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presents

**Stocks and Rights:
Protection of the rights of minority shareholders in Belarus**

Analysis and recommendations¹

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1. Introduction

The Belarusian stock market has been in a virtual frozen state for the past 10 years. This year's abolition of the moratorium on the sale of shares acquired by individuals during the privatisation process raised certain hopes. Despite this, the level of protection of the rights of minority shareholders remains significantly weaker than that of other countries, particularly in Europe and the US. With the imminent start of the privatization process in sight, there exists a real danger that minority shareholders' rights will be violated. Without a change in current legislation, the situation may arise whereby shareholders may demand rights, leaving the judicial process unable to cope. In turn, this may result in the further freezing of share market.

This paper calls for an abandonment of the attitude of the past and the introduction of minority shareholder's rights protection, comparable with that of the US and the EU. Specifically, we recommend the following as steps to ensure minority shareholders' rights are respected.

1. Ensuring a fair price for share purchase from minority shareholders and defining the notion of a fair price in law.
2. Expanding the right to a court hearing in the case of a shareholder's discontent with the purchase price; introducing the possibility to file claims at the expense of the company; and the recognition that further training of judges is required.
3. Creating a system of pre-court investigation for the claims of minority shareholders, parallel to the system of arbitral bodies.
4. Introducing the possibility to file a claim of unfair treatment by a minority shareholder.
5. Defining the procedure for transforming a joint-stock company with small gains into a private company and for buying out shares from shareholders of such joint-stock companies.
6. Increasing access to information about the activities of a joint-stock company to shareholders and potential investors.
7. Toughening and reinforcing liability for the use of insider information and committing other trading breaches concerning the securities and stock market.

2. Analysis

2.1. Redemption rights in Belarus

Legislation abroad provides for a series of mechanisms for the protection of shareholder's rights which clearly stipulate their rights. These include taking part in shareholders' meetings, managing the company and receiving information. However the bulk of such rights bears not much significance for Belarusian citizens, who became shareholders during the course of the mass privatisation drive, as they cannot exercise these rights due to various reasons; be it the lack of economic and legal knowledge or the lack of time and will to become part of corporate management.

For such passive shareholders, there is in fact only one significant measure of protection, which is the possibility to refuse to sell their shares at undervalued rates. It is exactly this right which is in dispute.

Internationally, this right (known as a redemption right) is usually seen as a means of protection for minority shareholders to guard themselves against the actions of majority shareholders.

The minority shareholder is not entitled to a mandatory purchase of their shares without good reason. In some countries the mandatory redemption right is granted to minority shareholders when one individual receives a controlling share. This is the case in the EU and in the Russian Federation.

Belarusian legislation regulating redemption rights is significantly weaker than international standards, despite the existence of the 1992 law №2020-XII which grants the redemption right in cases such as the re-organisation of a joint-stock company; the adoption either of a new statute or of changes and additions to the existing statute restricting shareholders' rights; and in a major undertaking of a joint-stock company.

The mechanism of price setting also seems to cause concern. The price at which a joint-stock company can buy its shares at the request of its shareholders is defined in line with legislation and approved at a general meeting of shareholders where a decision which may include the demand for the redemption right of the shareholder is made.

Unlike in law abroad, the problem facing Belarus is that existing legislation does not provide for setting a fixed price, which leaves the shareholder unprotected against the company. The requirement to endorse the price of selling the shares at a shareholders' meeting is strange too, as it appears that the determination of the price at which they can be bought by the public company can be made at any meeting.

Belarusian legislation does not envisage strict requirements for the procedure for notifying the shareholder of their right to demand redemption of shares; for the time frame during which the joint-stock company must make such a notification; for the procedure and deadline for requesting the buyout of shares; or the procedure for and period during which the company must either satisfy the demand for buyout of shares or inform the shareholder of rejection of their demand.

All these rules should be defined in the joint-stock company's statute. Companies can seemingly act as they wish, without taking into consideration the rights of minority shareholders.

2.2. The right to judicial protection

Of no less importance is another mechanism for protecting the rights of minority shareholders, namely the right to initiate claims against the company.

In the UK, a shareholder has the right to file a claim in the court against a company in the case that it is mistreating all or some of its shareholders. The courts may impose certain changes in the company's activities, initiate a civil suit on behalf of the company (against its management) or ensure the purchase of shares belonging to the discontented shareholder. The shareholder is also entitled to file a derivative claim on behalf of the company.

The situation regarding judicial protection in Belarus is poor. Belarusian law stipulates that the shareholder entitled to a buyout of their shares has the right to appeal for a refusal of buyout by the company within six months following receipt of the rejection. This clearly does not protect shareholders at all, as it implies that the shareholder forfeits their right to file a suit after six months.

The 1992 Law No 1512-XII *On Securities and Stock Exchange* has a chapter devoted to the protection of shareholder's rights. However, the law does not elaborate on either the shareholder's right to a court hearing at the expense of the joint-stock company or on any other special rights of minority shareholders. It only stipulates that offers to purchase shares addressed to all shareholders, shall be regulated by the rules set by the central body. Such an offer must be made at the same price for all shareholders, although requirements for setting the price rate are not mentioned.

2.3. Protection from unfair treatment

UK law entitles a shareholder to file a claim for unfair treatment. No Belarusian court will accept such a claim, yet there is a great need to introduce this, especially as shareholders are at increased risk of unfair treatment by company leadership in Belarus.

The right of the shareholder to leave a company in the case of unfair treatment should be enshrined in law. It may be sensible to create special funds of direct investment, which can buy out shares of such joint - stock companies from minority shareholders under specific circumstances, for example for a lack of dividends or their undervalued price.

2.4. Fair value

A key element in the protection of shareholders' rights judicially or by other means is the notion of fair value. In principal it is a calculated value of shares which would exist in the ideal market, when both the buyer and the seller expose complete information about the shares in question.

The real market value nearly always differs from the fair value, which is an important distinction. However, the value of shares is considered to be approaching with time the ideal one. Significantly, there is no single method of calculating the fair value.

One method is by comparing their value with the value of shares of other enterprises. Since there are no market prices in Belarus yet, it is not possible to determine the necessary ratio of value to profit. But knowledge of the ratio in other countries can help determine the share value in Belarus.

Other methods which exclude the possibility of profit manipulation include those which use the data on net gains. Significant differences in the accounting systems of Belarus and other countries make it difficult to say to what extent the book value of an enterprise corresponds to its assets.

A fair value can ultimately be defined as the mean average of those derived through a number of different methods taken alongside other indices.

2.5. Transparency of information

Information transparency plays an important role in protecting the rights of minority shareholders.

In recent years, the US saw a series of corporate scandals in connection with management abusing their position (most famously *Enron*).

As a result of the 2002 Sarbanes-Oxley Act, US shareholders have access to a large volume of information about the activities of companies, for example through annual reports, shareholders' registers and proxy statements.

Belarus has nothing of the sort. A Belarusian shareholder is only entitled to receive an annual report, but can access the websites of the Belarusian Foreign Stock Exchange and the Securities Department of the Finance Ministry which contain more information. These public websites publish a range of financial indicators of joint-stock companies, such as gains, profit and debts.

2.6. Fight against fraudsters

Shareholders' rights can be violated not only over the course of a company's operation but also while concluding shady deals on the market through suspect insider trading.

Nearly all deals must be executed at the Belarusian Stock Exchange through the intermediary of professional stock dealers, which is meant to ensure protection of the rights of minority shareholders. A professional broker must familiarise the parties of the deal with all necessary information and attach a corresponding note to the contract, which is signed by all parties.

The experience of the early years of privatisation in Belarus has shown that when a great number of people receive shares without an understanding of the process, management or external investors buy them out en masse at undervalued prices.

In order to stop potential fraudsters, the stock exchange has adopted a monitoring directive, alongside legislation which incorporates a series of bans on insider trading.

The existing system seems adequate, but two important elements are absent. Firstly, punishment for different breaches of the law is not prescribed and secondly, there is no special body which can hear complaints from minority shareholders. Such bodies exist in other countries, such as the Panel on Takeovers and Mergers in the UK.

3. Conclusion

The analysis conducted leads to a conclusion that if active operations with shares begin now in Belarus, then the rights of minority shareholders will be violated en masse. Belarusian legislation lacks the norms necessary for their protection. Shareholders will demand protection. As a result, bodies regulating stock operation will find themselves overloaded with cases for which they are currently unprepared. This in turn, may cause a further freezing of the share market.

Belarusian legislation must now be amended in order to increase the degree of protection for minority shareholders at least to the level which exists in other countries. For this purpose, an expert regulation group should be established, which would be tasked with drafting necessary amendments.

A possible objection to reform could be that increasing the protection of shareholders will create obstacles for the primary accumulation of capital in Belarus, as it would prohibit company management from buying up shares at undervalued prices.

Changing company law bears special significance for attracting investment from minority shareholders. There exists the perception of investment in Belarus as being some kind of unfair lottery or gambling. But it is of crucial importance to change public opinion in this regard in order to develop a market economy in Belarus.