

Know your shareholder-rights before investing



Photo: Shareholders at AGM

Shareholders in Kenyan companies have a long way to go when it comes to corporate democracy.

Many of them are not aware of their rights and believe that they do not have a say when it comes to corporate matters.

There is a common misconception that the board of directors is superior to the actual shareholders.

Disputes between shareholders are also common place with many AGM's turning violent.

This does not have to be the case as the Companies Act as well as incorporating documents accord shareholders basic rights in the company.

Last week I touched on the rights of shareholders vis-a-vis the board of directors.

This week I will highlight the rights of the minority shareholder vis-a-vis the controlling shareholder.

The new Constitution has provisions protecting and recognising the rights of minorities.

In the same way the Companies Act recognises and protects the rights of minority shareholder against controlling shareholders.

The general Company Law rule is that each share attracts one vote. Therefore, the person with the largest shareholding in the company calls the shots when it comes to company affairs.

Most of the controlling shareholders vote for their own interests even when the vote passed oppresses other members of the company.

The minority shareholder is left without bargaining power and is often at the mercy of the controlling shareholder. There are many ways to resolve such a situation.

As a minority shareholder, you may choose to sell off your share in the company when the controlling shareholder makes a decision that is not favourable to you.

Suitable remedies

However, you stand to lose especially where you had long term interest in the company. There are other more suitable remedies.

One measure that I believe can greatly reduce company disputes is resorting to arbitration or mediation clauses in the articles of association.

When incorporating the company, it is prudent to include a detailed clause on dispute resolution.

The clause varies depending on the nature of the company. For example, a family business would require a very detailed dispute resolution clause.

Issues such as what happens in case of divorce or remarriage need to be included in the dispute resolution clause.

The standard Kenyan article of association is silent on the issues of dispute resolution.

Parties usually have no option but to go to court whenever there is a dispute.

Never mind that sometimes filing a suit requires a majority vote.

The controlling shareholder would obviously not assent to this move, therefore leaving the minority stranded.

In addition to including a dispute resolution clause in the articles of association, the incorporating members can also enter into a detailed shareholders agreement setting out various ways in which the arbitration shall be conducted in the event of a dispute.

A shareholder's agreement can be very detailed to the extent of including the name of the desired arbitrator.

By doing this, parties will avoid going to court whenever there is a deadlock. The Companies Act provides a remedy for the minority shareholder under Section 211.

The effect of this provision is that the minority's interest in the company is protected when the controlling shareholder uses his power to run the company in an oppressive manner.

Some examples include where the controlling shareholder votes for a take over in disregard of the minority's rights, where he votes to sell off the company's crown jewels below their value, or when he votes in an incompetent board.

The issue of oppression is wide, meaning the minority shareholder has an opportunity to illustrate to the court that the conduct of the controlling shareholder is unfair.

Winding up

Another important thing that the minority shareholder must show the court is that the situation in the company justifies winding up, but that winding up is not suitable.

For example, where a profitable company is being run unfairly there is no need for it to be wound up.

The court has powers to make any orders it may deem fit regarding the running of the company.

These include injunctions, stopping the sale of a company's asset and compensatory awards.

I emphasize the need for companies to have a dispute resolution clause in their articles of association as this would save a lot of time and money in the event of disputes.

In case of oppression allegations, the minority shareholder has the burden of proving to the court that the conduct of company affairs is inequitable.

He also has the burden of seeking the right prayers from the court and showing that his prayers are merited.

However, in the event of a detailed dispute resolution clause this burden of proof is automatically expunged on the existence of some facts against the majority shareholder.

As a shareholder, take time to go through the incorporating documents and acquaint yourself with some of your basic rights to avoid losing out on your investment.