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## Mini Review

# PROTECTION OF MINORITY SHARE-HOLDERS RIGHTS

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## Abstract

In this modern and advance era of competition, corporate sector plays an extremely important role in the development of a state by strengthening its economy and ensuring the economic stability. The corporations are controlled by the shareholders. In a corporation/company, minority shareholders also play a vital role in the business of the company. Laws have been formulated for the protection of the minority shareholders, however, these laws are not observed in its true spirit due to the ignorance of minority shareholders about their rights. The scope of this article is to review the status of minority shareholders and safeguards of minority shareholders' rights.

**Key words:** Corporation; shareholders; minority shareholders; protection of rights.

## Introduction

Shareholders of the company have ultimate control of the company. They can appoint and remove directors who run the business and are also responsible for management of the company.

A general phenomenon about the corporations is that shareholders must accept majority rule in a company. Shareholders who own majority of the shares, feel that they have right to make majority of all decisions because they have more at stake. Minority shareholders can also participate in company affairs by checking majority shareholders power, and promote transparency, ethical practices and good governance (OECD, 2004) but they are often regarded as an unnecessary burden a "dead weight" in corporation (Shkolnikov, 2006)

In environment where the legal system fails to protect investors, fails to specify their rights and responsibilities and fails to resolve the rift between majority and minority shareholder can cause collateral damage to the business environment. This result in an increase risk and drive away investments, both foreign and domestic. In such a weak economic legal system the majority owners are more likely to squeeze out minority shareholders.

Such illegal techniques were practiced in Russia 1990s. A simple way to prevent minority shareholders from "meddling in the affairs" of majority owners was to change the date and location of the general assembly meeting a day or two before the meeting would take place. Thus, minority owners would not get the information in time and could not adjust their schedules. Minority owners would show up at an empty meeting hall, while the actual meeting was held

hundreds of miles away and decisions were made in their absence. Such blatant violations could be observed in Russia as late as 2001 (McCarthy *et al*, 2004)

In weak institutional environment the division between majority and minority owner is much more in vague. However the laws are similar that in the developed and developing countries the only difference lie is the process work on the institutional level, effective courts and much more transparency.

In weak institution the majority shareholders can easily engage in self-dealing and asset stripping therefore driving companies to bankruptcy and denying dividend payment to minority shareholders. The uncertainty in political and economic conditions leads to this attitude and system rewards that attitude by not punishing those that hold it. Due to abuse of the powers by majority shareholders, the laws/statute which regulates the companies' acts provides certain protection for minority shareholders.

## Protecting Minority Shareholders Rights

### *The Role of Associations*

The minority shareholders rights can be protected by good corporate governance. These practices can create transparency, responsible and accountable business. As the OECD's Corporate Governance Principles State, "Minority shareholders should be protected from Abusive actions by, or in the interest of, controlling Shareholders acting either directly or indirectly, and should have effective means of redress." (OECD, 2004)

CIPE (Center for International Private Enterprise) partner the Corporate Governance Center in Kenya is an illustrative

example. It arranges an awareness-building campaign on corporate governance rules so that shareholders know their rights and ensure that their rights are properly protected (Shkolnikov, 2006)

### ***Corporate governance in Pakistan***

In Pakistan, there is multifaceted corporate governance regime. Laws fall into one of the following six categories.

1. General corporate laws.
2. Rules and regulations made under corporate laws.
3. Stock exchanges' listing regulations and bylaws.
4. Civil laws, including those that provide remedies for seeking declarations, enforcement of a claim and recovery (Specific Relief Act, 1877).
5. Criminal laws for breaches of trust, fraud, etc. (PPC, 1860)
6. Special prosecution under the National Accountability Ordinance, 1999 for corporate fraud and misappropriation.

Under companies ordinance 1984 the requirement for seeking remedy against any oppression or mismanagement is that at least twenty five percent of shareholders to initiate a complaint. Shareholders representing at least ten percent but less than twenty percent apply to SECP to appoint an inspector to investigate company affairs.

The companies' ordinance 1984 does not recognize shareholder who represent less than ten percent of the company shares. Minority shareholders can seek remedy in civil courts by suing for tortuous loss.

### ***Rights under the Memorandum and Articles of Association***

The M&A are important documents as they set out and regulate the company affairs and the manner in which the company is to be managed. The M&A take effect as all contracts are made under the provisions of these, whether between the shareholders and the company or between each individual shareholder and every other.

Generally, every individual shareholder who is affected can bring an action in court to prevent any proposed breach of the M&A, and the court may also set aside acts done in breach of the M&A.

The law provides that the M&A can only be amended by a special resolution, that is to say a resolution passed by a majority of not less than three-fourths of the shareholders voting either in person or by proxy at the general meeting of the company. The M&A is therefore an important starting point for a shareholder who may feel aggrieved.

A shareholder is entitled at law to have a copy of the M&A and, on request, the company is required to send a copy of the M&A to the shareholder.

## **General Rights Provided to Minority Shareholders**

### ***The Right to Information***

The minority shareholder, who often by reason of not being involved in the day to day management of the company, not possess detailed information on the affairs of the company. All the details of the company are maintained in separate registers. Shareholders have the rights to inspect the following registers:

1. The register of shareholders provides information as to the names and addresses of the shareholders and their shareholdings.
2. The register of directors, secretaries, managers and auditors. Separately there is a register of director's shareholdings show a director's shareholding in the company or in a related corporation, and whether any director has rights or options to acquire or dispose of shares in the company or a related corporation.
3. The register of substantial shareholders.
4. The register of debenture holders and the register of charges.
5. The minute book of general meetings. A shareholder may inspect without charge the minute books which are required to be kept of proceedings of all general meetings of the company.
6. The audited profit and loss accounts of the company, the auditors' report and the directors' report. These reports are required to be sent to shareholders not less than 14 days before the general meetings of the company at which the accounts are to be presented. These documents provide useful information relating to the financial affairs of the company.
7. The prospectus of a public company making an offer to the public. The prospectus provides useful information on the affairs of the company.
8. The Registry of Companies.

### ***The Right to Attend, Vote and Call General Meetings of the Company***

A shareholder has a right to attend and is also entitled to speak at the annual general meeting. These meetings of companies are important occasions for minority shareholders, as it is an occasion to meet and ask questions from the management. Further, shareholders are entitled to vote on any resolution, but an exception is that the law allows a company to provide in its Articles for suspension of such rights where his or her shares have not been paid.

Extraordinary General Meetings ("EGM") of a company may be called. Two or more shareholders holding not less than 10% of the issued share capital of the company, or such

lesser number as is provided in the Articles, may call for an EGM.

### ***The General Right to Be Treated Fairly***

The general right of a shareholder, in particular a minority shareholder, to be treated fairly. A shareholder may apply to court for assistance where;

- a) The affairs of the company are being conducted or the powers of the directors are being exercised in a manner oppressive to one or more shareholders or in disregard of his or their interests as shareholders; or
- b) Some act of the company has been done or is threatened or that some resolution of the shareholders or any class of them has been passed or is proposed which unfairly discriminates against or is otherwise prejudicial to one or more of the shareholders.

## **Certain Protection Provided by Companies Act 2006 of UK**

### ***General protection of minority shareholder - against unfair prejudice***

A shareholder may apply to the court by petition on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its shareholders generally or some of them (including at least the applicant), or that any proposed act or omission of the company would be so prejudicial (DOV OHRENSTEIN, 26th May 2011).

If the petition is successful the court has wide powers to order redress for a minority shareholder who has suffered unfair prejudice (Dignam & Lowry, 2008)

Among other things the court may make an order:

- Regulating the conduct of the company's affairs in the future,
- Requiring the company to refrain from doing or continuing an act complained of or to do an act it has omitted to do,
- Authorizing civil proceedings on behalf of the company, as appropriate,
- Providing for the purchase of the shares of any shareholder by other shareholders or by the company itself.

Examples of unfair prejudice include failure to give accurate accounting information, serious mismanagement, diverting business to another company in which the minorities have no shareholding. There must be an unfair adverse effect on the minority. The unfairly prejudicial conduct must affect the shareholder in that capacity not, for example, solely as a director or creditor of the company.

### ***Specific protection***

#### ***1. Alteration of the Articles of Association***

Any shareholder can apply to the court for a special resolution to alter the Articles of Association to be set aside if it is not *bona fide* for the benefit of the company as a whole.

#### ***2. Variation of class rights***

Where shares in a company are divided into separate classes (e.g. ordinary shares and preference shares) makes provision for varying the rights of a class. The holders of at least 15% of the issued shares of the class so varied may apply to the court to have the variation cancelled. The applicants must not have consented to or voted in favor of the variation (Companies Act, 2006).

#### ***3. Re - registration as a private company***

A public company may by special resolution be re-registered as a private company. Holders of not less than 5% of the shares, or of any class of shares, or not less than 50 of the company's shareholders, may apply to the court to have the resolution cancelled (Companies Act, 2006).

#### ***4. Striking off the register***

The directors of a private company which has ceased to trade may apply for the company to be struck off the register. Shareholders must be notified of the application and any shareholder or other interested party can object on various grounds. Subsequently any shareholder (or creditor, or the company itself), may apply to the court for the company to be restored to the register although this must generally be done within 6 years (Companies Act, 2006).

#### ***5. Company voluntary arrangement (CVA)***

Part 1 of the Insolvency Act 1986 makes provision for company voluntary arrangements, in the form of a composition with a company's creditors or a scheme of arrangement of its affairs. Any shareholder may apply to the court if unfairly prejudiced by the CVA or if there has been a procedural irregularity (*Insolvency Act, 1986*).

#### ***6. Other insolvency procedures***

Where a company is involved in insolvency procedures IA 86 makes provision for various issues on which any shareholder may (in appropriate circumstances) apply to the court or take certain procedural steps. In practice these are rarely invoked.

#### ***Other minority rights***

*Accounts* – CA 06 s.431-2 entitles any shareholder to demand a copy of the company's last annual accounts and directors' report and a copy of the audit report, without charge.

*Shareholders Meetings* – Shareholders with at least 10% of the voting rights (5% if no shareholders' meeting has been held for more than 12 months) may require the directors to convene a shareholders' meeting. The requisition must state the objects of the meeting. Shareholders with 5% of the

voting rights are entitled to propose resolutions at shareholders' meetings and to have statements in support circulated to the shareholders (Companies Act, 2006).

## Conclusion

Issue that lies at the core of this article is that Minority shareholders are often dismissed as Unnecessary in many emerging economies yet they are instrumental in creating robust capital markets and sustainable companies focused on long-term value creation. The role of minority shareholder can be essential in the governance and success of a company. They can play a vital role in the development and sustainability of capital markets. They have responsibilities to oversight of board actions, lay check on the power of the majority shareholders, and most important of all to promote transparency, good governance and encourage ethical practices. In countries with weak institutions, their role becomes more important in fostering good governance and moving economies forward. More must be done to protect the rights of minority shareholders. A major role in this can be played by good corporate governance. In this regard the attention must be paid to those voluntary associations and institutes which arrange programs to develop awareness in shareholders of their rights and aware what they can do to protect their rights. Such organizations are instrumental in creating awareness in shareholders, exposing and combating violation of rights of shareholders and, overall, ensuring the implementation and enforcement of corporate governance standards.

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