

## SESSION IV: ENFORCEMENT OF MINORITY SHAREHOLDERS' RIGHTS

Presentation by

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### 1. INTRODUCTION<sup>1</sup>

1. The traditional view of company law in Finland and the Scandinavian countries has been that the *raison d'être* of individual rules in the law is either the protection of minority shareholders or the protection of creditors. (The idea of the law as a standard contract between interested parties is of recent origin.) The predominant feature of the minority shareholder protection rules in the Nordic countries is that they are mandatory, ie cannot *in advance* be contracted around. However, the shareholders can, if they are unanimous, decide in a situation at hand not to apply these rules. The standard argument is that one can not have minority investors in a company if there is no credible minority protection regime. This proposition is, of course, acceptable, but does not exhaustively explain why a minority protection regime should be *mandatory*.

### 2. WHICH RULES ARE "MINORITY PROTECTION" RULES ?

2. Traditionally in Nordic legal literature minority protection rules have been defined narrowly. These are usually rules which give a 10 per cent "absolute" minority (of all the shares) or in some cases a one third "relative" minority (of the shares represented in a meeting) certain rights, eg

- right to demand a continuation meeting
- right to demand an extraordinary General Meeting
- right to demand that an additional auditor be appointed
- right to demand that an authorized auditor be elected (if not required by law)
- right to demand that a special audit of the management and bookkeeping for a specific period or for specific measures is carried out.
- right to demand that the profit distributed shall equal at least half of the profit (after some deductions)
- in case of loss of capital, the right to demand the dissolution of the company
- right to bring an action on liability for damages on behalf of the company.

3. This traditional view of minority protection rules does not, however, really reflect the level of protection given to minority shareholders in the Nordic countries.

4. The general principles of company law, although this is not always clearly expressed in the text of the law, give basic protection for minority shareholders. The "principle of equal treatment" can be relied upon in court. This principle would mean that shareholders have the rights, especially to the profits and the capital of the company, as stated in the law and the by-laws. The majority has the right to decide what business is done, who is going to manage it and how it is funded, but the profits must be distributed as agreed. An other "general principle", the assumption that the company operates in order to create wealth for the company (ie shareholders), is the cornerstone in cases concerning liability for damages. The management have no right to channel profits to themselves or to parties near them.

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<sup>1</sup> The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries.  
This paper is subject to further revisions.

5. It should also be noticed that the excessive controls on the decision-making procedures are designed to protect minority shareholders. One example in Finnish law is the buy-back of a company's own shares. The bid to buy should always be made in proportion to existing ownership, acquisitions made at the stock exchange being the only exception. The decision is always made by the General Meeting which can, however, delegate the decision to the board. On top of this there are stringent rules on the information given to the shareholders prior to the decision. It can be said that these rules are not always compatible with the sophisticated practices of the securities markets - there are exotic procedures such as the Dutch auction coupled with market making practices which are not necessarily easy to fit in to our legal regime.

### 3. HOW MINORITY PROTECTION RULES ARE ENFORCED IN FINLAND (AND THE SCANDINAVIAN COUNTRIES) ?

6. Since it is not easy to say what rules should be counted as minority protection rules, it is not easy to explain how these rules are enforced. Below, I shall examine some of the more important measures the minorities can take in order to protect their legitimate interests.

7. As usual in market economies, the general sanction for infringing the minority protection rules (or any other rule for that matter) is the *liability to compensate all damage* caused to shareholders. It is not easy to assess how well this sanction works in practice. The majority of cases on which the supreme court gives its decision are connected to the liability of directors. However, these cases are mostly taken up by the company (or the bankruptcy estate), not by the minority shareholders. It is actually seldom that a minority has succeeded in a legal action against the directors. Derivative action is seldom used in practice. One reason may be that the shareholders' individual right to claim damages is comparable to the company's right.

8. Another, often quite effective tool for the minority is to bring action against the company to have a decision invalidated or changed. It is possible to challenge a decision by the AGM for instance on the grounds of a violation of the "equality principle" and every shareholder has this right. This is, particularly as concerns public companies, a very efficient tool since the possibility of having a decision by the AGM declared invalid - normally after some years of legal battle - is unpleasant. This is one of the reasons why companies try to be very careful both as concerns the form and the substance of decisions taken at the AGM.

9. The third set of sanctions are criminal. The amount of rules the breaking of which might result in criminal proceedings is small. The criminal sanctions are mostly connected to such acts as giving false information to the registrar etc. An important exception, however, is the case where a shareholder has received assets from the company in breach of the provisions of the companies act. There is a general obligation for the shareholder to return assets he has received in breach of the law (he can keep the assets if he had a justified reason to assume that the distribution of the assets took place in accordance with the law). There is also an obligation for the directors to remunerate for the part of the assets that are not returned. Furthermore, illegal distribution of assets is a crime. This is, firstly, a real threat to eg bankrupt persons which are active in companies. Secondly, the fact that illegal distribution of assets is a crime makes it possible for the shareholder to turn to the Police and ask for help in detecting the relevant facts and winning back the missing assets.

10. The right to redemption is also an important way of protecting the minority shareholders. Below, I shall further examine the most important redemption rules and especially the redemption procedure, which I think is - in principle - a well-functioning one.

#### 4. REDEMPTION: A WELL-FUNCTIONING REGIME

11. The two most widely used redemption regimes in Finland are redemption in a so called "squeeze-out" situation, ie the right to demand redemption of minority shares and the right to demand redemption of one's shares in the case of a merger.

12. The squeeze-out provisions are triggered when a single shareholder owns 90 per cent or more of the votes and the shares of a company. In this situation, the majority owner in question has the right to redeem at a market price the shares held by other shareholders. However, also a shareholder whose share can be redeemed shall have the right to demand that his share be redeemed. In the case of a merger, those shareholders who oppose the merger and who demand redemption shall have their shares redeemed at a market price.

13. In both cases, the redemption price shall be referred to arbitrators to be settled. The costs incurred shall be borne by the company itself (except in rare situations where a minority shareholder is deemed to have deliberately prolonged the case). A trustee is appointed by the court to look after the interests of absent shareholders. In a squeeze-out situation, the majority owner has the right to ask for a preliminary ruling on his right to redeem the shares and his right to receive ownership before the redemption price is decided. In such a case the majority owner must present a guarantee approved by the arbitrators.

14. This process has the following advantages

- the dispute concerns the redemption price, not the validity of the transaction: the companies can proceed with the merger without fearing that the decision on merger might be invalidated;
- the arbitrators are well informed and give their decision relatively quickly (as opposed to courts of first instance);
- the rulings are respected: although it is possible to appeal to a court, this is not done in practice;
- the companies who bear the costs of the arbitration are happy to do so because they are able to settle the issue quickly.

#### 5. ENFORCEMENT AND THE COURTS

15. How do the courts handle cases concerning minority protection ? The answer in Finland would be: not so well. Legal disputes connected on company law are usually complex. The courts of first instance lack the necessary expertise, which in practice means that both time-delays and poor predictability exist. The rulings of the first instance are routinely appealed.

16. The costs related to such cases can be considerable. Since in Finland the losing party usually is liable for the costs of the winning party, the cost risk in company law litigation is high. It may be of interest to note that the introduction of VAT on legal services some years ago has further driven the costs up. Adding VAT on top of costs that are already high has probably been the biggest single measure by the government with effect on minority shareholder protection. It is possible that smaller company law amendments do not have comparable significance.

#### 6. MINORITY PROTECTION THROUGH MARKET PRACTICE

17. The experience in Finland over the past ten years would suggest that institutional factors play a major role in defining the quality of minority shareholder protection. The ownership of Finnish shares was completely liberalized in the early 1990's. This measure, together with a shift in corporate financing from a bank-oriented system to a market-oriented system, has entailed a major improvement in the relative position of minority shareholders in public companies.

18. Foreign ownership means that large international institutional investors invest highly mobile funds in Finnish undertakings. These institutions have a strong bargaining position toward the firms' management and incumbent shareholders. They are ready to vote with their feet and sometimes even with their shares. Furthermore, they have the resources to litigate if need be. They also bring their understanding of fairness with them. This new strong form of minority shareholding has played an important role in changing the way companies consider and handle their shareholders. An increasingly market driven financial system has further underlined the importance of shareholders, including those not having a controlling post in a company.