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# Protection of Minority Shareholders' Rights under Lithuanian Law

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Lithuanian business law topics

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# Protection of Minority Shareholders' Rights under Lithuanian Law

## Introduction

The most common corporate vehicles used for making investments in Lithuania are private limited liability companies (*Uždaroji akcinė bendrovė, UAB*), and public limited liability companies – stock corporations (*Akcinė bendrovė, AB*). According to the statistics published by the Department of Statistics under the Government of the Republic of Lithuania ([www.std.lt](http://www.std.lt)), at the end of the year 2005 in total 160,800 entities were registered in Lithuania, 51,272 of which were UABs and 783 ABs. These are both forms of limited liability company, the capital of which is divided into shares. The legal regime for both UABs and ABs is laid down in the Lithuanian Company Law and the Lithuanian Civil Code. In general terms, a UAB and an AB have many similarities with respect to such matters as the incorporation procedure, management structure and corporate governance, and the rights and obligations of the shareholders. The main differences between them are found in the following areas:

- (i) Minimum share capital. The minimum share capital of a UAB amounts to LTL 10,000 (approximately EUR 2,900), and for an AB the figure is LTL 150,000 (approximately EUR 43,500).
- (ii) The procedure for transferring the shares.<sup>1</sup>
- (iii) The requirements for the public disclosure of information. In contrast to a UAB, an AB must report not only to its shareholders and the Lithuanian Companies Register but also to the Lithuanian Securities Commission and the Vilnius Stock Exchange.

The reality in Lithuania is that the vast majority of the country's limited liability companies (both UABs and ABs)<sup>2</sup> are owned by groups of people, while only a comparatively small number of companies (usually UABs) are owned by sole shareholders. It is common practice when businesses are started up to assemble a group of shareholders from the available pool of well-known and reliable entrepreneurs. Therefore, all the issues are settled amicably and

the shareholders do not encounter difficulties in reconciling their personal interests. However, due to the expansion of business activities and the increase in the number of company owners, as well as changes in the structure of corporate ownership, conflicts of interests can arise. As a consequence, yesterday's business colleagues may become today's enemies.

When a conflict of interest arises, control of the company and the ability to influence decision-making become crucial issues. The shareholders are then divided into two camps: 'majorities' and 'minorities'. Generally, in any case both the majorities and the minorities seek to satisfy their personal needs and interests; be it a majority shareholder seeking, for example, to reinvest the dividends into the prospective business of the company, or a minority shareholder seeking to have them paid out.

On the one hand, the shareholders holding the majority interest are in a better position to influence decisions and thus the activities of the company. On the other hand, the abilities and rights of the controlling shareholders should not be overestimated. The minority shareholders are invested with certain legal rights which serve as a protection mechanism against the abuse of rights by the majority shareholders.<sup>3</sup> The way in which this protection mechanism works requires more detailed analysis.

Therefore, this article initially lists and briefly describes the protection mechanisms that may be employed by the minorities. Thereafter, bearing in mind the importance of certain rights from the minority shareholders' perspective, it focuses on the shareholders' right to verify by judicial means whether the company's activities are carried out with due diligence. The description and comments below are based on the legal provisions as well as on related court practice. However, it should be stressed that, irrespective of a number of court judgments cited below, the reader should not be misled: it should at all times be remembered that the Lithuanian legal system belongs to the Roman-German family of law and thus does not accept court precedent as an official source of law.<sup>4</sup>

<sup>1</sup> For details see section 3.1.3 below.

<sup>2</sup> UABs and ABs are in this publication collectively referred to as 'the company'.

<sup>3</sup> The Lithuanian Civil Code, article 1.2 lays down the basic principles of civil relations, which also includes a prohibition on abuse of rights.

<sup>4</sup> Court precedents are considered as a derivative (unofficial) source of law (V. Mikelėnas, A. Vileita, A. Taminskas, *Commentary on the First Book [General Provisions] of the Civil Code of the Republic of Lithuania*, Vilnius, Justitia, 2001, at p70). However, in practice the courts take into consideration and follow the judgments of the Lithuanian Supreme Court (see also the Law on Court of the Republic of Lithuania, section 2 of article 33).

## 1. General Regulatory Framework

The Lithuanian Company Law does not establish any special mechanisms for the protection of minority shareholders. However, it does grant to all shareholders a wide range of legal rights which serve as tools for protection of the interests of minorities from the abuse of rights by the majorities.

These are rights which may be found in most jurisdictions, such as the right to participate and vote at the general meeting of shareholders, the right to apply to a competent court and challenge decisions made by the company's bodies, and the right to receive dividends.<sup>5</sup> These rights were conferred upon shareholders in 1990<sup>6</sup>. Since then, only the scope and implementation procedure, rather than the substance of such rights, have changed.

Certain rights granted to shareholders under Lithuanian law are not so commonly found in other countries. One example of this is investigation of the company's activities. The Lithuanian Civil Code, effective as of 1 July 2001, introduced the concept of investigation of the activities of the company, its management bodies, or their members. Minority shareholders are entitled to judicial verification of whether the activities of the company are being conducted with due care, as well as require the remedying and improving of such activities where necessary. The right to require investigation of the company's activities serves as one of the major protection mechanisms for minority shareholders.

## 2. Concepts of Majority and Minority Shareholders

No unified definitions of majority or minority shareholders exist in Lithuania.

From the theoretical point of view, any person having 50% of the shares plus one vote should be regarded as a majority shareholder, and those below this threshold should be regarded as a minority shareholder. However, the concepts of majorities and minorities vary according to the nature of the legal rights in question.

For example, under the Lithuanian Company Law a shareholder must hold more than 50% of the shares to be entitled to receive all the information about the company.<sup>7</sup> On the other hand, in order to employ squeeze-out mechanisms, such a shareholding in an AB must comprise at least 95% of the votes.<sup>8</sup>

<sup>5</sup> See section 3 below.

<sup>6</sup> In 1990 Lithuania regained its independence and started redrafting its legislation.

<sup>7</sup> Lithuanian Company Law, section 1 of article 18.

<sup>8</sup> Law on the Securities Market of the Republic of Lithuania, section 1 of article 19-1.

<sup>9</sup> Lithuanian Civil Code, paragraph 1 of section 1 of article 2.125.

<sup>10</sup> Lithuanian Company Law, paragraph 4 of section 1 of article 16.

<sup>11</sup> Lithuanian Company Law, article 15.

<sup>12</sup> The list of non-property related rights is not exhaustive.

Similarly, the minority shareholder must hold at least 10% of the shares to be able to demand an investigation of the company's activities.<sup>9</sup> However, one share is sufficient to challenge any decision of the company's bodies.<sup>10</sup>

The thresholds mentioned above are met if reached by a shareholder acting individually or collectively with other persons.

## 3. Overview of the Rights Conferred to the Minority Shareholders

In accordance with the equal treatment principle, all shareholders must be treated equally in the same circumstances. Deviation from this rule may only occur where different kinds of shares are involved, provided, however, that such deviation does not go beyond the mandatory limits established in Lithuanian law (for example, owners of preference shares may have the right to receive dividends earlier than other shareholders if this is provided for in the company's articles of association).

Each share grants each shareholder the following non-property related rights regardless of the number of shares held:<sup>11</sup>

- (1) to attend and vote at general meetings of shareholders;
- (2) to obtain information about the business of the company;
- (3) to challenge decisions of the company's bodies – i.e. the general meeting of shareholders, the supervisory council, the board, and the chief executive officer (CEO) – by applying to court, etc.<sup>12</sup>

The Lithuanian Company Law contains the principle of proportionality as to property-related rights. Shares are investment securities, which indicate the degree to which the owner of such shares participates in the capital of the company. The level of benefit obtainable pursuant to such property-related rights is proportionate to the number of shares held.

The shareholder is entitled to the following property-related rights:

- (1) to receive dividends;
- (2) to receive a portion of the residual assets of the company in liquidation;
- (3) to receive shares gratis when the share capital is increased out of the company's own funds;

- (4) to have the right of first refusal over each new issue of the company's shares or convertible debentures, except in cases when the general meeting of shareholders has decided to withdraw this right from all the shareholders;
  - (5) to have the right of first refusal over the shares sold by other shareholders (applicable only in case of a UAB);
  - (6) to make a loan to the company.<sup>13</sup>
- (iii) the equity of the company<sup>14</sup> is lower, or, after the payment of dividends would become lower, than the aggregate of the share capital, the legal reserve, the revaluation reserve and the reserve for acquisition of its own shares (the latter applies solely in respect of public companies) of the company.

### 3.1 Exercise of Property-Related Rights from the Perspective of Minority Shareholders

#### 3.1.1 RIGHT TO RECEIVE DIVIDENDS AND OTHER ASSETS OF THE COMPANY

Under the Lithuanian Company Law the shareholders may receive profits or assets of the company in the event of (i) payment of dividends; (ii) reduction of share capital; or (iii) liquidation of the company.

All ordinary shares rank *pari passu* with regard to dividends and other distributions by the company. Preferential shares confer priority in receiving dividends as compared with ordinary shares. Dividends and other assets of the company are distributed to the shareholders in proportion to the aggregate sum of the nominal value of the shares held by each individual shareholder.

**Dividends** may be declared by decision of the annual ordinary general meeting of shareholders. The company may only distribute dividends out of its distributable profit. This consists of the unconsolidated net profit for the financial year, as increased or reduced by any profit or loss carried forward from the previous year, plus any amounts held in the company's reserve that the shareholders decide to make available for distribution, other than those reserves that are specifically required to be maintained, either by Lithuanian law or by the company's articles of association, less any allocations for any other purposes decided by the general meeting of shareholders.

The general meeting of shareholders may not declare and pay dividends if:

- (i) the company is insolvent or would become insolvent after the payment of dividends;
- (ii) the company's distributable result of the financial year is negative; or

The company must pay out the declared dividends within one month of the date of the general meeting of shareholders at which the dividend was declared. Problems arise when the company was profitable at the date the dividend was declared, but is making a loss by the date of the shareholder's request for payment of dividend (in circumstances where the company does not make payment voluntarily). Court practice does not provide a simple answer in this scenario. As a result, some claims for payment of dividend are rejected and some upheld.<sup>15</sup> However, the decisive moment should be the date of the declaration of dividends by the general meeting of the shareholders, and not the date of filing a request for payment. Such an interpretation also serves to protect the interests of minority shareholders.

The right to dividend becomes statute-barred ten years from the date on which it would have become payable. At this point, the unpaid dividends return to the ownership of the company, unless the limitation period has been amended or suspended by law.

In practice, the main problem for the minority shareholders is in making the decision to declare and pay out the dividends. The majority shareholders often seek to reinvest them, while the minorities generally seek payment. The majorities often abuse their power. For example, the majorities may pay a hidden dividend as bonuses to the members of corporate or supervisory bodies.

The decision to declare and distribute dividends is vested in the competence of the general meeting of shareholders. The announcement of dividends requires a majority of two-thirds of the votes cast. Thus, the power to decide whether or not to pay the dividends is vested with the majority shareholders. The minority shareholders may only challenge the decision on dividends if it is made illegally,<sup>16</sup> but generally have no legal right to require announcement of dividends even if the company made a profit. The minority shareholder's request for a declaration of dividends is not likely to be upheld by the court simply because the general meeting of shareholders has made no decision in this respect.

<sup>13</sup> The list of property related rights is not exhaustive.

<sup>14</sup> The equity capital consists of the registered share capital, the share premium account, the revaluation reserve, the legal reserve (i.e. mandatory reserve), the reserve for own shares, other reserves and the unappropriated result (profit/loss): the Lithuanian Company Law, section 1 of article 38.

<sup>15</sup> See judgments of the Civil Cases Department of the Lithuanian Supreme Court in the civil cases *J. Rutkauskas v. AB Plasta No. 3K-3-1198 of 2003* and *I. Milvydas v. UAB Gelsta No. 3K-3-399 of 2002*.

<sup>16</sup> For details see section 3.1.1 above.

In the event of liquidation, **the assets** of the company are distributed to the shareholders pro rata to the aggregate nominal value of the shares held by the shareholder. If the company's liquidation is voluntary, the residual assets may be distributed to the shareholders only after the settlement of debts with creditors and not earlier than two months from the date of the public announcement of the liquidation procedures. If any judicial disputes arise with respect to payment of the company's debts, the residual assets may not be distributed to the shareholders until final settlement of disputes and debts has been achieved.

### 3.1.2. PRIORITY RIGHTS OVER NEW ISSUE OF SECURITIES OF THE COMPANY

The minority shareholders have pre-emptive rights in case of increase of the share capital of the company exercisable on the pro rata basis. These preferential rights require the company to give priority treatment to its current shareholders.

Increase of the company's share capital may be effected in two ways: (i) by subscribing and paying up newly issued shares; or (ii) from the company's own funds.

If the **company issues new shares**, to be paid up not from its own funds, every shareholder has preferential subscription rights to the securities on a pro rata basis. The general meeting of shareholders is entitled to withdraw such a preferential right from all the shareholders by a majority of three-quarters of the votes cast. Such a decision must clearly indicate the person (or persons) to whom the right to subscribe the shares is granted, and this person (or persons) may also be a shareholder of the company.

On the face of it, such provisions may look like an excellent way to dilute the rights of minority shareholders. However, to combat this, the Lithuanian Company Law lays down certain requirements which reduce the majority shareholders' abilities to abuse their rights. In particular, such shareholders are not entitled to vote at the general meeting of shareholders on the withdrawal of preferential rights if such shares are to be acquired by the shareholder or related persons<sup>17</sup>. Such legal requirements were initially formulated by court practice<sup>18</sup> and later incorporated into legislation.

Significantly, the dilution issue is directly linked to the financial capability of shareholders. If the right of pre-emption is not withdrawn, the only way for minority shareholders to resist dilution is to subscribe for the new share issue on a pro rata basis. This of course requires financial funds. Where such funds are lacking, the minority shareholders are exposed to dilution by the majority shareholders, who may well be acting in full compliance with the legal requirements.

The company's share **capital may be increased from the company's own funds**. In such cases, current shareholders are entitled to receive new shares free of charge on a pro rata basis. Alternatively, the nominal value of all the company's shares may be increased. In such cases, the principles of equality and proportionality of the shareholders are firmly established in Lithuanian legislation.

### 3.1.3. RIGHT OF FIRST REFUSAL WITH RESPECT TO SHARES SOLD BY OTHER SHAREHOLDERS

The shareholder of a private company (UAB)<sup>19</sup> is also invested with a right of first refusal over the shares on sale by other shareholders. Thus, unless the articles of association explicitly provide otherwise, the sale<sup>20</sup> of shares in a private company is subject to stringent procedural requirements. A shareholder intending to sell any part of its shares is required to notify the CEO and specify the number of shares intended for sale and the sale price. The right of pre-emption is vested in any current shareholder of a private company.

The controlling shareholder of a private company may circumvent this procedure by tailoring the articles of association so that the transfer restrictions are reduced.

### 3.1.4. LENDING FUNDS TO THE COMPANY

The shareholders are not legally required to ensure the sufficient funding of the company, although any shareholder (irrespective of the shareholding held) is entitled to lend funds to the company. Certain restrictions apply in this respect. When the company borrows from its shareholders: (i) it may not pledge/mortgage its assets to those shareholders; and (ii) the interest rate may not be higher than the average interest rate offered by commercial banks at the lend-

<sup>17</sup> The Lithuanian Company Law, section 4 of article 17, stipulates that a shareholder shall not be entitled to vote on the decision to withdraw the right of pre-emption in acquiring the securities issued by the company where the right to subscribe for such securities is to be granted to such a shareholder personally or to: (i) the shareholder's close relatives - persons related by direct consanguinity up to the second degree inclusively (parents and children, grandparents and grandchildren) and persons related in the second degree of kinship by collateral consanguinity (siblings), Lithuanian Civil Code, article 3.135; their spouse or cohabitant (where the partnership of the shareholder and his cohabitant has been registered in accordance with the legal requirements); as well as close relatives of the shareholder's spouse where the shareholder is an individual; or (ii) to the shareholder's parent company or subsidiary, where the shareholder is a legal person.

<sup>18</sup> See the judgments of the Civil Cases Department of the Lithuanian Supreme Court in the civil cases *UAB Baltic fund securities v. AB Geonafra No. 3K-7-471 of 2002* and *NSEL 30 indekso fondas v. AB Ekranas No. 3K-3-451 of 2002*.

<sup>19</sup> In order to ensure the better liquidity of the shares, such procedures are not applied in case of sale of the shares of a public company (AB).

<sup>20</sup> No restrictions apply when a private company's shares are transferred in another manner (another than by sale): Lithuanian Company Law, article 47.

er's place of establishment.<sup>21</sup> Such legal requirements guarantee that loan agreements between the controlling shareholder and the company are made on arm's length terms.

## 3.2. Exercise of Non-Property-Related Rights from the Perspective of the Minority Shareholders

### 3.2.1. ATTENDANCE AND VOTING AT THE GENERAL MEETINGS OF SHAREHOLDERS OF THE COMPANY

The powers of the meeting of shareholders relate to issues vital to the company.<sup>22</sup> Significantly, the general meeting of shareholders may not decide upon the issues falling within the competence of the corporate bodies of the company or which by their essence are relevant to their functions. The meeting of shareholders makes decisions on the appointment and dismissal of supervisory or management bodies, amendments to the articles of association, restructuring, reorganisation or transformation of the company or on other issues, which are not routine. Attendance and voting at such meetings is one of the basic rights of any shareholder of the company.

#### 3.2.1.1. CONVENING THE GENERAL MEETING OF SHAREHOLDERS

The minority shareholders, holding shares that carry at least one-tenth of all votes, are entitled to request convening of the general meeting of shareholders. At least one-tenth of the votes is required for the inclusion of additional matters in the agenda of a general meeting of shareholders. In addition, such shareholders may propose new draft resolutions on the matters on the agenda prior to and during the general meeting of shareholders.

If the general meeting of shareholders is convened by other persons (e.g. other shareholders or the board or CEO, if the board is not formed) the minority shareholders must be given 30 days advance notice of such meeting. In accordance with the Lithuanian Company Law, a statement announcing a general meeting of shareholders must be published either in a newspaper specified in the articles of association of the company, or sent by registered mail, or delivered personally to each shareholder. The statement must contain, among other things, the agenda, date, time, and place of the meeting, and the names of the initiators of the meeting. The agenda must detail the questions to be

addressed at the meeting, such as the identity of the assets to be sold, etc.<sup>23</sup>

In summary, Lithuanian laws lay down certain requirements which help protect the fundamental rights of minority shareholders. Nevertheless, any minority shareholder must keep in mind some additional rules, which have been mainly formulated by court practice. In particular, the failure to include the additional matters in the agenda of the meeting proposed by the minorities will not invalidate other decisions made at the meeting on matters which were duly included in the agenda.<sup>24</sup> Moreover, any claim of the minority shareholder contesting the decisions made on the questions not included in the agenda of the meeting (i.e. undisclosed to the minority shareholder in advance) will not be upheld by the court if its shareholding would not have had a material effect on the outcome of the vote. In such cases, the courts also consider whether or not the decisions are contrary to the interests of the company, and whether their invalidation may cause any adverse effect on the company's activities.<sup>25</sup> Interestingly, in practice such rules serve as justification for the majority shareholders for failure to inform the minority shareholders of the convening of the general meeting of shareholders or the inclusion of additional questions on the agenda.

#### 3.2.1.2. ATTENDANCE AND VOTING AT THE GENERAL MEETINGS OF SHAREHOLDERS

Each share in a company entitles its holder to one vote at the general meeting of shareholders. Shareholders may attend general meetings of shareholders and exercise their voting rights subject to the conditions specified in the Lithuanian Company Law and the articles of association. There is no requirement that a shareholder must have a minimum number of shares in order to attend or to be represented at the general meeting.

All shareholders who have properly registered and fully paid for their shares may participate in general meetings of shareholders. Shareholders may participate in general meetings either in person or by proxy. Shareholders may vote in person, by proxy or in writing by filling in a voting ballot which may be sent by mail or any means of telecommunications that enables sufficient identification of the shareholder. Alternatively, a shareholder may transfer voting rights carried by shares held by the shareholder to another person under a voting right assignment

<sup>21</sup> Lithuanian Company Law, section 1 of article 15.

<sup>22</sup> Lithuanian Company Law, section 1 of article 20.

<sup>23</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *AB Ortopedijos technika v. UAB Ortopedijos paslaugos* No. 3K-3-161 of 2003.

<sup>24</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *A. Bilinskas v. UAB Neringos • uvis* No. 3K-3-9 of 2004.

<sup>25</sup> For details see the judgments of the Civil Cases Department of the Lithuanian Supreme Court in the civil cases *UAB Vilnamisa v. AB Šeškinės Širvinta* No. 3K-3-878 of 2002, *UAB Vilnamisa v. AB Šeškinės Širvinta* No. 3K-3-613 of 2001, and *J. Vaiciskienė and others v. UAB Spec. drabužiai* No. 3K-3-215 of 2002.

agreement. Such agreement takes effect from the disclosure to the company of the existence of the agreement, the number of votes transferred, the period of transfer, the ground on which the voting right is held, and the identities of the shareholder transferring and the person acquiring the voting right, all in accordance with Lithuanian law and the settled practice of the company, if such has been developed.

In accordance with the Lithuanian Company Law, in order to meet the quorum requirement for any general meeting of shareholders, the shareholders holding shares carrying more than one-half of all votes must be present in person, or vote in writing or by proxy. If a quorum is not achieved, the meeting must be adjourned. When an adjourned meeting is resumed, no quorum requirement applies. However, only those matters set out in the agenda of the adjourned meeting may be voted upon.

A decision is considered as adopted at the general meeting of shareholders if more votes in favour of it are received than votes against it, save for the cases where a qualified majority is required. In accordance with the Lithuanian Company Law, a two-thirds majority of all votes carried by shares held by shareholders participating at the general meeting is required for passing resolutions on matters such as amendment of the articles of association, including, among others, increasing or decreasing the share capital, authorising the issue of convertible bonds or distributing profit. A three-quarters majority of all votes carried by shares held by shareholders participating at the general meeting and having the right to vote on the matter is required for withdrawing the preferential subscription rights of all shareholders to acquire new shares or convertible bonds.<sup>26</sup>

Therefore, depending on the size of the interest controlled by the majority shareholder, most of the decisions at the general meeting of shareholders may be passed by the controlling shareholder alone. In this regard, only the sufficient amount of the equity may fully protect the interests of the minorities.

### 3.2.2. RIGHT OF APPEAL

According to Lithuanian law,<sup>27</sup> any shareholder of the company may challenge a decision made by any body of the company (i.e. the general meeting of the shareholder, the supervisory council, the board or the CEO) if that decision violates mandatory provisions of Lithuanian law, the articles of association of the company, or the general principles of reasonableness and fairness.

The right of appeal becomes statute-barred after:

- (1) thirty days with respect to decisions made by the general meeting of shareholders; and
- (2) three months with respect to decisions made by the supervisory council, the board, or the CEO,

starting from the date when the shareholder became aware or should have become aware of the contested decision. Bearing in mind the possible constraints that may exist in respect of minority shareholders' access to information about the company, the ultimate aim of these subjective criteria is to grant minority shareholders an effective right to contest the decisions.

Notwithstanding the above, the right to contest the decisions made by the bodies of the company should not be overestimated. In several cases the Lithuanian Supreme Court has ruled that invalidation of the decisions made by the company's body is *ultima ratio* and therefore must be applied only in cases when the outcome of such decisions (consequently, the breach of the shareholder's rights) may not be eliminated by the employment of other measures.<sup>28</sup>

### 3.2.3. RIGHT TO INFORMATION

The right to information is the key element of the protection mechanism for minority shareholders – only the informed shareholder may properly exercise the other rights conferred on him or her by law. For example, a shareholder may require payment of dividends if he or she becomes aware of the decision of the general meeting of shareholders to declare dividends.

Prior to the year 2004, the right to receive all information about the company (including all transactions executed, data on business and financial situation, and even including all commercial or trade secrets) was granted to every shareholder or group of shareholders holding more than 10% of the shares (subject to a written undertaking to keep such information confidential). After the new Lithuanian Company Law entered into force in 2004, the threshold for the right of access to all company information was raised, so that only shareholders holding more than 50% of the shares (i.e. absolute majority shareholders) are now entitled to access to such information. Later on, several additional requirements in respect of the right of access to information were established by court practice: the courts may now refuse to order disclosure of information even to those shareholders who own more than 50% of the shares; and this restriction is based on clearly subjective

<sup>26</sup> For details see section 3.1.2.

<sup>27</sup> Lithuanian Civil Code, section 4 of article 2.82 and Lithuanian Company Law, section 10 of article 19.

<sup>28</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *Karsten Ree Holding ApS v. UAB Alio* No 3K-3-1057 of 2003.

criteria (e.g. if there is a basis for presuming that disclosure may cause significant damage to the interests of the company).

In accordance with the Lithuanian Company Law<sup>29</sup>, the company must, within seven days from receipt of a written request, present to any requesting shareholder (irrespective of the shareholding held) for inspection and/or copying the following documents:

- (i) the articles of association;
- (ii) annual financial statements;
- (iii) reports on the company's activities;
- (iv) auditor's opinions and reports;
- (v) minutes of the general meeting of shareholders or other documents evidencing decisions of the general meeting of shareholders;
- (vi) a list of shareholders;
- (vii) a list of the members of the board and supervisory council;
- (viii) other company documents which must be public according to the law;
- (ix) minutes of the board and supervisory council meetings, or other documents evidencing decisions of the board or supervisory council provided they do not contain commercial (business) secrets.

Having given a written undertaking not to disclose commercial (business) secrets, one or more shareholders holding more than 50% percent of the company's shares, have the right of access to all company documents.<sup>30</sup> Interestingly, due to the firm belief that the information may be used for purposes contrary to the company's interests, the court has in several cases refused to order disclosure of company information even to the controlling shareholder. The shareholder is entitled to inspect the above-listed information also for the period before he or she acquired shares in the company.<sup>31</sup>

Court practice has interpreted the above-mentioned provisions and ruled that company information falls into two categories:

- (1) **general information** about the company (i.e. articles of association, annual financial statements, reports on the company's activities, auditor's opinions and reports, minutes of the gen-

eral meeting of shareholders or other documents evidencing decisions of the general meeting of shareholders, list of the shareholders, list of the members of the board and supervisory council); and

- (2) **specific information**, which comprises the minutes of the board and supervisory council meetings or other documents evidencing the decisions of the board or supervisory council, etc.

The general information is considered as public and therefore must be made available to any shareholder, and even to a third party if so determined by Lithuanian law.<sup>32</sup> No restrictions may be imposed on access to the general information. Inspection of the specific information may be restricted if such information contains business secrets and disclosure may be detrimental to the interests of the company.<sup>33</sup> Information is considered as business secrets if the board or the CEO of the company passes a decision stating that certain kinds of information shall be regarded as such. As a general rule, all information about the company, with the exception of the general information referred to above, may be included in the list of business (trade) secrets. Thus, the board or the CEO of the company (meaning the majority shareholders) is invested with broad powers to limit shareholders' rights to information.

To summarise, the aforementioned provisions permit only those shareholders holding an absolute majority of the shares to inspect all the company documents. The minority shareholders are, on the other hand, permitted access only to general information, and to such specific information as does not contain business secrets.

#### 4. RIGHT TO REQUIRE AN INVESTIGATION OF THE ACTIVITIES OF THE COMPANY, ITS MANAGEMENT BODY OR ANY MEMBER

##### 4.1. GENERAL

The Lithuanian Civil Code provides a means for minority shareholders to require judicial investigation of the company's activities.<sup>34</sup>

In order to file a claim to a competent court for the investigation of the company's activities, a shareholder or group of shareholders must own or hold at least 10% of the share capital of the company. Otherwise the claim will not be considered.

<sup>29</sup> Lithuanian Company Law, article 18.

<sup>30</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *V. Norkus v. UAB Fonas No 3K-3-801 of 2002*.

<sup>31</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *Namisa v. AB Šeškinės Širvinta No 3K-3-1068 of 2002*.

<sup>32</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *R. Damulevičius v. AB Malsena No 3K-3-228 of 2004*.

<sup>33</sup> See the judgments of the Civil Cases Department of the Lithuanian Supreme Court in the civil cases *V. Norkus v. UAB Fonas No 3K-3-801 of 2002*, and *G. Krasnovskij v. UAB Vienituras No 3K-3-1198 of 2003*.

<sup>34</sup> The investigation of the activities of the company, its management body or any of its members is hereinafter referred to as 'investigation of the company's activities'. The investigation of the company's activities is regulated by the Lithuanian Civil Code, articles 2.124 to 2.131.

#### 4.2. SCOPE AND TARGET OF THE INVESTIGATION OF THE COMPANY'S ACTIVITIES

According to the Lithuanian Civil Code, the investigation of the company's activities may concentrate on the following three fields:

- (1) the activities of the company itself;
- (2) the activities of the management bodies of the company *in corpore* (under Lithuanian law the latter includes the board and the CEO of the company); or
- (3) the activities of the individual members of the management bodies of the company.

The purpose of the investigation is to provide the shareholders with legal measures aimed at ensuring the proper management of the company. The shareholder seeking investigation of the company's activities is not required to indicate whether the improper activities have been carried out by the company, its bodies *in corpore* or any member. The shareholder need only provide the reasoning as to why there are grounds for believing that such activities may be considered improper.<sup>35</sup>

A company's activities are regarded as improper if performed in violation of the provisions of the Lithuanian Civil Code, in particular articles 2.86-2.87, which apply to the body of the company *in corpore* as well as its any member. Article 2.87 lists the principal obligations of the members of the management bodies of the company. These include obligations of loyalty, prudence, fairness, confidentiality, avoidance of conflict of interests, etc. The principle of loyalty requires that the management body and any of its members must act in accordance with the articles of association of the company, make best efforts to ensure the health of the company, as well as seek the achievement of the company's goals. Thus, the incurrence of losses by the company, when its main purpose is to make a profit, may be considered a sufficient ground on which to commence the investigation.<sup>36</sup> The law does, however, not make a mandatory link between incurring losses and the investigation of the company's activities. Therefore, the investigation may also be commenced if the company's activities are profitable. In any case, each member of the management body must act as *bonus pater familias*.<sup>37</sup> Upon failure to act in such a way, there is a basis for believing that the activities are carried out without reasonable care.

It is important to emphasise that 'reasonable expectation' of the impropriety of the company's activities is the test for whether there exists sufficient grounds on which to commence an investigation into the company's activities. This rule involves two aspects. On the one hand, the minority shareholder is released from the burden of proving that the company's activities are improper. He or she needs only indicate that there are reasonable grounds for believing that such activities may be being carried out improperly. On the other hand, the investigation of the company's activities will not be commenced if it is obvious that the activities are being carried out improperly, or if the defendant acknowledges the impropriety.<sup>38</sup> Interestingly, it is a mandatory rule that the company be identified as a defendant; the management bodies or any of its members may be brought to trial as defendants jointly with the company.<sup>39</sup>

In summary, the basis on which the right to require the commencement of the investigation of the company's activities may be exercised is clear and rather simple. Moreover, the requirement to carry out investigation of the company's activities is without prejudice to other rights of the minority shareholders.<sup>40</sup> The investigation of the company's activities may be employed in line with other protection mechanisms (e.g. challenging the decisions made by the bodies of the company).

#### 4.3. PROCEDURE OF THE INVESTIGATION OF THE COMPANY'S ACTIVITIES

The investigation of the company's activities may be divided into two stages:

- (1) the pre-trial stage; and
- (2) trial procedures, which consist of the following steps:
  - (a) filing an application to a competent court;
  - (b) the making of a court judgment on whether investigation of the company's activities may be commenced;
  - (c) appointment of experts and determination of their remuneration;
  - (d) carrying out the investigation by the experts and preparation of a report and recommendations;
  - (e) review of the experts' report and recommendations by the court; and

<sup>35</sup> V. Mikelėnas, G. Bartkus, V. Mizaras, Š. Keserauskas, *Commentary on the Second Book ('Persons') of the Civil Code of the Republic of Lithuania*, Vilnius, Justitia, 2002, at p247.

<sup>36</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *UAB Khartli v. UAB Diagnostikos poliklinika No 3K-3-16 of 2005*, and in the civil case *D. Šilkus v. UAB Kaminera No 2-102 of 2005*.

<sup>37</sup> In Latin, *the prudent man*.

<sup>38</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *Ž. Verbel v. ŽŪB Panerio vairas No 3K-3-1233 of 2002*.

<sup>39</sup> See the judgment of the Court of Appeal of the Republic of Lithuania in the civil case *D. Š. V. UAB Stramina No 2-523 of 2005*.

<sup>40</sup> See the judgment of the Court of Appeal of the Republic of Lithuania in the civil case *D. Šilkus v. UAB Kaminera No 2-102 of 2005*.

(f) imposition of legal measures as listed in article 2.131 of the Lithuanian Civil Code.

#### 4.3.1. PRE-TRIAL STAGE

The pre-trial stage is mandatory and may not be avoided by the minority shareholder. It consists of the shareholder giving notice to the company requiring termination of the improper activities<sup>41</sup>. The shareholder must give the company a reasonable period of time in which to terminate the improper activities.<sup>42</sup> The shareholder is not required to indicate which bodies or members are acting improperly and need only describe the activities which may be considered as improper as well as provide motives.<sup>43</sup>

#### 4.3.2. TRIAL PROCEDURES

An application for the investigation of the activities of the company, its body *in corpore* or any of its members must be filed with the district court in the place where the company's registered office is located. The application must always be prepared by an attorney-at-law. The participation of an attorney-at-law is also obligatory during the hearings of an investigation case at court.

During the initial hearing of the application for an investigation, the court will either hand down a judgment ordering the commencement of the investigation of the company's activities, where there are grounds for believing that such activities may be being carried out improperly, or it will reject the application. A court order to commence the investigation procedures may not be regarded as a review of the matter, but only as the basis on which to start the investigation. The main criterion used by the court when considering whether to order commencement of an investigation is the expectation (consideration) of the court that the company's activities may be being carried out improperly. In this stage, the court does not examine whether the activities are improper. It merely determines the expectation that the company's activities may be regarded as such.<sup>44</sup> If the court makes an order to commence investigation of the activities of the company, this investigation is carried out by experts.

The appointment of experts and determination of their remuneration are subject to stringent legal requirements, as set out in the Lithuanian Civil Code, articles 2.127 and 2.129.

The right to determine the number of experts to be used is vested in the parties upon mutual consent. In the event of failure to agree amicably, the number of experts is determined by the court.<sup>45</sup> Prior to the appointment of the experts, the court must make a proposal for the parties to agree on specific experts. If consensus is reached, the court will appoint the persons agreed by the parties jointly to act as experts. Where no consensus is reached, the court will appoint the experts at its own discretion from the list of proposed experts submitted by the parties. Each party must compile a list of no fewer than ten experts, and has a right to remove, for any reason, five experts from the list submitted by the other party, as well as to give an opinion on the remaining five experts. Lithuanian law does not stipulate any detailed qualification requirements in respect of the persons to be appointed as experts. Nevertheless, only independent persons, who have the necessary qualifications to investigate the activities and prepare a written report on improper activities, as well as guidelines for eliminating such activities may be appointed as experts.

The remuneration of experts is probably one of the major reasons why investigation of companies' activities is not very frequently applied for by minority shareholders. The law mandatorily stipulates that the claimant (i.e. the minority shareholder) must pay the experts' remuneration in advance. Determination of the remuneration conditions is left in the sole discretion of the court. According to the Lithuanian Civil Code, article 2.129, upon appointment of the experts they must notify the court about their remuneration and compensation of expenses which may be incurred in carrying out the investigation. Upon receipt of such notification, the court may:

- (i) Agree with the remuneration conditions submitted. In this case, without hearing the opinion of the parties, it fixes the amount, which must not be less than 75% of the aggregate sum indicated by the experts, to be paid by the claimant prior to commencement of the investigation procedures. If the claimant fails to pay this amount in advance, the application for the investigation of activities is rejected.
- (ii) Disagrees with the remuneration conditions submitted. In this case, it appoints new experts upon hearing the opinion of the parties. If this occurs, the assessment of the remuneration to be paid is repeated from the beginning. The

<sup>41</sup> The request must be sent to the company irrespective of whether the improper activities are performed by the company, its management body, or its any member. V. Mikelėnas, G. Bartkus, V. Mizaras, Š. Keserauskas, *Commentary on the Second Book ('Persons') of the Civil Code of the Republic of Lithuania*, Vilnius, Justitia, 2002, at p250.

<sup>42</sup> The court may reject an application if the period granted by the shareholder for the elimination of improper activities is not sufficient. V. Mikelėnas, G. Bartkus, V. Mizaras, Š. Keserauskas, *Commentary on the Second Book ('Persons') of the Civil Code of the Republic of Lithuania*, Vilnius, Justitia, 2002, at p250.

<sup>43</sup> See the judgment of the Civil Cases Department of the Lithuanian Supreme Court in the civil case *UAB Khartli v. UAB Diagnostikos poliklinika No 3K-3-16 of 2005*.

<sup>44</sup> See the judgement of the Court of Appeal of the Republic of Lithuania in the civil case *A. Puodžiūnas v. UAB Utera No 2-176 of 2003*.

<sup>45</sup> V. Mikelėnas, G. Bartkus, V. Mizaras, Š. Keserauskas, *Commentary on the Second Book ('Persons') of the Civil Code of the Republic of Lithuania*, Vilnius, Justitia, 2002, at p251.

required sums may well exceed the minority shareholder's expectations. Therefore, it may be agreed that, from the minority shareholders' perspective, the remuneration of experts and the requirement of paying this in advance are the weakest points of the remedy of investigation of a company's activities.

The experts play an essential role in the investigation of a company's activities and have wide statutory rights to inspect any documents and the assets of the company, and examine the shareholders, officers, and employees of the company, as well as persons who were the shareholders or served as officers or employees of the company during the period under investigation. Moreover, in order to duly carry out the investigation, these actions may be carried out with respect to other legal persons as well. Therefore, the investigation of a company's activities has many similarities with the ordinary legal and financial due diligence of the company, and thus provides the minority shareholder with the opportunity to become aware of any important information related to the company.

After the investigation of activities, the experts must prepare a report stating whether the company's activities are carried out with due diligence, as well as making recommendations on the measures to be applied in case such activities are found to be improper. The report and recommendations of the experts are considered confidential, and therefore may be disclosed to the claimant and defendant only, while disclosure to other persons only permitted with the specific consent of the court.

Upon receipt of the experts' report and recommendations, the court must review them and decide whether the company's activities are to be considered improper. The documents prepared by the experts do not bind the court. The court may deviate from the opinions of the experts and pass judgment contrary to them. Court practice has, however, narrowed the scope of this rule and held that the court may not rule that the company has acted improperly where the experts' report states otherwise.<sup>46</sup> In any case, it is the court which, after assessing all the circumstances determined by the experts and considering the principal obligations of the company's bodies to act bona fide, passes a judgment on whether the company's activities may be regarded as improper. Significantly, the mere fact that the company incurs losses may not be regarded as sufficient proof of the impropriety of the company's activities.<sup>47</sup>

If the court considers the company's activities to be improper it may at its own discretion impose any of the measures listed below:

- (1) invalidate the decisions made by the bodies of the company, provided the period of limitation to challenge such decisions has not expired;
- (2) temporarily suspend the powers of the members of the management bodies or exclude a person from the management body;
- (3) appoint provisional members of management bodies;
- (4) permit deviation from certain provisions of the articles of association of the company;
- (5) order the making of amendments to the articles of association of the company;
- (6) temporarily assign the voting rights of members of the body to another person (or persons);
- (7) oblige the company to take or refrain from taking certain actions;
- (8) liquidate the company and appoint a liquidator. The decision to liquidate the company may not be made if such a decision would be contrary to the interests of other shareholders, and employees as well as the public interest.

The measure to be applied depends on the nature and scope of the improper activities as well as who (i.e. which bodies or persons) acted without reasonable care. In any case, liquidation of the company is considered as *ultima ratio*<sup>48</sup> and thus may be ordered only in exceptional cases. As at the date of this publication no cases have yet arisen in which liquidation of the company was ordered.

## CONCLUSIONS

Lithuanian law does not establish special mechanisms for the protection of minority shareholders. However, it does invest all shareholders with certain legal rights which serve as tools to protect their interests. These include those rights which are primarily based on the principles of equality and proportionality; as well as other rights, such as attendance and voting at the general meeting of shareholders, contesting the decisions made by the company's bodies, and the right to access to information about the company.

Minority shareholders are entitled to freely exercise any of the above rights (in certain cases a shareholding reaching a certain threshold is required). Moreover, they are entitled to require the investigation of the company's activities and thus judicially verify whether the company, its corporate bodies, or any of its members are acting with due diligence and reasonable care.

<sup>46</sup> See the judgment of the Court of Appeal of the Republic of Lithuania in the civil case A. *Puodžiūnas v. UAB Utera and others* No 2A-269 of 2004.

<sup>47</sup> See the judgment of the Court of Appeal of the Republic of Lithuania in the civil case A. *Puodžiūnas v. UAB Utera* No 2-1219 of 2002.

<sup>48</sup> In Latin, *the last resort*.

On the other hand, to some extent the door is left open for majority shareholders to abuse their rights in certain respects. For example, the shareholders' right to information may be limited by proclaiming the information to constitute the company's business secrets; the right to participate and vote at the gen-

eral meeting of shareholders may be circumvented by failing to provide the minority shareholder with the detailed agenda; the right to receive dividends may not be exercised if the majority shareholders decide to reinvest them instead of declaring the dividends, etc.

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This briefing constitutes a general guide only. It is not intended to contain legal advice: this should be sought as appropriate in relation to the particular matter in hand. If you would like further information on the issues outlined in this briefing, please contact Bernotas & Dominas Glimstedt: tel: +370 5 2690 700, fax: +370 5 2690 701, [vilnius@glimstedt.lt](mailto:vilnius@glimstedt.lt)

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