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Towards a New Solution of Minority Shareholder Protection in Libya:

Letting the Minority Shareholders Have a Voice

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Submitted in fulfilment of the requirements for the Degree of Doctor of Philosophy in Law (PhD in Law)

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Abstract

The study develops a framework for improving corporate governance mechanisms in Libya that takes into account its specific environment of weak formal enforcement and its corporate ownership structure, which is based on concentrated state ownership. The central goal of the research is to establish an adequate protection system for minority shareholders that can contribute to the development of an efficient and healthy commercial environment in Libya. To do so, the study examines the current solution for dealing with the conflict of interests between shareholders adopted by Libyan law under art 159 of Libyan Economic Activity Act (LEAA 2010): the minority shareholders' actions. Using a social and economic analysis and a black letter approach, this study presents a novel analytical framework that formulates an appropriate solution for controlling conflict of interests between shareholders in Libya. To that end, the study addresses the following questions: how effective is the current mechanism for dealing with the conflict of interest between shareholders in Libya? What are the economic and social implications of the different proposed approaches? What elements determine which approach is preferable in Libya? And, finally, what are the challenges that the proposed law reform may face?

To answer these questions, firstly, it is necessary to consider the general framework of corporate governance in Libya, examine the country's current position as an economy in the early stages of transformation and analyse the potential impact of this transformation on corporate governance. Following this, I locate the dimensions of the conflict of interest problem between the minority and majority shareholders in Libya through analysing literature of corporate governance with regard to the minority-majority shareholder problem and applying it to the case of Libya. After that, I examine the efficacy of the current mechanism available in Libyan law (minority shareholders actions) as a solution for dealing with the conflict of interests between the minority shareholders and the majority shareholders in Libyan companies. However, the current approach is not appropriate for Libya for several reasons that relate to either the efficiency of the approach itself or its application and enforcement in Libya.

After examining other possible solutions (e.g. a prohibition strategy), I propose the self-enforcing model as the most appropriate solution since it contributes to companies being able raise capital from investors, and it also lowers the number of conflict of interest transactions and makes a company's transactions more efficient. Finally, the self-enforcing model does away with the need for external monitoring. However, this is not the end of the story; adopting such a model will inevitably lead to some potential risks (such as the risk that the minority shareholders may abuse their rights), which will require the formulation and adoption of new and specific strategies of corporate governance that are appropriate to Libya.

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Abbreviation

GBO	General Board of Ownership Transfer
HRW	Human Rights Watch
ILAC	International legal Assistance Consortium
ICG	International Crisis Group
JSC	Joint Stock Company
LAB	Libya Audit Bureau
LCA	Libyan Commercial Act
LCB	Libyan Central Bank
LCGC	Libyan Corporate Governance Code
LEAA	Libyan Economic Activity Act
LSMA	Libyan Stock Market Act 2010
LCMA	Libyan Capital Market Authority
MENA	Middle East and North Africa
OECD	Organisation for Economic Co-operation and Development
PIIP	Public Institution for Investment and Privatization
SOE	State-Owned Enterprise
UNSMIL	Secretary-General on the United Nations Support Mission in Libya

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a. Statutes

Companies Act 1985

Companies Act 2006

UK Listing Rules

b. Codes

Stewardship Code 2012

UK Corporate Governance 2012

2. Libyan Legislations

a. Statutes

Banking Law No. 1/2005

Banking Law No. 1/1993 Concerning Banks and Credit Finance

Civil Act 1953

Commercial Act 1953

Economic Activity Act 2010

Supreme Court Act1986

Law No. 1 of 2005 Concerning Banks

Law No. 2/ 1992 Concerning Privatisation

Law No. 4/ 1978 Concerning Specifying Certain Provisions for Real Estate and Ownership

Law No. 5/ 1997 Concerning Foreign Capital Investment

Law No. 8/1983 Concerning Commercial Actions

Law No. 8 /1988 Concerning Allowing Private Business to Operate in the Retail Trade and Small-Scale Industries

Law No.11 of 2010 Concerning the Libyan Stock Market

Law No.15/ 1970 Concerning Nationalizing the Foreign Portion of Banks Operating in Libya

Law No. 31/ 1970 Concerning Insurance Companies

Law No. 46/ 2012 Concerning Banks and Islamic Banking, which amended the

Law No. 80/1970 Concerning Nationalizing Insurance Companies

Law No. 86/ 1975 Concerning Organising the Automobile Trade

Law No.87/1975 Concerning Regulating Commercial Agencies

Supreme Court Law No. 1 of 1375

Stock Market Act No. 10 /2010

Procedural Civil Act 1953

c. *Codes*

Corporate Governance Code 2007

d. *Executive Regulations and Resolutions*

Cabinet Resolution No. 11/1979

Cabinet Resolution No 99/ 2005

Cabinet Resolution No. 125/1979

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Cabinet Resolution No. 186/ 2012

Cabinet Resolution No. 198/ 2000

Cabinet Resolution No. 364/2012

Cabinet Resolution No. 447/1987

Economic Minister Decision No. 86/2012 Concerning corporate affairs

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ex parte Estate Acquisition and Development Ltd [1991] BCLC 154

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Grace v Biagioli [2006] 2 BCLC 70

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Groly v Good [2010] 2 BCLC 569

Hawkes v Cuddu [2009] 2 BCLC 427

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Re a Company (No 002612 of 1984) [1985] BCLC 80

Re a Company [1986] 2 BCC 99,453, on appeal sub nom *Re Cumana Ltd* [1986] BCLC 430

Re A Company [1986] BLCL 376

Re a Noble (Clothing) Ltd [1983] BCLC 273

Re Baumler (UK) ltd [2005] 1 BCLC 92 [180]

Re Blue Arrow plc [1987] BCLC 585

Re Cumana Ltd [1986] BCLC 430

Re DR Chemicals Ltd [1989] BCLC 383

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Author's declaration

I declare that, except where explicit reference is made to the contribution of others, this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature ________________________________

Printed name: Majdi Abdou

Introduction

Since countries with transition economies do not enjoy long established financial institutional infrastructure associated with more established economies, corporate governance issues are of particular significance. The importance of corporate governance in transition economies has become increasingly significant in recent times, as it has become obvious that privatisation and liberalisation alone are not sufficient to ensure the improved performance of firms and, in some cases, are even responsible for a dramatic worsening of performance.[1]

In Libya, itself a transition economy, corporate governance is still in its infancy as the state is in the early stage of transition, as discussed later. Corporate governance first became an issue in Libya in early 2001, when the state implemented a programme of economic reform and restructuring through a massive privatisation programme which aimed to move the country from socialist oriented policies towards a free-market economy. At that time the debate focussed on the need for strong corporate governance in order to attract local and foreign investment and enhance the role of the private sector in the economy. Although many positive measures and procedures were implemented in the 2000s towards the free market economy, which successfully established new institutions of corporate governance in Libya, many difficulties and challenges still face the state. One of the most significant issues facing Libya, as it attempts to develop an economic and financial environment in which a free market economy can operate, is the adoption of an efficient minority shareholders protection system.

Therefore, the main concern of this study is to establish a robust system of minority shareholder protection in Libya. Prior to discussing this issue, it is useful to provide a very

[1] For more details see Burno Dallago, 'Corporate Governance in Transformation Economies: a Comparative Perspective' in B Dallago and I Iwasaki (eds), *Corporate Governance Restructuring and Governance in Transition Economies* (Palgrave 2007) 16.

brief definition of what constitutes a minority shareholder. Simply put, a minority shareholder is a shareholder who is not a controlling shareholder. Most of the literature on corporate governance assumes that a system in which controlling shareholders are commonly found, a large shareholder has control over the company, a large shareholder has control over the company, as he owns a majority of shares. In other words, voting rights and cash flow rights are generally aligned. This kind of controlling shareholder ownership is referred to as a 'controlled structure'. [2] However, this is not the only type of controlling shareholder ownership. The other type occurs when a controlling shareholder exercises a significant percentage of voting rights even though he only holds a small percentage of equity. This means that the controlling shareholder may be also a minority shareholder. This system is known as the 'controlling minority structure' ("CMS"). In such a system, the minority shareholder can exercise his control over the company, as Bebchuk *et al.* explains, in three principal ways: through dual-class share structures, stock pyramids, and cross-ownership ties. [3]

To explain this briefly: in terms of a dual-class share structure, companies may have two or more classes of shares with different rights attached.[4] These shares can be divided into two kinds of shares: preference shares and conditional shares. Preference shares may give 'a preferential right as to dividend only or as to return of capital only, or both as to dividend and to return of capital'.[5] They may also provide their holders with no right to vote.[6] Conditional shares, on the other hand, are ordinary shares that are restricted by certain privileges or limitations. For example, the company may seek to attract particular investment or induce particular persons to enter into the company. To achieve this, the company may enhance voting rights for those potential investors and make their votes

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[2] See Lucian A Bebchuk, Reinier Kraakman and George Triantis, 'Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights' in Randall K. Morck (ed) *Concentrated Corporate Ownership* (University of Chicago Press, 2000) 295 – 318

[3] For more information, see ibid.

[4] See e.g. Geoffrey Morse and others, *Charlesworth & Morse company law* (Sweet & Maxwell, 1999) 177-8.

[5] John Birds and others, *Boyle & Birds' Company Law* (Jordan Publishing Limited, 2011) 249.

[6] See ibid 252; Richard M Buxbaum, 'The Internal Division of Powers in Corporate Governance' California Law Review 1671, 1684.

multiple. [7] On the other hand, the company may issue non-voting shares to allow the holders of the ordinary shares to maintain control or to enhance the role of the founder of the company.[8]

Secondly, a stock pyramid occurs when a controlling-minority shareholder holds a controlling share in a holding company that, in turn, holds a controlling stake in an operating company (a pyramid of two companies). [9] In addition, cross-ownership structures can establish a CMS as well. In such a structure, firms 'are linked by horizontal cross-holdings of shares that reinforce and entrench the power of central controllers'.[10] Here, the voting rights used to control a group are distributed over the entire group rather than owned by a single company or shareholder.[11]

It should be noted that even though holding a majority of common shares does not necessarily lead to control of the company, as seen in the CMS, the CMS structure is not applicable to Libya and so is not considered within this study. This is because a dual-class share structure is not possible under the self-enforcing model (which forms the main focus of this thesis) the central feature of which is the adoption of a one share one vote rule, as discussed in Ch.4.[12] Further, the other two CMS structures are not common in Libya. This is because the Libyan state, as discussed later in Ch.2, in most cases directly owns the majority of corporate assets in Libya. Thus, in this study, for the purpose of simplicity, a "controller" is defined as a shareholder with more than 50 percent of the voting rights.

The central concern that underpins this study is that majority shareholders (those who control the company with their voting power) can cause harm to minority

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[7] *Bushell v. Faith* [1970] 1 All ER 53.
[8] Such shares are rare in the UK. See Marc Goergen and Luc Renneboog, 'Strong Managers and Passive Institutional Investors in the UK' '1998' Available at SSRN, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=137068> accessed 04-04-2015' 16.
[9] Bebchuk and others (n 2) 289.
[10] ibid 299.
[11] ibid.
[12] See (4.3.2.1) 189.

shareholders and so require workable legal remedies. In general, the voting system is widely accepted as a collective decision-making mechanism in which the will of the majority is expressed, and it is often the best means of maximising the expected return for any given group (the 'group preference').[13] The voting mechanism assumes that the majority opinion expresses the 'group preference,' that is, the optimal choice for the group as a whole.[14] Therefore, gaining the majority of the shareholder's consent is the best tool for establishing transaction-efficiency.[15] This is supported by the fact that each member's vote is cast based upon an appraisal of his best interests as a member of the group (sincere voting).[16] However, when the voter's personal interests conflict with the interest of the company or another group in the company, as is often the case in Libya, the transaction will be questionable. Thus, 'an absence of sincere voting results in distorted decision-making'.[17]

To demonstrate this issue: in a concentrated ownership system such as Libya the agency problem involves the conflict between the majority of the shareholders (agents) and the minority or non- controlling owners (principals), rather than between shareholders and managers. Here the shareholders with a high ownership share are capable of using their position to acquire private benefits by using their voting rights to consume corporate resources to their advantage, an option that is not available to other shareholders. On the other hand, in such a system, large shareholders can address the managerial agency problem through monitoring the management more effectively than small shareholders as they can accommodate a larger part of the monitoring costs, have sufficient voting power to influence corporate decisions and a general interest in profit maximization. Also, the

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[13] See Ronald J Gilson and Reinier H Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 Virginia Law Review 549.
[14] See Shmuel Nitzan and Uriel Procaccia, 'Optimal Voting Procedures for Profit Maximizing Firms' 51 Public Choice 191.
[15] Zohar Goshen, 'Controlling Strategic Voting: Property Rule or Liability Rule' (1996) 70 Southern California Law Review 741, 744.
[16] See Amartya Sen, 'Behavior and the Concept of Preference' (1973) 40 Economica 241.
[17] Goshen, (n 15) 797.

controlling shareholder generally takes an active interest in running the company through choosing the management and sometimes directly taking executive positions. Thus, the impact of the first agency problem (shareholders vs. managers) is minimal.

In Libya, the situation is further problematised by Libyan Company Law, which provides controlling shareholders with unrestricted control over the company, thereby allowing for abuses and injustices towards minority shareholders. Indeed, the statutory provisions in Libyan Company Law that deal specifically with the protection of minority shareholders are very few and those that do exist are incomplete, ambiguous and unbalanced. In reality, they afford little protection to minority shareholders since they grant overall power in most circumstances to the majority shareholders who have the ultimate say on almost all issues.

In this light, this study examines the current solution adopted by Libyan law under art 159 of Libyan Economic Activity Act (LEAA 2010) to deal with the conflict of interests between shareholders: the minority shareholders' actions (Liability Action and Nullification Action). Here it should be noted that a large amount of majority-minority shareholders' conflicts are resolved by actions that the minority shareholders brings against the controlling shareholders, the exploration of which will be our focus in this thesis. Examining other solutions, which afford protection for minority shareholders, such as appraisal rights and pre-emptive rights, will be our task in future (not in this thesis).

Using a social and economic analysis and a black letter approach, this study presents a novel analytical framework in order to investigate a possible solution that could contribute to solving the problem of conflict between shareholders in Libya. To that end, the study addresses the following questions: how effective is the current mechanism for dealing with the conflict of interest between shareholders in Libya? What are the economic and social implications of the different proposed approaches? What elements determine

which approach is preferable in Libya? And, finally, what are the challenges that the proposed law reform may face?

There is a strong need to establish a robust system of minority shareholders protection in Libya for both economic and social reasons. Firstly, the protection of minority shareholders is considered a core mechanism for attracting both foreign and domestic investors. This is because effective minority protection provides a degree of confidence that is necessary for investors to make an investment decision. In this way, minority protection enhances the development of financial markets, as minority shareholders will be incentivised to pay a greater sum for shares if there is strong protection for them and their investments. This in turn provides increased capital for companies when the shares are first issued.[18] La Porta, *et al*., in a series of studies, assert that effective shareholder protection laws and strong enforcement results in larger stock market capitalization, initial public offerings (IPOs) and a greater number of publicly traded companies.[19] Further, it has been argued that countries that protect minority shareholders have more effective stock markets, larger numbers of listed shares and higher rates of capital demand in the market than countries where protection is lacking.[20] In addition, La Porta, *et al*, found that there is evidence of firms enjoying a higher valuation in countries with better protection for minority shareholders.[21] Beck and Levine confirm that strong legal protection of shareholders and strong accounting standards are positively correlated with stock market capitalization,[22] and, recently, Rathinam and Raja found that

[18] Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of Financial Economics 3, 15.
[19] Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 53 Journal of Finance 1131; Rafael La Porta and others, 'Law and Finance' (1998) 106 Journal of Political Economy 1113; Rafael La Porta and others, 'The Quality of Government' (1999) 15 Journal of Law, Economics and Organisation 222.
[20] La Porta and others, 'Investor Protection and Corporate Governance' (n 18).
[21] Rafael La Porta and others, 'Investor Protection and Corporate Valuation' (2002) LVII The Journal of Finance 1147.
[22] Thorsten Beck, Ross Levine and Norman Loayza, 'Finance and the Sources of Growth' (2000) 58 Journal of Financial Economics 261.

developments in law and investor protection actually cause market capitalization.[23] MacNeil claims that the failure to provide adequate protection for investors has a negative effect on confidence in the operation of capital markets, which is one category of securities markets, and, subsequently, undermines economic growth.[24]

However, it is worth mentioning that the relationship between legal minority protection for shareholders and the development of financial markets is a controversial area in academic discourse. For example, John Armour, *et al* found 'no evidence of a long-run impact of legal change on stock market development. Possible explanations are that laws have been overly protective of shareholders; that transplanted laws have not worked as expected; and, more generally, that the effects of legal origin are not as strong as widely supposed'.[25] It should be noted that even though the relationship between minority protection and growth is empirically controversial and the impact of an effective system of minority shareholders protection on market development may differ from one country to another, depending on other contributory factors, there is no doubt that protection of minority shareholders can solve the agency problem between the minority shareholders against both the management and the majority shareholders. As Cheffins notes, a country that has an effective mechanism for the protection of minority shareholders against the controlling shareholders can regulate transactions between companies and their 'insiders' (directors and key shareholders) by deterring controlling shareholders from extracting private benefits.[26] Such a protective mechanism can both encourage minority shareholder to buy equity[27] and facilitate access to external finance.[28]

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[23] Francis Xavier Rathinam and A. V. Raja, 'Stock Market and Shareholder Protection: Are They Important for Economic Growth?' (2010) 3 The Law and Development Review 306.

[24] Iain G MacNeil, *An Introduction to the Law on Financial Investment* (2nd edn Oxford and Portland, Oregon, 2012) 290.

[25] John Armour, Simon Deakin and Prabirjit Sarkar, 'Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis' ECGI - Law Working Paper No. 108/2008 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1094355> accessed 01/07/2013.

[26] Brian R. Cheffins, *Corporate Ownership and Control* (Oxford University Press, 2008) 34.

[27] ibid.

Secondly, justice and fairness necessitate protection for the minority shareholder for two reasons. First, minority and majority shareholders must be treated equally. This does not mean that the majority has no sole control over the company. Rather, it means the majority shareholders must not directly or indirectly extract private benefits at the expense of the minority shareholders. If the majority shareholder is free to unfairly exploit their position in the company and escape liability, then potential minority shareholders will be reticent to invest if there are no legal provisions that safeguard their investment.[29] Further, to a large extent, minority shareholders are more vulnerable (especially when there is a strong connection between the directors and majority shareholders) and more dependent on the law than either the company's employees or suppliers who, due to their usefulness, are less likely to be mistreated.[30] Therefore, the main goal of a protection system for the minority shareholders should be to ensure that majority shareholders do not abuse their corporate powers and that minority shareholders always have a means to obtain some kind of remedy where it is warranted.

The study is important to the case of Libya for several reasons. Firstly, corporate governance in Libya generally, and minority shareholders protection particularly, have not been adequately discussed by researchers. There has been a lack of attention paid thus far to such topics in Libya, particularly at the level of legal reform. Also, the need to address such a topic has increased following the move from socialist oriented policies toward a free-market economy and the establishment of the Libyan Stock Market in 2007. In other words, the most important step in achieving a free-market economy is through enhancing privatisation programmes and attracting both foreign and national investors to participate in Libyan businesses. This cannot be achieved without establishing efficient protection for

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[28] See e.g. Raghuram G Rajan and Luigi Zingales, 'Financial Dependence and Growth' [ ] 88 American Economic Review 559; Asli Demirgüç-Kunt and Vojislav Maksimovic, 'Law, Finance, and Firm Growth' 53 The Journal of Finance 2107; Jeffrey Wurgler, 'Financial Markets and the Allocation of Capital' 58 Journal of Financial Economics 187; Stijn Claessens and Luc Laeven, 'Financial Development, Property Rights, and Growth' 58 The Journal of Finance 2401.

[29] Themistokles Lazarides, 'Minority Shareholder Choices and Rights in the New Market Environment' '2009' (2009) SSRN, <http://ssm.com!abstract=1432672> accessed 20/07/2013, 5.

[30] La Porta and others, 'Investor Protection and Corporate Governance' (n 18) 4.

minority shareholders in private companies. Further, Libya needs to diversify its economy. Though Libya is a hydrocarbon rich country, it is still 'one of the least diversified economies in the Maghreb region and among the oil producing countries'.[31] This means Libya is still dependent on hydrocarbons, which, according to the 2013 IMF report, 'account for over 65 percent of GDP and 96 percent of revenue'.[32] However, it is likely that when Libya establishes an adequate system of corporate governance and provides robust protection for the minority shareholder, this will help the revival of the private sector, which in turn will contribute to economic diversification.

Having identified the problem of the study and the importance of tackling it, the core question here is what is the appropriate means by which an effective protection system for the minority shareholders in Libya can be provided? The departure point to answer this question is the fact that Libya is extremely deficient in terms of effective court enforcement. Therefore any solution provided must take this into account. In other words, the focus on reforming the minority shareholders' actions (laws on paper) to protect the minority shareholders against the controlling shareholders in Libya will be incomplete, at least at this stage of market transformation. This is because, as Opper and Serger claim: 'legal rules which are not enforced and do not influence an individual's behaviours are not even regarded as a part of an institution'.[33] In the same way, Pistor et al. found that though credit market development benefited from improvements in the law on the books (focusing on shareholder rights and creditors' rights), the effectiveness of legal institutions has a much stronger impact on external finance (the ability to raise equity, for example). This conclusion supports the argument that the proposition of legal transplants and extensive legal reforms are not in themselves adequate to establish effective legal and market

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[31] International Monetary Fund-IMF,'The Socialist People's Libyan Arab Jamahiriya: 2006 Article IV Consultation-Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for The Socialist People's Libyan Arab Jamahiriya,' (IMF Country Report No. 07/149, International Monetary Fund 2007) 4.

[32] International Monetary Fund, ,'Libya 2013 Article IV Consultation' (IMF Country Report No. 13/150, International Monetary Fund 2013) 4.

[33] Sonja Opper and Sylvia Schwaag-Serger, 'Institutional Analysis of Legal Change: The Case of Corporate Governance in China' 26 Washington University Journal of Law and Policy 245, 247.

institutions.[34] Indeed, if there is no competent authority that is capable of enforcing the laws, any reform of the law on the books will not deliver real world change or address the majority-minority problem effectively. As Coffee points out, massive expropriation by the majority shareholders can still occur even when the law on the books is nearly optimal.[35]

Accordingly, this study examines a model that takes into account the lack of effective court enforcement in Libya and investigates to what extent it is appropriate for the Libyan case. The model is known as the self-enforcing model and was elaborated by Black and Kraakman in their 1996 article: A Self-Enforcing Model of Corporate Law.[36] The model may provide appropriate solutions for corporate governance problems in emerging economies as it takes into account these countries' environmental features. Generally, these are characterized by weak judicial enforcement, the existence of market forces that encourage law avoidance, and cultural norms and constraints that inhibit free market dynamics. Therefore, the model provides a solution that minimizes reliance on official enforcement by primarily relying on a combination of voting rules and transactional rights. The voting elements include shareholder approval for broad classes of major transactions and self-interested transactions (supermajority shareholder approval for central business decisions and majority of minority rule for self-interested transactions). Transactional rights include pre-emptive rights, appraisal rights, and sell-out rights. These primary procedural mechanisms replace the largely absent mechanisms of formal enforcement, and generally allow the minority shareholders to police the opportunism of the controlling shareholders.

In addition to the self-enforcing model, this study attempts to take some lessons from UK company law as long as they are consistent with Libya's social, cultural and

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[34] Katharina Pistor, Martin Raiser and Stanislaw Gelfer, 'Law and Finance in Transition Economies' (2000) 8 Economics of Transition 325.

[35] Jr. Jack C. Coffee, 'Privitization and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 Journal of Corporation Law 1, 6.

[36] Bernard Black and Reinier Kraakman, 'A SELF-ENFORCING MODEL OF CORPORATE LAW' (1996) 109 Harvard Law Review 1911.

economic environments and do not contradict *Sharia* principles or fundamental foundations of Libyan society. Here it should be noted that the study does not rely heavily on a comparative analysis between Libya and the UK. This is because the study mainly argues for the self-enforcing model and simultaneously against the current approach adopted in Libya: the minority shareholders' actions. This necessitates adopting an economic and social approach, which cannot be drawn from the UK. Nevertheless, UK law does offer some key lessons that are useful in addressing specific issues in Libya.

Firstly, the UK is a common law jurisdiction and therefore it differs from Libya that has a civil law system. The variation between the two legal systems may contribute to enriching the study as laws from other legal origins can provide different ways of dealing with legal problems in Libya. The importance of seeking solutions from other legal origins is made clear by the fact that, in the case of minority shareholder protection, states that share the same legal origin (e.g. civil law countries) provide the same solutions as Libya. In the case of minority shareholders protection, as discussed, French and Egyptian legal systems (the root of Libyan Law)[37] provide the same solution in relation to many issues relating to minority shareholders protection. For example, the three countries adopt Personal Liability action and abuse of rights principle to deal with the problem between the majority shareholders and he minority shareholders.[38] As such, UK law may provide a valuable model for upcoming reform of Libyan law in regard to the minority shareholders protection due to the fact that it tackles the issue from a very different legal perspective.

Secondly, the UK has an effective law for regulating the relationship between the minority shareholders and the majority shareholders. This is because, initially, it has been dealing with the issue of minority shareholders for nearly one hundred and seventy years.[39]

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[37] See (1.1.1) 21.
[38] See (3.1.1.2) 115ff and (3.1.2.3) 117ff.
[39] The oldest case in this matter was in 1843 which is *Foss v. Harbottle* [1843] 2 Hara 461. Here it should be noted that English law was a guide for common law jurisdictions such as the United States, Canada, Australia and New Zealand until at least the beginning of the 20th Century. English case decisions were commonly

Furthermore, the UK has a common law system where judges are able to interpret statute when there is an area of ambiguity, thus enabling the courts to remedy statutory gaps.[40] As a result, such a system can offer comprehensive analysis provided by judges in the area of minority shareholders protection.[41]Libya, on the other hand, lacks such experience and development. The first statute in Libya to protect minority shareholders was introduced in 1953 as part of the Libyan Commercial Act (Libyan CA 1953) (art 543 for a Company Action and arts 546 and 557 for Personal Actions). In 2010, the new Company Act was issued under the name Libyan Economic Activity Act (LEAA 2010), and the same provisions of LCA 1953 are included (art 159).[42] In other words, the Company Act in Libya only underwent minor changes from 1953 to 2010. This was despite the fact that the economic system in Libya as a whole underwent major developments during this period (as discussed in Ch.1). Therefore, the LEAA 2010 can still be characterised as an underdeveloped law that lacks the level of detail that is required in an effective legal instrument in the modern commercial climate. As an example of this: LEAA 2010 fails to address many of the issues that relate to the shareholders' position and rights. Significantly,

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cited as precedents and almost invariably followed in these countries. See Len Sealy, 'Shareholders' Remedies in the Common Law World' (1997) 2 Company Financial and Insolvency Law Review 172, 172.

[40] See Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French and Ryan on Company Law* (28 edn Oxford University Press, 2012) 0.3.2.3. In this context, it has been argued that statute law is often inefficient. See e.g. Paul H Rubin, 'On the Form of Special Interest Legislation' (1975) 21 Public Choice 79; Paul H. Rubin, 'Why Is the Common Law Efficient?' (1977) 6 The Journal of Legal Studies 51.

[41] Here the study does not claim that common law is better equipped than civil law to provide protection for the minority shareholders as argued by La Porta et al. (see La Porta and others, ‘Law and Finance’ (n 19)) or North who argues that Britain has better institutions than those in France. Consequently, British colonies are likely to inherit better institutions than French colonies with positive ramifications on financial development (See Douglass C North, 'Institutions and Economic Growth: An Historical Introduction' 17 World Development 1319). This claim is controversial as there are some studies that claim that civil law countries provide more protection for minority shareholders than common law countries. See e.g. Prabirjit Sarkar, 'Common Law vs. Civil Law: Which System Provides More Protection to Shareholders and Creditors and Promotes Financial Development' '2011' <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1913624> accessed 06-04-2015.Here we should note that though a comparison between the two systems and the colonial legacy of British and French legal systems is certainly interesting and relevant in a broader sense, it falls outside the specific scope of the topic addressed in this thesis.

[42] Though the LEAA 2010 replaced the first Commercial Act that was introduced in 1953, it includes minimal changes since the main purpose of the Act was to collect multiple, scattered provisions that relate to business and commercial issues into a single act, rather than introducing major reforms to commercial activities. Specifically, LEAA 2010 abrogated 21 commercial laws that were diffused within several Acts and Codes and placed them in LEAA 2010. For example, LEAA 2010, art 1358 abrogated 21 laws, including Law No.40 for 1956 Concerning Commercial Brand Law and its amendments, Law No. 2 for 1962 Concerning Commercial Data, Law No. 38 for 1968 Concerning Imports and Exports, Law No. 110 for 1975 Concerning State-Owned Companies, Law No.9 for 1992 Concerning Economic Activities, Law No.6 for 1972 Concerning Commercial Agencies and Law No. 4 for 1974 Concerning Chambers of Commerce.

the law completely ignores the link between concentrated ownership structures and weak protection of minority shareholders and fails to sufficiently clarify the duties of the board of directors, thus leaving shareholders exposed to exploitation by the management.

Thirdly, although there are obvious differences between the Libyan and UK business environment (e.g. different legal origins and different ownership structures, namely dispersed ownership in the UK and concentrated ownership in Libya), both systems share similar corporate aspects, which suggests there may be some similarity to be found in the types of provisions that apply to minority shareholders protection. Specifically, both systems adopt the "shareholder primacy" theory, in which shareholders are provided with stronger powers at the expense of the board of directors.[43] Also both countries have the same limited Liability companies (in Libya "JSCs" and in the UK "limited Liability companies by shares").[44] In addition, the Libyan system follows the UK system in regard to making a distinction between public and private companies.[45] Therefore, aspects of UK company law can be taken as a model for improving the Libyan Company Act in relation to minority shareholders protection.

Fourthly, the relationship between the UK and State of Libya, in terms of the corporate environment, started a long time ago. According to Bait El Mal, the general structure of corporate managements and auditing and accounting systems in Libya comes from the UK.[46] Furthermore, the legal forms of business organisation in use in both the UK and Libya are similar. These can be arranged into four major categories: Sole trader, Partnership, Companies and Public Companies. This is because after World War II, the UK and French shared control over Libya until the Libyan Government declared Libya's

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[43] The most important debates regarding the primacy theories (shareholders primacy and board of directors' primacy theories) are presented in a series of articles between Bebchuk and Bainbridge. See: Lucian Bebchuk, 'The Case for Increasing Shareholders Power' (2005) 118 Harvard Law Review 833 and Bainbridge's response in Stephen M. Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 Northwestern University Law Review 547 to which Bebchuk in turn responded in Lucian A. Bebchuk, 'Letting Shareholders Set the Rules' (2006) 119 Harvard Law Review 1784.

[44] See (2.1.1) 53-4.

[45] See (2.1.1) 54-5.

[46] M. Bait El-Mal, C. Smith and M. Taylor, 'The Development of Accounting in Libya' (1973) 8 The International Journal of Accounting, Education and Research 83.

independence in 1951. Accordingly, there is a historical link between these two countries, which may be useful in terms of drawing ideas of best practice from UK law and applying them to Libya.

Finally, the UK, unlike Libya and other undeveloped countries, has numerous publications and reference books in the field of companies generally and in the minority shareholders protection particularly. These will prove a very useful source of information within this study.

The approach adopted in the study (the combination of the self-enforcing model and the lessons taken from the UK long experience in the minority shareholders protection) is aligned with the literature on law transplantation theory in corporate law. Many scholars have written about the concept of legal transplants, especially in the area of corporate law. The majority[47] adopt the view that the legal transplantation in corporate law differs significantly across countries due to the differences in economic, cultural, social, political and legal systems predominant in a country. As a result, the differences between societies must be taken into account in these matters since any law that is not suited to the needs of the recipient is unlikely to be effective.[48] In this regard Black and Kraakman state that:

[47] It should be noted that there is a trend towards the view that laws can be simply transferred and history suggests that transferred laws exist in many countries. Watson argues that law is independent since there is no relationship between it and society and as such laws are transferable and there is no need to undertake a systemic analysis. See Alan Watson, Legal Transplants: An Approach to Comparative Law (University of Georgia Press 1993) 111. See also, Alan Watson, 'Legal Change: Sources of Law and Legal Culture' [1983] 131 University of Pennsylvania Law Review 1121. However, this view has been criticized by many scholars, see for example, Matteo Solinas, Legal Evolution and Hybridization: The Law of Shares Transfer in England (Intersentia 2014) 14-6; Gail Edwards, 'Legal Transplants and Economics: the World Bank and Third World Economies in the 1980s-A Case Study of Jamaica, the Republic of Kenya and the Philippines' (2007) 9 European Journal of Law Reform 243.

[48] I believe that there should be a distinction between two types of laws: laws that aim to deliver fairness between two parties (e.g. shareholders) and other laws that provides economic efficiency. In the former instance, the transplantation should be easy and there is no need to take into account the differences or the similarities between the countries. However, in the latter instance, when the goal of the law is to provide economic efficiency and not to deliver fairness, there is a need to look at whether the transplanted law can obtain economic efficiency or not. To illustrate this: in regard to addressing issues that relate to justice, equity or fairness such as the appropriateness of a concept of legitimate expectation for inclusion in the Libyan legal system, we should ignore the specificities of the environment (that we would take into account when considering a law has pure economic goals e.g. takeover) but rather focus on how fairness and justice can be maximized within this system. However, to examine to what extent the law that has pure economic goal e.g. whether the takeover legal system in the UK is appropriate for Libya, we should look at the position of the markets in the these countries. No doubt we will draw a conclusion that the takeover legal system in the UK

> Emerging economies cannot simply copy the corporate laws of developed economies. These laws depend upon highly evolved market, legal and governmental institutions and cultural norms that often do not exist in emerging economies. Developed country corporate laws also reflect the idiosyncratic history of their country of origin. They are not necessarily efficient at home, let alone when transplanted to foreign soil. Moreover, in many emerging markets, corporate law must serve a second central goal that is less pressing in mature market economies: fostering public confidence in capitalism and in private ownership of large business enterprises.[49]

In the same context, Black and Kraakman argue that 'corporate law must be designed substantially from scratch to work within the infrastructure available in an emerging market'.[50] Similarly, Pistor and Xu claim that solutions that may work reasonably well in developed market economies with a long history of commercial law development may not work as well in transition economies because 'transition economies face conditions that render enforcement by both courts and regulators ineffective'.[51] Further, Gail Edwards argues that transferring laws between systems may not be successful when both systems do not share similar political or social environments.[52] Freund claims that 'any attempt to use a pattern of law outside the environment of its original country entails a risk of rejection [...] its use requires a knowledge not only of the foreign law but also of its social and above all the political, contexts'.[53] Further, many scholars (e.g. Frankel[54] and Smith[55]) argue that legal transplants that are not consistent with local culture

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is not appropriate for Libya since the market in the UK is a takeover market, whereas the market in Libya is not. Therefore, the problems encountered in the two systems, in this specific case, are different and cannot be addressed by a single system of law.

[49] Black and Kraakman, (n 36) 1913. Black and Kraakman continue by stating that

> the law that works for a developed economy, when transplanted to an emerging economy, will not achieve a sensible balance among company managers' need for flexibility to meet rapidly changing business conditions, companies' need for low-transaction-cost access to capital markets, large investors' need to monitor what managers do with the investors' money, and small investors' need for protection against self-dealing by managers and large investors. The defects in the law will increase the cost of capital and reduce its availability. (ibid 1914).

[50] ibid 1913.

[51] Katharina Pistor and Cheng-Gang Xu, 'Beyond Law Enforcement: Governing Financial Markets in China and Russia' in J Kornai, B Rothstein and S Rose-Ackerman (eds), *Creating Social Trust in Post-Socialist Transition* (Political Evolution and Institutional Change, 2004) 167. They identify two key circumstances that undermine law enforcement: the level of incomplete law, and the absence of reliable information.

[52] Edwards, (n 47).

[53] Otto Kahn-Freund, 'On Uses and Misuses of Comparative Law' 37 The Modern Law Review 1, 33.

[54] Tamar Frankel, ' A Recipe for Effecting Institutional Changes to Achieve Privatization' (1995) 13 Boston University International Law Journal 295.

will fail.[56] This is because, as Solinas claims, 'law is itself a form of culture'.[57] Thus any attempts to import a law must take into account the special environment of the recipient country.

Before starting to discuss the issues of the study, it is worth indicating that examining such an area is made more difficult by a lack of both English and Arabic resources on Libyan corporate governance. Additionally, the poor state of Libya's statistical system generally[58] results in serious deficiencies that affect the ability to comprehensively analyse the issues covered in the study.

To structure this study, it is necessary to provide an overview of the general framework of corporate governance in Libya, examine the country's current position as an economy in the early stages of transformation and analyse the potential impact of this transformation on corporate governance (Chapter. 1). Following this, in Chapter 2, I locate the dimensions of the conflict of interest problem between the minority and majority shareholders in Libya through analysing literature of corporate governance with regard to the minority-majority shareholder problem and applying it to the case of Libya. After that, in Chapter 3, I examine the efficacy of the current mechanism available in Libyan law (a liability action) as a solution for dealing with the conflict of interests between the minority shareholders and the majority shareholders in Libyan companies. Here, I conclude that the

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[55] James F Smith, 'Confronting Differences in the United States and Mexican Legal Systems in the Era of NAFTA' (1993) 1 U.S.-Mexico Law Journal 85.

[56] For a greater literature review in this matter see Curtis J Milhaupt and Katharina Pistor, *Law & Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008), 208.

[57] Solinas (n 47) 17.

[58] According to the 2006 IMF Report, Libya is in need of establishing a strong and reliable statistical system. To do so, the report suggests the following reforms:

> (i) establishing a National Statistical Council to ensure coordination among data-producing agencies, discuss and approve the national statistical work program, and monitor progress in building a high quality statistical system; (ii) creating a National Statistical Agency with the authority to produce and disseminate official statistics and coordinate the national statistical work program; (iii) increasing development and training; and (iv) participating in the Fund's General Data Dissemination Standards (GDDS), and using the GDDS as a framework for statistical development.

See International Monetary Fund-IMF,'The Socialist People's Libyan Arab Jamahiriya: Selected Issue—Medium-Term Economic Reform Strategy, and Statistical Appendix' (IMF Country Report No. 06/137, International Monetary Fund, International Monetary Fund 2006) 15.

current approach is not appropriate for the Libyan Law for several reasons that relate to either the efficiency of the approach itself or its application in Libya (for instance, I argue that the Libyan courts are ineffective and inefficient at providing predictable and timely judgments). Accordingly, I argue that there is a strong need to adopt an alternative solution. Thus in Chapter 4, after examining other possible solutions (e.g. a prohibition strategy), I propose the self-enforcing model as the most appropriate solution for reasons that relate to, for example, capital market and the efficiency of the market. However, this is not the end of the story; adopting such a model will inevitably lead to some potential risks (such as the risk that the minority shareholders may abuse their rights), which will require the formulation and adoption of new and specific strategies of corporate governance that are appropriate to the Libyan case (Chapter. 5).

Chapter 1: The General Framework of Corporate Governance in Libya's 'Transition Economy'

Introduction

The term 'transition economy' relates to the period in which a country's economy transitions from a centrally planned economy to a market economy. This process has already taken place in a large number of countries. For example, in Asia the transformation process began in the late 1970s and in Europe in the late 1980s. [1] However, in Libya this process only began in the early 2000s, the reasons for which I will return to later. Prior to Libya's economy entering the transition stage, corporate governance, from 1970s to the end of 1990s, was a marginal issue due to the fact that under the centrally planned economy most large equities were owned by the State.[2] In this context, as János Kornai claims, enterprises under central planning were not concerned with raising external finance and, hence, the concepts of financial discipline or accountability were absent. [3] In such a system, instead of the management being required to perform according to corporate governance best practice to attract more investment, the state assumes the role of monitoring the management to ensure that the managers of socialist enterprises act according to the targets set by the central plan.[4] Thus, in a case like Libya where the

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[1] For more information, see Marie Lavigne, *The Economics of Transition: From Socialist Economy to Market Economy* (2nd edn, Macmillan London 1999); Joachim Ahrens, 'Governance in the Process of Economic Transformation' <http://www.oecd.org/dac/governance-development/37791185.pdf> accessed 11-11-2013, 3.

[2] Andreas Heinrich, Aleksandra Lis and Heiko Pleines, 'Factors Influencing Corporate Governance in Postsocialist Companies: An Analytical Framework' William Davidson Institute Working Paper No 896, October 2007 <http://papers.ssrn.com/Sol3/papers.cfm?abstract_id=1087348> accessed 09/11/2013, 3; Robert W. McGee, 'Corporate Governance in Transition Economies' in Robert W. McGee (ed), *Corporate Governance in Transition Economies* (Springer 2008) 3.

[3] János Kornai, *The Socialist System: The Political Economy of Communism* (Princeton University Press 1992) 69.

[4] Ibid See also, Vito Tanzi, 'Fiscal Policy and the Economic Restructuring of Economies in Transition' IMF Working Paper No 93/22 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=883452> accessed 13-11-2013.

government owned 88% of national investments between 1970 to1999,[5] strong corporate governance was not relevant to the state.

There are several possible points of departure for an analysis of corporate governance in Libya's transition economies that the study will briefly mention prior to addressing the main focus of the chapter: corporate governance in Libya. First, many researchers have attempted to analyse corporate governance mechanisms in transition economies.[6] However, few of them have considered the changes in corporate governance that happen in such countries during a cycle transformation (transforming from one stage to another),[7] which is our approach in the chapter. Second, in Libya (as in any developing country), small unlisted companies make up the overwhelming majority of companies and shares of large family-owned, state-owned and/or foreign-owned companies are not commonly traded locally.[8] Third, Libya only moved from a planned economy to a free market economy in 2000 and from socialism to capitalism in 2011, following the recent revolution. These recent changes are suggestive of why corporate governance has been ignored for so long and so why Libya is still in the very early stage of establishing effective corporate governance.

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[5] S Ganous, *Libyan Revolution in 30 Years, Political, Economic and Social Transformations, 1969-1999* (Dar Al Jamahiriya for Publication, Distribution and Advertising 1999) 57 (in Arabic) cited in Hesham F. Shernanna, 'Critical Perspectives on the Efficient Implementation of Privatisation Policies in Libya: Assessing Financial, Economic, Legal, Administrative and Social Requirements' (Durham University 2013) 86.

[6] See e.g. Bavi Dharwadkar, Gerald George and Pamela Brandes, 'Privatization in Emerging Economies: An Agency Theory Perspective' (2000) 25 Academy of Management Review 650; K Hung Chan, Kenny Z Lin and Fang Zhang, 'On the Association between Changes in Corporate Ownership and Changes in Auditor Quality in a Transitional Economy' (2007) 6 Journal of International Accounting Research 19.

[7] Some studies indicate that different forms of corporate governance emerge at different stages of the transformation from centrally planned to market-based systems in transition economies See e.g. John McMillan and Christopher Woodruff, 'Private Order Under Dysfunctional Public Order' (2000) 98 Michigan Law Review 2421; Lawrence P King, *The basic features of postcommunist capitalism in Eastern Europe: firms in Hungary, the Czech Republic, and Slovakia* (Greenwood Publishing Group 2001); Son A. Le, Mark J. Kroll and Bruce A. Walters, ' The Impact of Institutional Changes on Corporate Governance Mechanisms in Transition Economies' (2003) 28 The Academy of Management Review 275; Mike W Peng, 'Institutional Transitions and Strategic Choices' (2003) 28 Academy of Management Review 275; Son A. Le, Mark J. Kroll and Bruce A. Walters, 'Stages of Corporate Governance in Transition Economies' (2011) 28 Journal of Business Strategies 151.

[8] Charles Oman, Steven Fries and Willem Buiter, 'Corporate Governance in Developing, Transition and Emerging-Market Economies' OECD Development Centre Policy Brief No 23, 2004 <http://www.oecd-ilibrary.org/development/corporate-governance-in-developing-transition-and-emerging-market-economies_604227826337> accessed 21-11-2013, 7.

The purpose of this chapter, as an introductory chapter that lays the foundation for the remainder of this thesis, is to provide an overview of the general framework of corporate governance in Libya and to examine its current position which, I argue, is still in the early stages of transformation. This can be achieved by examining the development of the Libyan economy and institutions of corporate governance in Libya (including formal constraints such as legal, regulatory, and judicial systems, and also informal constraints such as beliefs and norms, financial systems, and economic structures) and, further, by analysing how those institutions influence governance and its dynamics in Libya during the transition process.

To that end, this chapter provides a general overview of the Libyan Legal system in (1.1). Since a few introductory words are necessary to understand the Libyan legal corporate system, the first sub-section outlines briefly the civil law system in Libya (1.1.1). Then in (1.1.2), I provide a general overview of Libyan Corporate Law and in (1.1.3), I summarise a general idea of Libyan corporate governance.

In order to effectively analyse the current situation of Libyan corporate governance, I discuss the economic context in which laws of economy in Libya developed. In (1.2) I go on to provide a brief introduction to Libya's economic transition. In order to do so, (1.2.1) discusses the pre-transaction economy in Libya and (1.2.2) analyses the steps already taken in Libya towards a market economy. This section provides the foundation for many of the arguments that follow as it explores the development of the Libyan economy and its current environment.

Section (1.3) analyses the institutions of corporate governance in Libya within the context of the transformation process. In this section, I examine how those institutions influence governance and its dynamics in process of economic transition. In order to do so, first there is a need to understand briefly the stages (bureaucratic stage; relationships stage;

and free market stage) that any transition economy takes in order to achieve a market economy (1.3.1), following which I examine the institutions of corporate governance in Libya (1.3.2).

1.1. General overview of Libyan Legal system

In this section, the study outlines the legal system in Libya as a civil law country (1.1.1); it then provides an overview of corporate law in Libya (1.1.2) and finally, an overview of corporate governance in Libya (1.1.3).

1.1.1. Libya as a Civil Law country

Before discussing the corporate governance system in Libya, a few introductory words are necessary to understand its legal corporate system. To begin with, it is important to note that Libya is a civil law country, and its civil law system, including corporate law, was inspired by the 1948 Egyptian Civil Code, which, in turn, is based on the French Civil Code.[9] These laws transferred to the Libyan legal system Western commercial ideas and practices which were combined with existing principles of Islamic Law.[10] In this regard, Gaman Badr states that:

> Libya naturally turned to its immediate neighbour, Egypt, with which it shares a common historical, cultural and religious background as well as a common frontier. Egyptian legislation was the source of not only the Libyan civil code but also of all the other codes promulgated by the Libyan Government: commercial, penal, and civil and commercial procedure.[11]

[9] Mohamed Al badawi, *Law of Economic Activities: General Principles and Rules* vol 1 (3 edn, Al Maftoha University 2013) 32 (in Arabic). Al Badawi indicates that the French Commercial Code of 1807 was the historical source of the Egyptian Commercial Code which, in turn, was the historical source of the Libyan Commercial Code. ibid.

[10] Waniss Otman and Erling Karlberg, *The Libyan Economy: Economic Diversification and International Repositioning* (Springer 2007) 63. Interestingly, Libyan law is not based on Italian Law (except Criminal Law) although Libya was an Italian colony. I believe that this may be because the Italian colony began in the 1910s and lasted until February 1947. As such, the Italians left Libya before the start of enacting laws in Libya which, as Gamal Badr noted, started in the 1950s. (see Gaman Moursi Badr, 'The New Egyptian Civil Code and the Unification of the Laws of the Arab Countries' (1956) 30 Tulane Law Review 299, 303). Further, after World War II, the UK and French shared control over Libya until the Libyan Government declared Libya's independence in 1951. Accordingly, it is clear that the emergence of Libya's modern legal system has been far more influenced by France than Italy. This is because the emergence of legal system was accompanied by the presence of UK and France in Libya.

[11] ibid 303.

Since Libya is a civil law country, as in other civil law countries, there is a hierarchy of legislative texts. This system consists of the constitution at the top, followed by laws (including various codes), executive regulations (*laeha*),[12] and, finally, executive and ministerial decisions.[13] In such a system, judges must observe the legal authority enshrined in this hierarchy of legal rules and, in cases where there is a conflict between one or more of the legal rules, ensure that the rules of the lower level do not conflict with the rule of the higher level. For example, ministerial decisions must not conflict with laws or executive regulations (*Laeha*), and nothing must conflict with the constitution. [14]

Furthermore, judges in Libya have access to secondary sources of law. In cases where there is an absence of applicable legal provisions of Civil statutes, judges can refer to sources of law that are mentioned in the first article of the Libyan Civil Code, these include Islamic principles, custom, principles of natural law and rules of equity. However, in commercial law, the secondary sources of law are different. When there is no applicable commercial statute, a judge must look at civil law statutes first for an applicable statute. [15] If neither a commercial statute nor a civil law statute can be applied to the case, the judge can apply judicial precedents or fairness principles.[16]

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[12] An executive regulation (*Laeha*) is sometimes referred to as a secondary law (*Le Reglement* in French). This source of law is issued by an executive power such as a cabinet or a minister. It often details an existing law that has been issued by the Libyan Legislature (this type of *Laeha* known as Implementation *Laeha*). However, it can also create new rules that do not relate to existing laws (this is called an Independent *Laeha*). The policy behind the existence of *Laeha* derives from the fact that an executive power deals with people directly in a variety of areas. Hence it is more capable than a legislative power of responding to the needs of the people and enacting rules aligned with those needs. Also, as some issues are characterized as technical complexity, an executive power is more capable than the legislative authority of regulating such issues because they require a great deal of expertise that may not be available to the parliament. For more details about the definition of *Laeha* and its types, see Hasan Kera, *Entrance to Law* (Al maaref 1969) 235-9 (in Arabic); Alkoni Aboda, *Basics of Libyan Law: Theory of Law*, vol 1 (Naser University 1993) 189-203 (in Arabic).

[13] Aboda (n 12) 68.

[14] For information about the structure of the Libyan court system and their function, see Mahmud R. Mukhtar and others, *Libya : A Guide to Commercial Law, Banking Law and Accounting* (Philadelphia : GMB Publishing Ltd 2008)13-21.

[15] LEAA 2010, art 2.

[16] LEAA 2010, art 3.

1.1.2. General overview of Libyan Corporate Law

The first Commercial Act in Libya was introduced in 1953 and replaced in 2010 by the Libyan Economic Activity Act (referred to hereafter as LEAA 2010). The Act sets down the three types of companies permitted in the State of Libya:[17] 'persons companies',[18] 'funds companies',[19] and 'mixed companies'.[20] Persons companies are based on partnerships between people and are composed of General Partnerships (*Tadamun* Company)[21] (arts. 51-76), Limited Partnerships (*Tawssiyah Bassita* Company)[22] (arts. 77-90), and Joint Ventures (*Mohassa* Company)[23] (arts. 91-97). Funds companies, on the other hand, are based on capital and include joint stock companies (JSC) that are either private or state-owned companies (arts. 98-260). Mixed companies are a combination of the two and include Limited partnerships by shares (*Tawssiyah beashom* Company)[24] (arts. 261-270) and Limited Liability Companies[25] (arts. 271-291). LEAA 2010 explains all the details needed for establishing, registering, governing, managing, bankrupting and dissolving all these different types of companies. It also describes the sanctions established for any failure to fulfil these requirements.

The most common form of company in Libya, and thus the focus of this research, is the JSC. LEAA 2010 art.98 defines a JSC as 'a company in which the capital is divided

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[17] The forms of companies are covered in LEAA 2010 Book.1, Ch. 3

[18] Translated verbatim from the original Arabic: *Sharekat Al ashkas* شركات الاشخاص

[19] Translated verbatim from the original Arabic: *Sharekat Al amwal* شركات الاموال

[20] Translated verbatim from the original Arabic: *Sharekat Al moktalata* الشركات المختلطة

[21] A general partnership is established between two or more persons under a certain title to carry out commercial activities. It is a company in which all members will be responsible by solidarity and interdependence towards the company's commitments and every agreement contradicting this will not be valid in facing the others (art 51 of LEAA 2010).

[22] A limited partnership has two kinds of partners: firstly, a partner who enjoys limited liability and will be responsible for the debts and obligations of the company within the limit of what they provided from shares. He must be banned from participating in the management of the company. The other type of partners is a worker will be responsible by solidarity and interdependence to the company's commitments. In other words, he is personally, severally and jointly liable for the debts and obligations of the company. (art 77 of LEAA 2010).

[23] A Joint Venture Company is an agreement entered into by two or more parties for the purpose of carrying out limited operations. Every partner in this company shares with the others a particular dividend as a condition of buying a particular share. (art 91 of LEAA 2010).

[24] Limited partnership by share is similar to the Limited partnership company but the capital of the company is divided between the partners as shares (art 261 of LEAA 2010).

[25] A Limited Liability Company is formed by two or more persons, but not more than 25 persons, each of which is liable only to the extent of his contribution to capital. (art 271 of LEAA).

into equal and transferable shares and in which the shareholders are liable for company debts only to the extent of the value of their shares'. LEAA 2010 (arts 101-118) explains the processes and procedures necessary for establishing a JSC. According to LEAA 2010 art 99, a JSC can be established through one of the following mechanisms: (1) a decision made by the board of directors of a holding company; (2) an agreement between two or more JSCs; (3) an agreement between individuals or entities or both in which the portion of shares is determined by a resolution of the Cabinet; and (4) a decision issued by the a competent public authority in regard to state owned companies.

The LEAA 2010 also stipulates that the capital of a JSC shall not be less than the amount determined by a resolution of the Cabinet[26] which is currently LD 100,000[27] in accordance with resolution No 186 of the Libyan Cabinet, 2012. [28] The founders of the company must be at least 10 persons, except in cases when a JSC is established by a board of directors' decision of a holding company or another JSC.[29] The procedure to establish a JSC can remain open for a maximum period of 30 days and subscription of shares normally takes place through one or more of the approved banks.[30] However, if a JSCs capital exceeds LD 5 million, subscription of the original issue of corporate shares must take place through the Libyan Stock Market.[31] To ensure the integrity of the founders, LEAA 2010 requires the founders to deposit at least 30% of the value of the subscribed shares at any Libyan bank.[32] When the subscription operation has finished, the founder, within 20 days, must serve an announcement to the subscribers to attend the constituent meeting[33] at which the board of directors and the internal auditors are elected.[34]

[26] LEAA 2010, art 107.
[27] Approximately £45,000.
[28] See Libyan Cabinet Resolution No. 186 for 2012, s 1.
[29] ibid, s 3.
[30] LEAA 2010, art108.
[31] Libyan Cabinet Resolution No. 186 for 2012, s 4.
[32] LEAA 2010, art 108.
[33] ibid.
[34] LEAA 2010, art 109.

1.1.3. Overview of Libyan corporate governance in JSCs

In Libya, corporate governance rules are distributed across the strata of law described at the beginning of the chapter. Within the first category, there are two applicable Acts: LEAA No. 23/2010 and the Libyan Stock Market Act No. 10 /2010. In the second category are executive regulations (*Laeha*), which are issued either by the Cabinet of Libyan ministries or the Libyan Ministry of Economy. These include, amongst others, the Executive Regulation (Code) of corporate governance (known as the Regulation of Rational (or wise) management), Disclosure Executive Regulation, and so on. In the last category are executive decisions, such as Economic Minister Decision No. 103/2012 Concerning Foreign Ownership of Libyan corporations, Economic Minister Decision No. 86/2012 concerning corporate affairs, and so forth.

Here the study will provide some brief details concerning how corporate governance in Libya works within this stratified legal system. Particularly, it will provide a short description concerning the roles of both shareholders at general meetings (1.1.3.1) and the board of directors (1.1.3.2).

1.1.3.1. Shareholders and the general meeting of the JSC [35]

In a JSC, shareholders hold two types of meetings: [36] ordinary meetings, which must be held on a regular annual basis and should take place at least once a year within the first four months of the business organisation's fiscal year,[37] and extraordinary meetings that can be held at any time.[38] The board of directors can call a general meeting [39] and shareholders who hold 10% of the company's capital have a right to call a meeting of shareholders.[40] Furthermore, to provide more opportunities to shareholders to participate in

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[35] Provisions relating to the shareholders and their meetings are set down in Ch. 2, Branch. 2 of LEAA 2010 (arts 153-171).
[36] LEAA 2010, art 153.
[37] LEAA 2010, art 163 (b).
[38] LEAA 2010, art 167.
[39] LEAA 2010, art 154.
[40] LEAA2010, art 155.

the company's decision making processes, LEAA 2010 allows shareholders the right to represent others on their behalf in the general meeting.[41]

Within the context of general meetings, art 163 of LEAA 2010 requires of shareholders certain mandatory duties. The shareholders in general meetings are 'exclusively responsible'[42] for the appointment of board members and an external auditor and determining their remuneration. They are also responsible for ratifying financial statements, ratifying the board's declaration of dividends, reviewing and making decisions regarding all affairs concerning the company, looking at any issues that the board of directors may present, and discussing reports of the board of directors, the watchdog committee and/or the external auditors. In order for the resolutions of shareholders in ordinary general meetings to be valid, shareholders representing at least half of the company's shares are required to attend the meeting with a majority of the shareholders present voting in favour of the resolution.[43]

In extraordinary meetings, the shareholders are 'exclusively responsible'[44] for amendments to the constitution of the company, issuing bonds, hiring a liquidator for the company and determining their powers, and approving the board of directors action to sell more than a half of the company's assets.[45] In addition, shareholders at extraordinary meeting are responsible for deciding capital increases, capital reductions or share buybacks.[46] The approval of shareholders at an extraordinary meeting is required for central transactions such as mergers, divisions, changes of form and voluntary dissolution of the company.[47] In order to take place, an extraordinary general meeting requires the presence of shareholders representing at least three-quarters of the company's capital and

[41] LEAA 2010, art 158.
[42] LEAA 2010, art 163.
[43] LEAA 2010, art 164.
[44] LEAA 2010, art 167.
[45] LEAA 2010, art 167.
[46] LEAA 2010, arts151 and 141.
[47] See LEAA 2010, art 31 (dissolution), art 301(merger). For more information about the power of the shareholders in an extraordinary general meeting, see subsections (4.4.1.1), (4.4.2.1) and (4.4.3.1).

the enactment of shareholders resolution requires an approval of more than half of the attendees.[48]

In terms of shareholders' rights, it is worth mentioning that the Libyan Stock Market Act No. 10/2010 does not include any provision regarding the shareholders or even the board of directors (except in relation to disclosure issues).[49] However, the Libyan Corporate Governance Code (LCGC)[50] articulates the rights of shareholders in listed companies to ensure that such companies adhere to the best practices of shareholder protection.[51] According to LCGC, the shareholders have certain core rights. Specifically, they have the right to attend general meetings,[52] the right to vote,[53] the right to a share of the distributed profits,[54]and the right to a share of the company's assets upon liquidation.[55] Further, shareholders have the right to participate in the company's deliberations and vote on resolutions, the right to dispose of shares, the right to monitor the management and sue the board of directors, the right of inquiry and the right to request information that does not compromise the interests of the company and is consistent with the market system and the company's implementing regulations.[56] It should be noted that although some of the previous rights are also set out in LEAA 2010 (e.g. the right to attend the general meetings and to vote (art. 154), the right to participate in decisions concerning fundamental corporate changes (art. 167), and the right to sue (arts. 160-161)), most of the provisions

[48] LEAA 2010, art 168.
[49] Libyan Stock Market Act No. 10/2010 includes 8 chapters that cover the following areas: Capital Market Authority (Ch.1, arts 8-15), Issuing Securities (Ch.2, arts 16-24), Company of Stock Market (Ch.3, arts 25-31), Organisations Listed in the Market (Ch.4, arts 32-46), Investment Funds (Ch.5, arts 47-55), Settlement of Disputes (Ch.6, arts 57-61), Sanctions (Ch.7, arts 62-67), and General Provisions (Ch.8, arts 68-100).
[50] LCGC is an Exacutive Regulation (*Laeha*) issued by the Authority of the Stock Market. According to Libyan Stock Market Act, art 4 (10), the Authority of the Stock Market has the power to enact corporate governance rules for listed companies.
[51] Libyan Corporate Governance Code (LCGC) 2007, art 2 (a). The rules of LCGC 2007 are not mandatory and not applicable to non-listed corporations. See LCGC 2007, art 2 (b).
[52] LCGC 2007, art 5.
[53] LCGC 2007, art 6.
[54] LCGC 2007, art 7.
[55] LCGC 2007, art 3.
[56] LCGC 2007, art 3.

set out in LCGC 2007 contain additional provisions and clauses concerning best practice that are not present in LEAA 2010.

1.1.3.2. The Board of Directors

In Libya, the board of directors is based on the unitary board model.[57] It is responsible for managing the company in line with its interests[58] through taking decision that achieve the company's purpose.[59] The term of the board, as a default rule, is three years, although this is renewable for an unlimited number of times.[60] Additionally, though the LEAA 2010 does not specify the size of a company's board but leaves this decision to the shareholders, the LCGC 2007 recommends that the number of directors should be between three and eleven with a majority of non-executives.[61] Moreover, the law bans anyone (either personally or on behalf of another) from sitting on the board of more than three JSCs.[62]

Regarding the remuneration of the directors, art 183 of LEAA 2010 empowers the shareholders to monitor remuneration. The board must provide a report for the shareholders at least one week before the general meeting that must include: (1), a full statement of the board's remuneration during the financial year and any salaries or any other compensation that have been given to the board. Similarly, the statement must include any remuneration that has been given to board members in their work as employees or executives in the company or for any services or consultations they provided. (2) A full statement of the board's remuneration during the financial year in the form of

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[57] Some European states adopt a two –tier board structure. For example, in Germany, Netherlands and Denmark firms have a management board that runs the business and a supervisory board that appoints and supervises the management board. In France, a firm can choose between having a one tier or two tier board structure but most choose the one-tier board. See Stephen W. Mayson, Derek French and Christopher L. Ryan, *Company Law* (21th edn, Oxford University Press 2004) 458.

[58] See LEAA 2010, arts 172 and 182. According to LCGC 2007, the functions of the board of directors must include the adoption of a strategic direction and key objectives of the company, and oversee their implementation. The board must also set systems of internal control and supervision, establish a governance system, set clear and specific policies, standards and procedures of board membership, and put them into effect after approval by the general meeting. Finally, they must issue a written policy governing the relationship with stakeholders for their protection and preservation of their rights. (See art 10 of LCGC).

[59] LEAA 2010, art 172 (b).

[60] LEAA 2010, art 174 (a).

[61] LCGC 2007, art 12 (a) and (c).

[62] LEAA 2010, art 175.

cars, houses, etc. (3) A full statement of any remuneration or percentage of net profit that the board of directors suggests should be distributed to its members and a full statement of any remuneration that has been provided to current or former members such as salary or any remuneration. (4) A list of donations with a full statement of all donors.[63]

In regard to the duties of the board directors, the LEAA 2010 limits its requirements on the directors to a single sentence.[64] Art 182 entitled "duties of the board of directors" states that 'a chairman and members of the board shall undertake their duties as stated by the constitution of the company and as required by legal rules of agency.' [65] In a separate article, the LEAA 2010 does set down that the board of directors must not enter into conflict transactions that may occur in one of two circumstances.[66] The first is when a director wants to independently enter into a transaction to which the company is a party. Here the general principle is to ensure that the director avoids becoming involved in any conflict with the company, unless he gains the shareholders' approval. The second is when there is an interest in a particular transaction 'for a director or his relatives or his agent or his principal [67] that is in conflict with the company's interests. Here he must disclose the conflict to the board of directors of the company at a board meeting or a watchdog committee and also stop participating in the negotiation of the transaction. The breach of this rule results in the director being held responsible for any losses resulting from the transaction. However, despite the fact that these two circumstances are accounted for, LEAA 2010 does not cover other significant areas that may also result in a conflict, such as when a director (or other senior management), as a result of his position, takes a business opportunity that by right is the reserve of the company.

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[63] LEAA 2010, art 183.
[64] In the UK, there is a full chapter which sets down the duties of the directors (See CA 2006 part. 10 Ch. 2 ss 170-181).
[65] Provisions of agency are covered in Ch. 3 of the Libyan Civil Code (arts 699-717). For example, according to s 704 of the Civil Code, a wrongdoing director bears responsibility when a reasonable person would think that the conduct in question was wrong (this referred to as the Test of a Reasonable Person). Also, the agent must not take a personal interest while he is using the assets of his principal (Civil Code, s 706).
[66] LEAA 2010, art 181.
[67] ibid.

1.2. The Libyan transition economy

As corporate law development cannot be studied without reference to the economic and political ideas that have influenced it, here the study provides a brief introduction to the economic development of Libya in order to effectively analyse the current situation of Libyan corporate governance. To that end, this section discusses the pre-transition economy in Libya (1.2.1) and analyses what steps Libya has taken towards achieving a sophisticated market economy (1.2.2).

1.2.1. Pre-transition economy in Libya (1970s-1990s)

Libya became an independent country on 24 December 1951. During the period from independence to the establishment of the Qaddafi's regime in 1969, the Libyan economic system was mostly capitalist. [68] As such, private ownership existed with minimum governmental intervention. In the early of 1970s, a new political, administrative and legislative system was introduced that established a socialist state. This resulted in nationalizing the foreign companies that were operating in Libya, [69] restructuring the economy with regard to the new socialist principles through establishing public-owned companies and eliminating private and foreign companies. [70] The 2006 International Monetary Fund Report describes the situation in the following terms: 'in the early 1970s, Libya opted for a command economy with essentially state-driven investment, a strictly

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[68] It should be noted that Libyan economic development was extremely bleak until 1959 when it first discovered oil, and economic prospects changed dramatically. See M. Bait El-Mal, C. Smith and M. Taylor, 'The Development of Accounting in Libya' (1973) 8 The International Journal of Accounting, Education and Research 83, 84.

[69] A numbers of laws were enacted in this regard. For example, Law No 80/1970 Concerning Nationalizing Insurance Companies and Law No15/ 1970 Concerning Nationalizing the foreign portion of Banks Operating in Libya. By these laws and others, the government nationalized Roma Bank (after nationalisation: *AL Oma* Bank), Barclays Bank (*Al jomhoria* Bank) and Napoli Bank (*Al Estekllal* Bank).

[70] For example, see Law No 86/ 1975 Concerning Organising the Automobile Trade (distribution and spare parts, restricted to six state-owned companies, later merged into just two companies); Law No 4 of 1978 Concerning Specifying Certain Provisions for Real Estate Ownership (according to this law, no one can own more than one property for the purpose of investment); Law No 31 of 1970, Concerning Insurance Companies (the aim of this law was to keep insurance companies under state control); Law No.87/1975 Concerning Regulating Commercial Agencies (the aim of the law was to limit Commercial agencies within state-owned companies); Cabinet Resolution No 11/1979 (which limited the import of consumer goods to public companies). Cabinet Resolution No 125/1979 Concerning National Market Company (limited providing Libyans for goods retail).

controlled external trade, widespread price controls and subsidies, and an almost nonexistent private sector'.[71] According to Vandewalle, the state ownership structure in Libya started in the early 1970s, gained momentum in the mid-1970s and reached its peak in the 1980s, [72] by which time businesses such as manufacturing, foreign and domestic retail and banking and insurance services were all directly owned by the State. [73]

However, during the late 1980s, the Libyan economy saw various important economic developments. Perhaps the most significant of these developments occurred when Libya adopted the first privatisation programme and a policy of openness. The new privatisation policy was adopted by the Resolution of the Libyan Cabinet No. 447/1987 concerning the transfer of ownership of government. The policy was the first step in the Libyan government's privatisation programme, which consisted of transferring the ownership of public sector companies from the state to employees working for those companies, with the intention of enlarging the companies' ownership base. From the perspective of the state, the goal of this measure was to reduce public expenditure by promoting private investor initiatives in various sectors. Economic liberalization was further encouraged in 1988 by the issuing of law No 8 /1988 which allowed private business to operate in the retail trade and small-scale industries.

During the period of the planned economy of the 1970s and early 1980s, the Libyan government focused on diversifying productivity across the industrial sector. This resulted in an increase in the numbers of industrial enterprises[74] which, by the end of the 1980s

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[71] International Monetary Fund-IMF, *The Socialist People's Libyan Arab Jamahiriya: Selected Issue—Medium-Term Economic Reform Strategy, and Statistical Appendix* (IMF Country Report No 06/137, 2006) 3.

[72] For example, in this period, the Libyan legislature issued Law No 8/1983 Concerning Commercial Actions that prohibited any individuals from entering into commercial actions and Brokerage actions; during this period the Government issued some cabinet regulations to dominate and control the distribution of clothes, cloth, shoes, hardware and building materials (28/3/1981), meat trades (30/4/1981) and grocery businesses (31/8/1981).

[73] Dirk J. Vandewalle, *Libya since Independence: Oil and State-Building* (Cornell University Press 1998) 84ff.

[74] Assonosy AL Besecry, *Documents in the Libyan Economy: Evaluating the Libyan Economy (1973-2007)* (Maktabet ALwahba 2008) 125 (in Arabic).

suffered substantial losses as a result of, amongst other things, the monopoly policy employed by the government, underperformance of the management of stated owned companies and irrational changes of corporate policies that resulted from haphazard changes in the management.[75] As a result, since the early 1990s, all economic policies adopted by the government have attempted to address these issues.[76]

During the 1990s the Libyan state began to adopt new *macro-economic* reforms that provided greater liberalization of economic activities to help the country reduce the pressure on the government's general budget, which was suffering from a combination of losses by state-owned companies and the global decline in oil prices.[77] Consequently, as Alqadhafi notes, '[s]ome kind of limited economic openness took place during the period from 1990-1999, as the private activities were allowed to participate in certain fields such as trade and some light industries and fishing, etc'.[78] In the early 1990s the Libyan Legislature passed a number of new laws aimed at improving economic development. For example, Privatisation Law No 2/ 1992 Concerning Economic Activities, which permits the sale of state property to non-governmental Libyan interests. Also, Law No 9/1992, which encourages and regulates private sector activities in the national economy, and opens the door to the privatisation of a number of public sector enterprises. Further, Banking Law No. 1/1993 concerning banks and credit finance, which replaced the banking law of 1963, permits the establishment of commercial banks owned by the private sector. It also permits foreign banks to establish their representative agencies and offices in Libya and allows foreigners to acquire and maintain bank accounts in a foreign currency.

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[75] For more details about these factors see ibid 125-8.

[76] In fact, not only Libya adopted a reform policy during the period of 1990s, but also all Middle East and North Africa (MENA) countries - in particular Egypt, Tunisia, Jordan and Saudi Arabia began similar reform programmes aimed at achieving the stabilisation of their economies. See Susan Creane and others, 'Financial Sector Development in the Middle East and North Africa' IMF Working Paper, WP/04/201 <http://faculty.som.yale.edu/mushfiqmobarak/papers/financial%20sector%20development.pdf> accessed 28-08-2014.

[77] The price of a barrel of oil was $36 in 1980; it declined to $12.5 in 1998. See Yones Al Barakthy, *The Effect of Financial and Commercial Policies in the Performance of Libyan Economy* (Jamia Kanat Al Swis 2006) 7 (in Arabic).

[78] Saif-Aleslam M. Alqadhafi, *Libya and the XXI Century* (Editar Spa 2002) 22.

The second stage of economic reform started in the late 1990s after UN sanctions[79] were imposed. These reforms were aimed at decentralizing the Libyan economy by minimising the size and role of the public sector and giving the private sector a leading role in a market-based economy. In this period, Law 5/ 1997 Concerning Foreign Capital Investment, provided the Libyan Central Bank with the authority to issue licenses to foreign banks and free the interest rates on deposits, and this is maintained in Libyan Banking Law No. 1/2005. This policy led to the re-structuring of commercial banks owned by the government and transformed them into corporate organisations.

The changes that occurred in 1990s can be attributed to two main reasons: firstly, the Libyan economy declined due to the decrease in oil prices and the enforcing of international sanctions by the UN.[80] The 2006 IMF report states that '[e]conomic conditions started [in Libya] to deteriorate in the mid-1980s with the fall in world oil prices, and worsened in the 1990s as a result of international sanctions.'[81] The decline of the oil price resulted in cash flow problems and had negative consequences for the Libyan economy (e.g. the decline in total exports and the currency of Libya).[82] Second, the poor performance of publicly owned companies, resulting from socialist policies, created general apathy toward state-owned assets because of a general lack of monitoring by the state.[83] This situation forced Libya to relax controls on the non-state sector.

The dominance of the public sector in the Libyan economy over such a prolonged period resulted in a number of negative consequences, such as market deterioration and a

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[79] In1992, the UN Security Council adopted Resolution no.731 and 748 which imposed a ban on civil aviation. In1993, the UN Security Council tightened the sanctions against Libya with Resolution no.883.

[80] IMF, 'The Socialist People's Libyan Arab Jamahiriya: Selected Issue— Medium-Term Economic Reform Strategy, and Statistical Appendix' (n 71) 5; Besecry (n 74) 136.

[81] IMF, 'The Socialist People's Libyan Arab Jamahiriya: Selected Issue— Medium-Term Economic Reform Strategy, and Statistical Appendix' (n 71) 8. At the start of the 1980s Libya faced economic problems resulting from the reduction in oil prices and the fact that the US stopped importing oil from Libya which had previously constituted 40% of Libyan oil exports. See Salah Abidah, 'The Libyan Economy: Historical Perspective' (2005) 3 Journal of Economy and Trade 23 (in Arabic).

[82] N Baryun, 'The Impact of The Main Factors on the Value of Libyan Currency' (Conference of the Exchange of the Libyan Currency, Benghazi, Libya, 1993) (in Arabic).

[83] See (2.3.2.2.) 83.

decrease in its growth generally. This, in turn, contributed to the lowering of standards of living for individuals, the weakening of total economic conditions and the increase of external threats to the economy. [84] Further, the public budget, which relied substantially on oil revenues, was a key financier of most economic activities in Libya which resulted in the central employer of labour force becoming the public sector. Additionally, there was little correlation between the value of the massive state investment and companies' returns. The public sector struggled to achieve the minimum objectives of investment since it suffered too many substantial losses.[85] To explore this slightly further: Futaisi suggests that public sector enterprises suffer as a result of state ownership in three significant ways: [86](1) public sector enterprises depended mainly on public resources to fund investments, causing inflation in asset size and inefficiency in investment; (2) weakness in marketing capabilities of most public companies lead to the accumulation of commodity stocks and lack of liquidity; (3) managerial issues result from the dominance of the public sector, such as poor management and low levels of training of company employees. This can result in such negative consequences as increased costs, low profits, a lack of competitiveness, an inability to renew assets, and weak capacity and productivity.

In addition, the performance of State Owned Enterprises (SOEs) was below the desired level. According to the 1999 study by the Ministry of Planning and Finance in regard to the value, performance and productivity of SOEs, there was a 50% loss of capital in SOEs in engineering and metal industries, an 89% loss of capital in the food industry made by SOEs, and a 100% loss of capital in SOEs in the industry of construction

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[84] Michael E. Porter and Daniel Yergin, ' National Economic Strategy: An Assessment of the Competitiveness of the Libyan Arab Jamahiriya' General Planning Council of Libya,Tripoli 2006 <http://www.isc.hbs.edu/pdf/2006-0127_Libya_NES_report.pdf> accessed 9/12/2012.11-2; IMF, 'The Socialist People's Libyan Arab Jamahiriya: Selected Issue— Medium-Term Economic Reform Strategy, and Statistical Appendix', (n 71) 3.

[85] A Tapoli, 'The Transition from Public Sector to Private Sector and the Productive Efficiency' (Conference of Privatization in the Libyan economy, organised by Garyounis University on 19th and 20th of June 2004, Benghazi, Libya) (in Arabic) cited in Shernanna (n 5) 2.

[86] M. Futaisi, 'Privatization and International Conditionality ' (The Annual Cultural Season, organised by International Centre for Studies and Research on 10th October 2005, Tripoli, Libya)cited in Shernanna (n 5) 94.

materials.[87] Since SOEs dramatically failed to achieve satisfactory results and failed to contribute to the process of economic and social development, there was a need to move toward a market economy by enhancing the private sector and adopting an economic reform policy; as mentioned, this process began in the 2000s.

1.2.2. The move towards a market economy

Following twenty years of political chaos[88] and nearly three decades of economic central planning control, the move towards a market economy in Libya began in the early 2000s with the adoption of an economic reform programme and the launch of privatisation. Having failed to effectively instigate and regulate the privatisation programme of the late 1980s and 1990s,[89] the government recognised the need to establish an independent and autonomous privatization board. As a result, in 2000, the first organisation for supporting the privatization programme was established by Decision No. 198/ 2000 under the name of the General Board of Ownership Transfer (GBOT). [90] The board was a sovereign, independent state body that occupied a position similar to that of other ministries, which put it under the direct supervision of the Libyan Legislature. In 2003,[91] the first *Laeha* in relation to the privatisation programme (No. 31 of 2003) was issued which included the responsibilities of the GBOT. According to this resolution, listed among the duties of the GBOT, is the responsibility to perform initial studies into companies targeted for privatization, list the company's surplus assets, estimate their value according to normal

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[87] General People's Committee for Planning and Finance, 'Observations on the Economic Reality and Economic Policies ' (General People's Committee of Planning and Finance, Tripoli, 1999) (in Arabic).

[88] The US, in 1982, declared an embargo of the Libyan economy that was extended in 1986. In June 1986 the US government banned exports to third nations of goods and technology destined for use in the Libyan oil industry. In the 1990s the disagreement between Libya and the US increased after Pan Am flight 103 exploded over Lockerbie in Scotland. In April 1992, Resolution no.731 and 748 were adopted by the UN Security Council; these imposed a ban on civil aviation, a worldwide embargo on arms purchases and a reduction in Libyan diplomatic missions abroad. These sanctions were tightened in November 1993, with the adoption of Resolution no.883. For more information about this, see Luis Martinez, *The Libyan Paradox* (C. Hurst and Co 2007) 1-39.

[89] See (2.1.2) 53ff.

[90] The name of the General Board of Ownership Transfer was changed by Decision No. 364/2012 to the Public Institution for Investment and Privatization (PIIP).

[91] In June of 2003, Gadhafi admitted that the country's public sector had failed and should be eliminated, and called for the privatization of the country's oil sector. See Dirk Vandewalle, *A History of Modern Libya* (Cambridge University Press 2012) 184.

financial practices, and present these findings to the government. The GBOT is also tasked with following up on the consequence of privatisation in the target companies, and for arranging for payment for privatization to be made to a special account opened for that purpose. In the same year, the government issued Resolution No. 92 of 2003, amended by Resolution No. 64 of 2004. This resolution established the Higher Committee for Administrating the Programme of Transformation of Property and detailed its responsibilities, which include implementing the privatisation strategy and determining which SOEs should be privatized. The last piece of legislation is *Laeha* No. 118 of 2007, which provides comprehensive provisions concerning the evaluation of the target companies and the methods of transferring ownership.

In 2004, in a step to stimulate the private sector and make the business environment more attractive to investors, the Libyan government declared its aim to transfer ownership of 360 enterprises to the private sector in just 4 years.[92] The duration of the programme was extended under Cabinet Resolution No 99/ 2005, until 2015, and data available in the report of the Privatisation Agency (Public Institution for Investment and Privatization-PIIP) indicates that, as of 2012, only 115 companies have been privatised through various methods.[93]

In order to provide funding for economic activities, the state realised that reform of the banking sector was essential in order to increase the role of the private sector, shift the economic burden off the state and diversify sources of income in the Libyan economy.[94] Consequently, in 2002 the Central Bank of Libya adopted a new monetary policy to liberalise and reform the banking sector. The most important objective of this policy was to encourage the entry of foreign banks into Libya.[95] The government started to privatise

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[92] See Public Institution for Investment and Privatization-PIIP, *Report of Public Institution of Investment and Privatisation (2012)* (PIIP, 2012) 2 (in Arabic).
[93] ibid.
[94] Libyan Central Bank-LCB, *Executive Position for Monetary and Banking Policy During the Period 2002 - 2010* (Central Bank of Libya, Tripoli, 2010) (in Arabic).
[95] ibid.

these banks in 2007 when the government sold 19% of shares in Sahara Bank to BNP Paribas and delegated management rights to the foreign bank. Further, the government allowed BNP Paribas to buy additional shares of up to 51% within 5 years.[96] In 2008, the government sold the Wahda Bank to the Arab Bank of Jorden. In 2010, the Central Bank of Libya offered 15% of shares of both the Gumhouria Bank and the National Commercial Bank on the Libyan stock market.[97] In the context of the policy of financial reform, it is worth mentioning that recently Islamic banking is allowed by Law No. 46 of 2012 Concerning Banks and Islamic Banking, which amended the Law No. 1 of 2005 Concerning Banks.

Within the context of the transition from socialist oriented policies toward a free-market economy,[98] it was necessary to take appropriate measures to reform the financial sector by establishing a stock market. Accordingly, in 2006 the Libyan Stock Market was established by Cabinet Resolution No.134/ 2006 in the form of a joint stock company and was controlled by the Ministry of Economy until 2007. However, in July 2008 control of the Libyan stock market passed to the Social Economic Development Fund which includes about 47 companies from various sectors of the Libyan Economy. The market is regulated by several laws including: (1) Law No.11 of 2010 Concerning the Libyan Stock Market, which sets down several provisions relating to the management of the Market, the issuance process of securities, the activity of the Market and its entities, investment funds and the settlement of disputes; (2) *Laeha* of Trading Operations which sets forth shares trade; (3) *Laeha* of Listing and Disclosure that details provisions relating to conditions of listing and

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[96] International Monetary Fund-IMF, *Socialist People's Libyan Arab Jamahiriya: 2008 Article IV Consultation-Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Socialist People's Libyan Arab Jamahiriya* (IMF Country Report No 08/302, 2008) 7.

[97] Central Bank of Libya (CBL),'Executive Position for Monetary and Banking Policy During the Period 2002 - 2010' (n 94); International Monetary Fund, 'Socialist People's Libyan Arab Jamahiriya: 2008 (n 96). According to Oxford Business Group, 'following the positive Al Sahari Bank and Wahda bank privatizations, the Central Bank of Libya announced that two more wholly state-owned commercial banks will be privatized in initial public offerings (IPOs) on the Libyan stock market in 2009'. *See* .Oxford Business Group-OBG, *The Report: Libya 2008* (2008) 52.

[98] Otman and Karlberg (n 10) 132.

delisting, national and foreign securities in the Market and disclosure provisions; (4) *Laeha* of Investment Funds; (5) *Laeha* of Shares; (6) *Laeha* of Non-Resident Investors; and (7) *Laeha* of Corporate governance.

In short, following the change from capitalism to socialism in 1969, which resulted in a planned economy until the late 1990s, the government took control of both the production and services sectors. However, in the early of 2000s, there was a marked trend towards a free market policy that represented a move towards a new corporate system in Libya and a desire to rectify the accumulated economic problems and difficulties that occurred as a result of the socialist era. During this time the state adopted various economic reform measures (e.g. restructuring of banking rules, a privatisation programme, and establishing a stock market) which have had a profound effect on corporate governance in Libya, as discussed below.

1.3. Institutions of corporate governance in Libya's transition economy

Having established in the previous section that Libya is moving toward a free market economy, this section examines the institutions of corporate governance in Libya and analyses the extent to which those institutions influence governance and the dynamics of governance in the transition process in Libya. In order to explicate this, there is a need to understand the stages (bureaucratic stage, relationships stage, and market stage) that any transition economy goes through in order to achieve a market economy (1.3.1). Following which, I go on to examine the institutions of corporate governance in Libya and determine which stage Libya has achieved (1.3.2).

1.3.1. The stages of transition economies

There are three recognized stages that a transition economy takes when transforming into a market economy.[99] The first stage is known as the Bureaucratic Stage. This comes directly after the end of a planned economic system and therefore is characterized by hierarchical

[99] See (n 7).

and bureaucratic structures and controls associated with state administrative power.[100] At this stage, the state and its agencies, such as banks, state property agencies, and investment funds, directly control firms still using bureaucratic regulations.[101] The Bureaucratic Stage is largely influenced by the characteristics and constraints of the former centrally planned system, such as state control, state ownership, favourable contacts with the state, managerial risk aversion, and rule avoidance.[102] Thus, in this stage the dominant sources of control power and resources that affect a firm are still likely to be the state. However, during the transition, the state attempts to dismantle the formal constraints of the central paling regime and adopt the formal constraints of a market-based economy.[103]

The second stage is a Networks (or a Relationship) Stage where the dominant sources of control power and resources are associated with networks and relationships. [104] This stage is considered as an intermediate stage since there are still several steps required to move from the Bureaucratic stage to a market economy.[105] This phase develops gradually (since transition states are expected to develop a market institutional framework and abandon bureaucratic control over time) as the institutional framework that supports bureaucratic control weakens. [106] In fact, this stage is made possible by the increasing weakness of state bureaucratic control and the absence of practical formal rules or third-party enforcement. Together, these factors lead shareholders to create their own control power or seek control power from networks and relationships in

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[100] Le, Kroll and Walters(n 7) 162. See also, Max Boisot and John Child, 'The Iron Law of Fiefs: Bureaucratic Failure and the Problem of Governance in the Chinese Economic Reforms' (1988) 33 Administrative Science Quarterly 507.

[101] David Stark, 'Recombinant Property in East European Capitalism' (1996) 101 American Journal of Sociology 993, 1001. For more information relating to the role of the state and political power in this stage, see King (n 7) 4-6.

[102] Le, Kroll and Walters(n 7) 162.

[103] Michael W. Peng, *Business Strategies in Transition Economies* (Sage Publication, Inc 2000) 47.

[104] This stage is well documented in, for example, King (n 7) e.g. 6-7; McMillan and Woodruff (n 7); Peng Institutional Transitions and Strategic Choices (n 7). Also, I provide more details regarding this stage in (3.2.2).

[105] Boisot and Child (n 100) 511.

[106] See e.g. Oliver E Williamson, 'The Institutions and Governance of Economic Development and Reform ' <http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=477894&piPK=64165421&menuPK=64166093&entityID=000009265_3970716143826> accessed 28-08-2014.

order to protect their interests.[107] When a market's institutional framework is strong, it can effectively provide investors with the information and mechanisms that permit firms to trade with unknown parties (external investors).[108] This is not the case when there is a weakness in the institutional framework as companies rely on relationships with traditional customers, suppliers, and banks for resources rather than unknown parties. [109]

Market Economy is the final stage and it occurs when there is a perfect market institutional framework. Formal rules and state enforcement are more effective and can facilitate impersonal relationships between companies and external investors. Financial systems such as Stock markets and banks are more sophisticated since they can provide flawless services for firms and investors. [110] This stage derives from the fact that transaction-based relationships can lead to significant problems in the economy, such as inefficiency, corruption, social unfairness, and disorder. For that reason, the state and investors will be inclined to move toward a more sustainable legal system and formal enforcement mechanisms in order to deal with the deficiencies of transactions based relationships.[111] In this system, companies can obtain their sources from the market, and stakeholders will increasingly employ control power derived from the market instead of the state (as in a Bureaucratic Stage) or relationships (as in a Network Stage). [112]

1.3.2. The shift from the bureaucratic stage to the relationship stage and its effect on corporate governance: the current position of Libya

Despite the economic reform that has taken place so far, Libya is yet to achieve a minimum system of market economy. Instead, it is currently moving from a bureaucratic stage to a relationship stage. Such an early stage of transition necessarily has a significant

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[107] Le, Kroll and Walters (n 7) 166.
[108] McMillan and Woodruff (n 7) 2426 and 2429.
[109] For more information see (4.1.1.) 150ff.
[110] For detais, see Williamson (n 106).
[111] Daniel J. McCarthy and Sheila M. Puffer, 'Diamonds and rust on Russia's road to privatization' (1995) 30 The Columbia Journal of World Business 56; McMillan and Woodruff (n 7).
[112] Le, Kroll and Walters (n 7) 169.

influence on the development of corporate governance and its dynamics, which I discuss below.

1.3.2.1. Lack of viable formal institutions leading to a reliance on informal constraints

Moving toward a free economic market by a transition country requires two things: firstly, the weakening of the institutional frameworks that promote the state's bureaucratic control and administrative power over firms and, secondly, enhancing the institutional framework of a market economy. This can be done by enacting a number of new laws and altering or abolishing existing laws that do not align with the development of a free market economy.[113] As Lim *et al.* suggest: 'a decentralized market economy cannot function properly without a comprehensive system of commercial laws'.[114]

In Libya, in addition to the laws enacted by the state discussed in (1.2.2), by the end of 2010, the State had enacted significant pieces of legislation that were necessary for removing obstacles to market entry and facilitating the private sector's contribution to the economy. Specifically, the Libyan Legislative Authority passed a new commercial law that includes a set of provisions aimed at preventing monopolistic practices and helping to protect the consumer. In the same year there were a number of laws enacted related to Customs Law, Income Tax Law, Labour Law, Communications Law, Land Registry Law, and laws regulating the activities of the Libyan Investment Authority. Furthermore, despite the fact that the Libyan government began to privatise public sector companies at the end of 1980s, the competition law and Stock Market Law were only issued in 2010.[115] In 2011, following the revolution that toppled the regime of Colonel Muammar Gaddafi, the

[113] Burno Dallago and Ichiro Iwasaki, 'Introduction: Reasons for Focusing on Corporate governance to Understand Transition Economy ' in Burno Dallago and Ichiro Iwasaki (eds), *Corporate Governance Restructuring and Governance in Transition Economies* (Palgrave 2007) 1.
[114] Edwin Lim and others, *China: Long-Term Development Issues and Options: The Report of a Mission Sent to China by the World Bank* (1985) 10.
[115] In this regard, the legal system of competition in Libya is still weak. The government did not pay much attention to the establishment of independent agencies for the protection of the consumer and a competition council, which would monitor and enforce the new law provisions, has not yet been created.

Transitional National Council (the legislature Authority in 2011 and 2012) abolished certain laws that reflected socialist ideology, which had imposed restrictions on the private ownership of property. [116]

Despite these reforms, there remains a need in Libya to address the performance of the state's bureaucratic institutions, since it is acknowledged that such institutions play a crucial role in determining economic development.[117] In 2009, the IMF indicated that there is a need in Libya to improve the performance of the administrative system and regulatory framework in order to improve the business environment and progress economic, financial and accounting standards in line with international practices.[118] In June 2010, the Prime Minister, Shokri Ganem, acknowledged the problem, stating that 'Libyan bureaucracy is a complicated and slow acting because it is not as fast as the decision makers in Libya'.

Though corporate institutions in Libya are currently still effected by the poor standard of Libya's bureaucratic system, the institutional framework that supports the bureaucratic system will inevitably weaken as Libya continues to move towards a market economy. Examples of this institutional weakening are already evident in Libya, for instance, in order to facilitate the administrative procedures for the registration and issuing of licenses of private companies, Resolution No. 171 of 2006 on *Laeha* of Law No. 21 of 2001, as amended by Law No. 1 of 2004, facilitates both the establishment procedures and

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[116] For instance, Law No 38 in 1977 concerning real-estate ownership which set down that that ownership merely for possession purposes is prohibited. In addition, Law No. 4 of 1978 concerning real estate property stated that every adult citizen has the right to own a house as long as he resides therein. According to this Law, a citizen is not allowed to possess more than one house. It also gave any Libyan citizen who lives in a rented house the right to own it. Also, the new legislative authorities abolished Law No. 7 of 1986 concerning the abolition of land ownership deemed the land in Libya is not owned by anyone, and may not be the object of the actions of ownership transfer. In addition, the second article of this Law stipulates that every citizen has the right to possess land only in the case of use, be it in agriculture, grazing, or others, provided that he is exploiting only his own and his family's efforts. For more information see Habib Gaboda, 'Real Estate Property' (2012) 3 Tripoli University Law Journal 143 (in Arabic).

[117] See e.g. Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press 1990); Paolo Mauro, 'Corruption and Growth' (1995) 110 The Quarterly Journal of Economics 681; Stephen Knack and Philip Keefer, 'Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures' (1995) 7 Economics & Politics 207; Victor Nee and Sonja Opper, 'Bureaucracy and Financial Markets' (2009) 62 Kyklos 293.

[118] IMF, *Socialist People's Libyan Arab Jamahiriya: 2009 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Socialist People's Libyan Arab Jamahiriya* (IMF Country Report No 09/294, 2009) 15.

the granting of licenses for companies. It also established 51 offices in major Libyan cities in order to provide these services to investors. In addition, the Economy Ministry established a specialist programme called *One-step Window* through which every major city in Libya has an independent office (called one window office) [119] that can establish and register companies, oversee licensing offices, and help the private sector to engage in economic activity. The IMF noted that the One-step Window initiative facilitated the creation and establishment of companies and complimented its efficiency as investors only have to wait thirty days for approval of their request to establish companies.[120] In 2010, the Ministry of Economy issued Resolution No. 644, which indicates that license applications should be submitted to one of licensing offices in the cities directly, after which the license will be issued within just 8 hours.

Despite these significant changes in Libyan law that are aimed at establishing a viable market-supporting institutional framework, it is still very costly or even impossible for economic actors to conduct rule-based, impersonal exchange. Creane et al. found that most Middle East and North Africa (MENA) countries, of which Libya is one, have poor quality institutions, including the judicial system, bureaucracies, and property rights protection. [121] It should be noted that numerous developing and transition economies such as Libya have dysfunctional legal systems due to a lack of effective laws and enforcement mechanisms.[122] In other words, enforcement that is likely to enable unfamiliar parties to trade with each other[123] is still weak and is costly to develop. Formal rules such as those relating to minority protection, merger, takeover and competition are still undeveloped and

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[119] Public Institution for Investment and Privatization-PIIP, 'One-Step Window' (2013) <http://investinlibya.ly/index.php/ar/> accessed 20-11-2013.

[120] IMF, *The Socialist People's Libyan Arab Jamahiriya-2005 Article IV Consultation* (Country Report No 06/136, 2006).

[121] Creane and others (n 76).

[122] McMillan and Woodruff (n 7) 2421.

[123] Simon Johnson, John McMillan and Christopher Woodruff, 'Courts and Relational Contracts' (2002) 18 Journal of Law, Economics, and Organization 221.

are incapable of facilitating impersonal exchanges.[124] Moreover, certain laws and regulations still exist in Libya that are in line with socialist ideology and a planned economy, such as the pricing system of a very large number of goods.

Currently, therefore, notwithstanding legislative advancements, in the case of Libya informal institutions play a key role in shaping company behaviour,[125]where 'bilateral relationships, communal norms, trade associations, or market intermediaries […] work in place of the legal system'.[126] Accordingly, corporate governance in Libya can be characterised by the following features: Firstly, personal relations and family ties, as Agnaia indicates, play a key role in selecting managers in Libya instead of formal qualifications or experience. Accordingly, Libyan managers are concerned with establishing strong social networks.[127] To overcome the obstacles of a bureaucratic system, Libyan investors, as Ahmed claims, prefer to enter into a business contract with their family, friends, clans or tribes rather than investors that they do not know.[128] Accordingly, the competitiveness of various Libyan corporations is regularly 'built on personal networks which allows them to win contracts'.[129]

Furthermore, when the enforcement climate of courts and other institutions is weak, companies may choose to rely merely on internal funds or contributions from closely

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[124] See (2.3.1.2) 76-8.

[125] Verica Babic, *Corporate Governance Problems in Transition Economies* (2003) 11; See also, Roderick Martin, ' Politicized Managerial Capitalism: Enterprise Structures in Post-Socialist Central and Eastern Europe' (2002) 39 Journal of management studies 823; Michael N Young and others, 'Governing The Corporation In Emerging Economies: A Principal-Principal Perspective ' (2002) 2002 Academy of Management Proceedings E1; Peng (n 7) 292.

[126] McMillan and Woodruff (n 7) 2422. See also Peng, *Business Strategies in Transition Economies* 43 and 51ff.

[127] Almehdi A. Agnaia, 'Management Training and Development within its Environment: The Case of Libyan Industrial Companies' (1997) 21 Journal of European Industrial Training 117, 120. This is generally the case in Arab societies where management procedures are frequently influenced by personal connections, nepotism, sectarian and ideological affiliations. See Abbas J Ali, 'Management Theory in a Transitional Society: The Arab's Experience' (1990) 1990 (20) International Studies of Management & Organization 7.

[128] Zainab Abdussalam Ahmed, 'The Barriers to Effective Marketization of Corporate Equity in Libya' (PhD, Faculty of Business, Education and Professional Studies, University Of Gloucestershire 2009) 60.

[129] Porter and Yergin (n 84) 46.

related investors.[130] This possibility increases in the case of Libya because of the weak system of bank monitoring.[131] For instance, loans are regulated by personal relationship rules rather than corporate governance mechanisms and it has been identified that Libyan banks distribute loans to customers whom bank employees know personally.[132] As such, investors in Libya rely on a social relationship to borrow and this may reduce the cash flow which managers might misallocate and enhances the network's coordination and control over the firm. [133]

To protect the minority shareholders, it has been suggested that relational governance mechanisms can help stakeholders to use their control power to enforce, a multiple blockholders mechanism which can mitigate the majority-minority problem by deterring one of the blockholders from attempting to expropriate other shareholders' wealth.[134] Also, under such a system shareholders may create their own control power or seek control power from networks and relationships to protect their interests. Employees and minority shareholders who do not have sufficient power and protection are likely sell their positions to either managers or other powerful shareholders.[135]

1.3.2.2. Libya's undeveloped banking system and small, illiquid security market

The Libyan financial sector is divided into two parts: the banking system and financial and investment institutions. Whilst the banking sector is composed of the central bank, specialised banks and the commercial banks,[136] the other financial and investment

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[130] Erik Berglöf and Stijn Claessens, 'Corporate Governance and Enforcement' World Bank Policy Research Working Paper 3409, September 2004 <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3409> accessed 29-10-2013, 12.

[131] This is because the external finances provided by the banks represent only a small part of corporate financing and, as such, banks may not feel motivated to monitor clients effectively. Additionally, the banks are poor governance agents and have distorted incentives. See (2.3.2.2) 85-6.

[132] For more information see (2.3.2.2) 85-6.

[133] Dharwadkar, George and Brandes(n 6) 553.

[134] See (2.3.1.1).

[135] King (n 7) 6. For more information see (4.1.1) 151ff.

[136] Libyan Central Bank-LCB, *Report of Libyan Central Bank : 2010-2011* (Central Bank of Libya, 2012) 7. (in Arabic). This is the last report available online. See the Libyan Central Bank Website at http://cbl.gov.ly/ar/index.php?option=com_content&view=article&id=296&Itemid=175.

institutions consist of the insurance sector, the Social and Economic Development Fund, the Libyan Stock Market and three state-owned investment companies (Libyan Arab African Investment Company, National Investments Company, Libyan Arab Foreign Investment Company).[137]

The financial sector in Libya, like any transition country, is dominated by the banking sector[138] which, in turn, is dominated by four state-owned commercial banks.[139] However, it should be noted that the contribution of the banking sector in economic activities is still limited[140] since it offers low loan availability to the private sector, and the majority of commercial banks' assets are in short-term deposits or cash, though the banking system is characterized by high liquidity. [141]

The other financial institutions, such as the insurance sector and the social security fund, have a very narrow role and make a minor contribution to the Libyan economy.[142] Similarly, the Libyan Stock market is still very small and illiquid [143] (which is

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[137] Libyan Central Bank-LCB, *Libyan Central Bank Report: 2006* (Central Bank of Libya, 2006) (in Arabic).
[138] Fumikazo Sugiura, 'Economic Transformation and Corporate Finance in the Post-Communist World' in Bruno dallago and Ichiro Iwasaki (eds), *Corporate Restructuring and Governance in Transition Economies* (palgrave 2007) 44.
[139] Libyan Central Bank-LCB, *Report of Libyan Central Bank : 2010-2011* (n 136) 25; Patricia D Brenner, Amor Tahari and Marina Moretti, *Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries* (International Monetary Fund 2007) 125. Maghreb Countries are Libya, Tunisia, Morocco, Mauritania, and Algeria.
[140] Libyan Central Bank-LCB, *Report of Libyan Central Bank : 2010-2011* (n 137) 7.
[141] Brenner, Tahari and Moretti (n 139); LCB, *Report of Libyan Central Bank : 2010-2011* (n 136) 7.
[142] Libya's insurance industry is small with the ratio of premiums accounting for less than 1% of GDP. See LCB, *Libyan Central Bank Report: 2006* (n 138). In Addition, according to International Monetary Fund, the insurance sector 'is small and largely underdeveloped, with total market premium income at LD 190 million in 2006'. See IMF, *Socialist People's Libyan Arab Jamahiriya: 2008 Article IV Consultation-Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Socialist People's Libyan Arab Jamahiriya* (n 96) 7.
[143] According to the Libyan Stock Market (LSM) Annual Reports, in 2006, there were only three listed companies in the banking and insurance sectors, which increased to 6 in 2007. In 2008, there were 8 companies listed in the Market. Then, in 2009, the number of companies increased to 10 on the main list, and 14 on the sub-list of the market. In 2010, the number of listed companies increased to 12 on the main list and 13 on the sub-list of the market. In 2013, the companies decreased to 10 companies on the main list and 10 companies on the sub-list of the market. Regarding the liquidity of the LSM, in 2007, the number of shares for allotment was 4 million at 7 L.D per share. In the event, 3,365,327 shares were allotted. The total value of such transactions was 254 Milion D.L. In 2009, the trading volume increased to 6,166,718 shares and their value was almost 72 Million. See available reports of LSM available at <http://www.lsm.ly/Arabic/Media/Pages/PeriodicReports.aspx> (in Arabic).

the case with most transition economies in the early stages)[144] and has not reached an appropriate level of maturity to make a significant contribution to the Libyan economy. As Creane et al note, the financial system generally in Libya is still undeveloped and plays a limited role in the overall economy. They found that in comparison to other MENA countries in 2002/03, Libya had the lowest average of financial development index which includes the banking sector, nonbank financial sector, regulation and supervision, monetary sector and policy, financial openness, institutional environment.[145]

In addressing governance in small, illiquid security market and undeveloped banking system, there are two points that we should consider. First, the financial system determines, to a large extent, the mechanisms of corporate governance.[146] Second, Libya, as all transition countries, has a bank based system, in which banks, in theory, are supposed to play a leading role in mobilizing savings, allocating capital and overseeing the investment decisions of corporate managers.[147] Therefore, in a transition economy, the weakness of financial institutions and the poor enforcement of property rights results in strong insider control [148] and in the absence of significant outside investors or an institutional framework that supports corporate governance. Consequently, managers are unable to raise the capital needed for investments[149] or it is expensive to raise new capital.[150] Further, the monitoring cost for shareholders is higher than in that of market based system because the former cannot offer information which can substitute for

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[144] Sugiura (n 138) 43.
[145] Creane and others (n 22) 6.
[146] See e.g. John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change*, vol 15 (Cornell University Press 1983).
[147] Asli Demirgüç-Kunt and Ross Levine, 'Bank-Based and Market-Based Financial Systems: Cross-Country Comparisons' World Bank Policy Working Paper No 2143, 1999 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=569255> accessed 27-11-2013, 2.
[148] Erik Berglöf, 'Corporate Governance in Transition Economies: The Theory and Its Policy Implications' in Masahiko Aoki and Hyung Ki Kim (eds), *Corporate Governance in Transitional Economies* (The World Bank 1995) 47.
[149] ibid 45.
[150] Yingyi Qian, 'Reforming Corporate Governance and Finance in China' in Masahiko Aoki and Hyung Ki Kim (eds), *Corporate Governance in Transitional Economies* (The World Bank 1995) 151.

disclosure requirements.[151] Additionally, in a transition economy, the stock market plays a limited role in corporate control through takeovers or proxy fights due to illiquidity of the market, as detailed in Ch.4.[152]

Furthermore, banks have a monitoring capacity as a governance mechanism which requires complete disclosure from firms.[153] Though lacking monitoring capacity in the bureaucracy stage, state-owned banks can rely on state legitimacy to control managers, whereas in the relationships stage foreign and private banks are more capable of evaluating and monitoring borrowers.[154] However, despite a lack of data, it may be argued that, though banks are the main providers of external finance to Libyan companies and the relationships between banks and enterprises are naturally close,[155] the monitoring by banks in Libya is too weak. This is because the external sources represent only a small part of corporate financing and, as such, banks may not feel motivated to monitor clients effectively.[156]

1.3.2.3. Economic Structure

It should be noted that the privatisation programme, in Libya, is still not completed. So far only 115 SOEs out of 360 companies have been privatised as part of the government's programme.[157] Therefore, the debate has not shifted completely from traditional measures for the economic transformation (e.g. privatisation of state-owned companies) to how to shape the existing business firms into a market economy. In other words, despite the previous developments in the privatisation programme, this development is still insufficient because the vast majority of Libyan firms are still owned by the state. This, in

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[151] Steven Clark, Tao-Hsien King and Cinder Xinde Zhang, 'Idiosyncratic Risk, Governance and Equity Performance' (23rd Australasian Finance and Banking Conference, 2010).
[152] See (4.4.4.1) 192-3.
[153] Rahul Vashishtha, 'The Role of Bank Monitoring in Borrowers' Discretionary Disclosure: Evidence from Covenant Violations' Duke University, May 28, 2013 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2115637> accessed 24-11-2013.
[154] Dharwadkar, George and Brandes (n 6) 660.
[155] See (2.3.2.2) 85-8.
[156] Berglöf (n 131) 61.
[157] For more details see (2.1.2) 53.

turn, raises two problems that will be considered further in the next chapter. First, the dominance of concentrated ownership in Libya which, though it can prevent opportunistic managerial behaviour in the sense of using corporate control for their own benefit, allows blockholders to appropriate private benefit from the company at the expense of the minority shareholders. Second, since company ownership is concentrated in the hands of the State, this leads to a problem of corporate governance between the minority shareholders and the state as the controlling shareholder.

In short, Libya is still at an early stage of transition and this has had clear and significant effects on the development of corporate governance and its dynamics. This is due to a combination of factors, including an absence of adequate and effective institutional framework with appropriate laws that could enhance the institutional framework of a market economy and so weaken the state's bureaucratic framework. This situation has led to informal institutions, rather than formal institutions, playing a key role in shaping company behaviour in Libya.

Conclusion

Following the change from capitalism to socialism in 1969 and the adoption of a planned economy until the late 1990s, the government owned both the production and services sectors. However, in the early of 2000s, there was a marked trend towards a free market policy that represented a new corporate system in Libya which sought to rectify the accumulated economic problems and difficulties that occurred as a result of the socialist era. During this period, the state adopted various economic reform measures which, as discussed, have had a profound effect on corporate governance in Libya.

Although many positive measures and procedures were implemented, which established new institutions of corporate governance in Libya, many difficulties and challenges still face the new Libyan government in developing an economic and financial

environment in which a free market economy can operate. This situation, without doubt, affects the corporate governance system generally, as discussed in this chapter, and particularly the minority- majority shareholders relationship, as discussed in the following chapter.

This chapter argued that the Libyan economy is currently moving from a bureaucratic stage to a relationship stage which means that it is still in an early stage of transition. Firstly, this is because there is an absence of an adequate and effective formal institutional framework with appropriate laws that could enhance the institutional framework of a market economy and so weaken the state's bureaucratic framework. As mentioned, this has led to informal institutions playing a key role in shaping company behaviour in Libya, rather than formal institutions. Secondly, the weakness of financial institutions affects to a large extent the mechanisms of corporate governance in Libya which result in strong insider control and in the absence of significant outside investors. Also, since the stock market is still illiquid and small, it can only play a limited role in corporate control through takeovers or proxy fights. Finally, non-complication of privatisation programme affects corporate structure of the ownership in Libya. This, in turn, raises two problems, a majority-minority problem and the problem between minority shareholders and state-owned companies being controlling shareholders, both of which will be covered in depth in the following chapter.

Chapter 2: Defining the Issues: Dimensions of the Relationship between Concentrated Corporate Ownership and the Principal-Agent Problem

Introduction

The principal-agent problem is a central issue of comparative corporate governance research.[1] One of the major factors that influence the principal-agent problem is the nature of corporate ownership. When there is concentrated share ownership, the principal-agent problem takes the form of a conflict of interests between majority shareholders and minority shareholders. Conversely, when there is dispersed share ownership, the principal-agent problem takes the form of a conflict between the management and shareholders.

As discussed in the previous chapter, ownership structures in transition economies, such as Libya, are not well established and its transition to a market economy and a functioning capitalistic system is still in its infancy due to the lack of effective minority shareholder protection. The Libyan economy is dominated by controlling shareholders. In most cases it is the government who retain a large ownership position in many sectors of the economy and remain a significant owner of both public and large private commercial enterprises across several sectors.

Accordingly, the main corporate governance problem in Libya is the conflict of interests between minority and majority shareholders, which also constitutes one of the typical corporate governance problems within companies globally. This is in contrast to Anglo-Saxon corporations where conflicts result from the prevailing dispersed ownership structures. In this light, this thesis focusses on how to solve the majority-minority problem within the 'controlling shareholder' structure. To that end, through analysing the literature of corporate governance with regard to minority-majority shareholder issues and applying

[1] Traditionally, the literature of corporate governance has overwhelmingly focussed on the dispersed shareholders system which is common in the U.S and the UK, despite the fact that the controlling shareholder structure is the dominant system in the rest of the world.

it to the case of Libya,[2] this chapter determines the contours of the problem that will be addressed.

Defining the structures of ownership is crucial as different structures affect the nature of governance problems and thus the corresponding formulation of corporate governance strategies. In order to define the issue, section (2.1) begins by discussing structures of corporate ownership as described in literature (2.1.1) and manifested in Libya (2.1.2).

The following section, (2.2) outlines the relationship between the patterns of ownership and the nature of the principal-agent problem, which constitutes the fundamental rationale for this study. In this section, I explore the fact that in dispersed corporate ownership, the conflict of interests is between the shareholders as whole and the management. However, in concentrated ownership, the conflict exists between the majority shareholders and the minority shareholders.

Section (2.3) explores the issue of the conflict between the majority shareholders and the minority shareholders in theory and then its application in Libya (2.3.1). Additionally, as the state owns most of the public and large private equities in Libya, this section examines how this conflict is manifested when the state is a controlling shareholder (2.3.2).

2.1. Structures of corporate ownership

In order to locate the major issue that this thesis will address, I will begin by discussing structures of corporate ownership. These structures are considered by several commentators to be a highly significant element of the corporate governance system [3] as

[2] The literature on the principal-agent problem and corporate ownership is large. To summarize this disparate body of work in this chapter would be an insurmountable task. Therefore, the chapter instead will focus only on the most important points that serve our arguments.

[3] See e.g. Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) 52 Journal of Finance 737. It should be noted that Berle & Means identified ownership structure as a key issue in 1931.See

they influence the nature of governance problems and thus the formulation of corporate governance strategies.[4] Initially I briefly outline the two patterns of corporate ownership structure: the dispersed ownership structure and the concentrated ownership structure (2.2.1), following which, I examine the corporate ownership structure in Libya (2.2.2).

2.1.1. The patterns of corporate ownership: General discussion

Under CA 2006, there are three main types of companies: companies limited by shares, companies limited by guarantee and unlimited companies.[5] Also, as discussed in (1.1.2), LEAA 2010 sets down the three types of companies permitted in the State of Libya: (1) 'Persons Companies' which includes General Partnerships (*Tadamun* Company), Limited Partnerships (*Tawssiyah Bassita* Company), and Joint Ventures (*Mohassa* Company); (2) 'Funds Companies' include Joint Stock Companies (JSC) that are either private or state-owned companies; (3) Mixed Companies include Limited partnerships by shares (*Tawssiyah beashom* Company) and Limited Liability Companies by guarantee.[6] However, this research focuses solely on JSCs, both private and public, as they are the most common form of company in Libya and in the UK and, simply, because corporate governance largely focuses on JSCs.

Here it should be noted that JSCs in Libya is similar to limited Liability companies (by shares) in the UK. This is because both companies are limited liability companies. This means partners/members (i.e. either natural or artificial persons) are not responsible for the company's debt other than their contributions in the company's capital.[7] Also, both companies have transferable shares to either a member or a non-member of the company.

Aldolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (5th edn Transaction Publisher, 2005).

[4] See e.g. RafaelLa Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Corporate Ownership Around the World' (1999) 54 Journal of Finance 471; Lucian A Bebchuk and Assaf Hamdani, 'The Elusive Quest for Global Governance Standards' (2009) 157 University of Pennsylvania law review 1263; Brian L Connelly and others, 'Ownership as a Form of Corporate Governance' (2010) 47 Journal of Management Studies 1561.

[5] CA 2006, s 3.

[6] For more the definitions and details of this study, see (1.1.2) 23.

[7] See e.g. Paul Davies, *Introduction to Company Law* (Oxford University Press, 2002) 10-11 and 60ff.

According to art 98 of LEAA 2010, a JSC is 'a company in which the capital is divided into equal and transferable shares and in which the shareholders are liable for company debts only to the extent of the value of their shares'. Similarly, under s 3 of the UK CA 2006, a company is a "limited company" when the liability of its members is limited by its constitution,[8] and such a liability may be limited 'to the amount, if any, unpaid on the shares held by them'.[9] Regarding the Transferability of shares, 'the shares or other interest of any member in a company are transferable in accordance with the company's articles'.[10] Thus JSCs in Libya is similar to limited Liability companies by shares in the UK.

Moreover, the Libyan system follows the UK in regard to making a distinction between public and private companies. In the UK, the CA 2006 makes a distinction between public and private companies. S 4 of CA 2006 states that 'a 'private company' is a company which is not public company'[11] and 'a "public company" is a company limited by shares or limited by guarantee and having a share capital whose certificate of incorporating states that it is a public company'.[12] In addition, it has completed the requirements of the Companies Acts in regard to public company.[13] Here it should be noted that the vast majority of public companies are companies limited by shares. This is because limited by guarantee companies that have a share capital cannot be formed anymore. According to CA 2006, s 5 (1), 'a company cannot be formed as, or become, a company limited by guarantee with a share capital.[14] Similarly, in Libya, even though LEAA 2010 and the abrogated old Commercial Act 1953 do not set out any provisions

[8] CA 2006, s 3 (1).
[9] CA 2006, s 3 (2).
[10] CA 2006, s544 (1).
[11] CA 2006, s 4 (1).
[12] CA 2006, s 4 (2) (a).
[13] For information about the UK laws requirements in regard to public company, see Paul Davies, *Principles of Modern Company Law* (9th edn Sweet & Maxwell, 2012) 104ff.
[14] According to CA 2006 s 5 (2), 'provision to this effect has been in force (a) in Great Britain since 22nd December 1980, and (b) in Northern Ireland since 1st July 1983'.

relating to public companies,[15] the Libyan Stock Act 2010 recognizes public companies. This is because such companies are still a new form of business associations in Libya. The first law (Libyan Stock Market Act 2010) that regulates public companies was issued in 2010, although the Libyan Stock Market itself was established in 2006. Thus both legal systems recognize the distinction between public and private companies.[16]

It is worth mentioning that despite the fact that in practice the vast majority of companies in Libya and the UK are private companies,[17] in UK corporate governance there is much more focus on public limited companies by shares both listed and unlisted companies.[18] This is because the UK has a market based system where stock markets are more active and efficient than banks.[19] In such a system, 'securities markets share centre stage with banks in terms of getting society's savings to firms, exerting corporate control, and easing risk management.'[20] In addition, the countries that follow this system (e.g. the UK and the US) are characterized by the existence of a relatively large number of widely held companies which are listed companies.[21]

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[15] It is worthy indicating that despite the fact that LEAA 2010 does not recognize public companies, it does recognise SOEs. Many articles in the Act impose special provisions regarding these companies. This is because of the current corporate ownership structure in Libya which is based on state ownership.

[16] The both legal corporate system imposes extra statutory requirements on public companies. For example, in the case of Libya accounting and audit requirements on public companies are more detailed. See (5.1.1) 223 ff.

[17] As of July 2014, there were 3,103,821 Private limited companies and 7,821 Public limited companies. Companies House, *Statistical Release: Companies Register Activities 2013 - 2014* (Companies House, July 2014) 7.

[18] For example, in the UK, there are a lot of regulatory legal rules for corporate governance regulate public companies: For example, in addition to some parts of the Companies Act 2006; many law set forth provisions relating to provisions associate to public companies such as the Listing Rules (the LR), the Disclosure and Transparency Rules (the DTR) and the Prospectus Rules (the PR), which are made and enforced by the Financial Services Authority as the UK Listing Authority (UKLA); the UK Corporate Governance Code (the Code which 'applies to all Main Market companies, both UK and international, with a Premium Listing of equity shares in London'.) and the UK Stewardship Code for institutional shareholders, which are the responsibility of the Financial Reporting Council (FRC); and the Takeover Code, which is issued and administered by the Takeover Panel.

[19] ibid 5.

[20] Asli Demirgüç-Kunt and Ross Levine, 'Bank-Based and Market-Based Financial Systems: Cross-Country Comparisons' '1999' World Bank Policy Working Paper No. 2143, 1999, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=569255> accessed 27-11-2013, 2.

[21] The central characteristics of the market-based outsider model of corporate governance are:

> Diffuse equity ownership with institutions having very large shareholdings; shareholder interests are considered the primary focus of company law; there is an emphasis on effective minority shareholder protection in securities law and regulation; there is a

The corporate governance problem in public companies is more complicated than the problem in private companies. Most public companies (especially listed companies) have large numbers of outside minority shareholders and are run by professional managers who may not own shares of the company.[22] The significant issue resulting from such a situation is that based on the separation of control and ownership. Where the ownership here is dispersed and the directors have control of the company, the latter may use their position to expropriate some private benefits rather than maximising profits for the shareholders, as discussed in details in (2.2). This justifies the attention paid by the state in regard to regulating legal issues facing listed companies. Most of the legal governance regulations in the UK focus on listed companies rather than private companies such as the Listing Rules (LRs), the Disclosure and Transparency Rules (DTRs), and the UK Corporate Governance Code. This is unlike the normal situation (in private companies) where ‘owners continue to play a significant direct role in management’. [23]

Therefore, corporate ownership structures of JSCs around the world can be placed into two broad categories. The first category is dispersed corporate ownership, and the second category is concentrated ownership. The former category is dominant in the U.S and the UK where most public companies do not have a controlling shareholder.[24] Instead the shareholders own small fractions of shares and, consequently, lack influence over the control of the company.[25] In such countries, large companies often trade on the stock

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stringent requirement for continuous disclosure to inform the market’. See Thomas Clarke, *International Corporate Governance: A comparative Approach* (Routledge, 2007) 129.

For more details about a market based system, see Arnoud WA Boot and Anjan V Thakor, 'Financial System Architecture' (1997) 10 Review of Financial studies 693; Ross Levine, 'Bank-Based or Market-Based Financial Systems: Which Is Better?' (2002) 11 Journal of Financial Intermediation 398; Franklin Allen and Douglas Gale, *Comparing Financial Systems* (Cambridge, Mass. ; London : MIT Press, 2000); Colin Mayer and Oren Sussman, 'The assessment: Finance, Law, and Growth' (2001) 17 Oxford Review of Economic Policy 457.

[22] Brian R. Cheffins, *Corporate Ownership and Control* (Oxford University Press, 2008) 27.

[23] ecoDa Working Group, *Corporate Governance Guidance and Principles for Unlisted Companies in the UK* (Institute of Directors, 2010) 10.

[24] See e.g. La Porta, Lopez-de-Silanes and Shleifer, ‘Corporate Ownership Around the World’ (n 4). They argue that most firms in the US and UK are widely held.

[25] See e.g. Cheffins, *Corporate Ownership and Control* (n 22) 5.

market and so have ‘moved away from dependence on wealthy individuals, bankers, and financial institutions for a supply of capital’.[26]

It should be noted that the structure of corporate ownership in the UK is similar to that in the U.S. In the UK, a majority of equity is held by institutional investors such as financial institutions, predominantly pension funds and life assurance companies. This is because there was a major move in the second half of the 20th century[27] in corporate ownership companies from individual investors (retail investors) to institutional investors.[28] Since 1963, when individuals owned 54.0% of UK quoted shares in terms of total value, the amount of shares held by individuals has declined at the expense of institutional shareholders to 10.7% in 2012.[29] Therefore, today institutional investors own most of the shares of listed UK companies. Similarly, in the U.S, institutional shareholders are more widespread and they hold the majority of shares.[30]

Though dispersed ownership is predominant in the U.S and UK, concentrated ownership is dominant in the rest of the world. Here, companies have large shareholders who own blocks of shares that are large enough to give them control over the company.[31] In such a structure, stock market listings are less common. The first study[32] into

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[26] Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (the Brookings Institution, 1995) 29.

[27] Brian R Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 The Journal of Legal Studies 459, 476. He stated that ‘although a separation of ownership and control possibly occurred in the United Kingdom by the 1950s, the Berle-Means Corporation may in fact not have become dominant until the 1970s or even the 1980s’. See ibid 476.

[28] For more information about UK share ownership, see Cheffins’ studies, for example: Brian Cheffins, ‘Does Law Matter? The Separation of Ownership and Control in the United Kingdom’ (2001) 30 The Journal of Legal Studies 459; Brian R Cheffins, 'Dividends as a Substitute for Corporate Law: The Separation of Ownership and Control in the United Kingdom' (2006) 63 Washington and Lee Law Review 1273; Brian R. Cheffins, Corporate Ownership and Control (Oxford University Press 2008).

[29] See Office of National Statistics-ONS,'Ownership of UK Quoted Shares, 2012' (Office for National Statistics, 2012) available at <http://www.ons.gov.uk/ons/dcp171778_327674.pdf.>

[30] John Armour and Jeffrey N Gordon, 'The Berle-Means Corporation in the 21st Century' '2009', <http://www.law.upenn.edu> accessed 05-04-2015, 4.

[31] See e.g. Cheffins ‘Corporate Ownership and Control’ (n 22) 5.

[32] This has been noted by Christoph Van der Elst, 'The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation' '2003' Financial Law Institute, Working Paper Series, September 2000, <http://www.law.ugent.be/fli/wps/showwps.php?wpsid=32> accessed 02/01/2014, p13. See also Fabrizio Barca and Marco Becht, *The Control of Corporate Europe* (Oxford University Press, 2001) 2.

concentrated ownership structures was published by Franks and Mayer in 1997[33] who noted that the ownership of Continental European companies is primarily concentrated in the hands of two groups: families and other companies.[34] This was emphasised by La Porta *et al*. in 1997 and 1999 when they extended Franks and Mayer's study to many more countries and revealed that concentrated ownership applies widely around the world.[35] To give a brief illustration of the difference between the two structures: Becht and Mayer indicate that in more than 50% of European companies there is a single blockholder that owns a majority of shares; [36] in contrast this figure in the UK and the U.S is only 3%.[37] Faccio and Lang studied 5232 firms in Western Europe and found that dispersed ownership widely exists in the U.K and Ireland, whilst concentrated ownership dominates in the companies of continental Europe. They observed that whilst most non-financial and small firms are controlled by families, financial institutions usually have dispersed ownership.[38] Furthermore, Claessens et al., indicate that more than two-thirds of East Asian firms are controlled by a single shareholder.[39] Additionally, Prowse found that concentrated ownership is very common in Japan where companies are controlled by financial institutions.[40]

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[33] Julian Franks and Colin Mayer, 'Corporate Ownership and Control in the U.K., Germany, and France' (1997) 9 Journal of Applied Corporate Finance 30. This study has been reprinted in Julian Franks and Colin Mayer, 'Corporate Ownership and Control in the U.K., Germany, and France' in D Chew (ed) *Studies in International Corporate Finance and Governance Systems: A Comparison of the US, Japan, and Europe* (OUP Catalogue, 1997) 281.

[34] According to Frank and Mayer, most European countries have concentrated ownership. In 1990, almost 85% of the German and 80% of the French large listed non-financial companies had at least one shareholder with 25% of the shares. See ibid.

[35] Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 53 Journal of Finance 1131; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Corporate Ownership Around the World' (1999) 54 Journal of Finance 471.

[36] Marco Becht and Colin P. Mayer, 'Introduction' in F Barca and M Becht (eds), *The Control of Corporate Europe* (Oxford University Press, 2001)16.

[37] ibid.

[38] Mara Faccio and Larry HP Lang, 'The Ultimate Ownership of Western European Corporations' (2002) 65 Journal of Financial Economics 365. It is worth mentioning that only around 37% of Western European firms are widely held. See ibid.

[39] Stijn Claessens, Simeon Djankov and Larry HP Lang, 'The Separation of Ownership and Control in East Asian Corporations' (2000) 58 ibid.81. Their study included 2980 companies in 9 East Asian countries.

[40] Stephen D Prowse, 'The Structure of Corporate Ownership in Japan' (1992) 47 The Journal of Finance 1121.

In transition economies ownership structures are still not well established and widely held firms are extremely rare, even in countries that opted for early mass privatization.[41] In other words, though most transition economies carried out some large scale privatization, ownership in transition economies tends to be highly concentrated, as they have underdeveloped financial markets and lack institutional reforms. For example, Lazareva *et al* found that firms in Russia, Ukraine, and Kyrgyzstan are characterized by high ownership concentration in the hands of managers and large outside shareholders.[42] This is also the case in the Czech Republic[43] and Hungary.[44] Additionally, Gang Wei notes that in China there is a 'heavily concentrated equity ownership in the hands of large state-owned shareholders'.[45]

A significant explanation afforded for the difference between concentrated and dispersed ownership structures is the 'law matters theory' introduced in series of articles by La Porta et al in the 1990s.[46] The articles emphasise the importance of the law by

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[41] Erik Berglöf and Von Thadden, 'The Changing Corporate Governance Paradigm: Implications for Transition and Developing Countries' (Conference Paper, Annual World Bank Conference on Development Economics, 1999 1999) 4; Olga Lazareva, Andrei Rachinsky and Sergey Stepanov, 'Corporate Governance, Ownership Structures and Investment in Transition Economies: The Case of Russia, Ukraine and Kyrgyzstan' '2008', <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1102610> accessed 02-01-2014, 2.
Boycko *et al*., in regard to mass privatization, stipulate that:

> Mass privatization […] can take a variety of forms that can also be combined with each other. It can take the form of free grants of some shares to workers and managers in their own enterprises (almost all countries). It can also take the form of the distribution of vouchers to the whole population, with the subsequent exchange of these vouchers for shares in state enterprises (Czechoslovakia, Mongolia, Lithuania, and Russia). Finally, mass privatization may involve a direct allocation of shares to specially-organized mutual funds, followed by the distribution of shares in these funds to the population (Poland). Mass privatization has also been typically combined with sales of some assets through cash auctions or investment tenders (all countries). See Maxim Boycko, Andrei Shleifer and Robert W Vishny, 'Voucher Privatization' (1994) 35 Journal of Financial Economics 249, 251.

[42] Lazareva, Rachinsky and Stepanov (n 41).
[43] Robert Cull, Jana Matesova and Mary Shirley, 'Ownership and the Temptation to Loot: Evidence from Privatized Firms in the Czech Republic' (2002) 30 Journal of Comparative Economics 1.
[44] Zsolt Bedo and Eva Ozsvald, 'Corporate Restructuring and the Role of Foreign Direct Investment in Hungary ' in B Dallago and I Ichiro (eds), *Corporate Restructuring and Governance in Transition Economies* (palgrave, 2007) 178-203.
[45] Gang Wei and Mingzhai Geng, 'Ownership Structure and Corporate Governance in China: Some Current Issues' (2008) 34 Managerial Finance 934, 934.
[46] See, e.g. La Porta, Lopez-de-Silanes and Shleifer, , Corporate Ownership Around the World (n 4); La Porta and others, 'Legal Determinants of Outside Finance' (n 35); Rafael La Porta and others, 'Law and Finance' (1998) 106 Journal of Political Economy 1113; Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of Financial Economics 3.

pointing out that the extent of legal protection afforded to outside investors differs enormously across countries. Crucially, they suggest that controlling shareholders exist in jurisdictions where legal systems do not protect minority shareholders from controlling shareholders' diversion of private benefits of control. Also, they show that common law countries, such as the U.S and the UK, appear to have the best legal protection for minority shareholders and enforce the law more effectively, whereas civil law countries, and most conspicuously the French civil law countries (of which Libya is one),[47] have the weakest protection and weak enforcement. [48] In addition to law matters theory, Roe introduces the 'politics matters theory' and argues that countries that adopt strong social democracy have concentrated ownership and fewer publicly traded firms when compared to countries that have a weak social democracy. [49] One of the most significant reasons behind this, he suggests, is that democratic governments prefer employees to investors. Accordingly, they enact regulations that increase the leverage workers possess at the expense of the shareholders.[50]

However, it is important to note that though the empirical work on the relationship between law/policy and ownership structure done by La Porta at el. and Roe is significant, both theories have been criticized as they fail to provide the kind of comprehensive analysis that would support a correlation between the structure of corporate ownership and law/policy. For example, 'law matters theory' fails to take into account jurisdictions that provide strong protection for minority shareholders whilst simultaneously having a concentrated ownership structure, such as is the case in Sweden, Canada, Australia and New Zealand. [51] Further, it has been observed that controlling shareholder regimes exist in

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[47] The study does not include Libya.
[48] La Porta and others, 'Law and finance' (n 46); See also, Katharina Pistor and others, 'Evolution of Corporate Law: A Cross-Country Comparison' (2002) 23 The University of Pennsylvania Journal of International Economic Law 791.
[49] See Mark J. Roe, *Political Determinants of Corporate Governance* (Oxford University Press, 2003).
[50] ibid..
[51] For more flaws and drawbacks see e.g. Ronald J Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 Harvard Law Review 1641. He argues

countries without a serious social democratic movement. Coffee points out that the Roe's social-democratic thesis does not clarify the origins of concentrated ownership in any other country, and certainly does not fit the situations in Asia or in much of the Third World.[52] As such it is unlikely that Roe's politics theory can be relied upon to provide a comprehensive explanation.[53]

2.1.2. The Current Corporate Ownership Structure in Libya: Domination of the State over economic activities

As discussed previously, ownership structures of JSCs in transition economies are not well established and Libya is no exception.[54] As pointed out in the previous chapter, Libya is relatively early in its transition to a market economy and a functioning capitalistic system. As a result, the Libyan economy is still dominated by the government, which retains a large ownership position in many sectors of the economy and remains a significant owner of both public and large private commercial enterprises across several sectors.

Currently, the Libyan government controls, directly or indirectly, the majority of assets and enterprises through a substantial portfolio consisting of industries, financial institutions and real estate, which constitute the overwhelming majority of economic

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that 'there should be a distinction between the two situations where there is a functionally good law and where the law is functionally bad. The first situation can lead to both widely held corporations and concentrated ownership while the latter situation only allows concentrated ownership to exist'. See also Cheffins '*Corporate Ownership and Control*' (n 22) 39 ; Roe '*Political Determinants of Corporate Governance'* (n 49) 192; Pistor and others, 'The Evolution of Corporate Law ,A Cross-Country Comparison. (n 30); John C Coffee Jr, 'Do Norms Matter--A Cross-Country Evaluation' (2000) 149 University of Pennsylvania Law Review 2151, 2154-2165. He suggests that despite LLSV having shown a statistically significant relationship between strong capital markets and certain specific legal protections that tend to characterize common law legal systems, such a relationship does not prove causation; See, also, Curtis J Milhaupt, 'Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance' (2001) ibid.2083.

[52] John C Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 The Yale Law Journal 1, 74.

[53] For further flaws and drawbacks see e.g. Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (n 51); Cheffins 'Corporate Ownership and Control' (n 22) 47. He argued that 'Roe's Politics theory, as with his financial services regulation theory, does not fit the facts well in the UK'. ibid 47.

[54] It should be noted that there is not enough data or studies available to reveal a clear picture about how high state concentrated corporate ownership is.

activity in the country.[55] Practically, the state controls hundreds of State Owned Enterprises (SOEs) across the energy sector (oil, gas and electricity), telecommunication systems, and the main systems of transport. Furthermore, the state owns the majority of equity in the banking sector (see table no.1). It is the controlling shareholder in five banks which together dominate about 90% of bank equities in Libya.[56] In addition, the state controls three specialized banks, two specialized investment vehicles, and the insurance sector. Furthermore, it possesses a large real estate portfolio. The responsibility for managing the portfolio of all of these economic institutions is ‘spread across a wide number of different institutions and ministries including the Central Bank, Inspectorate for Industry, the Social Security Fund, Inspectorate for Education, Inspectorate for Health, Civil Aviation Department, the Authority for Transportation, and a range of Ministries’.[57] The Libyan Insurance Company, for example, is owned by three state owned institutions, the Economic and Social Development Fund (60% of the shares), the Social Security Fund Investment Company (10%) and Gumhouria Bank (7.7%) and private sector and individuals own only 23.3% of shares, making the state the controlling shareholder.[58]

Table no.1 The Structure of ownership in Libyan commercial banks

Banks	***Public Sector***	***Private Sector***	***Foreign shareholders***
Gumhouria Bank	83.0%	17.0%	0.0%
Al Sahara Bank	59.0%	22.0%	19.0%
Commercial National Bank	85%	15%	0.0%
Al Wehda Bank	54.0%	27.0%	19.0%

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[55] Michael E. Porter and Daniel Yergin, ' National Economic Strategy: An Assessment of the Competitiveness of the Libyan Arab Jamahiriya' '2006' General Planning Council of Libya,Tripoli. 2006, <http://www.isc.hbs.edu/pdf/2006-0127_Libya_NES_report.pdf> accessed 9/12/2012, 69.

[56] Central Bank of Libya (CBL),'Central Bank of Libya Report 2010-2011' (Central Bank of Libya, 2010-2011) (in Arabic).

[57] Porter and Yergin (n 55) 69.

[58] Libya Insurance Company-LIC, ' Shareholders of Libya Insurance Company' (Libya Insurance Company 2014) <http://libtamin.ly/ar/index.php?option=com_content&view=article&id=18&Itemid=117> accessed 14-01-2014 (in Arabic).

Al Commerce and Growth Bank	82.0%	18.0%	0.0%

Source: Libyan Central Bank Report, 2010-2011[59]

The major contributing factor in shaping the current structure of corporate ownership in Libya is the socialist policy adopted by the Libyan government under Gaddafi, which resulted in the issuing of laws and resolutions that contributed to expanding the role of the public sector in the Libyan economy.[60] As discussed in Ch.1, during the early 1970s the private sector played an important role in economic activity as its contribution to investment exceeded 30% of the total investment over that period. However, this picture changed significantly and from 1970-1999 the government owned 88% of national investments as the public sector came to dominate all economic activity in the country. [61]

Though the socialist policies adopted by the Libyan government during this period had a significant effect on forming the current structure of corporate ownership in Libya, since 1987 the government has made several attempts to change the structure of corporate ownership by adopting privatisation programmes. As discussed in Ch. 1, the privatisation agenda was raised and resumed several times during the 1990s and 2000s. However, the multiple privatisation programmes had no impact on corporate ownership structures and they have thus far been unable to shift Libya from the bureaucratic stage, which is based on state ownership, to the relationship stage, which is based on private ownership. This lack of impact is due, in large part, to the lack of efficiency and effectiveness of the privatization programmes in Libya. During the mid-1980s and 1990s, 4845 companies were privatised under government programmes, all of which were small and medium-sized enterprises. As seen in the data available in table no.2 below, the value of the targeted

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[59] Libyan Central Bank-LCB,'Report of Libyan Central Bank : 2010-2011' (Central Bank of Libya, 2012) (in Arabic).
[60] See (1.2.1) 23.
[61] S Ganous, *Libyan Revolution in 30 Years, Political, Economic and Social Transformations, 1969-1999* (Dar Al Jamahiriya for Publication, Distribution and Advertising, 1999) 225 (in Arabic).

privatised companies was only about 168 million LD (equivalent to approximately £80 million). The small value of these companies, relative to the overall Libyan economy, leads us to conclude that the privatisation programme had very little impact on the structure of corporate ownership and, accordingly, very little influence on the economy.

Table no. Public Projects Privatised from 1987 to 2001

Activity	**No of projects**	**The value(LD)**	**Instalments paid**	**% paid to value**
Industry	145	51,556,426	22,556,668	43.7
livestock	45	16,809,229	5,353,806	31.8
Marine	219	32,816,329	6,009,020	18.3
Agricultural	4436	66,640,346	9,268,300	13.9
Total	4845	167,822,330	43,177,794	25.7

Source: Shernanna and Elfergani.[62]

During the same period, all attempts to implementing privatisation programmes (which were intended to transfer the ownership of state small and medium-sized enterprises to the employees who worked in them) were either very slow or stopped completely. [63] The failure of these programmes can be attributed to several contributory factors. For example, the deterioration in performance and production in targeted companies was similar to, if not worse than, their output when they were part of the public sector.[64] This was largely because the ownership of the companies was transferred to the management and/ or employees. Although transferring corporate ownership to employees of privatised companies may be desirable (because, for example, they are familiar with the operation of the firm and will be incentivised by the opportunity to exercise governance,

[62] Hesham Shernanna and S Elfergani, *Privatisation and Broaden the Ownership Base "A Step Towards the Application of the People's Socialist* (International Centre for Studies and Research, 2006) 7 cited in Hesham F. Shernanna, *Critical Perspectives on the Efficient Implementation of Privatisation Policies in Libya: Assessing Financial, Economic, Legal, Administrative and Social Requirements* (Durham University, 2013)111.

[63] See e.g. Libya Audit Bureau-LAB,' Annual Report of the Libya Audit Bureau -2012' (Libya Audit Bureau Libya Audit Bureau 2012) 16 (in Arabic).

[64] Saif-Aleslam M. Alqadhafi, *Libya and the XXI Century* (Editar Spa, 2002) 124.

with the added bonus that employee ownership would reduce the principle-agent separation),[65] employee ownership may face big drawbacks. For example, employees in most cases, as Brada and Singh argue, cannot provide either new capital or new business skills. In many cases, the firms studied by them require infusions of capital to survive and employees cannot provide this.[66] This is also applicable in the case of Libya where privatised units faced many financial and technical problems, such as a lack of technically qualified and trained staff in the areas of management and finance, with the result that most privatised companies ceased production and went bankrupt.[67] As can be seen in the table above, the production units were worth about LD 168 million at the time of privatisation and the instalments that were paid amounted to only LD 43 million, which represents just 25.74% of the total value.[68] This means that most of the privatized companies were unable to pay their instalments.[69]

A further important factor in the lack of success of the privatisation programme at that time was the absence of core elements necessary for the effective implementation of the privatisation programme, such as a stock market[70] and an efficient data and information collection and dissemination system.[71] In addition, the slowness and periodic termination of the privatisation programmes in Libya was due to the lack of a support system for these

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[65] Josef C. Brada and Inderjit Singh, *Corporate Governance in Central Eastern Europe: Case Studies of Firms in Transition* (M.E.Sharpe, 1999) 34.
[66] ibid 43 and see also p12ff where Brada and Singh criticize insider privatisation.
[67] See Libya Audit Bureau-LAB, Annual Report of the Libya Audit Bureau -2012 (n 63) 16.
[68] The non-payment of instalments has continued although the Government issued Decision no.427 in 1989, which stipulated that each shareholder must pay 20% of the shares' value before receiving an ownership certificate, and the remaining instalments shall be paid through a direct debit of revenues of the privatised project.
[69] This conclusion is supported by Frydman *et al.* who found that the effect of privatization differs depending on the types of owners to whom it gives control. They found that privatization to outside investors is better than insiders as outsiders can provide significant affective performance. For more information see Roman Frydman and others, 'When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies' (1999) 114 The Quarterly Journal of Economics 1153.
[70] The Libyan Stock Market was established in 2006 and began its operations in 2008. However, the Stock Market Act was only issued in 2010.
[71] See M. H. Hamdo, ' Privatization Program in Libya: Requirements and Constraints of Assessment and Methods, an Analytical Study"' (2004) 6 University of Garyounis Jurnal 45 (in Arabic); M. M. Paddy and M. H. Zwai, 'The Role of the Financial Market in the Activation of the Privatization Program ' (Conference of Financial Markets" Role in the Economic Development "experiences - visions", Tripoli, Libya, 11th December 2005 2005) (in Arabic).

units, either before or after transfer from the public sector. In this context Saif Al Islam Alqadhafi states that:

> Perhaps the methods followed in the transfer of ownership were partly responsible for [the failure] because these foundations had not been restructured before the appropriation process in such a way that secures good performance afterwards. Furthermore, these foundations continued to work under the umbrella of the public foundations. Add to that the fact that the transfer of ownership was limited only to the people working in the foundations.[72]

Regarding the current privatisation programme, in 2004, as a means of stimulating the private sector and making the business environment more attractive to investors, the Libyan government aimed to transfer ownership of 360 enterprises to the private sector in just 4 years.[73] The duration of the programme was extended under Cabinet Resolution No 99/ 2005, until 2015, and data available in the report of the Privatisation Agency (Public Institution for Investment and Privatisation) (PIIP) indicates that, as of 2012, only 115 companies have been privatised through various methods of privatisation. [74] Consequently, the privatisation programme in Libya is still not complete and so the debate has not moved on from traditional measures for the economic transformation (e.g. privatisation of state-owned companies) to how to shape the existing business firms into a market economy.

The most recent report issued by PIIP in 2012,[75] sets down about thirty points that hinder the progress of the current privatisation programme in Libya. The most important points raised in this report are: [76] (1) the privatised companies lack the capital to help them to run the companies; (2) most of the privatised companies were looted during the revolution in Libya in 2011; (3) some of these companies have been taken over by rebels for use as offices for their militia; (4) most of them lack specialized technical workers; (5)

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[72] Alqadhafi (n 64) 124.
[73] See PIIP,'Report of Public Institution of Investment and Privatisation (2012)' (PIIP, 2012) 2 (in Arabic).
[74] ibid.
[75] The most recent PIIP report was issued in 2012 which is available at http://www.investinlibya.ly/index.php/ar/component/content/article?id=72
[76] PIIP (n 73) 36-7.

there is a lack of internal regulation (bylaws), and (6) a lack of administrative experience from managers and directors; (7) most privatised companies rely on renting their estates to raise profits, instead of relying on production; (8) some company owners have been rehired in the public sector and as a result they are no longer interested in the success of their privatised companies; (9) studies conclude that some loss-making companies that are expected to continue to lose money have been privatised and will face bankruptcy; and finally (10) these companies, once privatised, lack ongoing government supervision.

As a result of this report, the head of PIIP issued Decision No. 26/2012, which created the Committee of Developing the Privatisation Programme in Libya with a mandate to address these obstacles. This committee made an agreement with the Economic Studies Centre in Banqazi, Libya in 2012 and both parties have agreed that Libya should seek to gain similar benefits from the privatisation programme to those experienced in the Balkan countries, such as Slovenia, Serbia and Croatia, which have successfully negotiated large-scale privatisation programmes. In pursuit of this, PIIP entered into an agreement with IMAPSEE Company to provide consulting services.[77]

Based on the previous evidence, it may be expected that the current structure of corporate ownership in Libya will not change soon as there remains evident deficiencies in the current privatisation program. However, there is a further consideration that should be taken into account: the importance of the role of the law in influencing structures of corporate ownership within an economy. As the law in both the U.S and the UK has had a hand in changing the structure of corporate ownership in their respective jurisdictions from concentrated to dispersed ownership,[78] the Libyan law may also have the same effect on the structure of corporate ownership as laws have been adopted in Libya that lead logically

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[77] See Committee of Developing the Privatisation Programme in Libya-CDPP,'Report of Committee of Developing the Privatisation Programme in Libya in 2012' (PIIP, 2012) 6 (in Arabic).
[78] See e.g. La Porta, Lopez-de-Silanes and Shleifer, (n 4); Cheffins, *Corporate Ownership and Control* (n 22) 29-40.

to a dispersed ownership model or, at least, should mitigate its high concentration. For instance, according to the Bank Act no. 1/2005, banks can no longer own more than 10% of a joint stock company [79] and as of 2012 the same rule applies to individuals.[80] The policy behind this limitation on ownership of shares is one of diversification, which means reducing risk by investing in a variety of assets or shares.[81]

In summary, while the UK and the U.S have a dispersed corporate ownership structure, the rest of the world has structures of concentrated corporate ownership. The latter model differs from one country to another. In Libya, the government retains a large ownership position in many sectors of the economy and remains a significant owner of both public and large private commercial enterprises. This situation is the result of the socialist policies adopted during the period from 1970 to the 1990s. Despite the developments in the privatisation programme, the ownership model has not changed and these developments remain insufficient as they are neither comprehensive nor efficient, and thus the vast majority of Libyan firms are still owned by the state.

2.2. The rationale for the thesis: Ownership structures as determinates of the nature of the principal-agent problem

Having discussed corporate ownership and identified two types of corporate ownership, here I discuss the relationship between the patterns of ownership and the nature of the principal-agent problem, which constitutes the fundamental rationale for this study.

The principal-agent problem[82] arises when there is a conflict of interest inherent in any relationship where one party (agent) is expected to act in another's (principal) best

[79] See Libyan Bank Act No. 1/2005, art 77 (c).
[80] See Resolution of the Libyan Cabinet no. 186/2012, s (3).
[81] Arthur O'Sullivan and Steven M. Sheffrin, *Economics: Principles in Action* (Pearson Prentice Hall, 2003) 273.
[82] The agency problem is based on a contractual view of the firm, developed by Coase, Jensen and Meckling. See Ronald H Coase, 'The Nature of the Firm' (1973) 4 Economica 386; Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Cost, and Capital Structure' (1976) 3 Journal of Financial Economic 305.

interests. The problem comes when the agent, who is supposed to act in the best interests of the principal, is instead motivated by personal interests which may differ from the principal's best interests.[83] This is also known as the ‘agency problem’. In principle, corporate governance ‘focuse[s] on identifying situations in which the principal and agent are likely to have conflicting goals and then describing the governance mechanisms that limit the agent’s self-serving behaviour’.[84] The issue that underpins the agency problem is that the principals are often unaware of the details of the business activities of the agents (this is referred to as the asymmetric information problem).

Though it has been argued that the best way to solve the agent-principal problem is to structure the contractual relation between the principal and agent to provide appropriate incentives for the agent to make choices that will maximize the principal's welfare,[85] the fact remains that a well-drafted agreement between an agent and a principal is not always in place and such an agreement is not always able to cover all potential areas of dispute.[86] Therefore, as is widely recognized, contracts are often incomplete and cannot provide sufficient protection for the principal or be the sole source of protection.[87] Accordingly, limitations on the agent must be imposed by the law, since the presence of mandatory rules will assist in solving the problem of contractual incompleteness.[88] As MacNeil notes,

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[83] See e.g. Stephen A Ross, 'The Economic Theory of Agency: The principal's Problem' 63 The American Economic Review 134; Reinier R. Kraakman and others, *The Anatomy of Corporate Law* (Oxford University press, 2009) 35.

[84] Katheen M. Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14 Academy of Managemnt Review 57, 59.

[85] Armen A Alchian and Harold Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 The American Economic Review 777; Jensen and Meckling, (n 82).

[86] Erik Berglöf, 'A Control Theory of Venture Capital Finance' (1994) 10 Journal of Law, Economics, & Organization 247; Rafael La Porta and others, 'Agency Problems and Dividend Policies Around the World' (1999) LV The Journal of Finance 1, 5.

[87] This is referred to as an incomplete contract theory. For information see Sanford Grossman and Oliver Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94 Journal of Political Economy 691; Oliver Hart and John Moore, 'Property Rights and the Nature of the Firm' (1990) ibid.1119; Oliver Hart, *Firms, Contracts, and Financial Structure* (Oxford University Press, 1995) 22; Jean Tirole, 'Incomplete Contracts: Where do We Stand?' (1999) 67 Econometrica 741, 743-44; lain MacNeil, 'Company Law Rules: An Assessment from the Perspective of Incomplete Contract Theory' (2001) 1J Journal of Corporate Law Studies 107.

[88] According to Schwartz, the view of incompleteness can be an issue in any situation in which contract terms are vague or ambiguous, or no terms expressly govern the dispute at hand. See. A Schwartz, 'Legal Contract

'within the field of application of the mandatory rules […] the application of such rules is not dependent on the knowledge or consent of the contracting parties'. [89] The key question that arises here is who are the principal and agent?

The answer is not straight forward, but is dependent on the pattern of corporate ownership within the jurisdiction. In the UK and the U.S where dispersed ownership is very common, the principal-agent problem is based on the separation of control and ownership, as explored by Berle and Means in `The Modern Corporation and Private Property'. [90] Berle and Means argued that where the ownership is dispersed and the directors have control of the company, the latter may use their position to expropriate some private benefits rather than maximising profits for the shareholders. [91] In the same context, Jensen and Meckling point out that the relationship between owners and managers is similar to that between a principal and an agent and consists of:

> a contract under which one or more persons (the principals 'shareholders') engage another (the agent, 'the management') to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal. [92]

However, this kind of problem is not prevalent throughout the world. Instead, many countries are characterized by concentrated ownership structures, where corporations have a controlling shareholder or multiple shareholders. [93] Within this structure, the agency problem consists of a conflict between the majority shareholders (agents) and the minority or non- controlling owners (principals), rather than between shareholders and managers. La Porta *et al.* point out that 'the central agency problem in large corporations around the

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Theories and Incomplete Contracts' in L Werin and H Wijkander (eds), *Contract Economics* (Cambridge, MA, Blackwcll, 1992).
[89] MacNeil, 'Company Law Rules' (n 87) 109.
[90] See Berle and Means (n 3).
[91] ibid.
[92] Jensen and Meckling, (n 82) 308.
[93] See e.g. La Porta, Lopez-de-Silanes and Shleifer, 'Corporate Ownership Around the World' (n 4); Michael N Young and others, 'Corporate Governance in Emerging Economies: A Review of the Principal–Principal Perspective' 45 Journal of Management Studies 196.

world is that of restricting expropriation of minority shareholders by a controlling shareholder'.[94] This is termed variously as the majority-minority problem,[95] the horizontal agency problem,[96]and the second[97] agency problem.[98]

The separation of ownership from control that results from dispersed ownership leads to high agency costs between management and shareholders. [99] This is because of the weakness of the *de-facto* control right of shareholders over the management, which results from a lack of incentives for shareholders to monitor their investments.[100] The inability of shareholders to monitor the management is due to the inherent limitations on collective action and the free rider problem, which explains the collective action problem. In other words, when the company is a widely held company, shareholders do not have any real voice in how the corporation is run. For example, an active shareholder who owns only a small portion of shares has no incentive to monitor the management as this will involve a cost of money and time that is disproportionate to the potential benefit to a shareholder. [101] In this situation, a shareholder (Rationally Apathetic) who wants to make a change that benefits the shareholders as a whole, including himself, would have to persuade his fellow shareholders who have similar incentives to act but prefer to take no action and so not incur a cost (free riders). [102] Therefore, in countries with a structure of dispersed ownership, the management are capable of using their position to exploit dispersed shareholders in

[94] La Porta, Lopez-de-Silanes and Shleifer, 'Corporate Ownership around the World' (n 4), abstract.
[95] Harold Demsetz and Kenneth Lehn, 'The Structure of Corporate Ownership : Causes and Consequences' (1985) 93 Journal of Political Economy 1155; Shleifer and Vishny, (n 3).
[96] Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American corporate Finance* (Princeton University Press, 1994).
[97] The third agency problem involves a conflict between the firm itself (including, shareholders) and the other parties with whom the firm contracts, such as creditors and employees.
[98] Philippe Aghion and Jean Tirole, 'Formal and Real Authority in Organizations' (1997) 105 Journal of Political Economy 29.
[99] See e.g. Jensen and Meckling, (n 82); Aghion and Tirole, (n 98).
[100] See e.g. Mike Burkart, Denis Gromb and Fausto Panunzi, 'Large Shareholders, Monitoring, and the Value of the Firm' (1997) 112 The Quarterly Journal of Economics 693, 694.
[101] See e.g. Jensen and Meckling, (n 82); Sanford J Grossman and Oliver D Hart, 'Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation' (1980) 11 The Bell Journal of Economics 42. Davies139-44; Mahmoud Ezzamel and Robert Watson, 'Boards of Directors and the Role of non-Executive directors in the Governance of Corporations' in K Keasey, S Thompson and M Wright (eds), *Corporate Governance: Accountability, Enterprise and International comparisons* (John Wiley & Son Ltd, 2005) 97; David Kershaw, *Company Law in Context: Text and Materials* (Oxford University Press, 2012) 174-5.
[102] See ibid 175.

order to acquire private benefits, which can take several different forms. For example, the management may use their position to gain excessive remuneration or use their control rights to engage in self-dealing transactions or corporate opportunities that benefit managers rather than the shareholders. Also, the management are able to build a larger empire, which serves their private interests, which can be either monetary or non-monetary.[103]

However, in a concentrated ownership structure, this situation is not possible. In this structure, large shareholders are able to monitor the management more effectively than small shareholders as they can accommodate a larger part of the monitoring costs and have sufficient voting power to influence corporate decisions.[104] Bennedsen and Wolfenzon point out that controlling shareholders are able to monitor the management and directly manage firms, whereas other, smaller shareholders lack the incentive and power to monitor the controlling shareholder. [105]Additionally, large shareholders can mitigate asymmetric information problems. This is because, as Chidambaran and John indicate, large shareholders can gradually collect information on managers' investment through "relation investing" co-operation and then use this information to mitigate against irrational short term investments.[106] Accordingly, the free-rider problem and the collective action problem of shareholders encountered in dispersed structures are not present in concentrated ownership structures. Instead the controlling shareholder generally takes an active interest

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[103] See Andrei Shleifer and Robert W. Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461, 461.

[104] See e.g. Eugene F Fama and Michael C Jensen, 'Agency Problems and Residual Claims' (1983) 26 Journal of Law and Economics 327; Bernard S. Black, 'Agents Watching Agents: The Promise of Institutional Investor' (1992) 39 UCLA Law Review 811 , 822; Shleifer and Vishny, 'Large Shareholders and Corporate Control' (n 103).

[105] Morten Bennedsen and Daniel Wolfenzon, 'The Balance of Power in Closely Held Corporations' (2000) 58 Journal of Financial Economics 113.

[106] N.K. Chidambaran and Kose John, 'Relationship Investing: Large Shareholder Monitoring with Managerial Cooperation' NYU Working Paper, 1998, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297123> accessed 06-01-2014.

in the running of the company by choosing the management and sometimes directly taking executive positions by hiring themselves as managers.[107]

Consequently, concentrated ownership transforms the principal-agent problem into a problem of conflict of interests between the minority and majority shareholders.[108] This is because minorities are vulnerable to exploitation and fraud by the majority. Further, the shareholders with a high ownership share are capable of using their position to acquire private benefits by using their voting rights to consume corporate resources to their advantage,[109] an option that is not available to other shareholders. I will now go on to explore the forms that this conflict of interests can take between the majority shareholders and minority shareholders.

2.3. Basic dilemmas connected with the agent-principle problem in Libya's transition economy

In the previous sections I discussed the principal-agent problem and identified that the recent corporate governance literature indicates that the current central agency problem in corporate governance around the world (except in the UK and the U.S) is how to restrict the expropriation of minority shareholders by controlling shareholders. Here I explore the issue of the conflict between the majority shareholders and the minority shareholders, both in theory and as it occurs in Libya (2.3.1). Additionally, as the state owns most of public and large private equities in Libya, I examine how this conflict is manifested when the state is a controlling shareholder (2.3.2)

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[107] Kershaw (n 101) 650.

[108] See e.g. La Porta and others, `Investor Protection' (n 46) 15. M. Pagano and A. Roell, 'The Choice of Stock Ownership Structure: Agency Costs, Monitoring and the Decision to Go Public' (1998) 113 The Quarterly Journal of Economics 187, 188.

[109] See Michael J. Barclay and Clifford G. Holderness, 'Private Benefits from Control of Public Corporations ' (1989) 25 Journal of Financial Economics 371; Lucian Arye Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' '1999' Harvard Law School John M. Olin Center for Law, , <http://www.nber.org/papers/w7203> accessed 9/7/2012.

2.3.1. Conflict of interests between the majority shareholders and the minority shareholders

Here the study discusses the conflict of interests between the majority shareholders and the minority shareholders in theory (2.3.1.1) and then explore how this theoretical analysis corresponds with the conflict as it occurs in Libya (2.3.1.2). [110]

2.3.1.1. A theoretical analysis of the conflict of interests between the majority shareholders and the minority shareholders [111]

Though controlling shareholders can mitigate managerial agency problems to improve firm value, [112] another type of agency problem can result from their tunneling behaviour. Controlling shareholders (insiders) can extract (tunnel) wealth from firms through engaging in expropriating or tunneling practices. This behaviour is most likely to occur in emerging and transition countries[113] like Libya, where concentrated corporate ownership is very high and shareholder protection is very low. In such a structure, majority shareholders are more likely to exploit minority shareholders by pursuing their own interests.[114] Many

[110] It is important to indicate that this chapter will not discuss the solution for such conflict as this will be covered in the following chapters.

[111] Surprisingly, it has been noted that although the conflict of interest between the majority and the minority shareholders conflict is overwhelmingly dominant in most of countries in the world, the extensive legal literature deals with conflicts of interest between the management and the shareholders instead of the majority-minority problem.

[112] See (2.2) 61ff.

[113] There are several studies that examine tunneling in transition and emerging countries. See for example, Kee-Hong Bae, Jun-Koo Kang and Jin-Mo Kim, 'Tunneling or Value Added? Evidence from Mergers by Korean Business Groups' (2002) 57 The Journal of Finance 2695; Marianne Bertrand, Paras Mehta and Sendhil Mullainathan, 'Ferreting out Tunneling: An Application to Indian Business Groups' (2002) 117 The Quarterly Journal of Economics 121; An Buysschaert, Marc Deloof and Marc Jegers, 'Equity Sales in Belgian Corporate Groups: Expropriation of Minority Shareholders? ' (2004) 10 Journal of Corporate Finance 81; Vladimir Atanasov, 'How Much Value Can Blockholders Tunnel? Evidence from the Bulgarian Mass Privatization Auctions' (2005) 76 Journal of Financial Economics 191; Yan-Leung Cheung, P Raghavendra Rau and Aris Stouraitis, 'Tunneling, Propping, and Expropriation: Evidence from Connected Party Transactions in Hong Kong' (2006) 82 ibid.343; Jae-Seung Baek, Jun-Koo Kang and Inmoo Lee, 'Business Groups and Tunneling: Evidence from Private Securities Offerings by Korean Chaebols' (2006) 61 The Journal of Finance 2415; Henk Berkman, Rebel A Cole and Lawrence J Fu, 'Expropriation through Loan Guarantees to Related Parties: Evidence from China' (2009) 33 Journal of Banking & Finance 141; Vladimir A Atanasov and others, 'How Does Law Affect Finance? An Examination of Financial Tunneling in an Emerging Market' '2007', < http://ssrn.com/abstract=902766> accessed 24-01-2014.

[114] See the previous section. See also Raj M. Desai and Katharina Pistor, 'Financial Institutions and Corporate Governance: A Survey of Six Transition Economies' in IW Lieberman, SS Nestor and RM Desai (eds), *Between State and Market: Mass Privatization in Transition Economies (Studies of Economies in Transformation)* (World Bank Publications, 1997); Katharina Pistor, 'Patterns of Legal Change: shareholder and Creditor Rights in Transition Economies' (2000) 1 European Business Organization Law Review 59;

scholars, such as La Porta, *et al.*,[115] Johnson, *et al.*, [116] Glaeser, *et al.*, [117] Friedman, *et al.*[118] Burkart, *et al.*,[119] Nenova,[120] Dyck and Zingales,[121] and others, focus on the conflict of interests among different shareholders. They found that in countries with weak legal protection for investors, there is strong evidence to indicate that large shareholders may abuse their controlling powers by appropriating corporate resources and exploiting other shareholders' interests.

The recent literature on corporate governance indicates a firm's value can be affected by the majority shareholders when they pursue private benefits at the expense of minority shareholders.[122] However, when there are several large shareholders, they may be able to provide appropriate checks and balances to this sort of behaviour. In this context, Maury and Pajuste, [123] Pagano and Röell, [124] and Young et al.[125]found that the presence of a few large shareholders can mitigate tunneling transactions and so lead to the increase of corporate value.

Domagoj Hruška, *Protection of Minority Shareholder Interests in Post-Privatization Economies* (DAAAM International, Vienna, Austria 2010).

[115] See for example, La Porta, Lopez-de-Silanes and Shleifer, 'Corporate Ownership around the World' (n 4).

[116] Simon Johnson and others, 'Tunnelling' '2000' Working Paper, 2000, <http://www.nber.org/papers/w7523> accessed 08-01-2014.

[117] Edward Glaeser, Simon Johnson and Andrei Shleifer, 'Coase versus the Coasians' (2001) 116 The Quarterly Journal of Economics 853.

[118] Eric Friedman, Simon Johnson and Todd Mitton, 'Propping and Tunneling' (2003) 31 Journal of Comparative Economics 732.

[119] Burkart, Gromb and Panunzi, 'Large Shareholders, Monitoring, and the Value of the Firm' (n 100).

[120] Tatiana Nenova, 'The Value of Corporate Voting Rights and Control: A Cross-Country Analysis' (2003) 68 Journal of Financial Economics 325

[121] Alexander Dyck and Luigi Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 The Journal of Finance 537.

[122] See e.g. Shleifer and Vishny, 'A Survey of Corporate Governance' (n 3); Claessens, Djankov and Lang, 'The Separation of Ownership and Control in East Asian Corporations' (n 39); Dyck and Zingales, (n 121); Nenova, (n 120); Bae, Kang and Kim, (n 113).

[123] Benjamin Maury and Anete Pajuste, 'Multiple Large Shareholders and Firm Value' (2005) 29 Journal of Banking & Finance 1813.

[124] Pagano and Roell, (n 116).

[125] Michael N Young and others, 'Corporate Governance in Emerging Economies: A Review of the Principal–Principal Perspective' [Academy of Management] 45 Journal of Management Studies 196, 214.

The conflict of interests between the majority and the minority of shareholders can include the diversion of corporate assets.[126] This conflict arises whenever the controlling shareholders use their powers over corporate assets to divert the firm's cash flow into their own pockets.[127] Johnson *et al.* describe the process by which a controlling shareholder diverts a firm's assets and profits for their personal enrichment as "tunneling". They indicate that through these tunneling activities controlling shareholders can obtain more private benefits than they are entitled to according to their cash flow rights. [128] It is worth noting that the possibility of tunneling increases, and is more likely to take place, in firms that are directly managed by controlling shareholders.[129]

Opportunities in which majority shareholders can tunnel wealth from companies and gain personal benefits at the expenses of the minority shareholders can be divided into two categories: [130] firstly, the majority-minority shareholder conflict in related-party

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[126] Alessio M. Pacces, *Rethinking Corporate Governance: The law and econmmics control powers* (Routledge, 2012) 237. For more discussion relating to defining conflict of interest transactions see e.g. Lynne L Dallas, 'Control and Conflict of Interest Voting Systems' 71 North Carolina Law Review 1, 73ff.

[127] Bernard Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 UCLA Law Review 781.

[128] Johnson and others (n 116).2.

[129] Randall Morck and Masao Nakamura, 'Banks and Corporate Control in Japan' (1999) 54 The Journal of Finance 319.

[130] Atanasov, *et al* divide tunneling into three basic types: cash flow tunneling, asset tunneling, and equity tunneling (see Vladimir Atanasov, Bernard Black and Conrad Ciccotello, 'Unbundling and Measuring Tunneling' '2008' U of Texas Law, Law and Econ Research Paper, SSRN, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030529> accessed 29/08/2013; Vladimir Atanasov, Bernard Black and Conrad Ciccotello, 'Law and Tunneling' (2011) 37 Journal of Corporation Law 1. Atanasov, *et al* treat asset tunneling as separate from cash flow tunneling for several main reasons mentioned in their study. (See Atanasov and others (n 130) 8-9). Additionally, Gilson and Gordon divided expropriation of private benefits of control by controlling shareholders into three categories: taking a disproportionate amount of the corporation's ongoing earnings, freezing out the minority, and selling control. See Ronald J Gilson and Jeffrey N Gordon, 'Controlling Controlling Shareholders' (2003) 152 University of Pennsylvania Law Review 785. However, Johnson *et al*. combine the asset tunneling with cash flow tunneling into a single category, which is 'self-dealing transactions'. Accordingly, tunneling, as Johnson *et al*. suggest, is divided into two categories. The first one is self-dealing transactions where a controlling shareholder transfers resources from the firm to himself. The second category of financial transactions that 'discriminate against minorities' comes from the ability of the controlling shareholder to increase his share of the firm without transferring any assets through dilutive share issues, minority freezeouts, insider trading, creeping acquisitions or other financial transactions. (see Johnson and others 'Tunnelling' (n 116)). This division is what I adopt in this study as it is very common in legal studies. See for example, Pacces (n 126) and Kraakman and others (n 83) which covers related party transactions in chapter 6, and the restructuring of corporate ownership transactions in chapters 7,8 and 9.

transactions and, secondly, the majority-minority shareholder conflict in restructuring ownership transactions that discriminate against minorities.[131]

1. The majority-minority shareholder conflict in related-party transactions

A related-party transaction constitutes a common conflict of interests [132] and includes transactions in which a controlling shareholder engages in transactions in which a related party (in our case a controlling shareholder) deals with himself in the company's name. This is called a self-dealing transaction.[133] Such a transaction can result in the diversion of corporate assets when a controlling shareholder transacts with the company 'on terms less favourable than could be obtained in an arm's length negotiation.' [134] In other words, controlling shareholders with discretionary powers may naturally tend to set the transaction terms in such a way as to favour their own interest at the expense of the company and the minority shareholders. [135] For example, a controlling shareholder may transact with the company at off-market prices [136](e.g. the company buys goods or services from the controlling shareholders for an above-market price or sells them to him for a below-market price, or gives him loans at below-market rates). In cases where all shareholders participate in the management, for example in small companies, the agent-principal problem may not arise as shareholder-managers seek to receive the profits through their salaries rather than as dividends. However, when a shareholder does not participate in the management and other shareholders do, the excessive remuneration paid to those shareholder-mangers will

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[131] It is worth indicating that the forms of the conflict of interest between the majority and the minority shareholders are not limited. Instead they vary according to the transactions that the controlling shareholders can make according to the constitution of the company.

[132] Melvin Aron Eisenberg, 'The Structure of Corporation Law' (1989) 89 Columbia Law Review 1461, 1471.

[133] See Pacces (n 126) 234. According to Atanasov, et al, 'Cash flow tunneling can be loosely defined as self-dealing transactions which divert what would otherwise be operating cash flow from the firm to insiders (a controlling shareholder…)'. (See Atanasov, Black and Ciccotello (n 112) 7). Additionally, Atanasov, et al. note that cash flow tunneling 'does not affect the remaining stock of long-term productive assets, and thus does not directly impair the firm's value to all investors, including the controller'. Also they note that the transaction may be classified as asset tunneling when the transaction is large. See ibid. 4 and10.

[134] Kraakman and others (n 83) 154.

[135] It is worth mentioning that such transactions between a firm and its controlling shareholders can sometimes benefit the firm. This is called 'propping' which is out of the scope of our study. (For information see e.g. Friedman, Johnson and Mitton, (n 118); Cheung, Rau and Stouraitis, (n 113)).

[136] See Atanasov, Black and Ciccotello (n 112) 10.

reduce the profit available as dividends for the shareholders.[137] . In other words, in many close corporations, only a few shareholders will act as active managers, while the others are passive investors. In such a situation, the manager-shareholders may have an incentive to maximize management compensation at the expense of dividends or share appreciation even though all shareholders share in profits and losses.[138]

Another potential related party transaction occurs when a related party (in our case a controlling shareholder) appropriates value belonging to the corporation by taking its corporate opportunities. The controlling shareholders may identify a new business opportunity and exploit it at the expense of the company (thus at the expense of the minority shareholders). It is evident that the problem here is straightforward: if the controlling shareholder exploits an opportunity that the company is interested in, the company loses a potentially significant revenue opportunity.

The third instance of exclusionary misappropriation by the corporate controller is trading in the company's shares (insider trading).[139] Insider trading can impact negatively on the minority shareholders' interests in two ways. First, the controller (e.g. a controlling shareholder) can extract value by taking advantage of his access to information to trade with less-informed investors in public securities markets at advantageous prices, thus extracting value from their counterparties. [140] Second, insiders can increase their fractional ownership at the expense of minority shareholders by using their inside information to trade the company's shares, which may lead to easy profits at the expenses of minority shareholders.[141] The means of prohibiting such transactions is grounded in fairness or

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[137] See Kershaw (n 101) 648.
[138] Alison Grey Anderson, 'Conflicts of Interest: Efficiency, Fairness and Corporate Structure' 25 UCLA Law Reveiw 738, 772-3.
[139] Insider trading is a form of equity tunneling, because 'it transfers value from uninformed investors to insiders without directly affecting firm value'. Atanasov, Black and Ciccotello, (n 112) 10.
[140] ibid 22-3.
[141] Pacces (n 126) 236.

equity,[142] since, for example, 'controlling shareholders appropriate part of the value of yet undisclosed company information by selling or buying before it is reflected in stock prices'.[143]

It should be noted that related-party transactions, in order to take place, do not need to directly involve the controlling shareholders since the same issue of insider trading can occur in a much broader set of transactions in which, even though they are formally third-party transactions, the controller is personally interested in the outcome. In such cases the third party may be a family member of the controller or his representative (his agent) or his principal.[144]

2. The majority-minority shareholder conflict in restructuring ownership transactions that discriminate against minorities [145]

The conflict problem between majority and minority shareholders may not consist of the direct diversion of assets or cash flow from the company. Instead, it might come from corporate restructurings such as share issues, mergers, divisions, winding-up and the like. In this case, such transactions can result in the dilution of minority shareholders' shares in favour of the controlling shareholders or the other related party 'through dilutive share issues, minority freeze-outs, creeping acquisitions, or other financial transactions that discriminate against minorities'.[146]

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[142] Stephen Bainbridge, 'Insider Trading Prohibition: A Legal and Economic Enigma, The' (1986) [ ] 38 University of Florida Law Review 35, 36.

[143] Kraakman and others (n 83) 154.

[144] See for example, art 159 of LEAA 2010, which states that

> 'Any shareholder shall not vote on a resolution when he has a direct or indirect interest for himself, his representative (his agent) or his principal, and the personal interest conflicts with the interest of the company. The violation of this rule by the shareholder makes the shareholders' issued resolution actionable when (1) the resolution harms the company and (2) there is evidence that the vote of the interested shareholders was necessary to issue the resolution'.

[145] This is also known as 'equity tunneling' and it increases the controller's share of the firm's value at the expense of minority shareholders without directly affecting the firm's operations. Examples of equity tunneling include dilutive equity issuances and freeze-outs of minority shareholders. Atanasov, Black and Ciccotello (n 112)10.

[146] Johnson and others (n 116) 3.

Specifically, tunneling in restructuring ownership transactions can take a variety of forms including. Firstly, the majority-minority conflict in share issuance (increasing capital transactions), in which minority shareholders' interests may be appropriated by the controlling shareholders when the latter issues a number of shares that either dilute the voting power of the minority shareholders [147] or sets the price "at less than their value". [148] The risk that minority shareholders face in this scenario is serious since they are not protected by shareholders decision rights. Instead, they have to rely on other legal mechanisms such as pre-emptive rights.[149] In a transaction such as the one described above, the controlling shareholders, to a large extent, can make it difficult for minority shareholders to defend themselves by making subscribing a difficult and costly process. This renders participation in new issues prohibitive for shareholders with small shares. Alternatively, the controlling shareholder 'may deliberately cause the new shares to be issued at a time when a minority shareholder is in financial straits and cannot raise funds to buy his part'.[150] In addition to increasing capital transactions, the conflict between the majority shareholders and the minority shareholders can occur in decreasing capital transaction. For example, the majority shareholders may decrease the capital of the company for purposes that serve his interest rather than the company's interests, for example, to save money to establish a new company rather than there being a need to decrease the capital of the company.

The second scenario is the majority-minority conflict in mergers (Freezeouts). Here the conflict between the minority and the majority can occur in several ways. For example, controlling shareholders are able to eliminate the minority shareholders either for cash or

[147] Kraakman and others (n 83) 195.
[148] F Hodge O'Neal, 'Arrangements which Protect Minority Shareholders against Squeeze-Outs' 45 Minnesota Law Review 537, 541.
[149] Kraakman and others (n 83) 195.
[150] O'Neal, (n 148) 541. See also *Kohli v Lit* [2009] EWHC 2893.

stock through freezeout mechanisms[151] 'at a market price that reflects a discount equivalent to the private benefits of control available from operating the controlled corporation'.[152] In such a transaction, the minority shareholders may either miss an opportunity to sell their share at a high price, or be forced to sell at too low a price because of the illiquidity of the market.[153] Also, a minority shareholder may find himself, after the merger transaction, under new terms that he does not like (e.g. a term that reduces the minority shareholders' participation in decision making or that deprives them unfairly of income or advantages).[154]

In addition to the conflict of interest between the shareholders in merger transactions, the conflict between shareholders can occur in voluntary liquidation. For example, 'a firm may be liquidated by controlling shareholders who wish to take corporate opportunities for itself or the shareholders as a whole may wish to rid themselves of a contingent liability'.[155] Conflict of interests may also occur during the transformation of the company into another type of legal entity, such as a partnership and the sale or purchase of assets, which may be in the interest of only controlling shareholders and not the minority.

Finally, the majority-minority conflict in sales of control occurs when the acquirer enters into an agreement with the controlling shareholders of the target company first, and so is able to choose to what extent a general offer to the non-controlling shareholders should be made.[156] For instance, a controlling shareholder may extract private benefits of control by selling their controlling shares at a premium that reflects the capitalized value of

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[151] Although most of jurisdictions generally facilitate minority buyouts when a controlling shareholder owns more than 90% of the company's shares, standards here play an important role in regulating conflicted transactions. UK (under unfair prejudice) and Libya (under abuse of power principle) offer the minority shareholders the right to sue. Additionally, appraisal rights can also work as a mechanism to protect the minority shareholders. See Kraakman and others (n 83) 202-8.
[152] See Gilson and Gordon, (n 130) 796.
[153] Kraakman and others (n 83) 202-8.
[154] O'Neal, (n 130) 537.
[155] Kraakman and others, (n 83) 218.
[156] ibid 229.

the private benefits of control, rather than at the market value; a transaction that is detrimental to the minority shareholders as they are obliged to accommodate the added premium through accepting a lower share value.[157]

Finally, the conflict of interests between the majority and the minority of shareholders may not include the diversion of corporate assets or take either of the two forms of tunneling described above. Instead the conflict between the majority and the minority may occur when the controlling shareholders use their votes to amend the terms of the constitution of the company in their interest at the expense of the minority shareholders. For example, they may use their control to make changes to the balance of corporate power between the shareholders and the board of directors, or to amend the rights attached to minority shareholders' shares. Additionally, conflict occurs when the controlling shareholders support the management to build an empire, seeking greater personal status at the expense of the minority shareholders. In such cases, a controlling shareholder may aim to maximize the value that comes from non-pecuniary benefits, such as social prestige, reputation and social influence, including political power. [158]

2.3.1.2. Analysing the problematic of the conflict of interests between the majority shareholders and the minority shareholders in the case of Libya

As discussed above, Libya has a concentrated ownership structure which regularly leads to conflicts between the majority shareholders (in most cases the state) and the minority shareholders. This is because in such a structure the majority shareholders have incentives to extract private benefits from the company at the expense of the minority shareholders.

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[157] Gilson and Gordon, (n 130) 793. Many jurisdictions require that buyers make an equal offer to all shareholders.(See Kraakman and others (n 83) 229). Also, some countries (such as Bulgaria) require majority of minority approval for the transfer of control. See Vladimir Atanasov, Conrad S Ciccotello and Stanley B Gyoshev, 'Learning from the General Principles of Company Law for Transition Economies: The Case of Bulgaria' ( ) 31 Journal of Corporation Law 1003. (The article discusses minority approvals of tender offers in going-private transactions).

[158] Gilson and Gordon, (n 130).

Such benefits can be gained in two ways: either directly through control of decisions made at a general meeting, or indirectly through exerting influence over the board of directors.[159]

The conflict of interests between the majority shareholders and the minority shareholders is particularly problematic in Libya since the Libyan law provides controlling shareholders with unrestricted control over the company, thereby allowing for abuses and injustices towards minority shareholders. Indeed, the statutory provisions in Libyan Company Law that deal specifically with the protection of minority shareholders are very few and those that do exist are incomplete, ambiguous and unbalanced, as discussed later. This is due to the fact that the Libyan legal system generally, and the corporate legal system particularly, tend to protect the control of the state over the economy at the expense of other shareholders. The existence of the state as a controlling shareholder in most large companies in Libya made, in the words of MacNeil, the 'adoption of a "shareholder primacy" model of corporate governance relatively attractive', since it provided a way for the state to directly own and control its companies.[160] The application of such a model would allow the relevant state to pursue a socialist market objective by exercising controlling interests in most companies.[161]

The other crucial reason that the conflict of interests between the majority shareholders and the minority shareholders is pervasive and particularly problematic in Libya is the widespread nature of corruption within the private and public sectors. The empirical studies undertaken by Caron et al, found that in countries with high levels of corruption, firms lack efficient corporate governance practices. [162] Further, XUN WU indicates that low corporate governance standards can have a deep impact on the

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[159] Kershaw (n 101) 646.

[160] This is noted by MacNeil in the case of China but is equally applicable to the Libyan case. See Iain MacNeil, 'Adaptation and Convergence in Corporate Governance: The Case of Chinese Listed Companies' (2002) 2 Journal of Corporate Law Studies 289, 309.

[161] ibid.

[162] Michelle I. Caron, Aysun Ficici and Christopher L. Richte, ' The Influence of Corruption on Corporate Governance Standards: Shared Characteristics of Rapidly Developing Economies' 2 Emerging market Journal 21.

effectiveness of the global anti-corruption campaign.[163] Accordingly, since Libya is characterized by high levels of corruption (according to the last annual report on the Corruption Perceptions Index (CPI) in 2014 issued by Transparency International, Libya ranked 166th among 174 countries in the word),[164] Libya's firms lack the efficient corporate governance mechanisms capable of contributing to a resolution in the majority-minority conflict. Thus the combination of widespread corruption, combined with a lack of minority shareholders protection, makes the conflict of interests between the majority shareholders and the minority shareholders a significant issue in Libya.

However, the conflict problem that derives from corporate restructurings, especially mergers and takeovers, which result in the dilution of minority shareholders' shares, are significantly less frequent in Libya for several reasons. Regarding the majority-minority conflict in mergers (Freezeouts), it is worth mentioning that minority freezeouts are not an issue in the Libyan economy since the law does not even allow controlling shareholders who own more than 90% of a company's shares to freezeout or eliminate the minority shareholders. However, Libyan law does allow the elimination of minority shareholders in three cases: (1) when a shareholder does not pay the instalments of his shares; (2) when the company sees, in capital decreasing processes, that it is necessary to decrease the amount of shares; and (3) when there is an agreement between the shareholders that allows the company to eliminate particular shareholders in particular circumstances.[165]

Moreover, regarding the majority-minority conflict in a sale of control, it should be noted that takeover transactions generally, in emerging market economies that has a

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[163] See XUN WU, 'Corporate Governance and Corruption: A Cross-Country Analysis' (2005) 18 Governance: An International Journal of Policy, Administration and Institutions , 151, 155.
[164] See Ch.3 (n 126).
[165] For details see Mohamed Tibar, *The Theory of Shareholders' Rights in Joint Stock Companies* (Arab Union Madbaha, 1998) 913-26 (in Arabic).

concentrated ownership structure, are rare. This is because the market is illiquid[166] and such markets have low transparency and poor quality information disclosure, both of which are required to encourage potential acquirer companies to enter in to takeover transactions. By contrast, in the UK and the U.S, where controlling shareholders are unlikely, the market for corporate control is very active, which in turn facilitates takeovers that function as a disciplining device.[167]

Though today takeover transactions in countries with a concentrated ownership structure have become much more commonplace, this is not the case in Libya due to factors that relate to the specific environment of Libya. Firstly, the Libyan government follows a policy that prevents it from selling profitable equities. This is evident in the previous discussion on the Libyan privatisation programme where the government privatized only the non-profitable companies. Secondly, despite the fact that there is no official data or empirical study which confirm that merger and takeover transitions are rare in Libya, it is clear that the lack of a competitive environment in the Libyan market (which is one of the most important requirements for frequent merger and takeover transactions) is due to the fact that the state owns most enterprises in Libya.[168] Thirdly, takeover transactions in an environment like Libya are almost impossible since there is a complete absence of loan-financed purchases[169] that may help investors to enter into takeover transactions. Finally, currently the Libyan Stock Market has only ten listed companies, so public takeover has not taken place so far and is unlikely to occur in the near future.

This situation arguably justifies the present inadequacy of provisions (or a separate laws or acts) that set down takeover and even merger transactions in Libya. In other words,

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[166] Iain G MacNeil, *An Introduction to the Law on Financial Investment* (2nd edn Oxford and Portland, Oregon, 2012) 356, Kraakman and others (n 83) 308.
[167] If the management extracts too many private benefits, the share price drops and the company becomes a takeover target. In order to get control over the firm, an acquirer has to buy the majority of both cash flow and control rights. See Sanford Grossman and Oliver Hart, 'One-share-one-vote and the Market for Corporate Control,' 20 Journal of Financial Economic 175.
[168] It should be noted that even the competition law was not enacted in Libya until 2010.
[169] Alqadhafi (n 46) 65.

as merger and takeover transactions are not yet an issue in Libya, there are very few legal clauses that regulate merger and takeover transactions. For example, the Libyan Law only speaks to merger transaction in arts 294-305 of LEAA 2010 (about two pages)[170] and there are only a very few clauses that relate to takeover transactions.[171] Though, the general rules of civil law address the issue of coordination between the acquirer and the non-controlling shareholders, this is a wholly inadequate mechanism for to the regulation of such transactions.

2.3.2. The corporate governance problems of state ownership: Agency theory applied to a state owned enterprises

State ownership was common among developed nations in the 1930s, 1940s and 1950s, and in developing nations throughout the post-war period. In developing nations, state ownership was justified in terms of facilitating economic independence, planned development,[172] and delivering social justice.[173] In the case of Libya, the state remains a

[170] Branch 4 of Book 1 of LEAA 2010 entitled 'Changing a Company, its Merger, its Divisions and its Combination'.

[171] Takeover, in Libya, is only regulated under holding companies (arts.249-255 of LEAA 2010) (almost 2 pages). art. 249 of LEAA 2010 entitled 'The Structure of Holding Companies' identifies a holding company as a company that acquires one or more companies financially and administratively by owning the majority of their shares. The same article states that 'a JSC is not allowed to acquire more than 50% of another company unless it changes its shape to a holding company'. Additionally, art 250 of LEAA 2010 sets down the goals of the companies, art 251, covers the financial relationship of holding companies, art 252 sets down the capital of the company, art 253 addresses the hiring of the representatives of holding companies, and art 254 sets down the budget and financial statements of holding companies. Accordingly, there is no provision that regulates the relationship between the minority and the majority shareholders, or protects minority shareholders against the majority shareholders. However, general civil laws must be applicable, in such cases. This is the case in most Arab World countries such as Egypt and Iraq. See Ismael Ibrahem and Nofl Rehman AL-Jbouri, 'The Legal Responsibility to Acquired on Participation Company: Comparative Study' (2010) 1/year 4 Journal of Legal and Political Sciences 9 (in Arabic). Additionally, there is no any regulation of takeover transactions in the Libyan Stock Market Act no.11/2010. However, it should be noted that Art 71(3) states that 'the Executive Regulation of the Stock Market Act regulates purchases of shares within the Stock Market'. Thus far the Executive Regulation has not been issued. (Executive regulations of the stock market acts usually regulate takeover transactions and the minority shareholders protection in this regard. See for example the Executive Regulation of Kuwait Stock Market no 7/2010, Ch.7 art.247-292).

[172] Mary Shirley and Patrick Walsh, 'Public vs. Private Ownership: The Current State of the Debate' '2001' World Bank Policy Research Working Paper No. 2420, <http://ssrn.com/abstract=261854> accessed 28-10-2013, 3.

[173] Alqadhafi noted that the existence of the public sector interpreted for conditions related to achieving social justice. See Alqadhafi (n 46) 21-4.

key player despite the extensive privatisation programmes, a situation that can be found in many countries around the world,[174] such as China.[175]

Since most listed and large private companies are directly or indirectly controlled by the government or its agencies, there are many problems created by state shareholders, particularly in terms of the relationships between the minority-majority shareholders.[176] Here I argue that the structure of state-owned concentrated ownership in Libya and the political influence exerted on corporate governance, contributes directly to the poor quality of corporate governance of Libyan companies. Specifically, the problems are essentially attributable to the conflict between the state as a controlling shareholder and the other dispersed shareholders, which results in agency issues (2.3.2.1). Moreover, the poor quality of corporate governance is compounded by a lack of monitoring by representatives of the state (2.3.2.2).

2.3.2.1. The conflict between the state as controlling shareholders and the minority shareholders

In transition countries, there is a common phenomenon of so-called insider control in corporate governance, where insiders, managers and /or employees as new owners, gain

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[174] Sunita Kikeri and Aishetu Kolo, 'Privatization: Trends and Recent Developments' '2005' World Bank Policy Research Working Paper, 2005, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=849344> accessed 13-01-2014. This study examines the recent privatization trends and investigates the extent to which government ownership is still dominant in developing countries. The study also suggests that despite widespread privatization, government ownership in state enterprises is still dominant in some regions and countries, and in certain sectors in virtually all regions. See also Oleh Havrylyshyn and Donal McGettigan, 'Privatization in Transition Countries: A Sampling of the Literature' '1999' MF Working Paper No. 99/6, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=880533> accessed 13-01-2014.

[175] The Chinese Government are still the owner of most of enterprises in China. Privatization and restructuring of SOEs mostly relates to small and medium sized firms. This is similar to the case of Libya as discussed in (2.1.2). Today, China's SOEs still owns more than one-quarter of national production, two-thirds of total assets, more than half of urban employment and almost three-quarters of investment. See e.g. Yan Wang and Xiaonian Xu, 'Ownership Structure, Corporate Governance, and Corporate Performance: The Case of Chinese Stock Companies' (1999) 10 China Economic Review 75; Harry G Broadman, 'The Business (es) of the Chinese State' (2001) 24 The World Economy 849; Donald Clarke, 'Corporate Governance in China: An Overview' (2003) 14 China Economic Review 494; ; Henk Berkman, Rebel A Cole and Lawrence J Fu, 'Improving Corporate Governance Where the State is the Controlling Block Holder: Evidence from China' [2012] 20 The European Journal of Finance 1.

[176] See e.g. Chen Qintai, 'State Shareholders Should Become an Active Force in Promoting and Establishing Effective Corporate Governance' '2004', <http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/31452400.pdf> accessed 14-01-2014.

substantial control rights during the process of privatization.[177] In such economies the main issue facing corporate governance is how to design a mechanism which deals effectively with insider control problems that give rise to conflicts between the managers and/or employees who are controlling shareholders and other, minority, shareholders. However, this is not the case in Libya since the privatisation programme has not been completed. The main corporate governance problem arising within SOEs in Libya is the conflict of interests between minority shareholders and the bureaucrats and politicians who represent SOEs.

In principle, the main dilemma faced by Libyan SOEs is the conflicting objectives that result in agency issues (political interference).[178] In the structure of state concentrated share ownership, the state, as the biggest shareholder in both listed and large private companies, pursues its political goals (usually social welfare maximisation) at the expense of other shareholders rather than pursuing profit maximization or efficiency, [179] which should usually be given priority in a market economy. In other words, SOEs not only have commercial goals but they are also obligated to serve social objectives, such as providing jobs, serving public interests and providing basic necessities. As a result of these various demands, SOEs can be prevented from competing with their private counterparts for profits; a situation which hinders the development of a free, competitive system.[180]

The principal-agent issue that is considered one of the SOEs major problems has two dimensions. Firstly, in such a system, the management and also bureaucrats, and

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[177] See e.g. Aoki Masahiko, 'Controlling Insider Control: Issues of Corporate Governance in Transition Econornies' in M Aoki and HK Kim (eds), *Corporate Governance in Transitional Economies* (The World Bank 1995).

[178] These problems are, in fact, the main problem of any SOE in any country. However, there are other problems of corporate governance found in SOEs, such as unprofessional boards of directors and the underperformance of the management, which are not relevant to this study. For more information see e.g. Simon Wong, 'Improving Corporate Governance in SOEs: An Integrated Approach' (2004) 7 Corporate Governance International 6.

[179] See .e.g. Maria Vagliasindi, 'Governance Arrangements for State Owned Enterprises' '2008' World Bank Policy Research Working Paper No. 4542, 2008, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1102837> accessed 13-01-2014; Shirley and Walsh (n 172) 20.

[180] See Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine, 'Law, Endowments, and Finance' (2003) 70 Journal of Financial Economics 137.

politicians who represent the state as an owner, act as loyal agents of the citizens,[181] especially when political markets are assumed to be working efficiently.[182] In this respect, even in fully competitive environments, SOEs will be inefficient because politicians use them to deal with political goals such as over-employment.[183]Accordingly, the conflict of interest arises in corporate governance between the state as a controlling shareholder (even though its goal is to achieve social welfare maximisation) and the minority shareholders, since 'in many countries, it has been recognised that business operations, even if publicly owned, have to be run according to a commercial rather than an administrative cycle'. [184] As an example of such a conflict, currently the Libyan government is tending to grant Libyan rebels investment loans from commercial banks in which the state is the controlling shareholder, in order to encourage them to leave their militias and enter civil society. No doubt there is a social goal behind this policy. However, this strategy may prove detrimental to the minority shareholders in those banks since such loans may be not profitable as most of the rebels have no experience of running businesses.

Secondly, the principal-agent issue may come from the assumption that politicians and bureaucrats, as representatives of the state, may not perform their work either in the interests of the company itself or as loyal agents of the citizens. Instead they may run the company for their personal interest as opposed to the owner's (the state's) interest. The traditional example of this is when officials who control the SOE move the SOE's assets to another company, which is either owned directly by himself or a related party (e.g. friends or relatives). Even when this is not the case, it may be that the politicians and bureaucrats will not run the company seriously, since they have no direct interest in the SOE. More

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[181] All people of the state are the owner of an SOE's assets, but they are controlled by the government and its agencies. Unlike private shareholders, the government's role in corporate governance is largely dependent on political incentives and individual utility maximisation instead of shareholders' value.
[182] Shirley and Walsh (n 172).
[183] These arguments are verified by research documenting political influence over SOEs. For criticism of SOEs documenting the influence of politicians see Andrei Shleifer and Robert W Vishny, 'Politicians and Firms' (1994) 109 The Quarterly Journal of Economics 995; Shirley and Walsh (n 172).
[184] OECD, *Corporate Governance, State-Owned Enterprises and Privatisation* (OECD, 1998) 15.

than that, they can potentially be blamed if the SOE gains high profits as it would be regarded as too commercial an SOE.[185] In other words, SOEs are controlled by politicians who are supposed to implement the state's policy. However, this is not always the case since politicians and bureaucrats are known to act in their own interests as well. For instance, when SOEs request higher budgets, it can be the case that managers offer the politicians something in return. Shleifer and Vishny examine such a situation, linking the results of different assumptions to the prevalence of bribes. They found that SOE managers create employment that is politically desirable and economically inefficient, and in return politicians grant managers budget increases.[186]

Empirical evidence has proved that politicians in charge of SOEs do, in fact, act in ways that benefit themselves at the expense of general welfare of the society (and so at the expense of the minority shareholders as well). Shleifer and Vishny list a number of cases of SOE inefficiency that result from political intervention, such as excess employment, above-market wages, investment in projects that benefit politicians rather than consumers, and allocative distortions resulting from skewed pricing schemes.[187] Also, Frydman et al examined state ownership in transition economies and found that "politicization" prevents SOEs from restructuring and in particular e.g. they show that political pressures prevent layoffs.[188] Similar processes are described in the works of Jones.[189]

Furthermore, even though there are no studies or data available, it is commonly understood in Libya that the state often enters into related-party transactions as intra-group transactions. The state, as a shareholder (usually the Libyan Economic Ministry), controls a number of companies, both listed and delisted. In such cases, quite apart from outright theft, the Economy Ministry, for example, may have one company providing accounting

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[185] Wong, (n 178) 9.
[186] Shleifer and Vishny, 'Politicians and Firms' (n 183).
[187] ibid 995-6; See also Leroy P Jones, 'Public Enterprise for Whom? Perverse Distributional Consequences of Public Operational Decisions' (1985) 33 Economic Development and Cultural Change 333 387-41
[188] Frydman and others, (n 69) 1177.
[189] Jones, (n 189) 337ff.

services to the rest of the companies that it owns even though it provides a poor service. Also, the Ministry may transfer cash from a company to another that it owns. This allows the Ministry to redistribute profits or resources from one member firm to another member firm at the expense of the minority shareholders. While this kind of coordination may serve legitimate business purposes, each inter-firm transaction clearly provides opportunities for expropriation from minority shareholders.[190] It should be noted that Libyan law neither provides provisions to separate the social and business functions of SOEs, nor eliminates the problems that derive from political interference despite the fact that political interference in SOEs has the potential to prevent companies from being competitive in the open market.

2.3.2.2. The state as a controlling shareholder and the lack of efficient monitoring

In principle, controlling shareholders are able to efficiently monitor the management of private companies because of the existence of owner-operated private firms, the disciplining role of takeovers, [191] a healthy market for managers, profit-oriented monitors[192] and the ability of markets to generate information that helps private firms in monitoring processes.[193] Also, in private companies, the strong incentives of large shareholders to monitor mangers derives from their cash flow rights that line up their interests with those of the company.[194] However, state ownership is characterized by weak monitoring because the shareholding politicians and bureaucrats (agents) have no

[190] For information about intra-group transactions see Kraakman and others (n 83) 176-7.
[191] See e.g. Shirley and Walsh, (n 172) 8.
[192] Sunita Kikeri and John Nellis, 'Privatization in Competitive Sectors: the Record to Date' '2002' World Bank Policy Research Working Paper, 2002, < http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-2860> accessed 14-01-2014
[193] See .e.g. John Vickers and George Yarrow, 'Economic Perspectives on Privatization' (1991) 5 The Journal of Economic Perspectives 111, 115.
[194] Ding Chen, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Edward Elgar Publishing Limited, 2013) 93. It may be argued that the agent might be motivated to monitor if they are liable for the failure of the supervisees. However, 'it is very difficult to establish the causality between a company's poor performance and monitor's failure in order to hold them accountable; second, it will encourage the agent to over-monitor and might impede managers' discretion, which is necessary for the operation of the business'. ibid 94.

personal equity and no cash flow rights at stake in SOEs that they supervise compared with the majority of shareholders in private companies (sometimes referred to as the "absent owner problem").[195] Consequently, 'they do not have strong personal financial incentives to monitor company performance closely or otherwise to exercise formal shareholder rights to ensure the companies operate as efficiently as possible.'[196] Thus 'they do not directly benefit or suffer from the performance of the company'[197] that they monitor. On the other hand, it has been argued that citizens (in this case, Libyans) who are the real owners, and the ministries who hold the shares on behalf their collective benefits, are poorly placed to monitor the companies because of "free-rider" problems.[198]

It is important to stress that a lack of monitoring by the controlling shareholders in SOEs raises two conflicts. Firstly, because of the fact that managers and owners have different objectives, and because the owner does not have complete information about the behaviour and decisions of the manager, there is a conflict between the management and the owners which falls outside the scope of our study. Secondly, another principle-agent problem (the majority-minority problem) is brought about because the shareholding politicians and bureaucrats are not interested in monitoring the company and improving the performance of SOEs,[199] rather they are able to use their authority to serve their own

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[195] Wong, (n 178) 10; OECD 'Corporate Governance, State-Owned Enterprises and Privatisation' (n 184) 41; Chen (n 194) 93. See also Donald C Clarke, 'Corporate Governance in China: An Overview' 14 China Economic Review 494 .

[196] OECD (n 184) 41. For more details see Yuwa Wei, *Comparative Corporate Governance: A Chinese Perspective* (Kluwer Law International, 2003) 24; Donald C Clarke, 'Independent Director in Chinese Corporate Governance' 31 Delaware Journal of Corporate Law 125, 147.

[197] Chen (n 194) 94.

[198] OECD (n 184) 41.

[199] Empirical findings widely support the idea that state ownership has a negative impact on a firm's performance when compared with private ownership. (See e.g. William L Megginson, Robert C Nash and Matthias Randenborgh, 'The Financial and Operating Performance of Newly Privatized Firms: An International Empirical Analysis' (1994) 49 The Journal of Finance 403; Wei Li, 'The Impact of Economic Reform on the Performance of Chinese State Enterprises, 1980-1989' (1997) 105 Journal of Political Economy 1080; Agustin J Ros, 'Does Ownership or Competition Matter? The Effects of Telecommunications Reform on Network Expansion and Efficiency' (1999) 15 Journal of Regulatory Economics 65). Although this result is controversial, the studies that support the idea that state ownership has a positive effect on firm performance are very few. In this regard Shirley compared 52 empirical studies on the issue (see Shirley and Walsh (n 172)) 32 studies found that the performance of private and privatized firms is more efficient than SOEs. However, only 15 studies found no relationship between ownership and performance and only 5 studies concluded that SOEs perform better than private firms.

interests, which detrimentally affects the minority shareholders. Moreover, the lack of accountability and transparency of SOEs substantially increases the risk of exploitation by self-interested politicians. [200]

Importantly, the weak control and monitoring by the state in Libya has resulted from several financial and administrative problems such as 'bureaucracy, centralization of management, functional dissatisfaction, administrative and financial corruption, favouritism, fraudulence and bias, etc'. [201] In this context, some Audit Bureau reports indicate a lack of control and monitoring in the public sector. For example, in the Arab Cement CO, there was a lack of control and monitoring by the state and an absence of co-ordination between the production units, especially with respect to purchase operations abroad. In addition, a lack of discipline among the employees of the Company resulted in the stopping of production in certain factories. [202] Also, in the General Cargo Transport CO., there is weak control and monitoring concerning the fixed and movable assets of the company, thus exposing them to damage and loss. [203] This is applicable to animal production projects in the agricultural sector[204] and the Libyan Fishing Co,[205] and it also applies to the banking sector where the Central Bank of Libya failed to control and monitor the commercial banks of which it is an entire or partial owner.[206]

With the inefficiency of monitoring by the state as the controlling shareholder, it could be argued that Libyan banks, as the main financier of debt in Libya, should have a role in monitoring firms. However, the corporate governance theory that debt is a governance mechanism capable of providing additional monitoring over management

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Although it is controversial that the SOEs perform poorly, there is no doubt that in the case of Libya, such enterprises suffer a lot of losses as a result of poor performance. This situation is considered a main reason for transferring the economy from a planned economy to a free market economy as discussed in (1.2.2).

[200] Wong, (n 178) 10.[201] Alqadhafi (n 46) 35.

[201] Alqadhafi (n 46) 35.

[202] See Report of Audit Bureau for 1989 p. 47 cited in ibid. 35.

[203] Report of Audit Bureau for 1989 p. 115 cited in ibid. 35.

[204] Report of Audit Bureau for 1989 p. 53 cited in ibid 35.

[205] Report of Audit Bureau for 1990 p. 69-70 cited in ibid 36.

[206] Libyan Audit Bureau-LAB,'Annual Report of the Libya Audit Bureau-2013' (Libyan Audit Bureau, Libyan Audit Bureau 2013) 320 (in Arabic).

(since bank loans enables the debt-holders (the banks) to monitor the corporations directly and collectively)[207] does not work efficiently in Libya. The Libyan government has neither adopted the Anglo-Saxon model of corporate governance, which is characterised by the protection of investors and creditors, nor introduced a bank system that provides efficient monitoring of the performance of the enterprise, such as has been adopted in Japan and Germany. Instead, though banks are the main providers of external finance to Libyan companies and the relationships between banks and enterprises are naturally close, the banks in Libya are unable to play a role in corporate governance and monitor the firms efficiently.[208] This is because the external finances provided by the banks represent only a small part of corporate financing and, as such, banks may not feel motivated to monitor clients effectively.[209]Additionally, the banks are poor governance agents and have distorted incentives. The loans are regulated by personal relationship rules rather than corporate governance mechanisms. In this context, Porter, and Yergin pointed out that:

> [B]anks [in Libya] have difficulties in assessing the riskiness of loans, since they lack standardized and reliable information on the financial conditions of borrowers, and market data. In the absence of robust risk assessment systems, financial institutions have adopted alternative procedures to mitigate lending risks. For example, Libyan banks disburse loans primarily to customers whom bank employees know personally. For customers without personal connections, banks demand substantial collateral—as much as 125% of the total loan amount in some cases. […] In the SME survey Libyan SMEs identified banks' tendency to lend only to those known personally,

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[207] In this regard Berglöf and Claessens states that

> Lending and monitoring by banks, typically the most important source of external finance, is of particular interest. As lenders, banks will have a direct stake in the governance of corporations, requiring firm behavior that assures that their loans can be repaid. As monitors, banks can compensate for some weaknesses in the general enforcement environment as they have repeated dealings, have reputation to maintain in lending, and can economize on monitoring and enforcement technology. The development of bank lending itself obviously relies on the effectiveness of the regulatory framework and supervision, in addition to other institutions allowing collateral to be collected.

See Erik Berglöf and Stijn Claessens, 'Corporate Governance and Enforcement' '2004' World Bank Policy Research Working Paper 3409, September 2004 <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3409> accessed 29-10-2013, 34.

[208] See (1.3.2.2) 45ff.

[209] Erik Berglöf, 'Corporate Governance in Transition Economies: The Theory and Its Policy Implications' in M Aoki and H Ki Kim (eds), *Corporate Governance in Transitional Economies* (The World Bank, 1995) 61.

> and to demand large collateral, as the two main difficulties in raising capital from government banks.[210]

Further, the Libyan Bank Law does not delegate any role to Libyan banks in regard to the obligation of firms to disclose information to the banks about the firm's major business and financial activities, or even to accept monitoring from the creditor bank. Also, the law does not grant Libyan banks the right to audit all the dealings between the firm and other banking institutions, or to punish the firm if there are any activities that breach the terms of the loan. Such rules that endorse a primary monitoring role for banks to restrain the inside control behaviour within large SOEs have been adopted in many other transition countries, such as China.[211]

Since monitoring by the state as a controlling shareholder and by the banks is not effective in Libya, the government has adopted another way to monitor the management of SOEs which falls outside corporate governance. According to Law no 19 of 2013 Concerning the Reorganization of the Audit Bureau,[212] the Audit Bureau is delegated to monitor the management of SOEs of which the Government owns 25% or more of the capital[213] and enterprises that were obtained by donation or loan from the government (if the loan agreement stipulated that the Audit Bureau has the authority to monitor them).[214] Article 13 of Law no 19 of 2013 sets down the process of monitoring the management of these SOEs.[215]

In short, the conflict of interests between the majority shareholders and the minority shareholders is particularly problematic in Libya because LEAA 2010 provides controlling shareholders with unrestricted control over the company and there is a

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[210] Porter and Yergin (n 55) 57.
[211] See Jian Chen, *Corporate Governance in China* (Psychology Press, 2005) 54.
[212] The Libyan Audit Bureau is an independent body is guided by the legislative authority (art 1 of Law no 19 of 2013). The Libyan Audit Bureau aims to monitor the public assets and money and reveal any financial violations and breaches in public institutions (art 2 (1), (3) of Law no. 19 of 2013).
[213] See Law no 19 of 2013, art 3 (2).
[214] See Law no 19 of 2013, art 3 (5).
[215] For more information see Majdi Abdou, *Subsequent Financial Oversight of The State Budget: A Comparative Study between Libyan law and Egyptian laws* (Al Mergib University, School of Law 2006) 270ff (in Arabic). Ch.4 discusses the process of monitoring the public institutions.

widespread nature of corruption within the private and public sectors. Additionally, the conflict between the state as controlling shareholders and the minority shareholders differ from that which occurs between the controlling shareholders as an individual and the minority shareholders. This is because the management, and also bureaucrats, and politicians who represent the state seek to serve social objectives (as, they act as agents of the citizens) rather than commercial goals, which are the goals of the minority shareholders. Also, since the representatives of the state (as a controlling shareholders) have no direct interest in running the company, the principal-agent issue arise from the assumption that politicians and bureaucrats may not perform their work either in the interests of the company or the state. Instead, they may run the company for their personal interest. This situation contributes, among other things, to a lack of efficient monitoring.

Conclusion

In this chapter, I located the dimensions of the conflict of interest problem between the minority and majority shareholders in Libya. Having defined structures of corporate ownership, which is very important as it affects the nature of governance problems, the chapter discussed the corporate structure in Libya (a concentrated ownership structure) where the Libyan government retains a large ownership position in many sectors of the economy across both public and private commercial enterprises. Though this is a legacy of the socialist policies adopted from 1970 to the 1990s, the structure has not changed due to the inefficiency of the privatisation programmes.

The concentrated ownership structure in Libya forms the nature of the principal-agent problem, which is a problem of conflicts of interest between the minority and majority shareholders. In this system minorities are vulnerable to exploitation and fraud by the majority as the shareholders with a high ownership share are capable of using their

position to acquire private benefits by using their voting rights to consume corporate resources to their advantage. However, the conflict of interests between the majority shareholders and the minority shareholders is particularly problematic in Libya. This is because LEAA 2010 provides controlling shareholders with unrestricted control over the company, thereby allowing for abuses and injustices towards minority shareholders. This situation is compounded by the widespread culture of corruption within the private and public sectors in Libya.

The conflict between the state as controlling shareholders and the minority shareholders in Libya takes a specific form. This is because the state is the dominant owner of the most assets of public and private large companies in Libya. Therefore, the form of the conflict between the state as a controlling shareholder and the minority shareholders may occur in the two following ways: firstly, the management, (and also bureaucrats, and politicians) seek to achieve social objectives rather than commercial goals. Secondly, since the representatives of the state (as a controlling shareholders) have no direct interest in running the company, so there is an assumption that they may not perform their work in either the interests of the company or the state especially in the absence of effective monitoring.

Chapter 3: Evaluating the Current Mechanism Employed in Libya: The Deficiency of the Minority Shareholders Actions

Introduction

Having determined the dimensions of the minority-majority shareholder problem in the previous chapter, here the study evaluates the solution to this problem currently used under art 159 of LEAA: the minority shareholders actions. It is useful to note that the strategy adopted by UK law and Libyan Law in relation to the majority-minority shareholders problem differs from the one that deals with the directors-shareholders problem. In both countries, company directors are subject to a range of different provisions that address conflict of interest transactions, e.g. law duties of loyalty, statutory disclosure, and shareholder approval. Regarding listed companies, directors are subject to disclosure and approval obligations pursuant to the UK listing rules and Libyan Stock Market Regulation respectively.[1] However, controlling shareholders are not subject to such duties or obligations in either country. There are not, for either public or private companies, any *ex ante* disclosure obligations on the board or the shareholder body for matters concerning, for example, related-party transactions with controlling shareholders, or any approval requirement.[2] However, the UK Listing Rule makes an exception for premium listed companies: premium listed companies and their controlling shareholders must enter into a written agreement, under this agreement, transactions and arrangements with the controlling shareholder and their associates must be conducted at arm's length and on normal commercial terms. This new mechanism grants the minority shareholders a tool to

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[1] See (5.1.1).

[2] For example, there is no equivalent of a controller in section 177 and 182 of CA 2006 (and art 181 of LEAA 2010), board disclosure obligations for self-dealing transactions or any requirement to obtain shareholder approval for related-party transactions, as is required for self-dealing transactions pursuant to the substantial property transaction rules in sections 190-195 of CA2006 (and art 181 of LEAA 2010).

veto any unfair transactions between the company and controlling shareholder, as discussed in Ch.4.[3]

Therefore, the solution adopted in both countries to deal with conflict of interest transactions by controlling shareholders (except in relating to the UK premium listed companies) is a minority shareholders action. In fact, this option is the dominant tool for addressing conflict of interest transactions in the overwhelming majority of jurisdictions including the UK, which adopts the unfair prejudice remedy[4] and Libya which adopts the Liability Action and the Nullification Action.

However, Libya, like many developing and transition countries, and unlike many developed countries, has an inadequate legal system especially in terms of the enforcement court system, which is a common issue in such countries.[5] Indeed, writing good laws does not automatically solve the majority-minority shareholders problem as there are still many concerns regarding the effectiveness of the majority-minority shareholder remedies even with existence of good law. In other words, massive expropriation by the controlling shareholders can occur 'even when the law on the books is nearly optimal'.[6] This is largely because rules and regulations are not effectively enforced by courts. This situation may take years to be reformed as it requires the creation of a functioning court system and judges to be adequately trained. Thus, currently, enforcement (rather than regulations and laws on the books) is the key problem in Libya.[7]

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[3] See (4.4.1.2).

[4] See Reinier R. Kraakman and others, *The Anatomy of Corporate Law* (Oxford University press 2009) 175-6; David Kershaw, *Company Law in Context: Text and Materials* (Oxford University Press 2012) 704.

[5] Recent research underlines the fact that enforcement of the rule of law is the central functional difference between developed market economies and developing economies. Whilst in developed countries the debate concerns, for example, the issue of the optimal level of enforcement intensity (See for example, John C. Jr. Coffee and Adolf A. Berle, 'Law and the Market: The Impact of Enforcement ' (2007) 156 University of Pennsylvania Law Review) in transition countries, such as Libya, this is not the case, instead the debate concerns a lack of enforcement and how can it be enhanced, as discussed in (3.2).

[6] Jr. Jack C. Coffee, 'Privitization and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 Journal of Corporation Law 1, 6.

[7] According to La Porta *et al.*, transition countries achieve higher levels of investor rights protection on the books when compared to most developed economies. La Porta *et al.* found that transition economies score

The central objective of this chapter is to examine to what extent the current approach adopted under art 159 of LEAA 2010 to protect the minority shareholders is appropriate to the Libyan case. This chapter explores how a remedy can be effective within Libya which is currently characterised by a lack of legal enforcement. Currently, the Libyan courts system is ineffective and the Libyan judicial system can be considered as a system of non-intervention. [8] The combination of these factors prevents minority shareholders from suing majority shareholders for breach, misuse, wrongdoing or oppression. This chapter does not suggest a model of best practice that Libya could adopt in respect of the private enforcement of shareholders' rights. Instead it evaluates the general approach adopted in art 159 of LEAA 2010 regarding minority shareholder protection within the context of both the lack of enforcement in Libya and the minority shareholders' lack of access to the court system. [9] This is designed to provide the analytical context that will allow us to introduce our main argument in the following chapter, that self-enforcement is the most effective and appropriate solution to address this problem in the case of Libya.

In order to achieve this objective, and for the sake of clarity, section (3.1) begins by briefly outlining some basic factors concerning how the approach outlined in art159 is currently operative in Libya. To that end, this section firstly discusses actions that the minority shareholders can bring under LEAA 2010 (3.1.1) and secondly, outlines the mechanisms that Libyan courts can apply to solve such conflicts (3.1.2).

3.13, compared to the French civil law family (2.33), German civil law family (2.33), Scandinavian civil law family (3.0) and common law family (4.0). See Rafael La Porta and others, 'Law and Finance' (1998) 106 Journal of Political Economy 1113.

[8] The approach in this chapter is not restricted to legal enforcement. Instead I adopt a much broader approach to enforcement that consists of a set of institutions that could affect negatively on minority shareholders' ability to bring an action against the controlling shareholders. Following Barzel, who defines enforcement as 'the credible threat to induce compliance'. See Yoram Barzel, *A Theory of the State: Economic Rights, Legal Rights, and the Scope of the State* (Cambridge University Press 2002) 35.

[9] Here we should note that a detailed analysis of minority shareholders protection in Libya goes beyond the scope of this thesis.

Following this, section (3.2) undertakes an investigation that provides a theoretical framework for the problem of court enforcement both in transition economies generally and in Libya particularly. To that end, (3.2.1) begins by outlining the literature that engages with the problematic of effective court enforcement generally. Following this, (3.2.2) goes on to discuss how court enforcement is further problematized within the context of transition and developing economies and then (3.2.3) sites Libya as a particularly extreme case in terms of court enforcement.

Having discussed the theoretical framework for the problem of court enforcement, the three following sections analyse the situation in Libya[10] and the difficulties and challenges that minority shareholders face in bringing an action against the controlling shareholders. Firstly, in (3.3) the study explores the general environment in Libya with regard to the lack of law enforcement. This section evaluates the judicial approach adopted by LEAA 2010 and argues that the current judicial protection for minority shareholders is ineffective. This is because of the negative impact on court enforcement of both judicial corruption (3.3.1) and the slow pace of justice (3.3.2). In addition, as an analysis of court efficiency needs to extend beyond the courts themselves to understand their role in the larger system, this section considers how other political and social factors hinder the efficacy of court enforcement in Libya (3.3.3).

To extend this analysis further, in (3.4) I argue that the current Libyan courts are not equipped to deal with commercial cases that relate to abuse of power by the controlling shareholders. This is because the current judges lack the adequate experience and expertise to deal with such cases (3.4.1). This is especially the case as the current legal system

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[10] I consider variables that relate to the specific case of Libya (such as those associated with the Libyan societal structure) since every country has its own environment and preferred mix of enforcement technologies that vary according to the country's characteristics. (See Erik Berglöf and Stijn Claessens, 'Corporate Governance and Enforcement' World Bank Policy Research Working Paper 3409, September 2004 <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3409> accessed 29-10-2013, 26). In Addition, I consider the variables that are commonly used to assess legal effectiveness. (For more information, see (3.2.3).

concerning the protection of minority shareholders is based on the wide discretion of judges (open-ended legal standards) rather than a set of defined legal standards (3.4.2).

Finally, I argue in (3.5) that the approach to the protection of minority shareholders adopted under art 159 of LEAA 2010 has failed since the Libyan judicial system can be considered as a system of non-intervention. In Libya, the minority shareholders face difficulties in bringing an action against the controlling shareholders (who usually also sit on the board of directors) because there are gaps in the law that we must look to the UK to fill. A derivative suit, [11] which is allowed in almost all jurisdictions, is not allowed in Libya (3.5.1) and there are high risks and costs attached to bringing a dispute to court (e.g. the court requires a deposit from the shareholders in order to bring an action against the majority shareholders) (3.5.2). In addition, the courts are barred from intervening in certain cases. For example, the minority shareholders cannot bring an action against the majority shareholders when the latter is in the position of a shadow director (3.5.3). All of these factors lead us to conclude that the Libyan judicial system is a non-interventionist system.

3.1. Minority shareholders' action as a primary approach in addressing the majority-minority shareholders problem: overview of the case of Libya

Before beginning the evaluation of the minority shareholders' actions as an approach to dealing with minority-majority shareholders' conflict, it is necessary to provide a brief overview concerning how the approach currently operates in Libya. To that end, this section firstly discusses actions that the minority shareholders can bring under LEAA 2010 (3.1.1) and secondly, outlines tools that the Libyan courts apply to solve such conflicts (3.1.2).

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[11] A derivative suit can be relevant to the minority-majority shareholders problem for two reasons. First, the controlling shareholders are usually also on the board of directors, especially in Libya where the state is the often the controlling shareholder and owns massive assets in most of Libya's large companies. Secondly, directors may abuse their power against the minority shareholders in response to majority shareholder pressure.

3.1.1. The minority shareholders' actions under LEAA 2010

Art 159 of LEAA 2010 addresses the conflict of interests between shareholders and clearly allows the minority shareholders to bring actions against the majority shareholders by stating that:

> Any shareholder shall not vote on a resolution when (1) he has a direct or indirect interest for himself, his representative (his agent) or his principal, and (2) the personal interest conflicts with the interest of the company. The violation of this rule by the shareholder makes the shareholders' issued resolution actionable when (1) the resolution harms the company and (2) there is evidence that the vote of the interested shareholders was necessary to issue the resolution.

According to LEAA 2010, there are two types of suits: Nullification Actions and Personal Liability Actions. When the minority shareholders seek only to invalidate the shareholders' resolution, they may bring a nullification action (3.1.1.1). [12] However, if this cannot be achieved for some reason, or they want to pursue compensation they can bring a personal liability action [13] (3.1.1.2).

3.1.1.1. Nullification Action

In Libya shareholders have the right to challenge in court the validity of shareholder resolutions, if they violate the company's regulations or the law. Under art 160 of the LEAA 2010, 'resolutions of shareholders are binding to all shareholders. The board of directors, a watchdog committee, absent shareholders and any dissenters (including minority shareholders) can challenge the resolution if it contradicts law and the constitution of the company'.[14] This action is referred to in French, Egyptian and Libyan jurisprudence as an invalidity/ revocation/nullification action.

[12] Mohamed Tibar, *The Theory of Shareholders' Rights in Joint Stock Companies*, vol 2 (Arab Union Madbaha 1998) 928 (in Arabic).
[13] ibid.
[14] The same provision is found in Egyptian Companies Act no. 159/1981, art 76 (1) which states that 'any shareholders' resolutions which are in the interest, or harm a particular group of shareholders […] are voidable'.

It is important to note that the nullification of resolutions cannot be enforced without litigation. This means an aggrieved party must bring a nullification action against the board of directors or the majority shareholders in order to have their resolution revoked.[15] Moreover, to nullify the majority shareholders' resolution there must be evidence of abuse by majority shareholders against the minority shareholders. In other words, the burden of proof is on the minority of shareholders (Plaintiff) to evidence that a transaction is unfair.[16]

The decisions that the court can make in relation to a nullification action are limited to either confirming the resolution or revoking it. To reach its decision, the court deals with three categories of rules.[17] The first are rules associated with the formality (process/procedure) of making resolutions. In this category, the court must revoke a resolution if it does not adhere to particular legal formality. For example, the decision must be revoked if a shareholders' resolution has been made without the required quorum. In such a case, the court has no discretion, but must revoke the resolution if correct procedure in the decision making process has not been followed. In the second category are rules derived from a more general legal theory. These include principles (or doctrines) such as the no abuse of rights principle, fraud, bad faith, etc. In such cases the courts have discretion over whether they revoke resolution or not, based on these principles. The third are mandatory rules that relate to the object of the company, but not to legal theories or principles. For example, a resolution to issue shares at a price lower than the price determined by law [18] will be revoked.

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[15] See Ali Hasen Yonis, *Commercial Law: Financial Companies* (Madbea Wahba and Sons 1991) 484 (in Arabic); Esmael Kanem, *The General Theory of Commitment*, vol 1 (Wahba Library 2006) 279 (in Arabic).

[16] For details see Emad Rmadan, *Minority Shareholders Protection in Joint-Stock Companies* (Dar alkoteb Alkanonia 2008)799-810 (in Arabic).

[17] Tibar (n 12) 863.

[18] For example, according to s 2 of the Resolution of Cabinet Ministers (N. 86) in 2012, the nominal value of shares determined by the constitution of the company must be 10 Dinar (equivalent to £5).

3.1.1.2. Personal Liability Actions

The minority shareholder may not only seek to revoke the board's decision or the shareholders' resolution, via a Nullification Action, but may also seek compensation for the harm that results from such actions.[19] To get such compensation, Libyan law allows the aggrieved minority shareholders to sue the wrongdoer (either the majority shareholders or the board of directors) under a personal liability action if the minority shareholder suffers personal harm as a result of an action taken by the majority shareholders and/or the board of directors. Accordingly, the basis of such an action is the breaching of the minority shareholders' personal rights.[20] The rights of the minority shareholder are not vested in the company. Instead the minority shareholder acquires personal rights under an agreement to which he is party in his personal capacity, under the company' constitution or under statute'.[21]

A personal liability action is brought by the minority shareholders against both the majority shareholders and the board of directors. The legal source of such an action is derived from both LEAA 2010 and the Libyan Civil Code 1953. Under art 186 of LEAA 2010, 'the previous provision (art 184, Company Liability Action, which is discussed later) does not affect the shareholders' right to bring an action against the board of directors to get compensated for any harm that has occurred to them directly due to the conduct of the board of directors'. For example, if the board of directors disclosed false information (e.g. misleading financial statements) which led the investors to buy shares believing that their price would go up, under the LEAA 2010, the minority shareholders can sue the board of directors under a Personal Liability Action.

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[19] This kind of action may be brought either independently of a revocation action, or as the result one.
[20] Christopher Hale, 'What's Right with the Rule in Foss v Harbottle?' (1997) 2 Company, Financial and Insolvency Law Journal 219, 221.
[21] Victor Joffe and others, *Minority Shareholders: Law, Practice, and Procedure* (4 edn, Oxford 2011) 29 and 89ff. More discussion about personal rights is provided later in this subsection.

In addition, the minority shareholders can also bring a personal liability action against the majority shareholders. Whilst LEAA 2010 does not address a personal liability action brought by the minority shareholders against the majority shareholders, such an action comes from the general rule of Libyan Civil Code 1953. The origin of such an action is set down in art 166 of the Civil Code 1953 which states that 'any wrong that causes harm to others necessitates compensation'. The 'wrong' noted in the article denotes the breach of a legal obligation[22] which has two requirements.[23] First, there is a tangible requirement, in which deviation from a legal behaviour means that the wrongdoer commits an action that breaches a legal obligation.[24] The second is an intangible requirement of recognition. This means that the wrongdoer recognises that his behaviour has resulted in a wrong. Therefore, the source of such an action is the delictual liability[25] that emanates from a civil wrong or injury and is based on an intentional or negligent breach of duty of care that inflicts loss or harm and which triggers legal liability for the wrongdoer. As such, a personal liability action is applicable when an intentional or negligent act gives rise to a legal obligation, even in the absence of a contract.[26] According to Tibar, a personal liability action is a right delegated to any shareholders that is derived from general rules of civil law based on delict. The aim of such an action is to repair damage that has happened to the claimant shareholder to protect his personal interest.[27]

Here it should be noted that Liability actions in Libya are not restricted to personal liability actions. There is another action called a Company Liability Action, which can be brought when a majority of the shareholders believe that the company's interests as a

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[22] Mohammed Al Badawi, *The General Theory of Obligations: Sources of Obligations*, vol 1 (AL Markez Al Qawmi 2003) 292 (in Arabic).
[23] For details of these requirements see ibid 293-301.
[24] The approach adopted by CA 2006 is broader than that in Libya since the liability of unfair prejudice is not only based on breaching a legal obligation (as is the case in Libya) but also on a legal conduct that relies on legitimate expectation.
[25] Tort Liability is the equivalent legal term used in common law jurisdictions.
[26] Abu Zaid Radwan and Fair Naem, *Commercial Companies* (Dar Alfeker Al Arabi 2000) 643 (in Arabic); Yonis (n 15) 424.
[27] Tibar (n 12) 999.

whole are under threat because of the board of directors' actions. For this remedy to be applicable, the actions of the board must result in the breaching of corporate rights. This means the majority shareholders cannot bring this action without claiming that their corporate rights have been breached by the board of directors. Thus the function of this action is to enable majority shareholders, in limited circumstances, to pursue an action for harm done to the company *per se* and to seek compensation on the company's behalf.[28] For instance, the majority shareholders can seek to 'enforce a right vested not in him himself but in the company of which he is member, for example, a claim to the company's property fraudulently misappropriated by the directors'.[29] Only the majority shareholders can resolve to bring a liability action against the board of directors and request compensation.[30] Under Art 184 of LEAA 2010, 'to bring an action that makes members of the board of directors responsible shall be based on a resolution issued by the shareholders in a general meeting'.[31] This kind of action is known in French, Egyptian and Libyan legal jurisprudence as a Company Liability Action. A Company Liability Action is not a derivative action as it requires the majority shareholders to take action and issue a resolution to sue the board of directors; by contrast, a derivative action requires no such a resolution.[32]

It is worth mentioning that Libyan Law contains only the two previous liability actions: Personal Liability Action and Company Liability Action. Consequently, it is clear that there is a gap between these actions. This gap is evidenced by a third scenario which occurs when the company's interests (not personal interests) have been harmed by either an action of the board or the majority shareholders, but the majority shareholders refuse to take action. Here a minority of the shareholders should be able to sue the majority

[28] ibid 955.
[29] For more information about company rights see Joffe and others (n 21) 30.
[30] See LEAA 2010, art 184.
[31] This kind of Action existed under art 543 of revoked previous Libyan Commercial Law 1953.
[32] For more analysis about a derivative action, see (3.5.1)

shareholders and /or the directors of the company. This action is called Personal-Company Liability Action and is equivalent to a derivative action in UK law. This action is considered both a personal action - because a shareholder brings it personally - and a company action, as the harm has occurred to the company as a whole. As a result all shareholders may receive compensation.[33] However, such an action has not been adopted under the LEAA 2010, as will be discussed later. [34]

Thus, it is clear that the only action available to the minority shareholders against the controlling shareholders in Libya is a Personal Liability Action, which leaves a significant gap in the level of protection available to the minority and, potentially, leaves them open to abuse. This is because both scenarios (Company Liability Action and the Personal-Company Liability Action) deal with the conflict that occurs between the management and shareholders. To underline this further: under a Company Liability Action, only the majority shareholders can bring an action against the board of directors, whereas under a Personal-Company Liability, which has not been adopted into Libyan Law, the minority shareholders can bring an action against the board of directors. Though discussion of such conflicts lies outwith the focus in this study, what is clear is that the only remedy available to minority shareholders against the controlling shareholders in Libya is the Personal Liability Action.

It is worth noting that a Personal Liability Action is similar to the unfair prejudice remedy adopted in UK law. This remedy is applicable when the company has been run in 'a way that is clearly unfair in its consequence to the complaining shareholder, even if the respondents can claim to have acted in the best of good faith'.[35] The relevant section in CA 2006 provides that a member of a company may petition when:

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[33] Tibar (n 12) 819.
[34] See (3.5.1.1).
[35] John Birds and others, *Boyle & Birds' Company Law* (Jordan Publishing Limited 2011) 711. Under UK law, the petitioner does not have to prove that the controlling shareholder has acted in bad faith. See *Re R A Noble and Sons (clothing) Ltd* [1983] BCLC 273 at 290-1.

> The company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interest of members generally or of some part of its members (including at least himself) or (2) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.[36]

Here we should note that s 994(1) of CA 2006 provides a greater scale of protection for minority shareholders since it can protect against any action that may harm the company's affairs,[37] either actual or proposed, and even the omission of action is within the scope of the provision. By contrast, currently under Libyan law the minority shareholders are unable to bring an action in relation to proposed actions or omissions; rather, the Libyan statute explicitly focuses only on actions which relate to decisions that have been made by the majority shareholders or the management.

Further, in the UK the matter is different. The unfair prejudice remedy is not based on a civil wrong or delict, like civil law countries such as Libya. Instead it is based on a special statutory invention of the common law system that is set down in s 994 of CA. This section requires prejudice to the minority shareholders which must be unfair. This means that it is not sufficient if the actionable conduct satisfies only one of these requirements since the conduct may be prejudicial without being unfair (e.g. when the petitioner has agreed to the breach against which he is complaining).[38] Similarly, the action may be unfair without being prejudicial (e.g. the court in *Irvine v Irvine* (No1) [39] noted the failure of the board to meet statutory requirements but this did not cause the petitioner any material prejudice).

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[36] CA 2006, s 994. According to Davies 'by referring to the conduct of the company's affairs, the section is clearly wide enough to catch the activities of controllers of the companies, whether they conduct the business of the company through the exercise of their powers as directors or as shareholders or both'. Paul Davies, *Principles of Modern Company Law* (9th edn, Sweet & Maxwell 2012) 720.

[37] Brenda Hannigan, *Company Law* (3 ed, Oxford University Press 2012) 388. (Any action that may harm the company's affairs includes anything that can be done or undone by the company or those authorised to act as its organ, such as the directors or shareholders' resolution in general meeting).

[38] See e.g. *Groly v Good* [2010] 2 BCLC 569 at 94; *Hawkes v Cuddu* [2009] 2 BCLC 427 at 72.

[39] [2007] 1 BCLC 349. Also, in *Oak Investment Partners XII v Boughtwood* [2010] 2 BCLC 459 at 121. In this case there was evidence regarding unfairness by the petitioner since there was no disclosure of information; the situation did not cause any prejudice.

Thus a shareholder can establish prejudice where he can prove the economic value of his shares has been affected negatively.[40]

Clearly, when the claimant alleges damages or jeopardy to the value of his shareholdings, he can bring an action on the basis of financial damages.[41] However, a claimant does not have to establish a case based on damages or jeopardy that has happened to financial shareholdings. Instead he can bring an action on the basis of unfair prejudice even though there nothing serious has happened to the value of his shares. In *Quinlan v Essex Hinge Co Let*,[42] the court held that the petitioner succeeded although the unfairly prejudicial conduct had no effect on the value of his shareholding since he was harmed by being excluded from the management.

The test of unfairness adopted under unfair prejudice may be established for the purposes of CA 2006 s 994 in the two following ways: [43]

1. The starting point for the court should be to ascertain whether the act complies with an agreement between the shareholders (including the constitution of the company) or the legislation.[44] In other words, the shareholders are entitled to complain of unfairness when there has been some breach of the agreed terms on which the affairs of the company are conducted.
2. The court should take into account the informal agreements or understandings that result from discussing or negotiating formal agreements.[45] As Lord Hoffman suggests: 'there will be cases in which equitable consideration makes it unfair for those conducting the affairs of the company to rely upon their strict legal powers.'[46] Hence

[40] See e.g. *Re Brenfield Squash Racquets Club Led* [1996] 2 BCLC 184.
[41] See e.g. *Re Macro (Ipswich) Led* [1994 2 BCLC 354, 404d.
[42] [1996] 2 BCLC 417.
[43] See e.g. *Re Saul D Harrison and Sons Ltd* [1995] 1 BCLC 14 at 31; *O'Neill v Phillips* 1 WLR 1092.
[44] *Re Saul D Harrison & Sons Plc* [1995] 1 B.C.L.C. 14 at 18; *O'Neill v Phillips* [1999] 1 WLR 1092.
[45] See *Vujnovich v Vujnovich* [1990] B.C.L.C. 227; D. D. Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 Oxford Journal of Legal Studies 55.
[46] [1999] 2 BCLC 1 at 8.

these informal understandings constitute legitimate expectations, the breaching of which can result in oppression or unfairness. These understandings emerge exclusively in private companies and relate to the operating of the company; often they are based upon agreements between shareholders through the articles of association or a shareholder agreement. As Lord Hoffman explains, expectation 'often arises out of a fundamental understanding between the shareholders which formed the basis of their association, but was not put into contractual form'.[47]

Here it is worth noting that such a test is objective not subjective. In *Re Bovey Hotel Ventures* the court held that:

> '... it is not necessary for the petitioner to show that the persons who have *de facto* control of the company have acted as they did in the conscious knowledge that this was unfair to the petitioner or that they were acting in bad faith; the test, I think, is whether a reasonable bystander observing the consequences of their conduct, would regard it as having unfairly prejudiced the petitioner's interests.'[48]

Last but not least, the distinction between the personal rights of the shareholders and the company's rights is fundamental to the concept of minority shareholders protection since it determines the type of action that can be brought. Under LEAA 2010, the shareholders can bring a Personal Liability Action against the majority shareholders when a wrongdoing relates to the minority shareholders personally and, therefore, is not associated with the company's rights. According to Mostafa Kamal, the minority shareholders can pursue a personal action in cases where the harm occurs to the minority shareholders (one or a group) personally.[49] In the UK, the matter is more complex. The shareholders are entitled to bring a personal action if their personal rights (as set down in

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[47] *Re Saul D Harrison and Sons Ltd* [1995] 1 BCLC 14.

[48] *Re Bovey Hotel Ventures Ltd unreported* but quoted and followed in *RA Noble & Sons Clothing Ltd* [1983] BCLC 273 at 290.

In Re Guidezone Ltd [2000] 2 BCLC 321 at 355., the court found held that O'Neil established that 'unfairness (…) is not to be judged by references to subjective notions of fairness, but rather by testing whether, applying established equitable principles, the majority has acted, or is proposing to act, in a manner which equity would regard as contrary to good faith'.

[49] Mostafa Kamel, *The Liability of the Board of Directors* (Abeer lelketab 1982) 139 (in Arabic).

the company's article of association[50] or under statute and conferred on the individual as a member)[51] are infringed. [52] For example, a shareholder can seek a personal action when he wants to enforce his right to vote.[53] In other words, in a personal action, the issue revolves around the enforcement of the article of association[54] with a shareholder desiring to enforce his rights or prevent breaches of the articles by the majority, or even to prevent the articles from being altered. [55] However, though the unfair prejudice remedy is considered a personal action, it serves a different goal since it is granted when a corporate act unfairly prejudices the shareholders of the company. Also, whilst a personal action protects only personal rights, unfair prejudice protects not only shareholders' rights but also their interests.[56] As such, the wronged conduct does not have to be illegal to be actionable.[57]

Here it is worth indicating that Unfair Prejudice and a derivative action serve different goals: whilst a derivative action is focused on breaches of strict legal duties owed by the directors to the company, the unfair prejudice remedy is provided when the wronged conduct of the controllers unfairly prejudices a shareholder. [58] However, the two actions may overlap. This is because s 994 (Unfair Prejudice) permits the possibility of addressing corporate wrongs in addition to personal wrong by the inclusion of the phrase "interests of its members generally", [59] which is applicable to such corporate wrongs as a directors' breach of duty. [60] In other words, both unfair prejudice and a derivative action are

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[50] Rights are usually granted to the shareholders by the article of association not by the memorandum.
[51] Joffe and others (n 21) 87 and 97.
[52] There is no comprehensive definition of a personal right of a shareholder. (See ibid 29 and 87).
[53] See e.g. *Pender v Lushington* (1877) 6 Ch D 70.
[54] See CA 2006, s 33.
[55] Hannigan (n 37) 441.
[56] See *Re A Company* [1986] BLCL 376 at 378.
[57] For information about illegality see p122.
[58] For information about the distinction between unfair prejudice and a derivative action, see Joffe and others (n 21) 76, Jennifer Payne, ' Sections 459-461 Companies Act 1985 in Flux: The Future of Shareholder Protection' (2005) 64 Cambridge Law Journal 647, 662- 4; Rita Cheung, 'Corporate Wrongs Litigated in the Context of Unfair Prejudice Claims' (2008) 29 Company Lawyer 99, 99-100.
[59] See S Deakin, E Ferran and R Nolan, 'Shareholders' Rights and Remedies: An Overview' (1997) 2 Company, Financial and Insolvency Law Journal 162, 164.
[60] See e.g. *O'Neill v Phillips* [1999] 1 WLR 1092; *Clark v Cutland* [1986] 1 WLR 281. Lord Hoffmann, also, in *Re A Company* (No. 005287 of 1985), held that allegations of the directors' breach of fiduciary duties were capable of establishing unfair prejudice to minority shareholders in a private company or a small unlisted public company.

applicable 'in many of cases where the allegation of unfair prejudice has been based on loss caused to the company by breach of directors' fiduciary duties'.[61] However, this area of overlap is not applicable in the case of Libya since the minority shareholders can only rely on personal harm to bring a personal liability action and only the majority shareholders can rely on corporate harm to sue the management under a Company Action (as there is no derivative action in Libya).

3.1.2 Criteria Libyan courts use to solve the conflict between the minority shareholders and the majority shareholders

The current judicial policy in Libya concerning the monitoring of abuses by the majority shareholders and the directors is neither clear nor comprehensive since it is based on disparate elements of different judicial practices and diverse legal concepts, rather than one legal policy,[62] as in the UK.[63] Currently, LEAA 2010 gives no specific regard to the issue of abuse of rights by majority shareholders. As a result, company law scholars and judges (perhaps lawyers as well) are free to employ three alternative approaches to address the same problem. Though it is common for judges to rely on a single principle, it is important to explore the three solutions separately. These are: good faith, the principle of equality and the no abuse of rights principle. In the following section, the analysis will focus mainly on the no abuse of rights principle, as this is the most significant of the three in the case of Libya.

3.1.2.1. The principle of good faith

In general, the principle of good faith is one of the basic principles in civil law that has become accepted as an integral part of the Libyan legal systems. Libyan Civil Law adopts this principle and prohibits any action that contradicts it. However, it should be noted that Libyan Law does not define the principle of good faith but leaves that to the courts. In

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[61] Joffe and others (n 21) 312.
[62] Tibar (n 12) 820.
[63] As will be discussed later, UK law adopts specific criteria under unfair prejudice.

general the definition of such a principle relates to a set of general concepts such as honesty, integrity and sincerity. Despite the fact that there is no clear definition of the good faith principle, the Law imposes parties of a contract to act in good faith. Art 148 of Libyan Civil Code states that 'a contract shall be implemented in a way consisted with good faith'.[64] This means that any contractual relationship must be based on good faith, which results in the courts intervening in the contractual relationship of shareholders on a case-by-case basis without being able to consistently apply a clear definition of 'good faith'.[65]

In the context of minority shareholders protection, good faith is a judicial mechanism employed by Libyan courts to monitor the majority shareholders and the board of directors' actions (whether the board of directors and/or the majority shareholders' decision is in good faith or not). [66] This means, as Tibar claims, that the members of a company must implement their commitments and deal with each other in good faith. This necessitates the majority shareholders to exert a reasonable personal effort to serve the interests of all members of the company as whole (not only the majority shareholders' interests). [67]

Under the principle of good faith, the court assumes that the parties deal with each other honestly, fairly, and in good faith, if there is no evidence to prove the opposite.[68] In this situation, the minority shareholders must prove that the majority shareholders and/or the board of directors have acted in bad faith in order to gain compensation. In this context, Althiabi claims that the only way to prove good faith is through providing evidence of a

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[64] The same provision is adopted under Egyptian Civil Code art 5 and French Civil Code s 3/1134.
[65]Goode Roy, *Commercial Law in the Next Millennium* (Sweet & Maxwell 1998) 16,31- 32; Bradgate Robert, *Commercial Law* (3rd edn, Butterworths 2000) 3-4 and 26-34.
[66] Tibar (n 12) 821.
[67] Ibid 804.
[68] Libyan Civil Code, art 969 (3).

bad faith act has been committed by the wrongdoer. This is because it is assumed that a person has acted in good faith unless there is evidence that he has not.[69]

The principle of good faith and the abuse of rights principle may overlap. This means that bad faith can constitute the personal or intangible element of the abuse of rights, as discussed later. For example, when a majority shareholder intends to harm another (intangible element of abuse of rights), bad faith is established. In other words, when there is evidence that the majority of shareholder (a user of right) acts against the interest of the minority shareholders, this conduct is in bad faith.[70] However, it does not follow that every abuse of rights is in bad faith. For example, if the majority shareholder wants to achieve something trivial *vis a vis* the potential harm that may occur, in the absence of explicit intention to harm, the action is not in bad faith (this is discussed later in (3.1.2.3)).

3.1.2.2. The principle of equality

In the absence of any specific guidance in LEAA 2010, the courts have established their own criteria (or a new understanding of the criteria mentioned in Libyan Law) that are derived from other sources of law, such as Islamic principles, custom, principles of natural law and rules of equality.[71] Therefore, the courts sometimes may rely on the principle of equality between the shareholders. Here, the minority shareholders can gain compensation if they can prove that shareholders are being treated in an unequal manner. This is applicable, for example, in cases where the board of directors refrain from giving the minority shareholders their dividends when they have been given to other shareholders with the same class of shares. In this case, the court can compensate minority shareholders on the basis of the principle of equality between the shareholders.

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[69] Saed Althiabi, 'The Principle of Good Faith in Saudi Arabia ' (2004) 23 Journal of Sharia Law and Islamic Studies 44 (in Arabic).
[70] Tibar (n 12) 804.
[71] See the sources of Libyan Civil law in Libyan Civil Code, s 1 discussed in Ch. 1 at 23ff.

The breach of the principle of equality has two elements: (1) Personal privilege, which means that particular persons (e.g. majority shareholders) benefit more than other parties (e.g. minority shareholders), and (2) harm occurs to others (e.g. minority shareholders) as a result of the beneficial interest enjoyed by other parties (the majority shareholders). [72] The breach of such a principle may entitle the aggrieved party to compensation.[73]

It is worth mentioning that although the principle of equality can be used by Libyan courts as an independent remedy to deal with the conflict of interest between the shareholders, there is a trend in judiciary and civil law Jurisprudence that the principle of equality constitutes a physical (tangible) component of the abuse of rights principle (objective tendency). This means that breaching the principle of equality requires that some shareholders are harmed and other shareholders have gained some personal benefit. In this context, French courts held that the breach of the principle of equality constitutes an abuse of rights by the majority shareholders. There is no way of monitoring the majority shareholders in order to investigate whether there is an abuse of rights without monitoring all the shareholders in the company. The abuse of rights occurs when a majority shareholders' resolution seeks to favour their own interest over that of the minority shareholders. [74] This occurrence is acknowledged in Egyptian Company Law under art 2/76, which defines a resolution that constitutes an abuse of rights as 'any resolution issued in interest of a particular group of shareholders […] or to give private benefits to one or more of the members of the board of directors without consideration for the company's interest'. In Libya, LEAA 2010 adopts this view implicitly. Art 159 of LEAA 2010 states that 'any shareholder shall not vote on a resolution when (1) he has a direct or indirect

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[72] Esmael kannem, *The Theory of Commitments* (Maktabat Wahba 1970) 31.
[73] ibid.
[74] See Cass, Com.18 Avr1961 J.C.P. 1961, II, 1216 cited in Tibar (n 12) 788.

interest for himself, his representative (his agent) or his principal, and the personal interest conflicts with the interest of the company'.

3.1.2.3. The no abuse of right principle

The most common (and most important) criterion used by courts in Libya is the "no abuse of right" principle. The no abuse of right principle is a long-standing principle in many Civil Law countries [75] which requires individuals to take care of others' interests when exercising their rights in certain circumstances. [76] According to Byers, an abuse of right can be established 'when the exploitation of an individual right injuriously affects the interests of the community'.[77] In other words, no one is entitled to exercise his rights in a way that is injurious to others or detrimental to the public interest.[78] Accordingly, the principle is based on two concepts: first, there are two dimensions of interests, individual and public; second, rights should serve interests which may be individual or collective. Thus, the no abuse of right principle is employed as a compromise mechanism between individual interests and group or public interests, in the sense that the latter must have priority over the former.[79] In the context of minority shareholders rights, the principle means that the majority shareholders (and the board of directors) should not exercise their rights if they harm minority shareholders. The Libyan courts apply the principle to solve the conflict between the shareholders by restricting the majority shareholders' freedom to vote in such a way as to pursue their own self-interest (and not the company's) at general meetings.

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[75] Roberto G. MacLean, 'Judicial Discretion in the Civil Law' (1982) 43 Louisiana Law Review 42, 52. It is noteworthy that the old French law does not recognize this theory. However, at the beginning of the 19th century, French courts started applying the principle of "Preventing the usage of rights with intention to harm others" which, in effect, is the same as the no "abuse of right" principle under discussion. For details see Fathi Durainy, *The Theory of no Abuse of rights in Islamic Law* (4 edn, Moassaset Al Resala 1988) 300-3 (in Arabic). Also, it should be noted that the principle of abuse of rights is not so readily apparent in common law systems. Michael Byers, 'Abuse of Rights: an Old Principle, a New Age' (2001) 47 McGill Law Journal 389; 395.

[76] MacLean (n 75) 52.

[77] Byers, (n 75) 389.

[78] Durainy (n 75) 36.

[79] ibid 37.

The legal literature in civil law countries indicates two theories in regard to the definition of the no abuse of rights principle: [80] (1) a tangible theory which defines the principle as breaching the principle of equality. This means that it is enough to establish the abuse of rights by the majority of shareholders through proving that the majority shareholders seek to get personal benefits from a transaction at the expense of the minority shareholders, as discussed previously. (2) An intangible theory which means that there must be intention to harm the other. This definition is criticised by many scholars who argue that there is no need to prove intention to harm in order to establish the abuse of rights. Instead the intention to get personal benefits (not intention to harm) is enough to establish such a principle. [81]

In order to define the abuse of rights, Libyan Law incorporates the two previous definitions, which are summarised in Libyan Civil Act as: [82] The use of a right is illegal when (1) its user intends to harm another, or (2) the interests that the user of the right wants to achieve are trivial *vis a vis* the potential harm that may occurred to the other or (3) the interests that they want to achieve are illegal. [83]

Libyan Law adopts both theories (tangible and intangible) to define the abuse of rights. Therefore, any resolution issued by the controlling shareholders may be characterised as an abuse of the rights against the minority shareholders when there is a breach of principle of equality (e.g. getting personal benefit, or to harm the minority shareholder). Hence, there is no need to prove there is bad faith or intention to harm. Instead it is enough to prove the principle of equality has been breached between the shareholders to establish the abuse of rights.

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[80] Tibar (n 12) 793-9.
[81] ibid.
[82] It should be noted that LEAA 2010 does not set out any provision relating to the abuse of rights principle.
[83] See Libyan Civil Code, art 5. In fact, these criteria have been adopted into Syrian, Egyptian and Iraqi law practically verbatim.

In France it was the courts, rather than the legislator, that developed the doctrine of abuse of rights.[84] The French courts adopt both the previous concepts in order to define what constitutes an abuse of rights. The most important judgement in this regard is the 1961 judgement by the Commercial Court in the French Supreme Court. This court clearly set down the intention of controlling shareholders (intangible element) and the harm to the minority shareholders (tangible element) as the main elements in establishing an abuse of rights.[85] Equally, the Egyptian Civil Act contains these provisions verbatim, as does the Libyan Civil Code.[86] Thus it is clear that French, Egyptian and Libyan law have the same provisions in regard to the abuse of rights doctrine.

In addition to the two previous concepts, to establish the abuse of rights in Libya, a supplementary element that relates to the effectiveness of votes must also be established. This means that there is no abuse of rights when the shareholders' votes have no effect on the result of the resolution. For example, when a resolution is approved by 60 votes to 40, there is a need to investigate whether the 60 votes are subject to abuse. If it is found that 30 votes were subject to abuse, they must be revoked. If it is found that only 10 votes have been, there is no need to apply the abuse of rights principle at all. Art 159 of LEAA 2010 adopts the supplementary element through stipulating that 'the violation of this rule [the conflict of interest voting] by the shareholder makes the shareholders' issued resolution actionable when (…) there is evidence that the vote of the interested shareholders was necessary to issue the resolution'.

The principle, as stated in Libyan statute, has its origins in *Sharia* law and Islamic jurisprudence. [87] According to Durainy, the principle of abuse of rights is rooted in Islamic Law and man schools of Islamic jurisprudence. He provides a full discussion in relation to

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[84] Vera Bolgar, 'Abuse of Rights in France, Germany, and Switzerland: A Survey of a Recent Chapter in Legal Doctrine' (1974) 35 Louisiana Law Review 1015, 1019; Joseph M Perillo, 'Abuse of Rights: A Pervasive Legal Concept' (1995) 27 Pacific Law Journal 37, 43-4.
[85] See Cass. Com, 18, Avr 191, J.C.P. 1961, II, 12164.
[86] See Egyptian Civil Code art 525.
[87] Anwar Soltan, *The Theory of Obligations*, vol 1 (Dar Al Feket Al Arabi 1999) 511.

the principle's definition and how it derives from rules set down in the Quran and Sunnah (the words and acts of Prophet Muhammad).[88] To give a brief example of this: firstly, an abuse of rights occurs when the user of the right intends to harm another and this is counter to *Sharia* since rights are not imposed for a harmful purpose and harming others is not the aim of Islam. The Islamic scholar Ibn Rajab al-Hanbali[89]mentioned this when he stated that 'there may be [in relation to abuse of rights] intention to harm the others'.[90] According to Al Shatibi's view,[91] an abuse of rights occurs when the use of an individual right involves negligence or a lack of precaution that results in harm to others.[92] Accordingly, the principle may not not solely based on the fact that doing the act transgresses the boundaries of an individual right, but the theory also includes an intangible element that is based on negligence and a lack of foresight. [93]

Secondly, under *Sharia*, [94] an abuse of rights occurs when the achievable interests are trivial *vis a vis* the potential harm that may result. Logically, there is no need to pursue an interest where the harm exceeds the benefit. In addition, the absence of benefit, or lack of its importance, could be a clue in proving the actor's intention to harm. According to Al ez Eb Abdesalam,[95] in a case where the benefits and negative consequences (harm) are equal, there are two options available: the actor should pursue the benefit and avoid the negative consequences if possible. If not, and the negative consequences are greater than

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[88] Durainy (n 75) 7.

[89] Ibn Rajab was born in Baghdad in 1335. He was highly proficient in the scientific disciplines of *Hadith* (Prophet Mohamed's speech-peace upon him) in terms of the names of reporters, their biographies, their paths of narration and awareness of their meanings. Ibn Rajab died in1393 in Damascus.

[90] Ibn Rajab al-Hanbali, *The Compendium of Knowledge and Wisdom* (Turath Publishing Ltd 2007) 265

[91] Abu Ishaq al-Shatibi was an Andalusian (Spanish) Islamic legal scholar. He died in 1388 in Granada, Spain. His book *Al-Muwafaqaat* (The Reconciliation of the Fundamentals of Islamic Law) is one of the most important books in *Sharia*. It is on the topic of *Usul al-fiqh* (Islamic Jurisprudence) and *Maqasid Al-Sharia* (higher objectives of *Sharia*).

[92] Abu Ishaq al-Shatibi, *The Reconciliation of the Fundamentals of Islamic Law*, vol 3 (Dar Eben Affan 2008) 455.

[93] Durainy (n 75) 66.

[94] Ibid 320.

[95] Alez Eb Abdesalam was born in Damascus in 1181 and died in 1262 in Cairo.

the interest, he should avoid the negative consequences and sacrifice the potential benefit;[96] thus avoiding the abuse of rights.

Thirdly, using rights as a means to achieve illegal interests (for instance, donating money to avoid paying tax) is not permitted under *Sharia*.[97] Accordingly, it is clear that the elements of the abuse of rights principle have been discussed extensively by Islamic law scholars and addressed by in *Sharia*.

In regard to comparing the abuse of rights with unfair prejudice adopted in the UK, it is important to indicate that the scope of both concepts is different. The abuse of rights principle applies when the wrongdoer acts within his rights but an external factor turns the act, in eyes of the court, into an abuse of rights and thus it is considered as a fall back rule, not a free standing right, as it is a response to a right that the other party already has. However, unfair prejudice is applicable not only when the conduct relates to an abuse of rights (acting within rights), but also when there is a violation of the right to act. Thus, under unfair prejudice, the petitioner does not have to establish the infringement of a shareholder's right. This is because unfair prejudice aims to protect the interests of members and not merely their rights. [98]

Further, with regard to illegality (one of the criteria under unfair prejudice),[99] a conduct is considered unfairly prejudicial if it does not comply with the shareholders agreement or the law.[100] However, under the principle of no abuse of rights, the conduct is harmful if it is not consistent with legal interest. Further, under the remedy of unfair prejudice, the law relies on the conduct *per se* breaching the terms of the shareholders or the law whereas,

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[96] Alez Eb Abdesalam, *Rules*, vol 1 (1 edn, Dar Al Kalam 2000) 83, see also Mohamed Al Shawkany, *Guidance to Achieve the Rights: The science of Original Jurisprudence* (Dar ALfeker 2002) 246.
[97] Durainy (n 75) 38.
[98]. See *Re A Company* [1986] BLCL 376 at 378.
[99] Illegality is no longer a sole requirement for unfair prejudice since the corporate act can be unfairly prejudicial and at the same time legal .i.e. when the act breaches legitimate expectation.
[100] However, it is not necessary to show that the act complained of is improper or illegal, for an exercise of a legal right may have an unfairly prejudicial effect. See Hoffman L.J. in *Saul D Harrison & Sons Plc, Re* [1995] 1 B.C.L.C. 14. Per Hoffman J. in *Re a Company (No. 008699 of 1985)* [1986] BCLC 382, 387; Davies (n 36) 512.

under the no abuse of rights principle, the consequence of the conduct determines whether outcome of the conduct is illegal or not.[101] Notwithstanding these differences, both scenarios reach the same ends since a legal conduct can never achieve an illegal interest. The illegality of the interest will shift the conduct itself from legality (e.g. allotting shares by the majority shareholders) to illegality (since the real interest of the majority shareholders is to force the minority shareholders to sell their shares at a discount price). As a result, it has no material impact if we say the corporate act is unfairly prejudicial when the wrongdoer's conduct is illegal (as in the no abuse of rights principle) or the wrongdoer breaches the shareholders' terms or law (as in the remedy of unfair prejudice).

Furthermore, according to the no abuse of rights principle, the conduct may be harmful when the wrongdoer intends to harm another. Similarly, under the UK law, if there is such an improper intention or purpose behind a seemingly fair action, the conduct may be considered unfairly prejudicial. For example, in *Re Regional Airports Ltd,*[102] the ulterior motive behind a proposed rights issue was to enhance the majority's position and to increase pressure on the minority to sell their shares at a discounted valuation.[103] However, holding that the test of unfairness under the UK Law is an objective one, which means unfair prejudice may be established in circumstances where the controller did not intend to harm the petitioner,[104] does not *per se* contradict the previous sharia statement: the conduct may be harmful when the wrongdoer *intends* to harm another. Under Sharia and Libyan

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[101] In addition, Libyan Civil Code, art 5 stipulates that the corporate act might be illegal, and so an abuse of rights, when the wrongdoer's interests are trivial *vis a vis* the potential harm that may be caused to the other. However, under the UK law the prejudice must be real rather than technical or trivial. (See *Saul D Harrison* [1995] 1 BCLC 14 at18; *Irvine v Irvine* (No 1) 1 BCLC 349, 256. See, also, *Re Baumler* (UK) ltd [2005] 1 BCLC 92 [180] and *Re Sunrise Radio Ltd* [2010] 1 BCLC 367, 7-8). This is a different issue since under the Libyan law the wrongdoer's interests (not the harm) must be trivial. It seems that the UK provision is more comprehensive than the Libyan provision since when the wrongdoer's interests are trivial *vis a vis* the potential harm this includes real prejudice as well.

[102] [1999] 2 BCLC 30.

[103] See *Re RA Noble and Sons (Clothing) Ltd* [1983] BCLC 273 at 290; *Re Saul D Harrison and Sons Ltd* [1995] 1 BCLC 14.

[104] *Re Bovey Hotel Ventures Ltd*, unreported. July 31. 1981 cited and approved by Nourse J. in *Re RA Noble and Sons (Clothing) Ltd* [1983] BCLC 273 at 290, *Saul D . Harrison and Sons Plc*, ibid at 17, Davies (n 36) 733.

law, intention is a separate element that can be used to establish an abuse of rights, [105] whereas, under UK law, intention is not considered as a separate element. For example, when the majority shareholders breach the constitution of the company the minority shareholders can bring an unfair prejudice remedy and it is does not matter whether the breach occurred intentionally or not. However, under Sharia Law, the intention to harm is taken into account and can be relied on by the minority shareholders as an independent criterion to establish an abuse of rights.

In short, art 159 of LEAA 2010 addresses the conflict of interests between shareholders and clearly vests the minority shareholders with the ability to bring an action against the majority shareholders. The form of action that is available to the minority shareholders is a personal liability action, the effectiveness of which I evaluate in the following sections. The mechanism available to the courts when considering a conflict of interests between the majority and the minority shareholders is not based on one single policy; instead courts in Libya rely on many principals in this regard. However, they most often rely on a principle known in Libyan jurisprudence as the no abuse of rights principle.

3.2. To what extent the Minority shareholders' action is effective: the theoretical problem of formal private enforcement

This section discusses the theoretical issues that underpin the problem of formal private enforcement. To that end, this section begins by outlining the literature that engages with the problematic of effective court enforcement generally (3.2.1), and then goes on to discuss how court enforcement is further problematized within the context of transition and developing economies (3.2.2). Finally, it sites Libya as a particularly extreme case in terms of court enforcement (3.2.3).

[105] See Libyan Civil Code, art 5.

3.2.1. The general problematic of formal private enforcement

Delivering justice is one of the state's three fundamental functions, the others being security and defence. Though the judiciary is an integral part of any state system, its effectiveness may differ from country to country due to a number of factors, which are discussed below. There are some concerns that impact upon the effectiveness of formal private enforcement generally. The major issues facing court enforcement can be placed into three categories:

The first area of criticism relates to the ability of the court to deliver justice and fairness. The definition of fairness, which is a word with no single generally accepted meaning in law, is a further barrier within the litigious process. For example, Dammann argues that recourse to litigation in cases of minority-majority shareholder conflict strikes the wrong balance between the interests of the controller and those of the minority shareholders. According to Dammann, there should be a level of private benefit that the controller is able to extract from the corporation, which is determined by how valuable the controller's presence is to the corporation and the extent to which they shoulders the costs of control that are not shared by the other shareholders. A liability action fails to take these factors into account and instead focuses on the fairness of individual transactions. [106] Moreover, the courts' ability to deliver fairness is very difficult in some related party transactions, such as in the case of the avoidance of competition. In these cases the controlling shareholders may steer the corporation away from business areas where it might compete with the controller in order to protect his own profits.[107] Additionally, there is a body of literature that questions the judges' incentives to deal with lawsuits. For instance, Jackson and Roe provide legal academic analyses that questions 'why private lawsuits often do not

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[106] Jens Dammann, 'Corporate Ostracism: Freezing-out Controlling Shareholders' (2008) 33 Journal of Corporate Law Studies 681. In this article, Dammann argues that to prevent excessive benefit extraction, the law should give minority shareholders in publicly traded corporations the right to force the controller to sell his shares in the corporation. This mechanism would ensure that minority shareholders can rid the corporation of any controller whose presence harms the corporation. This mechanism should be a mere default rule.

[107] ibid 693.

penalize the relevant actors, [...] distort incentives, and can be inefficacious because the real world's on the ground private enforcement is often misdirected'.[108] In the same way, Glaeser et al., indicate that in reality courts in numerous countries are 'unmotivated, unclear as to how the law applies, unfamiliar with economic issues, or even corrupt. Such courts cannot be expected to engage in costly verification of the facts of difficult cases or contingencies of complicated contracts'.[109]

A second area of criticism concerning court enforcement relates to the motivation of the plaintiff or his attorney. In terms of the plaintiff, minority shareholders have small investments in a company. This is, in some cases, not enough to bring an action against the controlling shareholders when the latter extracts excessive private benefits. Also, many scholars doubt the remedies available to shareholders since, though courts have the opportunity to solve the dispute, it is well established that the vast majority of cases settle prior to reaching court.[110] The minority shareholders' action can be used as a bargaining or

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[108] Howell E Jackson and Mark J Roe, 'Public and Private Enforcement of Securities Laws: Resource-Based Evidence' (2009) 93 Journal of Financial Economics 207. Section 2 of the study (at 209-210) provides useful literature in this regard.

[109] See Edward Glaeser, Simon Johnson and Andrei Shleifer, 'Coase versus the Coasians' (2001) 116 The Quarterly Journal of Economics 853, 854. Glaeser *et al*., provide further explanation in this regard by stating that '[t]he interpretation of the contracts or statutes involving such terms is expensive, and requires powerful incentives to motivate an adjudicator to invest in understanding the case. Absent such incentives, courts often postpone decisions, or simply let go the potential violators of rules and contracts'. (See ibid). Also, they argue that

> the society does not have full control over the incentives facing law enforcement officials. Its ability to reward them for "enforcing the law" is limited because "doing justice" is largely unverifiable. Many of the rewards that these officials receive for doing justice are intangible, including self-esteem and the respect of one's peers. On the other hand, the government does have the ability to politicize the enforcement of particular legal rules by rewarding the enforcers for certain outcomes such as finding violations. We are interested in the conditions under which the government would choose such politicization. (ibid, 856)

In addition, they indicate that the government cannot increase judges' self-esteem or long-term respect of their peers since it cannot verify whether the adjudicator actually searches for or makes correct decisions. Training judges and building up their prestige presumably raises this ability, but such policies may take decades to pay off. ibid.

[110] Thomas M Jones, 'Empirical Examination of the Resolution of Shareholder Derivative and Class Action Lawsuits' (1980) 60 Boston University Law Review 542; Marc Galanter, 'Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) about our Allegedly Contentious and Litigious Society' (1983) 31 UCLA Law Reveiw 4; Marc Galanter, 'Worlds of Deals: Using Negotiation to Teach about Legal Process' (1984) 34 Journal of Legal Education 268; John C Coffee, 'The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation' (1985) 48 Law and Contemporary Problems 5; Coffee and Berle (n 5); Jackson and Roe (n 108);; Tamara Relis, 'Civil Litigation from Litigants' Perspectives: What We Know and What We Don't Know About the Litigation Experience of Individual Litigants' (2002) 25 Studies in Law, Politics and Society 151.

negotiating tool against the company or its controlling shareholders (sometimes known as strike suits). This is because they are able to blackmail the companies into a lucrative settlement agreement by, for example, blocking important transactions.[111] Here the management or the controlling shareholders sometimes accept the settlement to secure the reputation of the company rather than accepting that they have abused the minority shareholders.[112] Regarding the attorney, as it has been argued that the legal system can create 'misincentives' for the attorney, a conflict can sometimes exist between the interests of the attorneys and their clients, thus unnecessarily frustrating the utility of private enforcement.[113]

The final area of criticism is associated with the operation of the company. It has been argued that litigation may produce unwanted publicity[114] that could affect the reputation of the company and therefore deter further investment.[115] Moreover, increased litigation may disrupt the management and result in unwanted costs.[116] This situation may have a consequently negative effect on the performance of the management since the time spent on litigation would be more profitably spent elsewhere. Further the action may impact on profit maximization as imposing liability on directors may prevent them from

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[111] This is the reason why some countries restricted standing to sue to shareholders representing a particular percentage. However, a percentage requirement for the challenge of a shareholder resolution was not introduced in Libya, Egypt and France. In Libya, there are no restrictions to standing to sue, but the minority shareholders are allowed to bring such an action only when they have an interest to do so. (The origin of this rule is a Procedural Civil Act s 4. This rule also, can be found in Egyptian Procedural Civil Act s 3 and French Procedural Civil Act s 31).

[112] Coffee 'The Unfaithful Champion' (n 110) 17.

[113] John C Coffee Jr, 'Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working' (1983) 42 Maryland Law Review 215; Murray L Schwartz and Daniel JB Mitchell, 'Economic Analysis of the Contingent Fee in Personal-Injury Litigation, An' (1969) 22 Stan L Rev 1125.

[114] Brian R Cheffins, 'Reforming the Derivative Action: The Canadian Experience and British Prospects' (1997) 2 The Company Financial and Insolvency Law Review 227, 230; Robin Hollington Q.C, *Minority Shareholders Rights* (6 edn, Sweet & Maxwell, London 2010) 222; J. Paul Sykes, 'The Continuing Paradox: a Critique of Minority Shareholder and Derivative Claims under the Companies Act 2006' (2010) 29 Civil Justice Quarterly 205, 227.

[115] See *Taylor v National Union of Mineworkers (Derbyshire Area)* [1985] BCLC 237, 254-5; Arad Reisberg, Derivative Actions and Corporate Governance: Theory and Operation (Oxford University Press 2007) 48.

[116] Jennifer Payne, 'Shareholders' Remedies Reassessed' (2004) 67 The Modern Law Review 500, 503; Hans C. Hirt, 'The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest' (2005) The Journal of Business Law 159, 165.

taking entrepreneurial risks that could benefit the company.[117] Thus minority shareholder actions can be seen to be problematic in several key areas; however these are exacerbated in the context of transition and developing economies, as I will now discuss.

3.2.2. The lack of formal private enforcement in transition and developing economies

Many transition and developing economies lack court enforcement and so cannot offer adequate protection to minority shareholders.[118] Such countries lack the capacity to implement policies and to enforce laws and regulations. Also, they are not capable of preventing public officials from engaging in corrupt behaviour or influential pressure groups from distorting economic policies.[119]

The main study in this regard is Pistor *et al*'s 2000 study, 'Law and Finance in Transition Economies'.[120] This study provides a thorough analysis of the law on the books in transition countries comparing it with the effectiveness of legal institutions in these countries. Pistor *et al.* found that though credit market development benefited from improvements in the law on the books (focusing on shareholder rights and creditors' rights), the effectiveness of legal institutions has a much stronger impact on external finance. This conclusion supports the argument that the proposition of legal transplants and extensive legal reforms are not adequate to establish effective legal and market institutions.[121] Also, whilst they could not find a positive correlation between the levels of

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[117] Paul F. Banta, 'The New Indiana Business Corporation Law: "Reckless" Statute or New Standard?' (1987) Columbia Business Law Review 233, 236.

[118] Joachim Ahrens, 'Governance in the Process of Economic Transformation (2007) University of Applied Sciences Goettingen' (2007) University of Applied Sciences Goettingen <http://www.oecd.org/dac/governance-development/37791185.pdf> accessed 11-11-2013, 10. In fact, not only can such countries not offer adequate protection for the minority shareholders because of a lack of court enforcement but also most of their traditional corporate governance mechanisms are ineffective. See Berglöf and Claessens (n 10). Also, we should note that this lack of enforcement is also an issue in developed countries. In Russia, for example, it has been argued that investors almost never go to court because, when they do so, the likelihood of success is very small. Even if they win a judgment in their favour it is often not enforced. See ibid

[119] Ahrens (n 118) 10.

[120] Katharina Pistor, Martin Raiser and Stanislaw Gelfer, 'Law and Finance in Transition Economies' (2000) 8 Economics of Transition 325.

[121] ibid.

formal legal protection on the books and legal effectiveness,[122] they found that 'the proportion of firms, which do not trust the legal system to protect their rights, is staggering in many countries'.[123] Further, although they did find that the effectiveness of legal institutions are strikingly different among transition economies (and the variance in these measures is much larger than the variance in the law on the books as measured by the shareholder and creditor rights indices), they are still generally low.[124]

In Latin America countries, Chong and López-de-Silanes examined 'recent trends of Latin America's institutional development regarding investor protection'. They found that the Latin American countries generally suffer from low levels of legal protection and weak capital markets due to the poor enforcement of their laws.[125] In African countries, many studies observe that although there are laws in Africa that are intended to protect minority shareholders' rights, these laws are not strictly enforced in practice. The legal systems remain slow and inefficient and most investors are hesitant to use the courts due to the length of time it takes to obtain a satisfactory resolution.[126] The same results can be found amongst Asian transition economies. For example, in a survey of managers of small start-up firms in Vietnam in 1995, McMillan and Woodruff found that the managers they interviewed said that they did not believe the courts could help them,[127] suggesting that they 'normally just create more problems',[128] and that 'the court is weak and no entrepreneurs use it'.[129] Of those interviewed, only 9% thought that a court or other government agency could assist them,[130] and only 2% of managers said they would take

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[122] ibid.
[123] ibid 342.
[124] ibid.
[125] Alberto Chong and Florencio López-de-Silanes, 'Corporate Governance in Latin America' SSRN, 2007, IDB Working Paper <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1820067> accessed 02-03-2014.
[126] See e.g. Elewechi NM Okike, 'Corporate governance in Nigeria: The status quo' (2007) 15 Corporate Governance: An International Review 173; John O Okpara, 'Perspectives on Corporate Governance Challenges in a Sub-Saharan African Economy' (2010) 5 Journal of Business and Policy Research 110.
[127] See John McMillan and Christopher Woodruff, 'Dispute Prevention without Courts in Vietnam' (1999) 15 Journal of Law, Economics, and Organization 637.
[128] ibid 640.
[129] ibid.
[130] ibid.

disputes to court or appeal to local authorities.[131] Similar observations were made by Boisot and Child in the case of China.[132]

Additionally, in the majority of MENA countries, as Creane et al suggest, the quality of the judicial system is poor as is ‘susceptible to political pressure and long delays, resulting in poor legal enforcement of property rights’.[133] According to this study, the Heritage Foundation's index of private property protection shows that from 20 countries studied only Bahrain has a rating of very high protection, and only the United Arab Emirates and Kuwait have a rating of high protection.[134] Moreover, according to Alajlan, enforcement in Arab markets in general is not thorough and laws governing insider trading and financial disclosures are poorly regulated.[135] Sourial examined the governance models in the corporate and securities sectors in the Arab Word [136] and found that:

> Most of the rules and regulations that govern the MENA region markets is either recently issued or updated recently in conjunction with the international practices. Thus, the problem of misappropriation of rules and regulations does not pose a significant problem. However, similar to many world markets, there is gap between laws and regulations and the effectiveness of enforcement and implementation. The width of the gap varies across the region.[137]

Thus a major determinant for developing equity market in such countries is not primarily the law on the books, but the effectiveness of legal institutions (the law in

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[131] ibid.

[132] Max Boisot and John Child, ‘The Iron Law of Fiefs: Bureaucratic Failure and the Problem of Governance in the Chinese Economic Reforms’ (1988) 33 Administrative Science Quarterly 507, 524;See also, Ding Chen, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Edward Elgar Publishing Limited 2013).

[133] Susan Creane and others, ‘Financial Sector Development in the Middle East and North Africa’ IMF Working Paper, WP/04/201 <http://faculty.som.yale.edu/mushfiqmobarak/papers/financial%20sector%20development.pdf> accessed 28-08-2014, 11.

[134] ibid

[135] Waleed Alajlan, ‘Ownership Patterns and the Saudi Market’ in Mark Hirschey, Kose John and Anil K. Makhija (eds), *Corporate Governance: Advances in Financial Economics*, vol 9 (Emerald Group Publishing Limited 2004) 161–186.

[136] Sourial assessed the governance models of the corporate sector and the securities market of eleven Arab countries in the region out of eighteen: Morocco, Jordan, Lebanon, Egypt, United Arab Emirates, Bahrain, Saudi Arabia, Kuwait, Tunisia and Qatar. Maged S Sourial, ‘Corporate Governance in the Middle East and North Africa: An Overview’ SSRN 508883 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=508883> accessed 15-09-2014, 17.

[137] ibid.

practice). In the case of Libya an extreme situation has emerged in which laws have become effectively meaningless due to a lack of enforcement.

3.2.3. The problem of formal private enforcement in Libya

As discussed previously, there are three stages that any transition economy goes through when transforming into a market economy: the Bureaucratic Stage, the Networks Stage, and the Free Market Stage. [138] Libya is still in the very early stages of transformation and is currently moving from the Bureaucratic Stage to the Networks Stage.[139] In the early stages, many developing and transition economies still have dysfunctional legal systems because laws and rules supporting market-based transactions are incomplete and the machinery for enforcement is inadequate. [140] As a result, stakeholders rely on self-enforcement and informal constraints, such as social relationships, social norms, and personal power, as a means of regulating harmful opportunistic behaviours. This is referred as 'Relational Governance', which is discussed in detail in Ch.1.[141]

As the enforcement of the legal system is extremely weak (as discussed below), it effectively prevents minority shareholders from suing majority shareholders for breach, misuse, wrongdoing or oppression. The infectiveness of litigation encourages the solving of problems outside of formal channels and leads investors to rely on social networks as an alternative to formal rules and legal enforcement. In other words, the real problem in Libya is not enacting the laws and regulation generally (although this is still a problem in corporate governance), [142] instead the problem is their enforcement. In 2010, Larbsh studied the lack of law enforcement in Libya[143] and found it to be an extreme case. He states that '[a]lmost all interviewees (9 out of 10) argued that the implementation and

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[138] See (1.3.1).
[139] See (1.3.2).
[140] John McMillan and Christopher Woodruff, 'Private Order Under Dysfunctional Public Order' (2000) 98 Michigan Law Review 2421, 2421; Joseph Stiglitz, 'Whither Reform? Ten Years of the Transition' (Annual Bank Conference on Development Economics).
[141] See (1.3.1).
[142] See (1.3.2).
[143] To my knowledge, this is the only study available on enforcement in Libya.

acceleration of the enforcement is more problematic than establishing laws and regulation'.[144] He concludes that the main factor affecting the practice of corporate governance in Libya is the poor enforcement of law.[145]

Although there is no doubt that Libyan courts lack the capacity to enforce laws, which is a significant issue for corporate governance, the key question is to what extent. The answer to this question is complex as not only legal efficiency in general (which refers to outputs relative to inputs) is difficult to measure,[146] but a lack of data and sufficient empirical studies makes the evaluation of the deficiency of enforcing institutions a challenging task.[147]

In the following sections, the study argues that Libya is an extreme case in terms of lack of court enforcement. To do so, the study uses variables that relate to the special case of Libya and are commonly used to assess legal effectiveness. For example, Pistor et al use three variables to measure the effectiveness of legal institutions in transition economies: a rule of law rating provided by outside expert assessment; an index of the effectiveness of corporate and bankruptcy law in transition economies constructed by the EBRD;[148] and survey data on the ability of the legal system to protect private property rights and enforce contracts, which they call the enforcement index.[149] In addition, La Porta et al use five indices to analyse their forty-nine countries: rule of law, the efficiency of the judiciary, the prevalence of corruption, contract repudiation and expropriation by the government.[150] By comparison, Johnson et al use three indices of legal institution: efficiency of the judiciary,

[144] Mansor M Larbsh, 'An Evaluation of Corporate Governance Practice in Libya: Stakeholders' Perspectives' (PhD, Nottingham Business School, Nottingham Trent University 2010) 205.
[145] Ibid 235
[146] Berglöf and Claessens (n 10) 24
[147] ibid.
[148] Pistor, Raiser and Gelfer (n 120).
[149] ibid. Pistor *et al.*'s study, in regard to these variables, indicates that 'these variables are closely related, but not identical with indices that are commonly used in the literature to assess legal effectiveness'. See ibid.
[150] La Porta and others (n 7).

corruption, and the rule of law.[151] Accordingly, in the following sections the study will employ some of these categories and others that take into account the special environment in Libya, such as the impact on court enforcement of the tribal structure of Libyan society.

3.3. Lack of general enforcement environment of law in Libya

This section evaluates the judicial approach adopted by LEAA 2010 in regard to the protection of the minority shareholders. Through analysing the general enforcement environment of law, I argue that the current system of judicial protection is not effective. This section discusses both the negative impact of judicial corruption (3.3.1) and the slow pace of justice (3.3.2) on court enforcement. In addition, as an analysis of court efficiency needs to extend beyond the courts themselves to understand their role in the larger system, the section analyses other political (e.g. government intervention) and social (e.g. the structure of Libyan society) aspects that hinder the courts' enforcement of law (3.3.3).

3.3.1. Judicial corruption

There is no doubt that when enforcing institutions are corrupt, the level of enforcement is adversely affected.[152] Corruption lowers enforcement effectiveness by increasing the costs of motivating and monitoring bureaucrats.[153] Further, even though it is lower in rich countries, corruption is a global phenomenon.[154] However, in Libya it is endemic[155] and therefore impacts on court enforcement generally.[156] According to the last available annual

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[151] Simon Johnson and others, 'Corporate governance in the Asian Financial crisis' (2000) 58 Journal of Financial Economics 141.

[152] Daron Acemoglu and Thierry Verdier, 'The Choice between Market Failures and Corruption' (2000) 90 American Economic Review 194.

[153] Berglöf and Claessens, (n 10) 29-30.

[154] According to the empirical study of La Porta *et al.*, in rich countries, including continental Europe, judicial corruption is lower since judges are sufficiently honest and the judicial system is broadly efficient. See La Porta and others, 'Law and Finance' (n 7) 1141-1143.

[155] Throughout recent history, it has been argued that 'developing countries with large oil revenues [like Libya] have had a propensity for greater levels of corruption than those without'. See The U.S. Commercial Service, *Doing Business in Libya: 2008 Country Commercial Guide for U.S. Companies* (The US Commercial Service, 2008) 12.

[156] According to Umar Khan the big problem in Libya is that corruption has become socially acceptable. 'There is awareness that corruption exists in almost all areas of life but the general idea is not to resist it or work against it which often means others joining the same cycle. This attitude has allowed it to become a fact of the society, frowned upon by the people but it is so widespread that they can do nothing to stop it'. See

report on the Corruption Perceptions Index (CPI) in 2014, issued by Transparency International, Libya ranked 166th among 174 countries in the world.[157] Porter and Yergin found in 2005 that Libya lags behind its MENA peers by a substantial margin on control of corruption.[158]

Regarding judicial corruption in Libya, the courts face serious problems.[159] However, an assessment of the exact level of judicial corruption in Libya is a very hard task since there are no empirical studies or appropriate literature. Most of the information concerning judicial corruption in Libya is only available in the daily newspapers published in Libya. Prior to the Libyan revolution at the end of 2011, no international, regional or NGO "watchdog" organizations were able to operate in Libya due to the closed nature of the Muammar Gadhafi's regime.[160]

Though there is a lack of studies that examine judicial corruption in Libya, it is commonly held in Libya that judicial corruption is widespread and institutionalised, often being seen as part of the local system of state governance. Martinez notes that 'the judicial system lacks standards and procedures for fair and equitable trials and the judiciary is

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Umar Khan, 'Opinion: Corruption – The biggest Problem facing Libya' *Libya Herald* (Tripoli, 3-August-2013).

[157] Transparency International, *Corruption Perceptions Index 2014* (Transparency International Website, 2014). The reports published by Transparency International from 2003 to 2011 show an increase in the perception of corruption in Libya. This indicates a serious corruption problem in Libya that must be addressed for development purposes. For example, in the three recent years, Libya ranked 146th among 178 countries in 2010. However, following the Arab Spring in 2011, Libya was affected by the financial crisis and its rank in corruption went down to 168th amongst 182 in 2011. It has continued to decline and stood at 160th out of 176 countries in 2012 and in 2013 Libya ranked 172nd among 177 countries in the world.

[158] See Michael E. Porter and Daniel Yergin, ' National Economic Strategy: An Assessment of the Competitiveness of the Libyan Arab Jamahiriya' General Planning Council of Libya,Tripoli 2006 <http://www.isc.hbs.edu/pdf/2006-0127_Libya_NES_report.pdf> accessed 9/12/2012, 29. Also, Porter and Yergin conclude that Libya is lower than the MENA average not only in terms of controlling corruption but also on regulatory quality, governance effectiveness, rule of law and accountability. However, on political stability Libya does rank better than the MENA average (This was before the revolution in 2011). See ibid

[159] Administrative staff in courts often work as intermediaries in corrupt transactions between judges and parties to cases. See International legal Assistance Consortium-ILAC, *ILAC Rule of Law Assessment Report* (International legal Assistance Consortium 2013) 60.

[160] See The U.S. Commercial Service (n 155) 49. However, several websites critical of government corruption are operated by Libyan dissidents located outside of the country. Libya is a signatory to the UN Convention against Corruption (UNCAC), but there has been little evidence of its implementation. See ibid.

perceived by the population as corrupt'.[161] There is also a sense that this situation is a legacy of the Gaddafi regime; the International Crisis Group notes that under Gadhafi, the judiciary suffered from politicization of appointments and rampant corruption.[162] Despite the change in government, judicial corruption remains a major problem. Following the Libyan revolution in 2011, the leader of the National Transition Council (NTC), [163] Mustapha Abdul Jalil,[164] acknowledged that it would take years to overcome the 'heavy heritage' of judicial corruption in Libya.[165] Salah al-Marghani[166] indicated that 'there is little trust towards the judges who are still considered to be Qadhafi's judges'.[167] Mohamed Al Mogarif, who followed Mustapha Abdul Jalil in 2012, pointed out that 'judicial corruption in Libya is a cancer that needs to be removed'.[168] His statement was a response to the protest in Benghazi in October of that year against judicial corruption in Libya.[169] However, there is evidence that rather than improving, judicial corruption has got worse following the revolution. According to the international Crisis Group Report in 2013 'Civil cases [...] were still rife with corruption; according to several lawyers, the situation worsened following Qadhafi's fall insofar as there was less scrutiny than in the past' .[170]

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[161] Luis Martinez, 'Countries at the Crossroads 2011: LIBYA' in Jake Dizard, Christopher Walker and Vanessa Tucker (eds), *Countries at the Crossroads 2011: An Analysis of Democratic Governance* (Rowman & Littlefield Publishers 2012) 8.
[162] International Crisis Group, *Trial by Error: Justice in Post-Qadhafi Libya* (International Crisis Group, Middle East/North Africa Report N°140, 17 April 2013, 2013) at Executive Summary, i.
Examples of Judicial corruption can be seen in the following examples: protecting private interests or the interest of friends or relatives at the expense of the other party; judges adjudicating in violation of procedure or in an untimely manner; limiting the personal freedom and detaining interested parties or lawyers; extorting property, services, or fees. AbedAlbary Al trebel, 'Libyan Judiciary between the Past and Present and Future ' *Libya Al-Mostakbal* (Tripoli, 19-04-2012)accessed 20-02-2014 (in Arabic).
[163] This is the legislative authority in Libya. Its name changed to the General National Congress of Libya in 2012 and to the Libyan Parliament in 2014.
[164] Abdel-Jalil is a Libyan politician who was the Chairman of the National Transitional Council from 5 March 2011 until its dissolution on 8 August 2012. This position meant he was *de facto* head of state during a transitional period after the fall of Muammar Gaddafi's government. Before the revolution, he was a judge and then served as Minister of Justice in 2007. See Ronald Bruce St John, *Libya: From Colony to Revolution* (3th edn, Oneworld Publications 2012) 291-2.
[165] Aljazeera, *Reports and Dialogues - The Demands of Purifying the Libyan Judiciary* (Al Jazeera 2012) (In Arabic). Also see Korina Al Jadida, 'Mustapha Abdul Jalil: Libyan Judiciary is not Purified Yet' *Korina Al Jadida* (Al bida, 01-08-2012)accessed 20-02-2014 (in Arabic).
[166] Salah al-Marghani is a lawyer and human rights activist who became justice minister from 2012 to 2014.
[167] International Crisis Group (n 162) 18.
[168] Aljazeera (n 165).
[169] ibid.
[170] International Crisis Group (n 162).

Therefore, after Gadhafi, the judicial system is still rife with corruption, a situation that is exacerbated by an increase in threats and physical attacks on prosecutors and judge, which further inhibits the rule of law. [171] This situation clearly creates distrust towards the Libyan judiciary. [172]

The ineffectiveness and corruption of the Libyan judicial system discourages minority shareholders from seeking remedies in the courts. Consequently, many people including investors do not go to a court; instead they create informal institutions that work as an alternative court. For example, the informal institution of the tribe and its justice system play a crucial role in solving disputes since 'it is more accessible, quicker, more transparent, and less corrupt than the state courts. In addition, the tribal mediator, or *sheikh*, is felt to be better equipped to guarantee enforcement of tribal rulings'.[173] This idea has been discussed in chapter (1) from the angle of corporate governance based on relationships[174] and will be further discussed later in this section from the perspective of its impact on court enforcement.[175]

3.3.2. Slow pace of justice

In addition to an honest judiciary, speed is also important if investor remedies are to be meaningful. [176] Here the study argues that enforcement mechanisms function poorly in Libya since the machinery of justice is too slow, too cumbersome and too expensive to make it effective. In other words, Libyan courts are ineffective and inefficient at providing predictable and timely judgments. This is because the Libyan judicial oversight has

[171] Human Rights Watch, *World Report 2013: Libya* (Human Rights Watch, 2013) available at <http://www.hrw.org/world-report/2013/country-chapters/libya?page=2>. More details are provided in (3.3.3.1).

[172] Libya Herald, 'Libyan Judicial System Needs Urgent Reform: Report' *Libya Herald* (Tripoli, 17-April-2103) <http://www.libyaherald.com/2013/04/17/libyan-judicial-system-needs-urgent-reform-report/#ixzz2tciQizDh> accessed 20-02-2014.

[173] Jan Michiel Otto, J Carlisle and S Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (Van Vollenhoven Institute, Leiden University, cop. 2013) 193.

[174] See (1.3.2.1).

[175] See (3.3.3.2).

[176] Bernard Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 UCLA Law Review 781, 790-91 and 807.

numerous legal and physical obstacles that discourage the minority shareholders from bringing an action (3.3.2.1), and the current situation of a lack of security has a contributory impact on providing predictable and timely judgments (3.3.2.2).

3.3.2.1. The legal and physical obstacles in Libya's judicial system

The effectiveness of law enforcement may depend on matters of civil procedure.[177] In Libya, there are numerous legal procedural obstacles that hinder the minority shareholders in bringing an action against the majority shareholders. According to Maroof, foreign investors are most likely to rely on arbitration as an alternative to national courts because of the complexity of the national Act of civil procedure in Arabic countries such as Libya, and also the slowness of the procedure of litigations in these countries.[178] Additionally, the United Nations Development Programme (UNDP) indicated that courts do not apply uniform procedures or case management systems, resulting in significant differences in the time it takes to process cases.[179]

Most of the legal procedural obstacles in Libya derive from the fact that the Libyan Procedural Civil Act was enacted in the 1950s and there have been no serious amendments that reflect the new developments in Libyan society. Here the study briefly outlines these obstacles (since their details relate to civil procedure law, not corporate governance). The most important of these obstacles are as follows:

Firstly, the law does not state the time period in which the third party (e.g. witnesses and external experts) must co-operate with the court.[180] For example, external experts often fail to provide the court with requested reports on time. Though the reports of

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[177] Guido Ferrarini, Paolo Giudici and Mario Stella Richter, 'Company Law Reform in Italy: Real Progress?' (2005) 69 The Rabel Journal of Comparative and International Private Law 658.
[178] Faraj Maroof, 'The Role of the Judiciary in the Application and Enforcement of International Treaties of Investment Disputes ' (The Fourth Conference of Heads of Supreme Courts in Arab Countries-2013) (in Arabic).
[179] Interview, UNDP Libya, 20 February 2013., cited in International Legal Assistance-ILAC (n 159) 60, footnote 160.
[180] Asma Keskso, 'Cons of Libyan Judiciary' *Al Berniq* (Tripoli, 26-02-2012) 12 (in Arabic).

external experts are not binding to the courts, in about 95% of cases the courts seek an opinion from such experts.[181] Furthermore, the law allows the parties to extend the case for any reason. Often these reasons are not significant to the case but involve, for example, the exchanging of marginal documents between the parties, examining the documents and filing new documents which may have no effect on the case.[182] Moreover, there are many problems in delivering citation notices that the law does not address. For example, the law does not account for the lack of house numbers and street names in Libya.

Other contributory factors to the slowness court procedures in Libya are: the lack experienced judges (as discussed later); the weak performance of the Judicial Inspection Institution[183] concerning the observance of the litigation procedure; the length of judicial annual breaks (50 days a year); and the disproportionate number of cases received by the courts per year to the number of available judges.[184] There are also *ex post* reasons that contribute to the slowness of the pace of justice in Libya that follow litigation proceedings. For example, many court decisions have not been enforced by the judicial police due to their lack of efficiency. Further, many court decisions cannot be enforced when the ruling is against either a powerful public institution or a person who has political power.[185]

As well as procedural issues, there are further physical factors that contribute to the slowness in the pace of justice in Libya. For example, the deterioration of the institutional climate under which the judges work, the failure to adopt new technologies that could assist in speeding up the pace of the litigation, and a lack of suitable facilities in judicial institutions all contribute to extending the length of the court's proceedings.

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[181] ibid.

[182] Hithem Al Kobaei, 'Civil Procedure Law Allows the Parties to Delay the Decision of the Court' *Al Raia* (14-03-2013) 23 (in Arabic).

[183] The Judicial Inspection Institution is a body that has a duty to inspect and monitor the performance of the staff working in the judiciary sector.

[184] Al trebel, (n 162).

[185] Keskso, (n 180).

Due to the combination of these factors, a commercial case in Libya may take more than ten years to be decided by a court. In response to this, investors in Libya often do not deal with unknown persons. Instead they usually transact with people who they have a social relationship with. There are also other ways that have been developed that enable investors to protect themselves from relying on the civil law procedure of the courts. For example, when a civil transaction is breached a remedy can be sought under criminal law. An example of this might occur when an investor (or any individual) wants to borrow money from another investor (or individual). In such cases it is very common that the creditor will request from the potential debtor a *Wasel Amana* (an agreement based on trust). The procedure of breaking the *Wasel Amana* is that the creditor will undertake a criminal procedure in order to regain the debt faster, whereas under a civil procedure even a simple case could take several years to resolve.

3.3.2.2. The lack of security undermines formal private enforcement

On 17th of February, 2011, Libya witnessed a revolution against Gadhafi's regime which, as any revolution in the world, had numerous, unforeseen consequences. One of which is the resultant lack of security. Numerous post-revolutionary armed groups, so-called "militias" (*milishiat*) or "brigades" (*kataib*), have kept their arms and their power following the end of the revolution and the establishment of democracy.[186] The government thus far have failed to exert control over these militias who themselves have

[186] For more information analysing the situation in Libya following the revolution see e.g. Jan Michiel Otto, J Carlisle and S Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (Van Vollenhoven Institute, Leiden University, Report of the AJIDIL, 2013) 20-4; International Crisis Group (n 162) 16-27; William Wheeler, 'How Militias Took Control of Post-Gaddafi Libya' *GlobalPost – International News* (The U.S, 24-08-2013) <http://www.globalpost.com/dispatches/globalpost-blogs/groundtruth/how-militias-took-control-post-gaddafi-libya> accessed 25-02-2014. The best description of the current situation in Libya has been given by a former health minister, Fatima Al Humoroush:

> Before, there was fear and anarchy. Now the fear has gone, and the anarchy is there. So, I always say, OK there was fear of a dictator, and that's why order was kept, basically without law. Law wasn't applied, but there was order. Now there's no order, everything's a mess because there's no fear, and I think the way to bring back order is to apply the law. People should fear the law, not a dictator'. See International Crisis Group (n 162) 19.

their shared interests and political aspirations.[187] According to the International Crisis Group, this is because the government 'lack[s] appropriate means to control armed groups. The police do not have sufficient manpower, as many officers did not report back to work after the 2011 war'.[188] The report also notes that 'those who remained in office tended to be powerless, unarmed and subservient to the will of armed brigades'.[189] Thus the virtual collapse of the state security apparatus and the widespread availability of weapons constitute a vital problem plaguing the judicial system, which, as Amnesty International reported, is 'virtually paralysed'.[190]

In terms of the impact on court proceedings and enforcement, as Otto *et al*. note, 'judges, prosecutors and police lack the state's monopoly on the legitimate use of power and thus cannot enforce the law'.[191] In this context, the 2012 annual report of the UK Foreign and Commonwealth Office notes that:

> [T]he Libyan judicial system is not yet fully functioning, despite efforts made by the interim government to rebuild institutions. Many of the police officers, prison guards, lawyers and judges who left during the revolution have not returned. Court cases are often adjourned rather than dealt with immediately by judges, or do not progress as quickly as they should. [192]

Additionally, the International Crisis Group report in 2013, confirmed that 'there is still no functioning court system in many parts of the country, while armed groups continue to run prisons and enforce their own forms of justice'. [193] The same report notes that 'the absence of an effective national police force, widespread availability of weapons and persistent assassination of security officials have hampered the state's investigative

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[187] Hanan Salah, *Lawlessness in Libya* (Human Righst Watch Report, 2013); Human Rights Watch-HRW, *World Report 2014: Libya* (2014) available at < http://www.hrw.org/world-report/2014/country-chapters/libya?page=1>. HRW reported that 'the interim government failed to control deteriorating security in the country, especially in the capital, Tripoli, and in Benghazi, Libya's second largest city'. ibid.
[188] International Crisis Group (n 162) 26-7.
[189] ibid 21.
[190] Amnesty International, *Libya Must Seek Justice not Revenge in Case of Former Al-Gaddafi Intelligence Chief* (2012) available at < http://www.amnesty.org/en/for-media/press-releases/libya-must-seek-justice-not-revenge-case-former-al-gaddafi-intelligence-chi>
[191] Otto, Carlisle and Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (n 186) 22.
[192] UK Foreign and Commonwealth Office, *Human Rights and Democracy: The 2012 Foreign & Commonwealth Office Report - Libya* (United Kingdom: Foreign and Commonwealth Office, 15 April 2013, 2013) available at <http://www.refworld.org/docid/516fb7c5f.html>
[193] International Crisis Group (n 162) Executive Summary, i

capacity as well as its ability to carry out justice'.[194] The lack of security has led to lawlessness and the formulation of an appropriate and long term solution is complex.[195] The complexity comes from the conflict between the government and militias; while the government admits that it cannot enforce the law as long as the militias keep destabilising the law enforcement apparatus, the militias claim they cannot give up their positions as long as the state allows lawlessness and impunity.[196]

The lack of law enforcement, in the context of the lack of security in Libya, takes the two following perspectives. Firstly, armed groups and militia consider themselves above the law. They, to some extent, exercise informal supervision over local police stations and act as judges in some situations.[197] Following the revolution, the militias 'took on the roles of police, prosecutors, judges and jailers',[198] which stems from the fact that the revolutionary camp distrust the judiciary, considering them to be Qaddafi loyalists, [199] and their distrust extends to the police force that worked under the Qadhafi's as well.[200]

Additionally, the lack of security in Libya significantly affects law enforcement through preventing many members of the judicial sector from attending work. The U.S. State Department notes that "judges cited concerns about the overall lack of security in and around the courts as one of the reasons that they had not yet returned to work, further hindering the judiciary's reestablishment".[201] Amnesty International reported that: 'a return to a functioning judiciary could only happen when the security situation improves'.[202] International Crisis Group report notes that 'in late December 2012, Mustafa Tarabulsi,

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[194] ibid 3.
[195] ibid 39. Also the same report indicates that 'Judicial reform – including, inter alia, amending legislation inherited from the past, building an independent and capable police force and enhancing the capacity of prosecutors – inevitably will take time'. ibid.
[196] ibid.
[197] ibid 20.
[198] ibid 22.
[199] Wheeler, (n 186).
[200] For information about the solutions proposed for solving these dilemmas such as the introduction of a vetting law that will specifically apply to the judiciary and the police force see International Crisis Group (n 162) 17.
[201] U.S. State Department, *Country Report on Human Rights Practices: Libya* (2013).
[202] Amnesty International, *Libya: Rule of Law or Rule of Militias* (Amnesty International 2012) 32.

president of the Court of Appeals of the Jebel Akhdar, suspended all local cases "in order to maintain security and protect the court and its staff'.[203] Also, the same report notes that 'in some peripheral areas, such as the town of Derna in eastern Libya and its surrounding region of Jebel Akhdar, courts did not function at all.'[204] The 2013 report of the UN Secretary, also, notes that:

> The volatile security situation continued to represent a major challenge for the full resumption of the Libyan court system, with armed elements often cited by judges and prosecutors as a source of continuous threat. Following a number of attacks on courts, including the appeals court in the Green Mountain region and the office of the Chief Prosecutor in Benghazi, a number of senior judges threatened to suspend the work of the courts if their security were not guaranteed.[205]

Further, it has been reported that attacks on judges and lawyers has increased. Amnesty International has documented cases of violence against members of the prosecution, threats against judicial officers and challenges faced by defence teams.[206] More than that, many judges have already been killed. [207] The situation has led the Supreme Judicial Council in Libya to request personal protection form the government.[208]

3.3.3. Political and social hindrances to law enforcement

Larbsh argues that a 'system of governance that is based on law may not be effective in developing economies, where social connections and political intervention have a high

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[203] International Crisis Group (n 162) 19 (n 80).
[204] ibid19.
[205] United Nations Support Mission in Libya, *Report of the Secretary-General on the United Nations Support Mission in Libya* (United Nations Support Mission in Libya, 21 February 2013) available at <http://www.unsmil.unmissions.org/Default.aspx?tabid=3549&language=en-US> paragraph 26
[206] Amnesty International, *Libya: Rule of Law or Rule of Militias* (n 202) 33.
[207] See e.g. Lawyers for Justice in Libya, *Lawyers for Justice in Libya Concerned by Attacks on Judges and Lawyers in Libya* (2013) <http://www.libyanjustice.org/news/news/post/92-lawyers-for-justice-in-libya-concerned-of-attacks-on-judges-and-lawyers-in-libya>. (in Arabic). See Also, Salah (n 187); See also, Libya Al Mostakbal, 'The Libya Judicial Organisation Mourns Judge, Najeeb Hoiday and Considers him a Martyr of its Duty' *Libya Al Mostakbal* (Tripoli 19/7/2013) <http://www.libya-al mostakbal.org/news/clicked/36764> accessed 20-02-2014 (in Arabic); Al Watan Alibia, 'Judge, Milood Ammar Has Met his Demise by a Bomb' *Al Watan Alibia* (Tripoli, 2014-02-20) <http://www.alwatan-libya.net/more-30673-1-%D9%88%D9%81%D8%A7%D8%A9%20%D8%A7%D9%84%D9%82%D8%A7%D8%B6%D9%8A%20%D9%E2%80%A6 > accessed 20-02-2014 (in Arabic); Al Anba, 'The Supreme Judicial Council in Libya condemns attacks that affect judicial members ' *Al Anba* (Tripoli, 24/6/2012) <http://www.anbalibya.com/article_details.php?article_id=319 > accessed 20-02-2014 (in Arabic).
[208] Al Ayam, 'The Supreme Judicial Council in Libya Requests Personal Protection from the Government' *Al Ayam* (Tripoli, 12-11-2013) <http://www.al-ayyam.com/article.aspx?did=227295&date=11/12/2013> accessed 20-02-2014 (in Arabic).

influence on the governance practice'.[209] Accordingly, in this subsection I argue that court enforcement in Libya is not efficient since it is hindered by both the political (3.3.3.1) and the social (3.3.3.2) climate.

3.3.3.1. Political hindrances to law enforcement

The general enforcement environment is effected by the political climate in several ways. For example, when most controlling owners are politicians, enforcement is weak and the interests of minority shareholders are less likely to be protected.[210] Also, when the rich elite influence the path of justice, litigation does not work effectively.[211] Further, political corruption may affect how laws are written.[212] Consequently, the level of enforcement is ultimately a matter of political priorities, particularly when there are interferences from government, which is the case in Libya. To underline this, the 2012 U.S. State Department report suggested that 'the interim governments took no concrete actions to reform the justice system, and gaps in existing legislation and unclear separation of powers among the executive, judicial, and legislative branches contributed to a weak judicial system'. [213]

Under Gadhafi' regime, Gadhafi had almost unlimited power. This came from the fact that the "Charter of Revolutionary Legitimacy" gave him control over all of Libya's political, judicial, and economic institutions. As a result, Gadhafi's directives were prioritized *vis-à-vis* the law, including judicial rulings. [214] Also, the same Charter of Revolutionary Legitimacy delegated him the right to intervene in judicial issues by changing court judgments or obstructing the administration of justice. [215] At the government level, the executive authority had control over judges and compromised their independence. For example, the Minister of Justice directly intervened to prevent the

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[209] Larbsh (n 144) 69.
[210] Berglöf and Claessens (n 10) 18.
[211] Edward Glaeser, Jose Scheinkman and Andrei Shleifer, 'The Injustice of Inequality' (2003) 50 Journal of Monetary Economics 199.
[212] Berglöf and Claessens (n 10) 30.
[213] U.S. State Department (n 201) 9.
[214] Martinez (n 161) 347; Bertelsmann Stiftung, *BTI 2012 — Libya Country Report* (Gütersloh: Bertelsmann Stiftung, 2012) 9.
[215] Martinez (n 161) 8.

courts from enforcing rulings against the state in violation of the Code of Procedure and, separately, against oil companies.[216]

Following the revolution there remains a lack of many relevant international standards for the independence of the judiciary in Libya and both the executive and legislative power are still able to intervene in the work of Libyan judiciary. In this context, International Crisis Group in 2013 'acknowledged the need to restore public trust in the judiciary and recommended reforming the judicial system to guarantee its independence, integrity and impartiality.'[217] Martinez in 2012 indicated that 'the revolutionary authority has undue influence on judges and frequently uses that power to shape rulings in their favour.' [218] Also, he indicates that 'the judicial system fails to exercise any kind of oversight over the regime, which is not bound to comply with judicial rulings'. [219] Similarly, International Crisis Group expressed doubts about judicial independence since the council remains financially dependent on the Ministry of Justice and both the President of the Supreme Court and the Prosecutor General are appointed by the legislature[220] following nomination by the executive authority.[221] Additionally, the Judicial Inspection Department, whose duty it is to inspect and evaluate the work of members of the judicial sectors such as judges and prosecutors, is still a part of the Ministry of Justice (executive authority),[222] rather than being an independent institution. Moreover, the Minister of Justice's presidency of the Supreme Council of Judicial Bodies and the membership of the Secretary General of the Ministry of Justice still sit on the High Judicial Council.[223] Thus, executive authorities in Libya still exercise institutional control over Libyan judges.

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[216] Euro-Mediterranean Human Rights Network, *Reform of Judiciaries in the Wake of the Arab Spring* (Euro-Mediterranean Human Rights Network, 2012).
[217] International Crisis Group (n 162) 16.
[218] Martinez (n 161) 8.
[219] ibid.
[220] International Crisis Group (n 162).
[221] See Supreme Court Law No. 1 of 1375, art 7.
[222] Milad Al Haraty, 'Independence and Impartiality of the Libyan Judiciary ' *Al horia* (Tripoli, 22-09-2012) (in Arabic).
[223] Euro-Mediterranean Human Rights Network (n 185).

3.3.3.2. Social hindrances to law enforcement

The general enforcement environment is not only effected by the political climate, the social climate also has a significant impact on law enforcement in Libya. Libya's social environment is characterized by the extended family, clan, tribe and village. These play a major role in the community's life and people's relationships with each other.[224] However, these relationships and social connections constitute constraints that prevent improvement in the general enforcement environment and implementation of public laws in Libya. This is due to the fact that in tribal societies loyalty is to the family, clan, and tribe more than to a state and regionalism and sectarianism outweigh loyalty to profession and law.[225] This situation is not new; strong tribes, clans, and families have always been a countervailing force to the state and to its efforts to establish strong state institutions.[226] As Otto, Carlisle and Ibrahim, note:

> The bonds between tribe members are said to be generally stronger in eastern Libya than in the western part in and around Tripoli. Here, people rely in times of trouble heavily on their tribe rather than on the state. The state is often perceived as being tardy, inefficient, perhaps corrupt, and generally ineffective.[227]

Consequently, personal relations and family ties play a major role in solving disputes between the members of the tribes even in business affairs [228] and the tribe regularly takes on the role of local arbiter and mediator.[229] In fact, Libyan law *per se* acknowledges this power to the tribes by delegating arbitrating power to the *sheikh* (head) of a tribe. Reconciliation and Arbitration Committees, established by law no 74/1975

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[224] Almehdi A. Agnaia, 'Management Training and Development within its Environment: The Case of Libyan Industrial Companies' (1997) 21 Journal of European Industrial Training 117, 120; Wolfram Lacher, 'Families, Tribes and Cities in the Libyan Revolution ' (2011) XVIII Middle East Policy 1, Bertelsmann Stiftung (n 214) 9-11.

[225] Agnaia (n 224) 120.

[226] Otto, Carlisle and Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (n 186) 25.

[227] ibid 181-2

[228] This form of tribal dispute resolution is regarded as being beneficial in both criminal cases, such as crimes of rape or murder, and civil cases, such as land disputes, family matters, inheritance, marriage and business.

[229] Otto, Carlisle and Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (n 186) 193.

(amended by law no. 4/ 2010), [230] are composed of *sheikhs* and have power to resolve disputes. The parties of the dispute can bring their dispute to the official Reconciliation and Arbitration Committees to solve their disputes as an alternative to the courts. However, if the committee is unable to solve the dispute, it can transfer the parties to a court.

The advantages of appealing to the informal institution of the tribe and its justice system, as Otto et al. note, is that

> it is more accessible, quicker, more transparent, and less corrupt than the state courts. In addition, the tribal mediator, or sheikh, is felt to be better equipped to guarantee enforcement of tribal rulings. These rulings are closer to the collective beliefs of the communities and enforced with social pressure. This can be found not only in the rural areas, but also in the urban areas where the tribal attachment and loyalty is very strong.[231]

Therefore, though tribal and social institutions are not an alternative to the procedures of the state justice system, but rather are considered as a means of social mediation,[232] they impact on law enforcement in the following aspects. Firstly, judges are a part of a tribal system before they are judges. Accordingly, they may have personal, or at least social, ties with one of parties that could result in a social pressure that affects their ruling. Secondly, since in Libya, loyalty to family, clan, and tribe is more than to a state and its law, the informal judgement of *sheikhs* carries a greater likelihood of enforcement than the formal judgment of courts. For example, when the judgments of the court and the tribe are in conflict, the tribal judgment is more likely to be enforced. Here Al-Tir argues 'when tribal loyalty encroaches upon necessary qualification, then discussing modern institutions becomes meaningless'.[233]

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[230] According to Law no.74/1975, the parties must bring their dispute to the committee before they go to the court and the court can reject the case if it found that the case was not brought to the committee first. However, under law no. 4/ 2010, this provision has changed and become a default rule.
[231] ibid.
[232] ibid.
[233] Mustafa Al-Tir, ' Challenges of Democratic Movement in Libya' *Al Watan al-Libiya* (Tripoli, 23/Sep/2011) cited in Jason Pack, *The 2011 Libyan Uprisings and the Struggle for Post-Qadhafi Future* (Palgrave Macmillan 2013) 61, (footnote 14). It is worth mention that, according to Al-Tir:

> The major urban areas developed as a result of emigration from countryside and not as a result of natural increase [in population]. Thus, the tribe is still present today in the memory of a large number of urban dwellers. Instead of those coming from the

3.4. The quality of corporate law judges: the deficiency of expertise in the courts

It has been said that 'bad judges may spoil good laws',[234] and currently in Libya the deficiency in judges' expertise means that shareholders are not able to ensure the enforcement of their rights due to poor court institutions. Dulic and Kuzman suggest that the enforcement of laws and the quality of institutions which enforce legal norms, determine the effectiveness of investors' protection independently of a formally defined set of laws. [235] Therefore, a lack of expertise in the courts undermines the efficiency of the current solution adopted in art 159 of LEAA 2010. The rationale of the argument here is that the law on the books is meaningless if the quality of the courts' interpretation and the implementation of the law are weak. When courts are unable to enforce the law as it is stated in the statutes, then the law will be different from that envisioned by the legislators.[236] In other words, whereas access to court is primarily controlled by the quality of the law, the type of enforcement is primarily controlled by the quality of the judiciary system.[237]

In the following analysis, I argue that the current Libyan courts are not equipped to deal with commercial cases that relate to abuse of power by the controlling shareholders. This is because the current judges lack the adequate experience and expertise to deal with such cases (3.4.1). This is especially the case as the current legal system concerning the

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countryside integrating into the life of the city and adopting the ways and modes of urban life, they entered the cities …and imposed the various particulars of rural life. (See ibid 60, footnote 13)

[234] Luca Enriques, 'Do Corporate Law Judges Matter? Some Evidence from Milan' (2002) 3 European Business Organization Law Review 756, 771.

[235] Katarina Đulić and Tanja Kuzman, 'Protection of Rights of Minority Shareholders: Legal Framework and Enforcement' <http://policycafe.rs/documents/financial/research-and-publications/financial-sector-development-in-serbia/the-protection-of-minority-shareholder-rights.pdf> accessed 12-02-1013.

[236] Luca Enriques, 'Off the Books, But on the Record: Evidence from Italy on the Relevance of Judges to the Quality of Corporate Law' in Curtis J. Milhaupt (ed), *Global Markets and Domestic Institutions: Corporate Law and Governance in a New Era of Cross Border Deals* (New York: Columbia University Press) 257-294.

[237] Zohar Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (2003) 91 California Law Review 393, 420.

protection of minority shareholders is based on the wide discretion of judges (open-ended legal standards) rather than a set of defined legal standards (3.4.2).

3.4.1. The lack of adequate experience and expertise in dealing with cases of minority shareholder protection

Although there are no international (or even national) reports that focus intensively on the working of the courts and the training of the judiciary,[238] there are some reports that indicate a lack of sufficient experiences and adequate training in the Libyan court system generally. The 2013 report of the International Crisis Group notes that the Libyan regime appointed judges without legal training.[239] The same report notes that a 'high percentage of untrained judges continued to man the courts'. [240] The 2012 Report of the International Commission of Inquiry on Libya similarly noted that there still exists a lack of trained staff in the judicial sector in general.[241] Additionally, Libyan lawyers interviewed in the Report of the AJIDIL, stress that there should be more resources and training for the judiciary.[242] Also, the International Legal Assistance Consortium (ILAC) report recognises that courts' efficiency is dependent on the administrative staff (who, in Libya, receive no ongoing training) and the adequate resourcing of law faculties.[243] Similarly, the Report of the AJIDIL proposes that because of lack of qualified judges in Libya, the authorities should establish 'a systematic training programme for the legal professions, including joint training of judges'.[244] Because of this situation, the Secretary-General on the United Nations Support Mission in Libya (UNSMIL) in their report suggest that 'United Nations

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[238] This result is also found in Otto, Carlisle and Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (n 186) 35.

[239] International Crisis Group (n 162) 11.

[240] ibid. It is also noted that 'some judges and prosecutors also lacked proper interrogation techniques and accepted confessions extorted under duress'. ibid 15.

[241] UN Human Rights Council, *Report of the International Commission of Inquiry on Libya* (UN Human Rights Council, 2 March 2012, A/HRC/19/68, 2012) available at < http://www.refworld.org/docid/4ffd19532.html>

[242] Otto, Carlisle and Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (n 186) 103.

[243] International Legal Assistance-ILAC (n 159) 59, 69-72.

[244] Otto, Carlisle and Ibrahim, *Searching for Justice in Post-Gaddafi Libya. A Socio-Legal Exploration of People's Concerns and Institutional Responses at Home and From Abroad* (n 186) 202.

agencies would be prepared to provide support in developing the overall judicial infrastructure, including the training of judges, prosecutors and corrections officers, strategic planning and budgeting capacity, case management systems and legal aid services to the population'.[245]

Even though there are attempts by the government to train judges, these are not sufficient to raise the standard of expertise in the Libyan courts.[246] This is particularly the case in the field of the minority shareholders' protection where many judges in Libya are still unable to deal with complicated cases that relate to issues of, amongst other things, securities law, merger and takeover. For example, determining the objective value of a transaction is a complicated process (even though judges can rely on the existence of professional institutions capable of providing accurate assessments) that requires a high degree of competence from the courts. This is because 'such valuations involve future projections of different variables, all of which can affect the actual price, and the use of complex financial models'.[247]

Though it is clear that the number of poor judicial decisions can be reduced if the courts are competent,[248] most of Libya's courts are not capable of dealing with cases of minority protection since the court system contains no specialized judges.[249] Instead judges

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[245] United Nations Support Mission in Libya (n 205).

[246] For example, in 2013 The Ministry of Justice in Libya sent only 11 Libyan Judges from five different governorates: Tripoli, Sabha, Benghazi, Albidaa, and Darna, to the judicial training academy in Kromeriz in the Czech Republic. See UNDP, 'Training programme for 11 Libyan Judges in Kromeriz' UNDP, 27 May 2013 <http://www.ly.undp.org/content/libya/en/home/presscenter/articles/2013/05/27/training-programme-for-11-libyan-judges-in-kromeriz/> accessed 15-03-2014; Libya Helald, 'Libyan Judges Receive Training in Czech Republic' *Libya Helald* (Tripoli, 03-06-2013) <http://www.libyaherald.com/2013/06/03/libyan-judges-receive-training-in-czech-republic/#axzz2vezzNWjr> accessed 15-03-2014.

[247] *Cede & Co. v. Technicolor, Inc.,* No. CIV.A.7129, 1990 WL 161084

[248] Zohar Goshen, 'Conflicts of Interest in Publicly-Traded and Closely-Held Corporations: A Comparative and Economic Analysis' (2005) 6 Theoretical Inquiries in Law 277.

[249] It should be noted that there is a distinction between specialised courts (existing in Libya) and specialized judges (not existing in Libya). The former can be described as 'a court or an independent division within a general court with limited and usually with exclusive jurisdiction in one or more specific fields of the law'. (See Central European and Eurasian Law Initiative (1996), "Specialized Courts: A Concept Paper", p. 1, cited in OECD, *Corporate Governance in Emerging Markets Enforcement of Corporate Governance in Asia: The Unfiinished Agenda* (OECD 2007) 62. However, specialized judges means judges who are qualified and expert in a speciality that falls within the court's jurisdiction. It has been argued that specialised business courts can improve the enforcement of corporate governance rules through attract investment and contribute to economic growth. Also, it has been argued that specialised business courts can only be

in Libya can preside in different types of courts and consider any kind of case no matter the area. The judge may work for three years in a civil court and after that may work in a criminal court according to what has been decided by the Assembly of the court at its yearly meeting. This situation may contribute to the number of poor decisions and so can inflict a severe blow to economic efficiency as investors will be unwilling to invest in such a system as a minority group.

3.4.2. Wide discretion of judges and uncertain criteria

Though the lack of experience in the area of minority protection is a major contributory factor in poor judicial decisions, this is exacerbated by wide judicial discretion. Generally, judges in Libya have relatively limited discretion as Libya and other civil law countries rely on legal rules[250] more than principles. Legal rules, as MacNeil and Braithwaite observe, are more specific and increase legal certainty.[251] This point, in particular, has been noted in the case of *O'Neill v Phillips* where Lord Hoffmann highlighted that a balance has to be struck between the breadth of the discretion given to the court and the principle of legal certainty.[252]

However, in regard to minority shareholders' protection, Libyan corporate law relies heavily on open-ended legal standards, such as the abuse of rights principle that grants courts wide discretion in resolving minority-majority shareholders' conflicts, rather than providing corporate actors with specific legal standards that promote proper behaviour. In other words, the current test of fairness adopted in LEAA 2010 allows the court a very wide discretion and "sits under a palm tree", since it relies on a fluid notion of fairness that

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successful if certain preconditions are satisfied and one of them is the condition for well-trained judges (See ibid 14ff).

[250] Legal rules include laws, executive regulations (*Lawaeh (plural)* or *laeha (singular)*) and executive and ministerial decisions.

[251] See John Bradford Braithwaite, 'Rules and Principles: A Theory of Legal Certainty' (2002) 27 Australian Journal of Legal Philosophy 47, 51; Iain MacNeil, 'Uncertainty in Commercial Law' (2009) 13 Edinburgh Law Review 68, 72-76.

[252] [1999] 2 BCLC 1.

is based on general concepts of wrong or fraud. [253] Accordingly, the LEAA 2010 is consistent with the concept of a "wholly indefinite notion of fairness" that UK law has rejected.[254]

By contrast, unfair prejudice in the UK, as discussed previously, is clearly intended to bring greater commercial certainty[255] to the operation of the remedy [256] by referring to specific criteria that determine whether the remedy is available. Unfair prejudice, therefore, 'withdraws from the court a general fairness review power and refers them to the specific legal rules that determine whether the remedy is available in relation to different types of corporate conduct.'[257] Lord Hoffman, in addressing the issue, said that the court cannot do 'whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. […] The court […] has a very wide discretion, but it does not sit under a palm tree'. [258]

Although the wide discretion of judges can be used in a positive way to provide the minority shareholders with protection when the legal system has qualified judges who are able to 'create new standards themselves or extend the application of existing ones to areas

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[253] The absence of clear legal rules is costly and in addition the lack of qualified judges in commercial cases leads to several negative outcomes:

> 'First, it leads to variance in assessments of the legal standard and thus to divergences of behaviour from the social optimum. Some corporate fiduciaries may overestimate the legal constraints and forgo efficient transactions, while others may underestimate the very same constraints and carry out inefficient transactions. Second, legal indeterminacy creates liability risk, which risk-averse fiduciaries are in a poor position to bear. Exposing corporate fiduciaries to this risk makes their services more costly and less productive to shareholders'.

See Ehud Kamar, 'Shareholder Litigation Under Indeterminate Corporate Law' (1999) 66 The University of Chicago Law Review 887, 889.

[254] The concept that has been rejected in *Ebrahimi* [1973] A.C. 360 at 379.

[255] It should be noted that there is no direct causal relationship between certainty of rules and efficiency (as there is no reason to believe that, in general, efficient rules are more certain than those which are inefficient) As argued by George L. Priest, 'The Common Law Process and the Selection of Efficient Rules' (1977) 6 The Journal of Legal Studies 65, 68.

[256] Paul Paterson, 'A Criticism of the Contractual Approach to Unfair Prejudice' (2006) 27 Company Lawyer 204, 214.

[257] Kershaw (n 4) 684.

[258] [1999] 1 W.L.R. 1092. 1098.

other than those that the codes explicitly posit',[259] the lack of experience of most Libyan judges renders this possibility redundant.[260] Without the requisite experience, the lack of restrictions to judicial discretion means that the outcome of the courts' decisions will be inconsistent and there will be no explanation as to why one minority shareholder's claim is successful and another is not. The combination of wide discretion and a lack of expertise and experience in commercial issues, means that the current solution adopted in art 159 of LEAA 2010 is undesirable and not suitable in the Libyan case.

In conclusion, the lack of experience and expertise of corporate law judges constitutes another factor that weakens the efficiency of the current solution adopted in art 159 of LEAA 2010. This is because judges are not able to enforce the law as it is stated in the commercial statutes. This situation is more problematic in Libya since the current system used to protect minority shareholders is based on the wide discretion of judges (open-ended legal standards) rather than a set of defined legal standards.

3.5. Considering Libya's judicial system as a system of non-intervention: law enforcement problems under incomplete law

Here the study argues that the approach to the protection of minority shareholders adopted under art 159 of LEAA 2010 has failed since the Libyan judicial system can be considered as a system of non-intervention. As La Porta *et al.* argues, a judicial system should be regarded as a system of non-intervention, if the courts are inaccessible. [261] This inaccessibility can be put down to the issue of incomplete law in Libya.[262] As Pistor and

[259] Enriques 'Do Corporate Law Judges Matter?' (n 234) 771-2.
[260] Some scholars argue, however, that judges could fix corporate law only in a common law system. See ibid
[261] Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of Financial Economics 3.
[262] K. Pistor and C. Xu define a law as incomplete when 'law makers are unable to foresee all future contingencies'. Katharina Pistor and Chenggang Xu, 'Incomplete Law: A Conceptual and Analytical Framework' (2002) 35 New York University Journal of International Law and Politic 931. Also, they note that law is incomplete when all potential harmful actions cannot be clearly specified. This means that a law may be incomplete when the law does not address the potentially harmful act, or when it intentionally leaves some areas open to judicial interpretation. Ibid

Xu suggest, law enforcement by courts cannot be expected to effectively deter violations when the law is incomplete.[263]

In Libya, the minority shareholders face difficulties in bringing an action against the controlling shareholders (who are sometimes in the position of board of directors) because of the incomplete nature of the law. For example, a derivative suit is not allowed in Libya although it is allowed in almost all jurisdictions (3.5.1). Also, there are high risks and costs attached to bringing a dispute to the court (e.g. the court requires a deposit from the shareholders in order to bring an action against the majority shareholders) (3.5.2). In addition, the courts are barred from intervening in certain cases, for example, the minority shareholders cannot bring an action against the majority shareholders when the latter is in the position of a shadow director (3.5.3). All of these factors lead us to conclude that the Libyan judicial system is a non-interventionist system.[264]

3.5.1. The lack of derivative suits

In the UK, minority shareholders can bring a derivative action on behalf of a corporation against an insider of that corporation (e.g. a director).[265] However, despite the fact that French Law and Egyptian Law (the roots of Libyan Law) allow minority shareholders to bring a derivative action against the directors on behalf of the company,[266] the LEAA 2010 prohibits any shareholder (including the minority shareholders) from bringing a suit

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[263] Katharina Pistor and Chenggang Xu, 'Deterrence and Regulatory Failure in Emerging Financial Markets: Comparing China and Russia' Weatherhead Center, Harvard University, 1-04-2013 <http://wcfia.harvard.edu/publications/deterrence-and-regulatory-failure-emerging-financial-markets-comparing-china-and> accessed 15-03-2014.

[264] Here we should note that a detailed analysis of minority protection in Libya goes beyond the scope of this thesis.

[265] CA 2006, s 260.

[266] French Company Law (art L. 225-252) has not prevented the minority shareholders from bringing a derivative action since the mid-nineteenth century. (See Mathias M. Siems, *Convergence in Shareholders Law* (Cambridge University Press 2008) 214). This is also the case in Egyptian Company Law no 159/1981 article 102/3, Syrian Company Law article 196/2, Lebanese Company Law article 168, Jordanian Company Law article 188 Saudi Company Law article 78. However, Kuwaiti Company Law, similar to Libyan Company Law, does not provide the minority shareholder with shuch an action. It is important to indicate that s 226 of Egyptian Company Law sets no threshold on the percentage of shares an investor must hold before they are able to bring an action against the directors. However, under French Company Law, (Art. L. 225-252) only shareholders who own 5 % of the company capital are able bring an action against the majority shareholders.

without a shareholders' resolution, even if the company has been involved in an insolvency procedure.[267]

One potential reason for the absence of a derivative suit in Libyan law is discussed by Muhsen Shafiq[268] and Mohamed Kamel, [269] who suggest that to bring a derivative action against individual directors opens the door to numerous cases that could be brought by any shareholder seeking compensation. [270] This, they suggest, would threaten the stability of the management, trust in the management, and the reputation of the company. However, even if this were the case, such a criticism is applicable to all liability actions (including Personal Action) and revocation actions. As such, the appropriate solution is not to only allow the majority shareholders the right to sue the board of directors but, as is the case in the UK, to restrict the circumstances under which the action can proceed and allow an action only if permitted by the courts.[271]

It may be argued that there is no need for a derivative action (a company-personal action) in Libya since a personal action may be deemed as an appropriate alternative to a derivative action. Under this model, the harm to a corporation can be translated into personal harm (minority shareholder's harm). [272] In this context, according to Tibar, a personal action is considered as an exceptional auxiliary action. This means that minority shareholders should pursue an action only in cases in which the majority shareholders do not resolve to sue the directors (a company action). [273] In fact, this is not the case as the two actions (derivative action and personal action) are significantly different even if they sometimes overlap.[274] A derivative action requires a corporate basis, which is associated

[267] LEAA 2010, art 184.
[268] Muhsen Shafiq, *Intermediary in Commercial Law*, vol 1 (3 edn, Maktabt Al nahda Almasria 2006) 562 (in Arabic).
[269] Mohamed Kamel, *The Encyclopedia of Corporations* (Madbaha Kased Alkir 1980) 473 (in Arabic).
[270] See also K. W. Wedderburn, 'Shareholders' Rights and the Rule in Foss v. Harbottle' (1957) 15 The Cambridge Law Journal 194, 194.
[271] See CA 2006, s 261 (1). For more details see (5.2.2).
[272] Tibar (n 12) 820.
[273] ibid.
[274] See (3.1.1.2).

with corporate rights, and its function is to enable minority shareholders, in limited circumstances, to pursue an action for harm done to the company and to seek compensation on the company's behalf.[275] However, a personal action has personal grounds that relate to personal rights; hence it is a remedy for shareholders who have suffered personal harm.[276] Moreover, it is not a decision for the minority shareholder to determine which action is more suitable. Rather it should be the court's decision as to whether a minority shareholders' claim should be pursued on the grounds of corporate rights or personal rights. This is especially the case as proceedings based on corporate grounds bring certain advantages that are not available to proceedings based on personal grounds. For instance, using corporate grounds as the basis for an action allows the minority shareholder to use the company's name in the claim and perhaps to seek indemnity for costs if the case succeeds.[277]

Consequently, it is clear that there is a gap between the two scenarios that LEAA 2010 covers (Company Action and Personal Action) as discussed previously. LEAA 2010 does not allow for the fact that the minority shareholders may wish to pursue a derivative action on behalf of the company when the company's interests are harmed and the majority shareholders do not want to sue. This issue is particularly problematic in Libya due to the concentrated system of ownership, as it is highly likely that the directors and the majority shareholders are the same people. Accordingly, on the grounds that the action cannot be brought unless a resolution is issued by the shareholders, it is not logical for a shareholder (as the controlling shareholder) to bring an action or make a resolution to sue himself (as a director). As a result, the protection that the Act provides for the shareholders, in this scenario, is significantly lacking. The only protection that the Act does grant to the minority shareholders is a personal action which is still under evaluation.

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[275] Deakin and others (n 59) 164.
[276] Hale, (n 20) 221.
[277] Brenda Hannigan, 'Drawing Boundaries between Derivative Claims and Unfairly Prejudicial Petitions' (2009) 6 Journal of Business Law 606, 610-611.

Therefore, it is evident that the law intends here to grant the majority shareholders the ultimate voice in matters of dispute, rather than allowing the minority the chance to destabilize the company on every issue. Even in a scenario where a director is clearly misusing his position, only the majority shareholder has the right to question the director, hold him accountable and/or remove him. Moreover, the courts, in most cases, agree with the majority shareholder, preferring not to interfere in the company's internal affairs. Thus, it is clear that the purpose of this provision is to retain the power and control over the company's affairs in the hands of the majority shareholders, which in most cases is the state.

The current state of minority protection in Libya is strikingly similar to the traditional position adopted in the UK. Prior to the reform of UK Law, minority shareholders were not permitted to litigate for wrongs done to their company or to complain of irregularities regarding its internal affairs. This principle originated from *Foss v. Harbottle* [278] and is called the "proper plaintiff rule";[279] the main rationale behind this rule being to protect the company from unwanted and harmful litigation. [280] Similarly, the minority shareholders in Libya are restricted by the majority rule principle and majority shareholders have complete control over decision-making and litigation.

However, this principle created significant problems in the UK (discussed below) and, as a result, important exceptions were developed under traditional common law[281] that allowed a minority shareholder to bring an action when a wrong was done to the company;

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[278] [1843] 2 Hara 461.

[279] This principle was clearly stated by Lord Davey in *Burland v Earle* [1902] AC 83, PC, and also in *Edwards v Halliwell* [1950] 2 All ER 1064, where he divided the principle into two main concepts. The first case stated that the courts would not interfere in the internal management of companies as courts regarded the majority shareholders as being in a far better position than judges to decide what should be done. The second case found that when a wrong was done to a company, the proper claimant was the company itself and not any individual shareholder, namely the minority shareholder. For more details Ben Pettet, *Company Law* (2 edn, Pearson Education Limited 2005) 213.

[280] See *MacDougall v Gardiner* (1875) 1 Ch D 13, at 25; Andrew Dodd, 'Directors' Duties and Derivative Actions' (2007) 30 Company Secretary's Review 145, 145; Charles Wild and Stuart Weinstein, *Simth & Keenan's Company law* (Pearson Education Ltd 2011) 264. Also, according to Ben Pettet ' the other probably is that the courts dislike interfering in business decisions reached by a company and regard the shareholders as far better placed to decide what should be done than the judge is'. Pettet (n 279) 213.

[281] These exceptions are often described as "exceptions to the rule" in *Foss v Harbottle.*

a development that has not occurred in Libyan Law. Under traditional UK law, these exceptions related to acting *ultra vires* or illegally, [282] failing to meet the requirements of special resolutions,[283] the infringement of members' rights and fraud.[284] Importantly, the most recent development into UK law is the statutory 'derivative action', which, as noted, allows a minority shareholder to bring a claim on behalf of the company.

The absence of these exceptions in Libya and the resultant reliance upon the majority shareholders to bring a suit against the board of directors raises some serious issues. Firstly, adopting a shareholder resolution in a general meeting to bring an action against the board of directors is not possible since those who are responsible for the alleged wrongdoing control the voting power of the general meeting.[285] As an example of this: when the directors committed the wrongdoing, they may not have been acting on their own discretion or judgment, but rather following the instructions of the controlling shareholders' who sought to gain benefits without explicitly exercising corporate power (shadow directors).

Secondly, in a concentrated corporate ownership system, such as the one that dominates Libya, majority shareholders are highly likely to sit on the board of directors. As such, it is unlikely that a majority shareholder would make a resolution to bear liability for

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[282] Where an action is illegal (the act is contrary to company law or the directors have abused their powers) or *ultra vires* the company (beyond the legal powers or authority of the company which are posited in the memorandum of association), a shareholder could sue to restrain the action, because the majority could not ratify acts *ultra vires* the company. See *Rolled Steel Products v British Street Corporation* [1984] 2 WLR 908. Wedderburn (n 270) 204-205.

[283] Where an action was taken in breach of a requirement in the constitution requiring a special majority to authorise the action, a member could sue to challenge the validity of the resolution See *Edwards v Halliwell* [1950] 2 ALL ER 1064.

[284] Where the action amounted to a fraud on the minority and the wrongdoers were in control of the company, the minority shareholders were permitted to bring an action against the wrongdoers on behalf of the company. See *Prudential Assurance Co Ltd v Newman Industries Ltd (no 2)* [1982] Ch 204 at 210-11; Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French and Ryan on Company Law* (28 edn, Oxford University Press 2012) 678; Stefan Lo, 'The Continuing Role of Equity in Restraining Majority Shareholder Power' (2004) 16 Australian Journal of Corporate Law 96, 105

[285] Libyan law does not even adopt the UK traditional rule that a minority shareholder can bring a case when the alleged wrongdoers have sufficient voting power to ensure that if the matter arose at a general meeting the members would vote to terminate the litigation. See *Birch v. Sullivan* [1957] 1WLR 1247 (Ch.D.); D A Wishart, 'A Conceptual Analysis of the Control of the Companies' (1984) 14 Melbourne University Law Review 601, 621-2.

any wrongdoing. Currently, minority shareholders are unable to force a majority shareholder who is also a director to take an action when they simply decide to take the matter no further. This situation has compelled many legislative bodies to empower a minority shareholder to initiate an action on behalf of the company if the majority shareholders fail to do so.[286] In so doing, this avoids the doctrine of *Foss* under which, it has been widely agreed, minority shareholders would be at the mercy of majority rule if there were no exceptions, such as a derivative action.[287]

However, the problem of majority shareholder rule in relation to bringing a derivative action is more problematic in a legal system that has not adopted the rule of ratification by uninterested shareholders, such as LEAA 2010. Under the ratification rule, uninterested shareholders are entitled to vote on resolutions which enforce the company's rights against wrongdoers, which can provide some protection for minority shareholders.[288] However, when this rule is not adopted, as is the case in Libya, there are no restraints on the power of the majority shareholders in relation to litigations.

Finally, the application of the majority rule principle in widely held corporations is subject to a problem of collective action.[289] A rational shareholder will not spend too much time and effort in bringing an action because he knows in advance that the potential benefits resulting from his action are negligible.[290] As such, the shareholders' collective action problem results in a less than optimal amount of litigation.[291] However, in companies owned by controlling shareholders the situation is different as there is no

[286] For example, see arts 245 and 246 of France Company Law 1966 that give shareholders the right to start a derivative action; see David Sugarman, 'Reconceptualising Company Law-Reflections on the Law Commission's Consultation Paper on Shareholder Remedies' (1997) 18 Company Lawyer 226.
[287] Davies (n 36) 644.
[288] CA 2006, s 239 prohibits self-interested members from participating in the ratification vote. See also, *Smith v Croft (No 2)* [1988] Ch 114; *Taylor v National Union of Mineworkers (Derbyshire Area)* [19985] BCLC 237.
[289] Davies (n 36) 647; Brian R. Cheffins, *Corporate Ownership and Control* (Oxford University Press 2008) 128.
[290] Kenneth E. Scott, 'Corporation Law and the American Law Institute Corporate Governance Project' (1983) 35 Stanford Law Review 927, 945.
[291] Reisberg (n 115) 84; Davies (n 36) 647

collective action problem. Rather, even if the company is subject to the sort of wrongdoing that necessitates litigation, the majority shareholders will not litigate against themselves.

3.5.2. High risks and costs attached to bringing a dispute to court

Once an existing rule is violated, the injured shareholder should have a right to access the court and ask for a remedy. However, the injured shareholder may hesitate to do so because of the risks attached to bringing a dispute to court or the high cost of litigation. Firstly, in the case of Libya, as discussed previously, the owner of most large private companies and listed companies is still the state. As this is the case, the minority shareholders may be hesitant to bring an action as it is widely held that the courts always support the state against private investors.[292] This may be attributable to the fact that the state is able to afford professional lawyers to defend their case whereas the shareholders are not. Also, as Shleifer and Vishny suggest, private parties remain vulnerable to the threat of discretionary regulation and extortion by public officials without any effective legal recourse.[293] This is clearly the case in Libya and, as such, private enforcement is an inefficient mechanism for resolving legal disputes that involve the government.

Secondly, the costs attached to bringing a dispute to the court may be too high. Though lawyers' costs are relatively affordable, art 161 of LEAA 2010 allows the court to require a deposit from the plaintiff (minority shareholders in our case) as a guarantee in case he or she causes damages to the defendant (controlling shareholders). This kind of precondition affects the plaintiff's motivation to bring an action. This is because minority shareholders are investors before they are litigants, which suggests that they would probably prefer to keep their money in readiness for an investment opportunity rather than deposit it in the court as a guarantee. This is especially the case when investors know in

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[292] Though there are no empirical studies or data collection to prove this, but this is a perception that very common in Libya.

[293] Andrei Shleifer and Robert W Vishny, 'Corruption' (1993) 108 The Quarterly Journal of Economics 599.

advance that the deposit that he will pay will be held by the court for long time because of the slow pace of court proceedings.

3.5.3. Cases in which the courts are barred from intervening

Libyan law prohibits courts from intervening in certain cases. First, the directors, when they committed the wrongdoing, may not have been acting on their own discretion or judgment, but rather following the instructions of the controlling shareholders' who seek to gain benefits without explicitly exercising corporate power. A clear example of such activity would involve encouraging the board to enter into non-arm's-length-party transactions with controlling shareholders. Even though such a situation is possible in Libya, it is not recognised as an illegal action and hence there is no protection for shareholders in these circumstances. By contrast, the issue of controlling shareholders acting as shadow directors is addressed *directly* in UK law. [294] Under s.260 (5) (b) of the CA 2006 shadow directors are equated with directors for the purpose of bringing derivative claims.[295] Here it is important to indicate that though a shadow director does not normally owe fiduciary duties to the company,[296] a number of specific statutory duties, in addition to the general duties,[297] are applicable to shadow directors, all of which can be found in Ch3[298] and Ch4[299] of Pt 10 of CA 2006. Accordingly, many of the provisions concerning

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[294] See CA 2006, s 251. See also *Re Kaytech International Plc ; Secretary of State for Trade and Industry v Potier* [1999] B.C.C. 390 CA (Civ Div), per Robert Walker L.J. at 401.

[295] See also Companies Act 2006 s.170 (5). For details see Evripides Hadjinestoros, 'Stigmata of Fiduciary Duties in Shadow Directorship' (2012) 33 Company Lawyer 331, 336. According to Birds, *et al:*

CA 2006 'allow[s] derivative claims where controlling or dominant shareholders (or possibly senior managers) are involved in a director's breach of duty to the company' See Birds and others (n 35) 698.

[296] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) para 1279.

[297] In relation to the general duties, Ch2, s. 170 (5) refers to the corresponding common law rules, but, according to Kershaw, 'to date there is only one reported case which addresses this issue in detail.' Kershaw (n 4) 328.

[298] Ch.3 concerns the declaration of interests in existing transaction or arrangement. s 187 (1) states that 'the provisions of this Chapter relating to the duty under section 182 (duty to declare interest in existing transaction or arrangement) apply to a shadow director as to a director…'

[299] Ch.4 is entitled Transactions with Directors Requires Approval of Members. s 223 (1) states that 'for or the purposes of— (a)sections 188 and 189 (directors' service contracts),
(b) sections 190 to 196 (property transactions),
(c) sections 197 to 214 (loans etc), and
(d) sections 215 to 222 (payments for loss of office), a shadow director is treated as a director.'

shadow directors enforce liability when *de jure* directors (or *de facto* directors) breach their duties whilst acting under the instructions of the shadow director. [300]

Second**,** the Libyan courts do not recognise legitimate expectation in relation to small private companies.[301] At present, the Libyan courts only recognise formal and written agreements between the shareholders, so they are reluctant to look at informal agreements, even when there is strong evidence of legitimate expectation at the time of investing in the company, as recognized in the UK by Lord Hoffmann in *O'Neil v Philips*.[302] In other words, while the Libyan courts are bound to consider rights within the context of the abuse of rights principle, as discussed previously, the UK courts are at liberty to consider rights in other ways. Section 994 of CA 2006, adopts unfair prejudice to provide protection for minority shareholders from more than just a breach of their legal rights. In other words, unfair prejudice, as a criterion, attempts to avoid narrow rights-based protection. [303] This point is expressly indicated in the section when it states that 'the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interest of members'. [304] Thus the protection for the minority shareholders includes the interest of the shareholders, which covers both shareholders' lawful rights and also their legitimate expectations.

Lastly, to bring an action by the minority shareholders against the controlling shareholder, LEAA 2010 only requires proof of harm to the aggrieved shareholders.[305] However, in the UK, under CA 2006, the act which results in harm must be both unfair and prejudicial. To prove unfairness the petitioner needs to show that there is a breach of law,

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[300] Chris Noonan and Susan Watson, 'The Nature of Shadow Directorship: Ad hoc Statutory Intervention or Core Company Law Principle?' (2006) Journal of Business Law 763, 787.
[301] For information about legitimate expectation, see (3.1.2.2).
[302] [1999] 1 WLR 1092.
[303] Payne, ' Sections 459-461 Companies Act 1985 in Flux: The Future of Shareholder Protection', (n 58) 648.
[304] CA 2006 s 994. The fact that the word "interests" is wider than the strict legal rights of a member has frequently been recognised in many cases. See for example, *Re a Company* (No 00477 of 1986) [1986] BCLC 376, 378; *Re a Company* (No 008699 of 1985) [1986] BCLC 382, 387; *Re Blue Arrow plc* [1987] BCLC 585, 590; *Re Ringtower Holdings plc* [1989] BCLC 427, 437; *Re a Company* (No 00314 of 1989), *ex parte Estate Acquisition and Development Ltd* [1991] BCLC 154, 160.
[305] See Libyan Civil Code, s 166.

shareholders' agreements or legitimate expectation. In addition, to prove prejudice, a claimant must prove that there is harm caused by the conduct of the wrongdoer,[306] such as damages to the value of his shareholdings.[307]

As such, the approach adopted in the UK delivers more justice to the parties of the petition since actions may be prejudicial but not unfair. This can be clarified in the following examples. Firstly, unfairness cannot be found when the petitioner has acquiesced to the wrongdoings of which he now complains. In *Croly v Good*, the shareholders agreed to ignore their obligations under CA 2006 in relation to the running of the company. In this case, the court held that none of the shareholders were allowed to claim that the conduct of the other shareholders was unfair on that ground alone. [308]Also, when a shareholder who was a party to the other shareholders' unlawful participation in the management of the company (in breach of Insolvency Act 1986, s 216), he could not be protected under unfair prejudice since the conduct was prejudicial but fair.[309] Furthermore, removing a director is not always unfair, when his conduct merits removal, [310] even if it is prejudicial. Additionally, a lack of consultation of a minority shareholder by the majority shareholders is not always prejudicial since this would be fair when the petitioner has preferred to withdraw from active involvement in the business.[311]Thus, according to these examples and others, it is not rational and fair if the aggrieved shareholders are redressed on the bases of mere prejudice.

In summary, the approach to the protection of minority shareholders adopted under art 159 of LEAA 2010 is inefficient since the Libyan judicial system can be considered as a system of non-intervention. Due to the incomplete nature of law in Libya, there are still some cases in which minority shareholders are prevented from bringing an

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[306] *Re Unisoft Group Ltd* (No 3) [1994] 1 BCLC 609 (Ch D).
[307] *Re a Noble (Clothing) Ltd* [1983] BCLC 273 (Ch D), per Nourse J.
[308] See *Croly v Good* [2010] 2 BCLC 569 at 94, Also, *Hawkes v Cuddy* [2009] 2 BCLC 427 at 72.
[309] See *Fisher v Cadman* [2006] 1 BCLC 499.
[310] See for example *Grace v Biagioli* [2006] 2 BCLC 70.
[311] *Re Metropolis Motorcycle Ltd, Hale v Waldock* [2007] 1 BCLC 520.

action against the insiders. Particularly, a derivative suit which is allowed in almost all jurisdictions is not allowed in Libya. Furthermore, there are high risks and costs attached to bringing a dispute to the court (e.g. the court requires a deposit from the shareholders in order to bring an action against the majority shareholders). Moreover, the Libyan courts cannot intervene in certain cases and the LEAA 2010 does not recognize the issue of shadow directors or legitimate expectation.

Conclusion

As discussed, Libya is still in the very early stages of transformation from the Bureaucratic Stage to the Networks Stage. As it is still in this early stage, Libya's legal system remains dysfunctional since laws and rules supporting market-based transactions are incomplete and the machinery for enforcement is inadequate. In this chapter, I analysed how the minority shareholders' actions as an approach to the protection of the minority shareholders against the controlling shareholders, adopted in art 159 of LEAA, is inefficient and ineffective due, [312] in large part, to the Libyan environment.

Specifically, judicial protection is currently ineffective since the general enforcement environment is weak. Judicial corruption and the slow pace of justice affect the motivation of minority shareholders to bring an action against the majority shareholders. Also, there are significant political (e.g. government intervention) and social (e.g. the structure of the Libyan society) factors that hinder the courts' enforcement of law.

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[312] As Llewellyn notes: 'The term effectiveness relates to whether the objectives are met, while efficiency relates to them being met in an efficient way without imposing unnecessary costs on consumers or regulated firms'. (see David T Llewellyn, 'Institutional Structure of Financial Regulation and Supervision: The Basic Issues' Paper presented at a World Bank seminar, "Aligning Supervisory Structures with Country Needs," Washington DC, 6th and 7th June, 2006 <http://siteresources.worldbank.org/INTTOPCONF6/Resources/2057292-1162909660809/F2FlemmingLlewellyn.pdf> accessed 06-03-2014, 17.

In addition, the efficiency and expertise of the courts undermines the efficiency of the current law. The quality of institutions which implement legal norms determine the effectiveness of protection of investors independently of a formally defined set of laws. As such, the law on the books is meaningless if the quality of the courts' interpretation and the implementation of the law are weak. This is more problematic in cases where the judges have wide discretion.

Finally, the minority shareholders face difficulties in bringing an action against the controlling shareholders (who are often in the position of board of directors) because the law is not complete. A derivative suit, which is allowed in almost all jurisdictions, is not allowed in Libya and there are high risks and costs attached to bringing a dispute to the court. In addition, the courts are barred from intervening in certain cases, such as the minority shareholders not being able to bring an action against the majority shareholders when the latter is in the position of a shadow director. All of these factors lead us to conclude that the Libyan judicial system is a non-interventionist system.

Chapter 4: An Alternative Solution: the Self-Enforcing Model

Introduction

Having examined the current approach adopted by LEAA 2010 for dealing with the majority-minority problem in Libya, and recognized that it fails to offer effective and practicable solutions to the problem, in this chapter the study examines an alternative solution that could contribute to resolving the minority-majority shareholders problem. Accordingly, this chapter proposes the self-enforcing model, which mainly relies on a voting mechanism to decrease the necessity of judicial oversight through permitting minority shareholders to review important transactions before they occur. In other words, this chapter develops a legal framework of corporate governance for a system where the general enforcement environment is weak and existing enforcement mechanisms function poorly.

There are three departure points that should be considered before discussing the self-enforcing model. First, though the self-enforcing model is a practical model that deserves serious consideration, there are few academics that have written on the subject.[1] Second, the self-enforcing model regulates two problems, the management- shareholders problem and the majority-minority shareholders problem. However, this chapter focuses only on the latter problem since this study attempts to solve only the majority-minority shareholders problem. Third, this model, as discussed in greater length in the introduction of the thesis, [2] is not a solution that has already been developed in established market

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[1] See e.g. Yevgeniy V Nikulin, 'New Self-Enforcing Model of Corporate Law: Myth or Reality, The' (1997) 6 Journal of Internation Law and Practice 347; Shanthy Rechagan, 'Controlling Shareholders and Corporate Governance in Malaysia: Would the Self-Enforcing Model Protect Minority Shareholders? ' (2007) 3 The Corporate Governance Law Review 1; Vlad Frants, 'Russian Corporate Law: Is Self-Enforcement Still the Way to Go?' (2008) 13 UCLA Journal of International Law and Foreign Affairs 435; Petri Mantysaari, *Organising the Firm Theories of Commercial Law, Corporate Governance and Corporate, Law* (Springer 2012) Ch. 8, 115-128. However, though there are few studies that discuss the self-enforcing model, there is large amount of literature that discusses the rules proposed by the model such as the supermajority rule and the majority of minority shareholders rule.

[2] For details see the Introduction of the thesis at 9ff.

economies with a long history of commercial law. Instead, as the weakness of institutional, market and cultural elements combined with legal constraints associated with transition and developing countries make it inappropriate to import company law from developed countries, in this chapter, I argue for a new solution based on Black and Kraakman's proposal in their 1996 article: A Self-Enforcing Model of Corporate Law.[3]

Again, the central aim of this chapter is to propose the adoption of the self-enforcing model as an appropriate strategy to protect minority shareholders in Libya. In order to explicate this, section (4.1) discusses alternative strategies for solving the majority-minority shareholders problem in the absence of effective formal private enforcement in developing and transition economies. To analyse this, (4.1.1) deals with these alternative strategies theoretically and (4.1.2) evaluates the potential success of applying these alternatives (such as forming liability actions as a means of protecting minority shareholders, and public enforcement as an alternative to formal private enforcement) to Libya.

Having examined these strategies of addressing the majority-minority shareholders problem in the absence of formal private enforcement and found them inappropriate in the case of Libya, (4.2) introduces the self-enforcing model, which relies mainly on a voting system. Accordingly, this section briefly outlines the central features of the model (4.2.1) and the nature and scope of its rules (4.2.2).

Also, before any analysis can be made, (4.3) continues to describe the self-enforcing model through discussing primary procedural mechanisms of the model used to protect the minority shareholders. These are: the approval mechanism (4.3.2), procedure of the voting system (4.3.1), and the minority shareholders transactional rights (4.3.3).

[3] Bernard Black and Reinier Kraakman, 'A SELF-ENFORCING MODEL OF CORPORATE LAW' (1996) 109 Harvard Law Review 1911.

Having described the self –enforcing model in the previous sections, (4.4) examines the problem of majority-minority shareholders in particular corporate transactions and proposes that the appropriate solutions to these problems are based on the adoption of the voting mechanism and transitional rights of the self-enforcing model, with certain amendments that take in to account the specific case of Libya. These amendments take into account the different kinds of corporate transactions in which a company may engage: related-party transactions, which are mainly addressed by the majority of minority rule (4.4.1); merger and other central transactions, which are mainly regulated by the supermajority approval rule (4.4.2); the majority-minority conflict in transactions that effect corporate capital are addressed by the majority of minority rule, and other mechanisms such as pre-emptive and participation rights (4.4.3); and, finally, control transactions that are mainly governed by a takeout right (4.4.3).

Finally, since Black and Kraakman do not provide a comprehensive analysis that justifies why the self-enforcing model is an appropriate alternative to formal private enforcement in emerging countries, section (4.5) provides more analysis that contributes to my proposal that the self-enforcing model should be adopted in Libya. In addition to the lack of court enforcement discussed in the previous chapter, this section argues that the self-enforcing model should be adopted in Libya since it contributes to companies being able raise capital from investors (4.5.1), and it also lowers the number of conflict of interest transactions, making the company's transactions more efficient (4.5.2). Finally, the self-enforcing model does away with the need for external monitoring (4.5.3).

4.1. Alternatives for solving the majority-minority shareholders problem in the absence of effective formal private enforcement

Before discussing potential alternatives that may contribute to solving the majority-minority shareholders problem in the absence of effective formal private enforcement, it is necessary to describe various types of enforcement mechanisms, which can generally be

divided into two groups: self-enforcement and third party-enforcement.[4] The latter can be further divided into state enforcement (e.g. public enforcement) and non-state third-party enforcement (e.g. gatekeepers, arbitration, reputation. etc.). Also, it should be noted that whilst self-enforcement can be classified as informal enforcement (which is part of a private ordering system), state enforcement and court enforcement are regarded as formal enforcement (or public ordering).[5]

This section discusses alternative theoretical strategies in developing and transition economies, which are designed to solve the majority-minority shareholders problem in the absence of effective formal private enforcement (4.1.1) and it evaluates the possibility and potential success of applying alternatives in the case of Libya (4.1.2).

4.1.1. Alternatives for solving the majority-minority shareholders problem in the absence of adequate formal private enforcement: a general discussion

Corporate governance literature can be divided into three groups in terms of what kind of strategies should be employed in the absence of adequate formal private enforcement to address the majority-minority shareholders problem. The first group advocates the enhancement of public enforcement when formal private enforcement is too weak, believing that when small shareholders are unlikely to sue because of unreliable courts and a lack of enforcement, a public enforcer is needed and therefore regulatory enforcement presents an attractive alternative to judicial enforcement.[6] In this context, Glaeser and Shleifer suggest that courts are more vulnerable to subversion than regulators, especially in

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[4] This division is articulated by Barzel in Yoram Barzel, *A Theory of the State: Economic Rights, Legal Rights, and the Scope of the State* (Cambridge University Press 2002) 24-6.
[5] Ding Chen, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Edward Elgar Publishing Limited 2013) 15-16. According to Chen:

> [a]ll of these enforcement mechanisms, more or less, can be found in almost every country. But the role of each mechanism varies significantly across countries. Even for the same country, it varies from time to time, from transaction to transition. Also each means has a comparative advantage under different circumstances, and no single means is likely to be preferable to all the others all the times. (see ibid 16).

[6] Though there is a trend in various studies that suggests that a public enforcer can be an appropriate alternative to formal private enforcement, the efficiency of public enforcement cannot be taken for granted, as discussed in (4.1.2.3).

an environment of significant inequality of wealth and political power. Therefore, the switch to regulation can be seen as an efficient response to a weak judicial system.[7] Pistor and Xu showed that when law is incomplete and violations of the law may result in substantial harm (as is the case in many transition economies), it is appropriate to vest law enforcement rights in regulators rather than courts.[8] Similarly, Glaeser et al. argue that in emerging markets 'where the costs of verifying the circumstances of specific cases and interpreting statutes are high, judges may not be sufficiently motivated to enforce legal rules'.[9] Therefore, '[e]nforcement by regulators, with more lopsided but powerful incentives, may then be a more efficient way to protect property rights'.[10] Further, Landis concludes that regulation is a political response to the failure of courts to keep up with the peoples' ideas of justice. This is because the remedies that are available to the courts are insufficient and so, in these circumstances, it is rational to switch from litigation to regulation.[11]

The second group of scholars tends to rely on private ordering as a response to a weak system of private enforcement, claiming that in the absence of private enforcement, informal enforcement will certainly develop. Therefore, informal enforcement prevails when reliable state enforcement is unavailable. In this regard, Gray argues that in countries where formal legal systems are weak, such as in some developing and transition countries, 'informal legal processes may fill some gaps and permit some markets to function'.[12]

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[7] See Edward L Glaeser and Andrei Shleifer, 'The Rise of the Regulatory State' (2003) 41 Journal of Economic Literature 401.

[8] This argument has been mentioned by Pistor and Xu in several works. See Katharina Pistor and Chenggang Xu, 'Incomplete Law: A Conceptual and Analytical Framework' (2002) 35 New York University Journal of International Law and Politic 931; Katharina Pistor and Cheng-Gang Xu, 'Beyond Law Enforcement: Governing Financial Markets in China and Russia' in János Kornai, Bo Rothstein and Susan Rose-Ackerman (eds), *Creating Social Trust in Post-Socialist Transition* (Political Evolution and Institutional Change 2004). 168-190; Katharina Pistor and Cheng-Gang Xu, 'Law enforcement under incomplete law: Theory and evidence from financial market regulation' ELS Reaserch Online, 2008 <http://eprints.lse.ac.uk/3748/> accessed 12-04-2014.

[9] Edward Glaeser, Simon Johnson and Andrei Shleifer, 'Coase versus the Coasians' (2001) 116 The Quarterly Journal of Economics 853, 897.

[10] Ibid.

[11] James McCauley Landis, *The administrative process* (Greenwood Press 1974) 97.

[12] Cheryl W Gray, 'Reforming Legal Systems in Developing and Transition Countries' (1997) 34 Finance and

McMillan and Woodruff argue that when the law is dysfunctional, as in many developing and transition economies, private ordering might arise in its place. This is 'either because the laws do not exist or because the machinery for enforcing them is inadequate. In such countries, bilateral relationships, communal norms, trade associations, or market intermediaries may work in place of the legal system'.[13] In another article, McMillan and Woodruff argue that in Vietnam firms are often willing to rely on private ordering by renegotiation following a breach, rather than go to court.[14] In Arabic countries such as Libya, Maroof argues that foreign investors are most likely to rely on arbitration as an alternative to national courts because of the complexity of the national Act of civil procedure and the inertia of the procedure of litigation.[15] In Russia, Hay and Shleifer suggest that private ordering has emerged as a market response to the failure of the state to provide and enforce its own rules, largely because of very weak incentives for the government to provide law and order.[16] In other words, investors in Russia refuse to use the official legal system[17] and therefore 'private rather than state mechanisms are used to resolve disputes. These mechanisms range from social norms and pressures, to arbitration, to employment of private but legal protection agencies, to organized crime.'[18]

The development of private ordering as an alternative to a weak system of private enforcement was historically also the case in both the U.S and the UK. In these countries, in the absence of an effective legal system, various private ordering mechanisms arose to compensate for a lack of formal private enforcement. In the UK, the common law, as seen

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Development 14, 14.

[13] John McMillan and Christopher Woodruff, 'Private Order Under Dysfunctional Public Order' (2000) 98 Michigan Law Review 2421, 2421.

[14] John McMillan and Christopher Woodruff, 'Dispute Prevention without Courts in Vietnam' (1999) 15 Journal of Law, Economics, and Organization 637.

[15] Faraj Maroof, 'The Role of the Judiciary in the Application and Enforcement of International Treaties of Investment Disputes ' (The Fourth Conference of Heads of Supreme Courts in Arab Countries-2013) (in Arabic).

[16] Jonathan R Hay and Andrei Shleifer, 'Private Enforcement of Public Laws: A Theory of Legal Reform' (1998) 88 American Economic Review 398.

[17] Ibid 389.

[18] Ibid 390.

in the case of *Foss v. Harbottle*,[19] provided little protection to minority shareholders until the first half of the 20th century. The court, as discussed in (3.5.1.1), developed a 'proper plaintiff rule' in 1843 to address a wrong done to a company. The proper claimant in the case was the company itself and not any individual shareholder, especially not a minority shareholder.[20] The lack of protection afforded to minority shareholders remained until the second half of the twentieth century when formal investor protection emerged.[21] During this period (from 1843 to the beginning of second half of the twentieth century) the shareholders, as Frank et al. observe, relied more on informal relations of trust than on formal investor protection.[22] Additionally, Mayer argues that at the beginning of the 20th century the absence of formal systems and efficient equity markets led investors to substantially rely on informal relationships of trust.[23] Similarly, in the U.S., a combination of widespread judicial corruption, the inability of courts to provide adequate protection to minority shareholders,[24] and the high level of insiders' expropriation of personal private benefits,[25] all contributed to stock exchanges, such as the NYSE, relying on self-regulation as an alternative to formal private enforcement. [26]

Finally, the third strategy considered in corporate governance literature argues in favour of self-enforcement as an alternative to ineffective formal private enforcement. In their article *A Self-Enforcing Model of Corporate Law,* Black and Kraakman argue that:

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[19] [1843] 2 Hara 461.
[20] See (3.5.1.1).
[21] See Julian Franks, Colin Mayer and Stefano Rossi, 'Ownership: Evolution and Regulation' (2009) 22 The Review of Financial Studies 4009.
[22] Ibid.
[23] Colin Mayer, 'Trust in financial markets' (2008) 14 European Financial Management 617.
[24] See Edward L. Glaeser and Andrei Shleifer, 'The Rise of the Regulatory State in Europe' (2003) 41 Journal of Economic Literature 401; Woodrow Wilson, *The New Freedom* (Doubleday 1913) 240. Wilson suggests that during this period '[t]here have been courts in the United States which were controlled by the private interests. There have been supreme courts in our states before which plain men could not get justice. There have been corrupt judges; there have been controlled judges; there have been judges who acted as other men's servants and not as servants of the public'. (See, ibid).
[25] John C Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 The Yale Law Journal 1, 10.
[26] Chen (n 5) 52.

> in emerging markets, a self-enforcing model of corporate law - in which mandatory procedural and structural rules empower […] large minority shareholders to protect themselves against opportunism by insiders - dominates both the prohibitory model and the enabling model. The self-enforcing model minimizes the need to rely on courts and administrative agencies for enforcement. Thus, it is robust even when these resources are weak.[27]

Black and Kraakman's view of self-enforcement as an alternative for weak formal private enforcement has gained significant attention within corporate governance discourse. However, there are other potential strategies, the efficacy of which I will analyse in the following section before returning to Black and Kraakman's model.

4.1.2. Evaluating possible alternatives for solving the majority-minority shareholders problem in the absence of formal private enforcement: the case of Libya

Having recognized that the current approach adopted by LEAA 2010 fails to deal with the minority-majority shareholders problem and realized that the literature offers a variety of strategic alternatives in the absence of adequate formal private enforcement, this sub-section evaluates the range of solutions available to Libyan corporate law. To that end, firstly this section investigates whether it would be effective to attempt to reform the formal private enforcement system in Libya as a means of solving the majority-minority shareholders problem (4.1.2.1). It then examines the non-intervention and prohibition models (4.1.2.2) and public enforcement (4.1.2.3) as alternatives to formal private enforcement.[28] However, this section argues that for various reasons none of these solutions are fully effective in the case of Libya.

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[27] Black and Kraakman (n 3) 1912.

[28] In addition to these alternatives, there may be other options that are less important than those options discussed above and so are not included in this study. For example, it may be argued that private arbitration may provide an alternative to the lack of court enforcement. In fact, this is not true since the nature of arbitration is always a default rule that can be overridden by a contract, trust, will, or other legally effective agreement. In other words, the problem with arbitration in company law disputes is that arbitration is contractual in nature, It requires parties to the arbitration to have signed up for arbitration in advance and so cannot be mandated, it is therefore not capable of providing effective protection for minority shareholders. This is because the controlling shareholders have the power to revoke the arbitration rule at any time. Also, it may be argued that a reputation mechanism may be a good enforcement mechanism in Libya for protecting

4.1.2.1. Alternative (1): Reforming the system of formal private enforcement in Libya as a means of solving the majority-minority shareholders problem

There is no doubt that the effectiveness of private litigation adopted by art 159 of LEAA 2010 ultimately requires that the courts function efficiently and are supported by a strong legal system of enforcement, neither of which currently exist in Libya. Evidently, the development of such a system first requires the reform of the economic, political and rigid social systems in Libya. As discussed in (1.3.2), Libya is in the very early stages of the transition from a bureaucratic stage (which characterized by hierarchical and bureaucratic structures and controls associated with state administrative power) to a relationship stage (where the dominant sources of control power and resources are associated with networks and relationships). This means Libya is still far from realising a market economy stage which occurs when there is a perfect market institutional framework, effective formal rules, and adequate state enforcement.

In Libya, many changes are required before the efficient functioning of the courts and a strong legal system of enforcement can be achieved. For example, in order to provide predictable and timely judgments and so speed up the machinery of justice, the numerous legal and physical obstacles that currently discourage the minority shareholders from bringing an action (as discussed in (3.3.2)) need to be overcome. There is also an urgent need to reform the Civil Procedure Act and appoint an appropriate number of judges in order to address the disproportionate number of cases received by the courts each year. There is also the need for a training programme that will give judges the competency to deal with complex commercial cases.

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the minority shareholders against the controlling shareholder. In fact, this is not a case since the controlling shareholder in most large companies is the state. Accordingly, 'the controllers have little incentive to build a good reputation' See Chen (n 5) 102.

Additionally, there are endemic issues within Libya that will require significant effort over an extended period to overcome. As mentioned by Abdul Jalil, the former Chairman of the National Transitional Council, it may take years to overcome Libya's 'heavy heritage' of judicial corruption.[29] Moreover, the complex reasons behind the lack of security and Libya's social environment contribute to a lack of court enforcement and seem to present almost insurmountable challenges to the development of formal private enforcement.

In addition, reforming the system of formal private enforcement has a high cost. For instance, speeding up the machinery of justice is a very expensive task since it requires the government to train and hire numerous judges and repair the institutional judicial infrastructure. Also, overcoming judicial corruption requires a sustained effort and measures by the government including increasing the wages of judges, hiring more credible staff and increasing the budget of the judicial sector.

Taking all of these factors together, the focus on reforming the judicial approach (minority shareholders' actions) to protect the minority shareholders against the controlling shareholders in Libya is flawed, at least at this stage of market transformation, as it will only have a minimal effect on the minority shareholders protection system. Focussing on a reform of the law on the books as a means of affecting reform to the judicial approach (liability actions) will not deliver real world change or address the majority-minority problem effectively. As Coffee points out massive expropriation by the majority shareholders can still occur even when the law on the books is nearly optimal.[30]

However, this does not mean that reforming the judicial approach should be ignored. Instead, as discussed in (1.3.1), Libya is moving from the bureaucratic to the

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[29] Aljazeera, *Reports and Dialogues - The Demands of Purifying the Libyan Judiciary* (Al Jazeera 2012) (in Arabic). Also see Korina Al Jadida, 'Mustapha Abdul Jalil: Libyan Judiciary is not Purified Yet' *Korina Al Jadida* (Al bida, 01-08-2012)accessed 20-02-2014 (in Arabic).

[30] Jr. Jack C. Coffee, 'Privitization and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 Journal of Corporation Law 1, 6.

relationship stage where it requires Libya to develop a market institutional framework and abandon bureaucratic control over time by weakening the institutional framework that supports it. To do so, among other things, Libya is required to make formal reforms to its law, including the liability and revocation actions. As pointed out by Pistor and Xu: 'enacting law on the books is only the very first step in establishing an effective legal system'.[31] As discussed, statute reform will not offer an adequate protection for the minority shareholders on its own.

4.1.2.2. Alternative (2): Non-intervention and the prohibition models

Non-intervention is considered as a traditional model in which the role of the law in addressing a conflict of interests between shareholders is to do nothing and instead leave a resolution to the unconstrained forces of the market. In turn, the market determines a solution to the conflict transaction between the shareholders.[32] However, virtually no jurisdiction uses this approach since it is not rational to ignore conflict transactions and let the controllers 'take the money and run'.[33] Though this approach may work in a perfectly efficient market, where if a company provides shareholders' protections the prices of securities would reflect the value of the defences shareholders carry,[34] a non-interventionist model will not work in developing countries, such as Libya. Here, the market is not perfect and the different securities afforded to minority shareholders are not accurately priced.[35] Additionally, as Djankova et al. conclude: 'the strategy of no public involvement at all does not lead to more developed financial markets. The public sector clearly has a central role to play, but principally as the designer of the rules of the game,

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[31] Pistor and Xu, 'Beyond Law Enforcement' (n 8) 14.
[32] Zohar Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (2003) 91 California Law Review 393, 404.
[33] Simeon Djankov and others, 'The Law and Economics of Self-Dealing' (2008) 88 Journal of Financial Economics 430, 431.
[34] Goshen, 'The Efficiency of Controlling Corporate Self-Dealing' (n 32) 405.
[35] See ibid. It should be noted that in a perfect market in which companies provide shareholders with appropriate protection, investors are willing to buy shares at an appropriate price that includes such protection and they will not buy shares in a company that provides no or little of protection. However, in a non-perfect market such a scenario does not exist. See Frank H Easterbrook and Daniel R Fischel, 'Corporate Control Transactions' (1981) 91 Yale Law Journal 698, 715.

which are then enforced by private action.'[36] Thus, non-intervention cannot be seen as an effective solution to deal with the majority-minority shareholders' problem in Libya.

At the other extreme, the outright prohibition of conflict transactions is another alternative which is characterized as an easy mechanism for solving the conflict of interest problem between the shareholders since it obviates the need to perform complicated evaluations. As Marsh observes, the outright prohibition model is a traditional model that emerged in nineteenth-century corporation statutes in the U.S. and the UK.[37] Under this model, any deal born of a conflict-of-interest vote was automatically voidable at the insistence of the corporation or its shareholders regardless of its terms or its desirability to the corporation.[38] However, as Marsh also noted: 'thirty years later [from the emergence of an outright prohibition model] this principle was dead'.[39]Currently, no jurisdiction finds it practical to implement this approach.[40] Perhaps the strongest reason given for this was that outright prohibition has the potential to cause companies to lose too many efficient transactions that are in the interests of both the company and the insiders.[41] In addition, in Libya, the adoption of such an approach would not work because of the extreme lack of enforcement. [42] In such an environment, mere prohibition would not prevent conflict of interest transactions. Thus, outright prohibition is not an appropriate model for dealing with the majority-minority shareholders' problem.

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[36] Djankov and others, 'The law and economics of self-dealing' (n 33) 463.
[37] Harold Marsh Jr, 'Are Directors Trustees? Conflict of Interest and Corporate Morality' (1966) 22 The Business Lawyer 35.
[38] Such prohibitive statutes have been adopted in the U.S and the UK. See ibid.
[39] Ibid 30.
[40] See Djankov and others 'The Law and Economics of Self-Dealing' (n 33).
[41] Melvin Aron Eisenberg, 'Self-Interested Transactions in Corporate Law' (1988) 13 Journal of Corporation Law 997, 997.
[42] For more reasons see Black and Kraakman (n 3) 1931; Moeen Cheema and Sikander Shah, 'Corporate Governance in Developing Economies: The Role of Mutual Funds in Corporate Governance in Pakistan' (2006) 36 Hong Kong LJ 341.

4.1.2.3. Alternative (3): Public Enforcement

Public enforcement is a legal mechanism used to deter wrongdoers (e.g. a controlling shareholder) through sanctions such as fines and prison.[43] For instance, the controller can face criminal sanctions for misuse of company assets or if he intentionally causes damage to the company. It should be noted that public enforcement, unlike formal private enforcement, is not limited to one regulatory state organ. Instead, a public enforcement action can be initiated by a wide variety of state organs such as local prosecutors' offices, national regulatory authorities that monitor corporate actions in real time[44] (e.g. the Audit Bureau monitors the corporate performance of state owned companies and has the power to intervene to prevent breaches),[45] and some self-regulatory and quasi-regulatory authorities, such as national stock exchanges and the UK's Financial Reporting Council.[46] Accordingly, public authorities, as with private parties, can enforce the law that protects minority shareholders. The key question here is whether public enforcement can effectively enforce the protection of minority shareholders and so provide a substitute for private enforcement?

Though there is a trend in the literature that believes that when small shareholders are unlikely to sue because of unreliable courts and lack of enforcement, a public enforcer is needed, as discussed in (4.1.1), the efficiency of public enforcement cannot be taken for granted. According to recent academic work, there is doubt about the capability of public enforcement to take this role as a substitute for private enforcement. For instance, La Porta

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[43] Public enforcement agencies normally have the power to impose fines and penalties, even though they cannot bring actions for damages on behalf of private parties. See Djankov and others 'The Law and Economics of Self-Dealing' (n 33).

[44] Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'What Works in Securities Laws?' (2006) LXI The Journal of Finance 1; Howell E Jackson and Mark J Roe, 'Public and Private Enforcement of Securities Laws: Resource-Based Evidence' (2009) 93 Journal of Financial Economics 207.

[45] According to Law no 19 of 2013 Concerning the Reorganization of the Audit Bureau. The Libyan Audit Bureau is an independent body that is guided by the legislative authority (art. 1 of Law no 19 of 2013). For more information see (2.3.2.2).

[46] Such bodies are enforcers to the extent that they are able to compel compliance with their rules ex ante or to impose sanctions for rule violations ex post, whether these sanctions are reputational, contractual, or civil. See Reinier R. Kraakman and others, *The Anatomy of Corporate Law* (Oxford University press 2009) 47.

et al. examine the effect of securities laws on stock market development in 49 countries and found 'little evidence that public enforcement benefits stock markets, but strong evidence that laws mandating disclosure and facilitating private enforcement through liability rules benefit stock markets'.[47] Also, Djankov *et al*.,[48] and the World Bank[49] conclude that public enforcement is of limited value compared to private enforcement. Additionally, it has been argued that a public enforcement system is degraded since state officials have mixed and often weak incentives to perform their jobs well and because they often suffer from poor information concerning both the general market and specific firms' conditions.[50] Also, public agencies have limited budgetary discretion and must work within limited resources to enforce the law adequately, and they may also lack adequate resources such as manpower or budgets.[51]

In addition to these general drawbacks, in Libya, public enforcement cannot be seen as an alternative to weak private enforcement. In Libya and most developing countries, it is likely that regulators, in addition to courts, fail to provide adequate protection for the minority shareholders.[52] To illustrate this, here I discuss the efficiency of the three organs of public enforcement in Libya: local prosecutors' offices, the Audit Bureau, and the Libyan Capital Market Authority (LCMA), and argue that all of them fail to provide adequate enforcement to protect the minority shareholders.

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[47] La Porta, Florencio Lopez-De-Silanes and Shleifer (n 44.) abstract.

[48] They saw that to avoid self-dealing, however, it appears best to rely on extensive disclosure, approval by disinterested shareholders, and private enforcement rather than public enforcement. See Djankov and others, 'The Law and Economics of Self-Dealing' (n 33).

[49] World Bank, 'World Bank, Institutional Foundations for Financial Markets, 2006' Financial Sector Operations and Policy <http://siteresources.worldbank.org/INTTOPACCFINSER/Resources/Institutional.pdf> accessed 12-04-2014

[50] Jackson and Roe (n 44) 208.

[51] Chen, (n 5) 47.

[52] This leads some scholars such as Glaeser and Shleifer to argue that the optimal policy for governments in countries where there is no optimal public and private enforcement is to leave the market alone and do nothing. Glaeser and Shleifer 'The Rise of the Regulatory State' (n 24) 411. Also, it is worth indicating that both systems of enforcement, public and private, are related in some countries. This means high level of private enforcement goes hand-in-hand with higher level of public enforcement. See James D Cox, Randall S Thomas and Dana Kiku, 'SEC Enforcement Heuristics: An Empirical Inquiry' (2003) 53 Duke Law Journal 737, 761.

First, as discussed in the previous chapter, the local prosecutors' offices, which form part of the judicial sector in Libya, suffer from corruption, lack of adequate training in commercial cases and are affected negatively by the lack of security that Libya presently faces.[53] Taking these factors into account, it is not possible for the local prosecutors' offices to adequately enforce the protection of minority shareholders.

Second, the Libyan Audit Bureau[54] has an enforcement mechanism for monitoring public assets and money and can expose any financial violations and breaches in public institutions including SOEs.[55] As previously discussed, it is delegated to monitor the SOEs of which the Government owns 25% or more of the capital[56] and enterprises that were obtained by donation or loan from the government (if the loan agreement stipulated that the Audit Bureau has the authority to monitor them).[57] However, the Libyan Audit Bureau cannot offer effective and efficient enforcement since it faces several challenges that undermine and hinder its efficiency.[58] For example, social ties and connections affect its operations, these relationships and social connections constitute constraints that prevent the Audit Bureau's employees undertaking objective and neutral investigations. This is due to the fact that in tribal societies loyalty is to the family, clan, and tribe more than to a state and regionalism and sectarianism outweigh loyalty to profession and law.[59] Additionally, the lack of security in Libya significantly affects law enforcement through preventing many members of the Libyan Audit Bureau from undertaking many investigations. Also, the lack of expertise and experience of many employees and their ignorance of the laws and regulations related to the auditing operations contribute to the deficiency of the enforcement of the Libyan Audit Bureau. Finally, the lack of an adequate number of public

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[53] See (3.2), (3.3) and (3.4).
[54] For details about the Libyan Audit Bureau, see (n 45).
[55] Law no. 19 of 2013 Concerning the Reorganization of the Audit Bureau art, 2/1, 3.
[56] Law no 19 of 2013, art 3/2.
[57] Law no 19 of 2013, art. 3/5.
[58] For more details see Morajah Al rojbani, 'Obstacles of Effecient Performance of the Libyan Audit Bureau ' *Korina Al Jadida* (Tripoli, 01-Jan-2013) <http://www.qurynanew.com/46966> accessed 08-04-2014 (in Arabic).
[59] See (3.3.3.2).

enforcement staff, or sufficient budget and resources both result in weak enforcement by the Audit Bureau.[60] In such a climate, clearly the Libyan Audit Bureau is unable to work efficiently. This assessment is evidenced by the report issued by the Libyan Audit Bureau in 2012, during that year the Bureau inspected only 43 SOEs out of hundreds and it detected only 8 violations.[61] Since only 8 violations were detected in a country that is ranked 166th among 174 countries in the world regarding corruption,[62] at the very least, this suggests that the Bureau's findings were questionable.

Finally, the Capital Market Authority (CMA) [63] in Libya is a law enforcement agency (in addition to its regulating duties).[64]According to s 4 (7) of the Stock Market Act 2010, the Authority is responsible for, amongst other things, receiving and following up complaints that relate to the activity of the Stock Market or brokers and taking appropriate decisions which may include undertaking investigations and imposing sanctions. Though it has these legal enforcing competencies, the Capital Market Authority cannot provide an adequate level of enforcement. This is because, firstly, the authority was only established in December 2013 and so is still in its infancy.[65] Therefore, there is absence of self-regulatory institutions to fill the gaps in corporate law that otherwise would protect the public and enhance transactional flexibility such as is the case in the UK with the British

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[60] It should be noted that studies provide two indices for measuring the intensity of enforcement: looking at public staff relative to population, and enforcement budget. See for example, Jackson and Roe (n 44), La Porta, Florencio Lopez-De-Silanes and Shleifer 'What works in securities laws?' (n 44).

[61] The Libyan Audit Bureau, *The Libyan Audit Bureau Report of 2012* (Libyan Audit Bureau Official Website, 2012).

[62] See Ch.3 (n157).

[63] Capital Market Authority (CMA) in Libya is similar to the SEC in the U.S and FSA in the U.K. The Stock Market Act 2010 established a unified regulator for all financial markets, and delegates powers to the CMA to supervise, manage and publish rules to regulate both financial services and the behaviour of authorised individuals and firms. According to art 4 of SMA 2010, the CMA's powers are divided into three parts: (1) formulating regulation; (2) investigation and supervision; and (3) legal enforcement.

[64] For example, under art 4 of Stock Market Act 2010:

> Capital Market Authority is responsible for (1) regulating and monitoring issuing securities; (2) regulating and monitoring disclosure of information necessary for investors; […]; (4) collecting information and data about the Libyan Stock Market and publishing reports about it; […]; (10) enacting rules of corporate governance for listed companies; […]; (16) enacting a system to protect investors who deal with securities that set out rules of memberships, ways to compensate aggrieved parties. etc.

[65] Libyan News Agency, 'Abu Fenas Announces the Establishing of the Capital Market Authority in Libya.' *Libyan News Agency* (Libyan News Agency 30-12-2013) (in Arabic).

Panel on Takeovers and Mergers. Moreover, its competences are still not complete since the Executive regulation of the stock Market Act 2010 (*Laeha*), which is supposed to detail how the Authority will work, has not yet been issued.[66] In addition, because the state owns the majority of shares in listed companies, there is a conflict between the state as an enforcer and the state as an owner of most listed equities, meaning that the state is in the position of enforcing itself. This, in turn, limits the ability of the Market to grow and undermines its enforcement mechanisms. Further, if we accept that the state, under certain circumstances, can enforce itself, this kind of enforcement has a limited effect in Libya since the Libyan Stock Market is still very small and illiquid and has not reached an appropriate level of maturity to make a significant contribution to the Libyan economy.[67] Thus, the level of enforcement will necessarily be limited.

In short, even though reforming the system of formal private enforcement is recommended, since it will constitute a step forward towards the Free Market Economy, it should not be undertaken as a solution to the minority-majority shareholders problem in Libya during this period of economic transformation. Also, traditional models of non-intervention and prohibition are not recommended since they result in extreme outcomes. Further, public enforcers such as the local prosecutors' offices, the Libyan Audit Bureau and the Libyan Capital Market Authority fail to provide adequate protection for minority shareholders in Libya. Thus, in the following sections, the study argues that self-enforcement is an appropriate solution to the specific case of Libya.

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[66] For example, in the absence of detailed rules to regulate the Authority, the head of the Authority was appointed by the Minister of Economy in Libya. This action is not acceptable according to international standards which necessitate that such heads are hired by the Libyan Parliament based on a proposal of the prime minister or by the prime minister. Through such a procedure we can add value and independence to the Capital Market Authority. See Libyan stock Market, *Establishing Capital Market Authority is a Wrong Decision Now* (Libyan stock Market 2013) 10 (in Arabic).

[67] See (1.3.2.2).

4.2. The self-enforcing model as a solution for solving the majority-minority shareholders problem: the theoretical framework

Before any analysis can be made, we should recognize what the self-enforcing model is and what its features are. Accordingly, this section outlines briefly the central features of the model (4.2.1) and the nature and scope of its rules (4.2.2)

4.2.1. The central features of the self-enforcing model

Generally, the self-enforcing model is a model that relies on an internal rather than an external enforcer, such as contract parties, customers and shareholders.[68] Any self-enforcing model, as Mantysaari suggests, should 'work with minimal resort to legal authority, including the courts; work with minimal resort to other external monitoring inputs; reduce internal agency problems; enable the effective coordination of activities; and be sustainable.'[69] An identifying feature of the model is that the expected gains from obedience exceed the gain from violation.[70] In the context of minority shareholders protection, it means allowing large minority shareholders to protect themselves against insider opportunism with minimal resort to legal authority through empowering large minority shareholders' voices and their ability to protect their interests by guaranteeing participation in corporate decision making under certain circumstances.

The self-enforcing model, as a new strategy of corporate law for emerging countries, was created[71] by professors Black and Kraakman in 1996. The model provides appropriate solutions for corporate governance problems in Russia and other emerging

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[68] Avner Greif, 'Commitment, Coercion, and Markets: The Nature and Dynamics of Institutions Supporting Exchange' in Shirley MM Menard C (ed), *Handbook of New Institutional Economics* (Springer 2005) 756–757.
According to Greif, 'self-governance entails having bodies of collective decision-making, mechanisms, such as judicial processes and police forces, to overcome the free-rider problem and motivate and induce members to participate in sanctions'. See ibid 757.
[69] Mantysaari (n 1) 119.
[70] Lester G Telser, 'A Theory of Self-Enforcing Agreements' (1980) 53 The Journal of Business 27.
[71] I use the word 'create' rather than develop because, as Black and Kraakman note, the 'features of the self-enforcing approach produce a company law that is novel in the aggregate, even though many individual provisions (such as one share, one vote and cumulative voting) are familiar in developed markets'. See Black and Kraakman (n 3) 1918.

economies. [72] Accordingly, proposed solutions take into account these countries' environmental features that are characterized by weak judicial enforcement, the existence of market forces that encourage law avoidance, and cultural norms and constraints that inhibit free market dynamics.[73] Therefore, the model provides a solution that minimizes reliance on official enforcement and sits between an enabling model and a prohibitive model.[74]

In order to avoid reliance on formal enforcement, self-enforcement takes place primarily through a combination of voting rules and transactional rights. The voting elements include shareholder approval for broad classes of major transactions and self-interested transactions. Transactional rights include pre-emptive rights, appraisal rights, and sell-out rights, as discussed in (4.3).

The model in regard to the protection of minority shareholders against controlling shareholders sets down several measures that together should provide effective protection to the minority shareholders than is common in developed economies and respond to the frequent occurrence of conflict of interest transactions by controlling shareholders. [75] Firstly, the model relies on direct participation to enforce shareholder protection in the corporate enterprise, rather than reverting to indirect participants such as judges, regulators, legal and accounting professionals, and the financial press.[76]

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[72] It should be noted that though the self-enforcing model of corporate law focusses on the case of Russia, it can be applicable to other emerging markets as well because they have the same attributes that distinguish them from the western countries. See ibid 1911-12; Nikulin (n 1) 356.
[73] Black and Kraakman (n 3); Nikulin (n 1) 356.
[74] In this regard, Nikulin claims that:

> 'For a long time, most of the corporate models were created around two extremes: the "enabling model," as the most flexible and least constraining, and the "prohibitive model," as the least flexible and most constraining. The self-enforcing model attempts to "organize" and outline something in between, emphasizing self-enforcement. This makes the model very special and potentially useful in a wide variety of ways: from a prototype for corporate laws of emerging countries to a prototype of a new model of government allowing more efficiency and more participation from the public'. See Nikulin (n 1) 355.

[75] Black and Kraakman (n 3) 1916.
[76] ibid 1916.

Secondly, the model 'contains more procedural protections and fewer substantive protections',[77] through vesting significant decision-making power in large minority shareholders who have incentives to make decisions that are capable of reducing (though not eliminating) fraud and self-dealing by corporate insiders.[78] Hence the model maximizes the voice of the large minority shareholders and empowers their ability to protect their interests.

Thirdly, to compensate for the weakness of formal enforcement, the model provides, whenever possible, a bright-line rule and strong sanctions rather than standards, to define proper and improper behaviour. The use of bright-line rules is advantageous because they are designed 'to be understood by those who must comply with them'[79] and so have a better chance of being enforced. By contrast, standards 'require judicial interpretation',[80] which is often unavailable in emerging markets, and problematically 'presume a shared cultural understanding of the regulatory policy that underlies the standards'.[81] For example, the model can replace ambiguous terms like "fair price" with clearer terminology like "market value" in order to require a shareholder vote for a purchase or sale of assets that equals 50% or more of the book value of the firm's assets.[82] Finally, the model also provides strong legal remedies on the books, which compensates for the low possibility that sanctions will be applied.[83]

To achieve the bright-line rules proposed by the model, in the case of Libya, I propose that LEAA 2010 should adopt a non-exclusive statutory list of unfairly prejudicial conducts that provide both the court and the minority shareholders with a clear understanding of how they should respond to the controlling shareholders' wrong. As an

[77] ibid 1918.
[78] ibid 1915.
[79] ibid 1916.
[80] ibid.
[81] ibid.
[82] ibid 1965.
[83] ibid 1916.

example, the list could draw from the most common cases that have been brought in the UK. [84] Accordingly, the corporate act shall be unfairly prejudicial if one of the following conditions which are not exclusive is met:

1. When the majority shareholder(s) has failed to provide information about how the company is being run.[85]
2. When the allotment of shares, which is proposed or carried out in accordance with the provisions of LEAA 2010 but there has been a breach of duty by the directors of the company[86] or breach of statutory requirements.[87]
3. When the majority shareholders attempt to alter a company's articles of association by special resolution and the resolution has been passed not *bona fide* for the benefit of the company as a whole.[88]
4. When there has been a deliberate diversion of a company's business by those in control to another business owned by them. [89]
5. When there has been misappropriation of company assets. [90]
6. When there is payment of excessive remuneration. [91]
7. When there is failure to pay adequate dividends payments and the conduct complained of was not discriminatory between shareholders. [92]
8. When there is mismanagement that can constitute a corporate wrong.[93]
9. When there is an understanding that all shareholders in a company are to participate in management of a quasipartnership company. [94]
10. When minority shareholders are denied any dividends when the company is profitable and the majority shareholders are benefiting financially by having significant remuneration packages as directors.[95]
11. When a special resolution is passed to alter the company's articles of association and in so doing alters the understanding of the parties that the petitioner would control the management of the company.[96]

[84] For a rationale concerning the use of UK cases, see Introduction 11-4.
[85] *Re a Company* (No 00314 of 1989), *ex parte Estate Acquisition and Development Ltd* [1991] BCLC 154.
[86] *Re a Company* (No 002612 of 1984) [1985] BCLC 80,;
[87] In *Re DR Chemicals Ltd* [1989] BCLC 383. The allotment of shares was carried out unilaterally by the majority shareholder without reference to the minority shareholder, resulting in a substantial dilution of the minority's shareholding. This was in breach of s 17 of the Companies Act 1980, (now s 594 of the Companies Act 2006) (pre-emptive rights).
[88] *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656.; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286
[89] *Eg Re London School of Electronics Ltd* [1986] Ch 211; *Re Cumana Ltd* [1986] BCLC 430; *Re Stewarts (Brixton) Ltd* [1985] BCLC 4.
[90] *Eg Re Elgindata Ltd* [1991] BCLC 959 and *Re Little Olympian Each-Ways Ltd* (No 3) [1995], *Re Little Olympian Each- Ways Ltd* (No 3) [1995] 1 BCLC 636. In the latter case, the allegations related, *inter alia*, to a breach of trust by the sale of the company business to another company at an undervalued rate.
[91] *Re a Company (*1986) 2 BCC 99,453, on appeal sub nom *Re Cumana Ltd* [1986] BCLC 430.
[92] See Re a Company (No 00370 of 1987), ex parte Glossop [1988] 1 WLR 1068.
[93] *Re Elgindata Ltd* [1991] BCLC 959 and *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354. See also, *Re Five Minute Car Wash Service Ltd* [1966] 1 WLR 745, 752.
[94] *Saul D Harrison*[1995] 1 B.C.L.C. 14.
[95] *Quinlan v Essex Hinge Co Ltd* [1996] 2 BCLC 417.
[96] *Re Kenyon Swansea Ltd* [1987] BCLC 514.

4.2.2. Nature and scope of the rules of the self-enforcing model

In addition to the central features of the model described above, the model determines that corporate rules should be mandatory rather than default, which is a significant question in corporate law policy.[97] According to the creators of the model, to place greater weight on the goal of protecting outside investors against insider opportunism, procedural and structural rules that empower large minority shareholders to protect themselves against opportunism by insiders must be mandatory rules. [98] This is because the model will not provide adequate protection for the minority shareholders if the company is constituted with a set of default provisions as such rules may be altered by the controlling shareholders to reflect their self-interest.[99]

It is believed that in efficient and effective markets, a set of default rules may be appropriate as the controlling shareholders will adopt such rules to provide more value for their shares, as discussed previously.[100] However, when markets are not perfect, which is the case in Libya, the model should be mandatory since the controlling shareholders are in many cases evidently willing to extract private interest at the expense of the minority shareholders as this will not affect the company's share value. Thus, in the case of Libya (which is characterized as a business environment with a non-perfect market which lacks formal enforcement), if the rules of the model are positioned outside the law or as a default rule, it will have a minimal impact since most companies are controlled by controlling shareholders who are unwilling to share their own power with minority shareholders.

In addition to the nature of the model's rules, Black and Kraakman note that a well-drafted law must reflect the size of the company. Therefore, the procedural protections that are appropriate for a company that has thousands of shareholders should differ from one

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[97] Lucian Arye Bebchuk and Assaf Hamdani, 'Optimal Defaults for Corporate Law Evolution' NBER Working Paper No 8703, 2002 <http://www.nber.org/papers/w8703> accessed 06-05-2014.
[98] Black and Kraakman (n 3) 1932.
[99] ibid 1940.
[100] See (4.1.2.2).

that has few shareholders who all work in the business.[101] Accordingly, their model is 'designed to harness the monitoring ability of large, albeit still minority, outside shareholders'.[102] Therefore, their model focuses on companies that have large minority shareholders 'where at least some shareholders do not work in the business'.[103] However, Black and Kraakman do not discuss why their model should be limited to large companies that have a number of shareholders.

In fact, there is no obstacle to applying such a model to small companies especially in Libya where joint stock companies must be established by at least 10 shareholders.[104] If we assume that a small company has minimum number of shareholders (10 shareholders) and one or two controlling shareholders enter into a conflict of interest transaction, such as a self-dealing transaction, what is the reason that precludes the 9 or 8 minority shareholders from having the power over the transaction to approve or veto it? There is no doubt that the 8 shareholders are in similar position to the 100 minority shareholders in a large company when it comes to approving such a transaction. More than that, making an approval decision by the minority shareholders in small companies is cheaper and easier than making it in large companies.

Additionally, small companies form about 30% of investment in Libya and large companies constitute about 70% of investment in Libya, the vast majority of these being SOEs. Accordingly, if the model is limited to large companies it will only apply to SOEs. This means that minority protection will only be available to a single type of company, thereby excluding Libya's growing private sector which is currently being developed through a privatisation policy.

Further, is it appropriate to differentiate between a company that has capital of more than, for example £1 billion but only 5 shareholders who all participate in the

[101] Black and Kraakman (n 3) 1919.
[102] ibid 1932.
[103] ibid 1919.
[104] See (1.1.2).

management of the company, and another that has capital of only £100,000 and more than 1000 shareholders? According to Black and Kraakman, protection should only be offered to minority shareholders in the latter company, while the other does not deserve such protection. However, economically, minority shareholder protection should be a priority in the former company since it has a greater effect on the economy. Consequently, the number of shareholders, and whether they participate in the management, should not be an element in determining whether the model should apply to a company or not. Instead the most important element that should be taken into account is the percentage of shares that the shareholders should have to participate in the approval process. For example, the minority shareholders who hold small amount of shares (e.g. those that do not exceed 0.01%) should not have the right to approve or veto a transaction; this will be discussed further in Ch.5.[105]

4.3. The primary mechanisms of a self-enforcing model used to protect the minority shareholders: a general discussion

To solve such a conflict, Black and Kraakman rely on the voting system as a mechanism for self-enforcement, which fundamentally provides procedural mechanisms that allow minority shareholders (rather than indirect participants such as judges, regulators, and lawyers) to police the opportunism of controlling shareholders. Under this model, the minority shareholders can enforce the law through a combination of specific constraints on both the approval mechanism (4.3.2) and the procedure of the voting system (4.3.1). In addition, the model delegates transactional rights to the minority shareholders (4.3.3).

4.3.1. Shareholders' approval

Under the self-enforcing model, the controlling shareholders must obtain the consent of the minority to approve a conflict of interest transaction, which will be provided based on

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[105] The particular percentage of shares that the minority shareholder should hold in order to approve a conflict of interest transaction is discussed in (5.2.2).

the minority's subjective valuation of the transaction. This is in contrast to the judicial approach where the fairness mechanism employs an objective valuation which is determined by the courts. Under the model, when 'the power to determine whether or not a transaction will be approved is given to the minority, the majority is unable to force a deal upon the minority'.[106] Therefore, the implementation of the self-enforcing model empowers the minority to take care of their own interests and ensure that they obtain the maximum beneficial interests.[107]

According to Black and Kraakman's model, there are two types of rules that developing countries can adopt to protect the minority shareholders from the expropriation of controlling shareholders: supermajority shareholder approval for central business decisions and the majority of minority rule for self-interested transactions. In the first instance, the model requires that large transactions should be policed more strictly than those of the enabling models in order to eliminate any potential conflict of interest transactions. Accordingly, the law would require supermajority shareholder approval for all central business decisions, such as mergers, issuing shares, purchasing or selling major assets, rather than the simple majority approval of the enabling approach.[108]

Secondly, in self-interested transactions between the company and its insiders (e.g. controlling shareholders), a self-enforcing statute can replace 'the permissiveness of the enabling approach (loosely policed by courts) and the ban on the prohibitory model with approval by […] a majority of non-interested shareholders'.[109] Here the voting mechanism determines the group's consent by excluding those shareholders with a conflict of interest from participating in the vote.[110] This rule assumes that 'only the votes of the disinterested members of the group are relevant to determine the group preference.'[111] The analysis of

[106] Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (n 32) 410.
[107] ibid.
[108] Black and Kraakman (n 3).
[109] ibid 1933.
[110] Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (n 32) 402.
[111] ibid.

these rules is discussed later in the context of discussing particular corporate transactions in (4.4).

4.3.2. Procedural constraints of the voting system

To safeguard the voting mechanism, there are two relevant points regarding the procedural constraints of the voting system, which are the one share one vote rule (4.3.2.1) and confidential voting (4.3.2.2).[112]

4.3.2.1. The one share one vote rule

According to the self-enforcing model, law should require a single class of voting share with only one vote per share.[113] It should be noted that the one share one vote rule is universally accepted across jurisdictions such as in the UK, the U.S., and Japan (even if it is not a statutory requirement), [114] and also it is required by statute in many emerging market jurisdictions.[115]

In order to discuss this rule within the context of Libyan corporate law, we must first understand the system of preferred shares in Libya, which may be based on several elements, such as a dividend (when preferred shareholders must be paid dividends before common shareholders), liquidation (when the company must pay all creditors and bondholders, and preferred shareholders before common shareholders receive any money), approval (when the preferred shareholders must approve all or particular decisions that the shareholders take at the general meeting) or, finally, voting (when the preferred shares have multiple votes rather than being based on the one share one vote rule).[116] Under the previous Libyan commercial law issued in 1953, the law allowed any kind of preferred

[112] I exclude the procedural and structural constraints that relate to the management and shareholders problem, such as those constraints relating to mandatory cumulative voting and the use of a universal ballot.
[113] Black and Kraakman (n 3) 1945.
[114] ibid 1945.
[115] According to Black and Kraakman' survey, the one share, one vote rule is expressly mandated by statute in 9 of the I7 jurisdictions. (See ibid).
[116] Maseod Madi and Fatel Aljahrawi, *Commercial Companies in Libyan Law* (2 edn, Al Jabel Algarbi University 2012) 196-7 (in Arabic).

shares except those based on voting. Thus, the rule of one share, one vote was mandatory since the law banned the issuing of shares that provided their holders with multiple votes.[117] This was because, as Madi and Aljahrawi observe, the Libyan legislator intended to prevent a small group of shareholders from controlling the company via multi-vote shares.[118] However, LEAA 2010 revoked this rule and now permits shareholders to have preferred shares based on multi votes.[119] It should be noted that the trend of allowing preferred shareholders based on multi-votes is similar to French and Egyptian Laws, the historical roots of Libyan Law.[120]

In this light, it is clear that the current Libyan corporate law is not consistent with the self-enforcing model, and that there is a need to readopt the rule of one share, one vote. The rationale of this is 'to prevent insiders from acquiring voting power disproportionate to their economic interest in the company'.[121] Further, the re-adoption of the rule would increase the possibility that corporate actions will maximize firm value. As Black and Kraakman claim:

> The case for the one share, one vote rule turns primarily on its ability to match economic incentives with voting power and to preserve the market for corporate control as a check on bad management. By contrast, the case for permitting companies to deviate from a one share, one vote rule turns on (i) the usual claim that informed parties will choose optimal arrangements on their own; and (ii) the existence of a reasonably efficient market, in which the proceeds that company founders realize when they sell their shares will reflect the voting rights that those shares carry.[122]

4.3.2.2. Confidential voting

Under the model, confidential voting is a mandatory constraint that protects the integrity and quality of voting from manipulation by insiders (e.g. controlling shareholders). [123] without confidential voting, controlling shareholders can alter the minority's voting

[117] See Libyan Commercial Law 1953 art 503 (4).
[118] Madi and Aljahrawi (n 120) 179.
[119] See LEAA 2010, art 126.
[120] See Executive Regulation of Egyptian Company Law s 132 and French Company Law s 492.
[121] Black and Kraakman (n 3) 1933.
[122] ibid.
[123] ibid 1950.

tendency directly through, for example, coercion or vote buying,[124] or indirectly through influencing the management to fraudulently count the ballots.

For example, in the case of Libya, bureaucrats and politicians who represent the state, as the controlling shareholder, may compel the minority shareholders to vote in the controlling shareholder's interest by forcing them, or inducing them, to approve a transaction with a company that he personally owns. Also, with the wide spread of corruption, it is very possible that bureaucrats and politicians who represent the state can influence the company's employees and so falsify the outcome of a vote.

LEAA 2010 does not adopt mandatory confidential voting; instead it leaves it to an agreement between shareholders. However, in practice most of the articles of association provide for public voting. As such, Libyan Law lacks an important safeguard when it comes to qualitative voting. In order to effectively implement a self-enforcing model there is an evident need to adopt a rule of confidential voting since it will prevent insiders from knowing how a voter has cast their ballot (against him or not), meaning that insiders will 'lose the power to manipulate votes through rewards or sanctions'.[125]

4.3.3. Transactional rights

In addition to a voting mechanism, the model adopts certain transactional rights for shareholders that are of particular importance to minority shareholders. Many of the above procedural and structural constraints concern majority and supermajority approvals, but not the rights of a single shareholder. Transactional rights give power of self-enforcement to each shareholder individually. These rights include pre-emptive rights which provide protection against under-priced share issues when a company issues new shares. Also, appraisal rights, which are a statutory right granted to shareholders who do not approve

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[124] In this regard, Black and Kraakman claim that 'coercion and vote buying occur when someone - typically a company insider - induces shareholders to vote against their investment interests by punishing "wrong" votes, rewarding "right" ones, or both'. Black and Kraakman. See also, Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (n 32) 418.

[125] Black and Kraakman (n 3) 1950.

major transactions, to have a fair stock price determined by a judicial proceeding or independent valuator for the purpose of exit. Finally, takeout rights are granted to minority shareholders when new controlling shares in the firm are acquired. Under this right, the minority shareholder can require the new controlling shareholder to buy their shares and so protect themselves against transfer of control from known and trusted hands to less trusted ones.[126] All of these rights will be discussed in details in the following section.

4.4. The mechanisms of the self-enforcing model that govern particular corporate transactions

In (2.3.1.1), I undertook a theoretical analysis of the conflict of interests between the majority shareholders and the minority shareholders in the diversion of corporate assets, which include related-party transactions and restructuring ownership transactions that discriminate against the minority. The conflict of interests between the majority and the minority of shareholders may not be limited to these transactions but may also occur when, for example, the controlling shareholders use their votes to amend the terms of the constitution of the company in their interest at the expense of the minority shareholders.[127] Further, in (2.3.1.2) I argued that the conflict of interests between the majority shareholders and the minority shareholders is very problematic in Libya for reasons that are specific to its corporate environment.

In this section, I propose that the appropriate solutions to these problems reside primarily in the adoption of the voting mechanism and also in the transactional rights of the self-enforcing model, as discussed in the previous section, with amendments that take into account the specific case of Libya. These solutions, rather than being inflexible, need

[126] ibid 1917.

[127] It should be noted that conflicts between the majority shareholders and the minority shareholders may occur in any resolution in which the majority shareholders vote in a general meeting regardless of the nature of the resolution. Accordingly, there are certain decisions that I am unable to cover in this section. Instead I focus on the most important resolutions that can affect a company.

to be responsive to the different kinds of corporate transactions in which a company may engage: related-party transactions, which are mainly addressed by the majority of minority rule (4.4.1); merger and other central transactions, which are mainly regulated by the supermajority approval rule (4.4.2); increasing and decreasing capital transactions, which are addressed by the majority of minority rule (4.4.3); and, finally, control transactions that are mainly governed by a takeout right (4.4.4).

4.4.1. The mechanisms of a self-enforcing model in related-party transactions

Here, this sub-section provides an overview of the problems of the Libyan legal regime in terms of related-party transactions (4.4.1.1), and then makes a proposal for legal reform in order to afford minority investors greater protection from abusive related party transactions through the adoption of the majority of minority shareholders rule (4.4.1.2).

4.4.1.1. The problems of the legal regime in Libya in terms of majority-minority conflict in related-party transactions

The problem of related-party transactions such as self-dealing transactions and corporate opportunities constitute a common conflict of interests in Libya. However, the restructuring of corporate ownership transactions are rare, mainly because of the dominance of the state in Libya's economy. [128]

Currently, the Libyan legal regime does not contain adequate safeguards for the prevention of the abuse of related party transactions by the controlling shareholders. This is because the strategy adopted by LEAA 2010, like UK law, is separate from the one that deals with the directors-shareholders problem. Whilst in Libya, like in the UK, company directors are subject to a range of different provisions that address conflict of interest transactions (e.g. law duties of loyalty, statutory disclosure, and shareholder approval),

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[128] See (2.3.1.2).

controlling shareholders are not subject to such duties or obligations. There are not, for either public or private companies, any ex-ante disclosure obligations on the board or the shareholder body for matters concerning, for example, related-party transactions with controlling shareholders, or any approval requirements.[129] Instead, the solution adopted by Company Law in both countries to deal with conflict of interest transactions is a minority shareholders action. This option is the dominant tool for addressing conflict of interest transactions in the overwhelming majority of jurisdictions. In the UK, it takes the form of the unfair prejudice remedy[130] and in Libya it is both a Liability Action and a Nullification Action.

As in the UK formal rules and state enforcement are more effective than in Libya, relying on the judicial approach to protect the minority shareholders is not problematic. However, as concluded in Ch.3, the judicial approach is very problematic in Libya. Therefore, there is a need to formulate a solution that can provide an effective and practical alternative to the judicial approach, which is the task of the following part of the thesis.

4.4.1.2. The majority of minority rule

Under the majority of minority rule, related-party transactions that are not done in the ordinary course of business or at arm's length require the approval of minority shareholders by way of a special resolution.[131] Libyan corporate law, unlike the UK, does not recognise this rule. In the UK, listed companies with a premium listing are subject to additional regulation in related-party transactions and are required to comply with the related-party transactions rules set out in Listing Rule 11. This requires 'substantial shareholders'[132] to obtain ex-ante disclosure and shareholder approval by the disinterested shareholders.[133]

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[129] See Ch.3 at 89.

[130] See Kraakman and others (n 46) 175-6; David Kershaw, *Company Law in Context: Text and Materials* (Oxford University Press 2012) 704.

[131] Black and Kraakman (n 3) 1959.

[132] A substantial shareholder is defined in section 11.1.4A of UKLR as any person who is entitled to exercise

The majority of minority rule has several elements. Firstly, the consent of disinterested shareholders is a central aspect, as Goshen suggests: 'a transaction can only be performed with the consent of the disinterested group at a price that is a function of the group's subjective evaluation of its worth'.[134] Secondly, the transactions that come under evaluation by the controlling shareholders must be 'sizeable transactions' as only large transactions should require the costly additional step of shareholder approval. Here Black and Kraakman suggest that in the case of Russia (and it is applicable to the Libyan case as well), for a transaction to require the approval of non-interested shareholders, the value of the transaction should be more than 2% of the book value of the company's asset or 2% of annual revenues.[135] According to Black and Kraakman, the size threshold 'balances the risk that the cost and delay of a shareholder vote will block good transactions against the need to block large bad transactions'.[136] Finally, the rule should be applied only in cases where the non- interested shareholders conclude that 'the company will not receive value, in property or services, at least equal to the market value of the property or services the company gives up'.[137] This requirement may give the non-interested shareholders a basis to intervene and evaluate whether the transaction is legitimate and value-enhancing for the corporation, or it is a vehicle for illegitimate expropriation of corporate value by management or controlling shareholders.

Within Libyan listed companies, an interesting proposal can be drawn from the recent change made by the Financial Conduct Authority (FCA).[138] The FCA enacted a

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or to control the exercise of 10 % or more of the votes to be cast in general meeting.

[133] See UKLR s 11.4(c) (d) provides that in a transaction with a related party, the company must

(c) obtain the approval of its shareholders either prior to the transaction being entered into or, if it is expressed to be conditional on such approval, prior to completion of the transaction

(d) where applicable, ensure that the related party itself abstains, and takes all reasonable steps to ensure that its associates abstain, from voting on the relevant resolution.

[134] Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (n 32) 398.

[135] Black and Kraakman (n 3) 1959.

[136] ibid.

[137] ibid.

[138] It should be noted that significant new rules to strengthen the UK premium listing regime came into force in May 2014. The FCA has recently published its latest consultation paper, CP13/15, which contains measures that provide protections for minority shareholders by

(1) Placing requirements on the interaction between a premium listed company and a

number of significant changes to the Listing Rules, which are designed to give minority shareholders greater protection. Significantly, under the new rule, premium listed companies and their controlling shareholders must enter into a have a written agreement, which included certain provisions safeguarding the company's independence through imposing enhanced oversight measures.[139] For example, the agreement between a premium listed company and its controlling shareholder needs to expressly provide that transactions and arrangements with the controlling shareholder and their associates are conducted at arm's length and on normal commercial terms.[140] This is applicable in all cases where the controlling shareholder acts against the interest of the minority shareholders. Clearly, such a measure would help to establish a standard of best practice that is fundamental to the independent operation of a listed company as it will provide the minority shareholders with a strong mechanism of protection. In other words, it will grant the minority shareholders a tool to veto any transactions between the company and controlling shareholder that seek to disenfranchise the minority shareholders and so act as a powerful deterrent to inappropriate behaviour by the controlling shareholders.

The other relevant rule aims to enhance voting control for minority shareholders in the election of independent directors through a dual voting structure. This means, in a premium listed company where a controlling shareholder is present, the minority shareholders are required to approve the resolution of electing those directors separately from the shareholder vote.[141] In other words, independent directors must be separately

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controlling shareholder, where one exists, via a mandatory agreement; (2) providing additional voting power for minority shareholders when electing or re-electing independent directors for a premium listed company where a controlling shareholder is present; (3) enhancing voting power for the minority shareholders where a premium listed company with a controlling shareholder wishes to cancel or transfer its premium listing.

See FCA, *Response to CP13/15 –Enhancing the effectiveness of the Listing Regime* (Finacial Conduct Authority May 2014) 6.

[139] Listing Rules, LR 9.2.2A (2) (a).

[140] ibid, and LR 6.1.4D R.

[141] LR 9.2.2E R of LR states that 'where LR 9.2.2AR (2) applies, the election or re-election of any independent director by shareholders must be approved by: (1) the shareholders of the listed company; and (2) the independent shareholders of the listed company'. If the necessary majorities are not achieved in the dual vote, the company would be required to wait at least a further 90 days before the vote could be passed by a

approved both by the shareholders as a whole and the minority shareholders as a separate class.[142] Therefore, the FCA allocates to independent directors a critical role in endorsing effective corporate governance through granting the minority shareholders a greater say in the election of company directors. As this rule is compatible with the model of self-enforcement, it can be adopted by Libyan Law.

4.4.2. The mechanisms of a self-enforcing model in mergers and other central transactions

Here, firstly, I discuss the problem of the legal regime covering the majority-minority conflict in mergers and other central transactions in Libya, (4.4.2.1) and then go on to propose the supermajority approval of shareholders as an effective alternative for solving the majority-minority problem (4.4.2.2).

4.4.2.1. The problem of the legal regime in Libya concerning the majority-minority conflict in mergers and other central transactions

In (2.4.1.1) I discussed the theory of majority-minority conflict in mergers and other central transactions such as the liquidation of a company, divisions of the company, a transformation of the company into another type of legal entity, the sale or purchase of assets, and amendments to the article of association. To address these conflicts most jurisdictions adopt standards that play a major role in regulating these transactions. In the UK, conflict of interest transactions can be evaluated by the courts through the unfair prejudice remedy. Similarly, in Libyan law (as in French and Egyptian law) the abuse of rights doctrine plays a central role in dealing with such conflicts.[143]

However, although the rule of supermajority shareholders approval can be used as an alternative to formal private enforcement in many central corporate transactions, LEAA

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simple majority of all shareholders. See (LR 9.2.2FR of LR).[142] ibid.

[142] ibid.

[143] For information about the abuse of rights doctrine, see (3.1.2.2) 117.

2010 does not adopt such a technique. Instead the law adopts a simple majority rule to regulate the previous central transactions. Shareholders in special meetings have the power to approve mergers, [144] dissolution, [145] division [146] and amendments to the article of association. [147] For the resolution of the shareholders to be valid, shareholders who own at least two thirds of the company's capital must attend the meeting and the resolution must be agreed by at least half of the attendees. [148] Furthermore, in sale of assets transactions, the law delegates to the board the power to enter into any transaction that would affect up to half of the company's assets without the shareholders' approval. In any transaction that exceeds half of the company's assets, the shareholders in a special meeting have an approval right which enables them to agree or disagree. [149] Regarding the transformation of the company into another type of legal entity, LEAA 2010 does not regulate the transforming of joint stock companies to other forms of company. Instead, it regulates transforming other types of companies (e.g. partnerships, limited partnerships, limited liability companies) to joint stock companies and it requires that all shareholders of a company must approve the transforming transaction. [150]

Returning to the majority-minority conflict in mergers, it is worth mentioning that minority freezeouts are not an issue in the Libyan economy since the law does not even allow controlling shareholders who own more than 90% of a company's shares to freezeout or eliminate the minority shareholders. As Tibar notes, this is considered to constitute expropriating private property which is illegal. [151] However, although Libyan Law does not allow for minority buyouts and other elimination actions, there are some exceptions to this principle. Libyan law allows the company to eliminate or expel any

[144] LEAA 2010, art 301.
[145] LEAA 2010, art 31.
[146] LEAA 2010, art 308.
[147] LEAA 2010, art 167 (A).
[148] LEAA 2010, art 168.
[149] LEAA 2010, art 174.
[150] LEAA 2010, arts 393 and 394.
[151] Mohamed Tibar, *The Theory of Shareholders' Rights in Joint Stock Companies*, vol 2 (Arab Union Madbaha 1998) 913 (in Arabic).

shareholder under the following circumstances: (1) when the shareholder fails to pay the instalments of his shares;[152] (2) when there is a provision in the article of association that allows the company to freeze out shareholders under certain circumstances (this is because shareholders become a member of the company according to a contract and therefore they are regulated by contract law as well as the commercial legal system);[153] (3) when the duties of a shareholder cannot be performed because of a *force majeure* (e.g. the shareholder is rewarded shares as compensation for work, but illness prevents them from continuing to work); (4) when the dispute between shareholders is too difficult to solve. Under this circumstance, the court may decide that it is better that one or more of the shareholders leave the company rather than wind the company up.[154] This comes from the principle that the interest of the company is of greater importance than the individual shareholder. [155]

In addition to LEAA 2010 failing to provide protection for the minority shareholders because of the absence of formal private enforcement and the lack of adopting a supermajority approval rule, Libyan corporate law does not provide adequate protection for the minority shareholders in terms of appraisal rights. This is because there is no a statutory right that allows all minority shareholders who oppose a central transaction to sell their shares. Instead, LEAA 2010 grants only the dissenting minority shareholders the right to exit from the company when they do not agree with the majority shareholders' solution.[156] This means that this right is granted only to the shareholders who object to the resolution at the special meeting. Therefore, neither the dissenter who failed to attend the meeting, nor the shareholder who attended but took no action to object to the resolution has the right of appraisal. It should be noted that, under this right, the company must return the

[152] LEAA 2010, art 105.
[153] See Libya Civil Act, art 527 (2).
[154] Here the existing shareholder still has a right to demand compensation from the company if the freezing-out causes him harm.
[155] Tibar (n 153) 913.
[156] See LEAA 2010, art 160. This provision was enacted under previous Libyan Commercial Act 1953, art 585 (1) as well.

value of the minority shareholders' shares which are evaluated under two mandatory rules: (1) if the shares are listed in the Libyan Stock market, the evaluation must be according to the average price of the shares during the last six months; (2) if the company is a private company, the evaluation must be based on the book value.[157] This kind of evaluation is consistent with what Black and Kraakman propose.[158]

4.4.2.2. Supermajority shareholders approval rule

According to the self-enforcing model, the appropriate solution in mergers and other central transactions, discussed previously, is supermajority shareholders approval. Under this rule, the threshold for shareholder approval must be high enough to guarantee that the controlling shareholders 'cannot routinely complete major transactions without support from outside shareholders.' [159] However, the threshold should be neither 'so high that companies will often be unable to complete beneficial transactions because the necessary shareholder vote cannot be obtained, nor so high that it gives undue holdup power to outside blockholders'.[160]

Libyan law, unlike the UK law, does not include the rule of supermajority shareholder approval for central business decisions, as discussed. Instead, in Libya the shareholders can make a central decision by a simple majority approval.[161] Therefore, there is a need to adopt the supermajority approval rule. This is because a simple majority approval rule clearly does not provide adequate protection for minority shareholders since there is a possibility (one that is often the case) that a single large shareholder who owns more than half of the company's capital can exploit and abuse both the management and the minority shareholders, especially in the absence of formal enforcement.

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[157] LEAA 2010, art 160. This provision was enacted under the previous Libyan Commercial Act 1953, art 585 (1).
[158] See Black and Kraakman (n 3) 1195.
[159] ibid 1953.
[160] ibid.
[161] LEAA 2010, art 168.

The appropriate shareholder approval threshold should depend on the ownership structure of the majority of companies in Libya and should be high enough so that the controlling shareholder cannot complete major transactions without support from minority shareholders. Currently, the law in Libya with regard to central decision-making places the threshold at 50%, a level that is clearly inadequate. Though in most jurisdictions the threshold of 75% of shares is very common, this would also be insufficient to provide protection for the minority shareholder in Libya. This is because in Libya the state, as the controlling shareholder of most large companies, often owns more than 75% of a company's shares. For instance, according to the Table no.1 entitled *The Structure of ownership in Libyan commercial banks* provided in Ch. 2, we can find that the state owns more than 82% of shares in most large banks in Libya (for example, the state owns 83 % of Gumhouria Bank, 85 % of Commercial National Bank and 82% of Al Commerce and Growth).[162] Accordingly, the increase of shares from 51 % (the current statute) to 75% would be ineffective since the state would retain its control over corporate decisions. Therefore, the appropriate solution to include the minority, and so protect the minority shareholders, is to increase the percentage to 85%.[163]

Also, in order to provide adequate protection for minority shareholders, the corporate law should permit shareholders to increase the supermajority requirement for certain provisions even to the level of unanimity. This would provide adequate protection for minority shareholders as majority shareholders would be unable to complete central transactions without minority shareholder approval.

An alternative proposal that could also provide protection for minority shareholders, and possibly more effectively, is that instead of corporate law mandating a

[162] See (2.1.2).
[163] Here it is worth noting that the determination of an accurate percentage of shares needs data that determines the structure of corporate ownership in Libya and includes the accurate percentage of shares that the controlling shareholders own in every company. Such data is not available since there are no studies regarding corporate ownership structure in Libya; the Libyan government has also not published any data in this regard.

requirement for a particular percentage of shares, the law could require the approval of minority shareholders who own 5% or more of shares in any conflict of interest transaction. For instance, to approve a conflict of interest transaction in a company in which the majority owns 80% of the shares, the approval of minority shareholders who own 5% of shares would also be required. Also, the approval of a conflict of interest transaction in a company in which the majority owns 55% of shares would require the additional approval of minority shareholders who own 5% of shares.

This solution is more desirable and offers a greater level of protection to minority shareholders. This is because of two reasons: firstly, it provides protection for the minority shareholders in all companies including those in which the majority shareholders own very large amounts of shares. Secondly, this solution provides a fairer level of protection. To explicate this: assume Company A has controlling shareholders who own 84.99% of shares and Company B has controlling shareholders who own 85% of shares. In the first instance the minority shareholders are protected since the controlling shareholders cannot make a decision without an approval from the minority shareholders. However, in the second instance where the controlling shareholders own 85% (0.01% more than in Company A), the minority shareholders are not protected since the controlling shareholders have enough shares that allow him to engage in any transaction without the minority shareholders' consent. This is the case despite the fact that the difference in percentage in the both situations is minimal.[164] Consequently, the approach that adopts a particular percentage

[164] This situation is similar to how tax was imposed in the past. To illustrate this, we should understand that there are two methods to impose a tax: the traditional one, known as the Incremental Classes Tax, and the modern one known as the Incremental Sections tax. In the first scenario, for example, when the salary is between £1000 and £2000 the tax is 10%, when the salary is between £2001 and £3000, the tax is 20% and so on. This method has been criticized since a person who his salary is £2001 will pay more tax (20%) than someone who has a salary of £2000 (10%) even though the difference between the two salaries is only £1. Accordingly, the method was changed to the Incremental Sliding tax. Here if the salary is £2001, it will be divided into three sections. For example, the first £1000 is taxed at 10%, the second £1000 at 20% and the remaining £1 at 30%. This method avoids the unfairness that occurred under the traditional method.

threshold has the potential to not provide an equal level of protection to minority shareholders in all companies.[165]

Regarding the sale or purchase of assets, the model proposes a hierarchy of procedural and structural requirements depending on the size of the transaction of asset sales and purchases, which are as follows: [166]

1. The management of the company have power to purchase or sell less than 25% of the book value of a company's assets because it is not considered to be a large transaction.
2. Requires unanimous board approval to purchase or sell 25-50% of the book value of a company's assets. However, if the Board cannot reach a unanimous decision, approval must be transferred to the shareholders, presumably by a majority of votes.
3. Requires approval by a supermajority of three quarters of the shareholders at the meeting to purchase or sell 50% or more of the book value of the company's assets.

In the case of Libya, there is a need to reduce these percentages because of the widespread corruption by which Libya characterized. The management, for example, should be authorised to purchase and sell not more than 10% of the book value of the company’s assets and, to provide greater safeguards, the board of directors must vote to approve this transaction. Also, to sell or purchase between 10% and 25% of the company’s book value, independent directors must approve the transaction. Finally, to purchase or sell more than 25%, the supermajority rule under the new form must be applied since, as Black and Kraakman note, ‘transactions of this size can destroy a company's value with the stroke of a pen’.[167]

[165] However, though the approach that provides the minority shareholders protection under any circumstances regardless of the percentage of shares that the majority shareholders own is rational, we should take into account that the percentage of the minority shareholders that can participate in decision-making process should own 5% of the shares or more. This means only large minority shareholders can have a veto power and approval power in conflict of interest transactions. This issue will be discussed in details in the following chapter.
[166] Black and Kraakman (n 3) 1955.
[167] ibid.

Although LEAA 2010 adopts appraisal rights and the method of assessing the value of a company's shares is appropriate for the Libyan case, relying on courts to process such a right does not provide adequate protection for the minority shareholders because of the lack of formal private enforcement. Accordingly, it is rational to mandate that the dispute parties seek appraisal through arbitration rather than through the courts.[168]

Furthermore, Libyan Law does not facilitate minority buyouts when a controlling shareholder owns a large percentage of a company's share. This is appropriate for two reasons: first, if buyouts were allowed in Libya (where most large companies are owned by the state) most companies would be owned solely by the state. This is not consistent with Libya's current policy of privatisation and moving towards a Free Market economy in which concentrated state ownership tends to be diluted in favour of the private sectors. However, allowing freezeout provisions will lead to the increase of state ownership at the expense of the private sector.

Second, Islamic law, which is a source of Libyan law, does not allow for the expropriation of private property. Instead, Islamic Law adopts the 'consent principle' which means that any transaction must be based on the consent of the parties.[169] The Quran says in this regard: '*O you who have faith! Do not eat up your wealth among yourselves unrightfully,[170] but it should be trade by mutual consent'.*[171]Also, in the *Sunna,* [172] The Prophet Mohammed says 'a Muslim is a brother of another Muslim, it is not allowed for a

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[168] Black and Kraakman propose a choice between seeking a court or an arbitrator. (See ibid 1956). However, in the case of Libya I propose only seeking an arbitrator because of the extreme lack of court enforcement.
[169] However, under Islamic Law there are certain specific exceptions to the principle of consent. For example, it allows selling a bankrupt person's property without his consent for the interest of his creditor, selling a debtor's collateral or securities without his consent for the interest of his creditor, taking expenses for a person's wife or children without his consent if he does not spend enough money for his family. etc. See Tolba Al Kobashi, *The Clauses of the Private Property Expropriation and its Limitaions in the Interest of the Third Parties in Islamic Law* (Jameat Al Azhar 2001) (in Arabic).
[170] That is, by way of usury, gambling, usurpation, false claim, expropriating private property or any other illegitimate actions under Islamic Law.
[171] The Quran, *Surah Al Nessa* (Women) verse: 29.
[172] Sunna means 'The traditional portion of Muslim law, based on the words and acts of Prophet Muhammad, and preserved in the traditional literature'. See Dictionary.com, 'sunnah' <http://dictionary.reference.com/browse/sunnah> accessed 12-05-2014

brother to take anything from his brother but what he gave him with a pure consent'.[173] Thus, in Islamic Law the controlling shareholders are not allowed to freeze the minority shareholders out without their consent, which is also the case in Libya law.

4.4.3. The majority-minority conflict in transactions that effect corporate capital

To analyse the majority-minority conflict in transactions that effect corporate capital in Libya, I firstly provide an overview of the problem of the Libyan legal regime covering corporate capital transactions (4.4.3.1), and then makes a proposal for legal reform in order to provide minority investors greater protection from abusive corporate capital transactions (4.4.3.2).

4.4.3.1. The problem of the legal regime in Libya concerning the majority-minority conflict in increasing and decreasing capital transactions

The problem of the majority-minority conflict in transactions that effect corporate capital can be divided into two transactions: increasing capital transactions and decreasing capital transactions.[174] Whilst the problem of the majority-minority shareholders regarding increasing capital transactions relates to share issuance when the controlling shareholder issues a number of shares that dilute the voting power of the minority shareholders, in decreasing capital transaction the conflict may occur when, for example, the majority shareholder decreases the capital of the company for purposes that serve his interest rather than the company's interests, such as saving money to create another company rather than there being a real need to reduce the company's capital.

To address both problems in Libya, LEAA 2010 adopts a simple majority rule instead of the supermajority rule. Under Art 141 shareholders in a special meeting, where

[173] The Ministry of Awqaf and Islamic Affairs, 'Islam and Nationalization: Nationalization and Expropriation in Islamic Law' (2014) 158 Dauat Alhak Journal 1, available at http://habous.gov.ma/daouat-alhaq/item/4047 (in Arabic).
[174] See (2.3.1.1).

the owners of at least two thirds of the company's capital are in attendance and in which a resolution is agreed by at least a half of the attendees, can increase the capital of the company through issuing new shares.[175] Similarly, Art 151 allows the shareholders in a special meeting to decrease company's capital in certain cases. For example, when the capital of the company is more than what the company needs for its operations[176] and also, when the company has lost at least one third of its capital.[177]This being the case, Libyan corporate law fails to address either conflict satisfactorily, as it delegates the right to increase and decrease corporate capital to the majority of shareholders who can rely on only the simple majority rule, rather than requiring the supermajority rule to approve such transactions.

However, though LEAA 2010 fails to address the conflict that derives from increasing and decreasing corporate capital transactions, it does provide protection for the minority shareholders in relation to increasing corporate capital by adopting a pre-emptive right for the minority shareholders. Under art 144, the newly issued shares must be distributed among the shareholders on a pro rata basis that does not exceed the number of shares that they applied for. If there is an excess of new shares, they must be distributed among the shareholders who requested to buy more on a pro rata basis. If there are still more shares remaining after the two previous steps, the new shares must be offered for public subscription. Thus, Libyan law provides minority shareholders with adequate protection under pre-emptive rights.

[175] The ways that new shares can be issued under LEAA 2010 (art 144) are as follows: (1) issuing new shares equal to the increased capital at the par value of the shares of the company; (2) increasing the par value of the shares of the company; (3) transferring the bonds of the company to new shares.

[176] LEAA 2010 art 151 (2). The ways adopted in LEAA 2010 to decrease corporate capital are as follows: (1) exempt the shareholder from the remaining instalments of their share; (2) returning some the shareholders' instalments. (See LEAA 201 art 151 (2)).

[177] See LEAA 2010 art 152. In this situation, the board of directors must call the general meeting of the shareholders to evaluate the situation of the company after its loss and take the suitable measures. See ibid.

4.4.3.2. Mechanisms for addressing the majority-minority conflict that effect corporate capital in Libya

The self-enforcing model proposes a number of substitute tools to protect minority shareholders against issuing new shares that are priced below fair market value or shift the control of a company. Primarily, under the self-enforcing model, shareholders may allow the board of directors to issue unissued shares.[178] Additionally, the self-enforcing model offers a more flexible approach by imposing more limitations. First, selling shares to insiders is a related-party transaction that should be subject to the approval requirements of the majority minority rule, as discussed in (4.4.1). Also, issuing shares at under market value is prohibited. Further, issuing shares that are equivalent to 25% or more of the company's outstanding shares should require approval by the majority of the shareholders, excluding the purchasers if they are already existing shareholders. Finally, shareholders should have pre-emptive and participation rights. Here the model 'offer[s] to its existing shareholders rights to purchase newly issued shares in proportion to their prior holdings (pre-emptive rights)'.[179] However, because this right is costly for companies with many shareholders and can delay time-sensitive transactions, the model allows for waivers including routine waivers approved at annual meetings.[180] Further, the model grants the shareholder who waives their pre-emptive right what Black and Kraakman term participation rights, which 'entitle the shareholders who hold them to buy from the company after the offering has been completed as many shares, at the offering price, as they could have bought had pre-emptive rights been available'. [181]

It should be noted that LEAA 2010 provisions are in no way consistent with the self-enforcing model. Firstly, the law does not address whether the shareholders can allow the board of directors to issue unissued shares. Also, although the law flatly prohibits the

[178] Black and Kraakman (n 3) 1964.
[179] ibid 1965.
[180] ibid.
[181] ibid.

original share issuance below the par value, it does not prohibit any additional issuances to be below the market value.[182] Further, LEAA 2010 does not require shareholder approval by majority of shares for any issue of more than 25% of voting stock. Regarding pre-emptive rights, LEAA 2010 does not address this right sufficiently since it stipulates that 'the shareholders have the priority to buy the new shares issued by the company if the shareholders in general meeting agree not to adopt this provision'.[183] This means that the pre-emptive right is a default rule that shareholders in their general meeting can agree not to adopt. Therefore, there is no mandated protection available to the minority shareholders, since the controlling shareholders can withdraw pre-emptive rights from the minority shareholders at any time.[184]

Regarding decreasing corporate capital, Black and Kraakman do not include such a transaction in their model. However, when a conflict is obvious in a decreasing capital transaction between the majority shareholders and the minority shareholders, we can apply the same rule of supermajority approval in order to provide protection for the minority shareholders.

4.4.4. The mechanisms of a self-enforcing model in control transactions: takeout rights

Here I discuss the mechanisms that could be applied to solve the problem of the minority shareholders and the majority shareholders in control transactions. To do so, this sub-section examines the problem of the legal system in Libya concerning control transactions (4.4.3.1) and then it proposes an appropriate solution for this problem in (4.4.3.2).

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[182] See LEAA 2010, art 142 (1).
[183] See LEAA 2010, art 147 (1).
[184] This is in contrast to CA 2006 where, under section 561(1), which is a mandatory rule, a company must not issue shares to any person unless: (1) it has made an offer (on the same or more favourable terms) to each person who already holds shares in the company in the proportion held by them; and (2) the time limit given to the shareholder to accept the offer has expired.

4.4.4.1. The problem of the legal regime in Libya concerning the majority-minority conflict in control transactions

As discussed in Ch. 2, the majority-minority conflict in sales of control occurs when the acquirer enters into an agreement with the controlling shareholders of the target company under terms that may harm the minority shareholders. This can occur when the controlling shareholders extract private benefits by selling their controlling shares at a premium that reflects the capitalized value of the private benefits of control, rather than at the market value.[185] Also, in Ch.2 it is recognized that control transactions are not a significant problem in Libya because of reasons that relate to the concentrated system of ownership, the illiquidity of the Libyan market, state ownership of most large companies, a policy that prevents companies from selling profitable equities, poor information disclosure (which is required to encourage potential acquirer companies to enter in to takeover transactions), and a complete absence of loan-financed purchases.[186]

These reasons provide clear evidence that takeover transactions are not yet a real issue in Libya and explains why there are no adequate provisions (or a separate laws or acts) that set down takeover (or even merger) transactions.[187] In the same context, there is no provision that regulates the relationship between the minority and the majority shareholders, or protects minority shareholders against the majority. Instead, general civil laws must be applied in such cases. This is the case in most Arab countries such as Egypt and Iraq, [188] which, like Libya, do not provide adequate protect for the minority shareholders in the context of corporate control transactions. As Kraakman et al. argue, 'the general rules of civil law are not likely to address effectively the coordination between the acquirer and the non-controlling shareholders […] nor the agency problem between

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[185] See (2.3.1.1).
[186] See (2.3.1.2).
[187] See Ch.2 (n 153).
[188] See Ismael Ibrahem and Nofl Rehman AL-Jbouri, 'The Legal Responsibility to Acquired on Participation Company: Comparative Study' (2010) 1/year 4 Journal of Legal and Political Sciences 9 (in Arabic).

controlling and non-controlling shareholders.'[189] There are many complicated issues in takeover transactions that the general rules of civil law are not able to address. This necessitates a reform to Libyan law, which will be discussed in the following analysis.

4.4.4.2. Takeout rights

According to the self-enforcing model, Libyan Law could protect minority shareholders by adopting a mandatory bid rule which would grant them 'takeout rights' (a term used by Black and Kraakman) after a change of control. Under takeout rights, a shareholder who acquires a fixed percentage (often 30%) or more of the company's common stock 'must offer to buy all remaining shares at the highest price he paid for any of the company's shares within a specified period of time (we propose six months)'.[190]

In addition, there is another risk that may face the minority shareholders which relates to the secret accumulation of control. Here shareholders can be induced to sell control under the market value through numerous open market transactions. In order to address this, the self-enforcing model would give the shareholders an opportunity to negotiate a higher price by collectively negotiating a control premium, which would lead to other potential acquirers offering a higher price as well.[191] This model, which Libya law should comply with, requires that first any shareholder who acquires 15 % or more of a company's shares must publicly disclose their identity, their shareholdings and their intention to buy more shares.[192] Also, they must give the company 30 days' notice of their intention to purchase more shares, i.e. acquire control.[193] This mechanism assists the management of the company by giving them appropriate time to respond to the control transaction through 'seeking a higher bidder, proposing an alternate transaction that is

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[189] Black and Kraakman (n 3) 1961.
[190] ibid.
[191] ibid 1962.
[192] ibid.
[193] ibid.

more favourable to the shareholders, or convincing shareholders that their shares are worth more than the acquirer is offering to pay'.[194]

Finally, the minority shareholders may face what Black and Kraakman describe as a 'prisoner's dilemma', which describes the situation in which a shareholder 'cannot risk rejecting an offer that most other shareholders accept, because the price and liquidity of the remaining minority shares will collapse'.[195] Consequently, since the minority shareholders' shares may lose their liquidity when the acquirer gets a high percentage of the outstanding shares, an appraisal rights remedy is an effective solution for such a problem when a controlling shareholder's ownership crosses 90%.[196] Thus appraisal rights must be offered to all remaining minority shareholders by the company.

4.5. Factors which reinforce the proposal to adopt the self-enforcing model in Libya

Black and Kraakman do not provide a comprehensive analysis that justifies why the self-enforcing model is an appropriate alternative to formal private enforcement in emerging countries. Instead they focus only on the lack of enforcement in these countries as a reason to replace the judicial solution with the self-enforcing model. However, such an analysis does not provide us with the complete picture. In fact, there are other reasons that contribute to my proposal that the self-enforcing model should be adopted in Libya. Firstly, the self-enforcing model contributes to companies being able raise capital from investors (4.5.1), and it also lowers the number of conflict of interest transactions and makes a company's transactions more efficient (4.5.2). Finally, the self-enforcing model does away with the need for external monitoring (4.5.3).

[194] ibid.
[195] ibid 1963.
[196] ibid.

4.5.1. The self-enforcing model's positive impact on investor capital

Generally, it is agreed amongst corporate governance scholars that the protection of minority shareholders is considered a core mechanism for attracting both foreign and domestic investors as it enhances the development of financial markets.[197] Therefore, minority shareholders will be incentivised to pay a greater sum for shares if they are well protected.[198] Moreover, when minority shareholders are enabled to vote on transactions in which there is a conflict of interests (as they would be under the self-enforcing model) this will encourage more the investors to raise additional capital.

To illustrate this: in Libya, where an inefficient market is in place, it is not an easy task for companies to raise additional capital on favourable terms, unlike in an efficient market. Instead companies can only raise capital on expensive terms as minority shareholders are unwilling to invest additional capital in corporations where the controlling shareholders can extract private benefits at their expense.[199] Thus, such a market allows individuals to exploit small investors without suffering either market or legal penalties.[200]

Further, in such a market, where the general enforcement environment of courts and other institutions is very weak, companies may prefer to rely on internal funds (using retained earnings)[201] or contributions from closely related investors, since obtaining external finance is constrained,[202]especially in a weak contracting environment.[203] As a result, the only scenario in which investors and companies are able to raise additional

[197] See the introduction p3.
[198] See e.g. Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of Financial Economics 3, 15. For more information about the importance of minority shareholders in raising capital, see the introduction of the thesis 3-4.
[199] See Lynn A Stout, 'The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation' (1988) 87 Michigan Law Review 613; Gilson and Kraakman, 'The Mechanisms of Market Efficiency' (n 105).
[200] Alison Grey Anderson, 'Conflicts of Interest: Efficiency, Fairness and Corporate Structure' (1977) 25 UCLA Law Reveiw 738, 740.
[201] Zohar Goshen, 'Shareholder Dividend Options' (1995) 104 Yale Law Journal 881, 882.
[202] Erik Berglöf and Stijn Claessens, 'Corporate Governance and Enforcement' World Bank Policy Research Working Paper 3409, September 2004 <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3409> accessed 29-10-2013, 12.
[203] See Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine, 'Law, Endowments, and Finance' (2003) 70 Journal of Financial Economics 137.

capital on favourable terms is through a reliance on social relationships with each other.[204] However, under the self-enforcing model, investors are willing to enter the company as part of the minority when they are provided with power to approve conflict of interest transactions. The self-enforcing model facilitates such entrance since it overcomes the challenges described above and encourages investors to invest in a company with which they have no existing relationship; which is a significant step towards the establishment of a free market economy.

Additionally, the model of self-enforcement is a mechanism through which investment in companies that have a controlling shareholder can be increased, and it can help ensure the stability of such investment through encouraging the minority shareholders to continue investing in a concentrated ownership company long-term. According to Gutierrez and Saez, investment efficiency and welfare can be increased by letting the interested parties enter into long-term contracts that regulate private benefit extraction.[205] Similarly, under a law (similar to a contract) that provides minority shareholders with long-term protection against private benefit extraction, investment efficiency and welfare will be increased. In the same context, the company, under this model, can survive long-term. As Mantysaari notes, the company can ‘benefit from a self-enforcing corporate governance model. In the long run, it can increase the firm’s survival chances’.[206]

4.5.2. The self-enforcing model as a means of lowering the number of conflict of interest transactions and making controlling shareholders' transaction more efficient

Under the self-enforcing model, the conflict of interest transactions will be lower since controlling shareholders are provided with enough incentives to obey the rules. They

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[204] See (1.3.2.1).

[205] María Gutiérrez Urtiaga and Maria Isabel Sáez Lacave, ‘A Contractual Approach to Discipline Self-Dealing by Controlling Shareholders’ SSRN, 2012 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2176072> accessed 18-05-2014.

[206] Mantysaari (n 1) 118.

know in advance that the minority shareholders have the power to reject any transaction that takes advantage of them. Therefore, under this model there is an increased possibility that controlling shareholders will not initiate any transaction that conflicts with the minority shareholders' interests. In this way, whilst formal private enforcement is like a shield used when the minority shareholders need to defend themselves against controlling shareholders, self-enforcement is a sword used by private enforcers (minority shareholders) to deter controlling shareholders from initiating conflict of interest transactions. Therefore, the self-enforcing model provides the minority shareholders with a greater means of protection than formal private enforcement and as such can be regarded as a means of minimizing the number of conflict of interest transactions.

In addition, the transfer of decision-making power to the minority under the model enhances the minority's ability to demand that transactions are performed efficiently.[207] To illustrate this: the controlling shareholders will not enter into any transactions that does not benefit the company since they know in advance that it will be rejected by the minority shareholders. Consequently, the minority shareholders are better off because the model provides the controller with enough incentives to generate higher corporate benefits[208] that are aligned with the desires of the small shareholders. Moreover, the model provides the minority shareholders with a greater means of ensuring effective transactions, as requiring the minority shareholders' approval leads the controlling shareholders to enter into a negotiation with the minority which, as Urtiaga and Lacave note, allows both parties to profit.[209]

However, it may be argued that the judicial approach is able to offer greater efficiency than the model since the judicial approach uses a fairness mechanism which

[207] Goshen, 'The Efficiency of Controlling Corporate Self-Dealing' (n 32) 413-4. It should be noted that the model, in contrast, may preclude efficient transactions in certain situations, such as when the minority shareholders attempt to extract greater personal gain in return to their approval to the transaction. This will be discussed in Ch.5.
[208] Gutiérrez Urtiaga and Sáez Lacave (n 205) 3.
[209] Ibid 4.

employs an objective valuation on the conflict of interest transaction through the courts. This is in contrast to the self-enforcing model where the valuation of the transaction is in the hands of the minority shareholders and so is subjective (enabling the minority to capture a greater part of valuation of the transaction under approval regardless of whether it is fair or not).[210] This is the case when a country has efficient formal enforcement and their courts are able to value commercial transactions appropriately. However, in the case of Libya this is not applicable since there is a lack of enforcement and the quality of Libyan courts in dealing with commercial law and their efficiency of implementation of the law are still weak, as discussed previously. Thus, the adoption of the model of self-enforcement at the expense of the judicial approach is desirable in Libya.

4.5.3. The self-enforcing model compensates for the need for external monitoring

There are two types of financial systems: a market-based system, such as in the UK and the U.S., and a bank-based system, which is common in Japan and Germany.[211] Various studies indicate that the effectiveness of external monitoring mechanisms of these systems is largely determined by the ownership structure of corporations in each respective system.[212] Firstly, the countries that follow a market-based system are characterized by the existence of a relatively large number of listed companies, independent boards (unity boards), dispersed ownership, transparent disclosure, a liquid capital market, an active

[210] For the differences between the judicial approach and the minority shareholders' approval approach in terms of the valuation of transactions, see Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (n 32) 408-10.

[211] This classification of the systems is based on several criteria the details of which are not in this thesis. Examples of such criteria are: (1) the size of the banking systems and stock markets; (2) the degree of external finance that results from bank and market sources; and (3) the amount of corporate equity owned by banks including the role of the banks in corporate governance. For details see e.g. Ross Levine, 'Financial Development and economic Growth: Views and Agenda' (1997) XXXV Journal of Economic Literature 688; Randall Morck and Masao Nakamura, 'Banks and Corporate Control in Japan' (1999) 54 The Journal of Finance 319; Franklin Allen and Douglas Gale, *Comparing Financial Systems* (Cambridge, Mass. ; London : MIT Press 2000); Ross Levine, 'Bank-Based or Market-Based Financial Systems: Which Is Better?' (2002) 11 Journal of Financial Intermediation 398.

[212] See e.g. Andrei Shleifer and Robert W. Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461; Randall Morck, Andrei Shleifer and Robert W Vishny, 'Management Ownership and Market Valuation: An Empirical Analysis' (1988) 20 Journal of Financial Economics 293.

takeover market, and well-developed legal infrastructure for the protection of minority shareholders.[213] Under this system, the market can enhance corporate governance through facilitating the disciplinary mechanism for corporate control.[214] Here the takeover market[215] serves as a disciplinary mechanism when a corporation's internal controls become inefficient or incapacitated.[216] This can occur when a corporation is mismanaged and its shares, as a result, fall in-line with the company's market value.[217] Under these circumstances the company becomes a potential target for a takeover 'in which alternative management teams, who recognize an opportunity to reorganize or redeploy the organization's assets and hence to create new value, bid for the rights to manage the corporation's resources'.[218] Thus the market for corporate control is capable of correcting the inefficiency of the management in two ways: either through imposing the threat of a possible takeover and therefore deterring the management from acting poorly, or through

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213 For details see Arnoud WA Boot and Anjan V Thakor, 'Financial System Architecture' (1997) 10 Review of Financial studies 693; Levine, 'Bank-Based or Market-Based Financial Systems: Which Is Better?' (n 213); Allen and Gale (n 211); Colin Mayer and Oren Sussman, 'The assessment: Finance, Law, and Growth' (2001) 17 Oxford Review of Economic Policy 457.

214 See e.g. Eugene F Fama and Michael C Jensen, 'Agency Problems and Residual Claims' (1983) 26 Journal of Law and Economics 327; Michael C Jensen and Richard S Ruback, 'The Market for Corporate Control: The Scientific Evidence' (1983) 11 Journal of Financial Economics 5; Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) 52 Journal of Finance 737; Michael C Jensen, 'Takeovers: Their causes and Consequences' (1988) 2 The Journal of Economic Perspectives 21.

It should be noted that corporate control is not the only disciplinary mechanism for a management that acts poorly, also a management that fails to create shareholder value can be disciplined through other mechanisms such as closer shareholder monitoring, holding large share blocks, appointing nonexecutive directors See e.g. Julian Franks, Colin Mayer and Luc Renneboog, 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10 Journal of Financial Intermediation 209; Shleifer and Vishny, 'Large Shareholders and Corporate Control' (n 212); David Scharfstein, 'The Disciplinary Role of Takeovers' (1988) 55 The Review of Economic Studies 185.

215 The market for corporate control is 'often referred to as the takeover market'. See Jensen and Ruback (n 212) 6.

216 Eugene F. Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 The Journal of Political Economy 288; Jensen, 'Takeovers; their Causes and Consequences' (n 214); Michael S Weisbach, 'Corporate Governance and Hostile Takeovers' (1993) 16 Journal of Accounting and Economics 199.

It should be noted that the market for corporate control also makes it easier to tie managerial compensation to firm performance. Michael C. Jensen and Kevin J. Murphy, 'Performance Pay and Top-Management Incentives' (1990) 98 Journal of Political Economy 225, 242.

217 Krishna G Palepu, 'Predicting Takeover Targets: A Methodological and Empirical Analysis' (1986) 8 Journal of Accounting and Economics 3; Randall Morck, Andrei Shleifer and Robert W Vishny, 'Characteristics of Targets of Hostile and Friendly Takeovers' in Alan J. Auerbach (ed), *Corporate Takeovers: Causes and Consequences* (University of Chicago Press 1988) 101–136; Mark L Mitchell and Kenneth Lehn, 'Do Bad Bidders Become Good Targets?' (1990) 98 Journal of Political Economy 372.

218 James P Walsh and Rita D Kosnik, 'Corporate Raiders and their Disciplinary Role in the Market for Corporate Control' (1993) 36 Academy of Management Journal 671, 673.

actions taken by the acquirer, after a takeover has actually been executed, to improve the deficiency of the previous management.

However, the countries following the bank-based system have large effective banking systems, high levels of bank finance, concentrated shareholding, large equity holding by banks and their financial institutions are more active.[219] In such a system, where the rights of control are strongly concentrated, hostile takeover bids are very rare.[220] This is because hostile takeovers as a mechanism to restrain inefficient management or opportunism is based on the grounds of the separation of ownership and control which is not always the case in concentrated ownership countries.[221] Thus, the holding of a majority of shares by a controlling shareholder coupled with the separation of ownership provides the company with immunity against takeovers.[222] Therefore, non-market external monitoring mechanisms (e.g. continuous creditor control) play an important role as a substitute for disciplinary control changes.[223] As Shleifer and Vishny argue, large creditors are similar to majority shareholders since they have large investments in the firm and therefore a strong incentive to monitor. Additionally, large creditors typically have a

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[219] See e.g. Mark J Roe, 'Some Differences in Corporate structure in Germany, Japan, and the United States' (1993) 102 Yale Law Journal 1927; Gregory Jackson and Andreas Moerke, 'Continuity and change in corporate Governance: Comparing Germany and Japan' (2005) 13 Corporate Governance: An International Review 351.

[220] Julian Franks and Colin Mayer, 'Bank Control, Takeovers and Corporate Governance in Germany' (1998) 22 Journal of Banking & Finance 1385, 1386. According to Becht et al., '[t]his mechanism is highly disruptive and costly. Even in the USA and the UK it is relatively rarely used. In most other countries it is almost nonexistent' Marco Becht, Patrick Bolton and Ailsa Röell, 'Corporate governance and control' Handbook of the Economics of Finance, 2003 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343461> accessed 16-12-2013, 13.

[221] Rajeeva Sinha, 'The Role of Hostile Takeovers in Corporate Governance' (2004) 14 Applied Financial Economics 1291, 1291. 'The study makes a distinction between the role of hostile takeovers as a mechanism for downsizing and exit in the process of 'creative destruction' and the role of hostile takeovers as a corporate governance mechanism for curbing managerial slack and opportunism'.
see Jens Köke, 'The Market for Corporate Control in a Bank-Based Economy: a Governance Device?' (2004) 10 Journal of Corporate Finance 53. This study attempts to answer the following question: Does the market for corporate control fulfil a disciplinary function in a bank-based economy? To address this question, they examine the frequency, causes, and consequences of almost 1000 listed and non-listed German corporations from 1987–1994. The study's findings are: 'high ownership concentration makes control changes less likely. This is consistent with the view that tight shareholder control acts as a substitute for disciplinary control changes'. Also, 'control changes are more likely for firms under strong creditor influence. This suggests that creditor control and control changes are complementary'.

[222] See Zohar Goshen, 'Controlling Corporate Agency Costs: A United States-Israeli Comparative Law' (1998) 6 Cardozo Journal of International and Comparative Law 99.

[223] Franks and Mayer, 'Bank Control, Takeovers and Corporate Governance in Germany' (n 220); Köke (n 221); Colin Mayer, 'New Issues in Corporate Finance' (1988) 32 European Economic Review 1167.

variety of control rights and therefore sufficient power to monitor,[224] which may occur through offering financial advice to the borrower, owning shares in the company and acting as a proxy for its other investors at shareholder meetings.[225] In other words, debt as a governance mechanism provides external oversight over management under which bankers can intervene to correct governance mistakes and monitor the corporations directly. In practice, this means that when managers who mismanage the company reject the opportunity to develop strategies to act more efficiently, banks can withhold credit.[226]

Libya does not have either a market-based system because of concentrated ownership or a bank-based system because, as discussed in Ch.2, using banks as a mechanism for external corporate governance to monitor companies does not work efficiently in Libya. In other words, the Libyan Government has neither adopted the Anglo-Saxon model of corporate governance, which is characterised by the protection of investors and creditors, nor introduced a bank-based system that can provide efficient monitoring of the performance of the enterprise, such as has been adopted in Japan and Germany. Instead, though banks are the main providers of external finance to Libyan companies and the relationships between banks and enterprises are naturally close, the banks in Libya are unable to play a role in corporate governance and monitor firms efficiently.[227] This is because the external finances provided by the banks represent only a small part of corporate financing and, as such, banks may not feel motivated to monitor clients effectively.[228]Additionally, the banks are poor governance agents and have distorted incentives. The loans are regulated by personal relationship rules rather than corporate

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[224] Shleifer and Vishny, 'A Survey of Corporate Governance' (n 216) 752-3.
[225] See Jonathan P. Charkham, *Keeping Good Company: A Study of Corporate Governance in Five Countries* (Oxford : Clarendon Press 1995) 35-43.
[226] Hayne E Leland and Klaus Bjerre Toft, 'Optimal capital Structure, endogenous Bankruptcy, and the Term structure of Credit Spreads' (1996) 51 The Journal of Finance 987.
[227] See (2.3.2.2).
[228] Erik Berglöf, 'Corporate Governance in Transition Economies: The Theory and Its Policy Implications' in Masahiko Aoki and Hyung Ki Kim (eds), *Corporate Governance in Transitional Economies* (The World Bank 1995) 61.

governance mechanisms. Further, Libyan Bank Law does not facilitate the monitoring role of Libyan banks to their debtor companies.[229]

In the case of Libya, the self-enforcing model compensates for the need to implement external monitoring provided under both the market for corporate control and external monitoring by banks. The protection afforded by the market or banks is unnecessary under the self-enforcing model as it offers protection for the minority shareholders more effectively than the threat of a takeover or monitoring by banks. This is simply because the minority's consent is required to approve conflict of interest transactions, which means that the exploitation of the minority is a difficult task.

Furthermore, the model can eliminate the agency costs of external monitoring. According to Mantysaari, in the case of external monitors, the firm is the principal and external monitors, such as banks or markets, can be regarded as the firm's agents. Under this model, '[n]o agency costs for external monitoring will be incurred to the extent that no external monitors are required (no agency). This can mean savings'. [230] This is because the self-enforcing model relies on internal agents rather than external ones (thus making it self-enforcing).

Conclusion

Having examined liability actions and the other workable alternative strategies (e.g. public enforcement) and found that they fail to provide adequate protection for the minority shareholders in Libya, the chapter proposed the self-enforcing model as an effective alternative to deal with the majority-minority shareholders problem which, in turn, reduces (though not wholly avoids) the need for informal enforcement.

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[229] See (2.3.2.2).
[230] Mantysaari (n 1) 118.

In order to avoid reliance on formal enforcement, this chapter proposed that the appropriate solutions to majority-minority shareholder problems are based on the adoption of the voting mechanism and transitional rights of the self-enforcing model, with amendments that take in to account the specific case of Libya. Such solutions differ according to the kind of corporate transactions in which a company may engage: related-party transactions which are mainly addressed by the majority of minority rule, other central transactions (e.g. the liquidation of a company, divisions of the company, the transformation of the company into another type of legal entity, the sale or purchase of assets, and amendments to the article of association), which are mainly regulated by the supermajority approval rule, and control transactions that are mainly governed by a takeout right.

In order to effectively implement a self-enforcing model, there is an evident need to adopt the rule of one share, one vote since it prevents insiders from acquiring voting power disproportionate to their economic interest in the company. Also, there is a need to adopt the rule of confidential voting since it will prevent the controlling shareholders from knowing how a voter has cast their ballot (against him or not), meaning that insiders will lose the power to manipulate votes through rewards or sanctions. Further, all the rules and rights of the model should be mandatory and should be applicable to both large and small companies.

Finally, Black and Kraakman do not cover why the self-enforcing model is an appropriate alternative to formal private enforcement in emerging countries, instead focussing on the lack of enforcement in these countries as a reason to replace the judicial solution with the self-enforcing model. Therefore, their analysis does not provide us with a complete picture as there are other reasons that contribute to my proposal that the self-enforcing model should be adopted in Libya. These reasons, explored in this chapter, are: (1) that the self-enforcing model contributes to companies being able raise capital from

investors, and (2), it also lowers the number of conflict of interest transactions and makes the company's transactions more efficient. Finally, (3) the self-enforcing model does away with the need for external monitoring and is thus an appropriate solution for addressing the majority-minority problem in Libya.

Chapter 5: The Challenges of Adopting the Self-Enforcing Model in Libya

Introduction

Having examined the self-enforcing model in the previous chapter as an alternative solution for resolving the minority-majority shareholders problem, which relies mainly on a voting mechanism to decrease the necessity of judicial oversight, this chapter examines the challenges that face the implementation of such a model in Libya.

This chapter is divided into three sections. Section (5.1) discusses the problem of the lack of effective disclosure and its effect on the application of the self-enforcing model in Libya. After providing a brief description of the legal disclosure system in Libya (5.1.1), this section argues that minority shareholders are likely to be provided with insufficient information by the company, which may prevent them from being able to recognize when a conflict of interest transaction has been made by the controlling shareholders. This is due to the lack of an effective disclosure system in Libya, which results primarily from incomplete mandatory requirements of disclosure and the lack of their enforcement (5.1.2). Accordingly, there needs to be a solution that goes beyond the reform of company law and depends on the minority shareholders being represented on the board of directors to ensure the majority shareholders can access the company's information (5.1.3).

Section (5.2) examines the possibility of negative actions by the minority shareholders against the conflict of interest transaction by the controlling shareholders. To do so, (5.2.1) discusses the problems of abuse of rights by the minority shareholders and passive minority shareholders. (5.2.2) proposes effective mechanisms to solve such problems, such as enhancing the role of a financial expert or independent auditor and employing independent directors to review a conflict of interest transaction.

Section (5.3) discusses the costs resulting from the reliance on a voting system adopted under the self-enforcing model. To that end, (5.3.1) outlines the potential costs that result from adopting the self-enforcing model, such as administrative costs like those associated with calling the meeting of the minority shareholders to vote on the conflict of interest transaction. In order to ensure the adoption of the model is attractive, these costs must be as low as possible and this concept will be analysed in (5.3.2).

The practical challenge the study will discuss in (5.4) concerns how the model of self-enforcement can work without effective enforcement. In other words, how it will be ensured that the controlling shareholders are compelled to obey the rules of the model in an environment where there is an absence of adequate enforcement.

Finally, the last section in this study discusses the potential political risk that the model may face. It is difficult to anticipate whether the Libyan state will wish to adopt such measures and reforms voluntarily because the state owns most assets in Libya as a controlling shareholder. I will explore the nature of this political challenge in (5.5.1) and then analyse the appropriate responses to such issues in (5.5.2).

5.1. The ineffective disclosure system in Libya

This section initially discusses how the weakness of the disclosure system in Libya is an obstacle to the application of the self-enforcing model (5.1.2) and then attempts to find an appropriate solution for this problem (5.1.3). In order to give some context, there is a need to provide a brief description of the legal disclosure system in Libya examined in this section (5.1.1).

5.1.1. The legal disclosure system in Libya: brief legal overview

The minority shareholders can recognize the controlling shareholders’ conflict of interest transaction through either direct disclosure by the controlling shareholders or through the management of the company. While, as discussed in Ch.3, Libyan law, like UK law, does

not recognize the former type of disclosure (since controlling shareholders are not subject to disclosure obligations for either public or private companies), the law does require the board of directors to disclose certain information to the shareholders, including the minority shareholders.

Specifically, the Libyan legal framework identifies three types of laws that relate to disclosure. Firstly, LEAA 2010 requires company directors (private and public) to prepare a balance sheet and profit and loss account at least once a year, and also requires them to prepare a report detailing the company's performance.[1] All these reports must be available to the shareholders at least 15 days before the general meeting at which the reports are to be attested.[2] Here it should be noted that Libyan companies are not required by LEAA 2010 to provide the information included in the annual reports to the public (e.g. potential investors) although the latter may be provided with such reports if the company decides to disclose them (voluntary disclosure). Further, Libyan companies are required to keep certain records, which are a register of members, a register of bondholders, a minute book of members' meetings, a minute book of director's meeting, a minute book of statutory auditor's meetings, a minute book of executive committee's meetings and a minute book of bondholders' meetings.[3] However, the members of the company can only review the register of members and a minute book of members' meetings.[4] Additionally, LEAA 2010 requires the board of directors to submit an annual report to shareholders at least 7 days prior to the general meeting. All data and details on amounts received by the board of directors must be included in this report, including their salaries, bonuses, or shares of

[1] LEAA 2010, art 226 (1)-(2).
[2] LEAA 2010, art 154 (1).
[3] LEAA 2010, art 223.
[4] LEAA 2010, art 224 (1).

profits of the company, as well as all benefits or advantages taken during the past financial year, such as housing, cars, and so on.[5]

Secondly, the Libyan Stock Market Act 2010 (LSMA 2010) lays down certain additional disclosure requirements for public companies to ensure a high quality of disclosure and transparency in listed companies in the stock market in Libya. Under art.23 of LSMA 2010:

> All companies listed on the Libyan Stock Market must submit reports quarterly, half-annually and annually including information on the overall activity and financial data that disclose the financial position; they must also publish a summary of these reports in two newspapers, at least one of them in the Arabic language. Also, all companies must prepare balance sheets and financial statements in accordance with the accounting and auditing standards prescribed by the regulations of this Law.

Moreover, the Capital Market Authority[6] and the Stock Market management can require that listed companies clarify any information that encourages investors to invest in these companies.[7] Further, all listed companies must disclose immediately to the Stock Market 'any unforeseen circumstances affecting their activities or financial positions; in some necessary cases this information must be published in a daily newspaper. If the company does not respond, the stock market will publish the information about the emergency circumstances in the appropriate media, at the expense of that company'.[8] It is worth mentioning that as the Libyan legislator was late in issuing a law regulating the Stock Market [9] and its executive regulation (*Laeha*) has not been issued yet, some of its rules are still not applicable.

The third type of laws that regulate disclosure belong to the Corporate Governance Code (CGC), issued in 2007. The rules of this manual are neither mandatory nor legally

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[5] LEAA 2010, art 183. For more information see (1.1.3.2).
[6] For information regarding the Capital Market Authority, see (4.1.2.3).
[7] LSMA 2010, art 39 (1).
[8] LSMA 2010, art 78.
[9] The first law regulating the LSM was issued in 2010.

binding; rather, they promote and regulate responsible and transparent behaviour in managing corporations according to international best practice[10] for joint-stock companies listed on the LSM.[11] However, provisions that regulate disclosure by the board of directors' are mandatory.[12] With respect to disclosure and transparency, the code requires that at the same time as the annual financial reports are issued, the following is also disclosed:[13]

A. What has been applied from the corporate governance Code?

B. What has not applied and the reasons behind that?[14]

C. The names of any other companies where any of the Board of Director members is a member on its board.

D. Full disclosure of the name of the chairman and other directors.

E. Brief description of the responsibility of the sub-committees in the company as well as the names of the members, the name of the chairman and the time of meetings during the year.

F. Listings of all remunerations and bonuses to the chairman and other members as well as the top management and watchdog committee.

G. Any commercial disputes, penalty, fines or obstruction suffered by the company.

H. The annual review of results of evaluation of the procedures' efficiency of internal audit.

5.1.2. The problem of the weak disclosure system in Libya and its effect on the proposed self-enforcing model

Generally, the gathering of information is a challenging task for minority shareholders. There are information asymmetries between the management and the shareholders, thus directors are aware of the frequency of misconduct and amount of harm caused by them, whereas shareholders are not. The directors and the controlling shareholders are able to

[10] CGC 2007, art 2 (b).
[11] CGC 2007, art 2(a).
[12] CGC 2007, art 2(c).
[13] CGC 2007, art 9.
[14] This is similar to the provision adopted in the UK under the "comply or explain principle" where 'compliance with the codes is not mandatory, but that disclosure relating to compliance is'. The most important consideration behind this principle is flexibility as it is not possible to adopt a "one size fits all". For more information see Iain MacNeil and Xiao Li, '"Comply or Explain": Market Discipline and non-Compliance with the Combined Code' (2006) 14 Corporate Governance: An International Review 486, 486ff.

supress the information that reveals their liability. [15] However, to overcome this, as discussed later, in Libya as in the UK, there are limited rights granted to the shareholders to inspect company documents. These include, for example, the statutory registers, the minute books, and directors' service agreements.[16]

The self-enforcing model essentially relies on disclosure by the controlling shareholders or, at least, on disclosure by the members of the board (who in most cases represent the controlling shareholders). Without effective disclosure the minority shareholders are not able to recognize a conflict of interest transaction undertaken by controlling shareholders and, as a result, the main disclosure benefits of deterrence and a decrease of fraud, misappropriation by insiders and promotion of fairness to non-insiders[17] cannot be achieved. In other words, in the absence of adequate disclosure rules or the lack of its enforcement, the controlling shareholders and their representatives (members of the board) are free to choose how much to disclose, minimize particular disclosures or not disclose at all. Accordingly, minority shareholders may not be able to verify conflict of interest transactions and face a high burden of proof to prove the abuse of the conflict of interest transaction. The relationship between the lack of disclosure and the effectiveness of the self-enforcing model is apparent in the case of Russia. Here, Cunningham Jr argues that the self-enforcing model has not succeeded because the rules of disclosure that frame the model have failed:[18] 'Russian managers simply have worked harder to conceal their self-interested transactions, instead of disclosing them'.[19]

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[15] Robert A. G. Monks and Nell Minow, *Corporate Governance* (4th edn, John Wiley & sons, Ltd 2008) 184.
[16] See for example, CA 2006 ss 227–230 (service contracts); ss 116 and 118 (register of members); s 358, (Inspection of records of resolutions and meetings); s 877 (Instruments creating charges and register of charges to be available for inspection).
[17] See George J Benston, 'Public (US) Compared to Private (UK) Regulation of Corporate Financial Disclosure' (1976) 51 Accounting Review 483. See also, John McMillan and Christopher Woodruff, 'Private Order Under Dysfunctional Public Order' (2000) 98 Michigan Law Review 2421, 2427
[18] Richard P Cunningham Jr, 'Corporate Governance and Foreign Investment Nightmares in Russia: A Case Study of Unified Energy Systems' (2001) 42 Virginia Journal of International Law 889, 905.
[19] ibid.

In Libya this problem is further complicated by two main factors:[20] incomplete law in terms of disclosure (5.1.2.1) and the lack of enforcement of mandatory disclosure rules (5.1.2.2).[21]

5.1.2.1. Incomplete disclosure laws in Libya

It has been argued that when the law governing corporate disclosure is not complete, companies are unlikely to provide high quality information voluntarily.[22] This is the case in most developing countries that do not have an adequate system of disclosure,[23] and Libya is no exception. The transparency of corporate disclosure made by Libyan companies has always been an issue. As discussed, Libyan companies are only required to disclose their balance sheet, profit and loss account, and a report detailing the company's performance (which is not made public). Further, the shareholders are only allowed to review the register of members and a minute book of members' meetings. Additionally, art

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[20] There are many other factors that affect the quality of overall disclosure in Libya (the discussion of which falls outside the scope of this study). Examples of those factors relate to (1) competitive weakness between companies; (2) the cost of disclosures; (3) ownership structure; (4) size of the companies; (5) the politico-cultural environment; (6) the absence of an effective stock market; (7) stage of economic development; (8) colonial background; (9) education level; (10) technological development; (11) inflation; (12) corporate governance practice. Generally and theoretically see Jeffrey J Archambault and Marie E Archambault, 'A Multinational Test of Determinants of Corporate Disclosure' (2003) 38 The International Journal of Accounting 173. In the case of Libya see, Fathi Naser Bribesh, 'The Quality of Corporate Annual Reports: Evidence from Libya' (Ph. D, University of Glamorgan 2006).

[21] It seems that the main factor that undermines a disclosure system in Libya is the structure of corporate ownership. Most Libyan companies are either fully or partially state-owned companies. In such an economy, the state as a controlling shareholder is not interested in disclosing information as maximising their market value is not considered to be the companies' main objective. See for example, Adel Mashat, 'Corporate Social Responsibility Disclosure and Accountability (The Case of Libya)' (Ph.D Thesis, Manchester Metropolitan University 2005).

[22] See Rozaini Mohd Haniffa and Terry E Cooke, 'Culture, Corporate Governance and Disclosure in Malaysian Corporations' (2002) 38 Abacus 317.

[23] For example in Egypt, see Jennifer Bremer and Nabil Elias, 'Corporate Governance in Developing Economies? The case of Egypt' (2007) 3 International Journal of Business Governance and Ethics 430; (in Nigeria) RSO Wallace, 'Corporate Financial Reporting in Nigeria' (1988) 18 Accounting and Business Research 352; (In Tanzania) Abdiel G Abayo, Carol A Adams and Clare B Roberts, 'Measuring the Quality of Corporate Disclosure in Less Developed Countries: The Case of Tanzania' (1993) 2 Journal of International Accounting, Auditing and Taxation 145; (in Ghana) Mathew Tsamenyi, Elsie Enninful-Adu and Joseph Onumah, 'Disclosure and Corporate Governance in Developing Countries: Evidence From Ghana' (2007) 22 Managerial Auditing Journal 319; (in Zimbabwe) Zororo Muranda, 'Financial distress and corporate Governance in Zimbabwean banks' (2006) 6 Corporate governance 643; (in Saudi Arabia) Khalid Alsaeed, 'The Association between Firm-Specific Characteristics and Disclosure: the Case of Saudi Arabia' (2006) 21 Managerial Auditing Journal 476; (in Bangladesh) M Akhtaruddin, 'Corporate Mandatory Disclosure Practices in Bangladesh' (2005) 40 The International Journal of Accounting 399; (in Bahrain) Prem Lal Joshi and Sayel Ramadhan, 'The Adoption of International Accounting Standards by Small and Closely Held Companies: Evidence from Bahrain' (2002) 37 The International Journal of Accounting 429.

181 of LEAA 2010 prohibits any director of the board and his relatives, agents, or representatives (including the controlling shareholders) from becoming involved in any conflict with the company. If this happens, the director must inform the board at a meeting or a watchdog committee. He must also avoid becoming involved in any negotiation relating to the transaction or he will be responsible for any losses that result.

Therefore, Libyan Law fails to provide adequate disclosure that enables the minority shareholders to know about any conflict of interest transactions made by the controlling shareholders. In other words, the current requirements of disclosure do not oblige either the controlling shareholders or the directors of the board (who represent the controlling shareholders) to disclose any conflict of interest transactions made by the controlling shareholders.[24]

Academic studies in recent years support the view that Libyan companies are guilty of a lack of transparent disclosure because of incomplete law.[25] For example, Faraj Hamoda argues that Libyan laws relating to disclosure are still ineffective and do not follow the historical source of French Law. Also, he argues that the incompleteness of law in Libya is evident in terms of transparency and disclosure.[26] Ellabbar concludes that the information published by Libyan companies is insufficient and this is due to a lack of mandatory requirements. Thus the level of accounting disclosure of Libyan companies is low and this affects negatively on the ability of users of the reports to make precise and timely evaluations.[27] In the same context, Larbsh reveals that all of the interviewees in his

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[24] It should be noted that Libyan Law not only does not offer adequate disclosure in relation to a conflict of interest transaction, but also it does not cover other important aspects of disclosure that contribute to encouraging investors, such as ownership structure, key executives and their remuneration and a Cash Flow Statement.

[25] Most of these studies are PhD studies available at < http://ethos.bl.uk/Home.do>

[26] See Faraj Hamoda, 'Transparency in the Company Act' (2014) 3 Journal of Legal Sciences 65 (in Arabic).

[27] Khaled Ellabbar, 'Capital Market and Accounting Disclosure in Emerging Economies: the case of Libya' (PhD, University of Salford 2007). One of Ellabbar's interviewees (Prof. Altarhoune who obtained a PhD in Law from the UK 30 years ago and is currently a lecture at Benghazi University) remarked that 'there is minimal disclosure required by the Libyan Commercial Code… but that the Libyan companies are not even

study support the view that there is a lack of an adequate disclosure and transparency system in Libya. [28] Recently, Magrus in 2012 supported the view that there are too few areas that are subject to mandatory disclosure in Libya. One of his interviewees, who was a board member in Wahda Bank, believed that:

> The disclosure of all banks does not go beyond the income and financial position sheets. I would hardly call this disclosure. Additionally, there is even deficiency in preparing those sheets. Last year's financial statements are yet to be provided. As for transparency, it is almost completely missing. Thus, there is no disclosure other than to official supervisory bodies.[29]

Elmogla[30] and Mashat[31] found that low levels of disclosure in Libyan annual reports existed because of the absence of mandatory (i.e. statutory) disclosure requirements, coupled with a weak accounting profession and education in Libya. Additionally, Bribesh concludes that the low level of mandatory disclosure in Libya relates to the nature of different businesses. For example, service and construction companies scored the least, with the service companies sector reporting the lowest level of disclosure.[32]

5.1.2.2. The lack of mandatory disclosure enforcement in Libya

Ahmad and Nicholls argue that an inadequate regulatory framework and enforcement mechanism is one of the main reasons behind the low levels of accounting disclosure and accounting standards in developing countries.[33] Also, Haniffa and Cooke argue that when the legal system which governs information disclosure is not enforced, companies are

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complying with these requirements. There is no institute in power that enforces companies to apply these requirements'. Ibid 179.

[28] Mansor M Larbsh, 'An Evaluation of Corporate Governance Practice in Libya: Stakeholders' Perspectives' (PhD, Nottingham Business School, Nottingham Trent University 2010) 216.

[29] Abdelhamid Ali Ali Magrus, 'Corporate Governance Practices in Developing Countries: The Case of Libya' (Phd, Faculty of Business, Education and Professional Studies, University of Gloucestershire 2012) 147.

[30] Mahmoud Elmogla, Christopher J. Cowton and Yvonne Downs, 'Corporate Social Reporting in a Transition Economy: The Case of Libya' Financial Ethics and Governance Research Group The Business School University of Huddersfield <http://eprints.hud.ac.uk/11933/> accessed 13/8/2012.

[31] John D Pratten and Adel Abdulhamid Mashat, 'Corporate Social Disclosure in Libya' (2009) 5 Social Responsibility Journal 311.

[32] Bribesh (n 20) 225.

[33] K Ahmad and D Nicholls, 'The Impact of non-Financial Company Characteristics on Mandatory Disclosure Compliance in Developing Countries: the case of Bangladesh.' (1994) 29 The International Journal of Accounting 62.

unlikely to disseminate high-quality information.[34] In the case of Libya, although there are mandatory disclosure requirements (which require very little information), the level of disclosure is low due to weak standards of enforcement. Kribat found that 'Libyan banks failed to comply fully with mandatory disclosure requirements in any of the sample years (2000-2006) […] in terms of overall levels (i.e. mandatory plus voluntary) of financial disclosure in Libyan banks' annual reports, the figures were low'. [35] Also, he observed that noncompliance with mandatory disclosure reflects 'the absence of a developed regulatory framework, the lack of an enforcement mechanism to monitor the implementation of these requirements and/or the absence of formal penalties for not fully complying'. [36] Further, Ellabbar and Havard showed that Libya has a lower level of disclosure compared to Egyptian companies. They suggest that to help Libyan companies to disclose more effectively, there is a need to establish domestic standards or comply with international accounting standards. [37] Further, Mashat argues that the main reasons for not disseminating the social responsibility information in Libyan companies are down to the lack of legal requirements and administrative difficulties.[38]

Therefore, as the self-enforcing model mainly relies on an adequate disclosure system, if it is to work effectively there is a need to find a solution that is consistent with the model and accommodates the absence of adequate mandatory disclosure requirements and the lack of enforcement in Libya.

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[34] Haniffa and Cooke (n 22) 317.
[35] Musa M.J Kribat, 'Financial Disclosure Practices in Developing Countries: Evidence from the Libyan Banking Sector' (PhD, The University of Dundee 2009) xvi. This study also suggests that 'the annual reports of Libyan banks are frequently used for making financial decisions and are in fact considered to be the most important source of information for making economic and financial decisions about such firms'. See ibid 334.
[36] Ibid.
[37] Khaled Ellabbar and Tim Havard, 'The Accounting Disclosure in Developing Countries: A Comparative Study of Libyan & Egyptian Construction Companies' (Association of Researchers in Construction Management:; ARCOM twenty-first annual conference, 2005).
[38] Mashat (n 21).

5.1.3. The proposed solution for the disclosure problem in Libya

The development of an effective disclosure system in Libya goes beyond the reform of company law. This is because even reforming the legal disclosure system in Libya will not address the weak system of disclosure effectively because the poor enforcement of law remains an obstacle to the application of any new laws, as discussed particularly in (5.1.2.2) and generally in Ch.3. In this situation, the self-enforcing model will not work efficiently as minority shareholders will be unable to access information concerning conflict of interest transactions. This is because in an environment with a lack of disclosure enforcement, many companies are not willing, and to some extent not obliged, to disclose the conflict of interests transactions made by the controlling shareholders.

Therefore, there is a need, as Alajlan argues, to develop the capability of the minority shareholders to access companies' information away from the disclosure system itself, especially as the regulation of Arab markets (such as Libya) is generally poor and their legal rules that address disclosure and insider trading are not thoroughly enforced. [39] Here I discuss some possible solutions that may contribute to addressing the inability of the minority shareholders to access key information.

Firstly, as Black and Kraakman suggest, large minority shareholders should be placed on the board and this must be done by cumulative voting (which should be a mandatory rule). This can provide the minority shareholders with access to the company's information and gives large minority shareholders 'a substitute for the disclosure that is provided in developed economies'.[40] Also, they argue that 'cumulative voting makes it

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[39] Waleed Alajlan, 'Ownership Patterns and the Saudi Market' in Mark Hirschey, Kose John and Anil K. Makhija (eds), *Corporate Governance: Advances in Financial Economics*, vol 9 (Emerald Group Publishing Limited 2004)161 – 186.

[40] Bernard Black and Reinier Kraakman, 'A SELF-ENFORCING MODEL OF CORPORATE LAW' (1996) 109 Harvard Law Review 1911,1947 and see also p. 1952.

more likely that a minority of directors is truly independent of management and [...] that these directors will owe affirmative loyalty to the shareholders who elect them'.[41]

Secondly, sometimes the cumulative voting mechanism is ineffective because it only increases the minority shareholders' chances for obtaining representation in the board of directors, but it does not guarantee the result. For example, in cases where controlling shareholders own a high percentage of shares, the likelihood of obtaining representation on the board of directors is low. If, for example, the controlling shareholders own 90% of the company shares and there are only 3 seats on the board, the minority shareholders will have no opportunity to gain a seat even with the cumulative voting mechanism. Accordingly, it is better to look for another solution that guarantees the minority shareholders' a seat on the board, thereby enabling them to access the company's information. I propose that the largest minority shareholder who owns most of minority shares should be allowed to take a seat on the board, but his shares must not be less than 5% of the company's shares. For example, a company has a controlling shareholder (A) who owns 85% of the shares and minority shareholders, (B) who owns 6% of the shares, (C) owns 5% and other shareholders own small fractions of less than 1%.[42] (B) should receive a position on the board as he owns the largest portion of minority shares. I propose only one minority shareholder should take this position since it is not desirable for the board of directors to be made up of large numbers of directors and one is enough to help to access the company's information. In this regard, many studies have identified a negative relationship between the number of directors on a firm's board and the firm's financial performance and that those large boards can be less effective than small boards.[43] It is the

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[41] ibid 1947.

[42] This example is based on the assumption that the one share, one vote principle is a mandatory rule, as discussed in (4.3.2.1).

[43] See e.g. Martin Lipton and Jay W Lorsch, 'A Modest Proposal for Improved Corporate Covernance' (1992) 48 The Business Lawyer 59; Michael C Jensen, 'The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems' (1993) 48 The Journal of Finance 831; David Yermack, 'Higher Market Valuation of Companies With a Small Board of Directors' (1996) 40 Journal of Financial Economics 185;

quality rather than the quantity of directors that is important. Additionally, having one director representing the minority shareholders will ensure the majority shareholders' right to control the company.

Finally, though there is no evidence concerning the correlation between independent directors and corporate performance,[44] there is no doubt that requiring companies to hire independent directors can generally mitigate agency problems between majority shareholder and minority shareholders[45] and particularly address the weakness of the disclosure system. Here it should be noted that even though there is only a small amount of literature regarding the possible interaction between corporate disclosure and independent directors, all of them support the positive relationship between disclosure and independent directors.[46] For example, Forker argues that independent directors have more incentive to disclose more information.[47] Chen and Jaggi found that, in the case of Hong Kong, the total number of independent directors on corporate boards is positively

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Theodore Eisenberg, Stefan Sundgren and Martin T Wells, 'Larger Board Size and Decreasing Firm Value in Small Firms' (1998) 48 Journal of Financial Economics 35; Benjamin E Hermalin and Michael S Weisbach, 'Boards of Directors as an Endogenously Determined Institution: A survey of the economic literature' in Diance K. Denis and John J. McConnell (eds), *Governance: An International Perspective*, vol 1 (Edward Elgar Publishing Limited 2005) 42.

[44] See Benjamin E Hermalin and Michael S Weisbach, 'The Effects of Board Composition and Direct Incentives on Firm Performance' (1991) 20 Financial management 101; Hamid Mehran, 'Executive Compensation Structure, Ownership, and Firm Performance' (1995) 38 Journal of Financial Economics 163; April Klein, 'Firm Performance and Board Committee Structure 1' (1998) 41 The Journal of Law and Economics 275; Sanjai Bhagat and Bernard Black, 'Board Independence and Long-Term Firm Performance' University of Colorado, 2000 <http://leeds-faculty.colorado.edu/bhagat/bb-022300.pdf> accessed 18-06-2014; Sanjai Bhagat and Bernard S Black, 'The Non-Correlation between Board Independence and Long-Term Firm Performance' (2002) 27 Journal of Corporation Law 231, Victor Dulewicz and Peter Herbert, 'Does the Composition and Practice of Boards of Directors Bear any Relationship to the Performance of their Companies?' (2004) 12 Corporate Governance: An International Review 263; Hermalin and Weisbach, 'Boards of Directors as an Endogenously Determined Institution: A survey of the economic literature' 'Boards of Directors as an Endogenously Determined Institution' (n 43).

[45] See for example, James A Brickley and Christopher M James, 'The Takeover Market, Corporate Board Composition, and Ownership Structure: The case of banking' (1987) 30 Journal of Law and Economics 161; Michael S Weisbach, 'Outside Directors and CEO Turnover' (1988) 20 Journal of financial Economics 431; Rita D Kosnik, 'Effects of Board demography and Directors' Incentives on Corporate Greenmail Decisions' (1990) 33 Academy of Management Journal 129; Chun I Lee and others, 'Board Composition and Shareholder Wealth: The case of management buyouts' (1992) 21 Financial Management 58; Niclas L Erhardt, James D Werbel and Charles B Shrader, 'Board of Director Diversity and Firm Financial Performance' (2003) 11 Corporate Governance: An International Review 102.

[46] See Lorenzo Patelli and Annalisa Prencipe, 'The Relationship between Voluntary Disclosure and Independent Directors in the Presence of a Dominant Shareholder' (2007) 16 European Accounting Review 5, 6.

[47] John J Forker, 'Corporate Governance and Disclosure Quality' (1992) 22 Accounting and Business Research 111.

associated with the comprehensiveness of financial disclosures.[48] Also, Patelli and Prencipe found a positive relationship between independent directors and disclosure.[49] Additionally, Kaplan and Reishus argue that independent directors have incentives to defend or build their reputation as expert monitors.[50] Finally, Beasley argues that the existence of independent directors in the company reduces occurrences of financial statement fraud.[51] Therefore, the presence of independent directors on the board will help to solve the weak disclosure problem in Libya as they enhance the disclosure in the company.

5.2. Possibility of negative minority shareholders' actions against the conflict of interest transaction by the controlling shareholders under the self-enforcing model

This section discusses the possibility of negative actions by the minority shareholders, such as abuse of rights by the minority shareholders and passive minority shareholders, against the conflict of interest transaction by the controlling shareholders (5.2.1) and then proposes effective mechanisms for solving such problems (5.2.2).

5.2.1. The potential problems: abuse of rights by the minority shareholders and passive minority shareholders

In approving or vetoing a potential conflict of interest transaction, there are two negative actions that the minority shareholders might take. First, under the self-enforcing model, the minority shareholders are given a great deal of power to approve conflict of interest transactions made by the controlling shareholders and, therefore, are in a similar position to the controlling shareholders. Consequently, there is a risk that the minority shareholders

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[48] Charles JP Chen and Bikki Jaggi, 'Association between Independent non-Executive Directors, Family Control and Financial Disclosures in Hong Kong' (2001) 19 Journal of Accounting and Public Policy 285.
[49] Patelli and Prencipe (n 46).
[50] Steven N Kaplan and David Reishus, 'Outside Directorships and Corporate Performance' (1990) 27 Journal of Financial Economics 389.
[51] Mark S Beasley, 'An Empirical Analysis of the Relation Between the Board of Director Composition and Financial Statement Fraud' (1996) 71 Accounting Review 443.

may abuse their rights, which can be done by blackmailing controlling shareholders and asking them for favours or contracts to secure their votes in favour of the transactions. Thus, placing the decision making capabilities in the hands of the minority might preclude efficient transactions in certain situations, which could potentially cause hardship and disrupt business transactions.[52]

At the other extreme, there might be passive minority shareholders who do not care whether the majority shareholders extract a private benefit at their expense or not. In other words, a shareholder who is supposed to use his power to approve the conflict of interest transactions made by the controlling shareholders may have poor incentives to maximize the company's wealth. This is because minority shareholders frequently do not work at the company, are not involved in management, have a small share in the venture and bear a small risk of loss. This is especially applicable to minority shareholders whose fraction of shares constitutes less than 5% of the company. Thus, they are the most vulnerable to abuse by the majority shareholders as they have very little incentive to consider the effect of the action on other shareholders.

Here we should note that minority shareholder passivity is not inevitable. Instead, as suggested by Thamm, activity in corporate governance by the minority shareholders has recently increased since it leads to a significant positive increase in shareholder value.[53] Here there is a distinction to be made between two types of minority shareholders: portfolio investors, who may have incentives to monitor across their entire holdings, and shareholders who do not have such incentives. Generally, minority shareholders, including institutional investors, have a limited role in corporate governance. Nevertheless, such a

[52] Mohamed Tibar, *The Theory of Shareholders' Rights in Joint Stock Companies*, vol 2 (Arab Union Madbaha 1998) 826 (in Arabic). Tibar calls the minority shareholders who have sufficient votes to block conflict of interest transactions: 'blocking minority shareholders'. (See ibid). See also, Zohar Goshen, 'Controlling Strategic Voting: Property Rule or Liability Rule' (1996) 70 Southern California Law Review 741.

[53] See Christian Thamm, *Minority Shareholder Monitoring and German Corporate Governance: Empirical Evidence and Value Effects* (PL Academic Research 2013). Thamm concludes that the increase in the activity of minority shareholders is the case in Germany. See ibid.

role can be active in some circumstances,[54] and legal intervention may play a core role in inducing institutional investor activism, as concluded by Hamdani and Yafeh.[55] In the UK, under the Stewardship Code, institutional investors are required to monitor their investee companies[56] and, as discussed in Ch.4, in a UK premium listed company where a controlling shareholder is present the minority shareholders are required to approve the resolution of electing those directors separately from the shareholder vote.[57] Also, a proxy voting process, when it is in place, may be used by the institutional investors in order to monitor the company.[58] Thus, mechanisms are now employed to mitigate investor passivity.

5.2.2. The proposed solutions to mitigate the problems of abuse of rights by the minority shareholders and passive minority shareholders

The self-enforcing model provides the minority shareholders with power to block conflict of interest transactions that are sometimes in the best interest of both the company and all the shareholders, including the minority shareholders. Accordingly, there is a need to adopt certain checks and balances to protect controlling shareholders against the minority shareholders' abusing their power. In other words, LEAA 2010 should adopt particular measures to strike a balance between the minority shareholders protection (Agent) against the controlling shareholders (Principal) and providing safeguards for the controlling

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[54] It is worth mentioning that most literature regarding institutional investor activism covers the relationship between the management and shareholders as a whole. In other words, the activism of institutional minority shareholders has been discussed in terms of a dispersed ownership system, rather than a concentrated system. See for example, Edward B Rock, 'Logic and (Uncertain) Significance of Institutional Shareholder Activism' (1990) 79 Georgetown Law Journal 445; KJ Martijn Cremers and Roberta Romano, 'Institutional Investors and Proxy Voting on Compensation Plans: The Impact of the 2003 Mutual Fund Voting Disclosure Rule' (2011) 13 American Law and Economics Review 220.
[55] Assaf Hamdani and Yishay Yafeh, 'Institutional Investors as Minority Shareholders' (2012) Review of Finance 1.
[56] Stewardship Code 2012, Principle 3.
[57] See (4.4.1.2).
[58] Cremers and Romano(n 54). For more details about institutional investors activity see e.g. Rock; Roberta Romano, 'Public Pension Fund Activism in Corporate Governance Reconsidered' (1993) 93 Columbia Law Review 795.

shareholders against the minority shareholders to not use their rights improperly (e.g. for their interest only).[59]

Indeed LEAA 2010 adopts the doctrine of no abuse of rights, which is applicable to both the controlling shareholders and the minority shareholders. Under this doctrine, when the minority shareholder uses his right to block a conflict of interest transaction improperly (e.g. to blackmail the controlling shareholders to get personal benefits), the controlling shareholder has a right to sue the minority shareholders on the basis of the no abuse of rights doctrine.[60] However, such a mechanism cannot protect the controlling shareholders against the minority shareholders (or the minority shareholders against the controlling shareholders) effectively because of the general lack of court enforcement in Libya, as argued in Ch.3.

Therefore, there is a need to rely on another solution to deal with the potential abuse of power by the minority shareholders that does not require court enforcement and serves the self-enforcing model. Enhancing the role of a financial expert or independent auditor and employing independent directors to review a conflict of interest transaction can be effective mechanisms to mitigate the abuse of rights by minority shareholders. In other words, minority shareholders should be asked to rely on independent reports made by independent board members, independent experts, or an independent auditor, rather than their own opinion, to block the conflict of interest transaction.

Currently, independent board members, independent experts, and independent auditors have no statutory responsibilities to review a controlling shareholder's conflict of interest transaction in Libya. With regard to independent board members, there is no

[59] It should be noted that in ordinary situations when the controlling shareholders enter into a conflict of interest transaction, the agent is the controlling shareholder and the principal is the minority shareholder. However, this situation is reversed when the minority shareholders have the power to block such transactions. Here the minority shareholders become an agent and the controlling shareholders become a principal.
[60] For information about the abuse of rights doctrine, see (3.1.2.2).

special statutory role for independent directors on Libyan boards, and no requirement under the Libyan system to have independent directors.[61] By contrast, the voluntary Corporate Governance Code does contain a recommendation that boards of public companies ensure that at least one third of their members are independent, and that boards in any company should include at least two independent directors.[62] However, no statute in Libyan law empowers independent directors to deal with conflict of interest transactions. With regard to external auditors or external experts, similarly under Libyan law, they have no statutory responsibilities to review conflict of interest transactions, although they are responsible for reviewing company accounts including their compliance with accounting standards on related party transactions.[63]

With neither independent auditors nor external auditors (or external experts) playing a statutory role in reviewing or making recommendations on conflict of interest transactions, there is a strong need, under the proposed self-enforcing model, to put such transactions under the review of externals as they can offer neutral opinions or recommendations regarding whether the transaction is in the company's interest. Also, hiring independent directors can provide a neutral opinion to such conflicts. Thus these mechanisms can reduce the ability of minority shareholders to abuse their right to block a conflict of interest transaction, since they are required by law to rely on an external reviewer or independent directors to block such transactions.

However, the previous solution (the neutral perspectives of independent auditors, external auditors, and external experts) may not prevent the controlling shareholders from

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[61] This is similar to the French case. See OECD, *Related Party Transactions and Minority Shareholder Rights* (OECD Publishing 2012) 64.
[62] LCGC 2007, art 12 (D).
[63] See LEAA 2010 art 209. One of these standards is known IAS 24 Related Party Disclosures. The aim of this Standard is 'to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties'. For more details see IFRS, *IAS 24 Related Party Disclosures* (IFRS 2012) available at <http://www.ifrs.org/Documents/IAS24.pdf>

bringing an action against the large minority shareholders when the controlling shareholders claim that the minority shareholders have abused their rights, as the right to sue is considered a constitutional right that cannot be prohibited or precluded. This may occur, for example, when the minority shareholders block the potential conflict of interest transaction made by the controlling shareholders, and the latter may not wish to give up their interest especially if they can obtain a great deal of personal interest through such a transaction. Here it is very likely that the controlling shareholders will attempt to sue the large minority shareholders in order to get an approval for this transaction, claiming that the transaction is in interest of the company. Here the picture is completely changed. In this particular context, the minority shareholders may be characterised as agents who are expected to act in the principal's (i.e., the controlling shareholder's) best interests. That situation is different from when the controlling shareholders abuse the minority shareholders. The latter problem is addressed by the self-enforcing model as the model relies on direct participation by the minority shareholders to enforce shareholder protection in the corporate enterprise, rather than reverting to indirect participants such as judges, regulators, legal and accounting professionals, and the financial press, as discussed in detail in Ch.4.

Therefore, there is a fundamental problem that derives from the fact that the controlling shareholder may sue the minority shareholders in an environment in which, as has already been established, the Libyan courts are an ineffective enforcement body in respect of corporate law and governance matters. Accordingly, there is a need to establish how the Libyan courts might be capable of effectively dealing with conflict of interest transactions brought by the controlling shareholders in such an environment. However, more importantly, and more immediately, there is a need to find ways of discouraging litigation between shareholders and, instead, encouraging dispute settlement away from the court system.

Achieving this is central to the potential success of the self-enforcing model in Libya and in order to do so, Libyan law should impose some limitations and obstacles on the ability of controlling shareholders to bring actions against the minority shareholders (agents) in order to unblock the potential conflict of interest transaction. This will, in turn, reduce reliance on courts. As noted by Black and Kraakman, the self-enforcing model reduces the reliance on courts but does not eliminate the bringing of an action.[64] However, for the model to be effective in Libya there should be clear obstacles that prevent or discourage the controlling shareholders from bringing an action against the minority shareholders in order to encourage shareholders to settle disputes directly with each other. To do so, I propose borrowing the procedural steps that apply to bringing a derivative action under UK law.

In the UK, in order to strike a balance between protecting majority shareholders from multiple petty claims on one hand and providing protection for minority shareholders on the other,[65] the court, in terms of a derivative action, must be satisfied in order to give its permission to the plaintiff to continue his action. This necessitates achieving two procedural stages: first, the aggrieved shareholders must establish a *prima facie* case, supported by evidence, without which the court can dismiss the claim.[66] If the court is satisfied at this stage, it may direct the company to file evidence and may adjourn the proceedings to enable that evidence to be obtained.[67] In the second stage, after the shareholder claimant has established a *prima facie* case, the court opens the application for a hearing involving both parties. Here the court determines whether or not the permission should be given to the claim to proceed or it refuses permission and dismisses the claim.[68] Moreover, at this point, the court has the power to adjourn the proceedings and give

[64] Black and Kraakman (n 40) 1915.
[65] Brenda Hannigan, *Company Law* (3 ed, Oxford University Press 2012) 447.
[66] CA 2006, s 261 (2).
[67] CA 2006, s. 261(3).
[68] CA 2006, s 261(4).

directions for a general meeting to take place. This provision is designed for a situation where the court may not yet be in a position to evaluate whether to give permission to continue a derivative action, or not. [69]

The general concept of this approach should be adopted in Libya in order to discourage controlling shareholders from bringing unnecessary actions against the minority shareholders (or even actions in which the controlling shareholders seek to extract private benefits from the minority shareholders). Here Libyan company law should lay down two procedural stages: first, the aggrieved shareholders must establish a *prima facie* case that relies on acceptable evidence, without which the court can dismiss the claim. If such evidence is accepted by the court, it can give the controlling shareholders (in cases of minority shareholders abuse) or the minority shareholders (in cases of the controlling shareholders abuse) permission to proceed with the claim. However, if the court does not accept the evidence, it must dismiss the claim. The second stage comes when the shareholder claimant has established a *prima facie* case; here the court must open the application for a hearing involving both parties.

Further, to overcome the general ineffectiveness of courts in Libya, the model provides, whenever possible, a bright-line rule rather than standards, to define proper and improper behaviour. Such rules can be easily understood by those who must comply with them and so have a better chance of being enforced as discussed in (4.2.1). [70]

Regarding passive minority shareholders who prefer not to take action against any conflict of interest transactions undertaken by the controlling shareholders, the model provides powers only to large minority shareholders who own 5% of the company's shares to veto or approve the transaction. This percentage should be adequate to incentivise any

[69] Alan Steinfeld QC, Martin Mann QC and Richard Ritchie, *Blackstones Guide to the Companies Act 2006* (Oxford University Press 2007)14.24; Victor Joffe and others, *Minority Shareholders: Law, Practice, and Procedure* (4 edn, Oxford 2011) 49.
[70] See (4.2.1)

large shareholders and make them engage actively in the dealings of the company. Also, as large minority shareholders will be active in dealing with conflict of interest transactions due to the veto power provided under the model, minority shareholder activism will be ensured through law.

5.3. The costs resulting from the reliance on a voting system adopted under the self-enforcing model

There is no doubt that there will be certain costs that result from adopting the self-enforcing model since it mainly relies on a voting system (5.3.1). In order to ensure the adoption of the model is attractive, these costs must be as low as possible (5.3.2).

5.3.1. Costs resulting from the adoption of the self-enforcing model [71]

It may be argued that any resolution for solving any legal issue can result in increased costs. The self-enforcing model is no exception. Relying on a voting system and delegating the power to approve or veto the conflict of interest transaction to the minority shareholders may result in costs that are higher than those found in the judicial approach (Liability actions). Firstly, there will be administrative costs, such as those associated with calling the meeting of the minority shareholders to vote on the conflict of interest transaction (e.g. dispatching notices of an impending ballot and providing all the voting shareholders with background information on the transaction).[72] Secondly, after providing the minority shareholders with the necessary material and information regarding the transaction, there will be a need for the minority shareholders to study such information. Such a process can be expensive since the minority shareholders may need to rely on expert's opinion before they make a decision to approve or veto the conflict of interest

[71] These costs do not inevitability result from a conflict of interest transaction. Instead there are many cases where the minority will consider the proposed transaction to be fair and acceptable while in other cases negotiation will yield a settlement.

[72] Zohar Goshen, 'The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality' (2003) 91 California Law Review 393, 416.

transaction. [73] It should be noted that such costs increase when the frequency of the conflict of interest transaction are high, which can result in calling shareholders' meetings too often. [74]

5.3.2. Reducing the costs resulting from minority shareholders' power to vote

First of all, it should be noted that high administrative cost associated with calling general meetings is not an issue in Libya for two reasons: firstly, most joint stock companies in Libya are composed of a small amount of shareholders. Secondly, with regard to large companies, of which the state owns the majority, the cost of calling the minority shareholders' meeting in order to approve or veto a conflict of interest transaction will not be high since LEAA 2010 identifies newspapers and emails as appropriate tools for calling the shareholders' meetings. [75] LEAA 2010 adopts this mechanism to inform the shareholders since there is no effective postal system in Libya.

Regarding the costs that result from the need of the minority shareholders to study information, as noted in the previous section, they should rely on an independent reports made by externals before taking action against the conflict of interest transaction. While this mechanism can serve to reduce the ability of the minority shareholders to abuse their rights, it may also prove too expensive. The situation may lead large minority shareholders to not use their right to take action against the conflict of interest transactions undertaken by the controlling shareholders. Consequently, to deal with such an issue, the company itself should bear such expenses which, in aggregate, will not prove excessive since gaining an expert's opinion in Libya is not costly.

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[73] ibid.
[74] ibid.
[75] LEAA 2010, art 154 (1).

It should be noted that the costs that result from the need to assess information provided by companies is also an issue under the judicial approach, since judges may not have the requisite knowledge to assess the conflict of interest transaction. Since they lack experience when it comes to commercial and business decisions, [76] Libyan courts must call on professional experts to guide them. In Libya the Department of Judicial Experts forms part of the Justice Ministry. In this department there are a number of registered experts who are suitably qualified and experienced in business matters from whom the court may seek professional opinions regarding disputed matters. For instance, the court may hire an accountant to review the ability of a corporation to distribute dividends. Such expenses will be transferred to the loser of the case once it is resolved.

5.4. Is the model of self-enforcement workable under weak formal enforcement?

As discussed in Ch.4, Black and Kraakman's model provides strong procedural protections against conflict of interest transactions as well as numerous structural and procedural constraints to facilitate self-enforcement. As such, the self-enforcing model allocates as much enforcement power as possible to direct participants, such as minority shareholders, rather than to indirect participants, such as judges, regulators, lawyers and the press. Therefore, the model provides controlling shareholders with incentives to obey the rules as its provisions include features that demand enforcement through the actions of direct participants.

Here, at the end of this study, it may be wondered whether the self-enforcing rules can function in an environment of weak court enforcement. In other words, will the controlling shareholders comply with the rules of minority shareholders' approval and seek approval

[76] See e.g. I J Dawson and I S Stephenson, *The Protection of Minority shareholders* (Tolley Publishing Company Limited 1993) 28; Brian R Cheffins, *Company Law: Theory, Structure and Operation* (15 edn, Oxford University Press 1997) 543. Paul Davies, *Principles of Modern Company Law* (9th edn, Sweet & Maxwell 2012) 643.

from the minority shareholders before they enter into any conflict of interest transactions, or will they ignore the rules of the model as there is no real enforcement in the state?

To answer this question, we should make a clear distinction between two situations: a situation in which there is a complete lack of formal enforcement, and one where weak or ineffective court enforcement is in place. In the former situation, any legal rules including self-enforcing rules will not function at all since there is no enforcer, such as the courts, to enforce these legal rules. More than that, the legal rules in such a climate may not be called laws as one of the essential elements of law is enforcement. However, this is not the case in Libya since enforcement mechanisms exist, though they may be described as weak, ineffective or inadequate. Crucially, the self-enforcing model was designed for such an environment and so can still function effectively.

To demonstrate this: under the liability action approach currently adopted in Libya where a weak environment of formal enforcement is in place, the court must decide whether the conflict of interest transaction complies with the fairness test in the abuse of rights doctrine. Both the controlling shareholders and the minority shareholders know that enforcement mechanisms function poorly in Libya as enforcing institutions are corrupt and the machinery of justice is too slow and affected by political and social factors. Moreover, there is a lack of adequate experience and expertise in dealing with cases of minority shareholder protection, as well as a lack of appropriate laws that provide protection for the minority shareholders, as discussed in detail in Ch.3. The combination of these factors discourages the minority shareholders from bringing an action against the controlling shareholders and simultaneously encourages the controlling shareholders to abuse the minority shareholders by entering into a conflict of interest transaction, as it is high likely that the minority shareholders will not bring an action against them.

However, the picture under the self-enforcing model is completely changed in favour the minority shareholders. Under such a model, the controlling shareholders take into account the minority shareholder's power to veto any conflict of interest transaction. The controlling shareholders know in advance that if they approve the conflict of interest transactions (e.g. a self-dealing transaction) without large minority shareholders consent and then seek to implement it, the minority shareholders are easily able to block it. Also the controlling shareholders know that if they enter into such a transaction without the minority shareholders' approval, the latter will seek a remedy against them from the courts. The court will be quick to revoke the transaction as there is a formal defect in a transaction that is approved only by the controlling shareholders without the minority shareholders' consent. This situation creates a motivation for the controlling shareholders to obey the self-enforcing rules. However, it should be noted that when there is a stronger judiciary and more centralized enforcement institutions in place, controlling shareholders will have more incentives to obey the model's rules.[77] Accordingly, as the mechanisms of formal enforcement develop in Libya, so the effectiveness of the model will also increase.

5.5. Political Challenges

In the final section of this study, I discuss the potential political challenges that the model may face. To that end, firstly, I explore the nature of the political challenges that the proposed model may face (5.5.1) and then analyse the appropriate responses to such issues (5.5.2).

5.5.1. The Political issues facing the self-enforcing model

A major challenge that the self-enforcing proposal may face is the crucial issue of the political feasibility of the necessary programme of law reforms for implementing the

[77] Vlad Frants, 'Russian Corporate Law: Is Self-Enforcement Still the Way to Go?' (2008) 13 UCLA Journal of International Law and Foreign Affairs 435, 462. This article examines the political and economic conditions in Russia in order to determine which corporate governance model is appropriate for Russia. This study argues that under President Putin the self-enforcing model is successful and remains Russia's best solution for developing both strong securities markets and a favorable corporate culture.

desired institutional measures. It is difficult to anticipate the Libyan state's desire to adopt such measures and reforms voluntarily. This is because, as discussed in Ch.2, the Libyan state remains the predominant beneficial shareholder of the country's most significant corporate enterprises and it stands to benefit from the institutional status quo. The Libyan law provides controlling shareholders with unrestricted control over the company. This is due to the fact that the Libyan legal system generally, and the corporate legal system particularly, tends to protect the control of the state over the economy at the expense of other shareholders, as discussed in Ch.2. The existence of the state as a controlling shareholder in most large companies in Libya made the adoption of a "shareholder primacy" model of corporate governance relatively attractive. This is because it grants the state directly ownership and control of its companies. The application of the shareholder primacy model allows the state to pursue a socialist market objective by exercising controlling interests in most companies.[78] Accordingly, the state intentionally provides itself with strong power and it may not need to waive such power under any circumstances.

The other political challenge that faces the adoption of the self-enforcing model in Libya is the widespread nature of political corruption. Eempirical studies undertaken by Caron *et al.*, found that in countries with high levels of corruption, firms lack efficient corporate governance practices, including weak protection for minority shareholders.[79] Since Libya is characterised by high levels of corruption (according to the last annual report on the Corruption Perceptions Index (CPI) in 2014 issued by Transparency International, Libya ranked 166th among 174 countries in the word),[80] Libya's politicians and bureaucrats, as representatives of the state, may not work to adopt such a reform in either the legislative body or the executive body. Both officials of the government and

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[78] See (2.3.1.2)….
[79] Michelle I. Caron, Aysun Ficici and Christopher L. Richte, ' The Influence of Corruption on Corporate Governance Standards: Shared Characteristics of Rapidly Developing Economies' (2012) 2 Emerging market Journal 21.
[80] See Ch.3 (n 126).

members of the legislature may not be interested in adopting such a model as it will work against their interests if they, for example, gain direct benefit from the status quo (e.g. they can get some private benefits from these companies). For instance, the officials working for the Ministry of Economy will not propose any bill or undertake any studies in order to adopt such a model and, similarly, the members of Legislature are unlikely to pass such a model because they do not want to undermine the benefit they gain from the status quo. For example, the officials of the ministry of the economy or members of the legislature can employ their relatives in SOEs, use SOEs' assets in line of their personal interests, and get loans from such companies. In this context, it is found that when most controlling owners are politicians (or even state representatives) the interests of minority shareholders are less likely to be protected.[81] This is because political corruption may affect how laws are written.[82] Consequently, the ability to provide strong protection for the minority shareholders is ultimately a matter of political priorities. In other words, politicians, as representatives of the state, may perform their work in their own interest, rather than in the interest of the state or as loyal agents of the citizens. According to Oman, 'vested-interest groups that benefit from corporate control rents – at the expense of minority shareholders and other corporate stakeholders, both local and foreign, (…) are a major source of resistance to needed change'.[83]

5.5.2. The response to the political challenges

In response to the previous issues, there is a need to understand the current situation of the Libyan Legislature in Libya before engaging in any discussion aimed at solving these problems. As discussed in Ch.3, on 17th of February, 2011, Libya witnessed a revolution

[81] Erik Berglöf and Stijn Claessens, 'Corporate Governance and Enforcement' World Bank Policy Research Working Paper 3409, September 2004 <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3409> accessed 29-10-2013 (n 8) 18.

[82] ibid 30.

[83] Charles Oman, Steven Fries and Willem Buiter, 'Corporate Governance in Developing, Transition and Emerging-Market Economies' OECD Development Centre Policy Brief No 23, 2004 <http://www.oecd-ilibrary.org/development/corporate-governance-in-developing-transition-and-emerging-market-economies_604227826337> accessed 21-11-2013, 19.

against Gadhafi's regime which, as any revolution in the world, had numerous, unforeseen consequences. Some of which is the resultant lack of security and profound disagreements and disputes between the political actors. Therefore, numerous post-revolutionary armed groups, so-called "militias" (milishiat) have kept their arms and their power following the end of the revolution and the establishment of democracy.[84] Further, the disagreements between the Libyan politicians have grown and recently resulted in dividing the official bodies of the state into two governments and two legislatures.[85] The internationally recognised government of the Council of Deputies, formerly known as the Libyan Government, was elected in 2014 and is based in Tobruk in the east of Libya. The other government is Islamist and is led by the Muslim Brotherhood in Tripoli.[86] There is no need to discuss the current political situation in Libya in depth as this does not serve our argument here, but the most important thing we need to understand is the fact that there is no any chance nowadays for the both Legislatures to look at any proposal relating to economic efficiency in Libya. This is because the both bodies are focused on the political and safety issues that the state encounters today. Both parties are engaged in negotiations to solve the disputes between the two legislatures are taking place in Morocco under the

[84] For more information about the security issue in Libya, see (3.3.2.2) 138.

[85] There is a legal issue behind these disputes and the division of the legislative body besides the political issue. Specifically, 'Libya's highest court has ruled that general elections held in June (of 2014) were unconstitutional and that the parliament and government which resulted from that vote should be dissolved'. See Theguardian, 'Libya supreme Court Rules anti-Islamist Parliament Unlawful' *Theguardian* <http://www.theguardian.com/world/2014/nov/06/libya-court-tripoli-rules-anti-islamist-parliament-unlawful> . See Constitutional Court 61/17, Libyan Supreme Court (11-03-2014).

[86] For more information and a complete discussion concerning the current political situation in Libya, see The Guardian, 'War in Libya - the Guardian briefing' *The Guardian* (The Guardian, 29-08-2014) <http://www.theguardian.com/world/2014/aug/29/-sp-briefing-war-in-libya> ;Frederic Wehrey and Wolfram Lacher, 'Libya's Legitimacy Crisis' *Garnegie* (Garnegie, 06-10-2014) <http://carnegieendowment.org/2014/10/06/libya-s-legitimacy-crisis/hr9j> ; Ali Shuaib, 'Threat of Division Hovers Over Libya' *Almonitor* (06-06-2014) <http://www.al-monitor.com/pulse/security/2014/06/libya-crisis-threat-division-thani-maiteeq.html> ; The Economist, 'Libya's Civil War: That it should come to this' *The Economist* (10-06-2015) <http://www.economist.com/news/briefing/21638123-four-year-descent-arab-spring-factional-chaos-it-should-come> .

supervision of the UN and a solution has almost been reached.[87] To the best of my knowledge, following the revolution, no new economic laws have been enacted.

Assuming that the current political issues in Libya will be resolved and there will be only one legislature in Libya,[88] the core question here is how to respond to the previous problems, discussed in (5.5.1). Is there an opportunity for the Libyan Legislature to pass a new law that adopts the rules of the self-enforcing model even though such a proposal will work against the state as controlling shareholder?

As discussed in details in (1.2.2), following nearly three decades of economic central planning control, the move towards a market economy in Libya began in the early 2000s with the adoption of an economic reform programme and the launch of privatisation. In the 2000s, there was a marked trend towards a free market policy that represented a move towards a new corporate system in Libya and a desire to rectify the accumulated economic problems and difficulties that occurred as a result of the socialist era. During this time the state adopted various economic reform measures (e.g. restructuring of banking rules, a privatisation programme, and establishing a stock market) which have had a profound effect on corporate governance in Libya, as discussed in Ch.2. Therefore, adopting the self-enforcing model is consistent with the current ideological predisposition of the Libyan government in favor of market liberalisation and the advancement of Libya's status within the globalised free market economy, which is arguably sufficiently powerful to outweigh any countervailing prudential interest in maintaining the institutional status quo.

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[87] Azza K. Maghur, 'The UNSMIL Draft Agreement and International Engagement with Libya' *Atlantic Council* (Atlantic Council, 14-04-2015) <http://www.atlanticcouncil.org/blogs/menasource/the-unsmil-draft-agreement-and-international-engagement-with-libya> .

[88] According to the he United Nations Support Mission (UNSMIL), the solution in Libya is close to being resolved. See UN News Centre, 'Libyan Parties Open New Round of UN-Backed Political Talks Aimed at Restoring 'Stability and Prosperity'' *UN News Centre* (UN News Centre, 15 April 2015) <http://www.un.org/apps/news/story.asp?NewsID=50597#.VTazlCFVhHw> .

Libya only moved from a planned economy to a free market economy in 2000 and from socialism to capitalism in 2011, following the recent revolution. Before the revolution, the state still adopted many socialist economic legal policies even though there were reforms towards a free market economy. For example, certain laws and regulations still existed in Libya which were in line with socialist ideology and a planned economy, such as the pricing system of a very large number of goods. Further, there were many socialist laws, such as Law No 38 in 1977 concerning real-estate ownership, which set down that ownership merely for the purpose of possession is prohibited. In addition, Law No. 4 of 1978 concerning real estate property stated that every adult citizen has the right to own a house as long as he resides therein. According to this Law, a citizen is not allowed to possess more than one house. It also gave any Libyan citizen who lived in a rented house the right to own it. Also, Law No. 7 of 1986 concerning the abolition of land ownership deemed the land in Libya is not owned by anyone, and may not be the object of the actions of ownership transfer. In addition, the second article of this Law stipulates that every citizen has the right to possess land only in the case of use, be it in agriculture, grazing, or others, provided that he is exploiting only his own and his family's efforts. [89] Thus the policies that were introduced following the movement toward a free market economy and before the revolution were not comprehensive and they did little to affect either the privatisation programmes or the protection of minority shareholders. The general economic policy under Qadhafi's regime was not seriously aimed at liberalising the economy. The economic reforms, as discussed in Ch.1, were only introduced as a response to the economic crisis faced by Libya at that time.[90] Therefore, it is very unlikely that the previous regime would have looked favourably on the kind of economic reform proposed in this thesis.

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[89] see Habib Gaboda, 'Real Estate Property' (2012) 3 Tripoli University Law Journal 143 (in Arabic).
[90] See (1.2.1) 23.

However, following the revolution, the picture has entirely changed. Under the new Libyan draft constitution,[91] there is a clear trend toward a free market economy and the liberalisation of the Libyan economy. For example, under art 19/1, the state intends to establish a diversified economy based on a private sector and adopt high standards of transparency, competition, quality and protection for consumers. Also, art 19/2 noted that 'the state shall stimulate and develop the private sectors in order to ensure competition and innovation'. This is further emphasised in art 21/1 which suggests that the state will encourage private investment to meet the needs of the society. Accordingly, now there is a trend towards privatisation and free market economy, there are no longer the same issues facing the adoption of the self-enforcing model because as the state wishes to actively transfer corporate ownership into the private sector. Hence, enhancing the role of the minority shareholders will be highly desirable as it will attract more investment in Libyan companies.

Further, in this new era, where the capitalism is the official doctrine of the state, the state's desire to operate SOEs must change. Consequently, the SOE's goals will realign to reflect commercial rather than social values. In other words, the state will pursue commercial goals not political goals and focus on profit maximization and efficiency. [92] This must result in adopting mechanism that enhance economic efficiency, one of the most important of which will be providing minority shareholders with the kind of protection elaborated in the model.

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[91] See The Constitution Drafting Assembly, 'Constitution Draft ' (*The Constitution Drafting Assembly* 2015) < http://www.cdalibya.org/> accessed 22-04-2015.

[92] See .e.g. Maria Vagliasindi, 'Governance Arrangements for State Owned Enterprises' World Bank Policy Research Working Paper No 4542, 2008 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1102837> accessed 13-01-2014; Mary Shirley and Patrick Walsh, 'Public vs. Private Ownership: The Current State of the Debate' World Bank Policy Research Working Paper No 2420 <http://ssrn.com/abstract=261854> accessed 28-10-2013 (n 154) 20. Thorsten Beck, Asli Demirgüç-Kunt and Ross Levine, 'Law, Endowments, and Finance' (2003) 70 Journal of Financial Economics 137.

Although the state's general policy has changed completely and there is opportunity to overcome the assumption that the state as a controlling shareholder may not accept a self-enforcing model voluntarily, the challenge of political corruption is very difficult to address in Libya. Despite the fact that there is a lack of studies that examine political corruption in Libya, as noted, it is commonly held in Libya that political corruption is widespread and institutionalised, often being seen as part of the local system of the state. Overcoming political corruption requires a sustained effort and measures by the government and the legislature including increasing the wages of government's officials, hiring more credible staff and increasing the budget of the state, etc. It may take years to overcome Libya's 'heavy heritage' of corruption. Therefore, there is still a risk that the model will not be passed by the Libyan legislature and not be proposed by Libya's politicians and bureaucrats.

In conclusion, due to a lack of studies and data relating to the political issues, it is difficult to be sure that the Libyan state may reject adopting the measures and reforms proposed by the self-enforcing model or prove that there is a real risk that threatens the adoption of such a model by the corrupted politicians and bureaucrats. Such challenges are still based on probability and feasibility. It may be that the real picture is the opposite. For example, instead of the controlling shareholders having a seat in the Libyan Legislature, the minority shareholders may do and thus the possibility of adopting such a model increases.

Conclusion

Adopting the self-enforcing model in Libya leads to some potential risks that can be reduced by adopting particular measures. These risks have been discussed in this chapter and solutions offered for their satisfactory resolution. Firstly, the problem of the lack of an effective disclosure system in Libya can impact negatively on the application of the self-

enforcing model since minority shareholders within such an environment are likely to be unable to recognize any conflict of interest transaction undertaken by the controlling shareholders. Accordingly, there should be a solution that goes beyond the reform of company law and ensures that the minority shareholders are represented on the board of directors to ensure the majority shareholders can access the company's information.

Further, there will always be a passive minority shareholder who does not mind whether the majority shareholders extract a private benefit at his expense or not. Additionally, there is a risk that the minority shareholders may abuse their rights and so placing a decision-making capability in the hands of the minority might preclude efficient transactions in certain situations. To address such problems, there are some effective measures that should be adopted such as enhancing the role of a financial expert or independent auditor and employing neutral, independent directors to review a conflict of interest transaction. In addition, procedural stages should be imposed when a case goes to court, such as requiring that the aggrieved shareholders must establish a *prima facie* case that relies on acceptable evidence, that dictate whether he case is allowed to proceed. With regard to the problem of the passive minority shareholders, the model proposes that the minority shareholders must hold 5% of shares in order to benefit of the model and be able to vote against or in favour of the conflict of interest transaction. This ownership threshold should ensure that the minority shareholders are incentivised to engage in such transactions.

Moreover, there will be extra administrative costs, such as costs that are associated with calling the meeting of the minority shareholders to vote on the conflict of interest transaction (such as dispatching notices of an impending ballot and providing all the voting shareholders with background information on the transaction), or those costs that relate to evaluating the conflict of interest transaction before the minority shareholders take a decision about it, such as hiring financial experts. While the administrative costs are not a

serious issue in Libya since LEAA 2010 determines that newspapers and emails are appropriate tools to call the shareholders' meeting generally, the assessment of expenses is an issue that can be addressed by absorbing them into the company itself.

Additionally, the self-enforcing model can function in an environment of weak enforcement because the actions of the controlling shareholders are guided by the fact that the minority shareholders have the power to veto any conflict of interest transaction. Further, the controlling shareholders know in advance that any conflict of interest transactions made without the consent of the minority shareholders can be easily blocked. Added to this is the greater powers afforded to the minority shareholders by the courts who will immediately revoke any transaction that is approved only by the controlling shareholders.

Finally, it is difficult to anticipate the Libyan state's desire to adopt the self-enforcing model voluntarily. This is because, as discussed in Ch.2, the Libyan state remains the predominant beneficial shareholder of the country's most significant corporate enterprises and it stands to benefit from the institutional status quo. Also, the possibility of adopting the self-enforcing model may be reduced because of the widespread nature of political corruption. In response to the first issue, adopting the self-enforcing model is consistent with the current ideological predisposition of the Libyan government in favour of market liberalisation and the advancement of Libya's status within the globalised free market economy. However, the second issue remains complex in the case of Libya as it is very difficult to overcome.

Conclusion

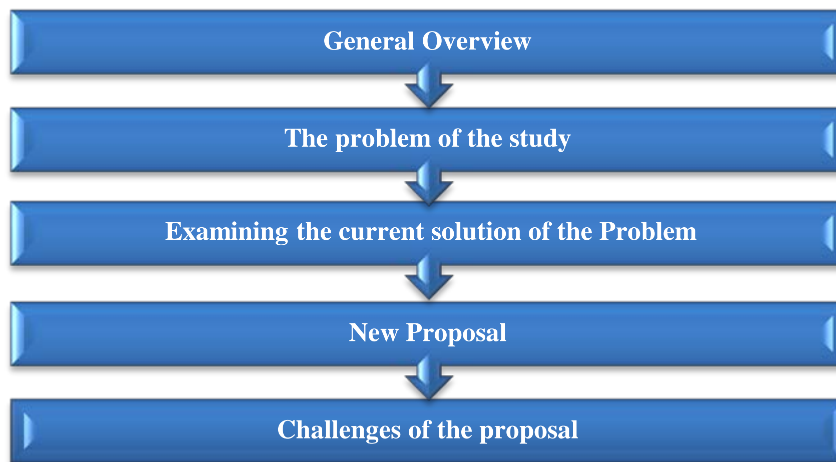
The central goal of this research was to propose an adequate protection system for the minority shareholder that would contribute practically to an efficient and healthy commercial environment in Libya. Accordingly, throughout the study I developed a framework to improve corporate governance mechanisms which, I believe, satisfactorily takes into account the specific environment and weak system of enforcement in Libya. Corporate governance mechanisms in any developing and transition country 'have to function and reform has to be implemented in an environment where courts and other enforcing institutions are missing or very weak'.[1] Consequently, this study examined the current solution adopted by Libyan law (Liability actions) to deal with the conflict of interests between the majority and the minority shareholders. Using a social and economic analysis and a black letter approach, this study used a novel analytical framework to formulate an appropriate solution for addressing the conflict of interests between shareholders in Libya.

Any reform to the legal system of minority shareholders protection in Libya that fails to take into account the enforcement issue will, I argue, be incapable of increasing the effectiveness of Libyan corporate governance. This is because writing good laws does not automatically solve the problem. Despite the fact that good laws can be transplanted easily and adopted by the legislator, it is more difficult (if not impossible) to transplant the institutions that enforce law such as courts or regulators. It may take many years to create the institutions of a functioning court system and to train judges and lawyers. Thus 'enforcement lies at the heart of the very distinction between rules-based and relationship-based systems of

[1] Erik Berglöf and Stijn Claessens, 'Corporate Governance and Enforcement' World Bank Policy Research Working Paper 3409, September 2004 <http://elibrary.worldbank.org/doi/book/10.1596/1813-9450-3409> accessed 29-10-2013, 4.

governance. It also lies at the heart of the concept of corporate governance'.[2] Accordingly, the study highlighted the enforcement issue as a decisive factor that contributes to the weakness of the current approach adopted under s 159 of LEAA 2010 to protect the minority shareholders in Libya.

To develop a workable reform, the study followed a logical sequence through providing a general overview of corporate governance in Libya (Ch.1). After which it examined the central issue of the study (Ch.2) and the solution adopted in Libya to protect the minority shareholders (Ch.3). Having concluded that such a solution has failed, the study suggested a proposal to deal with the conflicts between shareholders (Ch.4). Finally, the study ended by discussing the potential challenges and risks of the proposed solution (Ch.5).



1. A summary of the study

It was necessary to provide in **Ch.1** an overview of the general framework of corporate governance in Libya. The purpose of this chapter, as an introductory chapter, was to lay the foundation for the remainder of the thesis and examine the current position of corporate governance in Libya.

[2]Charles Oman, Steven Fries and Willem Buiter, 'Corporate Governance in Developing, Transition and Emerging-Market Economies' OECD Development Centre Policy Brief No 23, 2004 <http://www.oecd-ilibrary.org/development/corporate-governance-in-developing-transition-and-emerging-market-economies_604227826337> accessed 21-11-2013.

Having provided a brief overview of the Libyan legal system as a civil law country, Libyan corporate law, and the Libyan corporate governance system (1.1), the study analysed the development of Libyan economy (1.2). Here I showed that following the change from capitalism to socialism in 1969 and the adoption of a planned economy until the late 1990s, the government owned both the production and services sectors. However, in the early 2000s there was a marked trend towards a free market policy that represented a new corporate system in Libya. This system sought to rectify the accumulated economic problems and difficulties that occurred as a result of the socialist era. During this period, the state adopted various economic reform measures which have had a profound effect on corporate governance in Libya.

Although many positive measures and procedures were implemented, which established new institutions of corporate governance in Libya, many difficulties and challenges still face the new Libyan government in developing an economic and financial environment in which a free market economy can operate. This situation, without doubt, affects the corporate governance system generally, as discussed in (1.3), and particularly the minority- majority shareholders relationship, as discussed in Ch.2.

In (1.3), the study argued that the Libyan economy is currently moving from a bureaucratic stage to a relationship stage which means that it is still in an early stage of transition. This is because, firstly, there is an absence of an adequate and effective formal institutional framework with an appropriate set of laws, which is capable of enhancing the institutional framework of a market economy, and so weakening the state's bureaucratic framework. This has led to informal rather than formal institutions playing a key role in shaping company behaviour in Libya. Secondly, the weakness of financial institutions affects to a large extent the mechanisms of corporate governance in Libya which result in strong insider control and the absence of significant outside investors. Also, since the stock market

is still illiquid and small, it can only play a limited role in corporate control through takeovers or proxy fights. Finally, non-completion of privatisation programme affects the corporate structure of ownership in Libya. This, in turn, raises two problems, a majority-minority problem and the problem between minority shareholders and state-owned companies being controlling shareholders, both of which were covered in depth in the following chapter.

In Chapter 2, the study located the dimensions of the conflict of interest problem between the minority and majority shareholders in Libya. In order to locate the main issue to be addressed, section (2.1) discussed structures of corporate ownership as described in the literature and as manifested in Libya. Here the study recognized two broad categories of corporate ownership: the first category is dispersed corporate ownership, and the second category is concentrated ownership. Whilst the former category is the dominant system in the U.S and the UK, the other is predominant in the rest of the world (a significant explanation provided in this study for the difference between concentrated and dispersed ownership systems). However, the focus was on the concentrated ownership system (since it is the dominant system in Libya), under which large shareholders who own blocks of shares that are large enough to give them control over the company. Today it is the Libyan government that retains a large ownership position in many sectors of the economy and remains a significant owner of both public and large private commercial enterprises. This situation, I argue, is the result of the socialist policies adopted during the period from 1970 to the 1990s. I concluded that despite the developments in the privatisation programme, the ownership model has not changed and the developments towards a free market economy remain insufficient as the privatisation programme is neither comprehensive nor efficient, and this is evidenced by the fact that the vast majority of Libyan firms are still owned by the state.

In the following section (2.2), the study outlined the relationship between the patterns of ownership and the nature of the principal-agent problem, which constitutes the

fundamental rationale for this study. In this section, I highlighted the fact that in dispersed corporate ownership, the conflict of interests occurs between the shareholders as whole and the management (this falls outside the scope of the study). However, in a system of concentrated ownership, the conflict exists between the majority shareholders and the minority shareholders. This means that ownership concentration transforms the principal-agent problem into a problem of conflicts of interest between the minority and majority shareholders. This is because minorities are vulnerable to exploitation by the majority. The shareholders with a high ownership share are capable of using their position to acquire private benefits by using their voting rights to consume corporate resources to their advantage, an option that is not available to other shareholders.

Having discussed the principal-agent problem and identified that the recent corporate governance literature indicates that the current central agency problem in corporate governance around the world (except in the UK and the U.S) is how to restrict the exploitation of minority shareholders by controlling shareholders, in (2.3) the study firstly explored the issue of the conflict between the majority and minority shareholders both in theory and as it occurs in Libya. Here the study illustrated that the conflict of interests between the majority and the minority of shareholders can include the diversion of corporate assets and this can be divided into two categories: firstly, the majority-minority shareholder conflict in related-party transactions and, secondly, the majority-minority shareholder conflict in restructuring ownership transactions that discriminate against the minority. Additionally, the conflict of interests between the majority and the minority shareholders may not necessarily include the diversion of corporate assets or take either of the two forms of tunneling described above. Instead the conflict between the majority and the minority may occur in another form, such as when the controlling shareholders use their votes to amend the

terms of the constitution of the company in their interest at the expense of the minority shareholders.

In the same section, the study indicated that the statutory provisions in Libyan Company Law that deal specifically with the protection of minority shareholders are very few and those that do exist are incomplete, ambiguous and unbalanced. This is due to the fact that the Libyan legal system generally, and the corporate legal system particularly, tends to protect the control of the state over the economy at the expense of other shareholders. The existence of the state as a controlling shareholder in most large companies in Libya made the adoption of a "shareholder primacy" model of corporate governance relatively attractive, since it provided a way for the state to directly own and control its companies. The application of such a model would allow the relevant state to pursue a socialist market objective by exercising a controlling interest in most companies. Further, it was believed that the conflict problem that derives from corporate restructurings, especially mergers and takeovers, are significantly less frequent in Libya.

Furthermore, this section argued that the structure of state-owned concentrated ownership in Libya and the political influence exerted on corporate governance, contributes directly to the poor quality of corporate governance in Libyan companies. Specifically, the problems are attributable to the conflict between the state as a controlling shareholder and the other dispersed shareholders, which results in agency issues. For example, in the structure of state concentrated share ownership, the state, as the biggest shareholder in both listed and large private companies, pursues its political goals (usually social welfare maximisation) at the expense of other shareholders, rather than pursuing profit maximization or efficiency. Moreover, the principal-agent issue may come from the assumption that politicians and bureaucrats (as a representative of the state) may not perform their work either in the interests of the company itself or as loyal agents of the citizens. Instead they may run the company for

their personal interest as opposed to the owner's (the state's) interest. Even if this is not the case, it may be that the politicians and bureaucrats will not run the company effectively, since they have no direct interest in the SOE.

Finally, state ownership is characterized by weak monitoring because the shareholding politicians and bureaucrats have no personal equity at stake in SOEs compared with the majority of shareholders in private companies. However, with the inefficiency of monitoring by the state as controlling shareholders, it could be argued that Libyan banks, as the main financier of debt in Libya, should have a role in monitoring firms. In fact, this is not true in the case of Libya because the external finances provided by the banks represent only a small part of corporate financing and, as such, banks may not feel motivated to monitor clients effectively. This situation has led the government to adopt another way to monitor the management of SOEs through a public organisation known as the Reorganization of the Audit Bureau.

Having determined the dimensions of the minority-majority shareholders problem, **Ch.3** evaluated the solution to this problem currently used under Section 159 of LEAA 2010: the Liability Action. The study found that the protection of minority shareholders adopted under s.159 of LEAA 2010 has failed. This is because the enforcement of the legal system is extremely weak, the Libyan courts system is ineffective and the Libyan judicial system can be considered as a system of non-intervention. The combination of these factors prevents minority shareholders from suing majority shareholders for breach, misuse, wrongdoing or oppression. As Libya is still in the very early stages of transformation from the Bureaucratic Stage to the Relationship Stage, its legal system remains dysfunctional since laws and rules supporting market-based transactions are incomplete and the machinery for enforcement is inadequate. In this chapter, I analysed how the Liability Action is inefficient and ineffective due in large part to the Libyan environment. Specifically, judicial protection is currently not

an effective approach since the general enforcement environment is weak. Judicial corruption and the slow pace of justice affect the motivation of minority shareholders to bring an action against the majority shareholders. Also, there are significant political (e.g. government intervention) and social (e.g. the structure of the Libyan society) factors that hinder the courts' enforcement of the law. In addition, the efficiency and expertise of the courts undermines the efficiency of the current law. The quality of institutions which implement legal norms determines the effectiveness of protection of investors even independently of a formally defined set of laws as the law on the books is meaningless if the quality of the courts' interpretation and the implementation of the law are weak. This is especially problematic in cases where the judges have wide discretion, which is the case in Libya. Finally, the minority shareholders face difficulties in bringing an action against the controlling shareholders (who are often in the position of board of directors) because of gaps in the law. A derivative suit, which is allowed in almost all jurisdictions, is not allowed in Libya and there are high risks and costs attached to bringing a dispute to court. In addition, the courts are barred from intervening in certain cases, such as the minority shareholders not being able to bring an action against the majority shareholders when the latter is in the position of a shadow director. All of these factors led us to conclude that the Libyan judicial system is a non-interventionist system.

Having examined liability actions in Ch.3 and the other alternative strategies (e.g. public enforcement) in (4.1) and found that they fail to provide adequate protection for the minority shareholders in Libya, in **Ch.4** the study argued that there is a strong need to adopt an alternative solution that can contribute to resolving the minority-majority shareholders problem. Accordingly, I proposed the self-enforcing model, which mainly relies on a voting mechanism to decrease (though not wholly avoid) the necessity of judicial oversight through permitting minority shareholders to review important transactions before they occur. Here I

adopted Black and Kraakman' model of self-enforcement with amendments that take into account the specific case of Libya. The proposed solutions differ according to the kind of corporate transactions in which a company may engage: related-party transactions which are mainly addressed by the majority of minority rule, other central transactions (e.g. the liquidation of a company, divisions of the company, a transformation of the company into another type of legal entity, such as a partnership, the sale or purchase of assets, and amendments to the article of association), which are mainly regulated by the supermajority approval rule, and control transactions that are mainly governed by a takeout right.

In order to effectively implement a self-enforcing model there is an evident need to adopt the rule of one share, one vote since it prevents insiders from acquiring voting power disproportionate to their economic interest in the company. Also, there is a need to adopt the rule of confidential voting since it will prevent insiders (e.g. controlling shareholders) from knowing how a voter has cast their ballot (against him or not), meaning that insiders will lose the power to manipulate votes through rewards or sanctions. Further, all the rules and rights of the model should be mandatory and should be applicable to both large and small companies.

Finally, Black and Kraakman do not address why the self-enforcing model is an appropriate alternative to formal private enforcement in developing countries, instead focussing on the lack of enforcement in these countries as a reason to replace the judicial solution with the self-enforcing model. Therefore, their analysis does not provide us with a complete picture as there are other reasons that contribute to my proposal that the self-enforcing model should be adopted in Libya. These reasons, explored in this chapter, are: that the self-enforcing model contributes to companies being able raise capital from investors, and that it also lowers the number of conflict of interest transactions and makes the company's transactions more efficient. Finally, the self-enforcing model does away with the need for

external monitoring and is, therefore, an appropriate solution for addressing the majority-minority problem in Libya.

Nonetheless, any new proposed solution adopted may face some challenges and risks. Accordingly, the study devoted **Ch.5** to addressing the potential risks and difficulties that the proposal may face. This necessitates requiring the formulation and adoption of new strategies of corporate governance to deal with such risks and challenges that are specific to Libya. For example, the problem of the lack of an effective disclosure system in Libya may impact negatively on the application of the self-enforcing model since minority shareholders within such an environment are likely to be unable to recognize any conflict of interest transaction undertaken by the controlling shareholders. Accordingly, the solution should go beyond the reform of company law and enable minority shareholders' representation on the board of directors to ensure the majority shareholders can access the company's information.

Further, there will always be a passive minority shareholder who does not mind whether the majority shareholders extract a private benefit at his expense or not. Additionally, there is a risk that the minority shareholders may abuse their rights and so placing a decision-making capability in the hands of the minority might preclude efficient transactions in certain situations. To address such problems measures, such as the appointment of a financial expert or independent auditor and employing independent directors to review a conflict of interest transaction neutrally, should be adopted. In addition, it is also necessary to impose procedural stages before a court case can go ahead, that requires aggrieved shareholders to establish a *prima facie* case that relies on acceptable evidence. With regard to the problem of the passive minority shareholders, the model provides powers only to large minority shareholders who own 5% of the company's shares or more to veto or approve the transaction. This percentage should be adequate to incentivise any large shareholders and make them engage actively in the dealings of the company.

Moreover, the model will bring extra administrative costs, such as costs associated with calling meetings of minority shareholders to vote on conflict of interest transactions (e.g. dispatching notices of an impending ballot and providing all the voting shareholders with background information on the transaction), or those costs that relate to evaluating the conflict of interest transaction before the minority shareholders take a decision about it, such as hiring financial experts. While the administrative costs are not a serious issue in Libya since LEAA 2010 allows that newspapers and emails are appropriate tools to call the shareholders' meeting generally, the assessment of expenses is an issue that can be addressed by absorbing them into the company.

The practical challenge is whether the self-enforcing rules can function in an environment of weak court enforcement. The study found that the self-enforcing model is able to function in an environment of weak enforcement because the actions of the controlling shareholders are guided by the fact that the minority shareholders have the power to veto any conflict of interest transaction. Additionally, the controlling shareholders know in advance that any conflict of interest transactions made without the consent of the minority shareholders can be blocked and that the courts will immediately revoke any transaction that is approved without the consent of the minority shareholders.

Finally, it is difficult to anticipate whether the Libyan state will be keen to adopt these reforms. This is because, as discussed in Ch.2, the Libyan state remains the predominant beneficial shareholder of the country's most significant corporate enterprises and so benefits directly from the status quo. Also, the issue of corruption in Libya radically reduces the possibility that the political establishment will look favourably on increasing minority shareholder protection by adopting the self-enforcing model. In response to the first issue, as noted, adopting the self-enforcing model is consistent with the current ideological predisposition of the Libyan government in favour of market liberalisation and the

advancement of Libya's status within the globalised free market economy. However, the second issue is more complex and will prove very difficult to resolve.

2. Contribution to Knowledge

First of all, it should be noted that although there are scholars from varying disciplines who have studied corporate governance within developing countries, especially North Africa and Middle Eastern countries, there is a lack of research on corporate governance that relates specifically to Libya. The corporate governance discussion has only recently started within Libyan legal discourse. Therefore, there are relatively few credible studies of corporate governance. As such, this study contributes to the very limited body of Libyan literature on corporate governance and undertakes an in-depth and critical examination of the dynamics of the Libyan corporate governance framework. More than that, to my knowledge, this study is the first study that has focused in-depth on minority shareholders protection in Libya. As a result, I hope that the study can open the door for more research in this area and also be a good resource not only for Libyan policy and law-makers to improve the corporate law framework, but also for regulators and promoters of good practices to assist them in deciding the areas that need improvement.

The study concluded with a number of proposals, which are intended to be part of a general corporate governance reform strategy aimed at improving governance efficiency in Libya. The findings of the study are relevant for students, academics, policy makers, Libyan corporations, and Libyan regulators. Significantly, it can be introduced as a bill to the Libyan Parliament to reform the current system of minority shareholders protection. Thus, it is expected that the study will be able to make a major contribution to legal development in

Libya and contribute to filling the gap in the literature concerning current corporate governance practices in Libya from a legal perspective.

The study can offer both local and foreign investors an objective analysis of the current implementation of corporate governance standards in Libya; such information is undoubtedly important to investors wanting to make informed financial decisions before investing in organisations located within Libya.

3. Limitations and Suggestions for Further Research

This study examined a specific area of corporate governance within Libya and argues against the current solution adopted by Libyan law (Revocation and liability actions) as the sole solution for minority shareholder protection. Through undertaking a social and economic analysis and a black latter approach, the study argued for the adoption of the self-enforcing model. As a result, this study should not be considered as a comprehensive study covering all the concepts of shareholders protection, which is a very wide topic. In other words, the study is a reform study that attempts to replace an inefficient solution with an efficient one. Thus the scope of the study is limited to a particular, narrow argument.

There is still further research that may be undertaken in the area of shareholder protection in Libya under a comparative approach. Areas of further study may include an investigation into the extent to which UK company law, with its long commercial experience and knowledge, can offer further ways forward in the reform of Libyan laws, and to what extent UK law is compatible with Sharia principles. For example, it has been found that UK law can provide appropriate solutions to Libya in terms of, for example, codifying shareholder protection in Libyan Company Law that is capable of addressing the agency problem between the minority shareholders and the majority shareholders and between the shareholders as a whole and the minority shareholders. Particularly, under the majority-

minority agency problem, it may be valuable to explore issues that relate to certain aspects of unfair prejudice, as Libyan law adopts limited criteria under the no abuse of rights doctrine. Accordingly, further study could usefully be made into adopting a more comprehensive set of criteria from UK law. Moreover, in terms of the shareholders-management problem (which is a core issue due to the lack of monitoring by the controlling shareholders in state owned companies and widespread corruption in Libya) Libyan Company Law has not adopted a derivative action, as such it may be interesting to investigate whether incorporating derivative actions into Libyan law would be effective and whether the system of UK derivative actions is appropriate in Libya.

Further, due to the lack of studies of corporate governance in Libya, combined with the lack of development of Libyan company law (especially the economic system in Libya which has undergone major development),[3] there are many areas open for further research. There are many traditional subjects of corporate governance that are yet to be examined, such as how to improve the enforcement of disclosure; the strength of the fiduciary duty of loyalty and care of directors, the improvement of independent directors; the control of management; how enforcement can be improved in weak environments; the quality of internal and external monitoring; ownership and control and the development of institutional regulatory capacity to meet rapid change and progress in organisations in Libya; developing self-regulatory corporate governance policies of Libyan corporations; the improvement of the disclosure system in Libya; the interaction between privatisation and corporate governance frameworks; specific forms of privatisation that might be more attractive in weak corporate governance settings; the relationships between corporate governance changes and changes in the degree of state-ownership of commercial enterprises; ways to incorporate an Islamic perspective of corporate governance inside the legal system of corporate governance.

[3] As discussed, the Company Act in Libya only underwent minor changes from 1953 to 2010. See the introduction of the thesis at 9.

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