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Defending the Rights of Minority Shareholders in Estonia

One of the main principles of company law is the protection of persons in a lower position. When we consider the position of shareholders in relation to third (all other) persons on such a preference scale, the principle has to be taken into account according to which shareholders are usually viewed as relatively passive investors (they are not engaged in the everyday activity of the public limited company and their possibilities to guide the activity of the company are rather indirect). That is why the possibilities of shareholders to protect their rights have to be provided by law. This is just one aspect of protecting the rights of shareholders. The second problem is that shareholders are not equally positioned due to the number of the shares they hold. The shares may grant different rights (mainly concerning voting[1]), and the number of shares held by a person (or, to be more exact, the number of votes granted by such shares) is also decisive. The need to protect minority shareholders is chiefly related to the fact that investment in a public limited company should not become pointless or too risky for a shareholder.[2] Thus, when speaking about protecting the rights of shareholders in relations with third persons, the need to protect minority shareholders against majority shareholders should also be considered, to guarantee as equal as possible rights for shareholders.

Section 272 of the Commercial Code[3] (hereinafter CC) passed on 15 February 1995 prescribes that shareholders are to be treated equally under equal circumstances. This rule has been transposed to guarantee the principle laid down in Article 42 of the 2nd Company Law Directive[4] — the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position. The objective of this norm ought to prevent any discrimination of a shareholder. For example, before the Commercial Code entered into force, it was common practice that the founder shareholders were often granted rights different (greater) than these of other (newer) shareholders, such as special rights to receive dividends or the right to vote, which were not in proportion with the nominal value. In further analysis of the principle of equal treatment, it is important to keep in mind that "equal circumstances", the existence of which is a prerequisite for equal treatment, means first of all the investment as the shareholder's most direct link to the public limited company. The investment of course is not the sole prerequisite. Situations occur where the investment-related basis for treatment is equal, but legal inequality arises from other circumstances prescribed by law or the articles of association (for example, a shareholder may not vote where certain matters are being decided — the unequal treatment here is due to the fact that his or her interest in deciding certain matters may be partial; or a shareholder has to pay not only capital and capital over par, but also an interest — in this case, the basis for unequal treatment is the shareholder's delay in making the contribution). The objective of the equal treatment provision is to lay down the most general principle for treating all these problems where the law does not provide a specific norm. The freedom to make decisions is thus partly limited. The general principle applicable in private law is that everything not forbidden is allowed. The difference between company law and, for example, contract law, is that the prerequisite for various legal transactions is not consensus between parties, but the majority can influence the minority through the majority of votes. The equal treatment principle imposes certain limits to such possibilities of influencing. At the same time, the shareholder is not prohibited from waiving his or her rights[5] — the freedom to make decisions is only partly limited.

In the protection of shareholders, the rights provided by law for each single shareholder and the rights provided for shareholders whose shares represent a certain part of the share capital have to be distinguished. It is clear that in certain matters, each shareholder has to be protected by providing individual rights for him or her. An example of such rights is the right of a shareholder to receive information, prescribed by CC § 287. The law does not, however, provide rights for each shareholder to influence the course and resolutions of the general meeting, but prescribes a minimum participation, which usually is one-tenth of the share capital.

General Principles of Protection of Minority

The measures of minority protection established in Estonia chiefly regard the resolutions of the general meeting. According to CC § 303(1), a shareholder may not vote if release of the shareholder from obligations or liabilities, assertion of a claim against the shareholder or conclusion of a transaction between the shareholder and the public limited company or determination of a representative of the company in such claim or transaction is being decided. As opposed to the Swedish law, the Estonian law does not prohibit a shareholder from voting if the relations between the public limited company and a person concerning whom the shareholder has an important interest is being decided (Swedish Companies Act[6], Chapter 9 § 3). Neither does the Estonian law prohibit a person from voting as a representative of a shareholder if he or she has a personal (partial) interest different from that of the company in a matter. The main reason why the right to vote is limited is to prevent situations where a shareholder can, through voting, influence decisions in matters where his or her personal interests dominate over the interests of the public limited company, and to provide a basis for asserting a claim against the majority shareholder if he or she has caused damage to the company by adopting such a resolution. However, the Estonian law is apparently not sufficient to guarantee the protection of minority shareholders, as practice suggests that it is transactions with persons connected with shareholders which constitute a problem. The only minority protection measure here is to demand that shareholders be treated equally as provided by CC § 272. The provision, however, has not been applied in the Estonian court practice so far. The Supreme Court of Estonia, in its judgements and in its forming of court practice thought that, has always referred to special norms when interpreting the Commercial Code, and has never referred to the general norm providing "equal treatment".

As a second measure to guarantee the protection of minority, the law provides for a qualified majority requirement in deciding certain matters. While resolutions of the general meeting are usually adopted with a simple majority of votes, it is necessary that at least two-thirds of the votes represented at the general meeting vote in favour in matters such as increasing or reducing share capital, amending the articles of association, or adopting a merger, division or transformation resolution. Further, if a public limited company has shares of different classes, resolutions on the increase and reduction of share capital and on the merger, division or transformation of the company have to be adopted separately for each class of shares, while it is necessary that at least two-thirds of the votes represented by each class of shares at the general meeting be in favour. The requirement has been transposed from Articles 25(3) and 31 of the 2nd Company Law Directive, Article 7(2) of the 3rd Company Law Directive[7] and Article 5(1) of the 6th Company Law Directive[8] on company law. Thus, the Estonian law not only protects the minority, but also protects the rights of owners of different classes of shares. It should also be kept in mind that the Commercial Code allows the establishment of a greater majority requirement in the articles of association. The qualified majority requirement as a minority protection measure works best for traditional public limited companies whose capital is divided into a large number of shares and which has many shareholders (with presumably different interests). If the capital of a public limited company is divided equally between, for example, three shareholders, there is no basic difference whether a two-thirds majority of votes or the usual "over one-half of the votes" is required to adopt a resolution — in both cases, the resolution can be influenced separately by each third of the capital.

In some cases the law provides for a greater than 2/3 majority requirement. Such is the case with the possibility prescribed in CC § 235(2) to amend the rights attached to a class of shares. A resolution can be adopted here if at least four-fifths of all votes are in favour, unless the articles of association prescribe a greater majority requirement. It is further necessary that at least nine-tenths of those shareholders, the rights attached to whose shares are being amended, vote in favour of such resolution. It should be pointed out that when we consider the requirements of law, such a resolution can be adopted only if at least nine-tenths of the votes attached to the respective class of shares are represented at the general meeting, otherwise the majority required by law cannot be achieved. This a special norm protecting the rights of even the most passive shareholders — the shareholders who do not participate in the meeting (either incidentally or deliberately). So, while usually the majority of votes is related to the number of votes of participants, in this case the votes of all shareholders are decisive. It is a peculiar situation where even those shareholders vote who do not participate in the meeting.

In addition to the possibility to block the adoption of a resolution at a general meeting, the law provides for minority shareholders a possibility to demand the discussion of certain matters at the general meeting. Shareholders whose shares represent at least one-tenth of the share capital can submit such a demand to the supervisory board (which shall determine the agenda of the general meeting based on CC § 293(1)). As according to the generally accepted principle, the adoption of resolutions by the general meeting is limited to the agenda specified in the notice of the general meeting, the demand to add an item to the agenda has to be submitted before the notice of general meeting is sent to the shareholders or published (CC § 293(2)). The law prescribes the minimum period for notification of a general meeting in advance, but does not specify a maximum period, which means that the initiative of shareholders can be stopped by sending the notices very early (for example, 6 months prior to the general meeting). In such case, it may be argued that the management board is not prohibited from sending new notices with additional items of the agenda, but the law does not prescribe a direct obligation for the management board, therefore the situation fully depends on the will of the management board.[9] Attention should be drawn to the fact that the law provides for the minority shareholders the right to demand additions to the agenda of the general meeting, but does not directly prescribe that such demand be binding for the supervisory board in determining the agenda. Should the supervisory board choose not to satisfy the demand of the shareholders and not to include the item demanded by them in the agenda, the only thing the shareholders can do is sue. Considering the deadlines for court proceedings, this is a lengthy process and might not give the anticipated result regarding the possibility of enforcement of the judgement. § 156(1) 5) of the Code of Civil Procedure includes, among the measures for securing an action, a prohibition on the defendant from performing certain acts (in this case, it would be the prohibition to carry out a general meeting), and the enforcement of the judgement in this situation would indeed be difficult if the action were not secured. So, from a formal legal viewpoint, securing of the action would be justified, but no judge is likely to do that as the conduct or failure to conduct a general meeting (or rather, the approval of the annual reports at the general meeting) within a certain period of time is related to the compulsory dissolution of the public limited company (CC § 60(1)). In practice, it is not possible to apply the depositing of a specified amount of money with the court to prevent proprietary loss caused by securing the action as provided by § 155(3) of the Code of Civil Procedure, because it is difficult, if not impossible to estimate the damage caused by compulsory dissolution. This means that the shareholder might achieve a court judgement favourable for him or her and eventually the discussion of his or her demanded item at the general meeting, but considering the pace of economic activities and the time spent on court procedure, it might not be effective in preventing the rights of the shareholder.

In addition to the above problem, situations have occurred in practice where shareholders submit a demand to add to the agenda such items which according to CC § 298(1) do not lay within the competence of the general meeting of shareholders. As the general meeting may adopt resolutions in other matters (i.e. matters not directly prescribed by law) only on the demand of the management board or supervisory board (CC § 298(2)), the supervisory board may, in such case, satisfy the demand of the shareholders to add to the agenda of the general meeting, by adding the item on the demand of the supervisory board itself. But the supervisory board is not obliged to do anything of the kind and hence the outcome of the problem merely depends on the will of the supervisory board members, and such addition to the agenda cannot be sued.

The third right related to the general meeting is the right granted to shareholders whose shares represent at least one-tenth of share capital to demand calling the general meeting (CC § 292(1) 2)). The management board has to satisfy such demand within one month, otherwise the shareholders have the right to call the general meeting themselves. The management board is not obliged to satisfy the demand of the shareholders if the demand is submitted less than two months prior to the annual general meeting. A number of problems arise concerning these rules. Firstly, it is questionable whether the shareholders should have the right to call a special general meeting. In practice, the exercise of such right is relatively burdening for shareholders, as the calling of a meeting has its expenses and it is not clear who should cover these expenses. Although it seems that the public limited company should cover the expenses, the end result again depends on the will of management board members. Neither does the law specify the procedure for calling a meeting in such case (preparation of agenda, notification, etc.). There is another aspect to the calling of a general meeting by shareholders — minority shareholders may grab the opportunity and call a general meeting without good reason. Therefore, it would be more rational if the law provided for such case that the court call a general meeting on the demand of shareholders. A similar procedure is provided by the *Societas Europea* statute[10] (Article 83 (2)). According to Chapter 9 § 8 of the Swedish Companies Act, in such case the district government calls a special general meeting on the demand on shareholders.

An important minority protection measure is the right of the minority to demand the conduct of a special audit (CC § 330). A special audit can only be conducted by an auditor, thus the conductor of special audit can be called the minority auditor. The law prescribes certain limitations to the conduct of a special audit. Firstly, it is prescribed that a special audit can be conducted only in matters regarding management or financial situation. A special audit can be decided by two methods. Firstly, shareholders whose shares represent at east one-tenth of the share capital may submit a demand concerning special audit to the general meeting. The demand of minority shareholders is, however, not binding for the general meeting and if the conduct of a special audit is not decided, shareholders may submit the same request to a court. Here, the law imposes two additional restrictions. Firstly, only those shareholders whose shares represent at least one-quarter of the share capital may submit a request to a court. Secondly, the court may decide on the conduct of a special audit only with good reason. Of course, this does not imply that shareholders may submit to the general meeting a demand to decide the conduct of a special audit without good reason.

It should also be taken into account that the situation where the general meeting discusses special audit but decides not to conduct one, is not the only basis for requesting special audit through a court. Special audit can be requested through a court also if the general meeting does not respond to the demand to decide on the conduct of a special audit and does not take any decision in the matter.

For the general meeting to adopt a resolution, the shareholders have to submit to the general meeting at least the matters concerning which a special audit should be conducted. As opposed to a court, the general meeting is not bound by the question of whether the reasons submitted are justified or not. Special audit is a minority protection measure, but the results of the special audit are not disclosed solely to the shareholders who submitted the demand — the results are disclosed at the general meeting of shareholders. In practice, the question of who should cover the expenses of special audit has also been a problem. In no way can the company be charged where a special audit is justified and the shareholders be charged where shareholders have demanded the audit. Such an approach would considerably limit the possibility of the minority to achieve the decision of a special audit and would also contradict the implications of law. Thus, it is the obligation of the public limited company to cover the expenses of special audit regardless of its results. If a special audit is demanded without good reason, the general meeting should reject the demand. Of course it should be taken into account that due to the relatively limited availability of information, the shareholders may not have enough verified information at the time of submitting the demand, and the question of whether the conduct of a special audit was decided with good reason or not, can be answered only after the results of the audit are disclosed.

Protection of Shareholders in Allotment of Shares

When speaking about the regulation of allotment of shares, the first question that arises is whether it is a minority protection measure or a more general institution of shareholder protection. Here, Estonia can be compared with Sweden, where the matters of allotment of shares are rather thoroughly regulated and several minority protection measures are prescribed.[11]

Paragraph 29(1) of the 2nd Company Law Directive stipulates that where share capital is increased and shares are paid for in money, the shares have to be first offered to shareholders in proportion with their share of the share capital. If a public limited company has several classes of shares and additional shares of one class are issued, the pre-emptive right of purchase may be granted first to the owners of that class of shares and after that to other shareholders.

The Estonian law has transposed the norms laid down in the Directive quite similarly. CC § 345 stipulates that if new shares are paid for in money, shareholders have a pre-emptive right to subscribe for the new shares, while in the case of several classes of shares, the stipulations of the directive are transposed exactly. As mentioned above, the Commercial Code bars the pre-emptive right in case of contributions in kind and in case of increasing the share capital by the acquiring company upon merger (§ 422(1)), or the recipient company upon division (§ 466(1)). Such a distinction is essential, as the increase of share capital upon merger or division is needed for the shareholders of the company being acquired or divided to become shareholders of the acquiring or recipient company. The pre-emptive right is of course not barred where upon merger or division the share capital is increased to an amount exceeding that essential for performing the merger or division.

When we look at the conditions imposed on the allotment of shares, the law protects minority shareholders with a greater than usual majority requirement (according to CC § 345(1), the pre-emptive right of shareholders to subscribe for shares may be barred with three-quarters of the votes represented at the general meeting). At the same time, even this majority requirement is apparently insufficient to effectively prevent the majority shareholder from barring the shareholders' pre-emptive right. As at least a two-thirds majority of votes represented at the general meeting is necessary to adopt a resolution on the increase of share capital, this majority can be used to increase share capital by contributions in kind and thus bar the pre-emptive right of minority shareholders with a smaller majority of votes than the law establishes for the barring of the pre-emptive right.

The Right of Shareholders to Receive Information and Examine Documents

As mentioned above, the right to receive information has been granted to every shareholder in Estonia. The Estonian law has generally adopted the principles of German law regulated by § 131 of the German Stock Corporation Act[12] — a shareholder has the right to receive from management board members information at the general meeting of the public limited company, while the management board has the right to refuse to give information if there is a basis to presume that this may cause significant damage to the interests of the public limited company (CC § 287(1)). Whether the giving of information may cause significant damage, and the significance of the damage are decided by the management board. An important difference between the Estonian and German law is that the receipt of information in Estonia is not limited to the items on the agenda of the general meeting, but includes all matters regarding the activity of the public limited company. As regards the right to examine the documents of the public limited company, this right is relatively limited and can be exercised only in cases expressly prescribed by law. According to law, a shareholder has the right to examine the annual report (CC § 332(4)), the share register (CC § 234(1)), the minutes of the general meeting (CC § 304(3)), the merger or division agreement and report and the auditor's report on the merger or division agreement (§§ 397(2), 440(3)), upon transformation the transformation report and the approved annual report for the last financial year (§ 496(1)) and upon liquidation, the final balance sheet and asset distribution plan (CC § 378(3)).

The right to receive information is also guaranteed by the right of every shareholder to examine the annual report prior to approval for at least two weeks before the general meeting (CC § 332(4)). Every shareholder has also the right to receive additional information on the public limited company if the shares of the company are listed on the Tallinn Stock Exchange. Information is received according to the publicity rules of the stock exchange. As receiving information on the company's activities directly concerns the interests of each shareholder and is the basis for his or her (investment) decisions, this right cannot be limited to the size of the shareholder's holding and each single shareholder has such rights regardless of the nominal value of his or her shares or the votes attached to them.

In addition to the right to examine the documents specified by law, the law provides for the shareholder's right to receive copies of certain documents. Such documents are the share register (CC § 234(2)), the minutes of the general meeting (CC § 304(4)), the merger agreement and resolution (CC § 397(3)), the division agreement and resolution (CC § 440(2)) and the transformation report (CC § 496(2)). The expenses of making and issuing copies are covered by the company. A certain discrepancy can be noted here between the different norms. Attention should be drawn to the fact that in addition to guaranteeing the receipt of information, the disclosure of documents guarantees, thorough issuing copies, for the shareholder the possibility to file claims against the company (both in court and out of court). However, the law does not oblige a public limited company to disclose to the shareholder the resolutions of the supervisory board, which the shareholder is entitled by law to contest. Thus, the right of a shareholder to contest a resolution of the supervisory board is largely formal, because the shareholder might not receive adequate information on actual violations. Neither does the Estonian law require the public limited company to give the shareholder a copy of the articles of association. Such a right is established for example in France in Article 153 of the Decree of 23 March 1967 on Commercial Companies.[13]

If a shareholder is not given the information prescribed by law or he or she is not allowed to examine documents, he or she may demand the elimination of such violations in court, despite the fact that the law does not expressly provide for suing.[14] Such suing can serve two different aims. In a situation where the provision of information or disclosure of documents is related to later resolutions of the general meeting, CC § 302 can be applied and a resolution of the general meeting requested to be declared invalid because the resolution is not in conformity with law. Upon merger, division and transformation, the law provides essentially similar norms as grounds of action (CC §§ 398(1), 441(1) and 481(1)). A certain limitation has to be taken into account in the latter cases — a merger, division or transformation cannot be contested after its entry in the commercial register (CC §§ 403(5), 446(7) and 487(4)). The second aim can be the acquiring of information as a right in itself. Both aims have to be achievable by law, because as said above, a violation might not always be apparent in a resolution of the supervisory board.

Protection of Shareholders' Rights in Court

The matter of protection of a shareholder's right in court is somewhat more problematic. It is arguable whether each shareholder should have the right to sue, on which grounds he or she can be entitled to such a right and whether such right should be granted to those shareholders whose shares represent a certain percentage of the share capital (or at least, the exercise of this right made simple for them), whether "class actions" should be admitted, etc.[15] These issues are topical in the Estonian law too. If we look at the shareholder's right to sue a certain matter, first of all the right of every person to recourse to the courts to protect his or her violated or contested right should be taken into account (§ 4(1) of the Code of Civil Procedure).

This norm in turn arises out of § 15 of the Constitution of the Republic of Estonia.[16] The Estonian law generally accepts the right everyone, including every shareholder, to recourse to the courts if his or her rights have been violated or contested. At the same time, the principle is not so widely applicable to public limited companies in practice, as otherwise the actions brought by shareholders against the company might become so common that they may damage the interests of the company. The Commercial Code prescribes the cases in which only shareholders whose shares represent a certain proportion of the share capital may sue. A case like this is the request to decide on the conduct of a special audit, the prerequisite for which is the failure of the general meeting to satisfy a respective demand — in such case, only those shareholders whose shares represent at least one-quarter of the share capital may refer to a court (CC § 330(2)). The law provides no limits for other cases and each shareholder can sue. This regards requests that the resolution of the general meeting be declared void (CC § 296 and General Principles of the Civil Code Act[17], § 66(2)) or invalid (CC § 302), substitute members be appointed to replace withdrawn members of the management board or supervisory board (CC §§ 310, 319(6)), the compulsory dissolution resolution (CC § 366(2)), merger resolution (CC § 398(1)), division resolution (CC § 441(1), transformation resolution (CC § 481(1) be declared invalid, and other requests. Such a situation entails a possibility that each shareholder's rights are protected by court equally with his or her other rights. On the other hand, such an unlimited right to sue can cause problems as the law leaves the public limited company unprotected against the shareholder. Although the damage caused by an unfounded action has to be compensated for, it is usually difficult to prove specific damage caused by the unfounded action, and unfounded actions are brought because the burden of proof in such a case is very severe for the company. It is not only the matter of proving — damage can often be apparent, but in addition to the existence of damage, the causal relation between the unfounded action as a violation and the damage as a consequence has to be proved. Economic activity is a dynamic process where all activities are interrelated in some way or another, and it is very difficult, often impossible, to eliminate a particular aspect of the activity that led to the end result — damage — and to indicate a direct relationship between the action and the damage (otherwise said — to prove that if the action were not brought, no damage would have arisen).

The contestation of the public limited company's resolutions by a shareholder is also allowed in Sweden (Chapter 9 § 17 of the Companies Act). It has been noted for Swedish practice that only minority shareholders sue.[18] The same tendency is apparent in the Estonian court practice.

Notes:

[1] As a rule, disproportions between the nominal value of shares and the number of votes are not allowed in Estonia; problems may arise with shares issued before 01.09.1995, as until that time the matter was not regulated.

[2] Knut Rodhe. Aktsiaseltsiõigus Rootsi 1975. aasta aktsiaseltsiseaduse alusel. (Company Law based on the 1975 Companies Act of Sweden.) Stockholm 1992, p. 155.

[3] RT (Riigi Teataja = the State Gazette) I 1995, 1995, 26-28, 355; 1996, 40, 773; 51, 967; 1997, 16, 258; 48, 774; 77, 1313; 1998, 2, 48; 23;322; 30, 410; 36/37, 552; 59, 941.

[4] Second Council Directive of 13 December 1976 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 85 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (77/91/EEC). OJ No. L 26 31.1.77.

[5] Erik Werlauff. EC Company Law. Copenhagen, 1993, p. 289.

[6] Aktiebolagslag (1975:1385).

Available:http://www.jit.se/lagbok/9751385t.html 17.05.1999.

[7] Third Council Directive of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies (78/855/EEC). OJ No. L 295/36 20.10.78.

[8] Sixth Council Directive of 17 December 1982 based on Article 54 (3) (g) of the Treaty concerning the division of public limited liability companies (82/89/EEC). OJ No. L 378/47 31.12.82.

[9] Rodhe, p. 121.

[10] Proposal for a Council regulation (EEC) on the Statute for a European association 591PC0273(01). Commission Proposal — COM(91)0273 final.

[11] Rodhe, pp. 160-162.

[12] Aktiengesetz. The German Stock Corporation Act. Series of Legislation in Translation, Bilingual Edition with an Introduction to the Law. The Hague, London, Boston, 1996.

[13] Decree No. 67-236 of March 23, 1967 on Commercial Companies. French Law on Commercial Companies. As of 1 January 1988. Chicago, 1988, pp. 199-305.

[14] Such contestation is expressly provided for example in Article 172 of the French Law on Commercial Companies — Law No. 66-537 of 24 July 1966, on Commercial Companies. French Law on Commercial Companies. As of 1 January 1988. Chicago, 1998, pp. 33-197.

[15] André Tunc. Corporate Law // European Business Law. Legal and Economic analyses on Integration and Harmonization. Ed. by R.M. Buxbaum, G. Hertig, A. Hirsch, K.J. Hopt. Berlin, New York, Walter de Gryter, 1991, p. 214.

[16] RT I 1992, 26, 349.

[17] RT I 1994, 53, 889; 1995, 26, 355; 49, 749; 87, 1540; 1996, 4, 773; 1996, 42, 881; 1998, 30, 409; 59, 941.

[18] Rodhe, p. 168.