Central European University

International Business Law Program

Hostile Takeovers in the Kyrgyz Republic

In partial fulfillment of the requirements for the LLM degree

Written by: Aiganysh Daudova

Advisor: Prof. Tibor Tajti

2012, March

Budapest, Hungary

Abstract

This thesis paper examines the legal phenomenon of hostile takeovers in the Kyrgyz Republic. The goal of the present work is to identify what Kyrgyz hostile takeover is? And what is the relation with its western analogue? This research work provides an analytical framework for business law development in explaining the diversity of hostile takeover regimes in Kyrgyzstan and U.S.A. The framework identifies the problems of corporate law in response to market developments. And it emphasizes the role of lawmakers in filling the gaps left by legislative inaction. The research work also highlights the current state and possible future development of hostile takeover. Recommendations directed towards implementation of anti-takeover defense mechanisms, increased level of CEO's personal liability, introduction of management evaluation concepts, and lastly, accurate legal provisions. This work is based on comparative, historical analysis and logic reasoning methods.

Table of Contents

Abstract ii

TableofContents iii

Introduction 1

Chapter I The Notion and Development of Hostile Takeovers 3

1.1 The case of United States of America 3

1.2 Proxy contest 7

1.3 Tender offer 9

Chapter II Market for Corporate Control: Kyrgyz Style 13

2.1 Hostile takeovers in the Kyrgyz Republic 13

2.2 Scenarios 17

2.3 Legal framework 24

Chapter III Recommendations 31

Conclusion 34

Bibliography 36

Introduction

In the presence of the financial crises, many companies seek the survival in any other form of merger and acquisition. Companies try to synergy their capital on the principle “bite or I will bite you”. Thus the corporate takeover met its new wave in the history of the corporate world. For the past century market witnessed many waves of corporate takeovers and with every one of it the methods and strategy have improved. In the international arena the amount of the jack pot does not account in 100 % of profit, but it counts in 1000 %. Therefore corporate raiders have developed schemes to maximize profit with minimum losses.

Raiding appeared in the Kyrgyz Republic during the 1990s in the form of racketing. Through its evolution hostile takeovers reached its expansion during March 2005 and April 2010 revolutions. Acquiring companies took advantage of instable political situation and obtained control of target companies. The raiding emerged through legal as well as illegal methods. The debate is expanding on whether Kyrgyz raiding is a hostile takeover or not. Moreover in 2009 the Parliament recognized the need of eliminating some loopholes and recognizing hostile takeover problems in private property sphere.

The main purpose of the work is to identify the existence of hostile takeover institute in the Kyrgyz Republic. As a result the following research questions will be answered in order to achieve the purpose of the current work. Firstly, what is a hostile takeover in the developed countries? And what are the differences or similarities? Secondly, what is the efficiency of anti-raiding legal framework? What are the reasons of hostile takeovers? And what are the following recommendations based on found results?

In order to answer the above stated questions I will analyze the hostile takeover institute in comparison to the western analogue. Therefore United States of America was chosen. This country proved to be a leader in its legislative development and court practice.

Moreover, it is the country where corporate takeovers had appeared. Thus for the purpose of the present thesis work U.S.A. will be examined as a country model.

The thesis paper is based on researches and works of the Russian, Kyrgyz and American legal scholars and practicing lawyers. The Russian experts were used due to the lack of Kyrgyz scholars' work on this matter, and for the reason of similarity in the historical and legal essence. For the purpose of deep understanding of the historical roots and development of the corporate takeover institute, I used a historical analysis. Furthermore, in order to identify problematic aspects and trends of the development, a comparative analysis of legislation was used. For the comparative analysis I have used interdisciplinary provisional analysis of merger and acquisition institute: civil legislation, tax legislation, legislation on security exchange market. As a result comparative and historical analysis and logic reasoning were conducted in the current research.

The structure of the thesis paper reflects its goal, and presents the following content. Starting from description of the notion and historical development of this institute, I will identify terminology problems and answer the question why do we need this institute and what are the justifications behind, particularly focusing on: proxy fight and tender offer methods since they are most close to the Kyrgyz market. Furthermore, I will focus on hostile takeover in the Kyrgyz Republic through the examination of private ownership protection, presentation of main hostile takeover schemes and the scrutiny of legal-normative acts. Finally, based on the analysis I will provide recommendations towards general improvement of corporate governance.

Chapter I

The Notion and Development of Hostile Takeovers

1.1 The case of United States of America

Hostile takeover transactions are one of the most interesting methods in the Mergers and Acquisitions (hereinafter - M&A) sphere. Because companies see the opportunity to profit from a takeover bid this technique is still being used and developed despite restrictions and limitations within the law. In Kyrgyzstan M&A is relatively new institute and takeover field is in particular. In order to answer the main question of the present thesis paper I will start with analysis of emergence and evolution of this institute in United States of America. This country is chosen due to the developed legislation and established practice, also U.S.A. is considered as a motherland of hostile takeovers. Therefore in this chapter I will begin with terminology analysis, also I will discuss the aims and motives that cause hostile takeovers in U.S.A., and finally I will focus on two common takeover techniques such as proxy contest and tender offer.

The market of M&A in the Kyrgyz Republic is in its developing stage. Therefore the discussion of the terminology is at a current interest of scholars. First of all, there is a different understanding of merger in Kyrgyz and U.S.A. Particularly, Art. 13 of Law on Joint Stock Companies (hereinafter Law on JSC) defines merger as the unification of two or more companies by dissolving the existing ones and creating a single new one (A + B = C).[1] But according to U.S. Delaware Corporation Act the same transformation is defined as a consolidation: "two or more corporations may consolidate into a new corporation formed by the consolidation."[2] On the other hand U.S. interpretation of merger is defined in Art. 14 of

[1] Art. 13 Law on Joint Stock Companies (2003) #64, last amended October 12, 2009 #264.

[2] Del. Code Ann. tit. 8, §251(a), (1897).

Law on JSC as accession "the absorption of one or more companies that ceases to exist into another that retains its own name and identity and acquires the assets, rights and liabilities of the former ones."[3](A + B + C = A). Even though M&A is a commonly used institute, nevertheless legislations have different interpretations of the definitions. And as speaking to acquisitions as takeovers, Kyrgyz legislation does not provide any legal definition. Therefore more commonly takeover is referred to accession.

Due to the fact that there is no legal "takeover" definition authors give own interpretation. Patrick Gaughanin its book "Mergers, Acquisitions and Corporate Restructurings" states that: "This term is vaguer; sometimes it refers only to hostile transactions, and other times it refers to both friendly and unfriendly mergers."[4] M. Ioncev in his book defines takeover as establishing full control over the stock or the assets in a legal and physical sense.[5] But what is the difference between takeover and hostile takeover? Some scholars separate those terms, others argue that they are synonyms. However neither "takeover" nor "hostile takeover" definitions include illegal mechanisms, which are so close to the current Kyrgyz market condition. Personally I take position of author, who differentiates takeovers from "hostile takeovers" and "takeovers through illegal methods."[6] Kyrgyz market due to the number of factors commonly sees both cases through variety of scenarios, which will be discussed in Chapter 2.

Hostile takeover is a method, which requires money investment, a thorough due diligence and time. So what are the motives behind that stimulate companies to be willing to put their resources? Takeover motivations have been widely analyzed among legal scholars. Generally, authors such as Peacock A. and Jensen M. focus on the following takeover motives: First of all, in acquisition of an existing business there is a rapid means of expansion with self

[3]Art. 13 Law on Joint Stock Companies (2003) #64, last amended October 12, 2009 #264.
[4]Patrick Gauhgen, *Mergers, Acquisitions and Corporate Restructurings*, 12 (4th ed. 2007).
[5]M.G. Ioncev, *Korporativnye zahvaty: sliyaniya, poglosheniya, greenmail*, [Corporate takeovers: mergers, acquisitions, greenmail], 176, published by Os'-89, Moscow (2003).
[6]Ibid.

network, business, established strategy and channels of distribution.[7] Gaining control over the existing company saves time and money. Secondly, a hostile takeover can be a cheaper alternative to the regular market purchase. If a company is marked as a target, it is probably at the low point of stock market cycle or its shares are being sold at a substantial discount.[8] Acquiring company seeks that the present value of the company would be lower than the future returns.[9] Further, takeovers commonly occur because changing technology or market conditions require restructuring of corporate assets. New managers with a fresh view of business and no ties with current employees or communities have a higher chance of succeeding in making such changes.[10]Next reason relates to the takeover protection, where acquiring companies work to make company larger as a security against another hostile bid.[11]Small companies have better protection by uniting their powers against bigger acquirers. Therefore united companies will have better resources for performing defense measures. Another motive that drives companies to obtain control is to eliminate competition. Acquiring the other company creates a monopoly by absorbing similar businesses. However the Security Exchange Commission strictly regulates transaction in order to avoid monopoly and protect market.

Further, the tax planning options provide that a transaction of stock for stock is non-taxable, but a transaction of cash/debt for stock is taxable.[12] As a result tax cause has been widely discussed as one of the motivations for hostile takeovers. In her research, Carla Hayn developed evidence on the role of tax factors versus other factors in different types of Mergers

[7]Alan Peacock, Graham Bannock, *Corporate Takeovers And The Public Interest : Report Of An Inquiry Conducted For The Joseph Rowntre*, 10, Aberdeen : Aberdeen University Press (1991).
[8]Ibid.
[9]Ibid.
[10]Michael Jensen, *Takeovers: Their Causes and Consequences*, v. 2 # 1 Journal of Economic Perspectives, 21, 23 (1988).
[11]Alan Peacock, Graham Bannock, *Corporate Takeovers And The Public Interest : Report Of An Inquiry Conducted For The Joseph Rowntre*, 11, Aberdeen : Aberdeen University Press (1991).
[12]F. Weston, K. Chung, J. Siu, *Takeovers, Restructuring and Corporate Governance*, 61, Prentice Hall, New Jersey, 61 (2nd ed. 1990).

& Acquisitions. Her research was based on six hundred forty (640) target firms. By tax status fifty four percent (54%) were taxable; forty six percent (46%) were tax free or partly taxable. More than fifty percent (50%) were taxable transactions.[13]In addition, Auerbach and Reishus in their research of three hundred eighteen (318) mergers showed that tax benefits were not significant factors in majority of large acquisitions.[14]Overall, Hayn's conclusion was that "tax benefits do have an influence on tender offer transactions, but the magnitude does not explain the size of premiums that are paid nor it is likely that taxes generally are motivation force behind acquisition decision."[15] As a result of mentioned studies it is clear that tax reason is not a sole motivator for hostile takeover transactions. Acquiring company tent to see more advantage rather than just tax benefits.

Lastly, at the end of 1980s the hubris theory appeared as a justification for takeovers. This theory is based on lack of thoroughness of investment projects of excessive risk aversion and on high ambitions ("hubris") of managers who act as head of corporations.[16] Roll stated that the main problem is that entrepreneur discovers just "hubris", thinking that he/she could estimate the potential value of the firm better than the market. In practice takeover decision is based on a solid estimation rather than on an investor's excessive hubris.[17] I disagree with Rolls theory and as other scholars consider it weak, because acquiring companies spent a lot of resources in due diligence and other preparations before the acquisition. Obviously, there are many causes that stimulate companies to gain control of the target company through a hostile takeover method. Some reasons proved its worth in reality, some are still debatable.

[13]F. Weston, K. Chung, J. Siu, *Takeovers, Restructuring and Corporate Governance*, 61, Prentice Hall, New Jersey, 61 (2nd ed. 1990).
[14]Jarnell G., Brickly J., Netter J., *Market for Corporate Control: the Empirical Evidence Since 1980*, v.2, #1, Journal of Economic Perspectives, 48, 56 (1988).
[15]Weston F., Chung K., Siu J., *Takeovers, Restructuring and Corporate Governance*, 61, Prentice Hall, New Jersey, 66 (2nd ed. 1990).
[16]A.D. Radygin, *Vneshnie Mehanizmy Korporativnogo Upravleniya. Nekotorye Prikladnye Problemy*, [External Mechanisms of Corporate Governance: Some Practical Problems], 53, IET, Moscow (2006).
[17]Ibid.

The above discussed justifications advice raider to choose the takeover method. In this part I will analyze the common used techniques which can find its overlap in the Kyrgyz hostile takeover schemes. The primary methods to achieve control of a company without the consent and cooperation of the target board are "proxy contest" or "hostile tender offer". Also both methods may be combined as part of a unified hostile takeover strategy.[18]

1.2Proxy contest

Until the 1960s, proxy contest was one of the primary methods of changing corporate control through replacement of target company's board.[19]Proxy fights have been on the rise since the mid-1980s. The increased willingness of institutional investors to vote against incumbent managers and in favor of the insurgents was one of the factors promoting proxy contests. Voting their shares against management in a proxy contest is an alternative means by which institutional investors may express their dissatisfaction, while reducing chances of potentially damaging economic consequences.[20]The primary regulators of proxy contest are the Security Exchange Commission and the federal courts. Proxy solicitations are made pursuant to Section 14(a) of the 1934 Security Exchange Act and require that any solicitation be accompanied by the information set forth in Schedule 14A.[21]

Stach M. differentiates between three types of proxy fights: the classic proxy fight, shareholder proposal (solicitation for economic proposal or corporate governance proposal) and a combination of tender offer and proxy fight. In a classic proxy fight insurgents seek to elect their slate candidates for board of directors' positions in opposition to the current management. With new directors, insurgents will adopt the proposal for the company. Hence, companies developed a defense mechanism towards classic proxy fight. The implementation

[18]J. Armour, J. Jacobs, C.Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: an Analytical Framework*, Harvard International Law Journal, 219, 12 (2011).
[19]Ibid.
[20]Mark A. Stach,*An Overview of Legal and Tactical Considerations in Proxy Contests: the Primary Means of Effecting Fundamental Corporate Change in the 1990s*, George Mason University Law Review, (1991).
[21]Patrick Gauhgen, *Mergers, Acquisitions and Corporate Restructurings*, 268, (4th ed. 2007).

of staggered or classified board elections decreases the chances of winning fight for control of the board.[22] In this case companies elect only minority of the board's members at each annual meeting. This precludes the insurgents from electing a majority of the board at one meeting and immediately implementing their takeover agenda. The staggered or classified board provision may force insurgents to wage at least two successful proxy fights in order to elect enough directors to gain control of the target's board. In cases where classic proxy fights are not effective, Stach M. states that insurgents can offer a proposal. There are usually two types of shareholder proposal. It can be a proposal for economic reform, which generally calls for a "bust up" or "spin off" designed to require the board of directors to sell all or part of the company. Or a proposal of corporate governance can be made, which often calls for redemption of rights plans. In a last type of combination of tender offer and proxy fight, the acquirer first purchases a number of shares below the threshold level necessary to trigger the sterilization provision and then wages a proxy fight to gain control of the board.[23] If the acquirer wins the proxy fight, the new board recommends that the shareholders vote to give acquirer full voting rights. The acquirer then votes its shares in favor of takeover proposal.[24] Lastly, Stach M. argues that business combination statutes impose restrictions on transactions between the "target company" and "interested shareholders". If the transaction is conducted and approved by the target board before acquirer became an "interested shareholder", then the restriction is not applicable. Therefore in case of a dispute, the timing of the transactions and communications are very important.

Proxy contest is the first takeover method which appeared in the corporate market. The long history of its development gathered scholars who are favoring this method, and the ones who consider ineffective and too expensive. Becht, Bolton and Röell debate why proxy fights

[22]Mark A. Stach, *An Overview of Legal and Tactical Considerations in Proxy Contests: the Primary Means of Effecting Fundamental Corporate Change in the 1990s*, George Mason University Law Review,2, (1991).
[23]Ibid.
[24]Ibid., 3.

are often unsuccessful. According to them, firstly, the incumbent management has advantage in campaigning for shareholder votes as it has access to corporate information. Management can use their access to shareholder list for threatening them or blackmailing, or selling information to raiders. Furthermore, management can pressure institutional investors to vote for them through same blackmailing means.[25]Moreover in support, scholars Bebchuk and Hart also concluded that straight proxy fights are likely to be ineffective[26]. I disagree with radical elimination of proxy contest as a takeover method. This technique has its benefits, the issue is to evaluate the target and estimate the success of proxy fight. Overall I agree with Bebchuk and Hart who also propose the use proxy contest in combination with tender offer.

1.3Tender offer

In the mid 1960s the hostile tender offer gradually replaced the proxy contest. Acquirers preferred the tender offer for its comparatively lower cost and greater speed. The tender offer permits the interested company to bypass the board of the target firm and directly deal with stockholders.[27] Tender offers are regulated by the Williams Act of 1968 which is a series of amendments to the Securities and Exchange Act of 1934. These changes were made in response to the abusive tender offers used previously. First, the Act requires a disclosure by any person or group that obtains 5% of a class of securities.[28] It also limits the initial "stake" that a bidder can acquire before the market becomes aware of the increased possibility of a premium bid. Secondly, the Act requires disclosure by bidder upon the making of a tender offer and upon the seriatim resignation of directors that often accompanies transfer of

[25]M. Becht, P. Bolton, A. Röll, *Corporate Governance and Control*, Finance working paper № 02/2002, updated August 2005.
[26]L. Bebchuk, O. Hart, *Takeover Bids vs. Proxy Fight in Contest for Corporate Control* (2001), available at http://www.nber.org/papers/w8633.pdf, (last visited March 29, 2012).
[27]J. Armour, J. Jacobs, C.Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: an Analytical Framework*, Harvard International Law Journal, 219, 12 (2011).
[28]Security Exchange Act, P.L. 112-90, Sec. 13(d)(1).

control.[29] Next, it regulates the substantive terms of a bidder's offer to shareholders, to prevent bidders from rushing target shareholders into quick decision.[30] In addition, Act added general antifraud provision that applies specifically to tender offer.[31] It requires the target management to comply with SEC rules in connection with recommendations to shareholders concerning whether to accept tender offer.[32]Even though the Williams Act is an indispensable regulation on tender offer, nevertheless, it does not provide a definition. Jarnell G. defines a tender offer as a method where the bidder makes an offer directly to shareholders to buy some or all of the stock of the target firm.[33]Authors differentiate tender offers into friendly or hostile. He specifies that a friendly tender offer refers to proposals that are supported by target management. But the most controversial type of takeover is the hostile tender offer, which is an offer that is opposed by target management.[34]Therefore the definition of a tender offer seems pretty easy to understand. However the case numbers on disputes regarding the validity of tender offers are increasing. And since the Williams Act is silent on tender offer definition, courts later developed the Eight Factor Test. It contains following conditions:[35]

1. Active and widespread solicitation of public shareholders for the shares of an issuer.
2. Solicitation made for the substantial percentage of an issuer's stock.
3. Offer to purchase made a premium over the prevailing market price.
4. Terms of the offer firm rather than negotiated.
5. Offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased.
6. Offer open only a limited period of time.

[29]Security Exchange Act, P.L. 112-90, Sec.14(d)(1).
[30]Ibid., Sec. 14(d)(5)-(7).
[31]Ibid., Sec.14(e).
[32]Ibid., Sec. 14(d)(4).
[33]Jarnell G., Brickly J., Netter J., *Market for Corporate Control: the Empirical Evidence Since 1980*, v.2, #1, Journal of Economic Perspectives, 51, 56 (1988).
[34]Ibid.
[35]Patrick Gauhgen, *Mergers, Acquisitions and Corporate Restructurings*, 240, (4th ed. 2007).

7. Offeree subject to pressure to sell his stock.

8. Public announcements of a purchasing program concerning the target company precede or a company rapid accumulation of larger amounts of the target company's securities.

Those factors work as guidelines for courts in evaluating the validity of the offer in dispute settlements with consideration of additional factors on case-by-case basis.

What is the process of tender offer? Ribstein L. states that tender offers generally involve three stages. At the first stage the acquiring company buys a stock on open market.[36]This purchase before market is aware of the bidder's intent, allows them to buy stock before price goes up (without premium). In the second stage, the tender offeror places advertisement to buy more shares at the price significantly above the current market price. So there are three options for the shareholders: 1) to do nothing, 2) to sell stock in open market (likely to arbitrageur) or 3) to tender their stock to bidder. In the third stage, the bidder is using its previously obtained control to cause the acquired company to merge with another one wholly owned by bidder. Following the merger bidder will "squeeze out" minority shareholders through exchanging their shares in the acquired firm for cash, new securities or combination of both. Thus bidder is obtaining 100% control of target firm.

The appearance of tender offer significantly influenced in hostile takeover evolution. From the beginning acquiring companies favored this method, but treated harmfully the target itself. As a result SEC limited and guided tender offer transactions. Courts also establish practice and supervise its implementation. Nevertheless, raiders get inventive and use now the combination of proxy contest and tender offer. Overall, U.S. companies are major participants in M&A market, thus it sets and develops practice and new tendencies. The growth of hostile takeovers in U.S.A. cannot be compared to the Kyrgyz market. However, the Kyrgyz M&A

[36]Larry E. Ribstein, Peter V. Letsou, *Business Associations,* New York : M. Bender, 779,(4th ed.2003).

arena should use the knowledge, mistakes and practice. The next chapter will be devoted to the hostile takeovers in the Kyrgyz Republic.

Chapter II

Market for Corporate Control: Kyrgyz Style

2.1 Hostile takeovers in the Kyrgyz Republic

After the collapse of the Soviet Union the Kyrgyz Republic faced the fact of independent operation. The Kyrgyz Republic had to quickly reanimate the economy in order to play the game with standard rules. As a new player it had to take certain steps to be in compliance with the regulations. The market reforms consisted upon four main elements: stabilization, liberalization, privatization and institutional reforms.[37] Government proposed plan of improvement in order to escape the collapse and to provide stable platform for the upcoming reforms. The following step was to adopt its own legislation, through which a private property concept was introduced. This change obliged state to provide personal ownership protection. Therefore Kyrgyz Constitution declared private property as inviolable and it allowed property exemption only through the court decision.

This significant change led to a boom of privatizations. Especially during the beginning of 1990s country could not afford to administer independently all state properties located within its territory such as factories, plants, agricultural objects, enterprises and etc. The KR had to sell or give it in trust management. Kozarzewski P. illustrates the development of Kyrgyz privatization policy in several phases. At first stage (1991-1993), the main accent was made on the small privatization of trade objects, catering and consumer services, and management employee buyouts. The second phase during 1994-1997 consisted of the mass privatizations and as a cause it led to enfranchisement of insiders. Next period started in 1998 and it mainly performed case-by-case deals. And lastly after the March revolution of 2005 and following April revolution of 2010, the privatization process was de facto put on hold. Kozarzewski P. concludes that in the end the Kyrgyz government set to many goals for

[37] Robert W. McGee, *Corporate Governance in Transition Economies*, 255, Lighting Source UK Ltd., (2008).

private property reform. Government saw privatization mechanism as a key to most of the problems.[38] Introduction of private ownership policy stimulated the first development and growth of business sector. Hence, as a result to it other people used this time in their own advantage through illegal methods of racket and raiding. Raiders gained alien property through legislation loopholes. And the early development stage of Kyrgyz legislation and economy stimulated its expansion. As a consequence of later amendments and reforms government began the fight with hostile takeover phenomenon. Even though it has been twenty years since the independence and establishment of the new country, Kyrgyzstan is still in the process of its growth. As a result the recent research of Heritage Foundation and World Economic Forum reflects the current unstable situation in the country as whole.

This chapter is devoted to explain the existence of hostile takeovers in Kyrgyzstan and to emphasize the main causes of its expansion. Firstly, I will analyze the country's evaluation by the Heritage Foundation and World Economic Forum institutions. Next, I will illustrate the most common hostile takeover scenarios, such as stock share manipulations, forced bankruptcy and mercenary management and more. Lastly, I will analyze efficiency of the recent legislation amendments.

The Heritage Foundation is conducting the research on the world economic freedom by ranking countries.[39] The 2012 research shows that the KR is on the 88th place of economic freedom with the score of 60.2. This outcome is calculated based on the following criteria as rule of law, limited government, regulatory efficiency and open markets.

According to this inquiry the legal framework of the KR is very poor and the rule of law is fragile. One of the key problems that researchers raised was the undeveloped judicial system, with a particular issue being the lack of court independence. The existence of a weak judicial system is well stimulated by the high level of corruption. Low salaries and the fear of

[38]Robert W. McGee, *Corporate Governance in Transition Economies*, 258, Lighting Source UK Ltd., (2008).
[39]The Heritage Foundation. Section on the Kyrgyz Republic, available at http://www.heritage.org/index/country/kyrgyzrepublic (last visited March 29, 2012).

losing their job push judges to avoid rules. Furthermore the Heritage Foundation evaluated property rights of 20.0 points out of 100. The number is below the threshold of 50 which is recognized as "repressed". Therefore the Foundation finds the current situation of ownership rights as very poor and weak. The graph below (Figure 1) shows the evolvement of property rights in KR since 1995 until the present days. In the graph the red dots reflect Kyrgyzstan's results and the black spots show the world trend. As we can see from the scheme, the world development of private property has worsened, and it is now also considered as "repressed". There are many factors which caused this decline, such as economic crises, political instability and so on. However, the Kyrgyz ownership level has much more decreased in times of second revolution in 2010. Now in 2012 the KR shows the poorest result as it ever had. The Heritage Foundation's results clearly show that lacking of efficient property right protection in combination with poor judicial system activate a platform for hostile takeover activity.

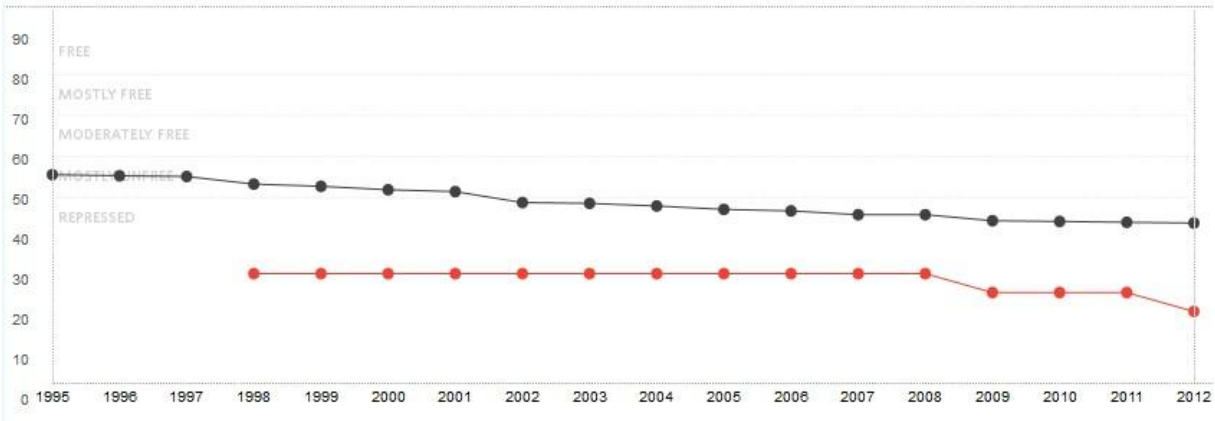

Figure 1

Moreover, the World Economic Forum (WEF) results further confirm the difficult situation of the Kyrgyz Republic. The report of 2011 evaluates Kyrgyzstan at 121st (out of

139)place with the score of 3.5 (out of 7).[40] Specialists of WEF base their results on country's macroeconomic stability (the level of public debt and budget deficit), infrastructure development, health and primary education, the labor market efficiency, financial market development and etc. WEF also analyzes the effectiveness of the state power, the independence of the judiciary system, the level of private property rights, the level of corruption, access to market, the level of criminal activity and inflation. The graph (Figure 2) below reflects the picture of current situation according to WEF results.

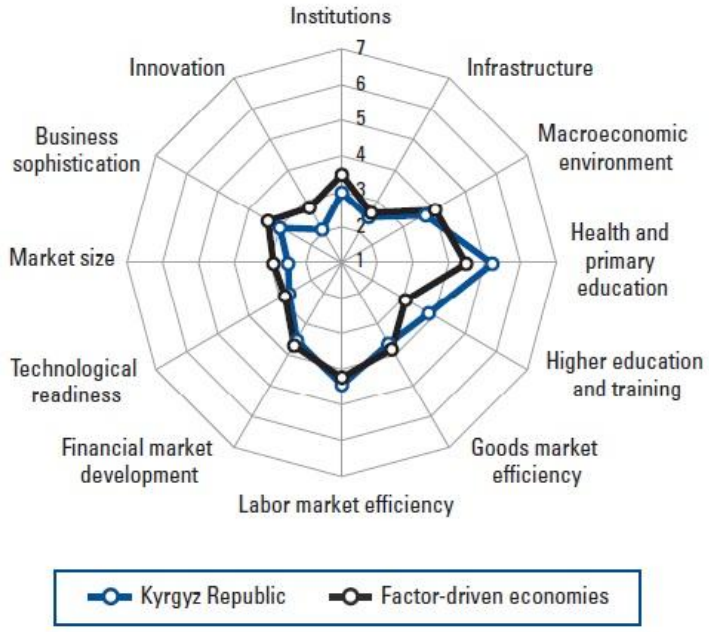

Figure 2

The graph reflects poor situation in the KR, particularly low level of financial market development, small market size and slow business sophistication. Moreover, researchers emphasized causes of most problematic factors of doing business. The biggest problems according to WEF are corruption, policy and government instability, low access to financing

[40]The World Economic Forum, Report on Global Competitiveness 2010-11,Section on the Kyrgyz Republic available at http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf (last visited March 29, 2012).

and poor legislation.[41] The existence of these problems inhibits the development of the state, and it provides grounds for property rights violations through takeover activity. John Armour states that "where the ownership of publicly traded firms becomes diffusely held, at some point hostile takeover activity is likely to develop."[42]

As a consequence of the Heritage Foundation's and World Economic Forum's findings illustrate that low results on efficiency legal framework, judicial independence, market access, low private property protection create loopholes for emergence of different takeover scenarios.

2.2 Scenarios

The following are the most commonly used hostile takeover scenarios in Kyrgyzstan:

1. Stock share manipulation

In order to gain control over the target company, raiders use different schemes involving target company stock. According to the Article 14 of Law on JSC, shareholders (owning not less than 20%) have a right to organize an extraordinary (special) shareholder meeting. This right allows acquiring company to promote their offers through minority shareholders. Raiders pay to minority shareholders to gather their voting shares and call for a special meeting. The key point here is to block major shareholders from participating in the meeting. According to Volkov V. there are several ways of blocking general shareholders vote. First of all, minority shareholders can write a claim stating that general shareholders decisions are detrimental to their right. The court might issue an order to block their vote. Or simply general shareholders might not be informed about extraordinary meeting or there can be a mistake about the date, time or the place of conducting a meeting. Disinformation

[41]The World Economic Forum, Report on Global Competitiveness 2010-11,Section on the Kyrgyz Republic available at http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf (last visited March 29, 2012).

[42]J. Armour, J. Jacobs, C. Milhaupt, *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: an Analytical Framework*, Harvard International Law Journal, 12 (2011).

regarding the shareholders meeting is also important in the takeover scheme in order not to establish quorum. In cases where there are issues with quorum, it evaluates in the following manner: First call establishes quorum at the presence of 60% of voting shares, second call allows 40%.[43] Therefore raiders can create necessary environment for legitimate extraordinary meeting, and to pass important decisions, such as election of new management board, termination and election of new board of directors, concluding a major agreement in target detriment, and issuing additional shares.[44] As a defensive measure shareholders can file a suit on validity of extraordinary meeting's decisions. However with new amendments in 2009, shareholder has to suffer property damage and prove a violation of his/her property rights. In cases where shareholder fails to prove it, the decisions of extraordinary meeting will be recognized as legitimate. And even though shareholder succeeds in proving violations, the lost time gives tremendous advantage to the raiders to manipulate company's stock and to conclude transactions with bona fide purchasers.

Moreover raiders can purchase shares on open market or they can force minor shareholders to sell their shares in order to get access inside the target firm. Raiders are particularly interested in accounting data, shareholders' list, or any other corporate information which is open only to shareholders. After becoming a shareholder, raider can follow the above discussed scheme with extraordinary meeting by gathering the rest of the minor shareholders, or s/he can provoke a revolt against current management and solicit a proxy fight with current management. As in the western proxy contest, raiders present proposal of management replacement. In event of a win, the newly promoted management will uphold all takeover decisions. Moreover raiders can apply to the court with claims against other shareholders and a company as a whole. So, raiders go to the court with a claim against the company about shares being obtained illegally in the past and making loss for the

[43] Art. 48 Law on Joint Stock Companies (2003) #64, last amended October 12, 2009 #264.
[44] Ibid., Art. 38.

company. At the same time raiders can file for judicial order to arrest shares of major shareholders with deprivation of voting right. Due to the poor level of judicial independence and high level of corruption, courts can render a decision in raider's favor. In raiding activities courts play a huge role, and very often they appear to be corrupt and make a decision that will satisfy a raider. Then raiders initiate an extraordinary general meeting, where they decide that 25% are 100% at the moment and this is a quorum. Then they appoint new managers who start chopping the firm into parts by selling off the assets of the company to third parties.

Furthermore, raiders can achieve control through "washing out" method, which is widely debated in majority and minority shareholders conflict. Generally, majority shareholders use an additional issue of shares in order to dilute share proportions of minor shareholders. Firstly, company is issuing a decision to increase founding capital on 300%. That means that if a minor shareholder has 8% of shares, after the issue he will possess only 2.7% of shares. Of course the shareholder can buy additional shares in addition to retaining the previously held number of shares, but not all the shareholders will be ready to pay money and actually do it. Undoubtedly, in share manipulation methods raiders can get very inventive and will use legislative loopholes to their own benefit. Unfortunately, even sometimes through illegal means by bribing a judge to make a decision in favor of the raider or by falsifying documents.

2. Bankruptcy procedure

Next method illustrates a hostile takeover attack through forced bankruptcy procedure. The raider company buys the debt of the target company and then they block payments and ignore attempts of the company to legally satisfy debt. Simultaneously, raiders send the case to the court in order to get shares of the company and initiate its bankruptcy to start

foreclosure proceedings.[45] Raiders organize auction where customer bids for the target's assets.

In addition new schemes with the support of banking sector appeared during the current economic crises. In this plan raider works with banking managers that help him to identify debtors whose financial positions are weakened by the crises. As soon as the company refinances the credit, the bank gets information on financial position of the company-debtor. If managers of the bank are associated with raiders, they can unite in order to seize assets of the company and leave the debtor with unpaid debts. As far as the debtor uses his assets as the credit security, the bank can conduct reassessment of his assets and decrease their value. Then the bank can inform the debtor about the necessity to bring in an additional pledge for securing the credit. Aiming to exert pressure on the debtor, very often bank acts together with tax inspection and other supervisory authorities. If the debtor is not able to bring in an additional pledge, then bank files a claim to the court that the debtor does not fulfill his obligations and demand the debtor to return the credit and penalty fee immediately. The bank then takes all the measures to ensure that the pledged assets of the company-debtor would be assessed lower than the amount of the credit and the raider gets the assets on a lower price. As a result, the debtor loses his property, which passes to the raider. Also, the raider still has the bank debt for the same amount of money as the sum of money that the raider paid for the property, that does not cover the credit or the penalty fee, which is set by the court's decision.

3. Mercenary management

Research of Center for Economic and Financial Research argue that the peculiarity of Kyrgyz firms is in concentrated management control.[46] Therefore corrupt management of the

[45] A. Sattels, *Spreading of Corruption: Hostile Takeover, Corporate Raiding and Takeover of Companies in Russia*, 4 (2009).
[46] O. Lazareva, A. Rachinsky, S. Stepanov, *Corporate Governance, Ownership Structures and Investment in Transition Economies: the Case of Russia, Ukraine and Kyrgyzstan*,3, NES working paper service (2008).

company can support hostile takeover of property, since legislation provides that the scope of management competence excludes the competence of the general Shareholders Meeting and Supervisory Board.[47] Thus, the company's Chief Executive Officer (CEO) has extensive powers to support raiding[48]. "The shareholders may significantly reduce the powers of CEO by delegating certain powers to the Board of Directors. Since the CEO manages the operations of the company, unrestricted authority over purchasing the loan decisions and company assets are frequently used to drive the company into bankruptcy and/or deprive the most valuable assets."[49] Hence law on JSC allows defining rights and obligations of the board not only through law, but also through charter, and by agreement between management body and the company (the agreement on behalf of the company is signed by the BoD, or Chairman). Thus company may stipulate within the charter or agreement rights, obligations and limitations of management board for the defensive purpose of avoiding self-serving management.

Furthermore, "principal - agent" problem of managerial abuse describes management's lack incentive to act in the interest of investors and corporation. Managers tend to short-term success in order to maximize profit in own benefit, where corporation needs long term run. Therefore shareholders can stimulate management work not for the short-term, but for the long-term benefits of the company, by allowing management to have stock of the company. Thus management becomes involved and interested for the growth, development and success of the corporation. Jarell, Brickly and Netter in their work discuss the "short term myopia and inefficient takeovers", which states that planning long term company development undervalues company. The theory is based on an allegation that market

[47]Part 2 Art.58 Law on Joint Stock Companies (2003) #64, last amended October 12, 2009 #264, and Part 3 Art. 148 of Civil Code of the Kyrgyz Republic (1996) #15, last amended October 12, 2009 #263.
[48]E. Segura, A. Bubnovsky, Hostile Takeovers in Ukraine, Public policy paper, The Bleyzer Foundation, 3., available at http//www. sigmableyzer.com/File/economic/Hostile_takeovers_in_Ukraine.pdf, (last visited March 29, 2012).
[49]Ibid.

participants, and particularly institutional investors, are concerned almost exclusively with short term earnings performance and tend to undervalue corporations engaged in long term activity. Thus this company will become a prime takeover candidate. Hence authors do not find any empirical evidence, and they conclude that based on SEC research that long term activity does not influence on takeover possibility.[50]

4. Manipulation with Tax Code

Raiders tend to use connections with state authorities in order to conduct illegal takeover of companies. One of the schemes that is associated with state authorities is related to Tax Code. For instance, a businessman that has some connections among politicians comes to an agreement with an inspector or officer of a local tax body that he "detects" violation of tax code that foresees a significant fine. Since not all companies keep their accounting books perfectly, in a majority of cases tax authorities have a fairly high chance of finding a violation or to manufacture a fake one. Then they set an outrageously big fine to the "violator" or they do not offer any form of redress for the violator. Next, the local tax inspection confiscates assets of the company and sells them in an illegal auction, which lets the corrupt businessman get the assets of the target company for a very low price. Even if later on another court makes a decision for the benefit of the legal owner, s/he will get only the sum of money for which the assets were bought on the auction but not the real value of the lost assets. Also a target company loses its time, and risks its reputation, which is important among Kyrgyz companies.[51]

5. Fraud and physical methods

Widespread occurrence of illegal hostile takeovers began in the 1990s as racketing. Further on business started to use fraudulent transactions, such as falsification of documents

[50]G. Jarnell, J.Brickly, J. Netter, *Market for Corporate Control: the Empirical Evidence Since 1980*, v.2, #1, Journal of Economic Perspectives, 48, 55 (1988).
[51]O. Lazareva, A. Rachinsky, S. Stepanov, *Corporate Governance, Ownership Structures and Investment in Transition Economies: the Case of Russia, Ukraine and Kyrgyzstan*, 7, NES working paper service (2008).

and management's or shareholders' signatures, bribery of registrars and state authorities. The common form of raiding is re-election on the basis of fake and semi legal meetings of shareholders, when they are conducted by 3-5% of shareholders and re-elect a director general. This method is also discussed in more detail in the share/stock manipulation technique. Another commonly used method is force in order to obtain control and for instance get access to founding documents with the help of which later on raider can change the owner through registration. Those methods were commonly used during both revolution in 2005 and 2010. Criminal raiders simply took advantage of instable political situation and weakness of militia body and took control over the companies through physical force. The Ministry of Internal Affairs of the Kyrgyz Republic received number of reports that unknown man were trying to takeover companies by representing falsified property ownership right certificates.[52] Moreover, during the chaos of last revolution in April 2010 a print house "Kontinent" experienced criminal hostile takeover. As Gennadiy Davidenko, a Director of the company reported that an armed group of people literally trespassed on private territory of the print house and by physical force took over the control and access of the company's documents.[53] Unfortunately, there is no final court decision available on this case, due to the continuing disputes. And there is a question whether there will be a valid judicial act which will administer justice.

The common problems in the Kyrgyz Republic are close family ties and tribal division.[54] Powerful families control the financial streams in and out of the country. Kyrgyzstan can be considered as a "low-trust" society, where business is very careful to foreign investments and partners. Business tends to develop and work with close relatives and friends. The first two Presidential families controlled the majority of business activities.

[52]Ella Kuvshinkina, Reiderstvopo-kirgizski – u novogo pravitelstva novaya golovnaya bol [Raiding in Kyrgyz way: new government has got a new headache], available at http://www.ekonbez.ru/news/cat/4944, (last visited March 29, 2012).
[53]Ibid.
[54]Robert W. McGee, *Corporate Governance in Transition Economies*, 254, Lighting Source UK Ltd., (2008).

Moreover during the President Bakiev K., government created a Fund of Development which controlled strategic objects and major businesses through a stock in the companies. For the past 20 years financial market did not have any opportunity in healthy development. Two revolutions which happened in exact 5 years apart keep investors in suspicious of business progress. Those events give a sign of instability, which cannot generate healthy business growth.

In this part of the chapter I have analyzed the most common hostile takeover scenarios used by raiders in Kyrgyzstan. Obviously, those methods differ from western approach due to the emerging Kyrgyz market, business criminalization, high level of corruption, lack of corporate transparency and current instable political state.

Now I turn to scrutinize legal framework of hostile takeovers in the Kyrgyz Republic due to the recent amendments made in 2009 in protection of private property.

2.3 Legal framework

The next part will focus on the legislation amendments. Those changes were made in order to protect private property from hostile takeovers. This part will analyze the amendments in Tax Code, Law on JSC, Law on Business Partnerships and Companies and Law on Bankruptcy. Also this section will answer the question what is the level of property protection? How efficient 2009 amendments are?

1) Tax Code

The amendment in the Tax Code protects shareholder from hostile takeovers through obtaining tax information of the target and its shareholders. Now the information about opening or closing an account of the taxpayer can be provided only on the basis of the judicial act which entered into legal force.[55] Moreover, the information about operations carried out with the accounts of the taxpayer, as well as information about the current stage of this

[55]Part 1 Art 126 Tax Code (2008) #230, last amended September 17, 2010 #128.

accounts also must be provided only on the basis of the judicial act which entered into legal force.[56] These changes will limit access to the target account information to raiders or any other 3rd party thus avoiding hostile takeover scenarios.

2) Law on Joint Stock Companies

In 2009 Law on Amendments №245 introduced the amendments into the Law on Joint Stock Companies. Generally amendments increase the shareholders' protection. First of all, now in order to challenge the validity of decisions and acts of JSC, party has to prove an actual violation of shareholders property rights and the infliction of property damage.

Art 25-3(g) – ***before***

Shareholder has the following non-property right:

(g) to defend in court their rights, to file a suit against public officials, as well as against any individuals who are interested in the company's transaction.

Art 25-3(g) – ***after***

Shareholder has the following non-property right:

(g) to defend in court their rights, to file a suit against public officials, as well as against any individuals who are interested in the company's transaction, in cases where the property rights of the shareholder is violated and he/she suffered property damage, with the obligatory participation of the private shareholder in the court hearing;

Thus currently the evidence of property right violation and property damage is obligatory.

Moreover in order to avoid falsifications of the judicial acts, presently law provides the mandatory participation and presence of the shareholder in the court hearings. Now courts will not be able to tender an award without it.

In addition, the holder of the shareholders register shall be only an independent licensed registrar. Here is the comparison of past and current provisions:

[56] Part 2 Art 126 Tax Code (2008) #230, last amended September 17, 2010 #128.

Art. 33-3 – **before**

The register of shareholders may be a company itself, or an independent registrar.

Art. 33-3 – **after**

The register of shareholders shall be a registrar, which operates based on the license and agreement with the company.

This amendment eliminates company as its own registrar. An independent registrar will provide protection of confidential shareholders' information from hostile takeover methods.

Furthermore, section 7 of the same article provided security for minority shareholders.

"Shareholders' Information, holding less than five percent of the issued shares of the Company, is confidential and may be obtained by third parties, government officials, including law enforcement and supervisory authorities, only on the basis of enforced judicial act"

The requirement of the judicial decision prevents acquiring company to gain control through minority shareholders. In case when target is refusing the offer, acquiring company could force minority shareholders to sell their shares by threatening them in order to obtain control.

Art. 34 was also amended by providing additional requirement to use official Stock Exchange documents in monetary share transactions. The reason behind is to ensure that the transaction was conducted on Stock Exchange which verifies its legality to the contract parties.

3) Law on Business Partnerships and Companies

A member of a limited liability company may be excluded from the company only by the court decision and only by causing a substantial harm to the company or to the rest of the

participants.[57] This amendment eliminates possibility of removing members of the target company in order to obtain control; it eliminates the alien influence on the company's members. The exclusion requires evidence of the substantial harm either to the company or to any other member of the company.

4) Law on Bankruptcy

As it was discussed above some acquiring companies use bankruptcy method to takeover the target company. Therefore the further analyzed amendments were adopted to protect company from hostile takeover attack.

First of all, bankruptcy law amended the definition of bankruptcy itself.

Art. 3 before

Bankruptcy (insolvency) is recognized by the court or declared by the creditors meeting with the consent of the insolvent debtor its inability to fully satisfy claims of its creditors on monetary obligations, including failure to provide the required payments to the budget and non-budgetary funds

Art. 3 after

Bankruptcy (insolvency) is recognized by the court or declared by the creditors meeting with the consent of the insolvent debtor its inability to fully satisfy <u>valid</u> claims <u>within the law or contract terms</u> of its creditors on monetary obligations, including failure to provide the required payments to the budget and non-budgetary funds, <u>due of exceeding its obligations on its liquid assets.</u>

Amended provision obliges creditors to follow terms of the contract and applicable law. Before creditors used to force bankruptcy through debt even though the debtor still had time to satisfy the obligation according to set up terms. This method was widely used in

[57] Art 45 of Law on Business Partnerships and Companies (1996) #60, last amended October 12, 2009.

takeovers. Now creditors have to wait until the given term expires in order to claim its money back.

Moreover, current provision provides the criterion for declaring bankruptcy only on monetary obligations. New amendment requires declaration of bankruptcy due to inability to satisfy obligation in exceeding its debts on its liquid assets (an asset that can be quickly converted into cash). Before it also included obligations such as goods and services, and acquiring company could easily declare target as insolvent. The intention of the legislator is to make sure that debtor used all possible opportunities in paying back the debt before declaring itself as insolvent. In addition new amendment also provides protection from forced bankruptcy by acquiring firm in takeover schemes. Therefore the new interpretation of bankruptcy definition aimed to provide protection, to eliminate takeover attacks, and to conduct bankruptcy only within the legal framework.

Furthermore Art. 9 was amended in part that a debtor can be recognized insolvent only if the monetary obligation exceeds the minimum amount of debt (500 of minimum index[58]).

In addition another tremendous change in the law experienced Art. 26 the resumption of the bankruptcy process. Before the time period for creditors for the resumption of the insolvency case was ten years. During this time a creditor could restart bankruptcy procedure in case of appearance of the liquid asset that could satisfy the obligation. Now legislature reduced the time from ten to three years.

The last novelty in the bankruptcy law relates to the pre-trial dispute resolution. Before the amendment creditors, state bankruptcy authorities, National Bank had a right to file insolvency procedure to the court without any pre-trial dispute settlement. Now the current provision states:

[58] Art 9-1 Law on Bankruptcy (1997) #74, last amended June 24, 2009;

The persons referred to in paragraph 1 shall have the right to petition the court to declare bankruptcy without complying with the pre-trial settlement only in cases where the size of the monetary obligation was established by a valid judicial decision. In all other cases, preliminary pre-trial dispute settlements are mandatory for bankruptcy procedure[59].

The current provision now allows debtor to exhaust all possible measures before facing the insolvency procedure. This is also anti-takeover provision protecting from forced bankruptcy. An acquiring company before could use this loophole to forced insolvency. Creditor could intentionally block any chance for debtor to negotiate and find other means of satisfying the debt. Now with mandatory pre-trial settlement there is a protection for the debtor to exhaust all possible means before going to court. Hence, raiders still can block pre-trial settlement and negotiations, or to falsify pre-trial settlement agreement in order to go to court.

Law adopted changes regarding bankruptcy grounds such as 1) only monetary liabilities (works and services) in amount of 500 of minimum index, and 2) the amount of monetary liabilities set only by court which exceeds the assets of the debtor, not debtor's refusal to pay, and the period for the resumption of bankruptcy procedure is reduced to 3 years;

As a consequence of recognizing raiding issues in the Kyrgyz Republic the Parliament adopted above analyzed amendments in most important corporate normative-legal acts. Analysis identified that changes did not significantly increase private ownership protection. Nevertheless, I still consider this step as a positive sign in legislation improvement.

Kyrgyz hostile takeovers significantly differ from hostile takeovers in the developed countries. And firstly that is caused by a weak private ownership protection, which is not only proved through the Heritage Foundation's and WEF's data, but also through the legislative

[59] Art 27-2 Law on Bankruptcy (1997) #74, last amended June 24, 2009;

analysis of the property provisions. Secondly, there is widespread of criminalized hostile takeovers, where raiders use fraudulent actions as falsification of property certificates, bribery and even physical force. Next, the peculiarity of Central Asian location, particularly strong informal family and clan relationships, significantly influence business activity. Lastly, experience of two politically dramatic revolutions swayed the balance away, and country just recently started to properly function again. Therefore I can conclude that there is no corporate hostile takeover in a sense of U.S. Merger & Acquisition due to the enumerated above reasons. Kyrgyz hostile takeovers are closely connected to illegal methods, which cannot be identified as a takeover in western world. Nevertheless, companies attempt to conduct hostile takeovers through the methods I have previously discussed. But as a matter of fact there is still no case practice which would clearly reflect the existence of this controversial institute. Most of the cases are pending its final award and there is no assurance that "independent" judicial system will render justice. Considering the identified issues next chapter will provide with recommendations that will improve the quality of corporate governance.

Chapter III

Recommendations

This Chapter will provide recommendations to improve the methods of defense and use of self-defense against the illegal takeover.

Since legislation allows companies to include defense mechanisms in the shareholder's agreement, I suggest implying some of the defense techniques, which are widely used in developed countries. Jarnell G., Brickly J. and Netter J. defined two types of defensive measures, those which require shareholders' approval through vote, and those adopted unilaterally by management.[60] The defensive measures consented by shareholders usually presented by CEO and require majority voting. This method is efficient since shareholders are in control and informed about defense activity. Firstly, "supermajority amendments require certain amount of vote on strategically important company decision and requires at least 2/3 and sometimes as much 9/10 of voting power of outstanding common stock."[61] Next, clause is a fair price amendment. This defense is a "supermajority provision that applies only to non-uniform, two-tier takeover bids that are opposed by the target's board of directors. The most common fair price is defined as the highest price paid by bidder for any of the shares it has acquired in the target firm during a specified period of time."[62] And the last one is a dual-class Recapitalization. "These plans restructure of equity of a firm into two classes with different voting rights. Although several methods are used, the common goal is to provide management with voting power disproportionately greater than provided by their equity holdings under "one share – one vote."[63]

[60] G. Jarnell, J. Brickly, J. Netter, Market for Corporate Control: the Empirical Evidence Since 1980, v.2, #1, Journal of Economic Perspectives, 48, 59 (1988).
[61] Ibid.
[62] Ibid., 60.
[63] Ibid.

On the other hand, the defensive measures adopted by management can be benefit in time consuming. Management shall implement the following methods: litigation, greenmail and poison pill. Jarnell G. states that litigation usually delays the control contest significantly and the target is beneficiary.[64]"Greenmail occurs when target management ends a hostile takeover threat by repurchasing at a premium the hostile suitor's block of target stock."[65]Jarnell G. argues that "it is not necessarily in the interest of shareholders to ban greenmail payment, because such a ban has a potential to discourage outside investment in the potential target's stock by investors anticipating greenmail payments and hence reduces incentives of outsiders to monitor managers."[66] In its turn, poison pill is described as most debated and controversial defense since its creation in 1982. "Poison pill is a shareholder rights agreement that, when triggered by an event (e.g. hostile tender offer), than target shareholders provided with a right to purchase additional shares or to sell shares to the target at very attractive prices."[67] Nevertheless, poison pill is an effective measure because it is quick and cheap for the management, and it makes hostile acquisition expensive in most cases.[68]

Further, I propose for target companies in hostile takeover attack to increase the CEO's remuneration in order to avoid mercenary conduct by the management. The practice in big companies that CEO's payment is tremendously big. Some argue that one person cannot be paid so much for just an executive performance, but I think CEO's decisions are significant for company's growth. It will increase operational costs for raiders, and decrease incitement to quasi-legal methods of takeovers. Another proposal of broadening the application of personal liability of managers and controlling shareholders for damage to shareholders will

[64]G. Jarnell, J. Brickly, J. Netter, Market for Corporate Control: the Empirical Evidence Since 1980, v.2, #1, Journal of Economic Perspectives, 48, 62 (1988).
[65]Ibid.
[66]Ibid., 63.
[67]Ibid.
[68]Ibid.

set this balance between management and shareholders conflict. This personal liability should have the criteria for evaluation, for instance as well known concepts of “business judgment rule”, “good faith” through “duty of care” and “duty of loyalty”. The stipulation of these criteria in the Law on Joint Stock Company and Law on Business Partnerships and Companies will increase the efficiency of corporate governance.

In order to minimize raiding attack I propose the following recommendations: firstly, to implement in shareholder-management agreement U.S. widely used defenses (with and without shareholder consent), also I suggest to stimulate management performance in the company by increasing his/her remuneration, furthermore, legislation shall increase personal liability for management in case of mercenary performance, and in order to evaluate management’s work, legislation should introduce management evaluation concepts.

Conclusion

With appearance of Mergers & Acquisitions in CIS countries, hostile takeovers, as one of the controversial methods, became quite popular for obtaining ownership. First, it emerged during the 1990s in the form of racketing, and further on Kyrgyzstan experienced so called big hostile takeover and criminal hostile takeover waves in 2005, and following 2010 years. Therefore the main question of the research raised the issue of what hostile takeover in the Kyrgyz essence is?

The analysis of U.S. hostile takeover institute, the Kyrgyz practice and legislation showed that hostile takeover does not exist in the sense of corporate governance in developed countries. This institute has its own essence and peculiarity due to number of reasons. First of all, there is low economy which creates small market for M&A. Secondly, there is weak private property protection, due to legislative loopholes that allow raiders to legally achieve control over the target. Also the poor judicial system, which lacks independence, cannot guarantee the implementation and protection of private property right. In addition, this problem is complemented with high level of corruption that increases possibility of falsification and fraud. The Central Asian customs of conducting business through family controlling shareholders, tribalism and management ownership concentration created barriers for the growth of M &A. Moreover, the instable political situation is mistrustful for foreign investors, because they fear unpredictability of the government. On the other hand, the appearance of criminal hostile takeover is caused by business criminalization, high level of corruption and lack of corporate transparency.

I believe that now country is in a transitional period when the changes need to be made in order to create environment for the productive growth of market and economy. Foreign investors require overall stability not only in physical way, but also through legislation and judicial independence. The general system before was created for avoiding rules, but not to be

followed. Hence, as the practice in developed countries show a professional business conducted under the rules of M&A allows to increase business sector, investments, economy, and it decreases economic crimes. Therefore with country's development, the national policy should be changed from "target protective" system to "takeover friendly". But this transition can be implemented only in healthy business environment.

Bibliography

Statutes

Civil Code of the Kyrgyz Republic (1996) #15.

Tax Code of the Kyrgyz Republic (2008) #230.

Security Exchange Act (1934).

Delaware Code Ann. title 8(1897).

Law on Joint Stock Companies of the Kyrgyz Republic (2003) #64.

Law on Bankruptcy of the Kyrgyz Republic (1997) #74.

Law of the Kyrgyz Republic On introducing amendments to some legislative acts of the Kyrgyz Republic(2009) # 245.

Law of the Kyrgyz Republic On introducing amendments to some legislative acts of the Kyrgyz Republic (2009) # 252.

Law of the Kyrgyz Republic On introducing amendments to some legislative acts of the Kyrgyz Republic(2009)# 246.

Law of the Kyrgyz Republic On introducing amendments to some legislative acts of the Kyrgyz Republic(2009)# 247.

Books

Patrick Gauhgen, Mergers, Acquisitions and Corporate Restructurings, (4th ed. 2007).

M.G. Ioncev, *Korporativnye zahvaty: sliyaniya, poglosheniya*, GREENMAIL, [CORPORATE TAKEOVERS: MERGERS, ACQUISITIONS, GREENMAIL], PUBLISHED BY OS'-89, MOSCOW (2003).

Robert W. McGee, Corporate Governance in Transition Economies, Lighting Source UK Ltd., (2008).

Alan Peacock, Graham Bannock, *Corporate Takeovers And The Public Interest : Report*

Of An Inquiry Conducted For The Joseph Rowntre, Aberdeen : Aberdeen University Press (1991).

Larry E. Ribstein, Peter V. Letsou, *Business Associations,* New York : M. Bender,(4th ed.2003).

A. Sattels, *Spreading of Corruption: Hostile Takeover, Corporate Raiding and Takeover of Companies in Russia*, (2009).

F. Weston, K. Chung, J. Siu, *Takeovers, Restructuring and Corporate Governance*, Prentice Hall, New Jersey, 61 (2nd ed. 1990).

Articles

J. Armour, J. Jacobs, C. Milhaupt, The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: an Analytical Framework, Harvard International Law Journal, 12 (2011).

M. Becht, P. Bolton, A. Röll, *Corporate Governance and Control*, Finance working paper № 02/2002, updated August 2005.

G. Jarnell, J. Brickly, J. Netter, *Market for Corporate Control: the Empirical Evidence Since 1980*, v.2, #1, Journal of Economic Perspectives, 48 (1988).

M. Jensen, *Takeovers: Their Causes and Consequences*, v. 2 # 1 Journal of Economic Perspectives, 21(1988).

O. Lazareva, A. Rachinsky, S. Stepanov, *Corporate Governance, Ownership Structures and Investment in Transition Economies: the Case of Russia, Ukraine and Kyrgyzstan*,3, NES working paper service (2008).

A.D. Radygin, *Vneshnie Mehanizmy Korporativnogo Upravleniya. Nekotorye Prikladnye Problemy*, [External Mechanisms of Corporate Governance: Some Practical Problems], 53, IET, Moscow (2006).

Mark A. Stach, *An Overview of Legal and Tactical Considerations in Proxy Contests: the Primary Means of Effecting Fundamental Corporate Change in the 1990s*, George Mason University Law Review, (1991).

Electronic sources

L. Bebchuk, O. Hart, Takeover Bids vs. Proxy Fight in Contest for Corporate Control (2001), available at http://www.nber.org/papers/w8633.pdf, (last visited March 29, 2012).

The Heritage Foundation. Section on the Kyrgyz Republic, available at http://www.heritage.org/index/country/kyrgyzrepublic, last visited March 29, 2012.

Ella Kuvshinkina, Reiderstvo po-kirgizski – u novogo pravitelstva novaya golovnaya bol [Raiding in Kyrgyz way: new government has got a new headache], available at http://www.ekonbez.ru/news/cat/4944, last visited March 29, 2012.

E. Segura, A. Bubnovsky, Hostile Takeovers in Ukraine, Public policy paper, The Bleyzer Foundation,3.,available ahttp//www.sigmableyzer.com/File/economic/Hostile_takeovers_in_Ukraine.pdf,(last visited March 29, 2012).

The World Economic Forum, Report on Global Competitiveness 2010-11,Section on the Kyrgyz Republic available at http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf, last visited March 29, 2012.