

## **THE PROMOTA BULGARIA PARADOX**

### ***Zhulieta Mandazhieva, Tocheva and Mandazhieva, 21.09.2005***

In May 2005, Austrian investment fund Tishman Lindner Bulgarian Real Property GmbH (new name: Tishman Bulgarian real Property GmbH) bought out the entire capital of the public company Promota Bulgaria. The aim of this acquisition is no secret to anyone aware of the developments on the real estate market – Tishman and Lindner are major players on the international market, while the Bulgarian company (fully owned by two Greek companies before the sale) owns two strategic land plots near the Sofia Airport. Upon closing the deal, however, the buyer overlooked the upcoming general annual meeting of shareholders of Promota. The task of the meeting seemed straightforward enough – there was one shareholder and the directors would directly benefit from the sale as they would indirectly receive the sales price of the shares. Nevertheless, there were laws to be abided by and the meeting was convened with two invitations – one in the State Gazette and one in a national daily. Things got complicated when the board of directors failed to promulgate the second invitation and decided to get rid of its contractual and legal responsibility for possible debts of the company against the regular convention of a new annual meeting. In order to be more convincing, the board of directors reminded the new owner of the existence of a single decision of the shareholders' meeting before the sale (again convened only through an invitation in the State Gazette) to dispose of the assets of the company to the benefit of a subsidiary of Tishman - Lindner or any other third person and added that it planned to create debts for the Company (including through voting and distributing substantial remunerations) and to call an annual meeting of shareholders at its own discretion.

The board of directors claimed that its actions did not contradict the law (they were, of course, wrong) and that no one could stop them from carrying out their plan – the latter, unfortunately, turned out to be true to a great extent.

#### ***What are the violations and the legal mechanisms to counter-act the owner***

The responsibilities of the board of directors of a public company are established by Article 116b of the Public Offering of Securities Act (POSA). Under it, directors are obliged (1) to act in goodwill and in a way that they could reasonable believe is of the best interest of all shareholders; (2) to be loyal to the company by preferring its interests to their own interests. These regulations have a concrete dimension in the case of Promota Bulgaria. The board of directors is obliged to take care of a legitimate convening of the general annual meeting of shareholders and to make sure this meeting is held by the end of the first half of the fiscal year, as well as to monitor the regular presentation of information and reports on the Company to the respective authorities. Also, the directors must not infringe upon the shareholders' voting rights and must not siphon the public company through disposing of its assets and creating additional debts for the company to their own benefit or to the benefit of related persons. It sounds obvious and similar actions on behalf of the board of directors, given the recent attention paid to protecting the rights of minor shareholder, should have been stopped easily, especially if the owner is only one, as is the case with Promota. This, however, did not happen.

The quickest and most efficient instrument to intervene in cases of infringement upon the rights of minor shareholders is to address the Financial Supervision Commission. What are the FSC's powers: in case it deems it necessary the commission can impose different forceful measures. FSC has the right to ban the board from accumulating debts for the public company that that it manages (such a measure was taken in Promota's case). Any deal carried out in violation of this measure, however, would not be considered nil and void. Instead, the defaulting director would be imposed a fine of around 20 000 levs. Given that the profits from the deal could be ten times bigger than this fine, the director in question can easily put up with this sanction.

Another possible measure is to convene a general meeting through the court. The text of Article 118, para.2 of POSA, which envisages a flexible procedure, could be applied in the case of Promota. The procedure could be applied in cases when the idleness of the managing bodies threatens the interests

of the company. A shareholder having more than 5% of the capital can turn directly to the court and needs not wait for the reaction of the board of directors (unlike the regulations of the Commercial Act, which requires that the shares are held for a period of more than three months). It was on this ground that the general meeting of Promota Bulgaria's shareholders was convened.

### ***The problem or what shareholders cannot do***

Unfortunately, the acting legislation does not envisage an efficient mechanism for prevention of any harmful consequences of the action of the management of a public company. The claims envisaged by Article 118, para.2, item 1 of POSA, as well as by Article 240a of the Commercial Act are claims related to damages caused to the company – that is, these are measures to fight the aftermath of this damage. The disposal of company assets and the creating of debt for the company above a set volume or to the benefit of interested persons without a valid decision of the general meeting of shareholders with announcement of concrete parameters of the deal have, indeed, been declared illegal only recently. Nevertheless, the collection of the already sold assets of the public company would be a complex and expensive operation, which would also create uncertainty for any third person that has concluded a deal with the Company in that period.

### ***Possible solutions***

POSA should provide for fines on the actions of directors of public companies that are at least to some extent compatible with the damage that could result from illegal disposal of company assets. A very efficient measure, which is currently not applicable to public companies but to the other subjects of the FSC, would be the possibility for FSC to order in written to a subject the dismissal of one or more persons authorized to manage and represent the subject in question and to withdraw the managerial and representative powers until its dismissal. It could even appoint a questor to the company. Of course, all these measures should be imposed only in cases of actual threats to the interests of the investors supported by written proof. Injunction, which is popular in the Anglo-Saxon legal systems, could be another efficient method. Injunction is a court order banning a given person from carrying out a given action. Bulgaria's Civil Procedure Code contains similar regulations in its Article 422, however it only concerns "court decision" and "debtor," that is, the procedure is far less flexible than that of injunction. The case of Promota Bulgaria poses a lot of questions and above all whether it is efficient and proper to apply the Civil Procedure Code both for civil legal relations and for corporate ones (especially as regards public companies, where interests are huge and quickness of decision is essential).

***\* The author represents the Sole Owner of the company in connection with the case "Promota", 8<sup>th</sup> July 2005***