Rights of Minority Shareholders

Commission in charge of the Session:

International Business Law Commission (IBLC)

London, 2015

National Report of Latvia

Igors Dambrāns

ZAB "RSP un Partneri (Rödl & Partner)"
Kronvalda bulvāris 3-1
Riga LV-1010
Latvia

igors.dambrans@roedl.pro

General Reporter

Ricardo Chacon, Chacon & Rodriguez S.C
Mexico City, Mexico
rchacon@chro.com.mx

14.04.2015

INTRODUCTION

A shareholder without voting strength or power to influence decision making on his own it's considered a minority shareholder. To be a minority shareholder could be tricky when it comes to protect your investment and its fruits. To avoid abuses from the majority, rules to protect minorities have been put in place in many jurisdictions. As for example, shareholder's agreements, the right of minorities to appoint a Director or other officers, rights to sell or buy shares at a fair value, the right to convene general assembly's, the right to get information from the management, etc.

Somehow, these rights may get in conflict with a fast decision making capability, impairing the management or the majority shareholders, which in turn may be a form of abuse from the minorities.

Therefore we would like to find out how these minority rights are handled in different jurisdictions.

1. Background

In Latvia, the question regarding the protection of minority shareholders remains yet a painful and unsettled issue. It must be noted that this jurisdiction is still relatively young and, during the past decades following the Soviet era, the legal framework has been changed several times as the country struggled to adopt laws that would suit modern market economy.

On January 1, 2002, the new Commercial Law (*Komerclikums*) entered into force, establishing the basic principles for the operation of general partnerships (*pilnsabiedrība*), limited partnerships (*komandītsabiedrība*), limited liability companies (*sabiedrība ar ierobežotu atbildību*), and stock companies (*akciju sabiedrība*) in a single document. This overview describes issues in connection with LLCs and stock companies, where general rules for capital companies usually apply to both types unless stated otherwise.

The Commercial Law creates the procedure for the establishment, operation, and liquidation of these entities and contains provisions that regulate the relationship between the shareholders and the company. However, the law provides very little regulation of the relationship between shareholders. It should be noted that the Commercial Law contains both imperative provisions as well as further provisions, which can be modified in the company's Articles of Association (AoA) (to the extent permitted by law).

Moreover, commercial law as such, dealing with issues of both civil law and public law, is based largely in Latvia on codified law, thus, minority shareholders commonly tend to resort only to the protection provided by the law. This happens due to the fact that individuals fail to understand clearly the extent to which they can protect their own rights with firm level protection measures and private arrangements.

2. Legal protection of minority shareholders

The Commercial Law explicitly grants certain protections for minority shareholders, although these are quite limited.

2.1. Voting procedure and thresholds

The Commercial Law provides for certain minimum thresholds for voting during shareholders meetings (a *meeting of shareholders* is a mandatory governing body with broad powers over the company, such as the appointment of the management board, deciding on reorganization or liquidation); through these thresholds the shareholders have the possibility to influence the adoption of certain decisions. For example, Articles 216.(1) and 284.(1) of the Commercial Law (regarding "ordinary" shareholders' decisions) provide that a simple majority of the shareholders has to vote in favor in order to adopt most decisions for both LLCs and stock companies. However, pursuant to Article 218 of the Commercial Law, decisions on "important

matters" (such as amendments to the AoA, liquidation, reorganization, entry into a corporate group agreement, etc.) require two thirds of the shareholders of a LLC (three fourths for stock companies pursuant to Article 284.(2) of the Commercial Law) to vote in favor to pass. Both provisions also permit for the company's AoA to require a higher quota, but never lower. However, this is a subject to the shareholders' decision on whether to allow a possible deadlock situation.

The voting procedures for LLCs and stock companies are similar in the sense that the shareholders must be notified about the shareholders' meeting and may, thus, exercise their voting rights. In the case of LLCs the first shareholders' meeting on a matter is competent if more than half of the share capital takes part. A repeated meeting, in turn, is competent regardless of the share capital taking part. Because of these thresholds, the minority shareholders have to participate in the shareholders' meetings in order to protect their rights.

Apart from these measures (or litigation as described further), the minority shareholder is not protected from the decisions the majority shareholder(s) could adopt during the shareholders' meeting.

2.2. Relations with the management board

The minority shareholder may not give direct instructions to the management board and, consequently, may not influence the operations of the company. The Commercial Law provides that the shareholders' meeting of an LLC may adopt decisions that normally lie within the competence of the management board.[1] For stock companies, the shareholders' rights to adopt such decisions are limited to a certain extent.[2] The shareholders are liable for the losses the company suffers as a result of such decision. It shows that the majority shareholder is, in fact, entitled to operate the company disregarding the management board, and it is almost impossible for the minority shareholder to protect the company's assets from rapid actions of the majority shareholder.

As the majority shareholder may usually freely appoint the management board, unless restrictions, for example, unanimous decision of the shareholders, is foreseen in the AoA, the minority shareholders usually remain almost unprotected, as they may not influence directly nor the shareholders' meeting, nor the appointment and operation of the management board.

The Commercial Law grants the minority shareholder of an LLC the right to receive information on operation of the company from the company's management board as

[1] Article 201.(2) Commercial Law, a law of the Republic of Latvia, January 01, 2002

[2] Article 268.(2) Commercial Law

well as be granted access to all of the company's documents[3]. However, the shareholders' meeting (essentially – the majority) may restrict the minority shareholders' access to the information, should grounded suspicions exist that the shareholder will use this information against the goal of the company, harming the interests of the company, an affiliated holding company, or any other third party. Thus, the majority shareholder may restrict the rights of the minority shareholder in this regard and any such restriction could only be resolved through civil proceedings.

2.3. Claim on behalf of the company

Nevertheless, the Commercial Law provides a tool, utilizing which the minority shareholder may protect its investment and company's assets and interests. It states that the company is obligated to file a suit against the founders, management board, council, or auditor if the minority shareholder representing not less than 1/20 of the share capital or those whose participation in the share capital constitutes at least EUR 71 100, demands it. A suit is to be filed within three months after the receipt of the minority shareholder's request. Should the board fail to meet the obligation within one month after the request was submitted to the board, the minority shareholder is entitled to file the claim by itself[4].

On December 20, 2012, the Supreme Court of the Republic of Latvia ruled that the company is considered the claimant in cases where the claim is filed based on the request of the minority shareholder; the minority shareholders, in turn, are considered to be the persons who are entitled to instruct (even to very specific detail) the management board regarding the course of action to be taken in respect to the claim. Thus, in such case, the management board of the company acts as a representative of the company and the board / the company may utilize the procedural rights only in accordance with and within the scope of authorization of the minority shareholders[5].

In the quoted case, the management board of the company filed a claim against the supervisory board based on the request of the minority shareholder. After the case was initiated, the management board withdrew the claim. The minority shareholder, in turn, filed an ancillary complaint (a complaint on procedural grounds in an existing case) regarding this fact. The court ruled that the minority shareholder did not authorize the board to withdraw from the claim as required by the Civil Procedure Law[6] – the management board may not withdraw the claim without the explicit consent of the initiating minority shareholder.

---

[3] Article 194 Commercial Law

[4] Articles 172.(2), 172.(6) Commercial Law

[5] Ruling of the Supreme Court of the Republic of Latvia in case No. SPC-55/2012 of December 20, 2012

[6] Article 86.(2) Civil Procedure Law, a law of the Republic of Latvia, March 1, 1999

This instrument is still not an ideal tool for protecting the minority shareholders' rights due to a number of limitations and restrictions still existing as regards the rights of the minority shareholders to file a claim. Although this tool is established in order to protect the rights of the minority shareholders, protection of the company's interests is essential as well, so that the minority shareholders would not maliciously utilize their rights.[7] First of all, there is the mentioned participation/share value threshold for access to these rights. Second, the claim must be filed within three months after the minority shareholder has notified the board, which opens the possibility of interference by uncooperative management board or shareholders.

Moreover, the law does not provide a possibility for the minority shareholders to file a claim on behalf of the company against other shareholders (other than the founding shareholders – the two categories of shareholders are somewhat distinct under Latvian law, owing largely to the vagueness of the relevant regulations). The Commercial Law[8] foresees that the shareholders' meeting has the exclusive competence to decide on the filing of a claim against a shareholder. As minority shareholders cannot realistically ensure the passing of such a decision in a shareholders' meeting, their rights may not be protected to a reasonable degree[9].

It should be stressed once more that the minority shareholder is allowed to file a claim only on behalf and in the interests of the company; thus, the beneficiary of the claim may only be the company itself or the minority shareholders' indirect interests.

The scope of claims the company or the minority shareholder may file remains limited as well. It is clear that the company is entitled to claim damages for losses it suffered due to an unlawful activity of the founder, the management board, or the auditor. However, more likely than not, the minority shareholder may not request to recognize an agreement concluded between the company and a third party as void. The Civil Law and the Commercial Law provide for the possibility to claim that a transaction between the parties is invalid only in cases where the management board is in breach of its representation rights[10] and the opposite party was aware of it (principle of public availability of the entries in the Commercial Register)[11].

---

[7] Rasnačs, Lauris, Sabiedrības prasību celšana pēc mazākuma pieprasījuma, Jurista Vārds, No. 38 (737), September 18, 2012

[8] Article 201.(1).(7) Commercial Law

[9] Rasnačs, Lauris, Sabiedrības prasību celšana pēc mazākuma pieprasījuma, Jurista Vārds, No. 38 (737), September 18, 2012

[10] Ibid

[11] Articles 12, 223.(3), 303.(3) Commercial Law

2.4. Voiding a shareholders' meeting decision

The decision of the shareholders' meeting of an LLC may be voided as illegal due to the fact that the decision contradicts the law or the AoA or the decision was reached with significant procedural violations in regard to the convocation of the meeting or the adopting of the decision[12]. As for stock companies, there are no general provisions on this matter – there is a definite list of grounds for voiding the shareholders' decisions[13], including special provisions regarding the right of shareholders to participate in the shareholders' meeting, examine the draft decisions of the shareholders' meetings, and obtain information that could influence the vote of the shareholder.

In both scenarios, a claim must be filed in court within three months after the adoption of the decision. In the case of stock companies, these rights are limited to a certain extent, for example, the shareholder who has been denied participation in a shareholders' meeting may challenge the shareholders' decision only if its vote would be decisive[14].

Recently, the Supreme Court of the Republic of Latvia ruled[15] that the court is not obligated to void a formally unlawful decision of the shareholders' meeting. Instead, the court must first and foremost evaluate the essence of the infringement and the interests of the parties involved. The main goal of the court is to achieve reasonable protection of the rights and interests. Even if the court recognizes an infringement of the shareholders' meeting convocation procedure, the court is still entitled to rule that the decision remains in force. In this ruling, the Supreme Court has also quoted the judgment of the Constitutional Court[16] stating that a decision may be voided only in cases where the procedural infringement is such that it would be reasonable to expect that the decision would differ if the proper procedure were observed.

On May 22, 2013, amendments to the Civil Procedure Law[17] entered into force, introducing a simplified procedure for cases concerning the voiding of shareholders' decisions. The aim of the amendments was to accelerate the litigation and clarify the procedure in such cases – previously this was done via the usually lengthy general litigation procedure. Among other provisions, the new chapter includes such crucial improvements as shortened procedural deadlines (a final ruling can be reached in four months and appeal is eliminated; it is still possible to file a cassation complaint) and

---

[12] Article 217.(1) Commercial Law

[13] Article 286.(1) Commercial Law

[14] Article 287.(2) Commercial Law

[15] Ruling of the Supreme Court of the Republic of Latvia in case No. SKC-1622/2014 of February 14, 2014

[16] Ruling of the Constitutional Court of the Republic of Latvia, case No. 03-04(98), July 13, 1998

[17] Chapter 30^4 Civil Procedure Law

temporary injunctions (prohibition marks may be entered in the Commercial Register, precluding certain activities).

The nature and scope of temporary injunctions still remain unsettled. Back January 2013, the Supreme Court, when the afore-mentioned amendments to the Civil Procedure Law had not yet entered into force, ruled[18] that a claim security restricting the shareholders from exercising their rights (i.e. convening shareholders' meetings, voting, electing the management board, etc.) contradicts the general principles of the commercial law. The new regulations on temporary injunctions in cases concerning the voiding of shareholders' decisions corresponds to the previous "general" wording as regards claim security, thus the minority shareholders are still unable to influence the decision making during the shareholders' meeting by restricting the majority shareholders' rights to vote. Thus, the minority shareholder may influence the decisions made during the shareholders' meetings only post factum and only in cases of obvious procedural violations.

3. Firm level protection of minority shareholders

At a lower level, where the shareholders are entitled to decide upon and implement protection measures themselves, two different options exist: the shareholders may develop their own procedures to be incorporated into the AoA of the company or they can conclude a shareholders' agreement.

3.1. Modification of the Articles of Association

Modification of the AoA must be done carefully. In Latvia, the AoA is a public document and can be examined by third parties. Moreover, the AoA is submitted to the Registry of Enterprises for review in order to establish whether the document complies with the applicable law. For these two reasons, the shareholders usually refrain from implementing provisions into the AoA that regulate relations between the shareholders in order to avoid disclosure. Provisions contrary to the law may be included into the AoA to the certain extent; should this, however, happen, the applicable law will apply instead, thus, this is realistically impossible to foresee provisions in the AoA that would grant a minority shareholder larger protection level as foreseen by the law.

As voting at the shareholders' meeting is the main instrument the shareholders use for influencing the company, the most common way to protect the minority shareholder is amending the AoA by foreseeing that certain decisions may only be adopted by a unanimous decision. Thus, it is possible to establish that 100% of the votes must be given in favor in order to resolve any question. This way, it is possible to protect the rights of every single shareholder regardless of the number of shares it owns. The

[18] Ruling of the Supreme Court of the Republic of Latvia in case No. SKC-1268/2013 of January 18, 2013

shareholder must then make sure to participate in every shareholders meeting of the company. However, it has to be taken into consideration that deadlock situation may occur should the shareholders argue about the decision to be taken.

3.2. Shareholders' agreement

In Latvia, a proper shareholders' agreement, with thorough and complete regulation of the relationship between the shareholders, remains a rarely-used tool. Although the founders of the company are obliged to enter into a founding agreement, this agreement mainly regulates the questions associated with the founding procedure (for example, the allocation of shares, covering of expenses, initial members of the management board, etc.). Normally, the founders foresee no stipulations in such agreements that would regulate the relations between the parties after the company is founded due to the fact that this document is publically available. The shareholders naturally strive to keep the internal arrangements in secret. It is a good practice to conclude simultaneously the shareholders' agreement, but unfortunately it is a rare case in Latvia.

The shareholders are under no obligation to enter into a shareholders' agreement. The scope and force of the shareholders agreement are not covered by the Commercial Law either. Thus, the shareholders are free to decide upon the necessity for and scope of the shareholders' agreement.

As mentioned before, shareholders' agreements are not widespread. In Latvia, it is unusual for family-held and small companies to conclude a shareholders' agreement. If a foreign natural person or an entity takes over the shares of the company fully or enters as an investor, they bring in their own understanding of how the company should be operated and their own models as common in their respective jurisdictions. In this case, the conclusion and scope of a shareholders' agreement is subject to discussion.

Content of the shareholders' agreement in Latvia does not differ considerably from the provisions common in shareholders' agreements across the world and especially in the civil law countries. Agreements normally foresee the mutual obligations of the shareholders and towards the company itself, containing rules for the election of the management bodies and voting during the shareholders' meetings. The level of protection of minority shareholders is subject to the stipulations of the agreement and prior arrangements and negotiations. In the shareholders' agreement, the minority shareholder(s) may reserve the right to appoint one member of the board (out of several) while the majority shareholders are obligated to support such an appointment.

The shareholders' agreements may also foresee procedures for the alienation of shares, thus supplementing the provisions of the Commercial Law (for example, on the right of first refusal). Drag-along and tag-along clauses may serve as both instruments protecting and restricting the rights of the minority shareholders.

The shareholders' agreement may exist in parallel to the AoA of the company, foreseeing stipulations that may contradict the AoA. It is not mandatory to remedy such contradictions as both documents exist on different legal "levels" – the shareholders' agreement establishes obligations between the shareholders only. For example, the shareholders' agreement may foresee that the board is elected only once the voting is unanimous. If this stipulation is not duplicated in the AoA, the majority shareholder is entitled to elect the board unilaterally. In such case, the board will be considered lawfully elected and will be entered in the Commercial Register. A breach of the shareholders' agreement does not constitute the unlawfulness of the respective shareholder's vote[19].

Thus, provisions of the shareholders' agreement granting special rights to the minority shareholders do not mean that the minority shareholder is fully protected and may influence the operation of the company directly, as the majority shareholder is still legally entitled to adopt any decisions permitted by the law and the AoA. Obligations under the shareholders' agreement that are not met cannot be enforced directly, i.e. if the breach of the shareholders' agreement has led to a decision of shareholders' meeting, the minority shareholder is not entitled to request the court to void the decision. However, it is possible for the minority shareholder to claim damages or a contractual penalty foreseen in the shareholders' agreement.

4. Balance between the majority and minority shareholders

The security of minority shareholders in this jurisdiction has indeed evolved in the recent years, increasing the protection of the minority shareholders against those in control (specifically, the governing bodies and majority shareholders).

One of the recent amendments to the Commercial Law, which entered into force on July 1, 2013, introduced numerous provisions aimed at combating the recent upsurge in corporate raiding activities (illicit takeover of companies with the goal of taking control of their assets). These amendments also indirectly protect the rights and interests of the minority shareholders. Previously, the alienation of shares required a very simple registration process – any alienation of shares had to be confirmed by the signatures of the members of the company's management board, the seller, and the buyer without any notarization. There was also no obligation to submit the share purchase agreement to the Registry of Enterprises for review. This, as well as the fact that the decisions of the shareholders' meeting did not require notarization either, allowed the shareholders or even third parties to interfere with the management of the company or even to arrange an illicit takeover of the company. Currently, the Commercial Law requires each alteration of the shareholders' register (a public document listing the current and past shareholders of a company) to be notarized. It is

[19] Bogdasarovs, Jānis, Akcionāru līguma loma kapitālsabiedrības pārvaldē, Jurista Vārds, No. 12 (659), March 22, 2011

mandatory for both the buyer and the seller to notarize their signatures for the sale; the entry must be confirmed also by the management board (the chairman of the management board if such is elected, or the member of the management board duly authorized to perform such task). Thus, the risk that the majority shareholder may influence the management board of the company in order to falsify the share transfer documents decreases (although various legal scholars consider such restriction and notarization requirement as too strict and cumbersome[20]).

4.1. Influence on the management board

The minority shareholders have little influence on the operations of the company. Even if the management board is appointed by all the shareholders, the majority shareholder may exercise its right to adopt any decision that lies within the competence of the management board. Although this means that the particular shareholder will be personally liable for the decision, in the short-term this entails unrestricted powers to operate the company, having also the ability to alienate the company's assets, enter into disadvantageous agreements, etc. In practice it means that at the moment the minority shareholder finds out about the actions of the majority shareholder, it may already be too late to remedy immediately these actions and an extensive litigation may follow.

4.2. Expulsion of the shareholder

The rights of the majority shareholders are so broad that they even may, under certain circumstances, request the court to expel the minority shareholder from the company. Article 195 of the Commercial Law foresees that the company or shareholders representing at least 50% of the shares may file a claim if a shareholder violates his obligations towards the company without justification or has harmed the interests of the company in any other way, or continues to harm the interests of the company even after receiving a written notification from the company. Thus, this tool may be utilized solely by the majority shareholder, not the minority shareholder. The majority shareholder / the company may do so and expel the minority shareholder only if the court rules that the minority shareholder has violated its obligations or harmed the company. Should the shareholder be expelled from the company, its shares are transferred to the company itself. The company, in turn, has to pay the expelled shareholder an adequate compensation for the shares[21]. The company has to sell the shares within one year after the shares were transferred to it[22]; after the deal is completed and the purchase price is received from the new shareholder, the company

[20] Strupišs, Aigars, Valsts, nespējot cīnīties ar blēžiem, ierobežo visus uzņēmējus, Jurista Vārds, No. 27/28 (778/779), July 9, 2013

[21] Article 195.(3) Commercial Law

[22] Article 153 Commercial Law

retains one fifth of the purchase price and disburses the remaining amount to the expelled shareholder[23].

A claim regarding the expulsion of a shareholder must be filed on behalf of the company, i.e., only if the shareholders harms the company. The majority shareholders may not file such a claim for their own benefit. The Supreme Court ruled recently that it is permissible for the majority shareholder to file such a claim on behalf of the company and it is not mandatory that the company file the claim itself[24].

4.3. Protection through the Corporate Governance rules

In Latvia, Corporate Governance rules as such are not very common, however – are being introduced more lately, especially by the foreign capital companies. The majority of companies rely solely on the rules and procedures established by the applicable law. The Commercial Law provides sufficient rules for operation of any company on such essential issues as appointment of the management board, decision-making during the shareholders' meeting, etc. Small, family-held companies do not require any specific Corporate Governance rules as these are usually held by a sole shareholder that is also the sole member of the management board.

There are two types of companies in Latvia that usually develop Corporate Governance rules.

International companies, held, usually solely or to the extent of majority, by foreign investors, are the first type. These shareholders try to introduce Corporate Governance practices from their jurisdiction in their subsidiaries in Latvia as well. As these companies are usually held by a sole foreign shareholder, the question concerning the protection of majority shareholders is not relevant. In this case, Corporate Governance rules are usually employed to restrict the local management board and to establish patterns for coordination of operations of the management board with the shareholders.

The second type are large, usually listed, companies, such as public utility suppliers, media companies, large factories established during the Soviet era, etc. These companies usually also take over practices common in other jurisdictions. There are two main goals for such companies: to establish control over the management board and supervisory board and to attract possible (foreign) investors. Naturally, the potential investor will be more likely to enter into a company if there is certainty that the investment will be protected from the malicious activity of the management board or the majority shareholder. However, the majority shareholders usually are not interested in implementing Corporate Governance rules as these may limit their ability

[23] Article 156.(2) Commercial Law

[24] Ruling of the Supreme Court of the Republic of Latvia in case No. SKC-2221/2014 of October 31, 2014

to influence the company. The minority shareholders, in turn, must play by the rules the majority shareholders offer them due to the fact that they have little power to ensure the adoption of Corporate Governance rules.

If the company moves towards listing, it usually implements the NASDAQ principles of corporate governance[25], including provisions on shareholders' rights and participation at shareholders' meetings, obligations and responsibilities of the board, disclosure of information, etc.

Although the Corporate Governance rules on the firm level would be a better and more suitable tool for protecting the interests of the minority shareholder, this tool is largely underestimated by local companies. The Corporate Governance rules provided by law currently remain the common tool for protecting the minority shareholders.

4.4. Making a choice

Minority shareholders definitely use benchmarking as they choose the most suitable country or company to invest in. The choice between this jurisdiction and any other one may be influenced by the notable uncertainty due to lack of case law in this field, as even lawyers, who are being asked about the rights and obligations of the shareholders, have doubts regarding the interpretation of the law in place.

Investors who enter the Latvian market tend to implement patterns from their own jurisdiction into the by-laws of the company. In these cases, a shareholders' agreement is a must as it regulates the obligations and rights of the shareholders to the broadest possible extent. The minority shareholders try to take the best aspects of their home jurisdictions and convince their partners to implement these models into the by-laws (as mentioned before, the scope of protection of the minority shareholder has to be agreed upon between the parties and cannot violate the regulations set by the law). Even if the stipulations of the shareholders' agreement are not enforceable in accordance with the applicable law, there are still options for claiming damages due to the violation of contractual obligation.

If the choice of jurisdiction is comparatively easy, the choice between companies may be difficult due to the fact that existing shareholders' agreements are not publically available. For this reason, the interested parties should obtain information (due diligence) from the company or the shareholders before entering the company as shareholders themselves.

The minority shareholders are forming groups within the companies based on interests on a case-by-case basis, and it cannot be stated with certainty whether the formation of groups may work in a long-term perspective. Naturally, the minority shareholders tend

---

[25] Principles of corporate governance and recommendations on their implementation, NASDAQ QMX Riga, AS, 2008, Available at http://www.ebrd.com/downloads/legal/corporate/latvia_code.pdf

to unite in cases where they feel that their interests are being harmed, but efficiency of such formation is conditional on the amount of shares they can represent collectively in order to influence at least some decisions (for example those where a majority of two thirds is required).

5. Exit option as a protection tool

5.1. Right to exit

Exit options that are previously agreed upon as such are not very common in this jurisdiction. The right of the shareholder to withdraw from the company and/or to sell the shares may be regulated by both the Commercial Law and the arrangements between the shareholders.

A question arises as to whether a third option, essentially an in-between of the said options, exists, and a solution via the AoA of the company exists, as they may foresee any procedure for exit options and calculation of the purchase price, remuneration, or compensation. The shareholders may freely decide to include a purchase price calculation provision in the AoA to the extent that it does not infringe the rights and diminish the obligations of the shareholders. Such a provision would be more suitable in case of a shareholders' agreement, as it governs the relations between the shareholders only.

The Commercial Law allows the shareholder to alienate its shares freely (with certain exceptions, such as rights of first refusal in case of a sale and the requirement to receive consent from other shareholders in case the shares are being gifted, altered, etc.). Thus, a shareholder may freely decide upon the price of shares in case the shareholder decides to exercise an exit option and sells the shares to other shareholders in accordance with the shareholders' agreement. The law does not provide any procedure for the calculation of compensation in these cases.

The Commercial Law provides very limited rights to LLCs in taking over the shares of a shareholder (permitted ways are through inheritance, reorganization, or when the shareholder gives up its shares)[26]. The limitations for stock companies are somewhat different[27], a kind of exit option is foreseen, for example, for employee shares where the company has rights of first refusal in case the employee or the member of the board to whom the shares were granted leaves the company[28].

As mentioned before, the shareholder of an LLC is entitled to give up its shares and, in this case, the company takes over the shares. A question arises here as to whether it

---

[26] Article 192 Commercial Law

[27] Article 240 Commercial Law

[28] Article 255 Commercial Law

can be foreseen in the AoAs or the shareholders' agreement that the LLC remunerates the ex-shareholder by buying the shares for a fixed price or the market price. The Commercial Law does not foresee that the shareholder is entitled to receive remuneration from the company. The cases in which an LLC is entitled to disburse any money to its shareholders are very limited, such as dividends, reduction of the share capital, or liquidation of the company. Any other reason, including the exercising of an exit option, may not include any payments.

5.2. Purchase price calculation

Two issues should be stressed regarding the remuneration for the shares in case the shareholder leaves the company.

As mentioned before, in case of expulsion from the company, the shareholder is entitled to certain compensation after the company sells the shares to a third party. This difference between the rights of an expelled shareholder and one who gives up its shares is considered disproportionate. An expelled shareholder is entitled to a commensurate remuneration for the shares even if the particular shareholder acts against the interests of the company and other shareholders; to contrast this, a shareholder who gives up its shares for any reason has no possibility to receive any compensation or even repayment of the initial investment.

The Commercial Law foresees only one scenario where the shareholder may a) sell the shares to the company b) receive a payment for the shares from the funds of the company and c) seek a fair compensation. Article 197.(1).(2) allows to increase the share capital by increasing the nominal value of the existing shares or issuing new shares by including in the share capital, fully or partially, the positive difference between own capital and the amount formed by the share capital and reserves, which, by law, may not be included for increase of the share capital. The new shares shall be divided pro rata to shares owned by the shareholders.

In the given case, the minority shareholder may not have enough votes to influence the voting results. Should the minority shareholder vote against such a decision, it is entitled to request that the company buys back the particular shareholder's shares within two months after the time of increase of the share capital. If the shareholder does not request remuneration, it may alienate its shares within two months regardless of restrictions provided for in the AoA or the law[29].

The Commercial Law provides for such regulation in order to protect the minority shareholders' right to dividends. Should the share capital be increased by any other means, the minority shareholder has no right to request its shares to be bought or to alienate them without restrictions.

[29] Articles 197.(6), 197.(9) Commercial Law

If the share capital is increased by investing retained earnings and the minority shareholder votes against such a decision and requests the company to buy back its shares, the company must conclude a share purchase agreement with the minority shareholder and disburse compensation equal to the sum the minority shareholder would receive if the company were liquidated at the time the share capital of the company was increased ("liquidation quota") as purchase price[30].

It can be concluded that market liquidity has little or no influence on the shareholder and on the compensation for the shares when the shareholders exercise the exit option voluntarily. The compensation amount to be paid or the procedure of calculation is normally fixed in the shareholders' agreement for cases where other shareholders are obligated to buy the shares. Market liquidity becomes relevant only in cases where the shareholder has not exercised the voluntary exit option has been expelled instead: the company is obligated to sell the shares on the market and disburse 80% of the price received from the buyer of the shares to the shareholder.

Under certain circumstances, a minority shareholder is still entitled to exercise the exit-option in case of listed companies. Should any of the persons directly or indirectly own at least 90% of the shares, other shareholders are entitled to request this shareholder to buy their shares. The price the shareholders are entitled to demand and the majority shareholder is obliged to pay for the shares must meet several conditions: it may not be lower than the price a bidder or an associated company has paid for the shares within the last 12 months; it may not be lower than the average price of the shares on the market within the last 12 months; it may not be lower than the price calculated by dividing net assets of the company by amount of the shares)[31].

5.3. Compliance and "legalization" of expropriation of minority

In the case of non-listed companies the majority shareholders have hardly any possibility to expropriate the minority shareholder. The Commercial Law foresees no option for the majority shareholder to acquire the shares of other shareholders without their consent. An indirect way of settling such matters is expulsion from the company (which is not connected with compliance). The law provides no tag-along or drag-along options and these may be governed only by the shareholders in the shareholders' agreement. Still, these rights remain unenforceable and, in case of a breach, the claimant may only seek damages.

In the case of listed companies, the majority shareholder has several tools in line with the applicable law. Listing, delisting, and associated compliance issues are governed by the Financial Instrument Market Law (*Finanšu instrumentu tirgus likums*). This enables the shareholders to express a voluntary public tender offer; other shareholders are only

[30] Articles 197.(7) Commercial Law

[31] Articles 74.(1), 83^1, Financial Instrument Market Law, a law of the Republic of Latvia, January 1, 2004

entitled to either reject or accept the offer, thus the shareholders may act as a group in respect to the bidder or to act at their sole discretion.

However, there are two cases when the majority shareholder has to express a mandatory public tender offer – a) a person directly or indirectly acquires at least 50% of the shares, or b) the majority of the shareholders have voted in favor of delisting. Other shareholders are still entitled to choose freely whether to sell their shares to the bidder.

The mandatory public tender offer is controlled by a special regulatory body, the Financial and Capital Market Commission (the Commission). For example, the Commission evaluates the calculation of the purchase price per share, the minimum value of which is directly governed by the law. Should the bidder pay a higher price as part of the public tender offer than indicated in the initial prospectus, said price automatically becomes the new takeover price.

If the majority shareholder owns at least 95% of the shares of a company, it may express a final public tender offer within three months after this shareholder has acquired said majority of the shares[32]. In this case, the minority shareholders are obliged to sell their shares to the bidder at the proposed price. There remain several statutory restrictions that protect the rights of the minority shareholders and the company itself. The Commission carefully examines all the documents submitted by the bidder and particularly in respect to the price calculated.

The bidder may not change the conditions of the public tender offer if it infringes on the interests of the shareholders who have already sold the shares. Conformity of any changes requires new evaluation and approval by the Commission.

Accordingly, under certain conditions, the majority shareholder is entitled to force the minority shareholders to sell their shares, but it is normally difficult for the shareholders of listed companies to reach the required 95% threshold. Additionally, the majority shareholders cannot buy the shares without paying a comparatively fair price or the market value.

6. Looking forward at my jurisdiction

6.1. Minority shareholders' activism in Latvia

In Latvia, minority shareholders' activism is not very widespread. First of all, this is to do with the fact that activism of the minority shareholders is primarily discussed in connection with listed companies. There are relatively few listed companies in Latvia and these companies have various shareholders' structures, ranging from companies with few major shareholders, such as the state or foreign investors, to the companies

[32] Article 81, Financial Instrument Market Law

where the legacy of the Soviet era has led to a situation where ex-employees of a company who have not been employed by it for decades still hold insignificant amounts of shares each. Such minority shareholders usually do not take any part in the management of the company, as they often do not clearly understand the meaning of the shares they hold and the rights associated with them.

The situation with the privately held companies is essentially the same as with the listed companies, since the general principles also apply in this case. Small companies are usually held by relatives or close friends / longstanding business partners. Moreover, the management board usually consists of the shareholders who run the company personally. Such companies usually do not make the issues raised in the company public, and thus it is difficulty to establish, to what extent and in what way the minority shareholder influences the company.

Secondly, such classic ways of shareholders' activism like lobbying activities or media publicity are ineffective. Company management is usually selected on the basis of association with the majority shareholder instead of management skills and is fully dependent on the attitude of the majority shareholders, who have exclusive rights to appoint the management board. Thus, the management board normally does not have a tendency to protect the rights of all shareholders equally. Situations where the management board changes its decisions and adopts a course of action desired by the minority shareholder are rare.

Unless the minority shareholders experience heavy abuse of their rights, they usually refrain from broad media campaigns with the goal to influence the management board, as this may considerably harm the interests of the company and lead to reduction of shares' value. Should really extreme situations occur, even normally calm Latvian shareholders may get into a panic and make public statements, thus harming potentially also their own interests.

The most common way for minority shareholders to influence the operations of a company is negotiation with both the management board and the majority shareholder. Involvement of the majority shareholder is necessary because, as mentioned, the management board of the company is very unlikely to act without any support of the majority shareholder.

Legal action, a hostile and final option for protecting the minority shareholders' interests, may only be used effectively in cases where the majority shareholder has violated the decision-making procedure during shareholders' meeting. In other cases, such as violations or misconduct by the management board or decisions of the majority shareholders influencing the operations of the company directly, the minority shareholder bears the burden of proof, and, depending on obstacles of the case, it may be very hard to prove in court that the defendant has not acted in the interests of the company and has harmed them. Due to the lack of established and reliable case law, use of this last option is unpredictable and time-consuming.

6.2. Trend for the protection of minority shareholders

The state has strived to adopt and implement almost every reasonable legal measure aimed to protect the minority shareholders. Due to a degree of ambiguity in the adopted regulations, reliable case law that helps to interpret the unclear provisions must first form for the situation to become sufficiently predictable. The body of case law on commercial law is still insufficient. A small number of judgments adopted by the Supreme Court are considered to be case law. Such a gap has developed due to the fact that the Commercial Law as such has entered into force fairly recently (in 2002), many extensive and essential amendments have been adopted since then and litigation is a lengthy undertaking in the Latvian jurisdiction, with cases routinely requiring up to five years for a final resolution.

However, formal mistakes and violation of the Commercial Law are also subject to examination by the state notaries (officers of the Registry of Enterprises) when a person with interest in the decision is entitled to file a complaint against the decision of the Registry of Enterprises. The Chief State Notary may examine the case and may revoke the entries in the Commercial Register. Although the Registry of Enterprises may not declare a breach of the subjective rights of the shareholders, it still protects the rights of the minority shareholders in cases, for example, where procedural violations have been committed in the convening of a shareholders' meeting or the decision has not been taken with the required majority of votes etc. The decision history of the Registry of Enterprises remains a practical source of guidance and contains the authority's explanations as regards the provisions of the Commercial Law.

Influential legal scholars have indicated[33] one major gap in the legal framework that is yet to be regulated and may help to protect the rights of the minority shareholders - a statutory exit option. Currently, a shareholder has no possibility to leave the company and receive an adequate remuneration for this from the company itself. Should the rights of the minority shareholder be infringed by the majority shareholder, the minority shareholder has no other practical option than to leave the company and sell the shares. More likely than not, such shareholder will face difficulties in finding a third party willing to buy the shares at a fair price, if the actual situation in the company will be duly disclosed to such potential buyer. Usually the minority shareholder must resort to selling the shares to the current majority shareholder, as no one else is interested in the shares. Thus, this would be remedied to a certain extent by the introduction of a statutory right to withdraw from the company, by transferring the shares to the company itself and receiving a just compensation. Should the minority shareholder act in good faith and do not harm to the company, he should receive at least the purchase price of the shares once they are sold by the company. However, in this case the minority shareholder is not protected if the company sells the shares below the market

[33] Lošmanis, Aivars, Sabiedrības ar ierobežotu atbildību dalībnieka izstāšanās no sabiedrības, Komerctiesību aktuālie jautājumi Latvijā un Eiropā, Tiesu namu aģentūra, 2013

value, for example, to any person affiliated with the majority shareholder. Thus, it would be essential to establish such a withdrawal mechanism that takes into consideration the real market value of the shares; application of the mechanism employed when increasing the share capital of the company by including in the share capital, fully or partially, the positive difference between own capital and the amount formed by the share capital and reserves. This would still not guarantee that the withdrawing shareholder would receive a fair market price[34]. However, it has to be accepted that the minority shareholder should not have the right to withdraw from the company without good cause, which also has to be established by statutes or case law.

6.3. Influence of foreign and international regulations on national capital market and Corporate Governance

Sarbanes-Oxley Act (SOX) as such did not have a direct impact on Latvian companies, except for those interested in being listed in the USA. As mentioned before, there are only a few listed companies in Latvia (29 as of 14.04.2015[35]), therefore the principles contained in SOX would not be of great importance indirectly either and the state and the companies have not implemented them. Moreover, it is more common to use the OECD (Organisation for Economic Co-operation and Development) Principles of Corporate Governance or NASDAQ principles of corporate governance as guidance as regards Corporate Governance rules.

The majority of other rules provided in SOX already existed or were implemented later into the applicable law. For example, the Law on Annual Reports foresees that the annual report must be signed by the management board[36]. In certain situations, the management board must prepare a management report, which is a part of the annual report and provides information on the operation and financial results of the company[37]. Thus, the management board cannot indicate that it has been unaware of the financial condition of the company. The Latvian Administrative Violation Code and the Criminal Law also establish both administrative and criminal liability for the management board for inappropriate bookkeeping[38] or falsification or concealment of bookkeeping documents, annual reports, etc.[39].

Operations of auditors are regulated by the Law on Sworn Auditors, establishing certain restrictions associated with conflicts of interest, prohibiting the auditing of companies where the particular auditor has its own interests to ensure the reliability of

---

[34] Lošmanis, Aivars, Sabiedrības ar ierobežotu atbildību dalībnieka izstāšanās no sabiedrības, Komerctiesību aktuālie jautājumi Latvijā un Eiropā, Tiesu namu aģentūra, 2013

[35] Available at http://www.nasdaqomxbaltic.com/market/?pg=issuers&lang=en

[36] Article 51.(2) Annual Accounts Law, a law of the Republic of Latvia, January 1, 1992

[37] Article 55 Annual Accounts Law

[38] Article 166^6, Latvian Administrative Violations Code, a law of the Republic of Latvia, July 1, 1985

[39] Article 217, Criminal Law, a law of the Republic of Latvia, April 1, 1999

audit results[40]. It also prohibits the auditing of the same listed company for more than seven years in a row[41].

6.4. Involvement of the general public under present circumstances

Due to various circumstances, it is unlikely that the concept of „popular capitalism", as defined in the 1950s by Joaquin Garrigues, could be implemented in Latvia in the foreseeable future. The lack of protection of minority shareholders' rights is just one of the reasons. In this jurisdiction, the population has limited access and possibilities to become the shareholders of large or medium-sized companies. As most of the companies continue to remain small and family-held or owned solely by foreign investors, natural persons have few actual opportunities to enter existing companies, as often the first would rather be more interested in professional investors and the second are able to draw funding from the holding or via bank loans. Thus, natural persons are largely only able to establish their own companies, a daunting proposition to the majority of the population due to relatively low income and difficulties in attracting a start-up capital. Other option is employee shares granted to the employees or the management for years spent with the company, individual performance, etc. Many shareholders willing to leave the market offer the management to exercise the management buy-out option.

The level of statutory and firm-level protection is rather low and cannot guarantee the minority shareholders sufficient safety for natural persons to invest their private resources without hesitation. With the worldwide market available for investment options, listed companies abroad are preferred as such investments are comparatively better protected due to compliance oversight. However, lack of local experience with listed companies and also the low number of such listed companies does not encourage the general public to buy and sell shares freely.

As mentioned, the importance of shareholders' agreements in local companies is underestimated, which also results in a lack of investments protection and certainty, discouraging the population from investing.

---

[40] Article 26.(2), Law On Sworn Auditors, a law of the Republic of Latvia, January 1, 2002

[41] Article 29.(4), Law On Sworn Auditors