



RiskMetrics Group

MARKET/REGION REPORT

# 2009 Preseason Report: Central & Eastern Europe

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## KEY TAKEAWAYS

Companies listed in Central and Eastern European (CEE) countries, including Russia, have not escaped the adverse effects of the global financial crisis. Many are struggling to stay afloat, while still others move to fortify defenses in a bid to fend off would-be acquirers. It should come as no surprise to investors in these markets, consequently, that the 2009 proxy season will be marked by an influx of crisis-related proposals, including: share repurchases, sometimes of a significant size; unusual capital increase requests; the introduction or tightening of takeover defenses; and, previously unseen and uncommon in this part of Europe, shareholder proposals asking to revoke previous general meeting resolutions, overturn management, or tighten shareholders' grip over certain company operations.

Key takeaways from this report include the following:

- The region is well-known for shareholder power struggles and government influence over corporate decisions. These characteristics will continue to be evident in 2009.
- Notable shareholder meetings this year are expected to be: Russian metals giant OAO MMC Norilsk Nickel, which shapes up to be a contested election yet again; OAO Vimpel Communications, the Russian telecom; and OAO TNK-BP Holding, the Russian oil producer, which has been without a CEO since December.
- Another notable development to play out this proxy season centers on the fact that EU member states, including those in the CEE, must integrate into their national legislation a number of governance-related EU Directives. Thus, shareholders will likely be asked to amend articles of association at a number of companies to comply with new local legislation.
- The region is likely to see some M&A activity this year, in addition. For some companies, the annual meeting season is a time to consider potential acquisitions. For others, it's a time to convince shareholders that takeover defenses are needed to protect companies from unwanted influence and to safeguard shareholder value.
- CEE countries hold their proxy seasons at different times, although the region always sees its last annual meetings by the end of June. The Hungarian proxy season peaks in late April, while annual meetings in the Czech Republic, Poland, and other Eastern European markets occur with more frequency in late April and May. The majority of Russian meetings take place in late May and early June, with the largest companies usually coming last.

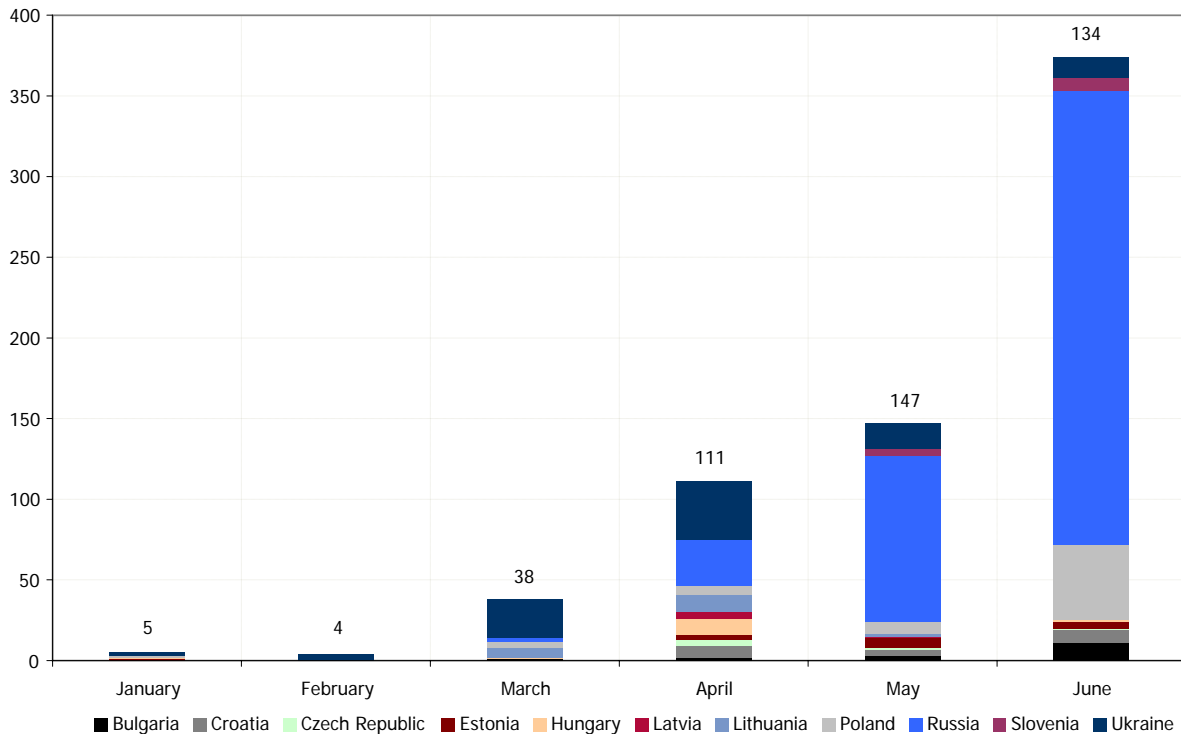


Fig. 1: CEE Annual Meetings by Month, 2008

## Background/Lessons Learned

### CEE in Financial Turmoil

The global financial crisis has by now caught up with CEE markets. As noted by the international law firm Squire, Sanders & Dempsey LLP, the downturn has highlighted regional winners and losers, although debate continues on which markets will in the long-run fare well or poorly. The so-called losers--those countries with unstable currencies and high rates of debt to GDP--are generally identified as Russia, Ukraine, the Baltic States, Hungary, Romania, and Bulgaria. Winners include the Czech Republic, Poland, Slovakia, and Slovenia. Hobbled by higher debt and unstable currencies, the losers are expected to be slower to recover and are predicted to have a difficult time luring new investors.

Overall, investment capital has been flowing out of CEE markets and is not being replaced with new investment, with many new investors fearful of committing to the region. Compounding the problem of capital flight is the lack of clarity from banks about their ability and willingness to lend. The region has been hit hard by currency instability. Considering that banks in many CEE countries are foreign-owned, and now have their own domestic issues to worry about, they are not seen as likely to help address the region's financial problems.

### Hungary

A few countries in the region appear more vulnerable to the crisis. Hungary, which turned to the International Monetary Fund (IMF) for a EUR 20 billion (\$26.6 billion) bailout last fall, is sliding into a deep recession. Even before the financial crisis

hit last year, Hungary had one of the largest budget deficits in the EU.

## Latvia

At the end of last year, Latvia, which has been hit hard by the global crisis, sought EUR 7.5 billion (\$9.9 billion) under an IMF stabilization plan to defend its currency peg. Private sector deposits in Latvian banks have fallen considerably, precipitated by the near-failure of JSC Parex Banka, Latvia's second-largest bank. The Latvian government considered the recovery of Parex Banka as crucial for Latvia's economy and injected LVL 227 million (\$428.9 million) to support the company and restore confidence in the banking sector. The government nationalized the bank by acquiring a controlling 85.1 percent stake in the company. In early April, the European Bank for Reconstruction and Development (EBRD) approved a financial package for Parex Banka, which will include the acquisition of 25 percent plus one ordinary share of the company and a subordinated loan of EUR 22 million (\$29.2 million). Following the capital injection, EBRD will be represented on Parex Banka's supervisory board.

## Lithuania and Poland

Lithuania is regarded as the next most likely EU member state to beat a path to the IMF's door. Earlier this year, the Lithuanian government approved an economic recovery plan of LTL 5 billion (\$1.9 billion). It is now, however, considering an IMF loan, despite past assurances that it did not need aid. If Lithuania qualifies, one option could be a new flexible credit line program unveiled by the IMF in March. The program gives countries credit to help them strengthen their currencies against possible collapse. Poland has already decided to participate. The country recently received \$20.6 billion from the IMF to halt the decline of its currency.

## Russia

As the financial crisis has unfolded in Russia, the primary concern for many investors has become the ability of Russian companies to repay their debts. In the years preceding the crisis, Russian companies grew rapidly, but took on high levels of debt to maintain their growth. In aggregate, the largest Russian companies accumulated approximately \$500 billion worth of debt to foreign creditors, as reported by *The Financial Times* on Feb. 22, 2009. A significant portion of that debt is

coming due this year. And, having been hit hard by the financial crisis, many Russian companies are struggling to meet their financial obligations.

The first signs of credit troubles came when the crisis first hit Russia in the fall of 2008. In the most prominent case, the Russian government, acting through the state-run development bank Vneshekonombank (VEB), extended an unprecedented \$4.5 billion loan to the debt-laden aluminum miner UC Rusal. The loan was extended to prevent foreign creditors from seizing Rusal's 25 percent stake in OAO MMC Norilsk Nickel, Russia's biggest miner, which Rusal had put up as collateral for a loan from a consortium of foreign banks.

Similarly, in late 2008, Russia's Alfa Bank, which controls approximately 44 percent of the Russian mobile phone company OAO Vimpel Communications, was granted a \$400 million government loan to stave off foreign creditors. The government funds were passed by VEB and allowed Alfa Bank to avoid having to give up its stake in VimpelCom. Earlier, Alfa pledged the stake to a group of foreign banks, led by Deutsche Bank, as collateral for a \$2 billion loan.

Despite much criticism of these and similar bailouts by the Russian government, the sentiment at the time was that most struggling companies would be able to obtain emergency financing from the Russian government, provided they carried enough favor with the Kremlin.

The situation has worsened considerably since then. The global financial crisis has deepened, hitting the Russian economy particularly hard as demand for oil and natural resources has plummeted. The Russian government has been forced to use much of the reserve fund it had built up in recent years to defend the national currency, the ruble, from rapid depreciation. As a result, Russia's reserve funds have fallen in value from just under \$600 billion before the crisis to \$376 billion in March (some estimates put the current reserves even lower), as reported by *The Financial Times* on April 14, 2009.

In 2008, Moscow pledged RUB 950 billion (\$29 billion) in subordinated loans to key banks to help the country's financial sector. In February 2009, Russia vowed to inject an additional \$40 billion into domestic banks, with the condition that they will lend some of the funds to businesses.

In light of the greatly diminished reserves and uncertainty over how long the financial crisis might last, the Russian government has decided to ration its use of reserves, and has adopted a new stance with regard to bailing out troubled companies. The government has moved to suspend direct bailouts, opting instead to encourage domestic banks to extend financing to struggling companies, while encouraging foreign and domestic creditors to negotiate loan restructuring agreements with troubled companies.

As reported by *The Financial Times* on March 21, 2009, Russia's first deputy Prime Minister, Igor Shuvalov, addressed foreign lenders to encourage debt restructuring agreements. He indicated that if lenders were willing to convert their bonds into shares of Russian companies, they would not be obstructed from doing so by the Russian government. Shuvalov said that the state would not oppose stake-building in Russian companies by foreign creditors, except in an "extremely limited" number of strategic companies. This list of strategic companies that can still count on government bailouts has not been disclosed, leading to difficulties for lenders in negotiating loan restructuring deals.

The Russian government has indicated that direct bailouts to troubled companies will be very limited going forward. The burden of financing or restructuring the foreign debt held by Russian companies will fall primarily on the companies and their creditors.

Other Russian companies have not been as lucky, including OAO Aeroflot, the Russian airline. The Russian government, which holds a majority stake in the company, appears to be willing to revive the country's airline sector by creating another national carrier, rather than pumping cash into Aeroflot and other privately-run airlines. The Kremlin has aggressively championed a plan to fold failing private assets into a state airline, Rosavia. While Rosavia is being formed, its assets will be managed by Russian Technologies, or Rostechologia, a government holding company focused on defense assets. The largest private shareholder of Aeroflot is Alexander Lebedev, a former KGB agent who is believed to own as much as 30 percent of the company. As reported by the Russian press, most of his stake--about 25 percent of Aeroflot--is pledged against a \$400 million loan from Deutsche Bank. The value of the stock is down 80 percent from its high in 2008, and

Lebedev has faced a series of margin calls, which he has so far paid from his own funds. Thus far, Lebedev has been denied state funding to bail him out, although the Kremlin has pledged billions of rubles in state funding to help other Russian businesses meet foreign credit obligations. Lebedev is seeking \$130 million in funds to pay off his margin calls, as reported by *eTurboNews*. He has frequently been an outspoken critic of the Kremlin and owns *Novaya Gazeta*, an opposition-oriented newspaper known for sharp criticism of the government.

Following the onset of the financial crisis in Russia in the fall of 2008, investors began fleeing the country. Although emerging markets were once seen as a potential haven for investors as western markets suffered from the financial crisis, the opposite has proved to be the case with Russia. Concerned about the prospects of the Russian economy in light of falling demand for oil and other natural resources, and the possibility of heavy-handed state intervention, investors dumped Russian stocks, creating a severe capital drain and strong downward pressure on the ruble.

The capital drain continued through late 2008, and reached as much as \$40 billion in January 2009, according to Aleksey Kudrin, Russia's finance minister. However, as reported by *The Financial Times* on Feb. 26, 2009, since then the levels of capital drain have come down and stabilized somewhat, following a policy of gradual currency depreciation by the central bank.

Uncertainty over the ability of Russian companies to repay their debts poses the potential risk of sparking another tide of capital drain through the remainder of 2009.

## Kazakhstan

As the world financial crisis began to show its impact on the oil-dependent economy of Kazakhstan, in November of 2008 the country's Prime Minister Karim Masimov announced a \$4 billion bank bailout plan.

Initially, the plan had a broad mandate to support troubled Kazakh banks. As the situation deteriorated, however, the government focused primarily on the country's four largest banks, BTA Bank, Kazkommertsbank, Halyk Bank, and Alliance Bank. The government's first intention was to acquire a 25 percent stake in each of the banks,

but through the course of the crisis, the banks exposed different degrees of loan quality deterioration, which required different levels of government intervention.

Samruk-Kazyna, the national welfare fund, became a channel through which state funds were funneled to the banks. Additionally, the government drew upon as much as \$10 billion from the National Oil Fund, created to serve as a cushion against the decline in crude oil prices. Part of the funds was used to acquire equity stakes in the troubled institutions, while another part was provided to the banks within the framework of the government's anti-crisis program.

BTA Bank, the country's largest, received the largest level of funding among all recipients. On Feb. 2, 2009, Samruk-Kazyna acquired a 78.1 percent stake in the bank for KZT 212 billion (\$1.4 billion). On the same day, the government ousted the bank's chairman, Mukhtar Ablyazov, who was succeeded by Arman Dunayev, the deputy head of Samruk-Kazyna. Ablyazov is a former energy minister and a long-time opponent of Kazakhstan's President, Nursultan Nazarbayev.

The most recent developments at BTA seem to have a strong impact on the bank's financial position. In its April 23, 2009, press release, the bank announced that it halted principal payments on its debt starting April 20 as some of the bank's creditors required accelerated debt repayments. The bank said it will not resume the payments until it has reached a debt restructuring agreement with all of its creditors. In late April, BTA warned that bankruptcy is a possibility if creditors will continue to demand immediate repayment. According to Bloomberg, BTA's liabilities currently stand at \$12.2 billion, with \$438 million maturing this year.

In February 2009, the government announced its intention to purchase a stake in Alliance Bank, Kazakhstan's fourth-biggest. Subsequently, the bank's management team was ousted and the head of The National Distressed Asset Fund was appointed Alliance's CEO. The company's major shareholder, Seimar Alliance Financial Corp. (SAFC), which owns 81.7 percent of the bank, offered to sell a 76 percent stake in Alliance to the government for a symbolic KZT 100 (\$0.70). In exchange, the government deposited KZT 24 billion (\$161.6 million) with the bank saying, however, that it's not going to finalize the deal until the

bank comes to agreement with its creditors to make sure they will not require an early repayment of the bank's debt. According to Bloomberg, Alliance has \$3.6 billion of bonds and loans outstanding.

In mid-April, Alliance announced that it would stop paying its creditors "for at least three months" after discovering \$1.1 billion of liabilities that weren't reflected on its balance sheet. In its statement the bank explained that it acted as a guarantor to offshore companies that borrowed from two financial institutions using U.S. treasuries as collateral. These securities were listed on the bank's balance sheet as an asset with no record that they were pledged. Following this discovery, the bank failed to redeem a KZT 7 billion (\$47.1 million) bond due on April 7, though it paid the final coupon on the 8.5 percent note, according to Bloomberg. Gaziz Shakhonov, Alliance's head of Investor Relations, said that the bank will finalize its debt restructuring plans by mid-June, Interfax reported.

Halyk Bank, the country's third-largest, became another one to be partly nationalized. On Feb. 3, 2009, the bank announced that Samruk-Kazyna acquired 20.9 percent of its outstanding share capital for KZT 27 billion (\$178.8 million) in the course of a share issuance conducted by the company. Samruk-Kazyna also paid KZT 33 billion (\$218.5 million) for an unspecified number of preferred shares of Halyk and deposited KZT 60 billion (\$397.4 million) to be used in line with the government's anti-crisis program. Thus, the total amount received by the bank equals KZT 120 billion (\$794.7 million).

Kazkommertsbank was also supported by the government under the program of saving the country's systemically important banks. On Feb. 2, 2009, the bank received a KZT 120 billion (\$794.7 million) deposit from Samruk-Kazyna. Kazkommertsbank is the country's second-largest bank, and, with net income of KZT 97,000 (\$644 million) in the first quarter of 2009, was the only bank to post a profit.

According to Bloomberg, the Kazakh government has already spent over KZT 716 billion (\$4.8 billion) supporting Kazakh banks.

## Meetings and Companies to Watch

Of the CEE countries, Russia attracts the greatest investor interest, followed by Ukraine, which has recently grown to become a destination for foreign investors, and then Poland and Hungary.

### Norilsk Investigated

OAO MMC Norilsk Nickel, Russia's biggest mining company, has recently come under investigation by Russian Deputy Prime Minister Igor Sechin, the Audit Chamber, and other regulators for allegations of shareholder abuse in a controversial share buyback and the purchase of energy assets carried out last year. In 2008, the company conducted a \$1.8 billion buyback of 4 percent of the company's shares. The buyback was decided before the onset of the financial crisis, but carried out thereafter when Norilsk's shares had lost a great deal of their value. Further, the company purchased assets for its energy generating subsidiary OAO OGK-3 from Interros Holding Co., which is controlled by Vladimir Potanin, who is also the largest shareholder of Norilsk. Some of Norilsk's shareholders have argued that the purchase was in effect a direct cash transfer to Potanin, at Norilsk's expense.

Interros and Norilsk have maintained that both deals were done in the best interests of all shareholders, as reported by *The Financial Times*

on March 25, 2009. Interros has defended the rationale behind the purchase of energy generating assets as part of an effort to make OGK-3 a vertically integrated energy company. The share repurchase, Norilsk has argued, was agreed upon before the onset of the crisis, and had to be carried out despite the fall in share prices. The outcome of the Russian authorities' investigation into these matters is pending.

Meanwhile, the high-profile shareholder conflict that has been going on at Norilsk since early 2008 continues to develop. As reported by *The Moscow Times* on April 21, 2009, Vladimir Potanin, who had been the company's largest shareholder to date with a 29.8 percent official stake (held through his holding company Interros), has reduced his stake to 25 percent. The development leaves Potanin with a stake equal to that held by Oleg Deripaska's UC Rusal, which has been involved in a lengthy struggle with Potanin for control of Norilsk.

The shareholder conflict between Potanin and Deripaska appears to have been put on hold in November 2008, when the two parties declared a truce. However, given the ongoing investigation into Norilsk by Russian authorities mentioned above, and other unresolved issues surrounding the shareholder conflict, the company's annual general meeting, to be held before June 30, 2009, may yet prove to be contentious.

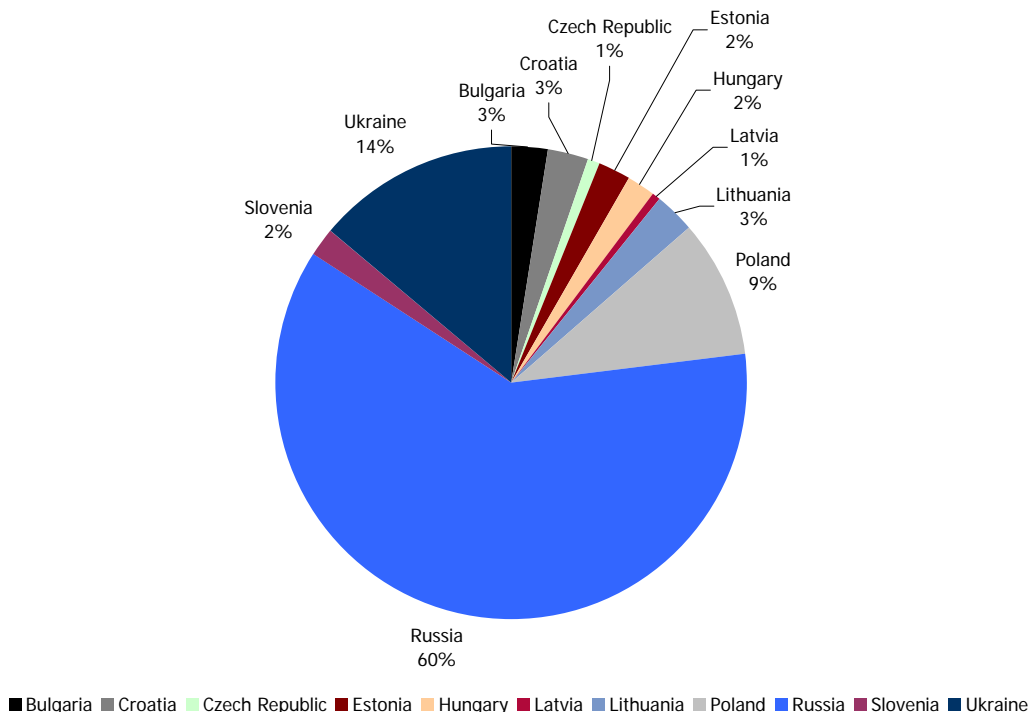


Fig. 2: Meeting Volume Breakdown by Market, 2008

### Potанин’s Stake in Polyus Gold Changes Hands

The biggest “divorce” in modern Russian business history between Vladimir Potanin, the owner of Interros Holding Co., and Mikhail Prokhorov, who controls Onexim Group LLC, affected a number of Russian companies throughout 2008, and is likely to continue in 2009.

MMC Norilsk Nickel’s affiliate company, the gold miner OAO Polyus Gold, did not remain unaffected by the feud. In early March 2009, Vladimir Potanin sold 20 percent of Polyus Gold to Suleiman Kerimov, according to media reports. Reportedly, Potanin plans to use the proceeds to pay back a loan from the Russian VTB bank. Prior to the sale, Potanin held approximately 35 percent of Polyus, and part of that stake was allegedly pledged as collateral to the VTB loan. In February 2009, VTB itself sought approval from the Russian Federal

Anti-Monopoly service to buy as much as 50 percent of Polyus. In the end, VTB withdrew its request for clearance to purchase the stake.

On April 17, 2009, Potanin sold his remaining 15 percent stake in Polyus Gold to Kerimov, who currently controls approximately 37 percent of the company’s outstanding shares. Reportedly, the structure used to purchase the stake is Nafta Moscow, Ltd., which is controlled by Kerimov.

### Yukos’ Khodorkovsky Back in Court

The second trial of Mikhail Khodorkovsky, the erstwhile CEO of OAO Yukos Oil Co., opened in Moscow on March 31, 2009. He is charged with the embezzlement of 350 million tons of oil and laundering the proceeds through offshore trading companies.

Khodorkovsky was first arrested in October 2003 on charges of tax evasion and fraud. He was found guilty and sentenced to eight years in prison, while

Yukos' assets were distributed among state-controlled enterprises. The case was widely seen in Russia and elsewhere as a politically motivated attack on an entrepreneur who built the Yukos oil conglomerate--once Russia's largest company-- and who was using his wealth to gain political influence to challenge Russian President Vladimir Putin by helping to finance Russia's liberal democratic opposition. The controversy over Yukos undoubtedly undermined Russia's credibility with both foreign and domestic investors.

The media widely speculates that the second trial aims at keeping Khodorkovsky behind bars as his sentence runs out in 2011, a few months before the next presidential election in Russia.

### Mechel Faces Lawsuit

The Russian steel and coal producer OAO Mechel was sued by an investor over the decline in the company's share price brought on by a government investigation into alleged anti-monopoly practices. In late July 2008, Russian Prime Minister Vladimir Putin commented on the company's alleged misconduct, and noted the possibility of government action, precipitating a sharp drop in the company's share price as investors feared another Yukos-style government crackdown.

Recently, investor Dean Frederick has filed a lawsuit against the company, alleging that it committed securities fraud by not properly disclosing the conduct which led to the government investigation.

Mechel has not commented publicly on the allegations as it has not yet had time to study the case files. The company has stated, however, that it has maintained full transparency with shareholders in all its affairs.

### TNK-BP Still without CEO

BP PLC and its partners in the Russian oil producer TNK-BP Ltd. have agreed to extend the contract of the joint venture's acting CEO, Tim Summers, as they attempt to find a new CEO. The TNK-BP joint venture was formed in 2003 through the merger of oil and gas assets of the U.K.-based energy company British Petroleum (BP) with the assets of a consortium of Russian investors collectively referred to as Alfa-Access-Renova, or AAR. The two shareholders have been involved in a long-running dispute over strategy and control over the joint

venture. The company's then CEO, Robert Dudley, fled Russia last summer and eventually stood down in December. Under the terms of the memorandum of understanding signed between the two conflicted parties, TNK-BP Ltd. would form a new management team, including a new CEO. A new TNK-BP Ltd. CEO is to be nominated by BP and will require the board's unanimous approval. Denis Morozov, the former CEO of MMC Norilsk Nickel, is rumored to be one of the candidates for the job.

### Currency Call Options Lead Polish Company to Financial Distress

The Polish family-controlled meat processing company Polski Koncern Miesny Duda SA (PKM Duda) is facing serious financial problems. In 2008 the company purchased currency call options under the assumption that the Polish zloty will keep strengthening against the dollar and the euro. However, the Polish currency weakened dramatically. Following claims denying its investment in the options, the company finally admitted to having incurred massive financial losses. PKM Duda is currently under the investigation of the Polish Financial Supervisory Authority (PFSA), which is trying to determine whether the company intentionally failed to inform its investors about financial problems caused by the purchase of the currency call options. Additionally, several of its creditors filed for the company's liquidation. Furthermore, the Polish Association of Individual Investors has made several statements indicating that the company's individual investors might try to file lawsuits against PKM Duda's management board. Meanwhile, the CEO has reassured investors that his family's intention is to keep an unchanged stake in the company. He has also disclosed that the company is currently negotiating its debts with creditors.

It is reasonable to expect that many of the company's investors will chose not to grant discharge to the company's management and/or supervisory board at this year's annual meeting. It is also possible that supervisory board elections will be contested. Finally, some of the company's shareholders might place their own proposals on the meeting agenda.

### RBC Information Systems

The prominent Russian media group OAO RBC Information Systems (RBC) has suffered severely

due to the financial crisis. After taking significant losses in the second half of 2008, the company's cash reserves have dropped substantially, from a reported \$290 million in July 2008 to approximately \$10 million most recently, as reported by *Prime-Tass*. Further, according to *Vedomosti*, the company has total outstanding debts of over \$200 million, with approximately \$133 million coming due before July 2009. In March 2009 the company allowed a technical default on \$1.5 million worth of debt obligations.

To pay off its debts, RBC has been looking to attract loans, restructure its debts and potentially spin off some of its businesses.

As reported by *Infox.ru*, two of the company's shareholders, UniCredit Securities and Management Company Rosbank, who jointly control approximately 28 percent of RBC's share capital, have called for the initiation of bankruptcy proceedings against the company, reportedly in order to write off some of the company's debts. Representatives of both shareholders have either denied these reports, or declined to comment. The two shareholders called a general meeting on April 15, 2009, in an attempt to put more of their representatives on the company's board of directors. However, the proposal to terminate the current board did not pass the shareholder vote.

RBC's conflict with these shareholders remains unresolved. Further, several lawsuits have been brought against the company by creditors and shareholders seeking to recoup their losses. Significant changes in the company's business structure and ownership are possible as a result of these proceedings. These and other issues may come up at the company's annual meeting, which is to take place before the end of June 2009.

## Key Voting Issues to Consider in 2009

On July 11, 2007, EU Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies went into force. The Directive aims at harmonizing the legal regulations on the exercise of the rights of shareholders in companies listed in EU member states, which are required to fold the regulations into local legislation by Aug. 3, 2009. Thus, during the 2009 proxy season, companies

based in EU member states will ask shareholders to amend their articles of association to incorporate the provisions into new local laws.

### Bulgaria

In March 2009, the Bulgarian parliament approved amendments to the Public Offering of Securities Act with respect to general meetings of publicly listed companies, thus harmonizing Bulgarian legislation with the provisions of the Directive. The changes will become effective on Aug. 3, 2009.

Public companies will now be required to publish meeting notices and all documents pertaining to general meetings on their Web sites from the time of announcement of the meeting, i.e., 30 days prior to the date of the meeting, until its completion. Minutes of meetings will be available on company Web sites for a minimum period of one year following a general meeting.

Among others, the amended Act sets new requirements regarding the content of meeting notices. Along with the company name and its corporate address, the location, time, and type of meeting, the conditions for participation in the meeting and for exercising shareholders' rights, the agenda, and an outline of proposed resolutions, each meeting notice should contain information on (1) the total number of shares and underlying voting rights at the company as of the date of calling the meeting; (2) shareholder rights to include items in the meeting agenda and the deadline for the submission of relevant requests; (3) shareholder rights to propose items for discussion at the meeting; (4) proxy voting requirements, including electronic proxy authorization; (5) rules for voting electronically or by mail, if applicable; and (6) the record date, which is to be fixed at 14 days prior to the meeting.

Next, companies will have the option to allow shareholders to participate in general meetings electronically. Thus, live broadcasting as well as instant messaging will be permitted. Further, shareholders will be allowed to cast their votes ahead of the meeting, via mail. The right to vote by correspondence should be exercised at least one day prior to the meeting. Companies will have to ensure proper identification of shareholders and their proxies, and provide a secure electronic connection.

The new provisions simplify the proxy voting procedures. It will no longer be required that the power of attorney for representation at the general meeting be notarized. The new law also sets out the minimum requisites a power of attorney should contain for it to be valid. The authorization could also be done electronically. Public companies should ensure the provision of at least one means for receiving electronic authorizations. The terms and conditions for that must be published on the company Web site. In addition, members of the board of directors (in unitary board system companies), and members of the management board and the supervisory board (in companies which follow the two-tier board structure) can now be appointed as proxies. They cannot, however, unlike other proxies, be authorized to act at their own discretion, but rather need to be explicitly instructed as to the vote they will be casting under each agenda item. Proxies can also represent more than one shareholder at a general meeting.

## Poland

In October 2008, the Polish Ministry of Justice presented an initial draft of the changes to the Code of Commercial Partnerships and Companies, which aim at implementing the EU Shareholder Rights Directive. The changes are to become effective on Aug. 3, 2009. Once implemented, shareholders of public companies will have easier access to information on general meetings and meeting results, the option to send votes by registered mail or participate in general meetings electronically. In addition, the trading of shares prior to a general meeting and split voting will be permitted.

Among others, the amendments will extend the record date from the current seven days prior to a general meeting to 16 days prior to the meeting, and blocking of securities will no longer be required, allowing shares to be freely tradable prior to the meeting. In addition, company statutes will be able to assume electronic participation in general meetings, including live broadcasting of meetings, issuer-investor communication through electronic means during the meeting, and electronic voting. Further, shareholders will be able to submit their votes via registered mail. Finally, issuers will be required to publish meeting notices on their Web site at least 26 days prior to a general meeting, as opposed to the current 21-day deadline.

## Slovenia

In early March 2009, the Slovenian government approved amendments to the Companies Act aimed at harmonizing local law with the Directive. Overall, the amendments reinforce the principle of equal treatment of shareholders, primarily through the content available on company Web sites, the possibility to participate in general meetings by electronic means, and to vote via mail.

If approved by the Slovenian parliament, the new law will require the publication of reference and other relevant meeting materials on companies' corporate Web sites. The amendments also aim at facilitating the appointment of proxies, mandate disclosure of conflicts of interest when providing representation at general meetings, and require publication of vote results on corporate Web sites.

## Key Governance Issues to Consider in 2009

### Ukraine Introduces Companies Act

On Sept. 17, 2008, the Ukrainian parliament approved the new Companies Act (Zakon pro aktsionerni tovarystva). The new law, whose introduction aims at providing greater protection of shareholder rights and interests, went into force on April 30, 2009, but companies will have up to two years to fully implement all of its provisions. The new Act amends existing regulations with respect to, among others, public companies' equity, general meetings, director elections, and information disclosure.

Unlike the previous Companies Act, the new law guarantees that shareholders' preemptive rights will be honored in the case of private issuances, which target selected investors. This is an important safeguard of shareholders' interests and rights. Shares issued to the general public in the course of public issuances do not carry preemptive rights, which was also the case in the past. Additionally, a new share issuance may be approved and conducted only if the results of all previous issuances have been registered.

The new Act introduces the right of withdrawal, which obligates companies to buy back their shares from shareholders who registered to attend a

general meeting which approved a transaction that triggers the right, and who voted against the proposal in question. The right of withdrawal, which can be exercised by common shareholders, applies to: (1) mergers, acquisitions, spinoffs, and conversion from public to private company; (2) large-scale transactions, and (3) increases and decreases in company's outstanding share capital. Preferred shareholders may exercise their right of withdrawal only with respect to issuances of a new class of higher-ranking preferred shares, or when a proposal affects their preferred rights.

The concept and definition of large-scale transactions have been introduced into the Companies Act. Under the new law, a transaction is classified as "large-scale" if its value is higher than the value of 25 percent of a company's assets. All large-scale transactions require general meeting approval. Transactions valued at between 25 and 50 percent of the value of a company's assets must be approved by a simple majority of all shareholder votes present at the meeting, while those valued at more than 50 percent of the value of the company's assets require a 75-percent supermajority vote. If certain details on a proposed large-scale transaction are unknown, a company may seek a less concrete authorization to conclude the deal. The authorization, valid for up to one year, must, however, specify the upper value of the transaction.

The new law relaxes the deadline of the publication of meeting notices from the previous 45 days prior to a general meeting to 30 days prior to the meeting. A written copy of the meeting notice must be provided to each shareholder. In addition, meeting notices must be published in a designated newspaper and provided to the stock exchange on which company shares are traded. The old Companies Act, which allowed each company to formulate exact rules pertaining to the disclosure of meeting materials, required that meeting notices be disclosed in several printed Ukrainian publications. Those, however, were often time unavailable to retail shareholders and foreign investors. Further, under the new law, meeting notices must include information on: (1) company name and location; (2) date and exact meeting location; (3) starting and ending time for registration of meeting participants; (4) record date; (5) meeting agenda; and (6) procedures for obtaining further details on agenda items.

The introduction of the new Act marks Ukraine's adoption of the record date system. The record date may not be set at more than 60 days prior to a general meeting. In the past, the lack of record dates caused problems in establishing the ownership structure of many companies. In extreme cases eligible shareholders were not allowed to attend and vote at general meetings.

Under the new Companies Act, any shareholder, irrespective of his/her stake in a company, has the right to submit proposals and counter proposals to be included in the agenda of a general meeting. If a (counter) proposal has been submitted by a shareholder or a group of shareholders controlling less than 5 percent of a company's common shares, the company's supervisory board decides whether it should be included in the meeting agenda. Proposals submitted by a shareholder or a group of shareholders controlling at least 5 percent of a company's common shares must be added to the agenda. The previous law set the respective ownership requirements at 10 percent. Further, under the new Act, the content of shareholder (counter) proposals cannot be modified by the company, which was not the case earlier. The new law also mandates companies to disclose any changes to the meeting agenda, made in connection with the reception of shareholder (counter) proposals, at least 10 days prior to the meeting.

Under the new Act, special meetings called by shareholders must be convened within 30 days following the submission of the request, in contrast to the 20-day period mandated by the previous legislation.

The new Companies Act introduces a number of new provisions regulating the supervisory board of public companies. First, the board must be elected at least every three years. Second, supervisory board members are elected via cumulative voting, in contrast to majority voting under the old legislation. Finally, the Act fixes the size of the board at no fewer than five directors at companies with no more than 1,000 shareholders, no fewer than seven directors at companies with at least 1,000 shareholders, and no fewer than nine directors at companies with at least 10,000 shareholders.

Under the new law, all Ukrainian public companies are required to have a Web site. The following information has to be disclosed on a company Web

site: (1) company statute and internal regulations (regulations on supervisory board, management board, audit commission, and others); (2) internal corporate governance code; (3) minutes of previous general meetings; (4) auditor's and audit commission's reports; (5) annual financial statements; (6) affiliated persons reports; and (7) other relevant information required by law. No such requirements existed under the previous Act. Some Ukrainian companies still do not maintain a Web site, and lack transparency with respect to their financials, governing statutes, and other internal documents, or other information.

### Russian State to Promote Director Independence?

Over the last few years, shareholders have begun to take a more active role in the management of Russian companies by nominating independent candidates to their boards and by forging alliances with other minority shareholders to have these independent nominees elected. Once on the board, these individuals have taken a more active role in reviewing the activities of management and making the companies more responsive to the interests of shareholders. Although the number of independents on the boards of Russian public companies has been gradually growing, only a handful of Russian company boards have one or more truly independent directors.

In July 2008, Russian President Dmitry Medvedev remarked that independent directors should replace government officials on the boards of companies with state ownership. The main reason behind the initiative is an objective set by Medvedev to reduce "legal nihilism" in Russia and strengthen requirements for the companies to adhere to foreign corporate governance standards. As explained by Igor Shuvalov, Russia's first deputy prime minister, the state is proposing to retain only one seat on the board of targeted companies.

Medvedev's remark has prompted the first wave of independent appointments at, among others, the state-controlled OAO Savings Bank of Russia (Sberbank), OAO Transneft, which is controlled by the Russian State and operates one of the largest networks of oil pipelines in the world, OAO Russian Railways, the wholly state-owned rail monopoly, and OAO Sheremetyevo International Airport, the Moscow-based international airport fully owned by the government.

While the initiative appears positive in terms of its ability to increase independence levels on Russian boards, the criteria of nominee selection and the mechanism of nominating independents remain non-transparent. The candidates themselves appear confused as to what role they should play on company boards. They are not government officials per se, but have been nominated by the state. Many appointments will likely raise questions about how truly independent candidates are and their ability to serve independently from the government. Press reports suggest many nominees would most likely have the status of semi-independent candidates who follow the instructions of the state when voting on key issues. For instance, as reported by the Russian daily *Kommersant*, the government nominated five independent candidates to the board of the government-controlled telecommunications holding company OAO Svyazinvest. When asked to clarify the nominees' status if elected to Svyazinvest's board at the company's 2009 annual meeting, the government responded that three of them would actually be expected to follow the instructions of the state when voting on a number of board resolutions, including the approval of general meeting agendas, increases in share capital via issuances of new shares, large-scale transactions, the company's dividend policy, and the appointment of the chairman of the board.

The independent status of two candidates nominated by the government as independents to the board of OAO Rosneft Oil Co., which is majority-owned by the state, is also questionable. Both nominees currently serve as general directors (CEOs) of the Russian oil giant OAO Surgutneftegas and the oil pipeline operator OAO Transneft. The latter is controlled by the state, while the former is reported to have close ties with the Kremlin.

Clearly, the state is willing to follow its new initiative at select companies only. Of the 18 candidates to the board of OAO Gazprom, which will hold its annual meeting on June 26, 2009, three have no material relations, either directly or indirectly, with the company, but none of them has been nominated by the state. The government has nominated seven candidates to serve as its representatives. The remaining eight nominees are executives of either Gazprom or its affiliates. Interestingly, not a single independent director currently serves on Gazprom's board. One of the board members elected at Gazprom's June 27,

2008, annual meeting, Boris Fedorov, was considered independent by the company, but passed away in November 2008. The company never called a general meeting to fill the vacancy.

The Russian parliament is currently working on a bill that would amend the Russian Law on Joint Stock Companies with respect to requirements imposed on candidates to companies' boards of directors. The group of Russian senators that proposed the bill claims that the issue is currently discussed only in the Russian Corporate Governance Code, and is therefore of an advisory nature. Opponents of the new legislation consider it a breach of civil rights and do not see why the government should decide on who is to be nominated to the boards of public companies.

Should the amendments be adopted, a person will not be able to simultaneously serve on more than two public boards or simultaneously chair more than one public board. Further, only persons ranging in age from 25 to 70 years old could be nominated to companies' boards. In addition, candidates would have to possess a college degree in the area of law or economics, or a college degree in an area corresponding to the field in which the company operates, both accompanied by relevant professional experience of no less than three years.

In general, the initiative to appoint independent directors to the boards of Russian state-owned and state-controlled companies is a positive step. However, the lack of qualified and professional nominees, unclear criteria for director independence, as well as vague procedures of nominee selection remains a concern.

### CEE Countries Establish Audit Committees

Due to the entry into force on May 17, 2006 of EU Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, CEE countries within the EU have either already amended, or are in the process of amending, their audit laws.

The goal of the Directive is to increase the quality of audits in Europe. The Directive obligates each member state to organize an effective system of public supervision of auditors and audit companies, which could secure high quality audits of financial statements and spur investor confidence in the

audited financial statements. In addition, the Directive sets out a number of ethical principles to ensure the independence and objectivity of statutory auditors. While the Directive does not make it mandatory for companies to maintain audit committees, it makes a reference to the European Commission Recommendation of Feb. 15, 2005, on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, which sets out how audit committees should be established and function. EU members were to adopt and publish the provisions necessary to comply with the Directive before June 29, 2008.

The Bulgarian Independent Financial Audit Act was amended in 2008, thus transposing into Bulgarian law the provisions of the Directive. Among others, the amendments introduced the obligation for public companies to maintain audit committees, which are elected by the general meeting. Under the amended Act, shareholders also determine the term of office and the number of members of the audit committee.

The Act states that at least one member of a company's audit committee must have a university degree in accounting or finance, and at least five years of professional experience in accounting or audit. In addition, at least one audit committee member must be independent. Executive directors and members of the management bodies of public companies may not serve on audit committees. Audit committees must report the results of their activity to the general meeting on an annual basis, alongside the adoption of financial statements. The appointment of a statutory auditor must be based on a recommendation made by the audit committee.

The Czech Act on Auditors is currently being amended due to the implementation of the Directive. Among other changes, a company's external auditor will be elected and recalled by the company's general meeting, and not its board of directors, as it is at present. The board will subsequently conclude a contract with the auditor. Further, the amended Act would require companies to set up an audit committee composed of at least three members. Of those three, at least one will have to be independent of the company and have at least three years of audit-related experience. Committee members will be elected either from among the company's supervisory

board members or from among third-parties outside the company.

The amended Act envisages strict independence requirements for statutory auditors and audit firms. Auditors of public companies will have to annually confirm to the audit committee their independence from the company and disclose any additional services rendered to the company. The oversight of the audit profession will now be performed by a new body, the Public Audit Oversight Board, composed of six members appointed by the minister of finance in agreement with the central bank.

All publicly listed Czech companies will have to start complying with the provisions of the amended Act by Dec. 31, 2009.

On Sept. 1, 2008, the amended Law on Audit went into force in Lithuania. The law, which aims to ensure high standards and quality annual report audits, creates a new system of public supervision. In addition, under the new law, public stock companies whose shares are traded on a regulated market in Lithuania and other EU member states, banks, and the Central Credit Union must maintain audit committees. The changes, in turn, prompted the Lithuanian Securities Commission to issue the Requirements for Audit Committees, which establish a detailed procedure for the formation of audit committees at Lithuanian public stock companies and regulate committees' activities.

Under the requirements, the audit committee should be composed of at least three members, one of whom must be independent and have at least five years' experience in the field of audit and accounting. The requirements provide for a two-member audit committee if a company does not maintain a supervisory board or if the size of the supervisory board does not allow for the formation of three-member board committees.

In addition, the requirements make it mandatory for companies to set internal regulations defining, among others, the rights and obligations of an audit committee, its size, and the term of office of committee members, as well as requirements for their educational background, professional experience, and independence.

## M&A Issues to Consider in 2009

### Telecoms

Press reports indicate that Russian telecoms group OAO AFK Sistema is seeking to acquire an additional 25 percent of state-controlled Russian telecommunications holding company OAO Svyazinvest. Currently, Sistema controls 25 percent plus one share in Svyazinvest via its subsidiary OAO Comstar UTS, while the Russian government owns the remaining shares. According to press reports, Comstar will offer RUB 20 billion (\$614.4 million) for a further 25 percent stake in Svyazinvest, allowing it to secure control of the company. Russia's Communications Ministry has said the government had no intention of selling its Svyazinvest shares, however. The government is currently mapping out another restructuring plan for Svyazinvest, whose privatization has been delayed by nearly a decade. It is believed that the government might try to negotiate a non-cash swap of the Svyazinvest stake held by Comstar for Svyazinvest's shares in the Moscow fixed-line network MGTS, which is already majority-held by Sistema.

The Russian fixed-line services provider OAO Comstar UTS has also been a subject of speculations on its merger with the Russian mobile service provider OAO Mobile Telesystems (MTS), which, like Comstar, is controlled by OAO AFK Sistema. On April 2, 2009, the media reported that Sistema had asked several investment banks to carry out a valuation of Comstar and work out a plan for the sale of the fixed-line operator. Russian business news provider *Vedomosti* also reported that MTS is interested in the merger, but so far the companies have not been able to agree on a price. MTS is said to value Sistema's stake in Comstar at \$850 million, while Comstar says it is worth about \$2.2 billion. As reported by *Interfax*, Sistema intends to decide on the merger by July, according to a statement made by Leonid Melamed, Sistema's president and CEO, at an April 30 press conference.

### Energy

On March 30, 2009, the Austrian energy company OMV announced in a press release that it had sold its 21.2 percent stake in MOL Hungarian Oil and Gas to the Russian energy company OAO Surgutneftegas, for a total consideration of EUR 1.4 billion (\$1.8 billion). The total price

corresponded to HUF 19,212 (\$82.01) per share, as compared to the closing price of the MOL stock of HUF 9,940 (\$42.42) per share on the last day of trading prior to the announcement of the sale. MOL immediately declared its intent to pursue its independent strategy and branded the Russians company's intentions "unclear." At MOL's April 23, 2009, annual meeting, shareholders approved a number of article amendments aimed at preventing a possible takeover of the company. These included, among others, a proposal that requires shareholders with stakes exceeding 2 percent to disclose their ownership. Further, the holder of the B series share (golden share) has now gained the right to veto any proposals approved by shareholders, but not by the board. Finally, a general meeting will have the right to dismiss only one director at a time, while no other board members can be recalled from the board within three months following the last dismissal. Surgutneftegas is run by Vladimir Bogdanov who, as reported by *The Financial Times*, is a close ally of Vladimir Putin, the Russian prime minister. The MOL-Surgutneftegas deal is widely considered the first foreign acquisition in the Kremlin's search to find ways to strengthen Russia's position in European energy markets.

Meanwhile, the Italian energy company Eni has closed a deal to sell a 20 percent stake in OAO GazpromNeft to its parent company, the Russian energy giant OAO Gazprom, as reported by Bloomberg on April 24, 2009. The sale will bring Gazprom's total stake in its subsidiary to 95.7 percent. Further, GazpromNeft has recently purchased a 16 percent stake in Sibir Energy, a UK-listed energy company operating in Russia and the UK. As reported by *The Financial Times* on April 23, 2009, the move puts GazpromNeft in a prime position to pursue a full takeover of Sibir Energy if desired, in what could be the first of a series of possible consolidations of Russian oil assets brought on by the financial crisis.

In February 2009, OAO GazpromNeft acquired a 51 percent stake in the Serbian national oil company Naftna Industrija Srbije AD (NIS) for EUR 400 million (\$535.9 million). According to the acquirer, the agreement also provides for the reconstruction and upgrade of NIS' process facilities by 2012.

The Russian OAO Lukoil Oil Co. is planning to bid for part of Ceska Rafinerska AS, the Czech Republic's largest crude oil processing firm and a

subsidiary of the petrochemical group Unipetrol. Unipetrol owns 51 percent of Ceska Rafinerska, with a consortium of Shell, Eni, and ConocoPhillips controlling the remaining stake. Lukoil, which already owns a network of 44 gas stations in the country, is interested in acquiring 16 percent of the Czech refinery, as reported by the Czech business daily *Hospodarske Noviny*. Lukoil reportedly has also approached Poland's largest oil concern, PKN Orlen SA, about the possibility of taking over Lithuania's refiner Mazeikiu Nafta from the Polish firm. PKN Orlen bought a controlling stake in Mazeikiu Nafta in 2006 and currently owns 90 percent of the refiner. PKN Orlen has also agreed to buy the remaining 10 percent from the Lithuanian government. Lukoil has denied the reports.

The media has also reported on Lukoil's talks with UK-listed Regal Petroleum regarding a possible acquisition of its core Ukrainian assets. Reportedly, the talks could even lead to a full acquisition of Regal, which said late last year it was inviting bids from industry partners to take a stake in its Ukraine gas fields, in return for helping to finance the fields' development, as reported by Reuters. Regal said it had received offers from several companies, but talks are at the initial stage. Sources tell Russian and other business media that Lukoil is prepared to pay \$1 billion for the assets. Lukoil has declined to comment on the reports.

## Financials

On Jan. 29 2009, Noble Bank SA, the publicly-listed Polish bank specializing in private banking services, issued a statement announcing its plans to merge with the private GETIN Bank. As explained in the statement, "the planned merger constitutes a friendly consolidation of two institutions comprising the same financial group." Both companies are controlled by Getin Holding SA, which holds 99.6 percent of shares in GETIN Bank and 73.7 percent of shares in Noble Bank, and is itself listed on the Warsaw Stock Exchange. Noble Bank will be the acquirer in this transaction. As explained further in the statement, "a fully universal bank will be created as a result of the merger. The bank will offer a wide range of financial credit, savings, and investment products, and a wide range of auxiliary financial services both for individual clients and corporations." A Noble Bank special meeting, which will vote on the proposed merger agreement, is scheduled for June 18, 2009.

As reported by the media in December 2008, the Russian State-controlled OAO Savings Bank of Russia (Sberbank) had held preliminary negotiations regarding the acquisition of Raiffeisen Bank of Austria and Hungary's OTP Bank. Allegedly, Sberbank is interested in buying one of the banks to expand its business beyond Russia. In a December 2008 interview with the daily *Russia Today*, German Gref, the general director (CEO) of Sberbank, called the reports "false rumors" and added that Sberbank was not interested in the acquisition of either bank. Whether in response to the rumor or for other reasons, the agenda of OTP Bank's April 24, 2009, annual meeting contained a proposal to lower the current 25 percent voting right cap to 10 percent. The proposal, which required the support of 75 percent of shareholders, was voted down at the meeting. On April 16, 2009, OTP Bank announced in a press release that it had transferred 24 million treasury shares to MOL Hungarian Oil and Gas, the country's largest refiner, in exchange for 5 million MOL series A shares. The share swap agreement expires on July 11, 2012, and both companies retain the option to buy back the shares until that date.

Sberbank is reportedly also interested in the Kazakh BTA Bank. Soon after the Kazakh government announced its acquisition in February 2009 of a 78.1 percent stake in BTA, it voiced its intention to sell part of the stake to a domestic or foreign investor. Sberbank was immediately rumored to be the number one candidate for BTA's acquisition. Shortly after, Sberbank CEO Gref said that the company was studying BTA's financial condition and that it is cautious about making large-scale acquisitions during times of financial crisis. According to recent media reports, both banks are working on a program to jointly appraise BTA's financial standing, after which Sberbank is expected to decide on the potential purchase. The results of the talks are to be released in May. Sberbank is rumored to potentially acquire as much as 53 percent of BTA.

Notwithstanding the above, the head of the Kazakh Central bank, Grigory Marchenko, said in mid-April that there is a possibility of a sale of the Kazakh

Alliance Bank and BTA to domestic investors after a debt restructuring has been completed. He did not, however, name any potential buyers. The Almaty-based Eurasian Bank expressed interest in buying BTA shortly after the February announcement of BTA's bailout and its possible sale to Sberbank. Eurasian Bank, which is wholly owned by three Kazakh billionaires, Aleksandr Machkevich, Alidzhan Ibragimov, and Patokh Chodiyev, remarked that Kazakh investors should be given priority in any BTA share sale.

## Consumer Goods

On May 5, 2008, Vistula & Wolczanka SA, the Polish clothes manufacturer, announced its intention to buy up to 66 percent of shares in W.Kruk SA, the Polish producer of luxury articles, including jewelry products, watches, and garments. As explained by Vistula & Wolczanka's CEO, the intent in part was to build the largest luxury goods company in Poland. The Kruk family, the founding family of W.Kruk, which at the time owned approximately 28 percent of the company's outstanding share capital, refused the offer of Vistula & Wolczanka. The management of W.Kruk initially opposed the offer calling it a hostile takeover. Still, Vistula & Wolczanka successfully purchased 66 percent of W.Kruk's outstanding share capital. This was possible as W.Kruk institutional shareholders, who initially controlled about 40 percent of W.Kruk's outstanding share capital, sold their shares to Vistula & Wolczanka. The two companies merged under the name The Vistula Group. The Kruk family, however, started buying shares of the merged company, and currently controls 10 percent of The Vistula Group, which makes it the third largest shareholder of the company. Wojciech Kruk, the former CEO of W.Kruk, currently serves on The Vistula Group's supervisory board.

It is possible that the Kruk family might attempt to increase its stake in the company to gain representation on its management and/or supervisory board. The Vistula Group has not yet set a date for its 2009 annual meeting, though these events suggest it will be one to watch.

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