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THE NEW LEGAL REGIME ON MINORITY SHAREHOLDER PROTECTION IN ALBANIA

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ABSTRACT

This article aims at introducing the main changes brought by the new Albanian Company Law on minority shareholders' protection. Due to the harmonization of our legislation with the acqui, new pieces of laws were introduced in commercial law. In 2008 the new law "On entrepreneurs and commercial companies" was enacted. The latter introduced new practices and concepts, some of them not familiar to the Albanian legal system. I was motivated to write a paper on minority shareholders protection in order to emphasize the new regime and instruments of protection granted by the new laws. A matter which concerns investors and especially foreign ones is the protection of minority shareholders. This paper discusses the instruments of protection of minority shareholders bringing the novelties of the newly introduced laws because of the unclear regime under the repealed law using the analytical and comparative method. Few rights which were known by the former Albanian company law were usually compromised, but under the law in force, minorities are much more protected.

Does the new law strengthen the position of such category of shareholders? What are the rights of minority shareholders conferred by the law? These and other questions will be addressed herein.

JEL CLASSIFICATION & KEYWORDS

■ K22 ■ Minority shareholder ■ Protection ■ Fiduciary duties

INTRODUCTION

The process of Albanian's integration in the European Union carries major obligations especially with respect to the legal reform. In this view, major legislative reforms were undertaken especially in company law area. Recently a set of new laws regulating commercial companies were introduced as a new piece of legislation in accordance with European standards. This paper takes into consideration the new law No. 9901, dated 14.04.2008 "On Entrepreneurs and Commercial Companies" and the rights conferred by this law to minority shareholders.

The position of minority shareholders, under the repealed law "On Commercial Companies" has been rather weak especially compared to the Supervisory Board. It is noteworthy that minority shareholders had no representation in the Board and its members were generally relatives or family members of the majority shareholders. Therefore, no protection was guaranteed to minorities based also on the fact that there was no obligation on Board members to treat equally all shareholders in the company, regardless the numbers of shares owned by them. In these circumstances, major shareholders had their dominance in the company whatever the will of other shareholders. These factors have contributed to a weaker minority shareholders protection which hindered attraction of foreign investors.

The newly introduced law creates a friendlier legal environment for foreign and domestic investors because it grants a more fortified level of protection for minorities.

Also, it is noteworthy to emphasize that in our country there is no tradition of Corporate Governance, due to the lack of any formalized Corporate Governance Code and due to the fact that the first law on companies was only approved in 1992 and our country had no experience on the management of Joint Stock Companies, because enterprises were held by state. Anyhow, principles of Corporate Governance have been incorporated in provisions of the Albanian Company Law.

The new law tries to introduce a new era on minority protection. This level of protection is important because as pointed out in La Porta et al (1993: 35); La Porta et al (1997); La Porta: (1998) "a country's legal mechanisms for the protection of minority shareholders have been seen by some Western economists as an important indicator of the success of these markets in attracting capital, such that 'countries with poor investor protections indeed have significantly smaller debt and equity markets" (Tomasic, 2007). This is the case of Albania, which in the current situation, has no functioning stock exchange, although existing as of 1996. The debt market is in its early stage of development, but far from an institutionalized and well regulated market.

Thus, a new legal environment protecting minority shareholders will positively contribute to develop new debt and equity markets.

Reasons of minority shareholders protection

Commercial companies usually have a non-concentrated ownership (not concentrated into the hands of few large shareholders), consisting in a number of shareholders that often do not own the same part in the company. Therefore some of them are controlling shareholders and the rest are minority ones. In certain circumstances, controlling and minority shareholders will have conflicting interests and in these cases the controlling shareholders may try to take actions to capture advantages of the business for themselves at the expense of the interests of the remaining shareholders. "Minority shareholders are vulnerable to expropriate from major shareholders. Expropriation can take the form of profit reallocation, assets misuse, transfer pricing, sell below the market price departments or parts of the firm to other firms that major shareholders own, or acquisition of other firms that major shareholders own at a premium (La Porta et al., 2000)." (Lazarides, 2010). It is in these circumstances that minority shareholder protection mechanisms assume importance as it is important to balance the interests of the majority and minority shareholders.

Why minority protection? The first reason why the Albanian legislation grants protection to minority shareholders is related to attraction foreign investors to invest in the domestic market, because the more protected the minorities are there are greater chances to attract their investments. A friendlier legal environment for investors is the one that grants the majority of mechanisms to protect minorities from the dominant shareholders.

Another reason why it is necessary to grant protection to minorities is related to the fact that all shareholder should be treated equally, despite of their ownership of shares in a company. All shareholders, large or small, should

receive adequate protection from the law and shall be granted equal rights because they have a thing in common, ownership of shares (regardless their part).

The legislative competition in European countries is contributing to attract foreign investments, because there exist a positive correlation between strong law based protection of minority shareholders and foreign investments. Albanian legislation is in the same pace offering this legislative framework; it aims at guaranteeing minority shareholders some basic rights in order to achieve their economic interests and to make safe investments.

"Better protection comes from better legal protection, stronger structure of the internal control mechanisms and more efficient capital markets and market for corporate control." (Lazarides, 2010).

One of the methods to ensure the minority rights is to follow good Corporate Governance principles because there exists a relation between the level of protection of minority shareholders and incorporation of good practices of Corporate Governance. Such principles aims at balancing the interest between major and minor shareholders, and usually do not infringe minorities rights through guaranteeing at least the following minority rights such as loyalty (of major shareholders toward minorities), voice (the right of minorities to be heard on regard of business matters) and exit rights.

Who is considered minority shareholder?

Minority shareholders are small investor in companies that generally due to their small of shares are not able to affect business decisions. The Albanian Company Law (hereinafter referred to as ACL), and case law so far have not defined the term "minority shareholder". There are several provisions in the ACL which refer to some special rights which are entailed by those shareholders representing at least 5% of the basic capital or a smaller amount envisaged by the statute. This definition does not mean that a minority shareholder is the one who represent at least 5% of the basic capital. The minority shareholders are to be considered case by case by analyzing the capital structure and especially due to the fact that the ACL allows the issuance of preferential shares the holders of which are entitled to specific rights conferred by the statute or by law, but generally are excluded from the voting right. Under Article 122 of the ACL preferential shares may be issued without voting rights, in which case their par value may not be greater than 49 percent of the company's basic capital. As a consequence a shareholder providing the majority of the capital may in certain cases do not exercise control over the company, therefore he may not be considered as a majority shareholder. In such a case the majority shareholder is effectively in a minority position with regard to the exercise of controlling rights. "Under these circumstances we would define minority shareholders as those shareholders who, irrespective of the amount of capital they provide, are unable to exercise any significant form of control within the company" (Timmerman & Doorman, 2001). This definition results more appropriate taking into consideration the abovementioned circumstances.

According to the ACL all shareholders are entitled to financial, political and control rights, irrespective of the number of shares they hold. Examples of these rights are: the rights to receive the dividend and to be informed on business matters, to vote to elect managing directors, to approve certain fundamental matters, such as mergers, statute amendments and dissolution. In addition, because shares are the personal property of shareholders, they are eligible to freely transfer them, save as the cases when the statutes make this transfer subject to certain requirements as preemption or a prior approval by the General Assembly of Shareholders. Nonetheless, the shareholder rights are in certain cases more restricted than what described above. They can be limited by contractual arrangement either in the company statute or otherwise.

The abovementioned rights pertain to all shareholders and therefore cannot be considered as minority rights due to the fact that they are not specifically addressed to certain shareholders who do not have the control of the company. Which is considered as minority right? The law is silent in that regard as well. It does not contain or any definition on 'minority rights'. The doctrine and the case law, have not define such issue. If we refer to Timmerman and Doorman, it results that a right in order to be considered a minority rights should possess the characteristic that it creates the possibility that an outcome can be reached and that is different from the outcome that the majority of the shareholders wish. Therefore, the main characteristic of minority right is that it enables them to affect the affairs of the company thereby influencing the policies of the majority shareholders.

Our company law offers to minority shareholders certain specific rights which are provided in the law or may be provided in the statutes. Therefore the protection mechanisms are statutory based or law based. These instruments of protection consist in several rights conferred to minority shareholders which empower them to affect company's business. In case of infringement of both statutory and legal rights shareholders may seek judicial protection which consists in minority shareholder rights to submit claims to the court and seek relief.

In the ACL, the protection provisions are generally law based. Usually the statutes are a copy of the law provisions and the founders do not pay special attention to the provisions regarding minority protection.

Rights attached to all shareholders

As mentioned above, shareholders rights are classified as rights attached to all shareholders and additional rights for minority. Minority shareholders are not excluded by rights derived by the fact that they are holders of shares in a company. For example, one of the principles that extends to all shareholders is equality which constitutes one of the main principles of the law "On Entrepreneurs and Commercial Companies". This principle extends to all shareholders of the company, being major shareholders of minority one, and must not be understood as a specific minority right, but as a guarantee offered to shareholders found in the same situation. Article 14 (2) reads as follows:

"Unless otherwise provided by this law or the statute, the partners, members, and shareholders shall under the same circumstances enjoy the same rights and the same duties, and be treated equally."

Equality of shareholders is a principle imported by European Company Law. Several Directives of Company law stipulates equality among shareholders as one of the principles of company law. For example, Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, provides in its Article 4 that "The company shall ensure equal treatment for all shareholders who are in the same position with regard to participation and the exercise of voting rights in the general meeting." These articles provide a limited scope of equality which extends only to voting rights and participation

in the general meeting. Furthermore, Article 42 of the Second Directive of Company Law (1976) provides the same principles applied to all shareholders of a public limited company. This article provides that "For the purposes of the implementation of this Directive, the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position." As the Article suggest this equality is not limited to certain rights but the legislation of the Members States should ensure equal treatment to shareholders in the same position.

The same provision is part of the Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE).

The provision grants shareholders under the same circumstances equality, but there is an exception granted by "unless otherwise provided by this law or statute". A question that may rise is whether a company may include provisions in its statute that draw a difference between shareholders who are in equal circumstances, if all the shareholders agree?

In our opinion, the shareholders may so agree, for so long as the law does not foresees invalidity of such provision as a sanction. Shareholders upon their free will can include in the statute provision that grant a different treatment to shareholders although they are in same circumstances.

The principle of equality applies mutatis mutandis to the right of information which is equally extended to all shareholders under Article 15 of ACL which foresees:

"Persons responsible for the management of a company shall keep all the partners, members and shareholders informed about the company performance, and make available, at their request, annual statements of account, including consolidated accounts, reports on the state of affairs and performance of company business…"

Another example of these rights is stipulated in Article 174 of the ACL that provides the pre-emption right of shareholders when increasing the capital of the company by issuing new shares.

"Company shareholders shall have a pre-emption right in respect of the newly issued shares in proportion to the par value of their previous capital portion. This right must be exercised within 20 days after the publication required by Article 169 of the present law."

Further examples of rights attached to all shareholders can be easily found in the ACL. As stated above, shareholders as entitled to have their say in direction and control of the company, and to receive the dividend which is the aim of investing in shares and being shareholders of that company. But in the following paragraphs we will focus on minority shareholders in joint stock companies and limited liability companies.

Rights attached to shareholders representing a certain percentage of the capital (also known as minority rights)

The other category of rights may be exercised only by shareholders that reach a legal or statutory or legal threshold. This group of shareholders is required to be formed in order not to have a sporadic influence in the company. The OECD principles on Corporate Governance (2004) provide that: "Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse".

Such a provision expresses the need to have an ongoing communication between shareholders in order to consistently influence in company's affairs. These communications are like alliances, formed to reach a certain goal between minority shareholders. These shareholders are mainly those who do not own the control of the company and due to this fact their position is reinforced by providing these rights who enable them to affect (to a certain extent) the life of company i.e. minority rights. Not all shareholders are entitled to these rights, only certain shareholders that reach the threshold provided by the law.

This threshold under our company law is 5 per cent or a lower percentage determined by the statute. Such threshold is equivalent to the threshold required by French law, whether the German law requires a higher percentage i.e. 10 per cent.

Explicitly Article 139 of the ACL requires a threshold in order for shareholders to convene the General Meeting (GM) of Shareholders.

"Shareholders representing at least 5 percent of the basic capital or a smaller percentage established be the statute may request the administrators in writing, including electronic mail, to convene the General Meeting and/or no later than eight days before the General Meeting, request that certain items be put on the agenda."

The provision is clear and in all cases requires the threshold to be met, whether it is 5 percent (as established by the law) or a lower threshold established by the statute. Therefore, shareholders owning a number of shares below the threshold cannot benefit from the rights provided by the articles mentioned above. This is considered as minority right because it constitutes an instrument in the hand of minorities to convene the GM or to amend the agenda of the GM. Majority shareholders may convene the GM any time through influencing the Administrator, who will usually obey because his appointment and removal in the company depends by the majority shareholders' will. Therefore, this right is a pure minority right because it enables minorities to affect or change a decision of minorities.

In case the administrators fail to convene the GM or the requested item is not put on the agenda, every requesting shareholder, under the second paragraph of Article 139, shall be entitled to:

a. Submit a claim and request the court to rule for a breach of fiduciary duties if the management organs fail to satisfy the shareholders' request within 15 days;
b. request the company to purchase his shares in accordance with Article 133 of the present Law.

These are concrete instruments in the hands of minority shareholders that case by case to decide whether it is the case to exercise their exit right or they still want to continue being shareholders in the company and to hold liable the administrator for breach of fiduciary duties.

The right of minority shareholders to appoint members of the Managing Board

Amongst the rights attached to minorities, one of the most important is the right to appoint members in the Board of Administrators or Supervisory Board (hereinafter referred to as Board). The general rule under Article 155 of ACL is that the members of the Board shall be elected by the GM by a majority vote of participating members, shareholders holding more than 30% of the voting shares.

The managing board consists of independent and non-independent members. The concept of independent member of the administration board is given by paragraph (4) of Article 155.

"An independent member of the Board of Administration shall be a person free from the conflict of interests in the meaning of Article 13 paragraph of the present law."

Because independent directors, as opposed to non-independent directors, are viewed as objective monitors of the company, minority shareholders are likely to desire independent directors to sit on the boards in which they own shares. Therefore, the requirement of the law with regard to the composition of the board is a guarantee for minority shareholders. However, the company's managers are not likely to desire independent directors. But, this does not constitute a strong protection mechanism because independent board members were a characteristic of Enron, Tyco and Disney, but this wasn't enough to prevent the fraudulent behaviors or to increase the controlling efficiency of the Board. Therefore, rather than the independence of Board members it is better to evaluate and to require the effectiveness of their independence.

Nonetheless, minority shareholders may like to affect board composition but in the given circumstances it results impossible. According to the ACL, minority shareholder may affect the board composition only if this right is stipulated in the statute of the company. If foreseen in the statute, shareholders holding at least 5 percent or a smaller amount of the basic capital to elect a member of the Board of Administration by a special decision [Article 155 (3) of ACL] and be removed by the decision of the electing minority shareholders.

If the statutory conditions for the special appointment do not apply any longer, the law sets forth that, the competent authority to remove the member concerned is the GM of shareholders acting by a simple majority. It is important to emphasize that this minority shareholders right is not mandatory, but optional and depends on its provision in the statute. Therefore, the drafting of the status take major importance in guarantying minority rights. But once this provision is set in the statute, it takes an obligatory nature, and other more influencing shareholders are obliged to comply. Nonetheless, given that the Board takes its decision with majority, and most members of the Board are appointed by the major shareholders, it is obvious that the member representing minority shareholders will only have a minor influence in Board decisions especially by informing minorities on specific issues which carry importance in protecting the minority shareholders' interest. This role will be eminent in cases when unanimous decisions are required.

However large or controlling owners are more influential than minority shareholder rights to affect board composition. If a large owner desires insiders on boards, then they are likely to get their wish no matter how strong are minority shareholder rights. And probably they won't stipulate this right in the statute.

Fiduciary duties

A key mechanism to protect minority shareholders is the duty of loyalty of board members to the company and to all shareholders (main and minority). There exist a correlation between fiduciary duties of board members towards all shareholders and the protection of minority rights. In cases where these duties are not set forth in the law, the protection of minority shareholders would be rather weak, due to any possible abuse by board members towards minorities.

In this respect our law sets a number of obligations imposed on the board members in order to ensure the proper treatment of all the categories of shareholders. Under Article 163 of ACL, the board members shall have the duty to:

a. "Perform their duties established by the law or the statute in good faith and in the best interest of the company as a whole, with particular attention to the impact of its activity on the environment;
b. exercise the powers vested in them by law or by statute only for the purpose defined therein;
c. give adequate consideration to matters to be decided;
d. prevent and avoid actual or potential conflicts between personal interests and those of the company;
e. ensure that approval is granted to agreements pursuant to article 13 paragraph 3 of the present law;
f. exercise adequate care and skill in the performance of their duties."

Under this obligation board members, when performing their duties, shall take into consideration the whole interest of the company, and shareholders [Article 14 (1)]. Furthermore, board members shall perform their duties in good faith. The good faith standard obliges board members to take into consideration minorities' rights as well where there are conflicting interests between major or minor shareholders.

Special investigation

Articles 150 to 153 of the ACL are basic rights for minority shareholders in Joint Stock Companies. Special investigation is often considered as a popular method of protection of minority shareholders. Special investigation has a very wide scope; Article 150 (1) states that the object of inquiry extends to irregularities of incorporation or conduct of ongoing business of the company.

The goal of special investigation is to restore the relationship between the parties involved with the company in the case of conflict. The underlying assumption is that, the independent expert appointed by ht GMS or the Court may reach a relief to the conflict concerned. The second goal of the investigation is to establish factually what has happened and to assess responsibility for mistakes that may have been made during the phase of incorporation of the company or the ongoing business of the latter.

According to the law, it is the GMS that primarily has the right to decide on the initiation of the special investigation by an independent expert. But, such right is also attached to a group of shareholders that represent at least 5 % of the total votes in the GMS and creditors whose unsatisfied claims against the company amount to no less than 5 percent of the basic capital, who cannot directly initiate a special investigation, but they may require the GMS to appoint such an expert. In cases of refuse or failure of GMS to appoint the expert, the aforementioned subject may invest the court. The shareholders and creditors concerned, entail as well the right to replace the expert appointed by the GMS [Article 150 (3)].

Irrespective of the subject that may initiate the procedure, all the eventual costs that may be incurred, shall be borne by the company.

This right is probably imported by German and French company law. In the German Stock Corporation Act, the holders of 10 % of the company's shares, or of share capital with the par value of 1 million Euros, may request the court to appoint special auditors to investigate the formation or management of the company. The minority shareholders' right to request the court only arises if the shareholders' meeting has rejected a motion to appoint

special auditors.[1] Furthermore, in the French law, governing joint stock companies (société anonyme) enables minority shareholders to request the court to appoint an expert to investigate the management of company's affairs.[2]

Minority shareholders and merger/division procedure

The merger procedure of the company affects a wide range of subjects i.e. shareholders of the company and creditors of the latter as well. The position of minority shareholders is often threatened by mergers and this may give rise to a majority-minority conflict. The relieves provided by the law are as follow[3]:

1. The right to request the company to buy their shares. This right gives the option to shareholders to exit the company because they cannot affect on the policies of the company. This category of shareholders who want to exit the company, may request the company to buy their shares, with the market price or in case of dispute, decided be the court;
2. alternatively these minority shareholders may request that the acquiring company exchange their preference shares without voting rights against voting shares.

In 1 above the main shareholder buys the shares at a market price, this is a little bit difficult to get assessed given the fact that we have a non-functioning stock exchange. How can be assessed the market price in such a case? The law gives another solution, which directs to the appointment of an independent expert by the court that will decide the market value of the shares. The law grants another mechanism protecting the minority shareholders, protecting them from the squeeze out, establishing the market value price of their shares. Under the current legislation in force, this is the only way the minority shareholder may exercise their exit right.

If there are exit costs, minorities should balance exit costs with costs of involvement with management and control. "Where capital markets are adequately liquid (Anglo-Saxon countries) the exit option may not have significant costs and hence it is feasible and attractive to shareholders. Lack of market liquidity (Continental Europe countries) creates problems in the effectiveness of shareholders exit option."(Lazarides, 2010).

Conclusion

The Albanian law on commercial companies entered into force on 14th of April 2008. Although it came into force one year prior to the Stabilization and Association Agreement, it incorporated most of the main provisions of the European Directives on Company Law.

The protection minority shareholders rights is a very sensitive issue, but despite that, there is no general principle on minority shareholder protection, even though there are a number of provisions spread in the legislation i.e. the Articles elaborated above. Furthermore, protection of minorities generally depends on the level of law enforcement and institutional framework. In case there is a decrease of the CG's quality level investors and other stakeholders will try to find better protection in countries with better institutional and law enforcement frameworks. Therefore, assessing the current situation of minority protection it is important to have a ranking and evaluation of country conditions.

It results from the European legislation on company law that protection of minority shareholders does not constitute a basic principle. There are several articles in some Directives such as the Transparency Directive 2004/109/EC, the Second Directive 77/91/EEC and the Takeover Bid directive 2004/25/EC, European Code of Conduct annexed to Recommendation 77/534 with regard to minorities protection. With regard to the question, whether there is a general principle of Community law of equality of shareholders under which minority shareholders are protected by the dominant shareholder's obligation, when acquiring or exercising control of a company, to offer to buy their shares under the same conditions as those agreed when a shareholding in that company conferring or strengthening the control of the dominant shareholder was acquired, the European Court of Justice ruled that:

"It must be observed, first of all, that the mere fact that secondary Community legislation lays down certain provisions relating to the protection of minority shareholders is not sufficient in itself to establish the existence of a general principle of Community law, in particular if the scope of those provisions is limited to rights which are well defined and certain. Therefore, in examining the provisions mentioned by the national court, the sole purpose is to ascertain whether they give any conclusive indications of the existence of such a principle. It flows from that detailed examination of the alleged secondary Community legislation that those provisions are essentially limited to regulating very specific company law situations by imposing on companies certain obligations for the protection of all shareholders."

The European Court of Justice in its decision in Audiolux case stated that irrespective of the fact that there are several provisions in the secondary legislation of the Community on minority shareholders rights, it does not constitute a general principle of the Community law. With respect to shareholders protection only those provisions which are drafted so to have binding effect may apply.

The Albanian company law, in this respect, is in the same pace because it lays down the general principle of equal treatment of shareholders but no principle regarding protection of minorities. Nonetheless, it incorporates a large numbers of articles protecting minority shareholders. It is evident that the position of minority shareholders is protected and the legal and regulatory framework in company law constitutes a safe legal environment for foreign investors that are interested to expand to new emerging markets. It is true that we lack a Code of Corporate Governance of the companies, but our newly law entered into force indicates that such principles are merged in the articles of the law, and an example of that is the minority shareholders protection. But yet we cannot make any positioning of the Albanian legal environment whether the standard of protection is as strong as the one in the common law countries, or it is weak as the French civil law countries, or whether it is located in the middle as the German and Scandinavian civil law countries. This confusion comes from the fact that the repealed law "On Commercial Companies" was drafted under the sole influence of the French company law, and that law demonstrated weak minority protection and mostly due to the fact that we lack a strong law enforcement. Furthermore, the law in force is a product of influence of several legislations like German, French and British company law

[1] Aktiengesetz (the German Stock Corporation Act of 1965, as amended), Article 142.

[2] Articles 225 and 226 of the Law of 1966, as amended Law No. 84-148 and Law No. 94-679.

[3] This article applies mutatis mutandis to limited liability companies, because articles on restructuring the company are applied to limited liability companies and joint stock companies.

and it is difficult to reach a conclusion which system of protection do we apply.

Most of principles of this law are imported by the European and international standards reflecting our effort in the process of harmonization and approximation of legislation.

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