions in circumstances, and according to criteria, clearly determined in advance. The regulator should:

- Establish a list of circumstances in which the highest price may be adjusted either upwards or downwards: for example, when the highest price was set by an agreement between the purchaser and a seller, the market price of the securities has been manipulated, and when market prices in general or market prices in particular have been affected;
• Define the criteria to be applied in such cases: for example, the average market value over a particular period, the break-up value of the company, or other objective valuation criteria generally used in financial analysis.

Any decision by the regulatory authorities to adjust the equitable price should be substantiated and should be public.

5. The controlling shareholder may offer securities, cash or a combination of both. However, when the consideration offered by the controlling shareholder does not consist of liquid securities admitted to trading on a regulated market, it shall include a cash alternative.

In any event, the controlling shareholder shall offer a cash consideration as an alternative where he or the persons acting together with him has purchased in cash securities representing five percent or more of voting shares in the company in which control is being acquired during a period that starts six months prior to the acquisition of the controlling position in the company and that ends when the period for the mandatory offer expires.

It is important that legislation in CIS member states prohibits the evasion of a mandatory bid. The mandatory bid, in particular, could be evaded when a compensation in kind for securities is offered. The law also should not provide for cash compensation only. Under certain circumstances, non-controlling shareholders might benefit more from receiving shares of a company that seeks to acquire a controlling position than receiving cash.

When the controlling shareholder or the persons acting together with him have acquired voting shares of a company with cash during a particular period and these shares amount to more than five percent of the voting rights in the company, the remaining shareholders should be given the opportunity to sell their shares either for cash or any other liquid consideration such as shares in an acquiring company. This period should start at least six months before the acquisition of a controlling position and end until the mandatory offer expires.
6. If a controlling shareholder has violated the requirements of Article 27 of the Model Provisions, the voting shares in excess of the control threshold specified in Clause 1 of Article 27 of the Model Provisions shall not bear voting rights until the mandatory offer is made in accordance with requirements of Clause 2 of Article 27 of the Model Provisions.

It is important to provide sanctions when the procedures for the acquisition of control have been violated. Violations may occur, for example, when the advance notice of acquisition, voluntary or mandatory offers, has not been observed. Because controlling blocks of shares are typically acquired to change the company’s direction and management by voting at the General Meeting of Shareholders, the sanction proposed in the Model Provisions is to make shares non-voting that have been acquired unlawfully. Such a sanction should not be used when controlling shareholders make a mandatory offer in accordance with requirements of Clause 2 of Article 27 of the Model Provisions.

Article 28. Sell-Out Right of Shareholders

1. When a person, acting individually or together with others, acquires 90 percent or more of the voting shares of the company through an offer made to all shareholders for all their shares in accordance with the requirements of Clauses 2 and 3 of Article 27 of the Model Provisions, any shareholder shall have the right to sell his shares to such a person within three months after the mandatory and voluntary offers expire.

2. The sell-out price shall be the price specified in Clause 4 of Article 27 of the Model Provisions.

The sell-out right of shareholders is a relatively new feature of European takeover regulation. It gives minority shareholders additional protection when a controlling shareholder and his affiliated persons acquire a nearly total control over the decision-making process of the company. The Model Provisions propose that the remaining shareholders use sell-out rights when a shareholder and his affiliates acquire more than 90 percent of a company’s voting shares. However, the sell-out right should only be available if this percentage of voting shares was acquired following a voluntary or mandatory offer made to all shareholders for all their voting shares as specified in Clauses 2 and 3 of Article 27 of the Model Provisions. Acquiring more than 90 percent, for example, prevents shareholders from using collective
rights such as the right to call a General Meeting of Shareholders or to require an extraordinary audit of the company. The sell-out right should be exercised within three months following the expiry of the offer. As a rule, the procedure for the acquisition of control is used to determine the sell-out price.

The Model Provisions propose that the sell-out price shall be determined the same way as the price of a mandatory offer.

The sell-out right in the Model Provisions is consistent with Article 16 of the Thirteenth EU Company Law Directive. This right is different from a controlling shareholder’s squeeze-out right that is also provided by the Thirteenth EU Company Law Directive (Article 15). The Model Provisions do not include any squeeze-out rights.

**Article 29. Major Transactions**

1. Any transaction or several connected transactions that directly or indirectly relate to the acquisition, sale or the possibility of a sale of assets with a value of at least 25 percent of the book value of the company’s assets as stated in the most recent financial statement of the company shall be considered to be a major transaction.

Transactions that fall under this definition are not considered to be a major transaction if they are carried out during the ordinary course of the company’s business or when they relate to the sale of company’s common shares or securities convertible into common shares.

The charter of the company may stipulate other transactions that require the same approval procedure as major transactions.

The Model Provisions propose that legislation of CIS member states regulate transactions that can have a major impact on the solvency of a company. A transaction (or a group of connected transactions) is a major transaction when it meets all conditions described in Clause 1 of Article 29 of the Model Provisions.
An important aspect of the definition of major transactions is the ordinary course of business of a company. Whether a transaction is carried out during the ordinary course of business usually depends on a company’s specific factors. For example, the purchase of real estate may be a major transaction when the company is normally engaged in the trade of consumer goods. However, the same transaction would not be a major transaction when the core business of the company is to trade real estate.

The charter of the company may include additional transactions that must be treated as major transactions. For example, the charter of the company may specify that any transaction involving assets with a value of less than 25 percent of the book value of the company assets (e.g., ten percent) must be approved in the same manner as major transactions, according to the law. The charter of the company can also provide that certain types of transactions (e.g., all loan agreements or pledges of the company shares, sale of real estate or shares of a subsidiary) must be treated as major transactions regardless of their value.

When two or more companies are engaged in a transaction, each company should determine whether the transaction qualifies as a major transaction. This can result in a situation where the transaction is a major transaction for only one company.

2. When a transaction is an acquisition of assets, the acquisition price shall be compared with the book value of the company’s assets as stated in the most recent financial statement of the company. When a transaction is a sale or the possibility of a sale, the book value of assets subject to the major transaction shall be compared with the book value of the company’s assets as stated in the most recent financial statement of the company.

The Board of Directors shall determine the market value of the assets or services subject to a major transaction based on an independent appraisal. The market value may not be less than the value determined by the appraiser.

An important aspect in determining whether a transaction is a major transaction is the value of the assets subject to the transaction. The value of assets should be determined prior to the approval of the transaction. The Model Provisions propose that the Board of Directors have the authority to determine
the value of the assets or services based on a comparison of the value of assets subject to the transaction with the book value of the assets of the company.

The appraisal of the value of the assets may be problematic since the book value of assets does not always reflect the market value of assets subject to a transaction, especially when accounting rules are not well developed as often is the case in CIS member states. As a result, major transactions are not recognized as such. The market value test also poses certain problems – it means that the Board of Directors should rely on the preliminary assessment of the executive bodies to determine whether the transaction is a major transaction. In principle, once the executives determine that the transaction might involve assets with a significant value, they should ask the Board of Directors for an appraisal. The appraisal may reveal that the transaction involves assets with a value less than a threshold that is provided by law or the charter of the company. As a result, the transaction is not a major transaction.

3. **Any major transaction with a value of at least 25 percent but less than 50 percent of the book value of the company's assets and major transactions specified in Paragraph 3 of Clause 1 of Article 29 of the Model Provisions shall be approved by the unanimous vote of all members of the Board of Directors.**

The Board of Director may decide with a simple majority vote of the members present at its meeting to have the General Meeting of Shareholders decide on the transaction when a unanimous vote has not been reached. A simple majority vote of participating shareholders in the General Meeting of Shareholders is required to decide on such a major transaction.

4. **Any transaction with a value of 50 or more percent of the book value of the company's assets shall be approved by a ¾-majority of participating shareholders in the General Meeting of Shareholders.**

Depending on the value of assets, the Board of Directors or the General Meeting of Shareholders should approve the transaction. Major transactions as defined by Paragraph 3 of Clause 1 of Article 29 of the Model Provisions should be approved by the Board of Directors. The Model Provisions propose that transactions that involve assets with a value between 25 and 50 percent of the book value of the company assets require the unanimous approval of all members of the Board of Directors. If the Board
of Directors is not able to reach a unanimous decision, it can request with a simple majority vote of directors who participate in the Board meeting the General Meeting of Shareholders to decide on the transaction. The General Meeting of Shareholders can approve the transaction with a simple majority vote of participating shareholders.

As an additional safety measure, transactions involving more than 50 percent of the book value of the company assets should require the approval of a \( \frac{3}{4} \) majority of shareholders participating in the General Meeting of Shareholders.

5. **A major transaction can be challenged in the courts by the company or a shareholder (or group of shareholders) owning at least 1 percent of voting shares of the company if the provisions of Article 29 of the Model Provisions were violated and if the other party to the transaction knew or should have known about any procedural violation in the transaction approval.**

The Model Provisions propose that a procedural irregularity in the approval of a major transaction does not automatically invalidate the transaction in order to protect legitimate parties in the transaction. Only the courts should be authorized to decide on this matter when the company or a shareholder (or group of shareholders) owning at least 1 percent of voting shares of the company has challenged the transaction and when it has been proven that the party to the transaction knew or should have known about such violations.

6. **Any party who violated the requirements of Article 29 of the Model Provisions shall be liable to the company to the extent of the losses that such transaction causes to the company. If several parties are liable, their liability to the company shall be joint and several.**

7. **The provisions stipulated in Clauses 1 to 4 of Article 29 of the Model Provisions do not apply to transactions that are concluded by a company with a single shareholder who is the General Director of the company and when the transaction is also a related party transaction as defined in Article 30 of the Model Provisions.**
The Model Provisions propose that legislation of CIS member states exempt companies with a single shareholder who is the General Director of the company from the major transaction requirements that are proposed by Clauses 1 - 4 of Article 29 of the Model Provisions. The General Director of the company is the only shareholder and additional protective measures designed to protect other shareholders are not required. Another exception refers to a major transaction that is a related party transaction and when stricter rules for related party transactions apply.

8. **The annual report of the company shall disclose any major transaction of the company concluded during the reporting period and shall include at least the following information for each major transaction:**

8.1. *The name and contact information of the parties in the transaction;*

8.2. *The governing body of the company that approved the transaction;*

8.3. *The reasons for concluding the transaction;*

8.4. *The value of the transaction as determined by the Board of Directors and the independent appraiser;*

8.5. *The name of the independent appraiser; and*

8.6. *Other material terms of the transaction that shall be disclosed according to the charter of the company.*

The Model Provisions propose that the annual report of the company include information on any major transaction that has been approved by the company during the reporting year. This ensures that shareholders are informed about major transactions that have been approved by the Board of Directors and for which an approval of the General Meeting of Shareholders is not required. The charter of the company can set additional requirements for the disclosure of transactions in the annual report.

**Article 30. Related Party Transactions**

1. *Any transaction in which a member of the Board of Directors, the General Director and members of the Executive Board (senior managers), including the company’s external manager and members of the governing bodies of the external manager, or a shareholder of the company who, together with his affiliates, holds 20 or more percent of the company's voting shares, or a person who has the authority to give binding
instructions to the company, is directly or indirectly interested shall be a related party transaction and be executed by the company in compliance with Article 30 of the Model Provisions. The law or the charter of the company may introduce additional requirements for the definition of a related party transaction.

Although related party transactions are not necessarily unlawful and can be of value to the company, its creditors and shareholders, the Model Provisions propose that legislation of CIS member states define detailed procedures to discourage insiders from entering into related party transactions that are disadvantageous to the company and its shareholders.

Related party transactions involve interested persons (related parties). The interested parties can be insiders of the company and can have a personal interest in the transaction that may not always coincide with the interests of the company and its shareholders. Most commonly, these transactions involve directors and managers as transacting parties who enter into a transaction with the company (otherwise known as “self-dealing”). There are other positions, rather than being a direct party in the transaction, that interested persons can have in the transaction. They can be:

- A beneficiary, an intermediary or an agent in the transaction;
- Own at least 20 percent of the voting shares (ownership or participatory interest) in a legal entity which is a party, beneficiary, intermediary or agent in the transaction; or
- Hold a position in a governing body of a legal entity that is a party, beneficiary, intermediary or agent in the transaction.

National legislation and/or the charter of the company may provide additional requirements for the definition of related party transactions. However, contrary to legislation of most CIS member states, the Model Provisions limit the definition of related party transactions to the criteria of Clause 1 of Article 30 of the Model Provisions, in the absence of other criteria that can be used to determine related party transactions.

It is important to note that a transaction can be a related party transaction for one company and not for another. Each company involved in a transaction should examine whether the criteria for a related party transaction are met. Only the company that defines a transaction as a related transaction is obliged to follow the procedures set forth in Article 30 of the Model Provisions.
2. The company shall not provide loans or other forms of credit to members of the Board of Directors or executive bodies or their close relatives/affiliated persons, unless this is approved in accordance with the requirements of Clauses 4 and 5 of Article 30 of the Model Provisions.

3. Any interested party specified in Clause 1 of Article 30 of the Model Provisions shall submit to the Board of Directors and the external auditor of the company information regarding:

3.1. Legal entities in which he independently or jointly with affiliated persons holds 20 percent or more of the voting shares (or 20 percent or higher share or participatory interest);
3.2. Legal entities in which he holds a position on a governing body; and
3.3. Transactions known to him in which he has been or may be deemed to be an interested party.

Unless it is known to the company that parties defined in Clause 1 of Article 30 of the Model Provisions have an interest in a transaction, it is not possible to enforce the rules on the approval of related party transactions. Often it is only known to the parties in the transaction whether they are an interested party. The Model Provisions therefore propose that legislation of CIS member states require parties to disclose to the Board of Directors and the external auditor at least the information that is required by Clause 3 of Article 30 of the Model Provisions.

4. The Board of Directors of the company shall approve any related party transaction by a majority vote of disinterested directors. If all members of the Board of Directors of the company are interested parties, the General Meeting of Shareholders shall decide on the related party transaction. If the number of disinterested directors is less than the quorum requirement for a meeting of the Board of Directors as specified by the charter of the company, the General Meeting of Shareholders shall decide on the related party transaction.
5. A related party transaction shall be approved by the General Meeting of Shareholders by a majority vote of all disinterested shareholders with voting rights when:

5.1. The property involved in a related party transaction or several connected transactions are valued at two or more percent of the book value of the company’s assets as stated in the most recent financial statement of the company;

5.2. A related party transaction or several connected transactions relate to the issue of shares through subscription or sale that represent more than two percent of the company’s already issued common shares and the common shares into which convertible securities issued earlier may be converted; or

5.3. A related party transaction or several connected transactions relate to the issue of securities through subscription, which may be converted into common shares representing more than two percent of the company’s already issued common shares and common shares into which convertible securities issued earlier may be converted.

Clauses 4 and 5 of Article 30 of the Model Provisions specify the governing body of the company that has the authority to approve related party transactions. As a rule, the Board of Directors should have the authority to approve related party transactions with the exception of transactions that fall under the authority of the General Meeting of Shareholders.

6. The General Meeting of Shareholders may approve future related party transaction(s) between the company and an interested party that will be concluded in the ordinary course of business. The decision of the General Meeting of Shareholders shall specify at least the maximum value of assets involved in such transaction(s). The decision of the General Meeting of Shareholders shall be effective until the next Annual Meeting of Shareholders.

Companies may enter into a series of similar transactions that fall within the ordinary course of business of the company. To avoid the requirement that the General Meeting of Shareholders must approve these transactions each time, the Model Provisions propose that the General Meeting of Shareholders can approve future related party transactions until the next Annual Meeting of Shareholders. The
advance authorization should as a minimum indicate the maximum value of assets that may be involved in such transactions to limit the authority of the company’s governing bodies.

7. **Related party transactions that require the approval of the General Meeting of Shareholders as specified in Clause 5 of Article 30 of the Model Provisions and that are concluded between the company and a party after he became an interested party do not require the approval of the General Meeting of Shareholders if the terms and conditions of such transactions are materially the same as transactions between the company and the same person that were concluded in the ordinary course of business before the person became an interested party. The approval of the General Meeting of Shareholders is not required until the next Annual Meeting of Shareholders.**

The Model Provisions propose an exception for certain related party transactions that would be subject to the approval of the General Meeting of Shareholders as specified in Clause 5 of Article 30 of the Model Provisions. These transactions are concluded in the ordinary course of business between the company and a person before he became an interested party.

8. **A related party transaction can be challenged in the courts by the company or a shareholder (or group of shareholders) owning at least 1 percent of voting shares of the company if the requirements of Article 30 of the Model Provisions are violated and if the other party in the transaction party knew or should have known about any irregularity in the transaction.**

To protect parties in the transaction, the Model Provisions propose that any procedural irregularity in the approval of a related party transaction should not automatically void the transaction. Only the courts should be authorized to decide on this matter when the transaction has been challenged by the company or a shareholder (or group of shareholders) owning at least one percent of voting shares of the company and when the party to the transaction knew or should have known about any procedural violations during the approval of the transaction.

9. **Any related party who violated the requirements of Article 30 of the Model Provisions shall be liable to the company to the extent of the losses that such transaction causes to
the company. If several parties are liable, their liability to the company shall be joint and several.

10. The provisions stipulated in Clauses 1 to 7 of Article 31 of the Model Provisions do not apply to related party transactions:

10.1. That are concluded by a company with a single shareholder who is the General Director of the company;
10.2. If all shareholders of the company are interested parties in the transaction;
10.3. If the transaction is concluded to exercise a shareholder's pre-emptive rights;
10.4. That are concluded to redeem or buy back the company’s shares; or
10.5. If the company is reorganized by consolidation or merger and the other company that has been consolidated or merged holds more than three-fourths of all voting shares of the reorganized company.

The Model Provisions propose that although a transaction formally meets the criteria of a related party transaction, the rules for approval set forth in Clauses 1 – 5 of Article 30 of the Model Provisions do not apply in particular circumstances.

11. The annual report of the company shall disclose any related party transaction of the company that has been concluded during the reporting period and shall include at least the following information for each related party transaction:

11.1. The name and contact information of the parties in the transaction;
11.2. The governing body of the company that approved the transaction;
11.3. The reasons for concluding the transaction;
11.4. The value of the transaction as determined by the Board of Directors and the independent appraiser, if invited;
11.5. The name of the independent appraiser(s), if invited; and
11.6. Other material terms of the transaction that shall be disclosed according to the charter of the company.
The Model Provisions propose that the annual report of the company include information on any related party transaction that has been approved by the company during the reporting year. This ensures that shareholders are informed about any related party transactions approved by the Board of Directors for which the approval of the General Meeting of Shareholders is not required. The charter of the company can set additional requirements for the disclosure of transactions in the annual report.

**Article 31. Investor Protection When Increasing the Charter Capital**

1. *The General Meeting of Shareholders shall approve any increase of the charter capital by a ¾-majority vote of participating shareholders.*

As a rule, only the General Meeting of Shareholders should have the authority to increase the charter capital. The Model Provisions propose that legislation of CIS member states require the same voting majority for the decision to increase the charter capital that is required for amending the charter of the company, *i.e.*, a ¾-majority.

2. *The charter of the company may authorize the Board of Directors to issue shares within the limits of authorized shares and thus increase the charter capital by a unanimous vote of all directors.*

If permitted by national legislation of CIS member states, the charter of the company may stipulate that the Board of Directors has the right to issue authorized shares in addition to already issued shares. This gives a company the opportunity to attract equity investment without the need to call a General Meeting of Shareholders.

The charter of the company should specifically stipulate the authority of the Board of Directors to issue additional shares. The Board of Directors should be authorized to issue additional shares only within the limits of the number, types and classes of authorized shares specified by the charter of the company. In addition, the charter of the company may set other requirements that limit the authority of the Board of Directors related to:

- The maximum amount of shares that can be issued by the Board of Directors – usually this maximum cannot exceed 100 percent of the charter capital at the moment of authorization;
• The period for which the authorization is given – usually five years;
• The type of subscription to shares – open or closed; and
• Other terms of the share issue.

To issue additional authorized shares, the members of the Board of Directors should unanimously approve the share issue.

3. **When the charter capital is increased by capitalizing internal reserves of the company (either by increasing the nominal value of issued shares or by the issue of additional shares without consideration), all shareholders shall be treated equally.**

One of the fundamental principles of good corporate governance is that all holders of a particular class and type of shares are treated equally. All shareholders of the company are affected when the company’s internal reserves are being capitalized to increase the charter capital. To treat all shareholders equally in this case means that:

• If the charter capital is increased by increasing the nominal value of issued shares, it should apply to all shares equally; and
• If the charter capital is increased by the issue of additional shares of a particular class and type without consideration, they should be distributed to all shareholders in proportion to the shares of each type and class they own.

4. **When the charter capital is increased by capitalizing internal reserves of the company (either by increasing the nominal value of issued shares or by issue of additional shares without consideration), the amount of resources used for the increase of the charter capital may not exceed the difference between the value of the net assets of the company and the sum of the charter capital and the reserve fund of the company.**

An increase of the charter capital by capitalizing the company’s internal reserves may affect the rights of creditors and the company’s ability to service its debts. The Model Provisions therefore propose that legislation of CIS member states introduce a limitation on the increase of the company’s charter capital based on the difference between the value of the company’s net assets and the sum of the charter capital and the reserve fund of the company. The reserve fund and the minimum charter capital
requirements are designed to protect the interests of creditors and bondholders and should not be used solely to benefit shareholders.

5. **Shareholders shall be entitled to pre-emptive rights when the issue of additional shares with consideration increases the charter capital.**

See the explanatory notes to Article 4 of the Model Provisions for more information on the pre-emptive rights of shareholders.

**Article 32. Investor Protection When Decreasing the Charter Capital**

1. **The General Meeting of Shareholders shall approve any decrease of the charter capital by a ¾-majority vote of participating shareholders.**

The Model Provisions propose that the General Meeting of Shareholders have the sole authority to decrease the charter capital of the company. The Model Provisions also propose that legislation of CIS member states require the same voting majority for the decision to decrease the charter capital that is required for amending the charter of the company, *i.e.*, a ¾-majority.

2. **The charter capital may not be decreased below the minimum charter capital requirement set by legislation.**

The General Meeting of Shareholders cannot decrease the charter capital below the minimum charter capital requirement that has been set by legislation. Minimum charter capital requirements are designed to protect the interest of creditors.

3. **The charter capital shall be decreased to the value of the company’s net assets if at the end of the second and any following year, according to the data included in annual financial statements submitted for shareholder approval or the results of an audit, the charter capital is lower than the value of the net assets of the company.**

Although minimum charter capital requirements are common in most continental European countries, many commentators argue that the charter capital concept is an outdated formality since low minimum
charter capital requirements do not guarantee that the cash and other liquid assets of the company will be available to satisfy creditor claims. However, together with other means of creditor protection, minimum charter capital requirements can protect creditors when the company defaults on its debts. It is thus important that the company’s charter capital is linked to the value of a company’s assets and the amount of the charter capital should not be less than the value of the company’s net assets. The net assets are normally defined by accounting legislation.

If the company’s charter capital is less than the value of the company’s net assets, the company should be required to decrease the charter capital to the value of the net assets of the company. However, this should not be a requirement for all companies. Starting companies may not always be profitable and the value of the company’s net assets may be less than the charter capital in the first years of operation. The Model Provisions therefore propose that legislation of CIS member states require that the rule specified in Clause 3 of Article 32 of the Model Provisions be effective for only two years after the formation of the company to give the company an opportunity to develop its business. After this period, the company should be required to decrease its charter capital to the value of the company’s net assets.

4. The company shall notify all known creditors in writing by registered mail and publish an announcement in the official gazette where information on commercial legal entities is published, about the decision to decrease the charter capital, and the new amount of the charter capital not later than 30 days after the decision of the General Meeting of Shareholders is adopted.

5. Any creditor of the company may, within 30 days after the deadline for the notification of creditors, request the company to:

5.1. Provide additional guarantees for the company’s obligations to the creditor;
5.2. Accelerate the performance of the company’s obligations to the creditor; and
5.3. Prematurely fulfill the company’s obligations to the creditor.

The creditor shall be entitled to a reimbursement of any losses caused to him as a result of the decrease of the charter capital.
6. **The state registration body shall register the decrease of the charter capital only if proof of creditor notification and satisfaction of creditors’ claims is provided by the company.**

Creditors’ rights are protected by the registration procedures for companies when they decrease their charter capital. The Model Provisions propose that a company be required to notify by registered mail each creditor known to the company at the time the decision to decrease the charter capital is made by the General Meeting of Shareholders. In addition, the company shall publish a written announcement in the official gazette that is used to publish information on commercial legal entities. If national legislation of CIS member states does not provide for an official gazette, the charter of the company should stipulate the publication in which official announcements of the company will be placed. The notification of creditors should be done within 30 days following the decision of the General Meeting of Shareholders to decrease the charter capital. The notification shall include information on the decrease and the amount of the new charter capital.

Following the notification, creditors may inform the company of their claims within 30 days after the company’s deadline for the notification of creditors in accordance with Clause 5 of Article 32 of the Model Provisions.

The company should also be required to present proof that creditors have been notified in accordance with the Model Provisions and that all creditors’ claims have been settled before the state registration body registers the charter capital decrease.

**Article 33. Investor Protection During Splitting and Consolidating Shares**

1. **Companies shall split or consolidate shares on the basis of a decision of a ¾ majority of voting shares of the shareholders participating in the General Meeting of Shareholders.**

2. **Only the Board of Directors shall have the authority to propose a split or consolidation of shares to the agenda of the General Meeting of Shareholders, unless the charter of the company provides otherwise. The charter of the company can stipulate special voting requirements for the decision of the Board of Directors. The Board of Directors shall provide the General Meeting of Shareholders with sufficient information on the reasons**
and the terms of the split and consolidation of shares to enable the shareholders to decide on this matter.

3. The decision to split or consolidate shares should include at least the following information:

3.1. The types and classes of shares to be split or consolidated;
3.2. The number of shares of each type and class that will be consolidated into one share of the same type and class (“the consolidation ratio”), or the number of shares of each type and class into which one issued share of the same type and class will be split (“the splitting ratio”);
3.3. The placement method of shares (in this case, the conversion of shares into shares of the same type and class but with a higher nominal value as a result of the consolidation of shares or lower nominal value as a result of the share split);
3.4. The date, or the procedure for determining the date, when the shares shall be converted; and
3.5. Other significant terms and conditions for the split or consolidation of shares that shall be disclosed in accordance with the law and the charter of the company.

4. The consolidation and splitting ratios shall be a whole number.

5. If during the process of the consolidation of shares it is not possible for a shareholder to acquire a full number of shares, fractional shares shall be allowed. The owner of a fractional share of a particular type and class shall have the rights attached to shares of this type and class in proportion to the percentage of the share that the holder owns.

A company may need to change the nominal value of shares by a consolidation or split of shares while it does not change its charter capital. This may offer advantages to the company and its shareholders while it may also have important implications for the protection of shareholders’ rights. When a company splits shares, a larger number of shares with a lower nominal value may decrease the market value of shares and dilute shareholdings. When a company consolidates shares, a smaller number of shares with a greater nominal value may increase the market value of shares and negatively affect the liquidity of shares. The Model Provisions therefore stipulate that:
• The General Meeting of Shareholders approve the consolidation or split of shares;
• Special voting majority be required if the rights of preferred shareholders are affected;
• Only the Board of Directors can propose the consolidation or split of shares unless the charter of the company provides otherwise;
• The Board of Directors be required to provide grounds for its proposal; and
• The General Meeting of Shareholders have the authority to decide on all significant aspects of the conversion (e.g., consolidation and splitting ratios and the procedure for the consolidation and split of shares).

Companies can amend requirements in their charter related to the consolidation and split of shares because of a particular situation in the country or their industry (e.g., voting majority requirements for the General Meeting of Shareholder).

Article 34. Investor Protection During Reorganization

1. A decision on the reorganization of a company shall be approved by a ¾-majority of each class of shareholders participating in the General Meeting of Shareholders.

Corporate reorganizations are complex, require coordination among governing bodies of the company and can have important implications for the rights of shareholders, creditors and other stakeholders (e.g., employees). The Model Provisions therefore propose that laws of CIS member states provide for shareholder approval of all types of reorganizations. A supermajority of ¾ of the votes of shareholders participating in the General Meeting of Shareholders should be required for each class of shares.

2. The Board of Directors of the company shall draw up in writing the draft terms of the reorganization of the company, which shall specify:

2.1. The type of reorganization;
2.2. The name and the registered office of each company participating in the reorganization;
2.3. The share exchange ratio and the amount of any cash payment;
2.4. The terms of the placement of shares in the company(-ies) resulting from the reorganization;
2.5. The date shares in the company(-ies) resulting from the reorganization entitles the holders to participate in any profits, and any special conditions affecting this entitlement; and

2.6. Other significant conditions and terms of the reorganization that shall be disclosed in accordance with the law and the charter of the company.

The Board of Directors shall submit to the General Meeting of Shareholders an opinion on the draft terms of the reorganization by an independent expert.

The draft terms of the reorganization shall be published in the manner in which shareholders are notified of the General Meeting of Shareholders and at least 40 days before the General Meeting of Shareholders that will decide on the reorganization.

3. The Board of Directors of the company shall draw up a detailed written report that explains the draft terms of the reorganization and that provides the legal and economic grounds for the reorganization and the share exchange ratio. The report shall describe any difficulties with the appraisal when the share exchange ratio was set.

4. All shareholders shall be entitled to inspect at least the following documents at the registered office of the company at least 40 days before the General Meeting of Shareholders that will decide on the reorganization:

4.1. The draft terms of the reorganization;

4.2. The opinion of an expert on the terms of the reorganization;

4.3. The annual accounts and annual report of each company participating in the reorganization for the preceding three financial years;

4.4. An accounting statement that is drawn up not later than 90 days before the date of the draft terms of the reorganization, if the latest annual accounts relate to a financial year that ended more than six months before that date; and

4.5. The report of the Board of Director as specified in Clause 3 of Article 34 of the Model Provisions.
To protect shareholders’ rights, the Model Provisions propose that the Board of Directors develop draft terms of the company’s reorganization. These terms should include as a minimum information that addresses the main issues of the reorganization. The Board of Directors should also be required to retain an independent expert to provide an opinion on the draft terms of the reorganization. This enables shareholders to make an informed decision on the reorganization.

After the terms of the reorganization have been prepared, they should be communicated to the shareholders. The draft terms of the reorganization should be published in the same manner as the notice for the General Meeting of Shareholders and be available to shareholders at least 40 days before the General Meeting of Shareholders that will decide on the reorganization.

The Board of Directors is responsible for the organization of the General Meeting of Shareholders that will decide on the reorganization. The Model Provisions propose that additional information be communicated to shareholders to enable them to make an informed decision. In particular, the Board of Directors should explain to the shareholders at the General Meeting of Shareholders the draft terms of the reorganization, and the legal, economic, social and other grounds for and the implications of the reorganization. Moreover, shareholders should be provided with the annual accounts and annual financial statements for at least three preceding financial years of each company participating in the reorganization. In addition, an accounting statement of the most recent reporting period should be provided to shareholders if not more than six months have passed after the end of the last reporting period for which financial statements have been prepared. Legislation of CIS member states may require additional documents and information that should be available to shareholders.

Redemption rights also protect shareholders when the company decides to reorganize. The redemption rights of shareholders are discussed in Article 6 of the Model Provisions.

5. The company shall notify all known creditors whose claims precede the publication of the draft terms of the reorganization and that have not been settled at the time of the publication of the terms. The creditors shall be notified in writing by registered mail not later than 30 days after the General Meeting of Shareholders of the reorganizing company approved the decision on the reorganization. The company shall also publish an announcement in the official gazette where information on commercial legal entities is published.
6. Any creditor of the company may, within 30 days after the deadline for the notification of creditors, request the company to:

6.1. Provide additional guarantees for the company’s obligations to the creditor;
6.2. Accelerate the performance of the company’s obligations to the creditor; and
6.3. Prematurely fulfill the obligations to the creditor.

The creditor shall be entitled to reimbursement of any losses caused to the creditor as a result of the reorganization.

The state registration body shall register the reorganization only if a proof of creditor notification and satisfaction of creditors’ claims is provided by the company.

Reorganizations may also have important implications for creditors. For example, debtor companies may change their identity (legal form) during the course of the reorganization. Company’s assets or liabilities may be altered which could affect the risks of credit agreements. Credit agreements may provide for additional guarantees to lenders in the event of a reorganization. The procedures and the creditor protection mechanisms in case of reorganization are the same as those for a decrease of the charter capital (see Clauses 5 and 6 of Article 32 of the Model Provisions).

7. In the case of reorganization in the form of division of companies, the newly created companies shall be jointly and severally liable for all the debts of the divided company for a period of one year after the reorganization has been completed.

8. In the case of reorganization in the form of a spin off (separation) of companies, the reorganized company and the newly created companies shall be jointly and severally liable for each other’s debts that have arisen prior to the completion of the reorganization for a period of one year after the reorganization has been completed.

Clauses 7 and 8 of Article 34 of the Model Provisions protect creditors during the division and separation of companies. In both cases, creditors of a reorganizing company may be defrauded and be left with no assets that would satisfy their claims. The Model Provisions therefore propose that
legislation of CIS member states stipulate joint and several liability of all companies participating in the reorganization for a period of one year.

The Model Provisions are consistent with the requirements of the Third and Sixth EU Company Law Directives for the protection of creditors during the reorganization of a company.

**Article 35. Investor Protection During Voluntary Liquidation (Winding-Up)**

1. A voluntary liquidation procedure shall be initiated:
   
   1.1. According to provisions in the charter of the company; or
   1.2. Upon the decision of the General Meeting of Shareholders that is made by a ¾ majority vote of participating shareholders.

2. The initiation of a liquidation procedure on the grounds specified in Clause 1 of Article 35 of the Model Provisions shall be publicly disclosed without delay but not later than ten days after the decision has been made in accordance with national legislation for the registration of companies. During the liquidation of the company, an addendum shall be added to the companies’ business name indicating that the company is in liquidation.

3. From the moment the liquidation procedure is initiated, the sole business purpose of the company is its liquidation.

4. The General Director (and members of the Executive Board) of the company shall be members of the Liquidation Commission (“liquidators”), unless the General Meeting of Shareholders decides otherwise by a ¾-majority of all shareholders. The liquidators perform the functions of the executive bodies of the company.

5. The General Meeting of Shareholders may elect different liquidators at any time. A shareholder (or group of shareholders) owning at least ten percent of voting shares, may request the court to appoint the liquidators. The court shall appoint liquidators if serious doubts exist for the trustworthiness of the liquidators that have been appointed
by the General Meeting of Shareholders or the company. The liquidators that have been appointed by the court shall receive a payment from the company as determined by the court.

6. The liquidators shall prepare an initial liquidation balance sheet as soon as possible following their appointment. The Liquidation Commission shall prepare an interim balance sheet based on the results of each fiscal year prior to the completion of the liquidation. An independent auditor shall audit the balance sheets. The General Meeting of Shareholders shall approve each interim balance sheet. If according to the initial liquidation balance sheet or any interim liquidation balance sheet the company meets the criteria for bankruptcy, the Liquidation Commission shall immediately start a bankruptcy procedure in accordance with bankruptcy legislation.

7. The company shall notify all its known creditors by registered mail. In addition, the Liquidation Commission shall publish a corresponding note two times in the official gazette that publishes information on commercial legal entities. These notifications shall be published sequentially with an interval of at least two months that shall start with the first notification as specified by Clause 2 of Article 35 of the Model Provisions.

8. The Liquidation Commission shall terminate the company’s activities, collect unpaid claims and sell the company’s assets. When the company's assets are sold, the Liquidation Commission shall ensure that the highest price is paid for the assets.

9. The Liquidation Commission shall treat all shareholders equally. When the company's assets are offered to shareholders or their affiliated parties, they shall be offered to all shareholders on equal terms.

10. The Liquidation Commission shall pay the company’s debts that are due and can deposit an amount that matches the unpaid claims of creditors in a banking account. When the creditor is also a shareholder owning at least ten percent of voting shares of the company, payments to that creditor-shareholder shall start only six months after the disclosure requirements of Clause 2 of Article 35 of the Model Provisions have been
satisfied. An amount that matches the claims shall be deposited in a banking account before the payment is made.

11. If creditors do not file claims that are recorded in the accounting books of the company, the Liquidation Commission shall deposit an amount in a banking account that matches the claim.

12. After the company has satisfied all creditors’ claims, the company’s remaining assets shall be distributed among shareholders. Payments or any other benefits to shareholders shall be provided not earlier than nine months after the liquidation procedure has been initiated.

13. When the company’s assets that remain after the creditors’ claims have been satisfied are not sufficient to satisfy all shareholder claims, payments are made to holders of preferred shares according to the priority stipulated in the charter of the company before the holders of common shares are paid. Within any type or class of shares, payments shall be in proportion to the shareholder’s participation in the charter capital.

14. When the liquidation of assets and the distribution of proceeds to creditors and shareholders are completed, the Liquidation Commission shall prepare a final report, which shall be audited by an independent auditor and be submitted for approval by the General Meeting of Shareholders.

15. The liquidators shall be jointly and severally liable to shareholders and creditors for any violation of Article 35 of the Model Provisions unless they prove that they acted in accordance with the requirements of Article 24 of the Model Provisions.

The General Meeting of Shareholders has the authority to terminate the company’s business activities and liquidate the company at any time. However, the liquidation of a company can pose risks to creditors and other investors. Major shareholders with inside knowledge may act in a self-serving manner at the expense of creditors and minority shareholders. Especially in transition countries, liquidation procedures often have been abused.
There are three rules which are fundamental to prevent abuses during the liquidation of a company. First, a distinction between a voluntary liquidation and a liquidation on the basis of a court decision should be made. The rules for a voluntary liquidation apply only as long as the company has assets to meet its debts. As soon as it becomes clear that a company can no longer meet its obligations, a bankruptcy procedure should be initiated (Clause 6 of Article 35 of the Model Provisions). Second, creditors should be protected from any abuses of shareholders who use inside knowledge. Disclosure rules under Clauses 2 and 7 of Article 35 of the Model Provisions and the minimum waiting period before the company can distribute assets to shareholders as defined in Clause 12 of Article 35 of the Model Provisions, help ensure that creditors have sufficient time to recover their claims. Third, minority shareholders should be protected from abuses of majority shareholders (Clause 9 of Article 35 of the Model Provisions).

The liquidation procedure in most CIS member states is provided in company laws and civil codes. In addition to some new elements proposed in Article 35 of the Model Provisions, the provisions attempt to streamline the procedures on liquidation that exist in CIS member states. A major exception, however, is the rule according to which debts shall be paid according to a certain ranking (see Article 64 of the Civil Code of the Russian Federation). This provision appears to be unnecessary since voluntary liquidation should be allowed only as long as a company has sufficient assets to satisfy all creditor claims.

The Model Provisions provide additional protection of (outside) creditors with:

- Improved disclosure procedures; and
- A “waiting period” of nine months, instead of two months, for shareholders.

Clause 10 of Article 35 of the Model Provisions introduce a special waiting period for the payment of debts to creditors who are also company shareholders (“inside creditors”).
Section 7. Financial Reporting and Accountability

Article 36. Mandatory External Audit

The company’s annual financial statements shall be subject to a mandatory independent external audit.

CIS member states already recognize the importance of this well-established requirement for the protection of investors. To be comprehensive and in view of the contents of Section 7 of the Model Provisions, however, this rule is included in the Model Provisions.

It is important to note that legislation of CIS member states may stipulate not only the requirement of a mandatory external audit but also specify that such audit shall be carried out in accordance with audit standards that are internationally recognized.

Article 37. Requirements for Auditor Independence

1. The auditor (an individual or an audit firm) shall be free of any influence, or interest or relationships to the company being audited, which may pose a threat to his independence and may impair his professional judgment or objectivity.

2. The company’s audit cannot be carried out by an auditor who:

   2.1. Has any actual or impending, direct or indirect financial interest in the company or its affiliated persons other than the audit of the company;

   2.2. Has any business relationships with the company which are beyond the ordinary course of business;

   2.3. Has an employment or other contractual relationship with the company that may compromise the auditor’s independence, and the ability of directors, senior managers, accountants or other persons to be responsible for the accountability and financial reporting within the company;
2.4. Has a close family relationship with directors, senior managers, accountants or other persons responsible for the accountability and financial reporting within the company; or

2.5. As an auditor has performed audit services for the same company for more than five consecutive years.

3. When the auditor or its affiliated persons provide non-audit services to the company, the auditor shall ensure that:

3.1. The individuals involved in providing non-audit services do not make decisions with respect to the audit on behalf of the auditor or its affiliated persons; and

3.2. The non-audit services do not compromise the independence of the auditor.

4. Auditors shall identify and evaluate all factors that may compromise their independence, including those arising from relationships with a company prior to the appointment as auditor of the company.

5. The appointment of the auditor shall be approved by the General Meeting of Shareholders by a simple majority of participating shareholders on the basis of full information regarding the guarantees for its independence and the main terms of the proposed contract with him. The Chairman of the Board of Directors shall sign the contract with the auditor.

6. Listed companies shall be obliged to disclose information about the replacement of an auditor within [...] days after the General Meeting of Shareholders’ decision on the replacement.

The Model Civil Code, the Model Law on Joint Stock Companies, and the Model Law on Audit contain brief references to the requirement for auditor independence. Independence is defined as the “lack of connection to the property interests of the company or its shareholders.” The Model Law on Audit adopted in 1997 contains the provision that “the independence of the auditors and the auditor organizations shall be guaranteed according to national legislation.” There is, however, virtually no guidance provided on this issue.
In light of recent business developments, the regulation of the auditing profession as well as of the relationships between the audited company and the auditor has become particularly important for investor protection. This has been recognized by the Sarbanes-Oxley Act of the U.S., the Code of Ethics for Professional Accountants (Nov. 2001), the EU Commission’s “Recommendations on Statutory Auditor’s Independence” of 2002, the “IOSCO’s Principles of Auditor’s Independence and the Role of Corporate Governance in Monitoring Auditor’s Independence” of 2002, the 2004 “OECD Corporate Governance Principles” and policy documents in a number of individual jurisdictions. In addition to general threats to an auditor’s independence, the above mentioned documents have emphasized concerns about non-audit services provided by audit firms, the rotation of key audit partners, and the responsibility of non-executive directors (the Audit Committee of the Board of Directors, in particular) in overseeing the relationships with the auditors.

The Model Provisions propose that these new regulatory developments be similarly reflected in CIS member states, especially with regard to listed companies. Clause 1 of Article 37 of the Model Provisions formulates general requirements with regard to an auditor’s independence. Clause 2 of Article 37 of the Model Provisions refers to some specific requirements for the appointment of an auditor. Thus, the intention is to go beyond the definition of independence provided by already existing Model Legislation. In addition, auditors are obliged to assess the threats posed to their independence (Clause 4 of Article 37 of the Model Provisions). An auditor may choose to take measures to mitigate these threats or resign from a particular assignment. An auditor’s independence may be ensured by special provisions for the approval of the appointment of the auditor (Clause 5 of Article 37 of the Model Provisions), the rotation of auditors (Clause 2.5 of Article 37 of the Model Provisions) and the disclosure of auditor replacement (Clause 6 of Article 37 of the Model Provisions).

**Article 38. Reporting Obligations of Parent Companies (Consolidated Accounts)**

1. *A company which is a parent company according to the law on […] shall at the end of the financial year, in addition to preparing individual accounts, also prepare group accounts.*

2. *Group accounts are the consolidated accounts comprising a consolidated balance sheet dealing with the state of affairs of the parent company and its subsidiaries, and a*
The introduction of consolidated financial reporting by groups of companies is essential for the protection of the interests of investors. Such accounts allow investors to judge to what extent two or more legally independent entities demonstrate elements of economic unity. Although the regulation of consolidated accounts is provided as a rule by accounting legislation, the importance of the subject matter for investor protection and its relative novelty for CIS member states is the reason that the Model Provisions refer to consolidated accounts in line with the provisions of the EU Company Law Directives.

The obligation to prepare group accounts falls upon the parent company. The parent company prepares two sets of accounts: its own accounts and the accounts for the group as a whole. The individual subsidiaries prepare only their own accounts. The consolidated accounts should be subject to the same requirements for legality, completeness, faithfulness and accuracy as the individual company accounts.

It is important to note that when companies are required according to the national accounting legislation to keep accounts in accordance with international financial reporting standards (IFRS), their consolidated accounting requirements are stipulated by IFRS as well.

**Article 39. Audit Committee**

1. The Board of Directors can form an Audit Committee. The Audit Committee shall consist of at least three members of the Board of Directors.

2. The Audit Committee shall consist of non-executive directors and be chaired by an independent director.
3. **The Audit Committee shall have the following functions:**

3.1. *Develop recommendations for the Board of Directors on the selection of the External Auditor and oversee the selection of the External Auditor;*

3.2. *Interact with the External Auditor to the degree necessary for the audit process;*

3.3. *Supervise the financial and business operations of the company;*

3.4. *Monitor the internal audit service;*

3.5. *Develop internal control and risk management procedures; and*

3.6. *Other functions as provided by the charter of the company.*

The Audit Committee, as an internal structure of the Board of Directors, is established by companies in many Western countries. Its creation is recommended by many national Corporate Governance Codes (including the corporate governance code of the Russian Federation) and a range of international documents (e.g., the “2002 IOSCO’s Principles of Auditor’s Independence and the Role of Corporate Governance in Monitoring Auditor’s Independence”).

As a sub-structure of the Board of Directors, the Audit Committee consists solely of directors. The Model Provisions recommend that the Audit Committee have at least three members who are non-executive directors as defined by Clause 1.2.25 of Article 2 of the Model Provisions. Although this requirement may be difficult to satisfy by some companies, an Audit Committee is important to win the confidence of investors with a Board of Directors that has the ability to objectively monitor management in the interest of all shareholders. Similarly, the Model Provisions recommend that at least the chairperson of the Committee be an independent director, as defined in Clause 1.2.20 of Article 2 of the Model Provisions. In addition, the charter of the company can set forth special professional requirements for the Audit Committee’s members. Ideally, members should have expertise in accounting and financial reporting and be persons with a good reputation. The Audit Committee should regularly (e.g., quarterly) report to the Board of Directors.

The Audit Committee performs a range of very important functions (Clause 3 of Article 39 of the Model Provisions). The Audit Committee assists the Board of Directors with overseeing the integrity of the company’s financial statements, the company’s compliance with legal and regulatory financial
requirements, the assessment of the external auditor’s qualifications and independence, and the performance of the company’s internal audit function. In particular, the Committee should:

- Oversee the selection of auditors;
- Propose the termination of contracts with auditors;
- Examine whether the criteria for auditor independence have been met;
- Evaluate audit fees;
- Meet on a regular basis with the auditor without the management being present; and
- Discuss any contentious issues that might have arisen in the audit process.

In addition, the Audit Committee oversees the internal financial reporting process and sets up control and risk management procedures.
Section 8. Protection of the Rights of Holders of Other Securities

Article 40. Protection of Corporate Bondholders

1. The Board of Directors shall have the authority to place bonds unless the charter of the company provides otherwise.

2. The General Meeting of Shareholders shall have the authority to place convertible bonds by a ¾-majority vote of participating shareholders.

3. A company may issue bonds only after its charter capital has been paid in full.

4. A company may issue bonds secured by a pledge, bonds with a guarantee by third parties and unsecured bonds.

5. Unsecured bonds may not be placed earlier than the third year after the state registration of the company and after two annual balance sheets of the company have been approved by the General Meeting of Shareholders.

Companies can issue bonds as an alternative to a share issue and bonds may be more flexible to raise external finance. However, it is important to ensure that the rights of existing shareholders, bondholders and new bondholders are protected in this process.

In the interest of financial flexibility (especially necessary when credit markets are not sufficiently developed), Clause 1 of Article 40 of the Model Provisions proposes that the charter of the company authorize the Board of Directors to issue bonds. In this sense, the Model Provisions differ from the Model Law on Joint Stock Companies and the legislation of several CIS member states. When the company issues convertible bonds, however, the interest of existing shareholders should be strictly protected. Thus, convertible bonds can be issued only with a supermajority vote of shareholders participating in the General Meeting of Shareholders (Clause 2 of Article 40 of the Model Provisions).

Following existing regulation in CIS member states, the Model Provisions allow for the issue of three kinds of bonds (Clause 4 of Article 40 of the Model Provisions). Articles 42 and 43 of the Model
Provisions provide more details of the regime applicable to secured bonds. Clause 3 of Article 40 of the Model Provisions provides a general guarantee that affects the interest of creditors. In addition, the rights of holders of unsecured bonds are protected by the requirement that sufficient information on the financial state of the company is made available to the bondholders, and the requirement that the General Meeting of Shareholders must have approved at least two annual balance sheets of the company prior to the issue of bonds.

Article 41. Rights of Corporate Bondholders

1. The company shall ensure that all bondholders of a particular type and issue are treated equally with respect to the rights attached to these bonds.

2. Each group of bondholders of a particular bond issue constitutes a General Meeting of Bondholders. The Board of Directors shall convene the first General Meeting of Bondholders not later than one month after the registration of the results of the bond issue. The General Meeting of Bondholders shall be valid when at least one tenth of the bond capital is present.

3. Each General Meeting of Bondholders elects its representatives and approves its internal rules. The representatives shall express and protect the interests of bondholders according to decisions of the General Meeting of Bondholders.

4. The General Meeting of Bondholders may be summoned by the representatives, by the holders of one tenth of the bond capital of the particular issue or the Liquidation Commission of the company in case of the company’s liquidation.

5. The General Meeting of Bondholders shall be convened when the company decides on a major transaction, or the reorganization and the liquidation of the company, unless the internal rules on the General Meeting of Bondholders provide otherwise.

6. The representatives of bondholders can participate in the General Meeting of Shareholders without voting rights and shall receive information from the company on the same terms as shareholders unless the charter of the company provides otherwise.
7. **The General Meeting of Shareholders shall take into consideration the decisions of the General Meeting of Bondholders on issues specified in Clause 5 of Article 41 of the Model Provisions when it makes decisions on these issues.**

By granting special rights to bondholders, Article 41 of the Model Provisions introduces a set of rules new to company laws of most CIS member states. In principle, the interests of bondholders are protected to a certain extent by rules on bond issues, the general rules on public disclosure of the company’s information, and the supervisory activities of the securities market regulatory authority as well as by the general rules on creditor rights in civil law countries. These general provisions may not be sufficient in some circumstances to protect bondholders. As a result, special regimes to protect bondholders have been introduced by a number of Western jurisdictions.

Special protection of bondholders is particularly important since the interests of shareholders and bondholders tend to diverge in situations of uncertainty (that are common in financial markets in CIS member states). Shareholders generally accept a higher level of risk than bondholders in exchange for potentially higher returns. If the company successfully takes greater risks, the returns to shareholders may be higher as well. If the company fails in its risk-taking, the losses to shareholders may be greater. Bondholders, on the other hand, always receive the same contractually stipulated return regardless of the level of risk of the company. Bondholders only stand to lose if the level of risk of the company increases to the level of corporate insolvency. This is especially true for holders of unsecured bonds. Bondholders wish to see a predictable, stable cash flow, and if possible, a reduction of the company’s risk profile. Similarly, the choices of holders of convertible bonds may be affected in situations where the capital of a company is reduced or when shares are redeemed when this conflicts with bondholders’ right to exercise conversion rights. The Model Provisions therefore propose special governance rights for bondholders. They also seek to ensure that these rights do not bring excessively high administration costs to the company or in any way impede the functioning of the General Meeting of Shareholders. The Model Provisions therefore propose:

- General Meetings of Bondholders. It is a matter of national regulation to what extent the preparation and holding of the Meeting should be determined by a company’s internal rules or by procedures for General Meetings of Shareholders;
• That the General Meeting of Bondholders be convened when the company will decide on major issues which might affect the interests of bondholders (Clause 5 of Article 41 of the Model Provisions);
• That only the representatives of the General Meeting of Bondholders have information rights (Clause 6 of Article 41 of the Model Provisions); and
• That the decisions of the General Meeting of Bondholders on particular issues (Clause 5 of Article 41 of the Model Provisions) be taken into consideration by the General Meeting of Shareholders (Clause 7 of Article 41 of the Model Provisions).

Due to their scope, the Model Provisions are not exhaustive. Additional provisions that provide remedies when bondholders’ rights have been violated could be introduced by national legislation that are in line with specific conditions of CIS member states.

**Article 42. Protection of Holders of Bonds Secured by a Guarantee**

1. *The guarantee contract for the issue of secured bonds shall provide for a joint and several liability of the issuing company and the guarantor in case of default on the bond obligations.*

2. *A bank guarantee issued as a bond security cannot be revoked. The period for which the bank guarantee is provided shall exceed the bond redemption date by at least six months.*

3. *The guarantee contract shall be available to subscribers of bonds.*

Article 42 of the Model Provisions aims to provide extra protection to bondholders that are secured by a guarantee. Clause 1 of Article 42 of the Model Provisions is based on the principle of civil law that provides for a joint and several liability of the company and the guarantor towards the bondholders. Clause 2 of Article 42 of the Model Provisions provides specific requirements for bank guarantee contracts. Finally, the Model Provisions propose that the terms of the guarantee contract be disclosed to bondholders if they deem it necessary to acquaint themselves with these terms.
Article 43. Protection of Holders of Bonds Secured by a Pledge

1. Only securities or immovable property can be subject to a pledge for the issue of secured bonds.

2. Bonds cannot be placed before the requirements for the state registration of the pledge of immovable property are fulfilled, or the registration of the securities in the securities register has been completed.

3. An independent appraiser shall determine the market value of immovable property subject to the pledge contract.

4. The pledge contract shall be available to bond subscribers.

The Model Provisions propose that only securities and immovable property be used as a pledge for the issue of secured bonds. These assets can be registered following the relevant requirements of national legislation (Clause 2 of Article 43 of the Model Provisions), thus providing for enhanced certainty with regard to the status of the pledge.

It would be premature for the Model Provisions to include other assets in the list of Clause 1 of Article 43 of the Model Provisions, such as immovable property and intellectual property. Should effective procedures for the registration of these assets be introduced in CIS member states, there is no reason to prevent companies in these states from using them as a pledge to raise external capital.

It is also important that an independent appraiser determine the value of the immovable property subject to the pledge contract to minimize potential abuse. As in the case of guarantees, the pledge contract shall be available to bondholders.

Article 44. Protection of Holders of Stock Options

1. Stock options can be issued only if:

   1.1. The charter capital has been paid in full; and
1.2. The number of authorized shares is not fewer than the number of shares used for exercising the option rights.

2. The General Meeting of Shareholders has the authority to issue stock options by a ¾-majority vote of participating shareholders.

3. The Board of Directors submitting the proposal to issue stock options to the agenda of the General Meeting of Shareholders shall also submit a report on the purpose and the consequences of the stock options issue. If stock options are issued as an incentive or for compensation, the report shall contain a clear reference to the performance goals to be reached.

4. The number of shares that can be obtained when a stock option is exercised cannot exceed ten percent of the shares of this type and class issued at the date of the submission of documents for the state registration of the stock options issue.

Stock options offer a number of advantages to the company. For example, they are frequently used as performance-related incentives for management and employees. Stock options can also have disadvantages and incur costs. Stock options are often issued when a company issues shares and shareholdings of existing shareholders may be diluted. In addition, the company normally funds the “incentive margin”, i.e., the difference between the exercise price of stock options and the market price of the shares that will be used for the stock options. Stock options are mostly effective when the shares of the company are liquid. The benefits for managers and employees who are entitled to stock options will not only largely depend on the market situation but also on the tax policy of the country.

The regulation of stock options requires more regulation than the Model Provisions provide. Given the use of (and interest in) stock options in many CIS member states, the Model Provisions propose that only the General Meeting of Shareholders with a supermajority voting requirement can issue and determine the terms of stock options (Clause 2 of Article 44 of the Model Provisions). Similarly, in approving the stock option issue, shareholders should have sufficient information on the issue and any performance goals (Clause 3 of Article 44 of the Model Provisions). These performance goals can be based on sales growth or turnover, annual or quarterly profits, an increase in the share value or a combination of these indicators. It is also important that the company consider the period within which
stock options can be exercised, any limitations on the transferability of the shares acquired in exchange of the options and whether voting or non-voting shares should be issued as part of the option plan.
Part III. Protection of Investor Rights During the Issue and Trade of Securities

Section 9. Protection of Investor Rights When Securities Are Issued

Article 45. Shareholder Approval of a Securities Issue

1. The decision to issue securities shall be adopted by the Board of Directors on the basis of and in compliance with the decision to place securities as adopted by the following governing bodies:

1.1. The decision to place shares shall be approved by the General Meeting of Shareholders, or the Board of Directors if stipulated by the charter of the company;
1.2. The decision to place convertible bonds and stock options shall be approved by the General Meeting of Shareholders; and
1.3. The decision to place bonds shall be approved by the Board of Directors unless the charter of the company provides otherwise.

2. A decision to issue securities cannot be made later than six months after the decision to place securities is adopted according to Clause 1 of Article 45 of the Model Provisions.

3. The decision to issue securities shall in its form and contents comply with the requirements of securities legislation.

Shareholder approval of any new placement of shares or convertible securities is an important precondition to protect shareholders’ interests when securities are issued. Article 31 of the Model Provisions provides for more information on the approval of capital increases by the General Meeting of Shareholders and the Board of Directors. This also allows shareholders to exercise pre-emptive rights. It is equally important that the decision to issue securities, normally delegated to the Board of Directors, is based on the decision to place securities. Article 45 of the Model Provisions therefore proposes that the decision to issue securities follow the decision to place securities within a reasonable period (6 months).
Article 46. Issue Price of Securities

1. The issue price of securities is determined by the Board of Directors and shall be the market value.

2. The issue price of shares and convertible securities cannot be lower than the nominal value of issued shares or the shares into which the convertible securities will be converted.

3. Exceptions to the rule stipulated in Clause 1 of Article 46 of the Model Provisions are allowed only in the following cases:

   3.1. When shareholders exercise pre-emptive rights, the issue price for these shareholders in accordance with the decision to issue shares cannot be lower than ten percent of the issue price for other investors;

   3.2. When additional shares are placed through subscription, the remuneration of an intermediary cannot be more than ten percent of the issue price; and

   3.3. When stock options are issued.

Normally, the Board of Directors determines the issue price of securities within the limitations of its authorization. To protect creditors’ interests with guarantees based on charter capital requirements, the Model Provisions also require that new shares (or convertible securities) be issued at a price that is not lower than their nominal value. The nominal value does not necessarily reflect the real value of the company. A number of international documents (e.g., the “General Principles for Company Law in Transition Economies” and the “Winter Report”) therefore recognize that securities (shares, in particular) cannot be issued below their market value (or “fair value” as it is referred to in some jurisdictions). Securities could be placed among insiders and/or related persons with artificially low prices if this principle was not followed.

A developed securities market is essential to determine the value of securities. Most CIS member states are currently developing their securities markets and fair prices for securities cannot always be established. In these circumstances, it is important to define a workable procedure to determine the value of securities. The Winter Report, for example, recommends that the market price of securities of
listed companies be calculated based on an average market price of shares for a given period before the last securities issue of a particular type and class. For unlisted companies, a market price can be determined based on the most recent audited annual accounts. The market price of securities can be presumed and rebutted only when clear evidence to the contrary is available. An independent appraisal could also be required to determine the market price of certain types of securities issues, unless the securities have been the subject to regular quotation (similar to Article 77 of the Law on Joint Stock Companies of the Russian Federation).

The Model Provisions introduce exceptions to procedures that are used to determine the issue price of securities (Clause 3 of Article 46 of the Model Provisions). In particular with regard to stock options, strict shareholder approval requirements as provided by Article 44 of the Model Provisions should be observed in order to avoid price abuses.
Article 47. Protection of the Rights of Retail Investors

1. A retail investor is an individual who is not registered in accordance with requirements of national legislation as an organization providing financial and investment services (“professional investors”).

The Model Provisions make a distinction between retail investors – individuals – and professional investors that provide financial and investment services in accordance with the requirements of national legislation. This approach reflects the capital market infrastructure in which the two groups of investors can be active. Professional investors, such as banks, investment funds and insurance companies, often have greater access to information and have expertise that is superior to that of retail investors. The Model Provisions therefore provide additional protection to retail investors. In the Model Provisions, professional investors are defined as intermediaries that provide financial and investment services in accordance with legal requirements. Some Western jurisdictions provide a broader definition of professional investors that may include state institutions and international organizations.

2. Any professional investor providing investment services to retail investors shall provide retail investors with full, timely and comprehensive information on:

2.1. The identity of the professional investor and its representatives;
2.2. The nature of the investment services provided to the retail investors;
2.3. The amount and terms of payment for the services provided; and
2.4. The retail investor’s rights when investment services are provided.

3. Information shall be provided in a form that allows a retail investor to compare the investment services with those of other providers.

Essential to the protection of retail investor is the requirement that sufficient information is made available before investment services are provided. This requirement should apply to all professional investors providing investment services to retail investors.
4. A contract for services provided to a retail investor without receiving the information specified in Clauses 2 and 3 of Article 47 of the Model Provisions may be challenged in the courts by the investor.

A retail investor who has entered into a contract for investment advisory services should be able to invoke civil remedies (invalidation and compensation of losses) when the services have been provided in violation of the requirements of Clauses 2 and 3 of Article 47 of the Model Provisions.

5. A professional investor shall have an internal complaint procedure in place for retail investors.

It is important that professional investors have an adequate internal complaint procedure in place for retail investors. Such a procedure should be efficient, inexpensive and fair in recording, assessing and resolving investor complaints. Complaint procedures are particularly beneficial to an investment service provider because they enhance investor confidence in the firm’s services and give important feedback to the firm about client’s satisfaction.

Article 48. Rules of Conduct of Professional Investors

1. In providing investment services, a professional investor shall act honestly, fairly and professionally in the best interests of its customers and the integrity of the market.

The Model Provisions recognize the need for more detailed regulation of professional capital market participants in national securities legislation of CIS member states and the development of rules of conduct through self-regulation. The important role of self-regulation is recognized by leading standards that include the “Market Conduct Standards for Participants in an Offering” of the “Forum of European Securities Commissions” (FESCO) in 1999, the “European Regime of Investor Protection: The Harmonization of Conduct of Business Rules” proposed by the “Committee of European Securities Regulations” (CESR) in 2002 and the “EU Investment Services Directive” of 1993.

Standards of conduct for professional investors are in essence similar to the fiduciary duties of directors and managers. These standards require that professional investors act honestly, fairly and in the best interests of investors (their clients) and the overall capital market. A professional investor providing
investment services should have the resources and the procedures in place that are necessary for the performance of its business activities, including back-up systems that ensure that investment services can be provided without interruption.

A professional investor providing investment services should take all reasonable measures to ensure that its directors, managers, partners and employees always act in accordance with the best interests of its clients and the integrity of the market. To this end, compliance policies and procedures should be in place. This should include an independent compliance function and an internal code of conduct for a professional investors’ directors, managers, partners and employees.

2. **A professional investor shall take all steps necessary to avoid conflicts of interest with customers. Conflicts of interests shall be disclosed to customers before the contract to provide investment services is concluded.**

The Model Provisions require that professional investors avoid conflicts of interest. This requirement re-enforces Clause 1 of Article 48 of the Model Provisions. When conflicts of interest cannot be avoided or managed, a professional investor providing investment services should refrain from activities that may cause these conflicts of interest. Such conflicts may arise during intra-group transactions or when several types of investment services or other business services are provided by an investment firm or its affiliated parties. An exception may arise when the professional investor enters into relationship with a client when a conflict of interests exists and when the client is properly informed about the nature and the scope the professional investor’s interest. These should be provided to the client in writing or by phone. The best solution would be to provide full disclosure of conflicts of interests between a professional investor and a retail investor before business relationships are formalized or before the any transactions are concluded.

3. **A professional investor providing investment services shall record, process, and execute customer orders in accordance with the customer’s instructions.**

This rule of conduct for professional investors requires that the organization acts strictly in accordance with the client’s instructions. An important precondition is the availability of information to the client as specified by Article 47 of the Model Provisions. Professional investors should record all terms of the client’s order as soon as possible and register and confirm all materials terms of the order. Professional
investors may deviate from the client’s instructions only if the order’s terms and/or the market situation make it impossible for the professional investor to execute instructions or when the client’s interests require other actions.
Section 11. Investor Compensation Funds

Article 49. Investor Compensation Funds

1. Investor compensation funds shall be created to protect retail investors from the losses caused by professional investors who maintain retail investors’ accounts or hold securities on behalf of retail investors when conditions stipulated in Clause 2 of Article 51 of the Model Provisions arise.

2. Investor compensation funds shall be established in the form of non-commercial organizations and shall be registered according to the requirements of the law.

3. The securities market regulator maintains the register of compensation funds in accordance with requirements of the law.

4. Compensation funds shall be financed by contributions from members.

Investor compensation funds in member states of the European Union are organized as non-commercial organizations in the form of non-governmental organizations. Investor compensation funds as non-commercial organizations are stipulated as well in the Law on the Protection of Investments of the Russian Federation.

In some CIS countries, e.g. Russia, state agencies have been established for the insurance of bank deposits (Russian Law N 177 of 23.12.2003). Contrary to this, the Model Provisions propose to establish compensation funds as self-regulatory organizations under the supervision of a state authority to avoid political interference in the management of the compensation fund.

More detailed regulation should be required to define the legal aspects of an investor compensation fund, including its governance, membership structure, and accountability requirements. In most CIS member states, separate laws on investor compensation schemes are in place as part of a system that regulates the financial, banking and investment services industries.
Article 50. Membership of Compensation Funds

1. A professional investor shall be a member of an investor compensation fund. No professional investor shall be authorized to carry out investment activities unless it is a member of an investor compensation fund. The compensation fund shall notify the securities market regulator if a professional investor does not meet the requirements of a fund's membership.

2. Each professional investor shall make an annual contribution to the investor compensation fund. The annual contribution shall be fixed by internal rules of the compensation fund which shall be approved by the supervisory authority. Funds received shall be deposited with an independent depositor and invested according to the principle of risk diversification.

3. The compensation fund shall be obliged to supervise its members. To this end it shall be entitled to demand information, to inspect and to cancel the membership when the member does not fulfill its obligations.

Following the requirements of the EU Directive 97/ of March 26-th 1997, the Model Provisions propose mandatory membership of a compensation fund. Concerns may arise whether this requirement conflicts with the freedom of association. However, in Western countries mandatory membership is uncontested since investor protection prevails over the right to abstain from associations and membership is determined by law. At the same time, financial institutions may be exempt from a membership requirement when additional deposit guarantees exist. It is also important that legislation is in place that regulates the establishment, supervision and sanctioning of professional investors.

Annual membership contributions of professional investors, as a rule, are fixed based on a percentage of the charter capital. The Model Provisions do not include provisions on the calculation of contributions due to the complexity of contribution schemes and country specific circumstances. It would be desirable that legislation of CIS member states regulate the contribution to compensation funds.
Article 51. Compensation of Retail Investors

1. Retail investors shall be entitled to demand compensation of losses from the compensation fund when professional investors are incapable of:

1.1 Repaying investors’ money; or
1.2 Returning any securities of investors that are held, administered or managed on their behalf.

2. The entitlement for compensation shall arise only if:

2.1 The supervisory authority has determined that a professional investor appears to be for the time being unable to meet its obligations arising from a investors' claims due to reasons directly related to its financial circumstances; or
2.2 A judicial authority has made a ruling due to reasons directly related to a professional investor's financial circumstances, which suspends the professional investors' ability to meet its obligations, whichever is the earliest.

3. The compensation a retail investor is entitled to according to Clause 1 of Article 51 of the Model Provisions shall be 90 percent of the losses as a result of the professional investor's incapability to fulfill its obligations. This amount shall not be more than € 5,000.

4. The investor's claim shall be calculated on the date when one of the conditions specified in Clause 2 of Article 51 of the Model Provisions occurs in accordance with the legal and contractual requirements for the appraisal of the market value of securities and the amount of money that belongs to the investor that the professional investor is unable to repay or return.

5. An investor seeking compensation shall submit his claim to the fund's governing body not later than one year after one of the conditions specified in Clause 2 of Article 51 of the Model Provisions occurs.
6. **The compensation fund shall have a reverse claim towards the professional investor to reimburse the compensation paid to retail investors.**

The proposed wording is based on the EU Directive 97/ of March 26-th 1997. Clause 3 of Article 51 of the Model Provisions provides an incentive to retail investors to check the credibility of professional investor. The maximum amounts as well as the uncovered part of losses are fixed arbitrarily in the Model Provisions. According to EU law, the maximum amount is € 20,000. However, a limit should be introduced that allow contributions to funds at a reasonable rate.

In the interests of the integrity of financial markets, the Model Provisions prohibit that claims can be made more than one year after one of the conditions specified in Clause 2 of Article 51 of the Model Provisions occurs. This period may be altered depending on national legislation of CIS member states, including the regulation on bankruptcy of financial institutions. Compensation claims should be appraised by a supervising authority. An alternative procedure may be established according to which the appraisal is made by the liquidators of the professional investor.