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TITLE

MINORITY SHAREHOLDER RIGHTS: COMMON FORMS OF OPPRESSION AND EXISTING LEGAL PROTECTION MECHANISM AND REMEDIES IN THE ARMENIAN LEGISLATION

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TABLE OF CONTENT

INTRODUCTION

The corporate governance framework in Armenia is mainly comprised by the Law on Joint Stock Companies, the Law on Banks and Banking Activity, the Law on Securities Market and the non-binding Corporate Governance Code, which was adopted in 2010 and is currently discussed to be updated by the initiative of the Ministry of Economy of Armenia, and has only recommendatory function for the business sector of the country. However, the binding corporate legislation is quite narrow and could even be described as being under-regulated. Corporate relations are mostly simple and often based on personal relations and informal agreements of the partners and division of power within business entities are often asymmetric. According to the CEO and Managing partner of "Yerevan Audit Consult" LLC, economist and auditor Mr Levon Ghonyan, noted that management's role in Armenian companies is mostly technical, and the real decision-making is done by the majority or controlling shareholders.

On November 24, 2017 during the Eastern Partnership Summit "Comprehensive and Enhanced Partnership Agreement (CEPA)" was finally signed between the Republic of Armenia and the European Union. The document ,is ratified by the parliament of Armenia, and is currently undergoing the process of ratification by the EU member states parliaments.

According to the section 1 of the Article 60 of EU-Armenia CEPA "***The Parties recognize the importance of an effective set of rules and practices in the areas of company law and corporate governance, as well as in accounting and auditing, in a functioning market economy with a predictable and transparent business environment, and underline the importance of promoting regulatory convergence in those fields"***.[1].

In the wording of the Section 2(b) of Article 60, it is clearly mentioned that the further development of corporate governance policy shall be in line with international and, in particular, OECD standards. CEPA is believed to be the engine of the new wave of regulations and policies to be adopted in Armenia. During his speech in the Foreign Affairs Committee of the European Parliament's on the 4th of March, 2019, Prime Minister of the Republic of Armenia Nikol Pashinyan stated "Implementations of the Comprehensive and Enhanced Partnership Agreement with the European Union is of tremendous importance for the success of our reforms! The value and the attractiveness of this initiative are in achieving its objectives

[1] "Comprehensive and Enhanced Partnership Agreement between the European Union and the European Atomic Energy Community and their Member States and the Republic of Armenia" (CEPA) 2017/0238 (NLE) https://eeas.europa.eu/sites/eeas/files/eu-armenia_comprehensive_and_enhanced_partnership_agreement_cepa.pdf

exclusively through the implementation of reforms. CEPA is a reform-generating tool. The fulfilment of its provisions will entail qualitative changes in many areas of our society."[2]

It is very important to assess the quality of the regulation we already have in the sphere of corporate governance, evaluate the balance of rights of shareholders and formulated the existing problems and contradictions with the international best practice and OECD recommendations before the major legislative changes will be put in the agenda.

Considering the major legislative changes that Armenia is undergoing starting the Velvet Revolution of 2018, the intention of the government to improve the economic environment and attract more quality investments to the country, especially FDI (Foreign Direct Investments), the need to review the corporate legislation and enhance the level of protection of property, especially to guaranty the protection of investments of any size is becoming really crucial for the country, and is also dictated by the international obligation of the Republic of Armenia (e.g. CEPA). A key aspect to the EU's support for the Armenian government is ensuring that the proper legislative and institutional changes solidify the democratic transformation currently underway in Armenia and that it is not only based on political will.[3]

From the overall political and legal context, the reforms in corporate legislation seem crucial. This also is pointed out via the initiative of the Ministry of Economy of Armenia in reforming the non-binding Corporate Governance Code. However, before starting any reform, it is very important to form some sort of a discourse around the issues that exist in the sphere subject to reformation. Analysing existing case law of Armenia in the sphere of corporate relations in this research it was decided to focus mainly on the rights of minority shareholders, as one of the most unprotected elements of the corporate chain, and in particular on so called "Freeze-outs"[4] and other similar techniques, that are used to pressure the minority shareholders or could

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[2] Press release of the PM Pashinyan's visit to the Foreign Affairs Committee of the European Parliament's on the 4th of March, 2019 https://www.primeminister.am/en/press-release/item/2019/03/04/Nikol-Pashinyan-Speech/

3 Anahit Shirinyan "Rebooting Armenia: What can the Eastern Partnership Offer after the Velvet Revolution?" 2019,https://ge.boell.org/en/2019/09/12/rebooting-armenia-what-can-eastern-partnership-offer-after-velvet-revolution

[4] ***Freeze out is*** any tactic used by majority shareholders to deprive minority shareholders of governing control of a corporation. It is used to pressure the minority shareholders to sell their stock in the corporation, usually in the context of an acquisition. Legal Information Institute of Cornell University. .https://www.law.cornell.edu/wex/freeze-out

potentially be used against them. Considering the above, it is important to ask the following question. What are the existing protection mechanisms and safeguard for the minority shareholders under existing Armenian legislation and what reforms could be lobbied for to enhance the level of protection and establish a mechanism of "checks and balances" between the minority and majority/controlling shareholders?

The research is consisting of three main chapters and the conclusion.

Chapter I: In this chapter, we analyse the existing legally binding and non-binding corporate law regulation, regarding the rights of minority shareholders, the mechanisms of participation in decision-making and level of influence on the management of the entity. The main objects for the analysis in this chapter are the law of RA "On joint-stock companies" and the "Corporate Governance Code of the Republic of Armenia.

Chapter II consists of the analysis the international best practice in terms of minority-oriented legislation and protection from abusive actions by, or in the interest of, controlling shareholders. One of the focal points for this analysis is the OECD "Corporate governance principles" guideline and the other one "Commonsense Principles 2.0" developed in October 18, 2018, by the representatives of prominent US corporations, pension funds and investment firms.

Chapter III: Analysing of the Armenian case law helps to us to understand the developments in the field of protection of minority shareholder rights and the existing tendencies in case law in this regard. The focus of the chapter will be the freeze outs, especially the ones by using the consolidation of shares as the main tool.

CHAPTER I

THE EXISTING GAPS OF THE ARMENIAN LEGISLATION THAT MAKE MINORITY SHAREHOLDER RIGHTS VULNERABLE

According to the Heritage Foundation and Wall Street Journal Economic Freedom Index 2016, where Armenia was ranked 54th (moderately free) out of 178 countries, the dynamics of the economic freedom index for Armenia[5] for the period of 1996-2016 show significant improvements in eight indicator from ten. Those are -

- Fiscal Freedom - +8.0
- Government Spending - +80.7
- Business Freedom +22.5
- Labour Freedom - +0.1
- Monetary Freedom +72.8
- Trade Freedom - +16.6
- Investment Freedom +50.0
- Financial freedom+20.0

The only two indicators, that however did drastically decrease were Property Rights (–30.0) and Freedom from Corruption (–13.0)[6]. Although there were improvements in other indicator but these two are the number one priorities for the potential investors to consider the country as an investment destination.

The recent report of the Economic Freedom Index (2020) already ranks Armenia 37th (mostly free) and is stressing out that the government is pursuing structural reforms, export promotion, and greater foreign investment to boost future economic growth[7].

However, foreign investors, and especially institutional investors such as hedge funds and mutual funds, are quite careful with their investment in a new environment and rationally will be cautious to make large investments in a country that undergoes drastic changes (revolution, transitional justice and judiciary system reform, expected constitutional reform). These

[5] Promoting Economic Opportunity & Prosperity: The 2016 Index of Economic Freedom/Heritage Foundation & The Wall Street Journal, 2016, page 98, < http://www.heritage.org/index/pdf/2016/book/index_2016.pdf>:

[6] Promoting Economic Opportunity & Prosperity: The 2016 Index of Economic Freedom/Heritage Foundation & The Wall Street Journal, 2016, page 97 < http://www.heritage.org/index/pdf/2016/book/index_2016.pdf>:

[7] Official web-site of the heritage Foundation at https://www.heritage.org/index/ranking

investors usually make small "pilot" investments, so to stimulate investments those investors need incentives, such as legal framework, that is able to protect their investments and their property as minority shareholders. Considering the pattern that is evident through existing limited court practice and the media coverage of the corporate disputes it is clear that in Armenia minority shareholders are quite vulnerable while exercising their role in the company.

To understand whether this pattern is the reflection of the shortcomings and lack of safeguards for the minorities in our legal framework we will first of all refer to the RA Law on Joint Stock Companies, that regulates the corporate relations and framework of both closed joint stock companies and open joint stock companies in Armenia.

According to the 2019 report of the State Registry of Legal Entities of the Republic of Armenia we currently have 2679 closed and 727 open joint stock companies registered in Armenia[8]. Although there is no up-to-date statistics, in the interview, Mr Levon Ghonyan states that the professional community, dealing with the companies it is a common knowledge, that most of these companies have majority or controlling shareholders who are usually key decision makers in the company.

Law on Joint Stock Companies (farther also referred to as the Law on JSC), as mentioned provides two types of company forms – open (hereinafter: OJSC) or closed (hereinafter: CJSC).

- A Company is deemed an open company if its shareholders have the right to alienate their shares without the consent of the other shareholders. A Company of this type may have an open subscription for and sell shares under the conditions defined by law. An open Company may also carry out a closed subscription for its shares. The number of shareholders in an open Company is not limited.
- A Company is deemed closed if its shares are distributed only amongst its shareholders or pre-decided persons. A closed Company may not hold an open subscription for its shares or otherwise offer them to the public and shall have no more than 49 shareholders. If the number of shareholders exceeds 49, the Company shall either reorganize within one year or reduce the number of its shareholders; otherwise, it shall be liquidated by court. Another important characteristic of the CJSC is that shareholders here have Pre-emptive rights to shares being sold by other shareholders of the Company. If none of the shareholders invokes the pre-emptive rights in the period stipulated by the Company charter, then the

[8] Official web-site of the State Registry of Legal Entities of the RA (https://www.e-register.am/am/docs/556)

Company shall exercise its right to acquire these shares at a price agreed upon with the shareholder. If the Company refuses to acquire the shares or does not reach agreement on prices with the shareholder in question, then the shares may be alienated to a third person. The procedure and timeframe for exercising the pre-emptive right are usually defined by the Company Charter, however this timeframe shall not be less than 30 and more than 60 days after the shares are offered for sale[9].

The main mechanism for the minority shareholders to exercise their rights is voting during the shareholder meetings. However, the influence on decision-making is not guaranteed, as many transactions are possible to approve by the vote of controlling shareholder.

For instance According to the Section 1, Article 15 of the Law on JSC's charter amendments and modifications, as well as the approval of an edited Charter shall be carried out by a decision of the General Assembly, which is adopted by a 3/4s vote of the shareholders or owners of voting shares ***participating in the General Assembly***, and if equity is being increased, then by either a majority vote of the shareholders or owners of voting shares in the General Assembly, or by a unanimous decision of the Board. It is clear that quorum has two conditions set - participation of at least some of the shareholders and votes of only 3⁄4s of those participants.

Analysing the Law on JSC, it can be stated that there are two main techniques that controlling shareholders have and are not hesitating to use to freeze-out the minority shareholders.

- ***Consolidation***

The Law on JSC provides that based upon a General Assembly decision, the Company may consolidate its outstanding shares, which will lead to the replacement of two or more Company shares with one new share of the same class. In this case, the Charter will be amended to reflect appropriate changes to the quantity and nominal value of announced and outstanding Company shares. **If fraction shares arise due to consolidation, the latter shall be bought back by the Company at the market price estimated in the manner stipulated by Article 59 hereof[10].**

Here are two major problems. In most of the cases, the fraction shares do arise, and generally, that is exactly what the initiating shareholder or the management plan to have as the result of the consolidation. When the company wants to attract new investment, but all the shares authorized by the charter are already issued to the existing shareholders and paid, this is quite

[9] RA Law "On Joint Stock Companies", Article 8

[10] RA Law "On Joint Stock Companies", section 1, Article 56,

a common way of getting rid of some minority shareholders by freezing them out. The company buys the shares out and then, as stipulates by the same Law, within 1 year period distributes the shares to other shareholders or to a newbie. Lawyers with more neoliberal approach will justify this method as a normal practice that is widely used to attract investments, but it is also legitimate to claim, that this approach undermines the idea of the owner's right to enjoyment of its property rights. According to Mr. Varoujan Avedikian, who is the managing partner in leading Armenian law firm "TK and Partners", this approach can be justified in Armenia for some cases. We have many companies established in 1990s by collectives with small ownership portions. The minority owners of such "privatization-born" companies' are mainly physical persons. Mr. Avedikian says, many of those companies have minority shareholders that are not interested in the course of business, are living abroad, or have possibly passed away, so their ownership is passive. The initiative of controlling shareholder to freeze such shareholders out may really be dictated by the interests of the company.

The main issue here is the balance between the business interest of the entity or the controlling shareholders and basic property ownership right of the minority shareholders. This aspect of the issue will be more thoroughly discussed in the Chapter III of the Research.

Another problem that arises during the consolidation is the calculation of the fair price of the shares for the buy out. Section 1 of the Article 59 of the Law on JSC provides that "the market price of property, including that of Company shares and other securities, is the price at which a seller that does not have to sell the property and is in possession of all the necessary information concerning the price of property would agree to sell the property, and a buyer that does not have to buy the property and is in possession of all the necessary information concerning the price of property would agree to buy it[11].

According to the Section 2 of the same Article of the Law on JSC *"The market price of property shall be determined* ***by a Board decision****, unless (b) cases stipulated by this Law, when the market price shall be determined by court or by other entities or persons."* To understand the risks covered here it is enough to just stress out, that according to the section 2 of Article 85 of the Law on JSC "The shareholders and nominal holders of the Company that own 10 percent or more of the Company's voting shares as of the date of elaborating the list of shareholders eligible for participation in the General Assembly may either become Board members without

[11] RA Law "On Joint Stock Companies", section 1, Article 59,

having to be elected, or appoint their representative in the Board. Each shareholder may take up only one place in the Board"

This regulation, though very understandable form the point of view of the shareholders that own more than 10% of the shares, contains elements of unfairness to those shareholders that own less than 10 percent. This owners have to be elected to the board, the chances of which can not be even measured, as this mainly depends to the environment and relation between the shareholders.

To balance the rights of majority and minority shareholders, some sort of a mechanism could be implemented to give the shareholders who own less than 10 % of shares in the company a right to join other shareholders with a same characteristic and in case of jointly forming ownership of 10% of shares to get a right to have one member of Board automatically, without having to undergo the election.

The mentioned mechanism could also serve as a guarantee that the minority shareholders have a voice in the Board, especially in case of determination of the market price of the shares during a consolidation process, as it is prescribed by the Section 2 of the Article 59 of the Law on JSC. Otherwise, what the law provides now, basically, means majority shareholders in general have a huge opportunity to abuse their rights and unanimously decide on the compensation to be paid to the exiting minority shareholder.

- ***Increase of the charter capital***

Charter capital increase as freeze out mechanism, works with almost the same logic as the Concentration does. A Company may increase its equity by means of increasing the ***nominal value of shares*** or ***allocating additional shares. The choice again depends on the factor, whether there are authorized and unissued shares left or not. If not, than the capital increase will most probably be executed by the increase of nominal value of shares.***

Corporate Governance Code

As it was already mentioned, the corporate regulatory framework of in Armenia includes another very important document: "Corporate Governance Code of the Republic of Armenia" from December 2010 approved the by the decree N 1769-A of the Government of Armenia

(hereinafter the Code). The Code, which by nature is a "soft law"[12], is not legally binding for the business community and urges the heads of public administration bodies of the Republic of Armenia to give preference to companies that comply with the requirements of the Corporate Governance Code in the process of public procurement, public-private partnership, public assistance, tax or customs privilege.[13] Although the code provides some very important solutions on shareholders meeting, introduces the idea of independent members of Board of Directors and provides some standards for the selection of such Independent directors, this non non-binding advisory document is mainly ignored by the private sector companies.

The Corporate Governance Code recommends board and audit committee to include at least two independent directors and have expertise according to the functions that they are called to undertake. However, only three companies – out of the ten largest listed in the country - disclose having independent members in their boards and only two companies disclosed having established an audit committee.

The Corporate Governance Code recommends companies to establish an audit committee made of non-executive board members, whose majority should be independent. The law instead requires companies to create a "control commission", appointed by and reporting to the general shareholders' meeting. Board members cannot be member of the control commission. By law, there is no qualification or independence requirement for members of the control commission. There is very little evidence (if any) of the added value of this body, which is not a "board committee".

Only two companies - among ten largest listed in the country - disclosed having established an audit committees; however, the committees' composition is not disclosed, hence it is not possible to assess whether they are composed of independent and qualified directors. Further, disclosure on audit committee's and control commission's activities and meetings is very limited hence; it is not possible to understand if they play a strategic role in the company. The Corporate Governance Code recommends companies to have a code of ethics, but only a

[12] Soft Law - Co-operation based on instruments that are not legally binding, or whose binding force is somewhat "weaker" than that of traditional law, such as codes of conduct, guidelines, roadmaps, and peer reviews, (OECD definition) https://www.oecd.org/gov/regulatory-policy/irc10.htm

[13] "Corporate Governance Code of the Republic of Armenia" RA Government decree 1796-N (2010) https://www.arlis.am/DocumentView.aspx?docID=65200

minority of companies appear to have one.[14]

[14] Gian Piero Cigna, Pavle Djuric, Yaryna Kobel, Alina Sigheartau "EBRD Corporate Governance in Transition Economies: Armenia Country Report 2017" file:///C:/Users/shushana/Downloads/Armenia%20SUMMARY%20FINAL.pdf

CHAPTER II

THE INTERNATIONAL BEST PRACTICE AND G20/OECD "CORPORATE GOVERNANCE PRINCIPLES" GUIDELINE 2015

On October 18, 2018, over twenty prominent executives, representing some of America's largest corporations, pension funds and investment firms, came together to sign Commonsense Principles 2.0. The signatories included, among others, Warren Buffett, Jamie Dimon and Larry Fink. In an open letter, the signatories make "a commitment to apply the Commonsense Principles of Corporate Government 2.0 (hereinafter CP 2.0) in their businesses" and "hope others will do so as well." Moreover, while recognizing that there is significant variation among public companies, and that not every principle will be applied in the same manner, the signatories expressed their intent to use the principles to guide their thinking, and encouraged others to do the same[15]

The Commonsence Principles are comprised of 8 main destinations, from which we will discuss the following 4[16] –

1. **Board of Directors – Composition and Internal Governance**
    a. Composition: CP 2.0 advices that (i) Directors' loyalty should be to the shareholders and the company. A board must not be beholden to the CEO or management. A significant majority of the board should be independent under the New York Stock Exchange rules or similar standards, (ii) all directors must have high integrity and the appropriate competence to represent the interests of all shareholders in achieving the long-term success of their company, (iii) directors should have complementary and diverse skill sets, backgrounds and experiences. Diversity along multiple dimensions is critical to a high-functioning board (iv) Directors need to commit substantial time and energy to the role. Therefore, a board should assess the ability of its members to maintain appropriate focus and not be distracted by competing responsibilities. In so

[15] Commonsense Principles of Corporate Governance 2.0, Columbian University Law school Blog https://millstein.law.columbia.edu/content/commonsense-principles-20

[16] Commonsense Principles of Corporate Governance 2.0 https://www.governanceprinciples.org/wp-content/uploads/2016/07/GovernancePrinciples_Principles.pdf

doing, the board should carefully consider a director's service on multiple boards and other commitments.

b. Election of directors and compensation - Directors should be elected by a majority of the votes cast "for" and "against/withhold" (i.e., abstentions and non-votes should not be counted for this purpose). Long-term shareholders should recommend potential directors if they know the individuals well and believe they would be additive to the board. Companies should consider paying a substantial portion (e.g., for some companies, as much as 50% or more) of director compensation in stock, performance stock units or similar equity-like instruments.
c. A board should have a well-developed committee structure with clearly understood responsibilities. Disclosures to shareholders should describe the structure and function of each board committee.
d. A company's independent directors should be fairly and equally compensated for board service and.

2. **Board of Directors' Responsibilities**
   a. Director communication with third parties - Directors should speak with the media about the company only if authorized by the board and in accordance with company policy. In addition, the CEO should actively engage on corporate governance and key shareholder issues (other than the CEO's own compensation) when meeting with shareholders.
   b. Setting the Agenda - The full board (including, where appropriate, through the non-executive chair or lead independent director) should have input into this function, Over the course of the year, the agenda should include and focus on forward-looking discussion of the business. Performance of the current CEO and other key members of management and succession planning, creation of shareholder value, calculation of risks.

3. **Shareholder Rights –** CP 2.0 obviously considers Board as the most important chain of the corporate structure in terms of effectiveness and ability to keep the checks and balances in the company. That is why it does not go in details of ownership structure and just declares that all shareholders should be treated equally in any corporate transaction. However, the document encourages the institute of written consent and provides that special meeting provisions can be important mechanisms for shareholder action.

4. **Public Reporting** - Transparency around quarterly financial results is important. As appropriate, long-term goals should be disclosed and explained in a specific and measurable way. A company should take a long-term strategic view and explain clearly to shareholders how material decisions and actions are consistent with that view. Companies should explain when and why they are undertaking material mergers or acquisitions or major capital commitments etc.

As we can see, the CP 2.0 is advocating for a sophisticated corporate culture with more powerful and sustainable Board of directors, which however, in my observation is not applicable to Armenia. The reason is that Armenian business environment is closely linked to the family relations and it is hard to reach a corporate culture, where ownership and management will be as divided as, for instance, in US.

"The idea of independent board members is a very expensive and cumbersome one for the Armenian companies, where management and controlling ownership are generally related" - states V. Avedikian.

G20/OECD "Corporate Governance Principles" guideline 2015

Another important set of corporate governance recommendations is provided by the G20/OECD "Corporate Governance Principles" guideline 2015 (hereinafter the Principles), which aims to help policy makers evaluate and improve the legal, regulatory, and institutional frameworks for corporate governance with the goal of promoting economic efficiency, sustainable growth, and financial sustainability.

First published in 1999, the Principles have since become an international benchmark for policy makers, investors, corporations and other stakeholders worldwide. They have also been adopted as one of the Financial Stability Board's Key Standards for Sound Financial Systems and form the basis for the World Bank Reports on the Observance of Standards and Codes (ROSC) in the area of corporate governance.

2015 edition contains the results of the second review of the Principles, conducted in 2014/15. The basis for the review was the 2004 version of the Principles, which embrace the shared understanding that a high level of transparency, accountability, board oversight, and respect

for the rights of shareholders and role of key stakeholders is part of the foundation of a well-functioning corporate governance system[17].

An important massage of the Principles is that "The corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights".[18]

Unlike PC2.0, the Principles don not focus only on the management and Board of the companies, but prioritize the ownership and its key functions herein –

1. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.
2. Shareholders should be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.
3. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:
    a. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
    b. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes[19].

[17] G20/OECD Principles of Corporate Governance (2015) https://www.oecd-ilibrary.org/docserver/9789264236882-en.pdf?expires=1581428620&id=id&accname=guest&checksum=86C58C3293F49F83256765547DB73163
[18] ibid page 18
[19] ibid, page 20.

The Principle is a recommendation that aims to influence the domestic legislations of not only the member states of OECD, but also other states like Armenia, which have the ambitions to enhance their economic environment and increase the quality of domestic legislation.

CHAPTER III

TENDENCIES IN THE DOMESTIC LEGAL PRACTICE AND CASE LAW

In this chapter, we will conduct the analysis of the Armenian case law regarding the rights of the shareholders, which is not very extensive and rangy. This will help us to understand the approaches of our courts to the shareholder disputes, especially arising out of freeze out (mainly focusing on concentration) and buy out

The first case we will examine is a very remarkable one, concerning the concentration and its effect in terms of rights of the minority shareholders: in this case the property ownership rights. In 2010, the Constitutional Court examined in writing the application of Citizens Ruben Avagyan, Hrachik Hakobjanyan, Hrachya Avetisyan, Arayik Avetisyan with the request to determine the issue of conformity of Articles 56, 57 and 58 of the Law of the Republic of Armenia on Joint Stock Companies to the Constitution of the Republic of Armenia."[20]

The applicants were shareholders of "Yerevan Ararat Brandy-Wine-Vodka Factory" OJSC. According to the adopted decision of the special general meeting of the company's shareholders on October 12, 2008, the ordinary nominal non-documentary shares of the company with a par value of 8000 AMD were consolidated, the order of consolidation, conversion of shares and repurchase , as well as the amendments to the company's charter were approved. The applicants appealed the above mentioned decision of the general meeting of the company in the Court of General Jurisdiction of Kentron and Nork-Marash districts of Yerevan as according to them, as a result of the mandatory repurchase of fractional shares created in stock of the Applicants in accordance with the Article 56 of the Law on JSC's as a result of the consolidation of shares in the company by the Company, they have been deprived of their right to ownership of shares without a court order, while according to Part 2 of Article 31 of the RA Constitution of 2005, a person can be deprived of property only by court order and in cases prescribed by law.

The courts main point arises from the following: Article 31 of the Constitution of the Republic of Armenia stipulates four separate circumstances for restricting the exercise of property rights.[21]

[20] Decision № DCC-903 of the RA Constitutional Court of 13th of June, 2010 https://www.arlis.am/documentview.aspx?docID=59485,
[21] Decision № DCC-903 of the RA Constitutional Court as of 13th of June, 2010 https://www.arlis.am/documentview.aspx?docID=59485,

a) Restriction on the exercise of property rights by prohibiting damage to the environment and violating the rights and legitimate interests of other persons, the public and the state (second sentence of Part 1 of Article 31).

b) deprivation of property (Part 2 of Article 31),

c) Compulsory alienation of property for the needs of the society and the state (Article 31, Part 3),

d) Restriction of land ownership rights for foreign citizens and stateless persons.

As follows from the section a), which is the main test applied here by the Court, the implementation of the right of ownership is restricted by the Constitution with the requirement to preserve certain public values. Those are: the environment, ***the rights and legitimate interests of other individuals***, society and the state. Such an approach is intended to ensure a reasonable balance between the owner's rights and the public interest of others, recognizing the exercise of a person's property rights to property as guaranteed but not absolute.

Although this approach could be justified under the 2005 Constitution in question, the 2015 Constitution takes other approach.

According to the Section 3 if the Article 60 of the current (2015) Constitution of RA "The right to property may be restricted only by law ***for the protection of the public interest or the fundamental rights and freedoms of others.***" So here the test for restriction is not just right of others, but the fundamental rights of others (including the right of ownership), which makes the restriction more clear.

Objecting to the applicant's arguments, that their property rights were infringed, the respondent pointed out the goals pursued by the consolidation of shares, noting that the issue in question ***is one of the mechanisms for forming control packages, which in turn is carried out to increase the efficiency of management and activities of the joint stock company.***

The courts logic seems to be in line with this approach, also implying that the ownership rights of the minority shareholders were restricted to protect the right (or in current constitution the "fundamental rights") of the others (meaning the Company and other shareholders). So the ownership right of the minority shareholders was contradicted to the ownership rights of other shareholders, initiating the Concentration, implying that by refusing to sell their fractioned

shares back to the company, those minority shareholders are violating the "ownership rights" of the others.

As a result, the Constitutional Court of the Republic of Armenia decided: that the Article 56 of the RA Law on Joint Stock Companies complies with the Constitution of the Republic of Armenia within the framework of the legal positions expressed by the Constitutional Court.

Leaving the Articles 57, and 58 out of discussion we will focus on the argument of the parties regarding the Article 56 of the Law on JSC's. Section 1 of the Article 56 of the Law provides amongst others that if fraction shares arise due to consolidation, ***the latter shall be bought back by the Company*** at the market price estimated in the manner stipulated by Article 59 hereof."

As it is clear from the wording of this article that shareholders who end up having fraction shares due to consolidation of shares, which may not have been voted for by them, but is still possible as the quorum is not high for this kind of decisions to be adopted under our legislation, don't have say in deciding whether they want to sell the their fractioned shares back to the company or not. The principle of voluntariness in possession and enjoyment of the property is overlooked.

As it was already mentioned, the Decision of the constitutional court regulated the issue in compliance with the 2005 Constitution of Armenia. The current Constitution of the RA adopted in 2015 applies the following wording regulating the issue of restriction of right to property in the Section 4 of the Article 60 – "No one can be deprived of property except through a court procedure in cases prescribed by law", which is not very different from the 2005 constitution wording. [22]

So even if we agree with the Constitutional court that the ownership rights of the minorities could be restricted, both Constitutions of RA (2005 edition and current Constitution (2015)) still provide a clear procedure for such restriction,

1. It should be prescribed by law
2. It can be restricted only by the court procedure.

This so these requirements and the violation of the rights of the minority shareholders from this perspective were ignored by the court. Summarizing the abovementioned, it is legitimate to argue that the constitutionality of the existing mechanism off consolidation of shares can be

[22] Section 4 of the Article 60 of the Constitution of the Republic of Armenia 2015

considered in contradiction to the constitutional rights of ownership of the owners of shares.

Interestingly, the possible view that freeze-outs are a violation of the property rights of minority shareholders, are never possible under Delaware law, (or only in very exceptional circumstances).In the United States, a shareholder is viewed more as an investor with a purely financial interest than as a holder of property rights[23]

This case further will show a pattern of ignorance toward the minority shareholder rights. A couple of years after the Decision № DCC-903 of the RA Constitutional Court as of 13th of June, 2010, by which the imperfection of the Law on JSC's regarding the loophole in concentration mechanisms was ignored, "Yerevan Ararat Brandy-Wine-Vodka Factory" OJSC was involved in another court proceeding with a foreign investor` "East Investor" LLC[24] (registered in British Virgin Islands but in media mentioned as a German company). The case was again regarding the consolidation of shares, where the foreign company found itself squeezed-out from the company, as after the October 12, 2008 special general meeting it was decided to consolidate the shares of "Yerevan Ararat Brandy-Wine-Vodka Factory" OJSC, issuing one new share for each 2363.5 held at a valuation of 18,908,000 Armenian drams (approximately 45.212 Euros.) Given that "East Investor" LLC only held 1,520 shares and one new share was to be the equivalent of 2,363.5 shares, the German firm wasn't able to secure even one share of the new stock issue. As a result of the share consolidation, "East Investor" LLC the other minor shareholders wound up with fractional shares via buy out of the shares by the company. The foreign invertor undergone a long and exhausting process of arguing the consolidation, and in particular the calculation of "market price", which was suggested as a buyout price by the company. Eventually, the company took the case to the European Court of Human Rights in 2014. This was after Armenia's Court of Cassation failed to accept the case in late 2013.[25]

There are only a small amount of court practice regarding the minority shareholder rights in Armenia, most of the practice do not even get to the Cassation Court stage and do not form a

[23] Vos, Tom "Freeze-outs of minority shareholders: a comparative law and economics approach" Ku Leuven, Faculty of Law (2016)

[24] Civil case No. EKD /3170/02/09 "East Investor LLC vs "Yerevan Ararat Brandy-Wine-Vodka Factory" OJSC" http://www.datalex.am

[25] Kristine Aghalaryan „German Investor Doesn't Regard Armenia as Safe Investment Bet Right Now; But He Hasn't Lost Hope in Future "https://hetq.am/en/article/40801

court precedent. As an example, we could refer to the case of Artashes Artashes Hovhannisyan, a former minority shareholder of Ameriabank CJSC, who had demanded the cancellation of the purchase transaction of the 0.625 fractioned ordinary nominal shares, restoreation of his ownership right to the 5 ordinary nominal shares (each with a nominal value of AMD 40,000) belonging to him before consolidation and bought back by the bank's majority shareholders.[26]

Hovhannisyan's lawyers qualified the transaction as "squeezing out" the minor shareholder from the Bank. Hovhannisyan, who had lost a similar case against Ameriabank (The Bank) in civil court, had filed the lawsuit against Armenia's Central Bank, Ameriabank and the Central Depository.[27]

[26]Civil case No. EKD / 2597/02/14 "Artashes Hovhannisyan vs Ameriabank CJSC" http://www.datalex.am

[27] Marine Madatyan "Minority Shareholder Sues Central Bank; Administrative Court Orders Return of His Five Ameriabank Shares" 2017 https://hetq.am/en/article/84630

CONCLUSION

This Paper aimed to mainly show and underline the gaps and loopholes in the Armenian existing legislation regarding the rights of the minority shareholders. Alongside with the existing domestic legislation, international best practice is discussed in the face of "Commonsense Principles 2.0" developed in October 18, 2018, by the representatives of US corporations, pension funds and investment firms and G20/OECD Principles of Corporate Governance (2015). It is worth mentioning that the OECD Principles of Corporate Governance are not just recommendatory for Armenia. Not after the ratification of CEPA, as it clearly places an obligation on Armenia to refer to the OECD principles, mentioning that the further development of corporate governance policy shall be in line with international and, in particular, OECD standards.

It is very important to assess the quality of the regulation we already have in the sphere of corporate governance, evaluate the balance of rights of shareholders and formulated the existing problems and contradictions with the international best practice and OECD recommendations.

Assessing the domestic legislation with the focus on minority shareholder rights two existing mechanisms were underlined, which in their current form, contain risks for the minority rights. Those are the consolidation and the increase of company's charter capital by the increase of nominal value of the shares or by the issuance and allocation of new shares. Although, it there is a lack of statistical information regarding the pattern of behaviour of the majority shareholders regarding these two main mechanisms, in the cases discussed in the Chapter III of this Paper, were consolidation was the most used mechanism, it is clear that in all cases it was used to freeze the minority shareholders out from the entities. The continuous use of the mechanism by the same firm as it was in the case of "Yerevan Ararat Brandy-Wine-Vodka Factory" OJSC shows, points out on the problem once again. When **fraction** shares arise due to consolidation, the owner of those shares has no other option: the shares shall be bought back by the Company at the market price. The minority shareholder has no mechanism to have a say in the calculation of the market share as well, as it is in most of the cases determined by the board, in which the shareholders holding less than 10 % shares have no guaranteed seat.

Basically, the minority shareholders in current construct, have a problem of being voiceless and also having their ownership rights disregarded, in case their interest go against those of the majority, and this is an approach legitimized by the decision of the constitutional court.

In Chapter I we discuss this issue and an interim solution is proposed to help balance the rights of majority and minority shareholders.

Shareholders, who own less than 10 % of shares in the company could be given a right to join other shareholders with a same characteristic and in case of jointly forming ownership of 10% of shares to get a right to have one member of Board automatically, without having to undergo the election.

This mechanism is not the prescription that can eliminate the problem of balance of power, however is could give the minority shareholders some voice and also could work in favor of strengthening the positions of the shareholder agreements, which are not widely used in Armenian business environment.

The mentioned mechanism could also serve as a guarantee that the minority shareholders have a voice in the Board, especially in case of determination of the market price of the shares during a consolidation process, as it is prescribed by the Section 2 of the Article 59 of the Law on JSC.

It should be noted that putting aside the legal side of the problem, an implication can be made that the protection level of minority shareholders is very much related to the corporate and business culture in the country. Without corporate democracy, minority shareholders are represented by the controlling or majority shareholder. These interests are not identical, which means the small portion investment in any business is not encouraged and contains a huge risk of simply being pushed out as some point.

The foreign investors are the main target in this situation, as they usually make small “pilot” investments. To stimulate such investments that bring a new quality and diversity in the business environment of the country, it is important to give those investors incentives, such as legal framework, that is able to protect their investments and their property as minority shareholders. Considering the pattern that is evident through existing limited court practice and the media coverage of the corporate disputes it is clear that in Armenia minority shareholders are quite vulnerable while exercising their role in a company.

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