PROTECTION OF THE RIGHTS AND INTERESTS OF MINORITY SHAREHOLDERS

Elijah Mwangi Kiboi
Ameli Inyangu and Partners Advocates
Nairobi

Background

Disputes between minority (non-controlling) shareholders and controlling shareholders and the boards of directors in listed and unlisted companies arise from time to time in Kenya. A recent example is the decision by the board of directors of Kakuzi Ltd and controlling shareholders to dispose of a major asset in the face of opposition by minority shareholders. One imagines that similar situations of conflict between boards of directors and controlling shareholders, on one hand, and minority shareholders, on the other, do occur also in unlisted companies. The typical outcome of such conflicts is that minority shareholders lose because they are unable or unwilling to challenge decisions by the board and are also outvoted at general meetings.

It is therefore an interesting question how minority shareholders can protect their rights and interests.

Remedies

Shareholders of companies listed at the Nairobi Stock Exchange appear to have the simple recourse of selling their shares when they disagree with the decisions of the board and majority shareholders. This apparent panacea is however deficient in several respects. Firstly, the shareholders may for a variety of reasons have a long-term investment horizon. Secondly, the market price of the shares may be below fair value. A third weakness of this approach is that what may indeed be unlawful or oppressive action by the board and majority shareholders will have no consequences for them and might persist or recur to the detriment of other shareholders.
Further, this remedy is unavailable to shareholders of unlisted companies. For one, a company may lack an Over-The-Counter (O.T.C) market for its shares. Even where an O.T.C. market exists, there may be problems of logistics and liquidity.

There are avenues for recourse offered by company law. These are supported by the Guidelines on Corporate Governance Practices by Public Listed Companies issued by the Capital Markets Authority (CMA). These remedies are:

1. A court action against the directors
2. A petition presented to the Court for winding up the Company
3. An application to the High Court ("the Court") for any order that it thinks fit

1. Legal Action Against the Directors

The Companies Act (Chapter 486 of the Laws of Kenya) has provisions under which minority shareholders can conceivably find recourse by way of suing the directors. Section 22 provides that the memorandum and articles of association shall constitute a contract binding the members to the terms of the memorandum and articles. Therefore the members, as parties to the contract, appear to have legal standing to bring actions on behalf of the company against directors for breach of provisions of the memorandum and articles of association or breach of the directors' duties as agents and fiduciaries of the company. The main directors' duties are: (a) to act in good faith in what they believe to be the best interests of the company, (b) not to exercise the powers conferred upon them for purposes different from those for which they were conferred, (c) not, without the informed consent of the company, to place themselves in a position in which their personal interests or duties to other persons are liable to conflict with their duties to the company, and (d) to exercise reasonable care and skill in the conduct of their affairs as directors.

Directors' duties to shareholders are alluded to in the Corporate Governance Guidelines issued by the CMA. Section 2.3.1. indicates that shareholders should participate in major decisions of the company. The board should provide shareholders with information on such matters as major disposals of company assets, restructuring, takeovers, mergers, acquisitions or reorganizations.

The major disadvantage of this remedy is that actions alleging damage to the company should, as a general rule, be brought by the company itself, not by individual shareholders. The power to bring an action on behalf of the company is bestowed upon the members in general meeting and is obviously unavailable where dominant shareholders act against the wishes of minority shareholders and force proposals through. The dominant shareholders and the board would also reject any attempt to bring an action against themselves.

Furthermore, there are stringent requirements to be met before a shareholder can bring an action on behalf of the company, as developed in the English case of **Foss-v-Harbottle**. However where the memorandum and articles of association confer rights upon the shareholders, these rights are enforceable by the shareholders directly as explained in section 3 below.

2. Winding Up

Section 219 of the Companies Act provides various grounds for which the Court may wind up a company. Two of these grounds conceivably available to minority shareholders are, (a) the company has by special resolution resolved that the company be wound up by the court and (b) the court is of the opinion that is just and equitable that the company should be wound up.

Minority shareholders cannot easily arrange and effect the passage of a special resolution to wind up the company. Section 141 of the Companies Act requires that special resolutions be passed by a majority of at least seventy five percent of members present (in person or by proxy) and voting at a general meeting of which appropriate notice has been given. It may be difficult for minority shareholders give notice and to marshal such numbers. Further, voting by individual members in attendance can be overridden by a poll.

The second ground can be availed by a shareholder presenting a petition to the Court to wind up the company. Courts, however, rarely grant this remedy due to its drastic nature. Even where a company is being run in a manner that is oppressive to some shareholders, the alternative remedy to winding up is likely to be applied. If the Court finds that there is an alternative remedy available to a petitioner and he is acting unreasonably is seeking a winding up order, the petitioner is not entitled to a winding up order. Section 222 of the Companies Act provides sets out this position and has been applied numerous times by the courts. Cases in point include: **In the Matter of Dynamics Engineering Ltd and In the Matter of the Companies Act (Chapter 486) (Bankruptcy and Winding up Cause No. 30 of 1983)**, and **Vadag Establishment –v- Yashvin Shretta and Others (Civil Appeal No. 83 of 2000)**.

Alternative remedies to winding up can vary widely but include those indicated in the previous section.

Overall, winding up is not readily available to minority shareholders. It may also be unsuitable for them if they seek continued investment in the company.

3. Alternative Remedy to Winding Up

The members as individuals have legal standing to sue where the directors, who are also fiduciaries vis-à-vis the shareholders, owe the shareholders certain duties. An example of such a situation is where directors propose to act in a manner oppressive to, discriminatory of or detrimental to certain shareholders. Under such circumstances, the shareholder(s) can bring an action against the directors and the company. Section 211 of the Companies Act enables a member who considers that the affairs of a company are being conducted in a manner oppressive to some part of the members (including him), to make an application for an order by the court such as it thinks fit. The order may be for regulating the affairs of the company, or for the purchase of the shares of any members by other members or by the company.

Specific remedies may include injunctions or declarations, damages or compensation, restoration of the company's property, rescission of contracts, account of profits, and summary dismissal of directors.

Conclusion

As this short article has outlined, minority shareholders do have various avenues for redress open to them. The most practical avenues for recourse are legal action against the directors and application to the Court for such order as may be suitable. What is seems necessary is the creation of awareness about the availability of these remedies.