Corporate Governance in Action: Effectiveness of Disclosure and Redress in South-Eastern Europe

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Effective corporate governance mechanisms protecting the interests of investors and other stakeholders in business ventures are key to a country’s financial and economic development. A precondition to the development of efficient capital markets is in fact that outside investors can expect insiders (managers and more often controlling shareholders) not to divert corporate assets to themselves.

The law and its enforcement institutions play an important role in preventing insiders’ opportunism and, hence, in strengthening investors’ expectations.

Extensiveness: the assessment

In 2004 the European Bank for Reconstruction and Development (EBRD) conducted an assessment of corporate governance legislation in the EBRD region. It enquired into whether and to what extent corporate governance legislation (laws on the books) in each of the EBRD’s countries of operation complied with the OECD Principles of Corporate Governance and reported an uneven situation (see Figure 1).

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In the South-Eastern Europe (SEE) region, FYR Macedonia was found to have the best compliance rating. Albania, Bulgaria, Croatia and Serbia and Montenegro were also found to have a substantially sound corporate governance framework, although evidencing some minor flaws. Bosnia and Herzegovina and Romania were, however, found to have several shortcomings in their laws.

Effectiveness: the Legal Indicator Survey

Laws on the books are all-important, but in early transition countries in particular there can be a gap – the so-called ‘implementation gap’ – between the rights the law grants on paper and the actual possibility of enforcing those rights or of otherwise having them respected. This is especially true with corporate governance, where usually small, unorganised or at any rate not well-connected investors deal with controlling shareholders (or managers) who are among the most powerful individuals in the country.

In order to assess corporate governance fully it is therefore essential to look at whether and how the law (in this context, mainly corporate law) works in practice. This implies a focus both on the legal actions available to outside investors, ie minority shareholders, and on the institutional environment features that may affect their outcome.

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2 The SEE region included Albania, Bosnia and Herzegovina, FYR Macedonia, Serbia and Montenegro (SEE-4); Bulgaria, Croatia, Romania (SEE-3 EU candidate countries).
The Legal Indicator Survey (LIS) conducted in 2005 focused on the effectiveness of corporate governance in the EBRD countries of operation; instead of looking at the ‘law on the books,’ it aimed to assess how the law works in practice by taking the perspective of a minority shareholder wishing to find out whether the controlling shareholder abused its control power and, having ascertained abuse, to obtain redress.

A hypothetical case study (see Figure 2) was developed in order to find out how well minority shareholders of both an unlisted and a listed corporation fare in the context of a typical conflict-of-interest situation between controlling shareholders and outside investors: when the controlling shareholder enters into a sale contract with the corporation and therefore stands on both sides of the transaction. The LIS focus is therefore on self-dealing, which is widely held to be ‘the central problem of corporate governance in most countries’.4

The survey’s scope broadly coincides with the EBRD’s area of operation. In total, the survey covers 26 EBRD countries of operations5 plus Mongolia.

This article presents the findings in the SEE region.

**Methodology**

The methodology employed in the 2005 LIS followed on from the successful methodology employed in previous years for EBRD surveys.6 These involved working with leading law firms in the EBRD region.7 These law firms were presented with two broadly similar hypothetical case studies involving a related-party transaction.

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3 The initiative was funded by Italy.
4 See Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, *The Law and Economics of Self-Dealing* (Mimeo, 2005), p 34 (emphasis in the original). Djankov et al’s paper similarly devises a case study involving a self-dealing transaction and uses responses from practitioners in a number of jurisdictions to analyse the treatment of self-dealing transactions across the globe.
5 There were 27 EBRD countries of operations at the time of the survey, geographically divided into three regions: Central Europe and the Baltics (CEB): Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia; South-Eastern Europe (SEE): Albania, Bosnia and Herzegovina, FYR Macedonia, Serbia and Montenegro (SEE-4); Bulgaria, Croatia, Romania (SEE-3 EU candidate countries); Commonwealth of Independent States (CIS): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. For the LIS, data on Turkmenistan were not available. Results for Serbia and Montenegro are represented separately (eg Serbia, Montenegro and Kosovo).
6 The results of previous LIS are available on the EBRD website:
LIS on insolvency (www.ebrd.com/country/sector/law/insolve/insolass/lis/index.htm) and
LIS on enforcement of charges (www.ebrd.com/country/sector/law/st/facts/ecs.htm).
In the first case study Alfa Ltd is an unlisted company, controlled by Beta Ltd with 76 per cent of the shares, while the minority shareholder Gamma Ltd owns the remaining shares.

In the second case Alfa Ltd is a listed company, with Beta Ltd owning a 56 per cent controlling stake, Gamma Ltd owning a 12 per cent minority stake and 32 per cent of the capital floating on the market. In both cases, the damage suffered by Alfa Ltd from the transaction was quantified at two million euros.

In this scenario, the minority shareholder is faced with two problems: first it has to find out whether the transaction was actually entered into and under what terms. Secondly, once this has somehow been ascertained, it has to obtain some form of redress through a private action in court or otherwise.

An extensive questionnaire was designed to find out how effective each country’s legal system is in protecting the minority shareholder’s interests in the circumstances outlined above. The questionnaire was sent to the law firms together with the case studies and law firms were asked to respond to it as if they were advising the minority shareholder on how best to protect its rights and preserve the value of its financial investment in the local company. The questionnaire focused on three main areas: the mechanisms by which the minority shareholder can find out whether the transaction had indeed been entered into (‘disclosure’); the tools for redress (‘redress’); and the ‘institutional environment’ in which such disclosure and redress tools have to be used. With regard to the first two areas, respondents were asked to provide information on the legal tools available and to assess their effectiveness in terms of speed, enforceability and simplicity. With respect to institutional environment they were asked to assess a number of institutional features influencing enforcement of corporate governance law provisions

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7 Among others, the following law firms contributed to and supported the 2005 LIS: Studio Legale Tonucci (Albania and Romania); Chadbourne & Parke LLP (Azerbaijan, Belarus, Kazakhstan, Kyrgyz Republic, Russia, Ukraine, Uzbekistan); Advokat (Bosnia and Herzegovina); Spasov and Bratonov Lawyers’ Partnership (Bulgaria); Wolf Theiss (Croatia and Serbia, Montenegro and Kosovo); Linklaters (Czech Republic, Poland and Slovak Republic); Luiga Mugu & Borenius (Estonia); Mgaloblishvili Kipiani Dzidziguri (MKD) Law Firm (Georgia); Ormai es Tarsai CMS Cameron McKenna (Hungary); Sorainen Law Offices (Latvia); Lideika Petrauskas Valiunas & Partners (Lithuania); Law Office Polenak (FYR Macedonia); Turcan & Turcan (Moldova); Colja Rojs & partnerji op, dnoi (Slovenia); Akhmedov Aziziv & Abdulhamidov Attorneys (Tajikistan); Lynch & Mahoney law offices (Mongolia).

8 For those countries where there is no active stock exchange, Alfa Ltd was to be considered a large open-type company with numerous minority shareholders.
and standards (eg competence of courts and financial market regulators, availability of previous case law, presence of arbitration bodies specialised in business law, etc). 9

Variables

Measuring the effectiveness of a legal mechanism is a difficult exercise. Several variables are to be taken into account and most of them involve subjective judgments by the respondents. The following have been used as measures for the effectiveness of disclosure and redress mechanisms.

9 The questionnaires were sent out in early June 2005. Answers were received between July and September 2005. Before treating the data, a number of additional questions and requests for clarifications were sent to the respondents in order to clarify their answers. In some cases conference calls were held with local practitioners.
**Speed**

Speed is the most straightforward factor. With regard to disclosure, it refers to the average time between the initial filing of proceedings with the court and the issue of an executable court order as assessed by the respondents. In redress cases, it spans the period from the initial filing of the proceeding to the issue of a court’s executable judgment, again taking into consideration an appeal by the defendant, and as assessed by the respondents.

**Simplicity**

Simplicity relates to the smoothness of proceedings and also takes into consideration the guidance offered by judicial precedents in interpreting the law. More precisely, respondents were asked to assess how clear, simple and straightforward the proceedings relating to the available actions are.

**Enforceability**

Enforceability relates to the carrying out of the executable judgment in cases where the other party fails to implement it, and extends far beyond corporate governance. Respondents were asked to assess how smooth the procedure to enforce a judgment favourable to the minority shareholder and to obtain the desired outcome would be.

**Institutional environment**

The institutional environment relates to the capability of a given legal framework to provide the basic guarantees that are needed for the legislation to be effectively implemented and enforced. It includes a number of factors: with regard to disclosure, consideration was given to the perceived reliability of company books, the requirement to have the corporate financial information audited, the presence of the ‘Big Four’ auditing firms in the country\(^{10}\) and the perceived independence of statutory auditors. With regard

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\(^{10}\) The underlying intuition is that the presence of the Big Four is a proxy of the quality of the audit profession. Cf OECD, *Corporate Governance in Eurasia: A Comparative Overview*, at 29 (underlining the importance of having well-trained accountants for a country’s corporate governance); Bernard S Black, ‘The Legal and Institutional Preconditions for Strong Securities Markets’ (2001) 48 UCLA L Rev 781, 793-94 (including ‘[a] sophisticated accounting profession with the skill and experience to catch at least some instances of false or misleading disclosure’ among the ‘core institutions that control information asymmetry’ and hence among the preconditions for strong securities markets).
to redress, consideration was given to the perceived degree of competence and experience of courts and prosecutors, the availability of up-to-date legislation, the ease with which the defendant can delay the proceedings and the perceived influence that might be exercised on courts and prosecutors by a powerful defendant. With regard to both disclosure and redress the ‘2005 Corruption Perception Index’ elaborated by Transparency International\textsuperscript{11} was also taken into account.

**Results**

The findings of the survey are necessarily limited and must be treated with caution. First, they reflect the views of a limited number of practitioners for each country.\textsuperscript{12} Secondly, they address a very specific set of circumstances and must be considered within the boundaries of the case studies. Thirdly, assessing effectiveness is by necessity far more difficult and subjective than finding out what the law on the books states in a given country, as one has to deal with hard-to-measure variables such as courts’ competence, simplicity of procedures, ease of enforcement and so on.

**Detecting dominant shareholders’ wrongdoing**

The first part of the analysis focuses on how a minority shareholder might find out whether a related-party transaction has indeed been entered into by the company’s management on the assumption that the majority shareholder controls the board and no disclosure of the transaction is spontaneously provided to the minority shareholder.

Disclosure is one of the key pillars of an effective corporate governance framework.\textsuperscript{13} In the context of related-party transactions, disclosure is usually analysed in terms of an obligation to inform the board and/or shareholders and/or the public at large about such transactions.\textsuperscript{14} Since the LIS is about effectiveness of the legal framework for corporate governance as opposed to its extensiveness, the case studies assumed that, whatever the disclosure obligations in place, no disclosure had been given on the transaction to the relevant bodies, as is often the case when assets are siphoned off a company by its dominant shareholder. Therefore, the questionnaire focused on the


\textsuperscript{12} In some instances, one single practitioner within the leading law firms to which the questionnaire was sent answered the questionnaire, in others it was a team of practitioners.

\textsuperscript{13} See OECD Principles II and V.

\textsuperscript{14} See, eg, Djankov \textit{et al}, n 4 above.
tools available to minority shareholders who have reason to suspect that a self-dealing transaction has been entered into and on how effective they are in the perception of the respondents, according to the criteria highlighted above (speed, enforceability and simplicity) and to their overall judgment on how likely it is that by using those tools the minority shareholder in our case study can succeed in detecting wrongdoing.

For this purpose, the questionnaire listed six legal tools that may help a minority shareholder find out about whether a self-dealing transaction has been entered into:

1. inspecting Alfa’s books and other corporate documents;
2. requesting information from the company’s auditor;
3. requesting an independent audit;
4. requesting the court to appoint an independent auditor;
5. requesting the court or another public body to have an administrator appointed;
6. calling a special shareholders’ meeting to question the company’s management.

Respondents were free to add other actions that they would advise the minority shareholder to take.

As the LIS reveals, only a few countries offer an institutional framework providing minority shareholders with effective mechanisms to obtain disclosure. In many countries, minority shareholders face substantial problems and their actions can be easily blocked by majority shareholders.

**General situation**

Within the SEE region, a relatively effective framework for disclosure is reported in Bulgaria, Croatia, Romania and Serbia. The average time needed to obtain a court order varies from a few months in Bulgaria and Romania to three or more years in Bosnia and Herzegovina and Serbia (Kosovo only), where procedures are also deemed to be complex and difficult to enforce. The institutional environment is considered especially weak in Serbia (Kosovo only) and Albania but relatively sound in Bulgaria and Croatia.

**Specific action: accessing reliable company documents**

Minority shareholders can request access to company books and documentation in a majority of the EBRD’s countries, but the action is deemed likely to lead to a positive outcome only in a few of them. In many
instances reports are not internally audited and corporate information is considered not fully reliable. Statutory auditors are often perceived as not being able to act fully independently, giving rise to serious doubts as to the reliability of audited company information.

In Serbia, shareholders are granted the power to inspect and extract copies of a variety of corporate documents, including accounting and financial documentation. In case of obstruction by the company, they can petition the court, which should come to a decision within three days, but in practice it is hard to assess even a probable duration of proceeding.

In Montenegro, the law grants shareholders the right to access the company’s financial books and auditor’s reports at the company’s headquarter during the 30 days before the general meeting. The effectiveness of the action may be limited by the quality of information obtained.

In Albania the law clearly provides the right for shareholders to have access and extract copies of the inventory of assets, annual accounts, directors and auditors reports. These documents and the minutes of the general meetings for the last three financial years should be available to shareholders at any time. Shareholders can also petition the court and a court order should be available in around eight months. Here the effectiveness is limited by the low quality of corporate information and possible bias of the courts especially towards powerful defendants.

Specific action: questioning the company’s auditor

This action is available in Albania, Bosnia and Herzegovina and FYR Macedonia. The venue is usually the general shareholders’ meeting, where the company’s documentation is discussed and approved.

In Albania internal auditors are requested to attend the shareholders’ meeting and can be questioned by shareholders. Unfortunately, the lack of clear provisions on auditors’ responsibility in case of refusal to provide the required information renders this avenue quite complex, difficult to enforce and in general not effective.

In FYR Macedonia the procedure is not well detailed in the law and likely to be complex. An executable court order against the auditors can be obtained in six months, but the lack of a specific procedure can render enforcement extremely difficult.

In Bosnia and Herzegovina, the move is likely to be possible only ‘on the books’ as there is no enforcement mechanism in case the auditor refuses to collaborate.
Specific action: requesting an independent audit

An ad hoc independent audit is generally considered the best action to obtain disclosure.

In the SEE, this procedure is available in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Serbia (not in Kosovo) and Montenegro.

In Albania, shareholders owning ten per cent of the company’s shares can request an audit over certain administrative matters. The court can then be asked to specify the scope and the powers of the special auditor. In general the procedure is simple, but in case of opposition by the controlling shareholder, enforceability can be an issue and it might take a year to see some results.

In Bulgaria the action is left to the general meeting decision, therefore leaving no chance to minority shareholders. Minority shareholders can also petition the court and here the action is considered the best available. The procedure is clearly stated by law, enforceability is not reported as a problem and the time needed to obtain a court order is generally limited to less than a month.

In Romania, requesting the court for the appointment of an independent auditor is considered quite effective, as the action is simple and fast, as a special proceeding is available.

Specific action: consider an extraordinary shareholders’ meeting

In all SEE countries a minority shareholder has the right to request a general shareholders’ meeting to question the management’s actions. Unfortunately this avenue is not very effective where a dominant shareholder can control the general meeting’s decisions.

In Serbia, shareholders owning ten per cent of the company’s shares can request a general shareholders’ meeting, but questioning the management will be limited to clarification of the company’s available documentation. A more effective and easy-to-enforce solution would be to request the court to appoint an independent audit and then have a general shareholders’ meeting to discuss the findings.

In Croatia, shareholders holding five per cent of the company shares can file a written request for a general shareholders’ meeting to the company’s management. In case of inaction, the request can be addressed to court. Local practitioners reported the avenue as quite complex and possibly lasting more than two years. Again the effectiveness of the action would increase when coupled with an independent audit.
Particular needs for improvement

Serbia and Montenegro (Kosovo only) was found to offer the least effective disclosure. The available corporate documentation is generally unreliable and minority shareholders therefore have to start specific actions if they want to obtain disclosure. Minority shareholders can only request a general shareholders’ meeting, but it is unlikely to be effective if the controlling shareholder is hostile. Moreover the legal framework is very complex, being a mix of UNMIK (United Nations Interim Administration Mission in Kosovo) regulations and old Yugoslavian law.\(^{15}\) While UNMIK regulations dealing with corporate governance are limited,\(^{16}\) there is reluctance on the part of local judges to apply the old Yugoslavian law, which leads to legal uncertainty.

The situation is only slightly better in Bosnia and Herzegovina where several courses of action are open to a minority shareholder, but none has a realistic prospect of enforcement should the controlling shareholder refuse to collaborate.

In Albania the weak institutional environment poses doubts on the disclosure that might be obtained through any of the above-mentioned legal actions.

Redress mechanisms

Once an abusive related-party transaction has been detected, the legal framework must offer effective mechanisms to obtain redress. Local practitioners were asked to indicate what legal remedies were available to the minority shareholder in the case study scenario. A menu of possible remedies was listed in the questionnaire.

The following civil remedies were the main focus of attention:

1. challenge to the validity of the transaction (ie rescission);
2. liability suit against the company’s directors on behalf of the company (ie a derivative suit);

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\(^{15}\) According to UNMIK Regulation 24/199 – as amended – on the ‘Law Applicable in Kosovo’, the applicable law is composed by the regulations promulgated by the Special Representative of the Secretary-General … and the law in force in Kosovo on 22 March 1989. In case of a conflict, the regulations shall take precedence. If a court … determines that a … situation is not covered by the [above-mentioned] laws but is covered by another law in force in Kosovo after 22 March 1989 which is not discriminatory … the court as an exception, shall apply that law.

\(^{16}\) UNMIK Regulation 2001/6 on business organisations; Regulation 2001/30 on the establishment of the Kosovo board on standards for financial reporting and regime for financial reporting of business organisations and Administrative Direction 2002/22 implementing UNMIK regulation 2001/6 on business organisations.
(3) direct liability suit against the company’s directors for damages incurred by the minority shareholder;
(4) liability suit against the company holding the majority stake (and/or its subsidiary on the other side of the transaction and/or its directors) on behalf of the company;
(5) direct liability suit against the company holding the majority stake (and/or its subsidiary on the other side of the transaction and/or its directors) for damages incurred by the minority shareholder;
(6) action against the counterpart to the transaction to obtain the disgorgement to the company of the profits made out of the transaction.

Respondents, again, were free to add further remedies.

The questionnaire also inquired into whether enforcement mechanisms other than before civil courts were available (criminal prosecution, national or international arbitration and – for case two only – action before the securities regulator and the stock exchange). Once again, practitioners were free to add further remedies.

For each of the remedies the usual questions on availability, speed, simplicity and enforceability were made. Respondents were also asked to assess the costs of the legal remedy they deemed to be most effective. More specific questions were also asked with regard to civil and criminal actions.

**General situation**

In general, it can be observed that in all SEE countries, except Bosnia and Herzegovina and Bulgaria (for unlisted companies only), minority shareholders have several options for legal action. Unsurprisingly, however, the effectiveness varies greatly from action to action and from country to country.

Romania has the most effective laws in the SEE region regarding redress, while Albania, Bosnia and Herzegovina, FYR Macedonia and Serbia (Kosovo only) showed several flaws.

In Romania, Serbia (not Kosovo) and Montenegro, minority shareholders can choose between several different procedures that are generally clear and enforcement appears not to be an issue. Unfortunately in Serbia and Montenegro the time needed to conclude proceedings is generally high.

**Specific action: challenge the validity of the transaction**

Only in Croatia was filing a request to render the transaction void deemed not available.
In Bulgaria it is available only for shareholders in listed companies. This action is available only to individuals and not to merchants (whether sole proprietors or companies). The time needed to obtain an executable judgment is around two years. While the procedure is simple, enforceability can be problematic and strongly depends on whether asset conservation is imposed to secure the implementation of the judgment.

In Albania, the transaction can be annulled by the general meeting’s decision, where the interested party is excluded from voting. The general meeting’s decision can then be appealed in court. Here, the support of an independent audit report might be important. In order to improve enforcement, assets should be seised or a guarantee requested at the beginning of the proceedings.

In Bosnia and Herzegovina it is the only avenue available and proceedings are complex. The time needed to obtain an executable judgment is generally longer than two years. Courts are overcrowded with cases and although the law lays down a very strict time frame for every legal action, the first instance trial can last more than one year.

In Montenegro, the law provides clear grounds for the annulment of the transaction and for obtaining compensation for damage. If the defendant was to use all means available to fight back, proceedings can last for anything up to 18 months. Enforcement has recently improved as the new Law on Enforcement has introduced new tools, but the institutional environment might pose some doubts on the outcome of the action, as the judiciary is strongly controlled by the local political elite and can be biased in favour of powerful parties.

**Derivative action against the company’s management**

This procedure presupposes the presence of specific provisions allowing a shareholder to represent the company in a legal action against the company’s management. It is not possible in Bosnia and Herzegovina and Serbia (Kosovo only).

In Bulgaria it is the only available action for minority shareholders in unlisted companies and is reportedly quite complex. The time needed to obtain an executable judgment ranges between one and three years, while the successful enforcement depends on the debtor’s creditability and the availability of liquid assets owned by the debtor.

In Romania the action is detailed in company law. The procedure is clearly specified and an executable judgment is usually obtainable in 18 months. In spite of recent changes to laws regarding the structure and functioning of the courts, the Romanian legal system still encounters major difficulties,
since judges have to manage an impressive number of cases, which often leads to them being solved without compliance with the requirements of celerity and efficiency.

**Direct liability action against the company’s management**

This avenue is not available in Bosnia and Herzegovina and Bulgaria.

In Serbia, Kosovo and Montenegro, the action is unevenly effective.

Under the new Serbian Litigation Act all evidence on which the claim is based must be submitted to the court when filing the suit, otherwise the claim is rejected. This adds complexity to the whole procedure. Speed is also an issue: courts are not bound by any mandatory deadlines and proceedings can last more than five years. Enforceability is not problematic unless the debtor’s assets have been secured. The typical problem that is being encountered in practice with respect to enforcement procedures is that parties in whose favour executable judgments have been issued cannot complete such execution owing to a lack of any assets on the side of the condemned party.

In Montenegro, the major flaw is time. Proceedings are generally slow, providing numerous possibilities for obstruction, without incurring procedural penalties. Moreover, defendants can easily delay the suit by not disclosing the relevant evidence. In order to improve enforcement a temporary injunction for securing the defendant’s assets should be requested.

In Kosovo, the legal framework is very complex. While UNMIK regulations do not include any legal basis for liability actions, the old Yugoslavian law provides certain legal grounds for this action. However there is reluctance on the part of local judges to apply pre-1989 law and, under certain circumstances, pre-1999 law. Enforceability is also an issue, and although in some cases enforcement of a judgment is successful, obtaining the sought result is generally difficult. Finally time is an issue as proceedings can easily last over seven years.

**Particular needs for improvement**

The LIS evidenced major weaknesses in Serbia and Montenegro (Kosovo only) and Bosnia and Herzegovina.

Challenging the validity of a related-party transaction is the only legal remedy available in Bosnia and Herzegovina and its effectiveness is limited. Courts have a backlog of cases and, despite strict time limits set by law, the complex legal proceedings can drag on for several years.
When considering unlisted companies, Bulgaria offers only one course of legal redress, the derivative suit; in addition, its procedure is not particularly smooth and can lead to enforcement difficulties. The time required to reach an executable judgment can be anything up to two years and the defendant can easily delay the process further.

Other enforcement mechanisms

The effectiveness of corporate governance mechanisms depends not only on the courts but also on other public enforcement institutions and on private enforcement institutions such as arbitration courts and stock exchanges.\(^{17}\) It may further be positively affected by the functioning of other informal types of pressure on insiders’ behaviour,\(^ {18}\) such as that exerted by the media or shareholders’ associations, especially when listed companies are involved, or by embassies, in cases involving foreign investors.

Arbitration

As an alternative to actions before the court, local practitioners were also asked to assess the availability and effectiveness of national and international arbitration procedures according to the same variables considered above. In order to assess the extent of the availability of arbitration it was also asked whether a provision in the company’s charter would suffice to start arbitration proceedings or whether an agreement among the disputing parties would be necessary.

The survey revealed an uneven situation throughout the region. Practitioners in Bulgaria pointed out the exclusive competence of courts on the issues described in the case studies, while in Bosnia and Herzegovina the law on civil procedure allows for the formation of so-called ‘ad hoc arbitration’, which is not deemed applicable to the scenario under analysis. In Albania arbitration is considered a valid alternative to the weak judicial environment. In Kosovo it is felt to be largely ineffective: in general, enforcement mechanisms are limited and their effectiveness highly unreliable.


**Action before the stock exchange**

With regard to the position of a minority shareholder in a listed company, the survey found that an action before a stock exchange to obtain enforcement of the relevant provisions in the listing rules is available in FYR Macedonia and Romania. Local consultants reported the action to be quite effective in Romania, while in FYR Macedonia procedures might be particularly lengthy.

**Action before the market regulator**

All countries in the SEE region have a securities market regulator, but only in Bulgaria and Romania is a specific action before the regulator considered feasible in order to obtain administrative sanction or some other enforcement action against the company’s directors or dominant shareholders. In both countries the procedure is simple and the action likely to have a positive outcome.

**Support to the actions**

Finally the questionnaire asked whether the plaintiff should consider other support mechanisms to their actions.

In Albania, Croatia, FYR Macedonia, Romania and Serbia and Montenegro, a media campaign was considered to be a good support for the action. Requesting support from the national embassy – remember that our minority shareholder was a foreign investor – was on the other hand considered helpful in Albania, FYR Macedonia, Serbia and Montenegro (Montenegro only) and Romania. Finally, only in Montenegro was support from a shareholder association judged to be helpful.

**How much does it cost to obtain redress?**

With regard to redress mechanisms, practitioners were also asked to assess the expected costs of the legal action they deemed to be most effective to obtain redress. A few questions were also designed to find out about the rules on an attorney’s fees in shareholder suits. Especially in publicly held companies, the prospect of having to pay one’s attorney’s fees and possibly even the winning defendant’s fees acts as a great disincentive to shareholder

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19 In the SEE region the stock exchange is reported to be inactive in Albania and Serbia (Kosovo only).
suits. Ideally, as happens in the United States and Japan, a shareholder bringing a *bona fide* suit should be in a position to pay either his or her lawyer’s fees (contingency fees) or the successful defendant’s fees, while being entitled to lawyers’ fees if he or she wins the case. Otherwise, bringing action against insiders’ wrongdoing will imply a risk of loss most shareholders would be unwilling to bear. Hence, shareholder suits in countries with rules other than the ones in place in the United States and Japan (i.e., in most states in the survey and even in continental Europe) will rarely challenge insiders’ behaviour in court, and laws protecting minority shareholders will be under-enforced and hence less effective.

Estimating legal costs is a difficult exercise, as it depends on a number of circumstances, several of which are unpredictable. Bearing this in mind, the survey compared the estimate of legal and administrative fees with the damage suffered by the plaintiff. As a result legal costs were estimated in a range from less than one per cent in Albania, Serbia and Montenegro (Kosovo only) and FYR Macedonia to more than 20 per cent in Bosnia and Herzegovina and Croatia. The survey also found that administrative fees are particularly high in Bulgaria (10-15 per cent of the damage) and Albania (12 per cent).

According to the LIS survey, in Albania, Bosnia and Herzegovina, Croatia and FYR Macedonia an agreement between a law firm and a plaintiff according to which the latter will owe the firm no fees in case of rejection of the action is considered valid and consistent with the Bar’s code of ethics.

In all SEE countries the plaintiff must pay for the other party’s lawyers’ fees in the event he or she loses the case and the defendant must pay for the plaintiff’s lawyers’ fees when he or she loses the case.

In Bosnia and Herzegovina, Romania and Serbia (including Kosovo), in case of an action for damages, lawyers are not allowed to agree with the client a share in the damages awarded. Finally, class actions\(^\text{20}\) are available only in Romania.

**Conclusion**

The 2005 LIS confirms that related-party transactions remain a cause for concern in all countries in the region. The degree to which minority shareholders can obtain effective disclosure or redress is limited, and well below what could be expected when looking at the laws.

\(^{20}\) Defined broadly as a lawsuit brought by one or more plaintiffs on behalf of a large group of others who have an identical claim (e.g., an action filed by one shareholder on behalf of other shareholders as well).
Disclosure and redress are inextricably linked. This is because an action for redress can only be initiated when evidence is secured. The assessment reveals that requesting a general shareholders’ meeting is the most common action provided by law to minority shareholders, but it is unlikely to produce any disclosure when the company is controlled by a powerful shareholder. In case of obvious misconduct, criminal proceedings are available by law in all countries in the region, but the vast majority of contributing practitioners expressed serious doubts as to the experience and competence of prosecutors in corporate cases.

When comparing extensiveness and effectiveness, it is interesting to note that countries that scored relatively high in terms of extensiveness (such as FYR Macedonia and Albania) fare worse in terms of effectiveness, while the opposite is true in the case of Romania.

Summing up the results from the region the following conclusions can be drawn. Consistent with previous studies on shareholder and creditor rights in transition economies, the LIS shows that EU candidate countries, while displaying a better institutional environment, do not systematically outperform other transition countries with regard to the effectiveness of disclosure and redress mechanisms.

Finally, even excellent laws can suffer from poor implementation. This undermines the usefulness of legal provisions and diminishes the confidence of foreign investors in the legal system as a whole – in particular, in its ability to uphold contractual rights. Most transition countries need to upgrade their commercial laws to standards that are generally acceptable internationally. Even more importantly, they must make those laws fully effective, particularly through strengthening their court systems, tackling corruption and adopting appropriate measures to strengthen the rule of law.

Effectiveness of corporate governance in South-Eastern Europe

Albania
- Speed of disclosure: 100%
- Institutional environment of redress
- Simplicity of disclosure proceedings
- Enforceability of disclosure
- Enforceability of redress
- Simplicity of redress proceedings
- Speed of redress

Bosnia and Herzegovina
- Speed of disclosure: 100%
- Institutional environment of redress
- Simplicity of disclosure proceedings
- Enforceability of disclosure
- Enforceability of redress
- Simplicity of redress proceedings
- Speed of redress

Bulgaria
- Speed of disclosure: 100%
- Institutional environment of redress
- Simplicity of disclosure proceedings
- Enforceability of disclosure
- Enforceability of redress
- Simplicity of redress proceedings
- Speed of redress
Effectiveness of corporate governance in South-Eastern Europe

Croatia

FYR Macedonia

Montenegro
Effectiveness of corporate governance in South-Eastern Europe

Note: The graphs show disclosure, redress and the institutional environment in the SEE. The average results from the case study scenarios are shown. Disclosure refers to a minority shareholder’s ability to obtain information about their company. Redress refers to the remedies available to a minority shareholder whose rights have been breached. Institutional environment refers to the capacity of a country’s legal framework effectively to implement and enforce corporate governance legislation. Costs refer to the expenses a minority shareholder must pay to take legal action. The extremity of each axis represents an ideal score: the fuller the ‘web’, the better the corporate governance framework. Data for disclosure in Serbia and Montenegro (Kosovo) were not available for case study 2, as there was no action available for minority stakeholders to take.