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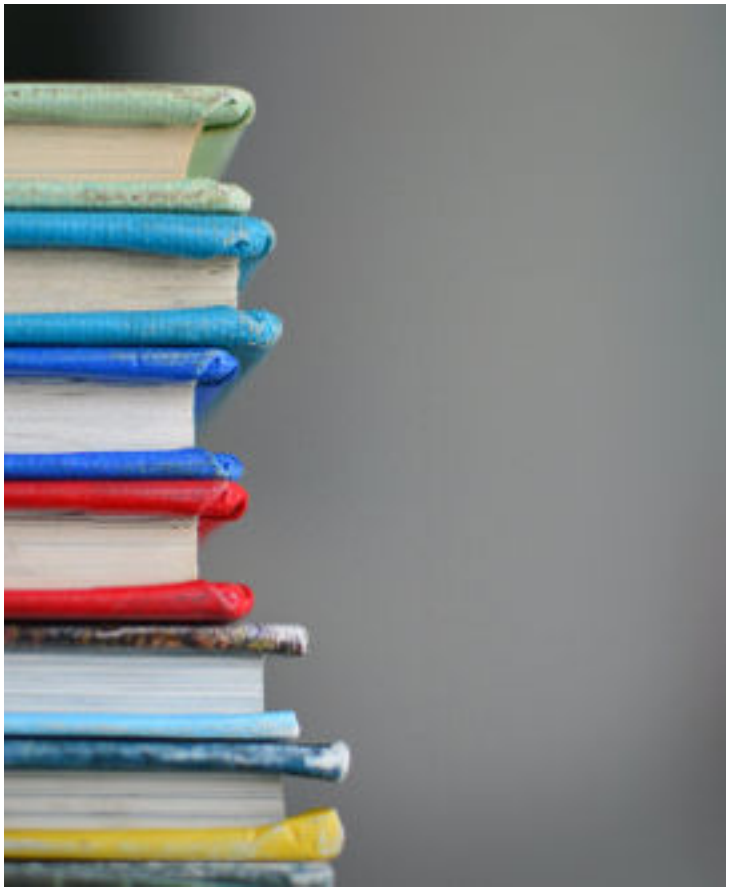
Methods by which protection can be accorded to minority shareholders in a company

By Geoffrey E. Odongo

Minority shareholding in a company may take a variety of forms. One instance being where a shareholder(s) owns less than 50% of a company's total shares hence is unable to muster sufficient votes to block ordinary resolutions proposed for approval by the majority. Another instance of minority shareholding arises where a shareholder(s) holds less than 25% of the shares in a company meaning that they cannot muster sufficient votes to block a special resolution proposed for approval by the majority.

In order to safeguard the interests of minority shareholders certain provisions can be included in the Articles of Association of the Company or in a Shareholders' agreements. However, it is worth noting that although Articles of association bind all the shareholders, they may be altered at any time by special resolution approved by a majority of shareholders without the consent of all the shareholders. Shareholders agreements, although only binding upon those persons who are party to them, are also useful in protecting minority shareholders from the domination in decision making process by the majority.



In order to protect minority shareholders the following provisions may be included in either the Articles of Association or in a Shareholders Agreement:

1. The requirement of a special resolution at general meetings for certain issues.

2. Creation of different classes of shares with weighted voting rights on certain issues. In this regard, minority shareholders may be made to have a right to a higher percentage of the vote than normal on some issues. The classes of shares could also have rights attached to them that can only be altered with the consent of a special resolution of the class of shareholders in question.

3. Making provision in the agreement so that certain acts which are usually within the powers of the board cannot be done without the approval of appointees of the minority shareholders to the board.

4. Making provision in the agreement so that certain acts cannot be done without unanimous shareholder consent, e.g., material changes to the articles of association, changes on pertinent matters related to the company share capital, matters touching on termination and insolvency of the company, etc.

5. Inclusion of pre-emption rights which ensure that existing shareholders have first right of refusal to purchase the shares of fellow shareholders who wish to exit the company at a fair price. In cases where several other shareholders wish to acquire such shares, the shareholders agreement or the articles of association will usually state that they will do so in proportion to their existing shareholding. A provision should also be included for ascertaining a 'fair price'. For instance a provision may be included to the effect that valuation of shares be carried out by an independent, reputable firm of accountants.

6. Inclusion of a dispute resolution mechanism by which the grievance of a disaffected shareholder can be resolved. Such mechanism should go on to provide for a mode of dealing with instances of a deadlock which may include contractually binding a majority shareholder to purchase the minority's shares based on a pre-determined formula.

7. The making of provision for protection should a third party offer be received to acquire the company. In such instances a clause could be included to have minority shares sold alongside any sale by the majority of its shareholding (referred to as 'tag-along' rights)..

In the absence of protection for minority shareholders in the Articles of association and or other contracts, a minority shareholder may have to apply to a court for relief on the basis of a breach of duty giving rise to a derivative claim or on the basis of conduct which amounts to unfair prejudice by the majority shareholders.

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