Rights of shareholders under the Companies Act No 07 of 2007: A Descriptive Analysis

Abstract

The Companies Act No 07 of 2007 is seen as a mastery piece of legislation in the Country. It is a combination of both the Canadian and the New Zealand's law on the subject matter and is a significant deviation from the English Law which has been the focal point in most of our commercial law statutes for well over a century. One of the key features of the new companies' legislations is the due recognition it has given to the shareholders. The Act has given a proper definition to the term 'shareholder' and has introduced a significant amount of rights and duties which under earlier legislations the shareholders were unable to enjoy. Shareholders while bring the owners of the shares and the properties of a company handover the same upon trust to a company governed by a board of directors. Shareholders would be at risk of corruption and fraud if they cannot get themselves involved in the decision-making process. In helping to bring a mechanism of participation and voice raising, the companies' Act has invented new concepts such as Minority buyout rights, formalized actions such as the derivative actions and have made provisions regarding oppression and mismanagement. This paper focuses on the new rights and duties which the companies' Act has introduced to both protect and enhance the shareholders of a company.

Keywords: Companies Act No 07 of 2007, Shareholders, Minority Shareholder Rights,

Introduction

Shareholders in Canadian corporations can be analogized to the general populace in the Canadian political system. They periodically elect others to manage the affairs of the enterprise and they must be reported to at regular intervals. They do not usually have direct managerial powers, but they determine the identity of those who do[1].

The above observation made by the learned Canadian author Bruce Welling has substantial validity in a Sri Lankan context as well. Shareholders being the axiomatic stakeholders in the company, by subscribing to the shares of the company become its owners[2]. However, compared to other owners of movable or immovable property they exert a minimum amount of authority regarding their properties[3]. They act as beneficiaries while handing over the managerial aspects of the company to a board of directors who are held accountable through a democratic process. However, Shareholder democracy which is in any event a democracy of shares rather than of shareholders, is, or may be, an imperfect one[4]. Shareholder democracy cannot work in practice unless the shareholder group can be reached, persuaded, and galvanized to active participate in corporate life. The practical inability of the shareholders to control an independent management has been a longstanding problem in corporate law. Shareholders are, therefore from the view point of the management, a source of capital and a constituency to whom to report[5]

Discussion

The rights of the shareholders can be gathered from three main sources with regard to Sri Lanka, they include, the Companies Act No 7 of 2007(The Act), Articles of Association and the Common Law. The Act has simplified the content of the law through the codification of legal principles in many areas in which the common law was complicated, especially with regard to rights and duties of shareholders and directors[6].

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1 B Welling, *Corporate Law in Canada: The Governing Principles* (3rd edn, Scribblers Publishing 2006) 443.
2 K Kang-Isvaran and D Wijayawardana, *Company Law* (1st, Author Publication, Colombo 2014) 237 ***"shareholders are the proprietors of a company and considered owners of the company".***
3 However, the shareholders are not the owners of the property of the company, as the company is deemed a separate legal entity which can own and dispose its own property. *See* ***Fiduciary Duties and the Shareholder-Management Relation: Or, What's so Special about Shareholders?*** [By John R. Boatright. Business Ethics Quarterly Vol. 4, No. 4 (Oct., 1994), pp. 393-407] where he states that **"Ownership of a corporation is different, of course, from the ownership of personal assets. Most notably, shareholders do not have a right to possess and use corporate assets as they would their own; instead, they create a fictitious person to conduct business, with the shareholders as the beneficiaries".**
4 PL Davies and S Worthington, *Gower and Davies' Principles of Modern Company Law* (8 edn, Sweet and Maxwell 2008) 413.
5 B Welling, *Corporate Law in Canada: The Governing Principles* (3rd edn, Scribblers Publishing 2006) 443.
6 AR Wikramanayak, *Company Law in Sri Lanka* (1 edn, Author Publication 2007) 37.

Under the previous legislations there was confusion on the use of the term's shareholder and member[7]. However, with the extended definition of the shareholder[8] under the new Act that has been dispensed with. Accordingly, any person, whose name is entered in the share register, a person named as a shareholder in an application for incorporation, a person who is entitled to have that person's name entered in the share register under a registered amalgamation proposal, a person to whom a share has been transferred and whose name ought to be but has not been entered in the register and where a notice of any trust has been entered in the share register in respect of any shares[9] the person for whose benefit those shares are held in trust shall be deemed to be a shareholder in the company and shall have all the rights/privileges and duties/obligations of a shareholder.

The Act provides for both individual and collective rights to be enjoyed by the shareholders. In general, these rights which are so provided by the Act or the Articles of Association may be exercised[10] either by a shareholder meeting or by a resolution in lieu of a meeting[11] and unless otherwise provided they can be exercised by an ordinary resolution[12]. However, there are some rights that can only be exercised through a special resolution[13]. Since the Articles of a company constitutes a contract between the company and the shareholders, and the shareholders *inter se*[14], a shareholder, *qua* shareholder, has rights which are his personal rights, covering the incidents of his shares, and constitutional rights, to ensure that the company functions properly in accordance with the basic statutory scheme[15].

These rights are exercisable even where there is a conflict of interest between the company and the shareholders[16]. Corporate statutes are designed to give the collective group of shareholders a major say, however, indirectly, in how the business is to be run[17]. Shareholders can, therefore, exercise certain powers of the company where the Act specifically provides for it and in instances where the Articles permits it. The shareholders' right to exercise powers of management in specific instances helps to provide proper checks and balances on the activities of the directors[18].

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7 *Ibid* at page 112.
8 Under Part V of the Act under Section 86 the shareholder is broadly defined. This is more exhaustive than the definition given under Section 112 of the United Kingdom's Companies Act of 2006.
9 Under subsection (2) of section 129.
10 Sections 90 of the Act provides for the exercise of these powers.
11 Section 144; which is a resolution agreed upon by not less than 85% of the shareholders.
12 Section 91; ordinary resolution is defined as, ***a resolution that is approved by a simple majority of the votes of those shareholders entitled to vote and voting on the question*** *under* section 529 of the Act.
13 Section 92; it includes changing the companies Articles, major transactions, amalgamations, reducing the stated capital, voluntary winding up, changing the companies name, changing the status of the company. Special resolution is defined as ***a resolution passed by a majority of seventy-five per centum of those shareholders entitled to vote and voting on the question.***
14 Section 16 of the Act.
15 K Kang-Isvaran and D Wijayawardana, *Company Law* (1st, Author Publication, Colombo 2014) 240.
16 ***Burland v Earle*** [1902] AC 83, ***Macuna v. Northern Assurance Co Ltd***. [1925] AC 619.
17 B Welling, *Corporate Law in Canada: The Governing Principles* (3rd edn, Scribblers Publishing 2006) 443.
18 K Kang-Isvaran and D Wijayawardana, *Company Law* (1st, Author Publication, Colombo 2014) 240.

Shares are personal property being of an intangible nature, they are regarded as choses in action. This means that ownership of shares confers certain rights on shareholders which are enforceable by law[19]. There is a presumption that shares in a company are usually equal in all respects[20]. The general rule is that each share of a company confers on its shareholder a right to one vote on a poll at a meeting of the company on any resolution; a right to an equal share in dividends; and a right to an equal share in the distribution of the surplus assets of the company on liquidation[21]. However, the articles may provide otherwise[22] and a company may issue shares in different classes, including redeemable shares, preference shares giving preferential rights to distribution, or shares with special, limited or conditional voting rights[23]. These rights may be called as the personal rights of the shareholders stemming from the ownership of the shares.

The best place for shareholders to have their say is at the Annual General Meeting[24] and this is the main vehicle for shareholders who wish to influence the course of corporate business. At the AGM shareholders get the opportunity to question the dealings and undertakings of the company from the board of directors directly and to get explanations on the conduct of the business affairs of the company and to pass resolutions in order to have their wants and needs to be administered by the board[25]. In political terms this is like questioning the executive by the parliamentary members. In theory, shareholder meetings lie at the heart of corporate democracy in the same way as town meetings lie at the heart of New England's political democracy[26]. Important company business is discussed at these meetings, and shareholders are given the chance to vote on important company issues. Furthermore, the shareholder meeting is the perfect place for a dissatisfied shareholder to voice his complaints to the directors about how his company is being run. A dissatisfied shareholder can also propose that the company change its ways, and if other shareholders agrees to this, the directors will have no choice but to act on the proposal. However, the problem has been that such public company meetings are extremely poorly attended. Although there may be thousands of shareholders, research has shown that about one in thousand bothers to attend[27].

19 P Lipton and ABE Herzburg, *Understanding Company Law* (9 edn, LBC 2000) 148.
20 ***Birch v. Cooper*** [1889] 14 App Cas 525. It was held that; **In the absence of specific rights, all shares have the same rights.**
21 Section 49(2) of the Act.
22 *Ibid*.
23 Section 49(3) of the Act.
24 Section 133; ***Subject to the provisions of subsection (2) and of section 144, the board of a company shall call an annual general meeting of shareholders to be held once in each calendar year.***
25 Section 136.
26 William Irvine, 'Corporate Democracy and the Rights of Shareholders' [1988] 6(3) Journal of business Ethics 99-108.
27 J Birds and AJ Boyle, *Boyle & Birds' Company Law* (7 edn, Jordans Pub 2009) 422, Consider, for example, the case of Fuqua Industries, Inc. Its 1986 shareholder meeting was attended by only three of its 9251 shareholders. Cited in 'Corporate Democracy and the Rights of Shareholders'.

A shareholders' right to vote is a proprietary right attached to a share, unless the right to vote has been expressly excluded in the Articles of Association, or by the terms of the issue of the share[28]. The shareholders also have the right to appoint a proxy to represent and vote for them in a general meeting[29]. They also have the right to demand a poll and to vote on it as well[30]. They further have the right to get notified about the up-coming general meetings, resolutions and the contents of such[31]. The shareholders both individually and collectively have the right to both appoint[32] and to remove[33] the board of directors by an ordinary resolution. This makes the shareholders, in theory, the most powerful voice in corporate politics, since they determine the makeup of the board of directors who decide what the corporation does[34]. In theory the shareholders are given the right to decide on who should manage and run the company and if they are not satisfied with the current management, they can easily get rid of them. However, theory does not always accord with practice as in most cases due to the lack of intelligence and personal gains, the board is always able to manipulate the votes of shareholders in their favor and to continue office for longer periods of time. The shareholders have the right and the power to decide on the remuneration[35] of the directors as well. This is also an important right because it gives the shareholders the power to incentivize those directors or managers who are doing a good job at running the business[36].

The shareholders are given the sole right of either approving or disapproving major transactions of the company[37] which in essence deals with the company acquiring or disposing more than 50% of its current assets or substantially changing the nature of the company business. This section can be seen as an important check pursuant to the removal of the object's clause and the doctrine of *ultra vires* in the Act. The provision is premised on the notion that some dealings have such far reaching effects that they should be referred to the body of shareholders[38]. However, if the articles of association contain an

28 However, not all the shareholders have the same right to attend and vote at the general meeting of the company. And the law does not require that an equal voting rights to be given to shares that carry the same amount of risk, See: Section 51 of the Act.
29 Section 139 of the Act; Any shareholder of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person (whether a shareholder or not) as his proxy to attend and vote instead of him. A proxy so appointed shall have the same right as the shareholder to vote on a show of hands or on a poll and to speak at the meeting
30 Section 140 and Section 141 of the Act respectively.
31 Section 142 of the Act.
32 Section 205 (1); ***Subject to the provisions contained in the articles of the company, the shareholders of a company that is not a private company may vote on a resolution to appoint a director of the company***
33 Section 206 (1); ***Subject to the provisions contained in the articles of a company, a director may be removed from office by ordinary resolution passed at a meeting called for the purpose or for purposes that include the removal of the director.***
34 B Welling, *Corporate Law in Canada: The Governing Principles* (3rd edn, Scribblers Publishing 2006) 444.
35 Section 216 (1); ***Subject to the provisions of section 217, the board of a company may, if authorized to do so by the articles or by an ordinary resolution.***
36 Appointing, removing and remunerating the board of directors are specially left to the shareholders in public quoted companies which are emphasized in the Listed Rules of the CSE.
37 Section 185; this right is only exercisable by a special resolution to that effect.
38 K Kang-Isvaran and D Wijayawardana, *Company Law* (1st, Author Publication, Colombo 2014) 407.

objective clause and the company is acting in *ultra vires* thereof, the Act allows[39] both the directors and/or shareholders to obtain a restraining order[40] from a court of law to halt such conduct.

They also have the right to get an Interim Orders[41] with regard to oppression[42] and mismanagement[43] which may have adverse effects on their rights[44]. The shareholders, especially the minority shareholders, also have the right to move to the Court where oppression and mismanagement is alleged in relation to the conduct of affairs of a Company. In this regard shareholders are entitled to obtain Interim Orders until the final determination of the dispute in order to conduct the affairs of the company subject to action, in a smooth manner[45]. The same applies to applications made in terms of section 225 in relation to allegations of mismanagement. In addition, shareholders are also entitled to move to the Court and obtain Interim Orders in relation to any application and/or reference made under and in terms of the provisions of the act as envisaged under Section 521 of the Act. However, it must be remembered that the said remedies contained in sections 224, 225 and 521 are given at the sole discretion of the Court.

Shareholders are further provided by the Act to bring in Derivative Claims[46] on behalf of the company to protect their rights and though this action depends solely on the discretion of the Courts it is for the first time in our law that such a right has been statutorily provided with. The shareholders are also given the power to approve an amalgamation proposal[47] and the Act has further protected the rights of the shareholders by requiring that the solvency test[48] to be passed therein.

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39 Section 17 (3) (b) of the Act.
40 Section 233 of the Act.
41 Section 521 of the Act.
42 Section 224 of the Act deals with oppression but the word is not interpreted; it will depend on the circumstances of the case. It was held by **Udalagama J** in ***Ratnam and Others v. Jayathilake*** [2002] 1 Sri L R 409 that ***"I am inclined to the view that the term oppression did include "burdensome", "harsh" and "wrongful" acts".***
43 Section 225 of the Act deals with Mismanagement, the term 'Mismanagement' in Section 225(1) (a) has two facets to it. One is where a positive act of the management results in prejudice being caused to the interest of the company. The other is where the management takes no action and such non-action results in prejudice being caused to the interest of the company. Section 225(1) (b) of the Act contemplates a material change taking place in the management or control in the company where, by reason of such change, it is likely that the affairs of the company will be conducted in such a manner prejudicial to the company. See K Kang-Isvaran and D Wijayawardana, *Company Law (*Pages 524-525).
44 Section 226 of the Act provides for the Procedural aspects that need to be followed when enforcing these rights.
45 *Vide* Section 224(3) of the Companies Act No 07 of 2007.
46 Sections 234-237 deals with derivative actions which are made available for directors as well, this acts as an exception to the rule laid out in ***Foss v, Harbottle*** [1843] 67 ER 189. In a Sri Lankan context the derivative action was recognized in ***Amarasekere v. Mitsui Company Ltd and Others*** [1993] 1 Sri L R 22 where it was held that ***"If in the circumstances it is impossible to get the company itself to bring an action to protect its own interests because the directors are unwilling or helpless to intervene, a shareholder can sue in his own name, but in truth on behalf of the company, to enforce rights derived from it".***
47 Section 241 of the Act; this has to be done by a special resolution. **This is based on section 181 of the Canadian Business Corporations Act of 1985 and section 219 of the New Zealand Companies Act of 1993.**
48 However, the test of solvency s of a lesser degree than that required by the provisions of section 57 by the exclusion of the stated capital.

The shareholders have a general right to wind up a company by resolving to do so by a special resolution[49]. However, a company must be solvent to qualify for a shareholders' winding up, in order to protect the rights of creditors. They also have the right to approve or disapprove the reduction of the Stated Capital by a special resolution to that effect[50]. The importance of the Stated Capital makes the reduction of the same a process which is a strictly controlled subject. Therefore, and this is a very important right that the shareholders should enjoy with caution.

Shareholders also enjoy the right of ratification[51] whereby by they are able to give retrospective approval for things done by a director or the board which was within the power of the shareholders to do or refrain from doing such things. However, it must be at arms-length and wrongdoers may not ratify irregular conduct[52]. The doctrine of unanimous[53] assent has also been recognized by the Act specifically for private companies[54]. This gives the shareholders the right to do what they otherwise would have done at a general meeting. However, this cannot be used to cure every defect of the board of directors[55]. The shareholders are also given the right to alter the article of the company[56]. This right is an inherent one and which cannot be abrogated by a contract[57]. On the other-hand the shareholders cannot be compelled to have their liability towards the company be increased without their assent[58]. This is a cardinal principle which runs through the entire body of company law. Moreover, a shareholder has the right to have his liability towards the company to be limited as to whatever is stated in the Articles or any special provisions of the Act[59]. Shareholders have the right, not to be liable for the other obligations of the company by reason only of the fact that they are shareholders[60].

49 Section 319 of the Act.
50 Section 59 of the Act.
51 Section 238 of the Act.
52 ***Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*** [1982] Ch 204 here Prudential owned 3.2 per cent of the shares in Newman. They alleged that two directors of Newman caused the company to purchase assets at an over value. The general meeting gave their consent to the purchase but Prudential further alleged that the meeting had been given misleading information. Prudential commenced a derivative action against the directors and sought damages. Prudential succeeded in their claim.
53 The common law of England recognized the doctrine of unanimous assent, better known as the democratic principle. This was laid down in ***Re Duomatic Ltd*** [1969] 2 Ch 365 See further; K Kang-Isvaran and D Wijayawardana, *Company Law* (Pages 247-248).
54 Section 31 of the Act.
55 K Kang-Isvaran and D Wijayawardana, *Company Law* (1st, Author Publication, Colombo 2014) 248.
56 Section 15 (1) (c); this has to be done by a special resolution.
57 ***Walker v. London Tramways Co*** [1879] 12 Ch D 705; it was held that ***'provisions in the articles to the effect that they cannot be altered has no effect in law and is void'.***
58 Section 89 of the Act.
59 Section 87(1) of the Act.
60 *Ibid.*

Further, the shareholders enjoy the Pre-emptive rights on issue of new issues[61]. The intention of the legislature in this regard can be viewed as an attempt to protect the shares of existing shareholders against possible dilution thereof. The discretion of public limited companies on the issuing of shares to persons other than existing shareholders is further restricted by the listing rules of the Colombo Stock Exchange[62]. The shareholders also have the right to inspect the company records[63]. A company has to make available for inspection to its shareholders, or persons authorized by them in writing; minutes of all the meetings and resolutions of the shareholders; copies of written communications to shareholders, including annual reports; financial statements and group financial statements; certificates issued by directors, and the interest register. Shareholders may change the company name by a special resolution[64].

A shareholder may have a dispute with the corporation, with corporate management, or with other shareholders. One way of resolving the dispute is political: if the shareholders can sway a majority of fellow shareholders (in some cases, a special majority may be required) almost anything can be accomplished. However, for the outvoted shareholders, the problem is systematic. The design and major premises of corporate law are calculated to sacrifice the minority shareholders' wants to the will of the majority[65] and there is a school of thought that the concept of majority rule is basic to corporate law[66]. However, many of the difficulties faced by the minority shareholders have been dispensed with by the Act by the introduction of the concept of minority buy out rights[67] directly borrowed from the New Zealand company legislation[68].

The buyout provision recognizes not only that there is a level of change to which it is unreasonable to require shareholders submit but also that in many cases the presence of disgruntled minority shareholder will be of little benefit to the company itself[69]. The essence of the minority buy-out principle is that when a company seeks to alter its articles imposing or removing a restriction on the business activities it can engage in, or approves a major transaction, or approves an amalgamation under section 241, a shareholder who votes against the resolution, or does not sign if it is sought to be passed under section 144, can require the company to purchase his/her shares[70]. When a request is made to that effect[71] the company itself[72] or

61 Section 57 of the Act.
62 According to the Section 3 of the Listing Rules issue of shares to persons other than existing shareholders needs to be approved by a special resolution.
63 Section 119 of the Act.
64 Section 8 of the Act.
65 B Welling, *Corporate Law in Canada: The Governing Principles* (3rd edn, Scribblers Publishing 2006) 493.
66 B Welling and others, *Canadian Corporate Law: Cases, Notes & Materials* (2 edn, Butterworths 2001) 409.
67 Sections 93-99 of the Act.
68 New Zealand Companies Act of 1993 Section 106 and Sections 110-115.
69 New Zealand Law Commission Report-NZLR R9, Para 206.
70 Section 93 of the Act.
71 Section 94 of the Act.
72 Section 95 of the Act.

through a third party[73] must make arrangements for the purchase of such shares. For any reason if the shares cannot be bought the company may have to withdraw its desired proposals for which the shareholders did not assent to[74]. Shareholders also enjoy the right to exercise altering of the rights attached to a share by a special resolution[75] and here again the dissenting shareholders has the right to ask the company to buy back its shares as with the previous instance.[76]

Hereto it has been seen that in theory the shareholders can basically do whatever they want with regard to the company. However, this is a branch of law where practice lags behind the theory for a variety of reasons. The most notable fact being the lack of interest shown by the shareholders in getting involved with the decision-making process. Most of the shareholders invest in many companies but the level of engagement displayed by them in such companies appear to be minimal. Comparatively there voting rights and/or powers may be of insignificance and the power to influence the decision-making process is at a minimum. Shareholders in common parlance, appear to be interested only in the dividends a company may declare. This is further emphasized by the fact that shareholders unlike the board of directors owes no fiduciary duty towards the company and therefore, can even conduct themselves in a manner detrimental to the company if it is in the best interest of the shareholders themselves. However, the shareholder has a greater amount of choices when he decides to invest monies. And if an investor does decide to buy stock, he has a choice, in America, of perhaps eight thousand different companies to invest in [may be little less in Sri Lanka]. It must be noted that each of these companies have different charters and by-laws which confer at varying degrees, different rights to shareholders therein. If shareholders' rights are important to an investor, he has a wide variety of rights-packages to choose from. If investors are to be attracted as shareholders in corporations, then much effort would have to be taken to ensure that their rights as shareholders are violated at a minimal level or not at all. Since Investors are not forced to be shareholders, though, so the issue of shareholders' rights is not as nearly serious as the issue of political rights[77].

73 Section 96 of the Act.
74 Section 97 (2) (a).
75 Section 99 of the Act.
76 And the advantage of a right being classified as a right of an ‘interest group’ is that any alteration of shareholder rights cannot be carried out without the consent of the shareholders of that interest group.
77 William Irvine, 'Corporate Democracy and the Rights of Shareholders' [1988] 6(3) Journal of business Ethics 99-108 *emphasis added.*

Conclusion

Shareholders after all have the right to decide on their own faith, they can decide where to invest and make wise decisions. It is through these wise decisions where they can benefit from the statutory and common law rights which are so granted to them. In a world where communication technologies are advancing by the day, countries like England have allowed communications in electronic forms with regard to voting at resolutions[78]. Even with these kinds of advancements it is the shareholders themselves who has to in the end be accountable for their own misfortunes. Since taking part in a profit-making venture is a voluntary exercise by a shareholder, he/she has to take all the risks and rewards but nevertheless he/she is protected by some statutory and common law mechanisms to some extent but most lies with the shareholder itself.

Controlling shareholders (or coalitions of block-holders) have both the incentive to monitor corporate managers and the power to control them. A corporate law dominated by these shareholders would need little more than strong appointment and decision-making rights to control managerial opportunism[79]. However, rights are conferred to be acted upon and enforced and not to be slept over. As long as the shareholders sleep over their rights it would be meaningless to speak of such rights.

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