

# Chapter 7

## An **Introduction** to **Shareholder Rights**



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### **The Chairman's Checklist**

- ✓ Does the company charter protect shareholder rights as stipulated by the Company Law and recommended by the Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code)? Do all directors take appropriate measures to ensure that these rights are respected?
- ✓ Do all directors take measures to encourage shareholders to exercise their rights, in particular, the right to vote? Do shareholders exercise their rights collectively?
- ✓ Does the Supervisory Board provide shareholders with free access to company information beyond the requirements of the Company Law? Are shareholder requests processed properly and on time?
- ✓ Does the Supervisory Board ensure that an independent External Registrar maintains the shareholder register? Are shareholders provided with full and accurate information regarding their account from the Registrar?
- ✓ Does the Supervisory Board encourage shareholders to protect their rights by using all the mechanisms provided by legislation and the FCSM Code?
- ✓ Does the Supervisory Board ensure that the charter and other internal documents do not stipulate obligations of shareholders other than the ones that are clearly defined by the Company Law?

Shareholders rely on the rights they receive in return for their investment. For most shareholders, this includes the right to participate in the profits of the company. Other rights are also important, such as the right to vote on the Supervisory Board's composition, approve charter amendments and capital changes, approve the annual report and financial statements, and the right to access information about the company and its activities. Through these rights, shareholders ensure that the managers of the company do not misappropriate their investment.

The quality of investor protection has several corporate governance implications, such as the depth of capital markets, ownership patterns, dividend policy, and the efficiency of allocating resources.<sup>1</sup> Where laws are protective of shareholders and well enforced, shareholders are willing to invest their capital, and financial markets are broader and more valuable. In contrast, where laws do not adequately protect shareholders, the development of financial markets is stunted. When shareholder rights are protected by the law, and indeed by the company itself, outside investors are willing to pay more for financial assets such as equity. They pay more because they recognize that, with better legal protection, more of the firm's profit will return to them as dividends and/or capital gains as opposed to being expropriated by managers or controlling shareholders.

The mere “law on the books” is not necessarily sufficient to ensure that shareholder rights are adequately protected. Effective enforcement is also required. Tantamount to shareholder rights protection is the company's behavior itself — especially for Russian companies that do not benefit from an effective enforcement regime and continue to be blemished by the many corporate governance scandals during the privatization years.

This chapter provides an overview of shareholder rights and the rules a company must follow to protect these rights. Some specific rights, such as the participation in the General Meeting of Shareholders (GMS), are discussed in detail in other chapters of this Manual.

### A. General Provisions on Shareholder Rights

#### 1. Reasons for Being a Shareholder

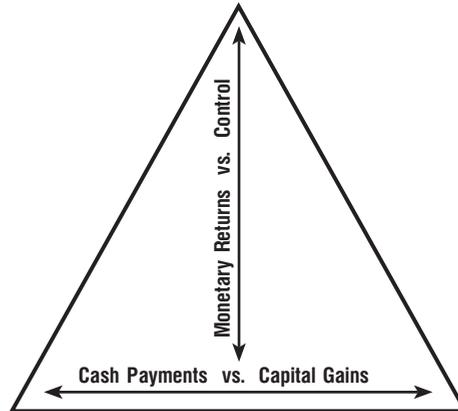
Investors purchase company shares for a variety of reasons. The most common reasons are shown in Figure 1.

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<sup>1</sup> Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, Robert Vishny, Investor Protection and Corporate Valuation, National Bureau of Economic Research, Working Paper 7403, October 1999.

**Figure 1: Common Reasons for Becoming a Shareholder**

**Control:** Shares provide investors with the opportunity to legally control the company and influence decision-making by nominating directors and, possibly, management. The greater the number of voting shares a shareholder holds, the greater the influence he wields.



**Dividends:** Dividends play an important role in the decision to invest. Regular dividend payments, especially if an investor holds a portfolio of shares, can generate predictable cash flows.

**Capital Gains:** Investors purchase shares to benefit from capital growth. Unlike dividends, shares need to be sold to realize the gains represented by rising share prices.

Source: IFC, March 2004

## 2. Types of Shares

Legislation specifies two types of shares: common and preferred. A company is required to issue common shares.<sup>2</sup> In addition, a company may also issue preferred shares.

→ For more information on charter capital and shares, see Chapters 9 and 11.

### a) Common Shares

Owners of common shares have the right to participate in the decision-making of the company, most commonly exercised by voting during the GMS. They also have the right to share in the profits of the company either through dividends or through capital gains.

<sup>2</sup> Law on Joint Stock Companies (LJSC), Article 25, Clause 2, Paragraph 1.

Common shares have certain characteristics. The charter defines the number, nominal value, and rights attached to common shares.<sup>3</sup> The aggregate nominal value of all issued common shares cannot be less than 75% of the charter capital.<sup>4</sup> All common shares must have the same nominal value and must provide the same rights to their owners. Common shares cannot be divided into different classes or be converted into other securities of the company.<sup>5</sup>

### **b) Preferred Shares**

A company has the right to issue various classes of preferred shares. The total nominal value of preferred shares of all classes cannot exceed 25% of the charter capital.<sup>6</sup> All preferred shares of the same class must have the same nominal value and must provide the same rights to their owners.<sup>7</sup> In contrast to common shares, preferred shares can be divided into classes depending on the rights and preferences attached to them.

Preferred shares can give their owners preferential rights associated with the distribution of dividends, liquidation value of shares, and voting rights attached to shares under specific circumstances.

The charter must specify the number of preferred shares issued by the company, as well as the nominal value and rights attached to preferred shares. In addition, the charter must specify the amount of dividends and/or the liquidation value of preferred shares or, alternatively, the procedure for determining the amount of dividends and the liquidation value of preferred shares.<sup>8</sup>

The charter can provide preferred shareholders of a specific class with the opportunity to convert their shares into common shares or other classes of preferred shares.<sup>9</sup>

The Company Law distinguishes preferred shares according to the dividend rights that they grant:<sup>10</sup>

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<sup>3</sup> LJSC, Article 11, Clause 3; Article 27, Clause 1.

<sup>4</sup> LJSC, Article 25, Clause 2.

<sup>5</sup> LJSC, Article 31, Clauses 1 and 3.

<sup>6</sup> LJSC, Article 25, Clause 2.

<sup>7</sup> LJSC, Article 32, Clause 1, Paragraph 2.

<sup>8</sup> LSJC, Article 32, Clause 2.

<sup>9</sup> LJSC, Article 32, Clause 3, Paragraph 1.

<sup>10</sup> LJSC, Article 32, Clause 2, Paragraph 3.

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- **Cumulative:** the charter can provide that unpaid dividends be accumulated and paid on a later date; and
- **Non-cumulative:** if the charter is silent, unpaid dividends shall not be accumulated.

The principal differences between common and preferred shares are summarized in Figure 2.

Figure 2: Comparison of Common and Preferred Shares		
	Common Shares	Preferred Shares
<b>Mandatory</b>	<b>Yes</b> , must always be issued	<b>No</b> , are optional
<b>What is the percentage of shares that can be issued?</b>	A <b>minimum of 75%</b> of the charter capital is mandatory	A <b>maximum of 25%</b> of the charter capital is allowed
<b>Can different classes of shares be issued?</b>	<b>No</b> , only one class of common shares may be issued	<b>Yes</b> , different classes of preferred shares can be issued
<b>Can this type of share be converted into other securities?</b>	<b>No</b> , common shares cannot be converted into preferred shares or other securities	<b>Yes</b> , preferred shares may be converted into common shares, if so provided for in the charter
<b>Do shareholders have the right to vote during the GMS?</b>	<b>Yes</b> , with certain exceptions	<b>No</b> , except under certain circumstances. → See Section B.1 of this Chapter
<b>Can the charter grant additional rights to shareholders?</b>	<b>Yes</b>	<b>Yes</b>

Source: IFC, March 2004

### c) Voting Shares

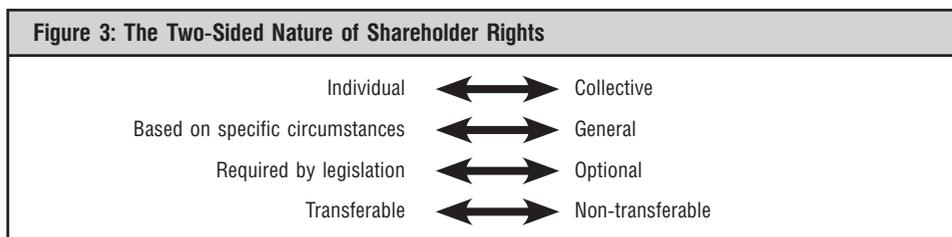
The Company Law also defines the term “voting share.” Common shares are always voting shares. Preferred shares can be voting shares under certain circumstances.<sup>11</sup>

→ For more information on voting shares, see Chapter 8, Section C.11.

<sup>11</sup> LJSC, Article 49, Clause 1, Paragraph 2.

## 3. Types of Shareholder Rights

The Company Law distinguishes between the rights of individual shareholders and the rights held collectively by a group of shareholders. It is also possible to distinguish shareholder rights according to their nature. Some rights relate to the decision-making process and the organization of the company. Others relate to the capital and the return on shareholder investment (see Figure 3).



Source: IFC, March 2004

Figure 4 summarizes the rights of shareholders by types of shares, and by the percentage of shares held. Neither the company nor its shareholders can change these rights. The charter can, however, provide additional rights to shareholders as long as they are not prohibited by legislation.

## B. Specific Shareholder Rights

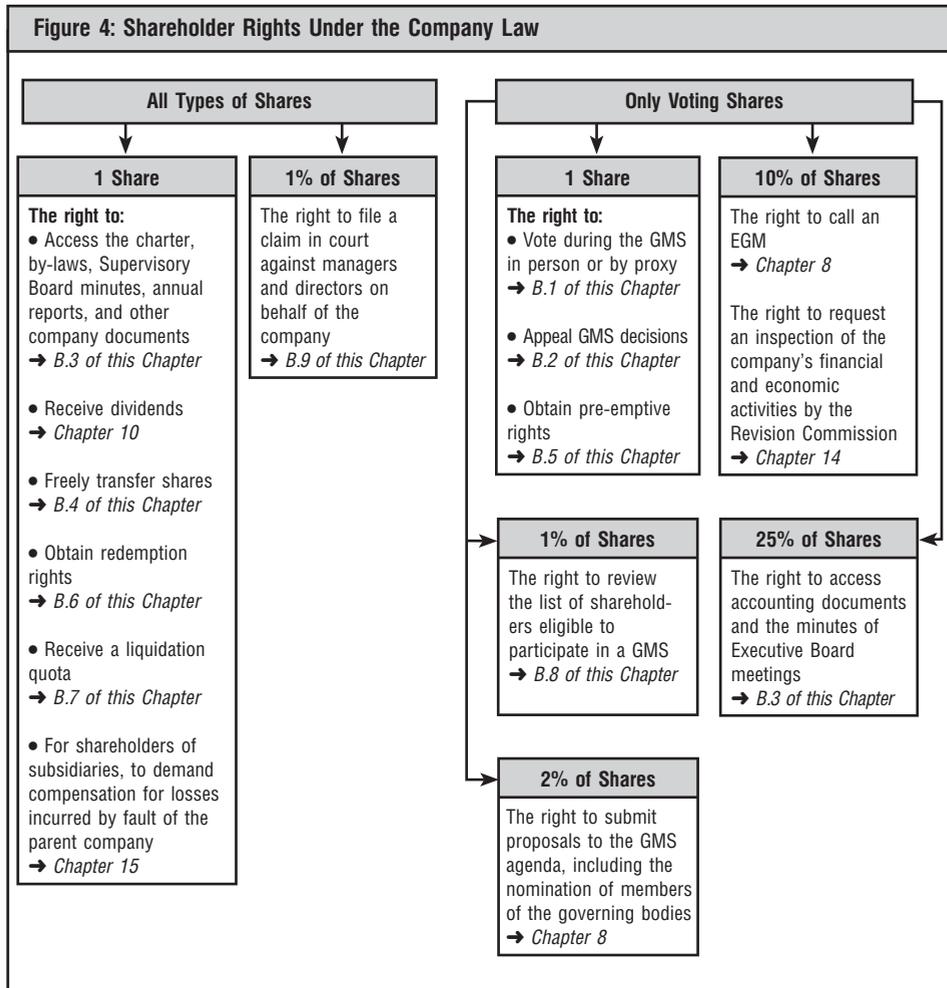
### 1. The Right to Vote

Shareholders can participate in the decision-making of the company through their right to vote during the GMS. Shareholders can, for example, control the long-term direction of the company by electing Supervisory Board members and by deciding on important matters that fall within the authority of the GMS.

The right to vote can be exercised personally or by a power of attorney.<sup>12</sup> A power of attorney provides its authorized holder (proxy) with the right to act on behalf of the shareholder and to make any decision the shareholder could have

<sup>12</sup> LJSC, Article 57, Clauses 1–2.

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Source: IFC, March 2004

made during the GMS. Except for limitations provided by legislation,<sup>13</sup> any individual can serve as a proxy as long as this person is given a written and duly executed power of attorney.

→ For more information on the GMS, see Chapter 8.

<sup>13</sup> Civil Code (CC), Article 21.

### a) The Right to Vote Common Shares

Common shares grant voting rights to their holders. However, there are some circumstances when common shares become non-voting. These circumstances are summarized in Table 1.

Table 1: Non-Voting Common Shares	
Preconditions	Legal Consequences
<p><b>Failure to fully pay for shares:</b> When common shares placed to the company's founders are not fully paid for, unless the charter provides otherwise.</p>	Precludes voting on any issue during the GMS <sup>14</sup>
<p><b>Limitations on the number of votes and/or shares that a single shareholder can possess:</b> When a shareholder has more votes than the maximum established by the charter that can be used during the GMS</p>	Precludes casting more than the maximum number permitted by the charter on any issue during the GMS <sup>15</sup>
<p><b>Treasury shares:</b><sup>16</sup> When the company possesses issued common shares of the company because:</p> <ul style="list-style-type: none"> <li>• The founders have not fully paid the shares within the period that they have to fully pay the common shares; or</li> <li>• The company redeemed common shares; or</li> <li>• The company fought back common shares.</li> </ul>	Precludes voting on all issues during the GMS
<p><b>The approval of related party transactions:</b> Common shares that are owned by a shareholder who is an interested party in a related party transaction.</p>	Precludes voting on the approval of the related party transaction in which the shareholder is an interested party <sup>17</sup>
<p><b>Waiver to extend the buy-out offer in control transactions:</b></p> <ul style="list-style-type: none"> <li>• When common shares are owned by a controlling shareholder, including his affiliated parties; and</li> <li>• When the company has more than 1,000 common shareholders.</li> </ul> <p>→ See Chapter 12.</p>	Precludes voting on the waiver of the controlling shareholder's obligation to buy-out the minority shareholders <sup>18</sup>

<sup>14</sup> LJSC, Article 34, Clause 1, Paragraph 3.

<sup>15</sup> LJSC, Article 11, Clause 3.

<sup>16</sup> LJSC, Article 34, Clause 1, Paragraph 5; Article 72, Clause 3, Paragraph 2; Article 76, Clause 6, Paragraph 2. Shares are commonly reacquired by a corporation to be retired or resold at a later date. Treasury shares are issued, but not outstanding, and are not taken into consideration when calculating earnings per share or dividends, or for voting purposes.

<sup>17</sup> LJSC, Article 83, Clause 4.

<sup>18</sup> LJSC, Article 80, Clause 2, Paragraph 2.

Table 1: Non-Voting Common Shares	
Preconditions	Legal Consequences
<p><b>Violation of rules on the acquisition of shares in control transactions:</b></p> <ul style="list-style-type: none"> <li>• When a person (or a group of affiliated persons) acquires common shares that are equal to or exceed a total of 30% of common shares; and</li> <li>• When this person (or this group of affiliated persons) has not followed the procedures specified by the Company Law when acquiring these shares; and</li> <li>• When the company has more than 1,000 common shareholders.</li> </ul>	<p>Common shares (the acquired shares that cause the holdings to equal or exceed 30%) cannot be voted at the GMS<sup>19</sup></p>
<p><b>Violation of rules on the acquisition of shares in control transactions:</b></p> <ul style="list-style-type: none"> <li>• Each time a person (or a group of affiliated persons) acquires 5% of common shares; and</li> <li>• This person (or this group of affiliated persons) already possesses at least 30% of common shares; and</li> <li>• When this person (or this group of affiliated persons) has not followed the procedures specified by the Company Law when acquiring the additional 5% of common shares; and</li> <li>• When the company has more than 1,000 common shareholders.</li> </ul>	<p>Precludes voting on all issues during the GMS<sup>20</sup></p>
<p><b>Election and dismissal of Revision Commission members:</b> When common shares are held by Supervisory Board members, the General Director, and Executive Board members.</p>	<p>Precludes voting on the election of Revision Commission members<sup>21</sup></p>

### b) The Right to Vote Preferred Shares

The Company Law limits the right of preferred shareholders to participate in voting during the GMS. Preferred shareholders normally do not have voting rights at the GMS except under specific circumstances when their rights are affected. These circumstances are summarized in Table 2.

<sup>19</sup> LJSC, Article 80, Clause 6.

<sup>20</sup> LJSC, Article 80, Clause 7.

<sup>21</sup> LJSC, Article 85, Clause 6, Paragraph 2.

Table 2: When Preferred Shares Become Voting Shares	
Circumstances	When Owners of Preferred Shares Can Vote
Reorganization or liquidation	The owners of preferred shares can vote on agenda items that are directly related to the reorganization and liquidation of the company <sup>22</sup>
Charter amendments that restrict preferred shareholder rights of a specific class	The owners of preferred shares of a specific class can vote on charter amendments restricting the rights attached to preferred shares of that specific class <sup>23</sup>
Non-declaration of dividends on non-cumulative preferred shares	The owners of non-cumulative preferred shares have the right to vote on all agenda items during the GMS until the first payment of dividends is made in full <sup>24</sup>
Partial payment of dividends on non-cumulative preferred shares	The owners of non-cumulative preferred shares have the right to vote on all agenda items during the GMS until the first payment of dividends is made in full <sup>25</sup>
Non-declaration of dividends on cumulative preferred shares	The owners of cumulative preferred shares have the right to vote on all agenda items during the GMS until the full payment is made of all accumulated dividends <sup>26</sup>
Partial payment of dividends on cumulative preferred shares	The owners of cumulative preferred shares have the right to vote on all agenda items during the GMS until the full payment is made of all accumulated dividends <sup>27</sup>

## 2. The Right to Appeal Decisions of the General Meeting of Shareholders

A shareholder has the right to appeal decisions of the GMS in court when:<sup>28</sup>

- The decision is adopted in violation of legislation or charter provisions; and
- The decision violates the rights and lawful interests of the shareholder; and

<sup>22</sup> LJSC, Article 32, Clause 4, Paragraph 1.

<sup>23</sup> LJSC, Article 32, Clause 4, Paragraph 2.

<sup>24</sup> LJSC, Article 32, Clause 5, Section 1.

<sup>25</sup> LJSC, Article 32, Clause 5, Section 1.

<sup>26</sup> LJSC, Article 32, Clause 5, Section 2.

<sup>27</sup> LJSC, Article 32, Clause 5, Section 2.

<sup>28</sup> LJSC, Article 49, Clause 7.

- The shareholder did not participate in the GMS or voted against this decision of the GMS.

A shareholder appealing a decision of the GMS must file his appeal with the court within six months after the shareholder learned or should have learned about the decision.<sup>29</sup>

→ *For more information on appealing decisions of the GMS, see Chapter 8, Section E.5 and Part V, Chapter 17, Section B.*

### 3. The Right to Receive Information About the Company

The Company Law provides shareholders with the right to receive information about the company based on the percentage of shares held. Distinctions are made between any shareholder and a shareholder (or a group of shareholders) owning at least 25% of voting shares.

Any shareholder has the right to receive information about the activities of a company. The charter and by-laws can specify the procedures that the company and shareholders must follow for the distribution of information and documents. The information rights of common and preferred shareholders are depicted in Figure 5.<sup>30</sup>

A company must also provide shareholders (or a group of shareholders) holding at least 25% of voting shares access to the:<sup>31</sup>

- Accounting documents;<sup>32</sup> and
- Minutes of the Executive Board meetings.

The company must provide shareholders the opportunity to familiarize themselves with the above-mentioned documents at the premises of the company within seven days after a request was received.<sup>33</sup>

<sup>29</sup> LJSC, Article 49, Clause 7.

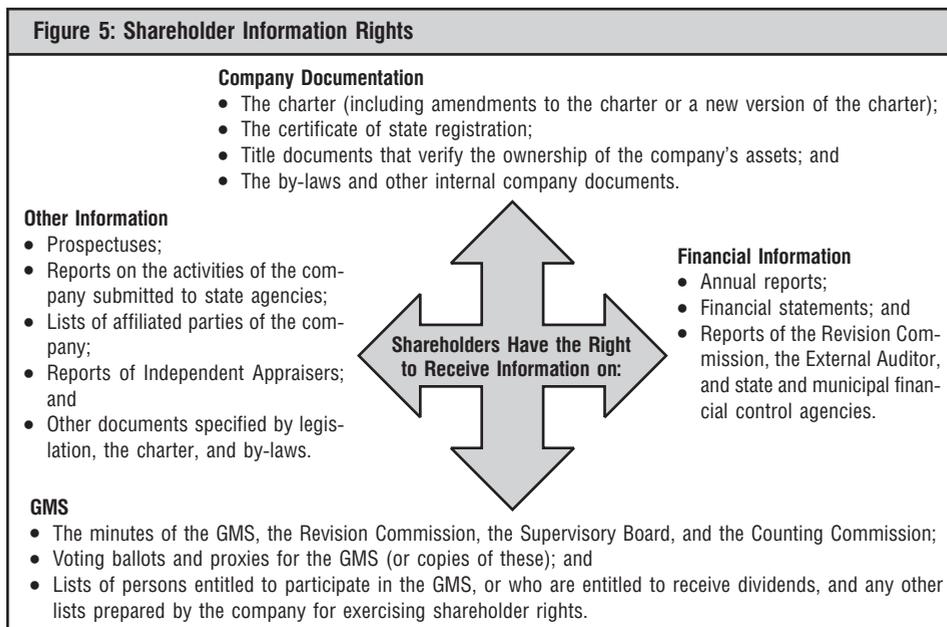
<sup>30</sup> LJSC, Article 89, Clause 1; Article 91.

<sup>31</sup> LJSC, Article 91, Clause 1, Paragraph 1.

<sup>32</sup> The Company Law is not clear about the definition of “accounting documents.” The primary accounting documents (which serve as the basis for the balance sheet and other financial statements) could be considered “accounting documents” pursuant to LJSC, Article 91, Clause 1, Paragraph 1. However, the primary accounting documents are also defined as confidential commercial information in accordance with the Law on Accounting, Article 9.

<sup>33</sup> LJSC, Article 91, Clause 2.

**Figure 5: Shareholder Information Rights**



Source: IFC, March 2004

**Best Practices:** It is good practice to provide the requested documents to the shareholders for their examination at the company's premises within five days after the request is received.<sup>34</sup>

Upon the request of any shareholder, a company must also provide a copy of documents specified in Figure 5.<sup>35</sup>

**Best Practices:** Although the Company Law does not provide a specific time frame within which copies must be given to shareholders, it is recommended that this be done within five days.<sup>36</sup>

<sup>34</sup> Federal Commission for the Securities Market's Code of Corporate Conduct (FCSM Code), Chapter 7, Section 3.1.1.

<sup>35</sup> LJSC, Article 91, Clause 2. The LJSC is not clear when the company must provide copies of these documents to shareholders.

<sup>36</sup> FCSM Code, Chapter 7, Section 3.1.1.

The company cannot charge shareholders more than the actual costs of copying the requested documents.<sup>37</sup>

→ For more information on information disclosure, see Part V, Chapter 13.

### 4. The Right to Freely Transfer Shares

The owners of common and preferred shares of a company have the right to sell their shares at any time and at any price, without the consent of, or any pre-emptive right on the part of, the company and other shareholders.<sup>38</sup> This means that the company cannot restrict the free transferability of shares, regardless of type and class. Any charter provisions purporting to restrict the transferability of common and preferred shares are null and void.<sup>39</sup>

→ For more information on the transfer of shares, see also Chapter 11.

### 5. Pre-Emptive Rights

In certain circumstances, shareholders have pre-emptive rights, which allow them to purchase shares or convertible securities on a priority basis before they are offered to third parties. Thus, a shareholder has the right to purchase newly issued shares in proportion to the number of shares he owns at the time the company decides to issue new shares or convertible securities of the same type and class.<sup>40</sup>

The pre-emptive rights of shareholders cannot be detached from shares. This means that a shareholder cannot transfer his pre-emptive rights to another shareholder. Pre-emptive rights are only transferable together with shares.

#### a) The Purpose of Pre-Emptive Rights

Pre-emptive rights ensure that all shareholders of the same class are treated equally. They provide the opportunity to purchase new shares when the company wants to increase its charter capital. Pre-emptive rights help protect shareholders from dilution, which can result in losing some of their rights due to the decrease of the percentage of shares they hold.

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<sup>37</sup> LJSC, Article 91, Clause 2.

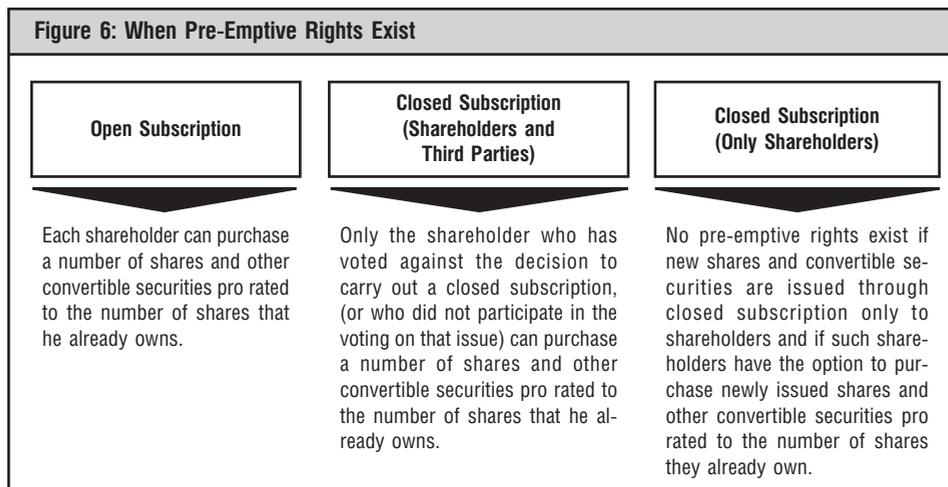
<sup>38</sup> Note that this Manual refers to open joint stock companies.

<sup>39</sup> LJSC, Article 7, Clause 2, Paragraph 3.

<sup>40</sup> LJSC, Article 40, Clause 1.

### b) When Pre-Emptive Rights Exist

The existence of pre-emptive rights depends on the type of subscription (open or closed) and whether it is limited to the existing shareholders or whether third parties can purchase new shares. Figure 6 specifies the cases in which shareholders have pre-emptive rights.



Source: IFC, March 2004

→ For more information on open and closed subscriptions, see Chapter 9, Section B.3.

### c) Pre-Emptive Rights and Fractional Shares

When shareholders exercise pre-emptive rights, fractions of shares (fractional shares) can result.<sup>41</sup>

A fractional share provides its owner a fraction of the rights attached to the full share of the specific type and class. For purposes of calculating the amount of the charter capital, all fractional shares must be added together. If, as a result,

<sup>41</sup> LJSC, Article 25, Clause 3, Paragraph 1. For example, shareholder A has 123 common shares out of 1,000 common shares, which represent 12.3% of all common shares. If the company is placing 250 additional common shares, shareholder A will be entitled to purchase 12.3% of 250 shares or 30.75 shares.

a fractional share is left, the number of issued shares in the charter must indicate the fraction of a full share.<sup>42</sup>

Fractional shares circulate together with full shares. If a shareholder acquires two or more fractional shares of the same type and class, these shares must be added together to create one full and/or one fractional share which is equal to the sum of these fractional shares.<sup>43</sup>

### d) The Procedure for Exercising Pre-Emptive Rights

The list of shareholders with pre-emptive rights must be compiled based on the shareholder register as of the date of the decision to issue additional shares or other convertible securities. The shareholders included in the shareholder list that have pre-emptive rights must be notified in the same manner as the notification of the GMS.<sup>44</sup> This notification must include information on:<sup>45</sup>

- The number of shares or convertible securities to be issued;
- The placement price or the procedure for determining the placement price (including the placement price or the procedure for determining the placement price of additionally issued shares for shareholders with pre-emptive rights);
- The procedure for determining the number of shares and convertible securities that each shareholder has the right to purchase; and
- The period within which pre-emptive rights must be exercised.<sup>46</sup>

A shareholder that has pre-emptive rights can exercise these rights fully or in part by submitting to the company:<sup>47</sup>

<sup>42</sup> LJSC, Article 25, Clause 3, Paragraph 3. If shareholder A owns 12.3 shares, shareholder B 34.5 shares, shareholder C 40.6 shares, and the remaining shareholders collectively own 50 shares, the charter must state the following number of issued shares of the company:  $12.3 + 34.5 + 40.6 + 50 = 137.4$  shares.

<sup>43</sup> LJSC, Article 25, Clause 3, Paragraph 4. For example, shareholder A purchases one fractional share of 0.3 and the second fractional share of 0.6. As the result, shareholder A has one fractional share of 0.9.

<sup>44</sup> LJSC, Article 41, Clause 1, Paragraph 1. *See also: Chapter 8, Section B.4.*

<sup>45</sup> LJSC, Article 41, Clause 1, Paragraph 2.

<sup>46</sup> LJSC, Article 41, Clause 1, Paragraph 2 provides that this period cannot be less than 45 days from the date of submitting (presenting in person) or publishing the notification on pre-emptive rights. Before the expiration of this period, the company does not have the right to issue shares and other convertible securities to persons other than the shareholders who have pre-emptive rights.

<sup>47</sup> LJSC, Article 41, Clause 2, Paragraph 1.

- A written statement requesting the purchase of additionally issued shares or other convertible securities, which must include:
  - The name of the shareholder,
  - The place of residence (location) of the shareholder, and
  - The number of shares or convertible securities to be purchased by the shareholder; and
- A document verifying the payment for shares or other convertible securities.

If the placement of additional shares and other convertible securities calls for payment in-kind, the Company Law also grants shareholders with pre-emptive rights the right to pay in monetary form.<sup>48</sup>

### 6. The Right to Demand the Redemption of Shares

A shareholder has the right to have the company redeem all or a part of his shares when the company:<sup>49</sup>

- Reorganizes, and the shareholder voted against the decision or did not participate in the voting on this decision during the GMS;
- Concludes an extraordinary transaction approved by a decision of the GMS and the shareholder voted against this decision or did not participate in the voting on this decision;<sup>50</sup> or
- Adopts a new version of the charter or amends the charter by a decision of the GMS, which limits the rights of the shareholder, and the shareholder voted against this decision or did not participate in the voting on this decision.

To exercise his redemption rights, a shareholder must be informed about the right to demand the redemption of his shares. The notice of the GMS that must approve the decisions that can trigger the redemption rights must include the following information about the redemption rights:<sup>51</sup>

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<sup>48</sup> LJSC, Article 41, Clause 2, Paragraph 2.

<sup>49</sup> LJSC, Article 75, Clause 1.

<sup>50</sup> LJSC, Article 75, Clause 1 provides that redemption rights arise only when the extraordinary transaction involves assets, the value of which is 50% or less of the book value of the company's assets. However, the Plenum of the Supreme Arbitration Court has interpreted this provision to include extraordinary transactions involving assets with a value of more than 50% of the book value of company's assets; see Resolution No. 19, the Plenum of the Supreme Arbitration Court, on Some Issues of Application of the Federal Law on Joint Stock Companies, 18 November 2003, Section 29.

<sup>51</sup> LJSC, Article 76, Clauses 1 and 2.

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- The right of shareholders to demand the redemption of all or part of their shares if they vote against or do not participate in the voting on specified agenda items;
- The redemption price the shareholders will receive if they demand redemption; and
- The procedure for exercising redemption rights.

The Supervisory Board must determine the redemption price, which cannot be less than the market value of shares to be redeemed as determined by an Independent Appraiser.

Shareholders have the right to submit a written request to the company to have their shares redeemed, which shall be done no later than 45 days after the GMS has approved the decision that gave rise to redemption rights.<sup>52</sup> The request must contain the following information:<sup>53</sup>

- The address of the shareholder who is demanding the redemption of his shares; and
- The number of shares the shareholder wants to redeem.

After the period for submitting requests for redemption has expired, the company must redeem the shares within 30 days.<sup>54</sup> The steps required to redeem shares are summarized in Figure 7.

### 7. Shareholder Rights During the Liquidation of the Company

Shareholders are residual claimants when a company is being liquidated, i.e. they will receive a portion of the assets remaining after creditor claims are satisfied. Owners of common shares have a right to receive a portion of the company's property in proportion to their holdings in the company. Owners of preferred shares have a right to receive the liquidation value of their preferred shares. The charter must determine the liquidation value for each class of preferred shares.

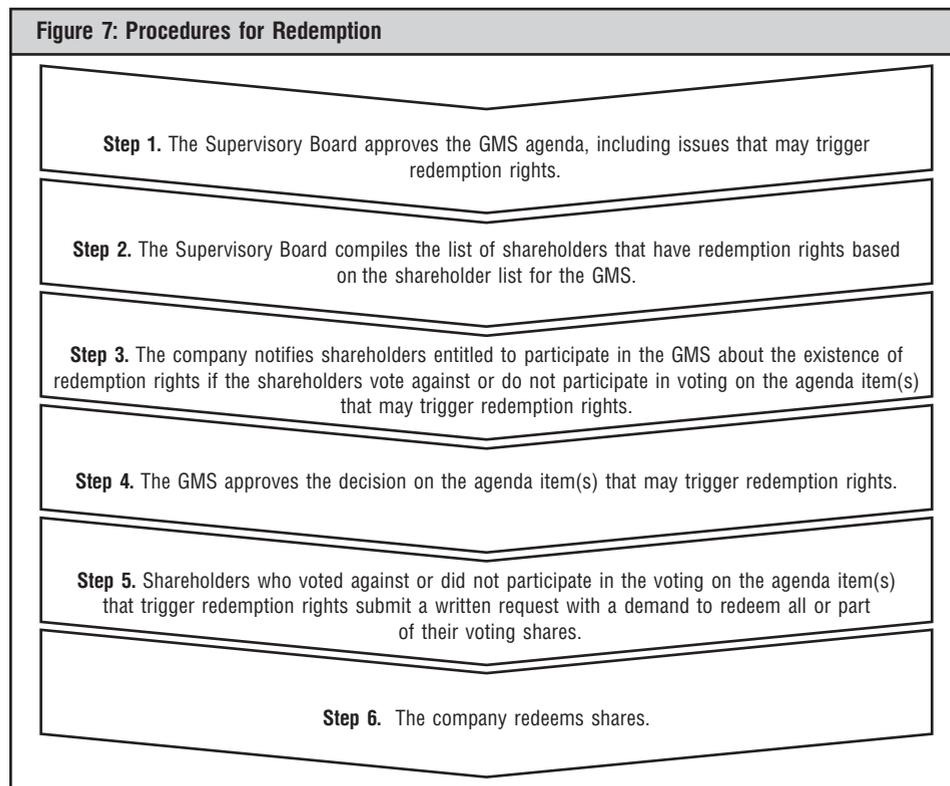
If the company has placed preferred shares of two or more classes, the charter must specify the priority of claims for each class of preferred shares.<sup>55</sup>

<sup>52</sup> LJSC, Article 76, Clause 3, Paragraph 2.

<sup>53</sup> LJSC, Article 76, Clause 3, Paragraph 1.

<sup>54</sup> LJSC, Article 76, Clause 4.

<sup>55</sup> LJSC, Article 32, Clause 2.



Source: IFC, March 2004

During liquidation, a company must first satisfy its obligations to creditors; then priority claimants (usually administrative expenses and salaries, wages, employee benefits, customer deposits, and taxes); and finally, the Creditors Committee divides the remaining assets among the shareholders following a specific order of priority:<sup>56</sup>

- 1) Common and preferred shareholders that can exercise redemption rights have the first priority to exercise their rights;
- 2) Second priority is given to preferred shareholders for the payment of declared but unpaid dividends on preferred shares and to the payment of the liquidation value of preferred shares as specified by the charter; and

<sup>56</sup> LJSC, Article 23, Clause 1.

- 3) The claims of the other shareholders with common shares and preferred shares without a liquidation value are satisfied after the first and second priorities.

The company's assets must be distributed to each group in order of priority. For example, the company cannot pay the liquidation value of preferred shares until it has paid the full liquidation value of higher priority shares.

If the company does not have sufficient assets to pay all shareholders of the same priority class, then the assets must be distributed in proportion to the number of shares in the class.

### 8. The Right to Review the Shareholder List

The company must give registered shareholders holding at least 1% of voting shares the opportunity to inspect the shareholder list within three days of a request.

This right gives shareholders the opportunity to contact other shareholders and coordinate voting for collective action purposes. It is also important for verifying the information in the shareholder list, as well as exercising rights attached to shares.

The company is obliged to provide the following information:<sup>57</sup>

- The shareholder list; or
- A document confirming that the inquiring shareholder is not included in the shareholder list.

In order to protect the privacy of shareholders, the company is not allowed to provide passport data and postal addresses to third parties without the shareholder's prior consent.

### 9. The Right to File a Claim on Behalf of the Company

A shareholder (or a group of shareholders) holding at least 1% of common shares has the right to file a claim with the court on behalf of the company to recover losses caused by:<sup>58</sup>

- A Supervisory Board member;
- The General Director;

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<sup>57</sup> LJSC, Article 51, Clause 4.

<sup>58</sup> LJSC, Article 71, Clauses 2 and 5.

- An Executive Board member; and/or
- The External Manager.

→ *For more information on the liability of directors and managers, see Part II, Chapter 4, Section F, and Chapter 5, Section E, respectively.*

### C. The Rights of the State as a Shareholder

The state can participate in a company either as an ordinary shareholder or as the holder of a “golden share.” A golden share can be established to ensure the security of the state, or protect the morale, health, rights, and interests of its citizens.<sup>59</sup> Golden shares give agencies and subdivisions of the Russian Federation the right to:<sup>60</sup>

- Propose items for the agenda of the GMS;
- Request an Extraordinary General Meeting of Shareholders (EGM);
- Veto the following decisions of the GMS:
  - Amendments to the charter or approval of a new charter,
  - Reorganization of the company,
  - Liquidation of the company, appointment of the Creditors Committee, or approval of the intermediary and final liquidation balance sheets,
  - Amendments to the charter capital, and
  - Approval of extraordinary and related party transactions; and
- Access all corporate documents.

The holder of a golden share may appoint a representative to the Supervisory Board and the Revision Commission. The representative can be replaced at any time by the body that appointed the representative. The representative is considered an official Supervisory Board or Revision Commission member.

Golden share rights can be established in the following circumstances:<sup>61</sup>

- Upon the privatization of assets of “a unitary enterprise;”<sup>62</sup> or
- Upon the removal of a company from the government list of strategic companies irrespective of the number of state-owned shares.

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<sup>59</sup> Law on the Privatization of State and Municipal Property, Article 38, Clause 1, Paragraph 1.

<sup>60</sup> Law on the Privatization of State and Municipal Property, Article 38, Clause 3.

<sup>61</sup> Law on the Privatization of State and Municipal Property, Article 38, Clause 1.

<sup>62</sup> For more details about ‘unitary enterprises’, see CC, Article 113.

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The special rights under a golden share arrangement can be exercised starting from the moment when the state sells 75% of its shares in the company.<sup>63</sup>

**Best Practices:** Although present in some other developed European countries, (foreign) investors are usually cautious about investing in companies with golden shares. Despite the fact that golden share arrangements can play a useful role in protecting the interests of the state and the public, it is recommended that state agencies carefully weigh all the pros and cons of implementing golden share arrangements for each company.

Golden shares are terminated by a decision of the body that made the decision to introduce them.<sup>64</sup>

The Russian Federation, state agencies, and municipal entities can be shareholders without a golden share arrangement. In this case, their rights are identical to the rights of the company's other shareholders.

### D. The Shareholder Register

The shareholder register is an important document that identifies the shareholders and the owners of other registered securities of the company. It can be used to verify the number, nominal value, types, and classes of shares and other registered securities held. The shareholder register is also maintained to secure shareholder rights, and to monitor the circulation of shares and other registered securities.

#### 1. Maintaining the Shareholder Register

Companies must have a shareholder register that is either maintained by the company itself or an External Registrar.<sup>65</sup> The Registrar is a professional company which maintains shareholder registers pursuant to a contract with companies. In companies with more than 50 shareholders, an External Registrar must maintain the shareholder register.<sup>66</sup>

<sup>63</sup> Law on the Privatization of State and Municipal Property, Article 38, Clause 5, Paragraph 1.

<sup>64</sup> Law on the Privatization of State and Municipal Property, Article 38, Clause 5, Paragraph 2.

<sup>65</sup> LJSC, Article 44, Clause 3, Paragraph 1.

<sup>66</sup> LJSC, Article 44, Clause 3, Paragraph 2.

A company that has transferred the register to an External Registrar remains liable for its proper maintenance and safekeeping.<sup>67</sup>

If a company decides to change its External Registrar, it must either place an announcement in the media or inform all holders of securities in writing. The company must pay for the costs of the announcement.<sup>68</sup>

## 2. The Contents of the Shareholder Register

The shareholder register must include information about the:<sup>69</sup>

- Company that has issued securities;
- External Registrar (its branches and transfer agents), if the company uses a Registrar;
- Securities issued by the company;
- Persons (owners and nominal shareholders) and number, nominal value, and state registration number of securities of each type and class placed by the company that such persons own; and
- Details about the personal accounts of registered persons and transactions with securities requiring registration in such personal accounts.

Information about registered persons must include:

- Family name, first name, mailing address, and passport data of individuals; and
- Full company name, bank account number, mailing address of the legal entities, as well as the name of the registration agency, and the date and the serial number of the company's registration.

The company cannot be held liable for any losses caused to shareholders and owners of other securities if they fail to submit the necessary information for inclusion in the shareholder register.<sup>70</sup>

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<sup>67</sup> LJSC, Article 44, Clause 3, Paragraph 4.

<sup>68</sup> Law on the Securities Market, Article 8, Clause 3.

<sup>69</sup> LJSC, Article 44, Clause 1. See also: FCSM Regulation No. 27 on the Maintenance of the Register of Holders of Securities, Section 3 for more information that must be included in the shareholder register.

<sup>70</sup> LJSC, Article 44, Clause 5.

### 3. Accessing the Shareholder Register

The following parties have access to the shareholder register:

- The company;
- Owners of securities and nominal shareholders registered in the shareholder register; and
- State agencies, in cases specified by legislation.<sup>71</sup>

Although the company has the right to obtain information from the shareholder register, it does not have the right to disclose this information. Owners of registered securities and nominal shareholders are entitled to obtain information related to their personal accounts. They do not have the right to receive information related to other owners of securities of the company.

A shareholder or a nominal shareholder can receive information from the shareholder register in the form of an extract from his personal account. The extract must be provided upon the request of the shareholder or his representative within five working days.<sup>72</sup> Information that must be included in the extract from the personal account is specified by legislation.<sup>73</sup>

The entity that maintains the shareholder register of the company is liable for the completeness and reliability of the information specified in the extract.<sup>74</sup>

### E. The Protection of Shareholder Rights

The protection of shareholder rights lies at the center of corporate governance and is of particular importance for companies operating in emerging markets or transition economies. This protection is realized both internally, i.e. through internal corporate procedures and other guarantees envisaged by the Company Law and other legislation, and externally, i.e. through outside parties.

<sup>71</sup> FCSM Regulation No. 27, on the Maintenance of the Register of Holders of Securities, Section 7, Clause 7.9.3.

<sup>72</sup> Law on the Securities Market, Article 8, Clause 3.

<sup>73</sup> FCSM Regulation No. 27, on the Maintenance of the Register of Holders of Securities, Section 3, Clause 3.4.4.

<sup>74</sup> Law on the Securities Market, Article 8, Clause 3.

### 1. Guarantees in the Company Law

The Company Law provides many guarantees to realize and protect shareholder rights. Some of these guarantees are procedural in nature and relate to the organization of the GMS. Others are reflected in the respective obligations of the governing bodies and officers of the company, i.e. Supervisory Board members, the General Director, and Executive Board members.

**Best Practices:** It is important for the charter to ensure that shareholder rights, and the mechanisms designed to ensure and protect these rights, are clearly defined.

→ See also the model charter and company-level corporate governance code in Part VI, Annexes 2 and 4.

For example, the right of shareholders to make proposals to the GMS agenda is guaranteed by the following provisions of the Company Law related to the authority and obligations of the Supervisory Board:<sup>75</sup>

- Directors cannot reject proposals on other than procedural grounds envisaged by the Company Law, thus preventing the removal from the agenda of questions that directors simply do not wish to address;
- Directors have to provide reasons when rejecting a proposal;
- Directors are required to review the proposal within a strictly defined time-period; and
- Directors are prohibited from making changes to the text of the proposal.

### 2. Judicial Protection

When shareholder rights are violated, shareholders have the right to judicial protection. This is a fundamental right guaranteed by the Constitution of the Russian Federation.<sup>76</sup> In addition, the Company Law provides remedies such as the right to appeal certain company decisions, and to sue directors and managers on behalf

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<sup>75</sup> LJSC, Article 53.

<sup>76</sup> The Russian Constitution, Article 46, Section 1. According to the Russian Constitution, Article 18, such rights are directly applicable.

## Chapter 7. An Introduction to Shareholder Rights

of the company. Table 3 provides examples of these rights, which are discussed in other chapters of this Manual.

<b>Shareholder Action</b>	<b>Legal Basis</b>
Appeal the refusal to enter data into the shareholder register.	LJSC, Article 45, Section 2, Paragraph 2.
Appeal decisions of the GMS.	LJSC, Article 49, Section 7.
Appeal the refusal of the Supervisory Board to call an EGM.	LJSC, Article 55, Section 7, Paragraph 2.
Compel directors and managers to reimburse the company for losses caused to the company by their wrongful acts.	LJSC, Article 71, Section 5.

→ For more information on enforcement of shareholder rights, see Part V, Chapter 17.

### 3. Protection by the Federal Commission for the Securities Market<sup>77</sup>

Securities legislation provides the Federal Commission for the Securities Market (FCSM) with the authority to:<sup>78</sup>

- Monitor activities of companies, brokers, stock exchanges and other professional participants of the securities market for compliance with securities legislation;
- Carry out inspections of the activities of these participants;
- Examine complaints from shareholders;
- File claims in court to protect the rights of shareholders, and to request the liquidation of entities that violate (shareholder rights) legislation; and
- File claims in courts to protect shareholder rights.

<sup>77</sup> In late March 2004 under government reorganization, the FCSM was replaced by the Federal Service for Financial Markets (FSFM). Its authorities are expected to be widened, with additional supervisory authority from the Antimonopoly and Finance Ministries. At the time of publishing this Manual, the authority of the new FSFM had not been finalized.

<sup>78</sup> Law on the Securities Market, Article 42, Clauses 10 and 19; Article 44, Clauses 6 and 7; Law on the Protection of Rights and Lawful Interests of Investors in the Securities Market, Articles 11 and 14.

The FCSM must examine complaints from shareholders within two weeks from the date a complaint is submitted.<sup>79</sup> Based on the results of the examination, the FCSM can issue a resolution to end the violating practice. Such a resolution can include penalties.

All individuals and legal entities in Russia must comply with the rulings of the FCSM. Its rulings can only be changed, amended, or repealed by the FCSM itself or a court decision.

### 4. Non-Governmental Organizations for the Protection of Shareholder Rights

Shareholders may seek assistance from associations, institutes, or other non-governmental organizations (NGOs) dedicated to the protection of shareholder rights. NGOs have the right to assist shareholders with:<sup>80</sup>

- Filing a claim in court to protect shareholder rights; and
- Establishing special funds for the protection of shareholders interests.

NGOs can play an important role in exerting pressure on companies, in particular those companies that act with wanton disregard of shareholder interests. NGOs may do this in a number of different ways. They may become shareholders themselves and participate in the GMS. They may also conduct letter or media campaigns to exert pressure on companies and draw public attention to the issue of shareholder rights protection. They also serve as discussion platforms, contribute to the drafting of legislation, and the education of shareholders, directors, and managers.

→ *For a list of NGOs, see Part I, Chapter 1, Section D.4. For the role of NGOs in enforcement, see also: Part V, Chapter 17, Section F.1.*

### 5. Shareholder Activism and Collective Action

The protection of shareholder rights begins with good corporate behavior, an appropriate legal and regulatory framework, and appropriate enforcement procedures. Shareholders themselves must, however, also play a role in this process. Shareholders

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<sup>79</sup> Law on the Protection of Rights and Lawful Interests of Investors in the Securities Market, Article 7.

<sup>80</sup> Law on the Protection of Rights and Lawful Interests of Investors in the Securities Market, Article 18.

are often the only parties who know about violations of their rights, and are in the best position to either file a complaint with the company or, ultimately, with the regulatory and judicial bodies.

**Company Practices in Russia:** The protection of minority shareholder rights remains a key concern for many (international) investors considering investing in Russian companies. Powerful owners/managers often pay little or no heed to minority shareholders. On the other hand, shareholders themselves are often passive, reflecting the lack of a shareholder culture among Russian investors. This comes as no surprise since citizens (often former employees of plants and factories) became shareholders practically overnight during the privatization phase, typically without having invested (material) funds before or having been educated about their rights. This makes the role of regulatory and supervisory bodies, as well as shareholder NGOs, even more important in ensuring that proper attention is paid to the protection of shareholder rights.

Another aspect of shareholder rights protection is collective action. Collective action is when a group of shareholders, who are unable to attain a right on an individual basis, combine their votes to reach a threshold to obtain the right collectively. Legislation provides for most of the above-mentioned rights to be exercised collectively. Moreover, the Company Law also provides shareholders with access to shareholder lists that helps them contact other shareholders to solicit their cooperation.

### 6. Shareholder Agreements

Shareholder agreements can be an important device for exercising collective action among shareholders. In fact, such agreements can enable minority shareholders to make use of minority rights (e.g. acquiring the 10% necessary to request an extraordinary inspection of business and economic affairs of the company). The situation is more complex if agreements are concluded between shareholders and the company (or one of its governing bodies). In those circumstances, shareholders may be “locked in” in a variety of ways, e.g. by obliging themselves to always vote in favor of proposals by directors or to always follow the instructions of management in matters relating to essential shareholder rights (the right to sell their shares, the right to receive dividends, and other rights).

**Best Practices:** Shareholder agreements can often be used to abuse shareholder rights and force (minority) shareholders to act in a certain way that is suitable for directors, managers and/or controlling shareholders. Therefore, such agreements must be carefully regulated. For example, in the U.K., shareholder agreements cannot require a shareholder to vote in one of the following ways:

- Always to follow the instructions of the company or one of its bodies;
- Always approve the proposals of the company or one of its bodies; and
- To vote in a specified manner or abstain in consideration of special advantages.

Shareholder agreements are, in principle, a form of private, civil law contract. Yet, because of their corporate governance implications, it is necessary to make certain provisions. First, shareholder agreements cannot substitute (or contradict) the founding documents of the company. It is the founding document (charter) that is mandatory, publicly regulated, and subject to disclosure (according to the state registration regime and/or securities regime). Second, it is necessary to prevent the above-mentioned forms of abuse of the ability to control the voting power of minority shareholders by prohibiting the inclusion of certain terms in such agreements. Lastly, it is necessary (particularly for publicly traded companies) to provide for greater transparency of voting control by requiring the disclosure of such arrangements.

### F. Responsibilities of Shareholders

In addition to rights, shareholders also have responsibilities. The main legal responsibilities of shareholders are to:

- Pay the full value of shares that they have acquired;<sup>81</sup> and
- Inform the Registrar about changes in their status.<sup>82</sup>

Other responsibilities may exist. They may include disclosure obligations when certain thresholds of ownership are passed, or disclosure of the intent to acquire

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<sup>81</sup> LJSC, Article 34, Clause 1.

<sup>82</sup> LJSC, Article 44, Clause 5.

## Chapter 7. An Introduction to Shareholder Rights

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further shares or gain control of a company. These additional responsibilities generally apply to larger shareholders, and are described throughout the Manual.

→ *For a discussion on the disclosure of beneficial ownership, see Part IV, Chapter 13, Section B.3.*

Under certain conditions, shareholders may be held liable despite their limited liability. In particular, this refers to controlling shareholders who have the opportunity to determine the actions of or give mandatory instructions to the company.<sup>83</sup>

**Best Practices:** Finally, in some countries, shareholders, especially institutional investors, may be required to vote their shares. In other countries, there is no legal requirement but it may be considered a moral imperative. While no legal requirements for voting exist in Russia, good corporate governance depends heavily on the active participation of shareholders in the governance of the company.

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<sup>83</sup> LJSJ, Article 3, Clause 3, Paragraph 1.