

**The Reform of Minority Shareholder Protection  
in Saudi Arabia and Dubai  
in Private Companies**

**Mahmoud H. Almadani**

200444691

This thesis submitted in accordance with the requirements for  
the degree of **PhD**

**The University of Leeds**  
**School of Law**  
May 2011

I confirm that the work submitted is my own and that appropriate credit  
has been given where reference has been made to the work of others.

This copy has been supplied on the understanding that it is copyright  
material and that no quotation from the thesis may be published without  
proper acknowledgement.

## Acknowledgments

During the completion of my PhD thesis, I have to admit that I faced many difficulties, complexities and dilemmas, including the lack of materials in certain areas. Although sometimes I doubted whether I would be able to complete this research, I never lost hope. Several factors in particular kept me inspired and encouraged me to continue. The main motivation was the publication of two sections of this research as articles in two different well-recognized English journals<sup>1</sup> and, happily, two other potential articles may be published in the coming months. It is not claimed that this research is by any means perfect or absolutely comprehensive, but it does offer a reliable foundation and guidance for any researcher who may wish to investigate the subject matter further.

Of course, no books, research or works of literature are absolutely perfect because they are manmade products and someone else may come along to prove their ideas wrong and establish a different outcome. There is one book, however, which is absolutely complete and perfect and contains no doubt: the Holy Quran. In fact, at the outset of the Quran it says “This is the perfect Book, there is no doubt in it...”.<sup>2</sup> More interestingly, the Quran has a verse which challenges any man to produce a similar book (or even a chapter) which would prove it wrong. It says “And if you (mankind) are in doubt concerning that which we have sent down (i.e. the Quran) to Our slave (Muhammad peace be upon him), then produce a chapter of its like....”.<sup>3</sup> The fact that this challenge has not been defeated until now can be seen to prove conclusively that the Quran is not a manmade book.

Further encouragement which pushed me to progress in my research came from Professor Andrew Keay, my main PhD research supervisor, who was always there to offer me help, support, direction and guidance. In fact, he often went beyond his role as a supervisor and also acted as a father or older friend, showing me care and concern and giving me valuable advice. I still remember many incidents in which he clearly acted in

---

<sup>1</sup> M, Almadani., Derivative actions: does the Companies Act 2006 offer a way forward?, *Company Lawyer*. 2009, 30(5), 131. Also see: M, Almadani., The Role of Sharia Law in Protecting Minority Shareholder in Private Companies, *International Company and Commercial Law Review*. 2010, 21(12), 395.

<sup>2</sup> Holy Quran, Chapter 2, Verse 2.

<sup>3</sup> Holy Quran, Chapter 2, Verse 23.

my interests and in favour of my research. Therefore, I pay tribute to his effort and would like to thank him, from the depths of my heart, for everything he has done for me throughout my PhD research.

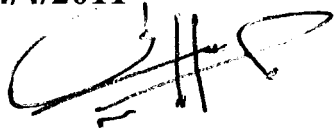
I would also like to express my gratitude to a number of people who have made an indirect but important contribution to this project. Firstly, I want to thank my father, Hamza, who raised me in a legal environment and has sponsored me through my education, and also my mother, Samira, who prays for me to succeed and has always asked God to give me all the best. Secondly, thanks go to my younger brother, Amr, who is always supporting me. Thirdly, thanks also go to all the members of my extended family, and especially my father and mother in law, who have called me regularly to follow my progress.

Of course, I will never forget the contribution of my wife, Abeer, in helping me to carry out this research for without her support, encouragement and motivation, little would have been achieved.

Finally, I extend my appreciation to my friends in Jeddah, Nottingham and Manchester who, by calling me regularly, have been able to push me forward to realize this achievement, and they will certainly share my success with me.

**Mahmoud H. Almadani**

14/4/2011



## **Abstract**

This thesis explores the state of the law as it affects the protection of minority shareholders in private companies in Saudi Arabia and Dubai. This research was precipitated by the apparent insufficiency of the law in these two jurisdictions as far as minority shareholder protection is concerned. It has been found that the minority shareholder's rights and interests are not satisfactorily protected by the company law in these two countries. In fact, the law grants majority shareholders an unrestricted control over the company that is capable of causing abuses and injustice as far as minority shareholders are concerned. Thus, for these two countries to meet domestic demands to have effective protection and to match international trends in order to attract foreign investment, it is argued that they should develop and improve their company law in this respect.

This research has sought to address the following questions. How should Saudi Arabian and Dubai law be reformed in terms of minority shareholder protection? How can the UK company law with its long experience and knowledge proffer a way forward for the reform of both jurisdictions? What is workable in the context of SA and Dubai if UK law is adopted, and what adaptations may be required? In order to answer these questions the research has employed doctrinal, theoretical and empirical approaches.

The products of this research are proposals for wide-ranging reforms to the system for minority shareholder protection that exist in SA and Dubai. The research has come up with codification of minority shareholder protection that follows in the footsteps of the UK statute, but not in every respect. The code has been carefully examined to comply with the needs, culture, tradition, conventions and Sharia that exist in both jurisdictions.



# Contents

Acknowledgment.....	(i)
Abstract.....	(iii)

## Chapter 1

### Introduction

1.1 Background.....	1
1.2 Overview of minority shareholdings.....	3
1.3 Where does the problem lie? What remedies are in place to protect minority shareholders?.....	4
1.4 The main research issue.....	6
1.5 Research questions and aims.....	8
1.6 The reason for addressing this subject matter.....	9
1.7 Methodology.....	10
1.8 The proposed structure for this research.....	11

## Chapter 2

### Why protect minority shareholders?

Introduction.....	14
2.1 The weak position of the minority shareholder.....	15
a. Majority oppression or unfair prejudice of a minority shareholder (personal interests).....	19
(i) Generally.....	19
(ii) The majority breaches legitimate expectations (informal agreement).....	22
b. Majority abuse of the company (corporate interest).....	26
2.2 Criticisms against the principle of minority shareholder protection.....	30
2.2.1 Arguments against the importance of minority shareholder protection....	30
2.2.2 The majority shareholder's interests should always be a priority.....	34
2.3 Justifications for protecting the minority shareholder.....	37
2.3.1 The economic aspect.....	37
2.3.2 Justice and fairness necessitate protection for the minority shareholder....	39
2.4 What is it exactly that needs to be protected for the minority shareholder? And what is the court's role in ensuring this protection?.....	42
2.4.1 The rights and interests of the minority shareholder which need to be protected.....	43
2.4.2 The court's role when dealing with minority shareholder cases.....	47
a. The court's involvement in commercial and litigious decisions..	49
b. Scepticism of the court's capacity to judge in minority cases....	50
c. Clear criteria to guide the court.....	52

<b>2.5 What would be the ideal way to produce efficient protection for minority shareholders?.....</b>	<b>53</b>
2.5.1 Corporate governance.....	53
a. Its definition and scope.....	53
b. Its general aims.....	55
c. Its role to provide remedies.....	55
2.5.2 Grounds on which to establish an action for corporate interests.....	57
2.5.3 The ideal model of protection.....	59
<b>2.6 Conclusion.....</b>	<b>62</b>

## **Chapter 3**

### **An examination of minority shareholder protection in Saudi Arabia and Dubai**

<b>Introduction.....</b>	<b>64</b>
<b>3.1 General outline of Saudi Arabia and its laws.....</b>	<b>65</b>
<b>3.2 Saudi Arabian Company Law and minority shareholder protection.....</b>	<b>67</b>
<b>3.3 The role of Sharia law in protecting minority shareholders.....</b>	<b>75</b>
3.3.1 Background.....	75
3.3.2 Sources of Sharia.....	77
3.3.3 The application of Sharia.....	78
3.3.4. Sharia protects the weaker party.....	80
3.3.5. Sharia and the protection of minority shareholders.....	83
3.3.6. The role of company statute in regulating protection alongside Sharia...86	
<b>3.4 The Bill for a new Saudi Arabian Company Law.....</b>	<b>90</b>
<b>3.5 The position of minority protection in Dubai.....</b>	<b>93</b>
3.5.1 A general overview of company law and regulation in Dubai.....	94
3.5.2. Advantages and disadvantages of minority shareholder protection provisions in Dubai.....	95
3.5.3. Proposed solutions and recommendations.....	98
3.5.4. New Company Law in Dubai.....	99
<b>3.5 Conclusion.....</b>	<b>101</b>

## **Chapter 4**

### **An empirical study of minority shareholder protection in Saudi Arabia**

<b>Introduction.....</b>	<b>104</b>
<b>4.1 Why conduct an empirical study?.....</b>	<b>105</b>
<b>4.2 Obtaining approval for the empirical study.....</b>	<b>106</b>
<b>4.3 Analysis of the empirical study.....</b>	<b>107</b>
4.3.1. The Problem.....	109
4.3.1.1. Existence of oppression and wrongdoing.....	109
4.3.1.2. Minority complaints.....	110
4.3.1.3 Theory adopted by the Act.....	112
4.3.1.4. Absence of protection causes problems.....	112
4.3.1.5. Impact on the economy and investment.....	114
4.3.1.6. Undiscounted payout.....	117
4.3.1.7. The provision of criteria to be followed.....	118

4.3.2 Current remedies available.....	120
4.3.2.1 Available remedies.....	120
4.3.2.2 The court's role.....	121
4.3.2.3 Shareholder agreement's role.....	124
4.3.3 Participants' recommendations.....	125
4.3.3.1 Rights and interests.....	125
4.3.3.2 Extra remedies and a healthy environment.....	128
4.3.3.3 Adoption and adaptation of remedies.....	131
<b>4.4 Assessment and reflection.....</b>	<b>134</b>
<b>4.5 Conclusion.....</b>	<b>137</b>

## Chapter 5

### An examination of minority shareholder protection in UK Company Law

<b>Introduction.....</b>	<b>140</b>
<b>5.1 Minority shareholder protection under common law and pre-2006 company law.....</b>	<b>141</b>
<b>5.1.1 Common Law.....</b>	<b>141</b>
5.1.1.1 Personal actions.....	143
5.1.1.2 Derivative actions under common law.....	145
a. How to prove fraud on the minority under common law.....	145
b. Difficulties with derivative actions under common law.....	148
c. Indemnity in derivative claims.....	149
d. Comments on the functioning of the derivative action under common law.....	152
<b>5.1.1 Statutory personal rights for minority shareholders before 2006.....</b>	<b>153</b>
5.1.2.1 Background.....	153
5.1.2.2 The meaning of s459 (conduct of the company's affairs).....	158
5.1.2.3 The concept of unfair prejudice in s459.....	158
5.1.2.4 The minority shareholder's interest in the company.....	159
5.1.2.5 The remedies available under s461.....	160
5.1.2.6 The winding-up order.....	161
5.1.2.7 The valuation of shares.....	162
5.1.2.8 The impact of <i>O'Neill v Phillips</i> on s459.....	164
a. Introduction.....	165
b. Background to <i>O'Neill v Phillips</i> .....	165
c. Unfair prejudice and legitimate expectation in <i>O'Neill v Phillips</i> .....	166
d. Changes delivered by <i>O'Neill v Phillips</i> .....	169
<b>5.2 Proposals to reform minority shareholder protection (Law Commission and Company Law Review Group).....</b>	<b>171</b>
<b>Introduction.....</b>	<b>171</b>
<b>5.2.1 Proposals regarding common law.....</b>	<b>171</b>
5.2.1.1 Recommendations to reform personal action.....	171
5.2.1.2 Recommendations to reform derivative actions.....	171
5.2.1.2.1 Law Commission.....	173

5.2.1.2.2 Company Law Review.....	176
<b>5.2.2 Proposals towards the statutory protection under s459.....</b>	<b>177</b>
5.2.2.1 The Law Commission.....	178
5.2.2.2 The Company Law Review.....	180
<b>5.3 Minority shareholder protection under the Companies Act 2006.....</b>	<b>182</b>
<b>5.3.1 Derivative action under the Companies Act 2006.....</b>	<b>182</b>
a. Statutory derivative action.....	182
b. Ratification under the statute.....	184
c. How to establish a derivative action under the statute.....	186
d. Stages and filtering process in the statutory derivative action...	188
e. Concerns about the statutory derivative action.....	192
f. Matters still remaining unreformed under the Act.....	193
<b>5.3.2 Unfair prejudice under the Companies Act 2006.....</b>	<b>197</b>
<b>5.4 Conclusion.....</b>	<b>198</b>

## **Chapter 6**

### **Solving the problems of Saudi Arabia and Dubai**

<b>Introduction.....</b>	<b>201</b>
<b>6.1 Outlining the Saudi problem.....</b>	<b>202</b>
<b>6.2 The problem of having no statutory provisions.....</b>	<b>205</b>
<b>6.3 The problem of restricting judges' discretion.....</b>	<b>209</b>
<b>6.4 The problem of costs.....</b>	<b>211</b>
<b>6.5 The need for establishing personal grounds as a basis for minority shareholder action.....</b>	<b>212</b>
<b>6.6 The need for statutory rights and interests.....</b>	<b>219</b>
<b>6.7 Alternative remedies.....</b>	<b>221</b>
<b>6.8 Recommendations regarding the reform of Dubai Company Law.....</b>	<b>224</b>
<b>6.9 Conclusion.....</b>	<b>225</b>

## **Chapter 7**

### **Conclusion**

a. Summary.....	226
b. The reform and outcome which this research has offered to SA and Dubai.....	233
c. Recommendations and comments.....	235

<b>Bibliography.....</b>	<b>237</b>
--------------------------	------------

<b>Appendix.....</b>	<b>245</b>
----------------------	------------

# Chapter 1

## Introduction

### 1.1 Background

In many parts of the world, religious groups have organized to implement policies which influence the manner in which civil society is run. The Middle East, particularly the Gulf States, is one of those regions in which religion has a powerful effect in regulating the law. The Gulf States consist of six countries - Saudi Arabia, The United Arab Emirates (UAE), Bahrain, Kuwait, Oman and Qatar - which all share similar political legal systems based on the Islamic creed, a joint destiny and common objectives.<sup>1</sup> In designing their basic laws, these countries have taken their constitutions and regulations from Islam. Nevertheless, there are certain aspects of modern life that the Islamic or Sharia Law has not covered in detail. This is not to say that Sharia Law does not touch all aspects of life, but rather that it sometimes provides only general principles. In this situation, it is the role of legislative authorities to formulate appropriate law to be put into operation as a viable alternative, as long as it does not contradict Sharia Law. Modern commercial law and company law are two of the areas of life where Islam and Sharia law have not had a major influence on the principles that have been adopted. However, there has been a need for the Gulf States to develop and improve their company law, not only to meet the domestic demands to do business, but also to match international trends in order to attract foreign investments.

In accordance with this interest in creating a healthy company law in the region, the French/Egyptian model was introduced by each of these jurisdictions as a basis upon which to enact corporate legislation<sup>2</sup> in order to provide an exhaustive corporate framework, functional for all parties (local and international), and in order to enable them to do business successfully.<sup>3</sup>

---

<sup>1</sup> Only lately two other countries (Iraq and Yemen) have joined the Gulf States group but still have not obtained full membership.

<sup>2</sup> R, Lewis. & C, Mallat., Centre of Islamic & Middle Eastern Law, *Commercial Law in the Middle East* [online]. Available at: <<http://www.soas.ac.uk/Centres/Isalmiclaw/Materials.html>> accessed 12 February 2009.

<sup>3</sup> ANON., *Companies under the UAE Commercial Company Law* [online]. ALTAMIMI & Company, Available at: <[http://www.tamimi.com/site\\_1024/pdf/Complaw.pdf](http://www.tamimi.com/site_1024/pdf/Complaw.pdf)> accessed 14 February 2009.

Saudi Arabia and the UAE, which attract the bulk of the investment in the Gulf, have embarked on reforms to diversify their oil-reliant economies by opening up most of their sectors, privatizing public enterprises and expanding their industries. This has required the two countries to produce certain regulations to facilitate the arrival of foreign investments.<sup>4</sup> According to the Dubai Statistics Centre of the Dubai government, foreign investment in 2006 in Dubai alone reached over \$11.5 billion and this figure even increased in 2007.<sup>5</sup> On the other hand, Saudi Arabia attracted \$24 billion of foreign investments in 2007 alone, an increase of 33 per cent compared to 2006.<sup>6</sup> The UAE company law applies the 51/49 rule when dealing with foreign investors (that is, foreign investors are allowed to have no more than 49 per cent of the shares, so they are always in the minority, (this will be explained below in detail)).<sup>7</sup> But as an alternative way to proceed, foreign investors can establish companies in one of the Dubai Special Zones and own more than 50% of them.<sup>8</sup> In Saudi Arabia, in contrast, foreign investors may own 100 per cent of a company as long as they have complied with the requirements of the Foreign Investment Act 2000.

The main concern of this research is the protection of minority shareholders in private companies. Such shareholders can include foreign investors who are forced to be minorities in the UAE, or foreigners or nationals who choose to have minority shares in either Saudi Arabia or the UAE. These two jurisdictions have a very large market for private companies and they attract many foreign and national investors who need to be protected. However, it is important to note here that this research will not study the UAE as a whole, but will only concern itself with Dubai, which is one state of a

---

<sup>4</sup> A, Sambidge., *Foreign Investment in GCC Rockets* [online]. (2008) Arabian Business.com. Available at: <<http://www.arabianbusiness.com/526019-foreign-invesbtment-in-uae-rockets?ln=en>> accessed 2 January 2009.

<sup>5</sup> P, Terblanche., United Arab Emirates: UAE company law overview, *Taylor Wessing (Middle East) LLP*. (27 May 2009), Available at: <<http://www.mondaq.com/article.asp?articleid=80106>> accessed 5 May 2010.

<sup>6</sup> ANON., *Foreign direct investment in Saudi Arabia up 33%* [online]. (2008) AME Info. Available at: <<http://www.ameinfo.com/176732.html>> accessed 15 December 2008.

<sup>7</sup> According to Othman (A, Othman., *Essential Trade Law*. 1<sup>st</sup> ed. Kuawit University, Kuawit, 1995. pg: 192) the purpose of granting nationals more shares and control than foreigners is to improve the status of nationals and ensure they can be easily held accountable for any liability towards the national economy.

<sup>8</sup> Dubai promotes foreign investment by setting up specialized economic zones in which foreign investors are entitled to 100 % ownership and profits with 0% taxes. See: Dubai Technology and Media Free Zone Private Companies Regulations 2003.

federation of seven emirates (states).<sup>9</sup> Dubai has been chosen for this study from among the other states in the UAE for many reasons including its ability to attract foreign investment, the fact that it is developing quickly and, to a certain extent, because of the availability of reliable materials. So whenever the UAE is mentioned in this research, reference is made, primarily, to Dubai.

## 1.2 Overview of minority shareholdings

Prior to focusing on the current doctrine in the two countries, it will be helpful to give a very brief overview of minority shareholdings. Shareholders, in private companies, who do not control the affairs of the company by voting, alone or in coalition with others, are to be regarded as minority shareholders. Obviously, the more shares a person or a company holds, the more influence that person or company may have. If the majority of shares are held by one particular shareholder then he/she can have substantial control. This influence or power can be wielded to pass decisions in general meetings or at the meetings of the board of directors as each of these bodies generally makes their decisions by majority vote.<sup>10</sup> The practical concern here is that the majority shareholders, who control the company with their voting power, can cause harm to the company and prevent it from taking any action to remedy the harm done.<sup>11</sup> If a company suffers any kind of wrong, because it is a separate legal entity from its incorporators (majority and minority shareholders), it is only the company that should and can take legal action in order to redress the wrong. Unfortunately for the minority shareholder, if the wrong is committed by the directors and is one that is capable of being approved or ratified by the majority of the shareholders, then no individual minority shareholder can remedy the wrong as the company's will is, in most cases, exercised by the majority shareholder in a form of decision-making at general meetings.<sup>12</sup>

---

<sup>9</sup> Dubai is one state of a federation of seven emirates (states), the United Arab Emirates, in which each state is governed by a separate federal authority and slightly different laws. In this research, the focus will be solely on Dubai and its federal commercial company law of 1984.

<sup>10</sup> A, Hicks. & S, Goo., *Cases and Materials on Company Law*. 6<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 429.

<sup>11</sup> S, Mayson. D, French. & C, Ryan., *Company Law*. 24<sup>th</sup> ed. Oxford: Oxford University Press, 2007-2008, pg: 515.

<sup>12</sup> A, Reisberg., *Derivative actions and corporate governance: theory and operation*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2007, pg: 76-77.

It is also possible for the majority shareholder to act unfairly towards or oppress the minority shareholder. This unfairness or oppression is related to running the company in a way which has clearly unfair consequences for the minority shareholder. The primary concern of the law in providing actions against majority shareholders who act unfairly is not to protect the company from any wrongdoing but rather to protect the minority shareholder's interests. To pursue this type of protection, the court may pay regard to the equitable consideration of "legitimate expectation" and the loss of trust or confidence between shareholders as a basis to litigate. Therefore, it is clear that the law should always provide relief in respect of both wrongdoings against the company itself and any improper or illegal act that is unfair and oppressive to the minority shareholder.<sup>13</sup>

### **1.3 Where does the problem lie? What remedies are in place to protect minority shareholders?**

The commercial market in the Gulf States has attracted many international investors to do business in this region. A recent survey ranked Saudi Arabia and the UAE as being the best locations in the Arab world for conducting business and Saudi Arabia is positioned in the top twenty countries in the world in this respect.<sup>14</sup> The survey measured a range of factors including ease of starting a business, how simple it is to obtain credit, how cross-border trade operates and the level of minority investor protection.<sup>15</sup> Kjaer has recently shown that there is a focus on smarter regulation in these countries as the whole business model is based on attracting foreign investment. On the other hand, foreign investors are also attracted to the region because of its high liquidity and oil revenues which lead to fast business development.<sup>16</sup>

---

<sup>13</sup> A, Hicks. & S, Goo., *Cases and Materials on Company Law*. 6<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 451.

<sup>14</sup> According to the recent study (2008) available at: <<http://www.thenatinal.ae/article/20081110/BUSINESS/555050371/1118/rss>>, Saudi Arabia ranked as the number one country in the Arab world and 16<sup>th</sup> overall whilst the UAE ranked second in the Arab world and 46<sup>th</sup> overall.

<sup>15</sup> A, Foxwell., *UAE Climbs in world Ease of Business Rankings*. The National. (2008), Available at: <<http://www.thenatinal.ae/article/20081110/BUSINESS/555050371/1118/rss>> accessed 15 January 2009.

<sup>16</sup> Jesper Kjaer, the general manger of the private enterprise partnership for MENA at the International Finance Corporation. See: <<http://www.thenatinal.ae/article/20081110/BUSINESS/555050371/1118/rss>>.



Therefore, one might think that these two countries, in particular, would have comprehensive, functional, practical and convenient company law systems which accommodate all parties by protecting their rights and interests. However, this is far from the reality. Although there have been changes in company law in Saudi Arabia and Dubai, as far as minority shareholder protection goes, they seem to be insufficient.<sup>17</sup> The fact is that the company law currently in place does not provide full protection for minority shareholders.

It is true that the law in the two countries under investigation has granted the minority shareholder the right to complain to the majority shareholder (not the board) over any wrongdoing that they believe is occurring.<sup>18</sup> However, it is important to note that the same section restricts the minority so that they can only raise complaints prior to the completion of the conduct or act complained of. If the conduct or act has been completed, then the minority shareholder has no right to complain to the majority shareholder in order to have the conduct reviewed. Moreover, if the majority shareholder ratifies the conduct after it has taken place, then there is little that the minority shareholder can do and the court in most cases agrees with the majority shareholder, preferring not to interfere in the company's internal affairs. Even if it appears that a director is clearly misusing his/her position, only the majority shareholder has the right to question the director, hold him/her accountable and/or dismiss him/her.<sup>19</sup>

Consequently, the minority shareholder's rights and interests do not appear to be sufficiently protected by the company law in these two countries, as their company statutes tend to grant unrestricted control to the majority shareholder over the company's interests and do not clearly allow the minority shareholder to bring any action on behalf of the company against the directors or the majority shareholders. Therefore, it is left to shareholder agreements to provide for the rights and interests of minority shareholders, since the statute does not offer adequate protection.

---

<sup>17</sup> A, Naciri., *Corporate Governance Around the World*. 1<sup>st</sup> ed. Routledge, London, 2008, pg: 357.

<sup>18</sup> s28 of the Saudi Company Law 1965. Section 39 of the UAE Commercial and Companies Law 1984 has a similar provision.

<sup>19</sup> s33 (1)&(2) of the Saudi Company Law 1965.

Company law in Saudi Arabia and Dubai leaves it open to shareholders to state whatever they wish in the shareholder agreement.<sup>20</sup> This agreement, which is equivalent to the “articles of association” in the UK, must be filed with the General Company Authority for registration and disclosure.<sup>21</sup> The agreement allows the shareholders to protect themselves by focusing on certain areas of dispute that are likely to arise if a well-drafted agreement is not in place.<sup>22</sup> It can also provide a mechanism for an exit procedure that can be called upon where amicable agreement cannot be reached, and this has the effect of enabling a minority shareholder to exit the company with minimal disruption. Furthermore, an express term can be included in the agreement to avoid any dispute regarding the removal of minority shareholders or termination of their directorships.<sup>23</sup> Nonetheless, it is important to highlight the fact that, according to Saudi Arabian company law,<sup>24</sup> and also that applicable in Dubai, the shareholders are allowed to state whatever they wish as long as it does not contradict the statute.

#### 1.4 The main research issue

The failure to provide any protection for minority shareholders in company law statutes emanates from a limited recognition of the rights and interests which are attached to each share in the first place. To comprehend the legal nature of a share from a UK perspective, Farwell J, in *Borland's Trustee v Steel*, explains that “...a share is not a sum of money... but is an interest measured by a sum of money and made up of the various rights”.<sup>25</sup> On this basis, there are certain rights attached to ordinary shares once acquired, such as the rights to capital, voting, dividends and other rights.<sup>26</sup> These need to be provided for by the statute, and minority shareholders must have some protection concerning these rights and interests

---

<sup>20</sup> s27 of the Saudi Company Law 1965. As long as it does not contradict Sharia law or the statute.

<sup>21</sup> s21 of the Saudi Company Law 1965. It is important to note that this section does not require the constitution or article of association to be sent alongside the shareholder agreement, as in UK and US law. However, the section requires shareholders to clarify certain clauses in the contract.

<sup>22</sup> H, Hamd Allah., *Saudi Commercial law*. 1<sup>st</sup> ed. ANNAHDAH, Cairo, 2003, pg: 259.

<sup>23</sup> R, Cooper., *How Do You Protect Your Shareholding?*. Rtcoopers. (2005), Available at: <[http://www.rtcoopers.com/pdf/benefit\\_of\\_a\\_well\\_drafted\\_shareholders\\_agreement.pdf](http://www.rtcoopers.com/pdf/benefit_of_a_well_drafted_shareholders_agreement.pdf)> accessed 18 October 2008.

<sup>24</sup> Sections 24 – 34 of the SA Company Law 1965.

<sup>25</sup> [1901] 1 Ch 279, 288. This description was also cited with approval in *IRC v Crossman* [1937] AC 26, HL.

<sup>26</sup> E, Ferran., *Company Law and Corporate Finance*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 1999, pg: 337.

The problem starts when shares are placed in the hands of those who control more than half of the votes at a members' meeting. Minority members must, in principle, accept the decisions of the majority shareholder and must also acknowledge that the power is lawfully enjoyed by shareholders who hold a greater number of shares. It can be argued that once the minority shareholder simply disagrees with, or is faced with any abuse or misuse by those in control, he/she should sell his/her shares and invest elsewhere. Indeed, this is usually what happens in publicly listed companies as the exit option is always open for the disgruntled minority, meaning he/she can sell the shares on the market.<sup>27</sup> On the contrary, in private companies, which are the concern of this research, there will almost always be no ready market for his/her shares, as the only available buyer may be the majority shareholder who is likely to offer a discounted price.<sup>28</sup> In such circumstances, the minority shareholder may turn to the law for help. Clearly, the law must decide if an abuse of power has occurred and provide remedies to meet those cases in which the power has been abused.

The main issue here emerges from the tension that exists between the need to empower the majority shareholder to run the company and the fundamental necessity to provide remedies for minority shareholders so they can protect their rights and interests. Although not easy, one would think that it is not an impossible task for Saudi Arabia and Dubai to make provision in their company to uphold the right to pursue litigation against directors/majority shareholders who are acting improperly and, at the same time, ensure that they do not allow every litigious minority shareholder to make nonsense claims.<sup>29</sup> In fact, UK company law recognized this tension of interests within companies a long time ago.<sup>30</sup>

This research will argue that the idea that the majority shareholder's interests are the only ones that should be protected within the company should not be embraced.<sup>31</sup> It will

---

<sup>27</sup> It is admitted, as outlined in Chapter 3, that the SA and Dubai company laws address the minority shareholder protection within public companies in an effective manner.

<sup>28</sup> L, Sealy. & S, Worthington., *Cases and Materials in Company Law*. 8<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 500.

<sup>29</sup> E, Ferran., *Company Law and Corporate Finance*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 1999, pg: 337.

<sup>30</sup> UK law had realized these different interests in companies since the case *Foss v Harbottle* [1843] 2 Hara 461, over 160 years ago, clearly before the concept of corporate governance was born.

<sup>31</sup> This is the case with both the SA and UAE models as their company laws state indirectly that propriety should be granted to the majority's interests. This is also touched upon in s28 and s33 (1) & (2) of the

also argue that the view that the minority shareholders should not be granted any remedial devices because they may not use them in good faith when acting on behalf of the company is flawed.<sup>32</sup> These arguments and others will be addressed by demonstrating the need to reform Saudi and Dubai company law in order to produce efficient protection for the minority shareholder. Finally, it is claimed that the reforms suggested by this research will create a practical commercial environment which will benefit each party equally and protect the corporate and personal interests.

### **1.5 Research questions and aims**

It is believed that Saudi Arabian and Dubai company law does not offer adequate statutory protection for minority shareholders in private companies. Although the shareholder agreement can provide, to a certain extent, some protection for minority shareholders, there must be some protection reserved in the statute for the minority shareholder, so, for instance, if disputes arise post-execution of the shareholder agreement, possible relief remains available. Minority shareholder protection, as a right, must not be subject to the will of the majority shareholder or the terms of the shareholder agreement alone. This latter point relies on the recognized fact that contracts are incomplete and therefore cannot provide sufficient protection for the minority shareholder and, accordingly, cannot be the sole source of protection.

This research seeks to answer a number of critical questions. First, do existing minority shareholders in Saudi Arabia and Dubai experience any type of abuse of power or oppression by the controlling majority shareholders, which therefore necessitates some form of protection? And is the abuse a real problem? Second, is there any actual acknowledgment by both countries' laws and courts of the risks and problems attached to granting the majority shareholder supreme power over a company? Third, does the law or do the courts furnish any legal mechanism for the oppressed minority

---

Saudi Company Law 1965 which says that the minority can only complain to the majority if wrongdoing has taken place and then it is up to the majority to deal with it. This has granted the majority the full capacity to cover up any wrongdoing towards the minority or even the company knowing that no litigation can be brought.

<sup>32</sup> In (A, Reisberg., Judicial Control of Derivative Actions, *International Company and Law Review*. 2005, 16(8), pg: 337&338) the author revealed that there are some who believe that no automatic right should be given to the minority to bring an action on behalf of the company because of a fear that this right can be abused with no good faith.

shareholder to remedy any wrongdoing or unfairness? Fourth, are there justifiably convincing reasons to pursue reform for minority shareholders in both countries? Further, how, if at all, can UK company law, with its long commercial experience and knowledge, provide a [theoretical] way forward for the reform of both Saudi Arabia and Dubai's laws? Can UK minority protection laws be adopted for effective use in both countries? If so, to what extent might they have to be adapted? Finally, how should Saudi Arabia and Dubai law be reformed?

A significant aim of this research is to ascertain the present position of minority shareholders in both Saudi Arabia and Dubai. Another aim is to identify whether there is any insufficiency or breakdown in the legal and judicial system of either jurisdiction when it comes to minority protection. More importantly, the research aims to propose and recommend a practical system of minority shareholder protection that avoids all identified disadvantages and defects and facilitates the provision of an efficient and healthy commercial environment that provides a basis for the equal contentment of all shareholders.

### **1.6 The reason for addressing this subject matter**

The principal motives behind the adoption of this subject matter are as follows: firstly, Saudi and Dubai company laws have not, up until this time, been satisfactorily discussed by researchers. Secondly, both countries have attracted many foreign companies and international investors to participate in their businesses without, at the same time, providing efficient protection for those who are minority shareholders in private companies. Thirdly, UK company law has been dealing with the issue of minority shareholders for many years and it is worthwhile considering how Saudi Arabia and Dubai can both learn from its experience and avoid its mistakes. Finally, company law in Saudi Arabia and Dubai is not well-developed and there is no case law in the legal systems of these countries to fill the gaps. Therefore, there is strong justification for proposing a statutory reform.<sup>33</sup>

---

<sup>33</sup> However, it should be understood that, although these countries have no common law, Islamic general principles have a role to play which is similar to that of common law. See: H, Hamd Allah., *Saudi Commercial law*. 1<sup>st</sup> ed. ANNAHDAH, Cairo, 2003, pg: 23.

In addition to the reasons highlighted above, there is a clear intention from the law-makers in both Saudi Arabia and Dubai to reform their company law, especially in respect of minority shareholder protection. This intention was recently observed when the law-makers responded to the urgent need to activate a statutory device for minority shareholders in public companies (not applicable to private companies). This device, which is similar to the derivative action process in the UK and elsewhere, has been called 'liability action'.<sup>34</sup> It enables a minority shareholder to bring an action against the company's directors, where they have breached duties etc, on behalf of the public company if the company fails to do so. In Saudi Arabia and Dubai, this action must be commenced in the minority shareholder's name and not in that of the company. But, because this action is limited to public companies, it does not assist the minority shareholders in private companies who are the subject of this thesis. As a result, this research will seek to formulate a practical and actionable mechanism which can be employed by the minority in private companies.<sup>35</sup>

## 1.7 Methodology

It is crucial to note that both countries, Saudi Arabia and the UAE, not being common law jurisdictions, have no case law that can be referred to for guidance on future cases and to provide reasons why judges reach particular decisions.<sup>36</sup> In this respect, they are unlike the UK, where case law has a very significant role to play. Therefore, this research, when covering Saudi Arabia and the UAE, will rely, in the main, on the study of the statutory company law, new regulations, legal texts and academic literature. This doctrinal approach will be employed as one of two main methods.

The second method is an empirical approach which will involve face-to-face semi-structured interviews with businesspersons, minority shareholders, majority

---

<sup>34</sup> This action has an origin in the Saudi Company Law 1965 under s78. The law-makers have not created a new device as such but have added certain duties and obligations for the directors to comply with and designed a simpler mechanism and a more straightforward procedure for the minority to exercise the action. For more information see:

<[http://ksb.com.sa/j/index.php?option=com\\_content&task=view&id=95&Itemid=102](http://ksb.com.sa/j/index.php?option=com_content&task=view&id=95&Itemid=102)>.

<sup>35</sup> Minority protection in UK company law has been in existence since *Foss v Harbottle* [1843] 2 Hara 461 and been left in place for over 160 years, going through several reforms and developments under common law and the statute until it was most recently shaped under the Companies Act 2006.

<sup>36</sup> However, as is proved in Chapter 3 section 3.3, Sharia law, to a great extent, fills the gaps and works in a similar way to UK common law.

shareholders, regulators, judges, lawyers and academic researchers. The deficiency of case law and, accordingly, case comment, together with a lack of relevant research in the field, necessitates this approach. But also importantly, this work will help to assess what is actually occurring in the commercial world, by reflecting the reactions of people who are directly involved in companies and their practices. This will hopefully help to build a clearer picture which, in turn, will facilitate finding a way forward towards appropriate reform. The collected data will be subject to qualitative analysis based on a coding system which divides participants into categories in order to expose each group's opinions, views and perspectives.

### **1.8 The proposed structure for this research**

Chapter 2 addresses the issue of why minority protection is needed. This will involve consideration of the theories and arguments that underpin this area of the law. The chapters following Chapter 2 then discuss the research which is divided into three main stages:

**The first stage** involves an examination of the present position in Saudi Arabia and Dubai as far as minority shareholder protection is concerned. This will include identifying the weaknesses, defects, problems and inefficient aspects of the law in the two countries. In other words, this stage will ascertain what really needs to be reformed in the statute and will also demonstrate the failure of the statute to build an effective statutory footing to protect the minority shareholder. It will illustrate how minority shareholders, despite having considerable motive to invest, do not trust the minority shareholder protection that exists at present, as no rights and interests of minorities are formally acknowledged in statutes.

**The second stage** studies in depth how UK company law deals with minority shareholder protection. However, this stage will not just study the law in this respect, but also observe, examine and analyse the developments and processes which have brought the law to its current position in providing effective statutory protection for minority shareholders. It is important to note that various remedies offered under UK law for minority shareholders had their origin under common law and have been reformed under the company law statute. So UK company law has not given, under the

statute, minority protection new enforcement mechanisms but minority rights and interests were already recognized in common law. Recently, however, since the Companies Act 2006 fully came into operation, there has been even more recognition of the need to protect the minority shareholder's rights and interests.

The third and **final stage** will demonstrate how Saudi Arabia and Dubai should recognize and protect minority shareholder's interests and rights. In addition, this stage will indicate which statutory provisions existing in the UK minority shareholder laws can be adopted by Saudi Arabia and Dubai and to what extent they need adaptation.

The introductory chapter of this thesis, above, has dealt with the agenda, objectives and methodology of the research. In beginning to outline the content of the remaining chapters, the second, as mentioned earlier, discusses minority shareholder protection in general and addresses the question of why there is a necessity to protect the minority shareholder. This chapter in particular shows how the majority shareholder can have the ultimate power and authority to abuse the company and the minority shareholder, if there is no efficient protection in place. It will also illustrate the various justifications for the need to adopt effective, efficient, practical and actionable protection for minority shareholders.

Chapter Three's main concern is to examine the situation in Saudi Arabia and Dubai in terms of minority shareholder protection, with a greater emphasis on the former. This part of the research will set out what is the current doctrinal position of Saudi Arabia and Dubai company law in regard to minority shareholder protection. Also included in the chapter is a consideration of the relevance of Sharia law and, finally, there will be some discussion of the new Saudi Arabia and Dubai Company Law Bills in order to see what fresh features they include on this issue, if any.

Chapter Four offers a detailed analysis of an empirical study that was carried out in Saudi Arabia to look into how minority shareholder protection truly works in the marketplace. This chapter will contain evaluation and reflection of this empirical study in order to judge the issue of minority shareholder protection in Saudi Arabia.



Chapter Five of the thesis is concerned with the UK context and how its laws and processes play a statutory role in protecting minority shareholders. This chapter will outline the protection offered to minority shareholders under common law, i.e. the statute prior to 2006, and how difficult and complex the law was then. It will also explain the results of investigations and reviews carried out with the aim of reforming the old law, as reflected in the Companies Act 2006. The reason for exploring UK law is to assess whether jurisdictions like Saudi Arabia and Dubai can learn and derive benefits from its long experience of addressing minority shareholder protection (over 160 years so far), which has made the UK system a leading model in this respect.

Chapter Six investigates the possibility of Saudi Arabia and Dubai borrowing and adopting certain devices from those workable, practical and actionable remedies which exist under UK law. This chapter will address each current problem in Saudi Arabia and Dubai, to discover what may be workable in their particular contexts if adopted, and what kind of adaptations may be required.

Chapter Seven draws conclusions and makes comments relevant to any future study that is required.

## Chapter 2

### Why protect minority shareholders?

#### Introduction

As trade barriers continue to collapse, it will become progressively easier for investors from one country to invest in companies in another. The competition for investment will not only be at the domestic level, but countries will also build structures that serve different interests in order to attract sophisticated investors from abroad. A crucial factor influencing the attractiveness of a particular jurisdiction will be its system for protecting shareholders.<sup>37</sup> A good system will assure foreign and domestic investors that the company is managed by trustworthy, honest and effective managers and that all shareholders are treated fairly and equally. More importantly, a proper system for protecting the rights and interests of shareholders, particularly those of minority shareholders, must be in place.<sup>38</sup> The primary purpose of such a protection system is to establish a mechanism for ensuring that majority shareholders do not abuse their corporate powers and that minority shareholders always have a means to obtain some kind of remedy where it is warranted.<sup>39</sup>

Many legal researchers have discussed the issue of minority shareholder protection as part of various practical approaches in the context of exit options, court interference etc. However, few in the UK, and almost none in Saudi Arabia and Dubai, have paid attention to the theoretical and philosophical justifications behind the necessity to protect the minority shareholder. This chapter, in response, will provide a clear picture of how the minority shareholder is generally treated by the majority shareholder and how the minority shareholder may suffer if no effective safeguards are in place. The chapter is divided into six sections, each split into further sub-sections. The first section will highlight the majority shareholder's power as opposed to the weak and limited

---

<sup>37</sup> B, Cheffins., *Minority shareholders and corporate governance*, *Company Lawyer*. 2000, 21(2), pg: 41.

<sup>38</sup> L, Miles. & M, He., *Protecting the rights and interest of minority shareholders in listed companies in China: challenges for the future*, *International Company and Commercial Law Review*. 2005, 16(7), pg: 275.

<sup>39</sup> A, Boyle. J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007. pg: 381.

position of the minority shareholder in private companies. The second will refute the criticism which is against the principle of minority shareholder protection systems and refute the belief that they are not necessary, while the third section will go on to present tangible justifications for providing minority shareholder protection. The fourth section aims to show how an understanding of the rights and interests of minority shareholders makes it easier to protect them and will also explain the court's role in dealing with minority shareholders' cases. The fifth section is divided into three sub-sections: The first demonstrates the impact of corporate governance on minority shareholder protection; the second discusses how the law can provide grounds for the minority shareholder to establish cases; and the third part proposes a list of factors which should be taken into account when seeking to formulate effective and efficient protection for minority shareholders. The sixth and final section is the conclusion.

## **2.1 The weak position of the minority shareholder**

To understand how majority shareholders may indulge in some abuse or misuse of their power, it is important to visualize how a company or a minority shareholder might be treated by the majority shareholders who would seem to have supremacy. Majority shareholders, in this sense, can flex their muscles to exclusively benefit themselves without regard for the interests and rights of others, namely the minority shareholders. So the main concern of this section is to clearly deliver the idea that, if the powerful and authoritative control of the majority shareholder is left without restriction, the minority shareholder may suffer. Several possible scenarios will be explored and the different types of misuse and unfairness which the majority shareholder may be involved in will be shown.

It is appropriate to begin this section by specifying exactly what a private company, or close corporation, is. Moll attempts to define it as an enterprise in which an intimate or even an intense relationship exists between capital and labour. He also indicates that private company investors are often linked by family or other personal relationships which ensure a certain level of familiarity among participants.<sup>40</sup> Consequently, this definition may suggest that everything will progress smoothly and efficiently between

---

<sup>40</sup> D, Moll., Shareholder Oppression & 'Fair Value': Of Discounts, Dates, and Dastardly Deeds in the Close Corporation. *Duke Law Journal*. 2004, 54(2), pg: 6.

shareholders as long as the personal relationship is there to secure the company's existence. One would assume that because shareholders have strong relationships within the company, the directors will be forced to look after all shareholders' interests, otherwise they may face dismissal.<sup>41</sup>

However, this assumption is far from the reality when it comes to the structural workings of private companies. This is because, once the voting procedure is applied, corporate democracy will award the majority ultimate power over the affairs of the company.<sup>42</sup> In effect, the democratic principle of majority rule means that substantial power is placed in the hands of those who control more than half of the votes on the board and/or at the members' meetings. On the other hand, the minority shareholders must, in principle, accept the decisions of the majority shareholder and must also acknowledge, as a fact of business life, that the power is lawfully enjoyed by those holding more shares.<sup>43</sup> It is understood that a minority shareholder's individual vote is unlikely to carry sufficient weight to influence decisions and accordingly is unable, by itself, to block certain decisions and actions.<sup>44</sup> This is due to the fact that, for an ordinary resolution to be passed, only a simple majority of 50% of the vote is required, whereas a special or extraordinary resolution requires something greater - perhaps, as in the UK, a majority of 75%. Therefore, all ordinary resolutions will be controlled by the majority shareholders who may also control special or extraordinary resolutions if they hold 75% or more of the shares within the company. Thus, individual minority shareholders are too powerless to impose their will, unless a controlling shareholder who has a high proportion of the shares, but less than 50% overall, and the minority shareholders can together formulate a coalition of shareholders.<sup>45</sup>

As a consequence of these facts, directors (where they are not the majority shareholders) are expected to fear the majority more than the minority shareholders, as the only votes that count to create an ordinary resolution for, say, the removal of a director, are

---

<sup>41</sup> A, Boyle, J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007, pg: 384.

<sup>42</sup> J, Abugu., A comparative analysis of the extent of judicial discretion in minority shareholder protection litigation: the United Kingdom and Untied States, *International Company and Commercial Law Review*. 2007, 18(5), pg: 181.

<sup>43</sup> A, Hicks. & S, Goo., *Cases and Materials on Company Law*. 6<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 425.

<sup>44</sup> A, Boyle, J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007. pg: 385.

<sup>45</sup> A, Keay., Company directors behaving poorly: disciplinary option for shareholders, *Journal of Business Law*. 2007, Sep, pg 664.

effectively in the hands of the majority shareholder.<sup>46</sup> In return, the directors appreciate the value of being in charge and tend to strive to keep the majority shareholder satisfied. An example of this is seen in Australian law,<sup>47</sup> where a company may remove a director before the expiration of his/her term of appointment if an ordinary resolution is passed by the majority of shareholders. In the Australian case of *National Roads and Motorists' Association Ltd v Scandrett*<sup>48</sup> an ordinary resolution was passed by the majority shareholder to dismiss directors of the company and the minority shareholder was powerless to block the resolution. The debate in this case was over whether more than one director could validly be removed by a single resolution, and the court concluded that indeed the majority shareholder had the power to do this.

Kim, Chatjuthamard and Nofsinger have argued that if the majority shareholders alone have the power to appoint and remove directors, they will appoint directors that are aligned to their way of thinking, in order to facilitate any mistreatment or unfairness they want to perpetrate.<sup>49</sup> Moreover, Cesari has noted that conflicts of interest may separate the majority shareholders and directors from the minority shareholders. Since the directors are monitored by the majority shareholder, the majority shareholder can divert resources from the company to pursue private interests with the help and support of the directors, and at the expense of the minority shareholder.<sup>50</sup> Therefore, it is certainly possible for the majority shareholder to impose his/her will on the corporation, and pressure the directors into a state of submission and timid compliance by coercion, in order to seize every opportunity to abuse his/her position and steal value or opportunity from the company.<sup>51</sup>

Since the majority shareholders have the lawful power to control and are, in most cases, the directors in private companies, minority shareholders may find their interests and

---

<sup>46</sup> As Schlimm and others have mentioned, (D, Schlimm. L, Mezzetti & B, Sharfman., Corporate Governance and the Impact of Controlling Shareholder, *Corporate Governance Advisor*. 2010, 18(1), pg: 3) a majority shareholder has the ultimate power to dominate the board through his direct voting power and also by threatening removal of the directors.

<sup>47</sup> Australian Corporation Act 2001, s34(3).

<sup>48</sup> [2002] NSWSC 1123, (2002) 43 ACSR 40.

<sup>49</sup> K, Kim. J, Nofsinger & P, Kitsabunnarat-Chatjuthamard., Large Shareholders, Board Independence, and Minority Shareholder Rights: Evidence from Europe, *Journal of Corporate Finance*. 2007, 13(5), pg: 861.

<sup>50</sup> A, Cesari., Expropriation of Minority Shareholders and Payout Policy. (May 12, 2009), Available at: <<http://ssrn.com/abstract=1403202>> accessed 27 July 2009, pg: 6.

<sup>51</sup> D, Schlimm. L, Mezzetti & B, Sharfman., Corporate Governance and the Impact of Controlling Shareholder, *Corporate Governance Advisor*. 2010, 18(1), pg: 12.

rights harmed by those who can override their interests via lawful democratic decisions taken at either board or general meetings. On this point, Lord Davey in the English case of *Burland v Earle*<sup>52</sup> observed that this type of abuse of power occurs when “the majority shareholders are endeavoring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company or in which other shareholders are entitled to participate”. What is most worrying is that majority shareholders may simply view the company as a mere extension of their own interests.<sup>53</sup> The abuse of power can even go further to the point where the majority shareholder expropriates the minority shareholders’ interests and rights. Expropriation can take a variety of forms, such as stealing the profits, selling the assets, or selling additional shares in the company to another company they own at below market prices, or they may divert corporate opportunities to another company which they control or in which they have substantial interests. In sum, expropriation can mean that the majority shareholders use their power for their own gain rather than returning money to the company in a way which directly or indirectly benefits all shareholders.<sup>54</sup>

It should be understood that the more power the majority shareholder has within the company, the weaker the minority shareholder will be, and the more he/she will remain limited and immobilized. The minority shareholder can find him/herself totally powerless when, for instance, the majority shareholders manipulate the accounting reports of the company’s performance in an attempt to hide their ‘private control benefits’.<sup>55</sup> In such instances, the majority shareholder can make reported profits appear less than the actual profits so that they can distribute a smaller amount of those sums. When this happens, the minority shareholder’s ability to access information may be denied or his/her involvement in the company’s management may be undermined,

---

<sup>52</sup> [1902] AC 83, at 93. See also a classic example of abuse of power in the case *Rolled Steel Products Ltd v British Steel Corporation* [1985] 2 WLR 908(CA).

<sup>53</sup> L, Miles. & M, He., Protecting the rights and interest of minority shareholders in listed companies in China: challenges for the future, *International Company and Commercial Law Review*. 2005, 16(7), pg: 276.

<sup>54</sup> R, La Porta & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), pg: 873.

<sup>55</sup> The meaning of such a term in this respect is that the majority use their control over the company’s recourses to benefit themselves at the expense of the minority. See: C, Leuz. D, Nanda. & P, Wysocki., Earnings Management and Investor Protection: An International Comparison, *Journal of Financial Economics*. 2002, September, pg: 2.

especially when the financial reports inaccurately reflect the company's performance.<sup>56</sup> Thus, the majority shareholder's authority is far stronger than that of the minority shareholder who, in most cases, has little or no control. The following few points will elaborate on how the majority shareholder's power can cause harm to the minority shareholder's personal interests and expectations as well as the company's interests. The purpose of this is to show the different types of wrong, misconduct, abuse and unfairness the majority shareholder may perpetrate if no efficient minority shareholder protection is in place.

a. Majority oppression or unfair prejudice of a minority shareholder (personal interests)

(i) Generally

There are a number of ways in which majority shareholders can take advantage of their position in order to serve their own individual interests. The oppression of the minority shareholder is one such way. This oppression or unfair prejudice relates to running the company in such a way that has consequences which are clearly unfair for the minority shareholder him/herself rather than for the company.<sup>57</sup> So, if the conduct was challenged, the minority shareholder here would not be pursuing a wrong that has been committed against the company, but rather would be protecting his/her own personal rights and interests. In this situation, the minority shareholder litigates against the majority shareholder to remedy the unfair conduct. This type of misconduct has been recognised and defined by certain jurisdictions and denied by others.<sup>58</sup>

UK company law has recognised this type of unfair action since 1948 under the old term "oppression",<sup>59</sup> which was replaced in a later statute (Companies Act 1980) by "unfair prejudice". With the use of this new term, a minority shareholder may bring an action "if the company's affairs have been conducted in a manner which is unfairly prejudicial

---

<sup>56</sup> C, Leuz, D, Nanda, & P, Wysocki., Earnings Management and Investor Protection: An International Comparison, *Journal of Financial Economics*. 2002, September, pg: 2.

<sup>57</sup> A, Boyle, J, Birds, & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007, pg: 695.

<sup>58</sup> As will become clear in Chapters 3 & 4, SA and Dubai have not clearly stated a ground or a device that covers the function of the unfair prejudice ground.

<sup>59</sup> The UK Companies Act 1948, s210.

to members' interests",<sup>60</sup> or, as clearly established by the House of Lords in *O'Neill v Phillips*,<sup>61</sup> a shareholder will be entitled to complain if:

"... some breach of the terms on which the member agreed that the affairs of the company should be conducted; or some use of the rules in a manner which equity would regard as contrary to good faith i.e. cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers".<sup>62</sup>

An American court, on the other hand, defined oppression or unfair conduct as,

"burdensome, harsh and wrongful conduct ... a visible departure from the standards of fair dealing and violation of fair play on which every shareholder who entrusts his money to a corporation is entitled to rely".<sup>63</sup>

To exemplify how this type of unfair act can be dealt with, the court in the English case of *Re Sam Weller & Sons Ltd*<sup>64</sup> considered that the failure to pay proper dividends to shareholders, over a long period without explanation, was an unfairly prejudicial act and accordingly the minority shareholder was successful in a claim for relief. However, in cases such as this, the minority shareholder must prove his/her allegation with supporting evidence, otherwise the claim may fail. Indeed, this was what happened in the American case of *Pinnacle Data Services, Inc v Gillen*,<sup>65</sup> where a lack of evidence defeated the minority shareholder, who had alleged that the majority shareholder had engaged in oppression by withholding profit distribution, terminating employment and paying for individual legal fees with corporate funds. On the other hand, the minority shareholder was successful in proving the claim in the American case *Patton v Nicholas*<sup>66</sup> where it was alleged that the majority shareholder had refused to declare a dividend. The court found that the majority shareholder indeed had wrongfully controlled the board so as to prevent the declaration of dividends, and also found that the majority shareholder did this for the sole purpose of preventing the minority shareholder from sharing in the profits. The court ordered a mandatory injunction requiring the majority shareholder to pay reasonable dividends at the earliest practical date, as well as in future years.

---

<sup>60</sup> The UK Companies Act 2006, s994.

<sup>61</sup> [1999] 2 B.C.L.C.1 pg: 8.

<sup>62</sup> *O'Neill v Phillips* [1999] 2 B.C.L.C.1 pg: 8.

<sup>63</sup> *Fix v Fix Material Co.*, 538 S. W.2d 351, 358 (Mo. Ct. App. 1976), and *Shierka v. Skierka Bros., Inc.*, 629 P.2d 214, 221 (Mont. 1981).

<sup>64</sup> [1989] 3 W.L.R 923.

<sup>65</sup> 104 S.W.3d 188, 191-92 (Tex. App. – Texarkana 2003, no pet).

<sup>66</sup> 279 S.W.2d 848 (Tex. 1955)



So, the majority shareholder's conduct, which can take a variety of forms, may result in unfairness and oppression if it violates the minority shareholder's interests and rights. Another example can be seen in cases where the majority shareholder dismisses the minority shareholder from management. In this type of instance, the minority shareholder will be left with two options, namely to either hold on to his/her shares which may pay no dividends, or to sell them for whatever the majority shareholder is willing to offer.<sup>67</sup> To be more precise, such actions, which oppress the minority shareholder, are often referred to as "freeze out" techniques. Common freeze out techniques include the refusal to declare dividends, the termination of a minority shareholder's employment and the wasting of corporate earnings through the payment of high amounts of remunerations to the majority shareholder.<sup>68</sup> Quite often, these tactics are used in combination, as seen in the American case of *Donhaue v Rodd Electrotype Co.*<sup>69</sup> In fact, once the minority shareholder is faced with an indefinite future and no likely return on the capital he/she contributed to the enterprise, the majority shareholder may well, at this point, propose to purchase the minority shareholder's shares at a low price. Unfortunately for the minority shareholder, his/her investment will be effectively trapped if he/she does not want to sell the shares to the majority shareholder since there is no ready market for the shares of private companies. Thus, in a private company, the minority shareholder may be "locked-in", and accordingly "frozen-out", from any business returns.<sup>70</sup>

Another form of minority oppression is when the majority shareholder sells its controlling shareholdings to a third party without allowing the minority shareholder to participate in or to object to the decision to sell.<sup>71</sup> In fact, there is no case law which has directly considered such conduct as unfair conduct and accordingly ordered the majority

---

<sup>67</sup> Selling the shares to the majority shareholder is required by pre-emption, which forces the minority to sell the shares (if he/she wants to sell them) to the insiders (shareholders within the company) and not to any outside party.

<sup>68</sup> D, Moll., Shareholder Oppression & 'Fair Value': Of Discounts, Dates, and Dastardly Deeds in the Close Corporation. *Duke Law Journal*. 2004, 54(2), pg: 8. The term 'freezeout' is often used as a synonym for 'squeezeout', which is said to mean the use by some of the owners or shareholders in a company of some legal devices or techniques which eliminate from the company one or more of its shareholders.

<sup>69</sup> 328 N.E.2d 505, 513 (Mass. 1975).

<sup>70</sup> D, Moll., Shareholder Oppression in Texas Close Corporations: Majority Rule Isn't What It Used to Be, *Houston Business and Tax Law Journal*. 2008, Vol. IX, pg: 3.

<sup>71</sup> E, Rock. & M, Wachter., Waiting for the Omelet to Set: Match Specific Assets and Minority Oppression in the Close Corporation, *Journal of Corporation Law*. 1999, 24(4), pg: 4.

shareholder to refrain from selling. However, courts in some jurisdictions may order the acquirer of the shares to give the minority shareholder the opportunity to sell his/her shares at the same premium price as the majority shareholder.<sup>72</sup> This principle was discussed in the American case of *Weinberger v UOP, Inc*<sup>73</sup> when the acquirer of the majority shares intended to buy out the minority shares at a lower price than he paid for the majority shares. Although the minority shares were not offered to be purchased at the same price as the majority shares, the court dismissed the claim on the grounds that the price offered for the minority shares was in accordance with the current market price. Therefore, the minority shareholder has, in such situations, the right to at least be bought out at a fair price; otherwise, he/she can bring an action on an unfair ground.

(ii) The majority breaches legitimate expectations (informal agreement)

Generally speaking, informal agreements or understandings emerge in private companies when co-investors discuss how the company will operate. Although most of what is agreed upon between co-investors goes into the articles or a shareholder agreement, there are always some matters of understanding which result from the discussions which are not ultimately stated so formally. These un-stated understandings may include the legitimate expectations which each shareholder may carry, and breaching these legitimate expectations or informal agreements may be seen to constitute oppression or unfairness. Therefore, the court should not allow the majority shareholder to breach the legitimate expectations of the minority shareholder. It is believed that the concept, which is designed to recognize wider application of minority shareholders' interests, originated in UK company law. The relevant provision in the UK law, s.994,<sup>74</sup> states that "a member...may apply to the court...for an order on the ground that the company's affairs are being...unfairly prejudicial to the *interest* of its members or at least himself". The word "interest" is applied more widely than "rights" and therefore it will include certain advantages that "rights" cannot offer, since "rights" (for shareholders) emanate solely from the statute or the company's agreement or

---

<sup>72</sup> R, Szudoczky., *Takeover Regulations and Protection of Minority Shareholders: A comparison between the European and US approach*. 1<sup>st</sup> ed. Lambert Academic Publishing, Koln, 2009, pg: 16.

<sup>73</sup> 457 A2d 701 (Del. 1983) pg: 1641.

<sup>74</sup> This section has a base in the CA 1985 under s459 but now an identical provision is stated in s994 of the Companies Act 2006.

articles. Effectively, members may have different interests, even if the rights of all members are the same.<sup>75</sup>

Furthermore, this concept is more likely to be important in private companies<sup>76</sup> when close personal relations are often present and a quasi-partnership between shareholders exists. This can be seen when the scope of legitimate expectations arises from a shareholder's understanding at the time of getting involved in the company or at some later stage. For example, legitimate expectation can exist if each of the parties who has subscribed his/her capital on the basis that he/she will participate in the management of the company and receive the return on his/her investment partly or totally in the form of a salary rather than dividends. It was noted in the English case of *Re Saul D Harrison & Sons Plc*<sup>77</sup> that legitimate expectation "often arises out of a fundamental understanding between the shareholders which formed the basis of their association, but was not put into contractual form".

The American courts have also recognized the concept of reasonable expectations, as indicated by the Court of Appeals in New York in the case *re Kemp v Beatley, Inc*<sup>78</sup> when it said that:

"A shareholder who reasonably expected that ownership in the corporation would entitle him or her to a job, a share of corporate earnings, a place in corporate management, or some other form of security, would be oppressed in a very real sense when others in the corporation seek to defeat those expectations and there exists no effective means of salvaging the investment".

Moll has claimed that the *Kemp* decision focused on the minority shareholder's expectations at the time he/she decided to invest in (and therefore join) the company.<sup>79</sup> Nevertheless, the majority shareholder has the power to ignore this fundamental

---

<sup>75</sup> J, Lowry., The pursuit of effective minority shareholder protection: S459 of the Companies Act 1985. *Company Lawyer*. 1996, 17(3), pg: 70. He also says in this article that the scope for the courts to find legitimate expectation, which goes beyond strict contractual rights under the company's constitution, is subject to limitation.

<sup>76</sup> As the concept of shareholder's expectations is limited in widely-held companies, where the expectations of members do not generally extend beyond the wish of receiving a return on their investment.

<sup>77</sup> [1995] 1 BCLC 14, CA, pg: 19

<sup>78</sup> 473 N.E.2d 1173 (N.Y.1984).

<sup>79</sup> D, Moll., Shareholder Oppression and Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes, *Minnesota Law Review*. (2002), available at: <<http://ssrn.com/abstract=297503> or DOI: 10.2139/ssrn.297503>, accessed 24 February 2010.pg: 2.

understanding and act in a way that is contrary to it, neglecting the minority shareholder's interest emanating from his/her legitimate or reasonable expectation. In the US, courts have been willing to order dissolution and buyouts when convinced that the majority shareholder has violated the reasonable expectation of the minority shareholder, classifying such conduct as oppressive.<sup>80</sup>

However, the basis or ground for upholding legitimate expectations is something that has not been clearly discussed or explained. Paterson<sup>81</sup> has attempted to do so, however, by distinguishing between the different types of contractual approaches which exist in unfair claims. Generally speaking, he emphasises that the contractual approach means that parties are only able to make claims where there are breaches of the explicit terms agreed between the shareholders in the contract. This is because a violation of any of these stated rights would be considered a violation of the contractual terms and would therefore be dealt with through an unfair prejudice claim. However, he argues that this contractual approach is not a particularly appropriate description for claims relating to reasonable expectation because legitimate or reasonable expectation may also contain promises or understandings between shareholders which do not have a contractual basis. For this reason, he suggests the quasi-contractual approach to accommodate all types of interests and expectations.

On the other hand, Goddard has also noted that there is a need to provide a legal description of the kind of legitimate expectation which exists between parties but is not subject to express contractual provision.<sup>82</sup> He suggests the 'hypothetical bargaining model' should govern various types of reasonable expectations. This approach is divided into two hypotheses to cover two types of legitimate expectations: the generalised hypothetical bargain and the particularised hypothetical bargain. The first can be distinguished on the grounds of the generality which reflects the expectations and interests of the corporate parties collectively, and which shareholders and the company expect each other to abide by. So, as long as all parties share the same expectations, they will be categorised under this hypothesis. The second reflects an

---

<sup>80</sup> E, Rock. & M, Wachter., Waiting for the Omelet to Set: Match Specific Assets and Minority Oppression in the Close Corporation, *Journal of Corporation Law*. 1999, 24(4), pg: 4.

<sup>81</sup> P, Paterson., A Criticism of the Contractual Approach to Unfair Prejudice, *Company Lawyer*. 2006, 27(7), pg: 211.

<sup>82</sup> R, Goddard., Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985, *Company Lawyer*. 1999, 20(3), pg: 70-73.

individual shareholder's expectations which are formulated, not just because the relationship between all shareholders is personal, or because the company is small, but also because there is a fundamental understanding that this individual acted pursuant to these particular reasonable expectations.<sup>83</sup>

Whether the quasi-contractual approach or the hypothetical bargaining model is used to provide a ground or legal description to reasonable expectations, it must be said that identifying reasonable expectations in each company is a difficult task because the court needs to take into account the parties' actual understandings, whether at the time of investment or as they might evolve. But even then, it will again become difficult to create an objective base for deciding whether any or all of those expectations should be honoured.<sup>84</sup> In the American case of *re Kemp v Beatley, Inc*<sup>85</sup> the court endeavoured to establish what the majority shareholders knew, or should have known about the minority shareholder's expectations on entering this particular company, so that the court could honour them.

Another example which shows the extent of these expectations is the English case of *R & H Electric Ltd v Haden Bill Electrical Ltd*<sup>86</sup> where the court found that the minority shareholder had a legitimate expectation to be allowed to participate in the management of the company as long as he remained a significant creditor of the company. Consequently, when he was removed from management by the majority shareholder, the court ordered the majority shareholder to purchase the minority shareholder's shares and repay as soon as possible the loans made to the company by the minority shareholder.

It is believed that legitimate expectation was first used in the context of shareholder disputes in the English case *Re Saul D Harrison & Sons plc*<sup>87</sup> where the minority shareholder claimed that the directors had acted in a manner contrary to the minority shareholder's legitimate expectations by not acting in the best interests of the company in deciding whether to pay dividends and how much to pay. The claim was dismissed in

---

<sup>83</sup> The particularised hypothetical bargain should give coverage to individual expectations as opposed to those of a collective to which this individual may belong. An example is the right to an investment return.

<sup>84</sup> B, Means., A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, *Georgetown Law Journal*. 2009, 97 (5), pg: 22.

<sup>85</sup> 473 N.E.2d 1173 (N.Y. 1984). (New York)

<sup>86</sup> [1995] 2 BCLC 280.

<sup>87</sup> [1994] B.C.C. 475.

this case and Hoffmann LJ explained that the reasoning behind this was that the minority shareholder's actual legitimate expectations amounted to no more than an expectation that the board would manage the company in accordance with their fiduciary obligations and the terms of the articles. The judgment in this case might have been different if the minority shareholder had been able to prove that the expectation in question was actually the same expectation which he had when setting up the company.<sup>88</sup>

In sum, breaching legitimate expectations is another form of misconduct which the majority shareholder may commit. If the minority shareholder brings a legal action to seek relief in line with his/her legitimate expectation then, of course, he/she will be representing him/herself and not the company as these types of case are based on personal, and not corporate, grounds. The minority shareholder can bring proceedings based on a right of the company only if the rights and interests of the company are breached. The next sub-section will illustrate these kinds of proceedings and how the majority shareholder can abuse the company itself in their own favour.

#### b. Majority abuse of the company (corporate interest)

There are several different ways in which the majority shareholder can abuse their position. As already detailed, the first is oppression against the minority shareholder's own interests. The second, to be explored below, concerns how the majority shareholder's power can be used to abuse and misuse the company's rights and interests.

Traditional theories maintain that the majority shareholder should control the company. However, when the majority of shares in a company are held by those controlling that company at board level, they may perpetrate all kinds of wrongdoing to the detriment of the company and subsequently vote to prevent the company from taking legal action to gain compensation. This kind of vote can take place in the general meeting but it is more likely to occur at board meetings, where the shareholders might directly or indirectly control voting, and which are held far more frequently. If these scenarios prevail and the majority shareholder is free to do what they want in the company and escape liability,

---

<sup>88</sup> Chapter 5 will also discuss legitimate expectation in the case *O'Neill v Phillips*.

then potential minority shareholders may be very reluctant to invest if there are no legal provisions that are able to safeguard their investment.<sup>89</sup>

The traditional position in both the United States and the United Kingdom was that the courts would give unrestricted room to majority shareholders to run the company and would refrain from interfering in the internal management as long as the majority shareholders were acting within their powers.<sup>90</sup> To this effect, it was stated in the English case of *Carlen v Drury*<sup>91</sup> that “the court is not required on every occasion to take over the management of every playhouse and brew house in the Kingdom”. As a result, courts became reluctant to get involved in internal issues within the company, leaving it to the majority shareholders to do what they thought was best for the company. The impact of this unrestricted authority, however, can allow the majority shareholder (or an associate of such a shareholder) to engage in wrongdoing, to vote to ratify his/her own misconduct and prevent the company from bringing any action against him/her. Therefore, those who have majority control utilise the concept of ratification to restrict the scope of any litigation by the minority shareholder and, as a consequence, the wrong causes a detriment to the interests of the company and, ultimately, the minority shareholder.<sup>92</sup> In UK case law, for example, the majority shareholder has the capacity to stop an action brought by the minority shareholder on behalf of the company if the majority shareholder believes that no purpose would be served by the action.<sup>93</sup>

Vinelott J explains the traditional approach operated by UK courts in *Taylor v National Union of Mineworkers (Derbyshire Area)*:<sup>94</sup>

---

<sup>89</sup> T, Lazarides., *Minority Shareholder Choices and Rights in the New Market Environment*. (July 10, 2009), Available at: <<http://ssrn.com/abstract=1432672>> accessed 24 February 2010, pg: 5.

<sup>90</sup> J, Abugu., *A comparative analysis of the extent of judicial discretion in minority shareholder protection litigation: the United Kingdom and United States*, *International Company and Commercial Law Review*. 2007. 18(5), pg: 183.

<sup>91</sup> (1912) 35 E.R. 61. See also Cooper L.J. in *Scottish Insurance Corp Ltd v Wilsons & Clyde Co Ltd* [1948] S.C.360.

<sup>92</sup> H, Hirt., *The Company’s Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors’ Conflict of Interest*, *Journal of Business Law*, Mar 2005, pg: 185 & 186.

<sup>93</sup> S, Mayson. D, French. & C, Ryan., *Company Law*. 24<sup>th</sup> ed. Oxford: Oxford University Press, 2007-2008, pg: 515. However, there are few cases where the court did not allow the majority shareholder to ratify the wrongdoing, as seen later on in the case *Cook v Deeks* [1916] 1 AC 554.

<sup>94</sup> [1985] BCLC 237.

“...it is open to a majority of the members, if they think it is right in the interests of the corporate body to do so, to resolve that no action should be taken to remedy the wrong done to the corporate body and such a resolution will bind the minority”.

While this is no longer the position of the UK courts,<sup>95</sup> the approach remains applicable to many other jurisdictions and, importantly for the purpose of this research, this list includes Saudi Arabia and the UAE (Dubai).<sup>96</sup> This position has enabled the majority shareholder to have the final say over any wrong committed against the company so, if majority shareholders are the wrongdoers, they effectively act as judges in their own case. This very clearly constitutes a conflict of interests, and the outcome is always more than likely to be a decision not to take action.

However, courts may choose to ignore the majority shareholder's wish not to pursue an action and instead allow the minority shareholder to bring an action on behalf of the company, if there is a clear case of fraud and bad faith occurs (“fraud” as a ground to establish a claim is discussed in 2.5.2). This type of conduct does not mean that actual deceit has to occur; even abuse or misuse of power would be sufficient if it carries a small element of fraud. For example, in the English case of *Cook v Deeks*,<sup>97</sup> the company (X) had built up considerable goodwill with the Canadian Railway Company as a result of the satisfactory performance of contracts. However, when the last contract between the two companies was being negotiated, the majority shareholders, who were involved in the negotiations, decided that the contract would be granted to another company which they had incorporated rather than X. In addition, they passed a resolution to the effect that X had no interest in the contract. The minority shareholder claimed that X was entitled to the benefit of the contract and that the resolution was unfair. The Privy Council held that the benefit of the contract belonged in equity to X, and the majority shareholders could not validly use their voting power to advance their own company and ultimately gain from this for themselves.

---

<sup>95</sup> A new company law has been produced and put into effect under the Companies Act 2006. This new law has facilitated the action for minority shareholders. This area will be discussed in detail in Chapter 5.

<sup>96</sup> See Chapter 3&4, where it has been proved that the statute and courts in these countries still give too much power to majority shareholders within companies.

<sup>97</sup> [1916] 1 AC 554.



When the company has suffered a wrong, then the general rule is that it should be that company which attempts to recover compensation and not the minority shareholder.<sup>98</sup> But as we shall see, the minority shareholder can bring an action on behalf of the company in certain circumstances in the UK (and other jurisdictions such as Canada and Australia), but any compensation awarded will go to the company itself. In the English case of *Garden v Parker*<sup>99</sup> a company had suffered significant losses and gone into administrative receivership as a result of the wrong done to it by the majority shareholder. A minority shareholder brought a legal action to remedy the losses suffered by the company. However, the action was dismissed because it was brought on a personal basis, and not on behalf of the company.

Moll<sup>100</sup> has pointed out that a breach of a fiduciary duty claim can provide a minority shareholder with the right to bring an action in only one situation in the US. This exception occurs when a company has only two shareholders and the majority shareholder is also the director. In such a company the fiduciary duty will be directly owed to the minority shareholder who can, therefore, use a breach as a ground to bring an action on his/her own behalf. Moll observed this in the American case *Redmon v Griffith*.<sup>101</sup> In this case only two shareholders invested in the company, one majority and one minority shareholder. The minority shareholder filed an action against the majority shareholder claiming that he was oppressed by a breach of fiduciary duty since the majority shareholder used corporate funds to pay personal expenses. The court found the breach of the fiduciary duty to be oppressive, and therefore the minority shareholder was successful.<sup>102</sup>

To sum up, the majority shareholder may be able to wield significant power which, if not restricted, can harm both the minority shareholder and the company itself. For this reason, the majority shareholder's power needs to be monitored and controlled through the law in order to protect the minority shareholder and the company. However, some

---

<sup>98</sup> B, Hannigan., Drawing boundaries between derivative claims and unfairly prejudicial petitions, *Journal of Business Law*. 2009, 6, pg: 613.

<sup>99</sup> [2004] 2 B.C.L.C. 554.

<sup>100</sup> D, Moll., Shareholder Oppression in Texas Close Corporations: Majority Rule Isn't What It Used to Be, *Houston Business and Tax Law Journal*. 2008, Vol. IX, pg: 10.

<sup>101</sup> 202 S.W.3d 225 (Tex. App.- Tyler 2006).

<sup>102</sup> This is a situation where the majority shareholder may owe fiduciary duty to the minority shareholder.

still do not see the necessity and importance of having a comprehensive system of minority shareholder protection. Their arguments will be discussed in the next section.

## 2.2 Criticisms against the principle of minority shareholder protection

This section explores the views of those who do not necessarily agree with granting the minority shareholder more protection or restricting the majority shareholder's power. Once their arguments are presented, their position will be challenged in order to establish that it is indeed necessary for minority shareholder protection to exist. The section is divided into two parts. The first disagrees with those who want to justify unrestricted power being in the hands of the majority shareholder. The second challenges the position of those who tend to prioritise the rights and interests of the majority shareholder alone.

### 2.2.1 Arguments against the importance of minority shareholder protection

Several researchers have attempted to find justification for not establishing any strong form of minority shareholder protection. Payne points out that, generally speaking, minority shareholder protection is designed to be complex and obscure.<sup>103</sup> She believes that the purpose behind making it cumbersome is to protect the company against a single vexatious shareholder who (through misjudgement or malice) would waste the company's money if allowed to litigate on its behalf.<sup>104</sup> A similar view is expressed by Pettet who highlights the wish of certain jurisdictions to deliberately restrict minority shareholders' litigation, because, otherwise, the courts would be unable to cope with the volume of litigation.<sup>105</sup> In response to these two claims, however, it can be said that, since minority shareholders are vulnerable and subject to oppression and abuse from majority shareholders, law-makers and judges in any jurisdiction must provide them with protection even if the volume of litigation is expected to be high. Moreover, the

---

<sup>103</sup> It can be seen that the intention of the company laws in some countries, or at least SA and UAE (Dubai), is to make it difficult for the minority to bring an action especially on behalf of the company. See Chapter 3&4.

<sup>104</sup> J, Payne., Section 459-461 Companies Act 1985 in flux: The Future of Shareholder Protection. *Cambridge Law Journal*. 2005, 64(3), pg: 658.

<sup>105</sup> B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005, pg: 213.

court can always control litigation and monitor cases in order to prevent nonsense claims which waste the company's money and occupy court time.<sup>106</sup>

Another argument against having protection in place for the minority shareholder has been articulated by Leuz and others who believe that having a strong system of protection may potentially provide majority shareholders with an increased incentive to hide their wrongdoings and their private benefits when faced with possible compensation claims. They add that majority shareholders would have little incentive to conceal their indiscretions if the minority shareholder could not seek to have these activities made the subject of litigation.<sup>107</sup> However, this is to assume that the majority shareholder will engage in wrongdoing at all times, whether there is protection for the minority shareholder or not. If that is the case, it would be much better to have strong protection with remedial devices available to facilitate the minority shareholder's ability to hold the majority shareholders accountable for their wrongdoing, rather than to have weak protection that offers nothing. Nonetheless, Leuz and others' assumption is actually based on a false premise, because statistics and studies have shown that the stronger the minority shareholder protection is, the less abusive and oppressive the majority shareholders are (See: 2.5 The ideal model to follow).<sup>108</sup>

Another argument against offering legal protection for minority shareholders has been proposed by Klapper and Love<sup>109</sup> who believe that completely overhauling the law and regulations in terms of minority shareholder protection is difficult, whereas improving the internal company code is not. They claim that voluntary internal codes or company level initiatives are better, more effective solutions to protect the interests and rights of the minority shareholder than those that could be offered by statute. This argument seems reasonable in only one respect, however: that it may be easier and simpler for the shareholders to adopt a voluntary code that would suit the company and at the same time

---

<sup>106</sup> This is only in relation to cases brought on the corporate ground, but there is no prioritising of the company's interest when it comes to unfair or personal cases; instead, the court will deal with each case according to what justice requires, regardless of the company's interest.

<sup>107</sup> C, Leuz, D, Nanda, & P, Wysocki., Earnings Management and Investor Protection: An International Comparison, *Journal of Financial Economics*. 2002, September, pg: 9.

<sup>108</sup> It has been found by La Porta et al in their article (R, La Porta, & Others., Law and Finance, *Journal of Political Economy*. 1998, 106(6), pg: 1116) that common-law countries confer on shareholders and creditors stronger protection which results in a better legal system and market.

<sup>109</sup> L, Klapper, & I, Love., Corporate governance, Investor protection, and Performance in Emerging Markets, *Journal of Corporate Finance*. 2004. 10, pg: 705. However, the writers emphasize the importance of legal reform for investor protection in the rest of the article.

offer some protection for the minority shareholder. However, the argument relies on the possibility that companies may adopt an internal code, but ignores the fact that, as it is voluntary, there is neither any obligation for companies to adopt it, nor to comply with it. It is true that some companies can obtain an internal code before the incorporation, but its contents are at the discretion of the shareholders. If the protection of rights and interests is subject to the company's internal code, then the minority shareholders will be at the mercy of the majority shareholders who can include or exclude rights and interests according to their wishes. This is because the majority shareholders will be able to outvote other shareholders at any general meetings held to consider the change in the articles of association (provided that the majority shareholder has the sufficient majority). However, if these rights and interests were fully protected in the statute, there would be no opportunity for the majority shareholders to negotiate or bargain with the minority shareholders over them. Rather, the majority shareholders would be obliged to maintain and respect the statutory rights and interests of shareholders. One concern which may be raised here, however, is that, even where there is statutory protection, there might have to be some reliance on court judgments to explain the law, and accordingly this reliance may lead to uncertainty. Yet even if this concern is well-founded, it must be recognised that the court is an independent body which, unlike the majority shareholder, has no vested interests in the company.<sup>110</sup> (See: 2.4.2 The court's role when dealing with minority shareholders' cases).

Similar to the above argument - namely that protection can be provided via the company's internal code - it can be said that it is possible for effective minority shareholder protection to emanate from the shareholder agreement (contract). This argument is based on the contractual approach to company law which embraces the freedom-to-contract position, and which presumes that shareholders should be able to draw up whatever contracts they see fit. Therefore, it is argued, the minority shareholders in this case would be able to contractually protect their interests and rights.<sup>111</sup> In response to this suggestion, although it is accepted that the contract can protect some interests and rights for the minority shareholder, it certainly cannot provide comprehensive protection. The argument relies on the contract being the sole provider

---

<sup>110</sup> It can be also argued that it is necessary sometimes to have some parts of the company's internal code interpreted by the court if there is a dispute.

<sup>111</sup> D, Millon., *Communitarians, Contractarians, and the Crisis in Corporate Law*, *Washington and Lee Law Review*. 1993, 50, pg: 1379-1381.

of such protection, neglecting the recognised fact that all contracts are incomplete.<sup>112</sup> Keay and Zhang explain this ‘incomplete contract theory’ with reference to the fact that the parties are not able to foresee the future in definite terms and so cannot make complete provisions in a contract for every eventuality. Hence, contracts are by their nature incomplete.<sup>113</sup> This is because there will be problems (such as the majority shareholder seeking to engage in opportunistic behaviour or changes in the circumstances of companies) that cannot be foreseen by the minority shareholder at the time of signing the contract.<sup>114</sup>

Goddard<sup>115</sup> has discussed another possible reason for contracts being incomplete. He has observed that, out of strategic behaviour, informational asymmetry may arise once the majority shareholder has an incentive to withhold certain relevant information from the minority shareholder. Thus, as he has emphasised, incomplete contracts are the inevitable product of asymmetric information. Schwartz<sup>116</sup> has also noted that contracts may be commonly incomplete because of the collective shareholders’ unwillingness to bear the strategic behaviour risk created by a complete contract. This happens because shareholders may fear judicial misinterpretation if there is a high level of specificity in the contract.<sup>117</sup> But no matter what the reason behind contractual incompleteness, as a result of it the shareholder agreement creates difficulty for the courts to apply principles associated with company law (such as equitable principles),<sup>118</sup> and therefore the minority shareholder may not be fully protected by it. It is, then, a fact that, since contracts are incomplete, protections afforded by contracts alone will be inadequate.

---

<sup>112</sup> I, MacNeil., *Company Law Rules: An Assessment from the Perspective of Incomplete Contract Theory*, *Journal of Corporate Law Studies*. 2001, 1(1), pg: 107.

<sup>113</sup> A, Keay. & H, Zhang., *Incomplete Contracts, Contingent Fiduciaries and a Director’s Duty to Creditors*. *Melbourne University Law Review*. 2008. 32(1), pg: 154.

<sup>114</sup> A, Keay. & H, Zhang., *Incomplete Contracts, Contingent Fiduciaries and a Director’s Duty to Creditors*. *Melbourne University Law Review*. 2008. 32(1), pg: 154 & 155.

<sup>115</sup> R, Goddard., *Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985*, *Company Lawyer*. 1999, 20(3), pg: 68-69.

<sup>116</sup> A, Schwartz., *Relational Contracts in the Courts: An Economic Theory of Default Rules*, *Journal of Legal Studies*. 1992, 21, pg: 271.

<sup>117</sup> This point in particular is controversial because it is believed that, the more the contract is well drafted and detailed to cover all specificity, the clearer the rights, interests, power and obligations will be. However, the costs of stating full specificity in the contract may be unaffordable for the shareholders who also may not initially see the resulting benefit.

<sup>118</sup> Other examples are reasonable or legitimate expectation, personal and corporate interests.

Another argument has been put forward by Means<sup>119</sup> who has tried to offer the ‘voice-based framework’ (in which the minority shareholder’s voice will be influential in decisions) as an alternative remedy that can always offer protection for the minority shareholder. He believes that, in order to improve the minority shareholder’s responses to the majority shareholder’s wrongdoings and oppression, better account of voice is needed in the company in order for the minority shareholder to participate in decisions. In response to this view, it is certainly undeniable that the minority shareholder’s voice is vital to the health of the company.<sup>120</sup> However, the role of the voice-based framework is solely an internal, operational and precautionary system which can in no way replace statutory protection which offers external solutions in order to remedy different types of wrongdoing and oppression. Effective protection cannot just rely on a perfect internal structure that grants the minority shareholder the right to vote on decisions, because there are many minority shareholders who do not intend to engage in management, but nevertheless invest in companies. If protection depends on the voice-based framework, then the minority shareholder, who is not involved in management, will be denied protection, and this is far from what comprehensive minority shareholder protection should seek to achieve.

It is concluded that ultimate power should not be left in the hands of the majority shareholders to use without limitation, and that any attempt to solve this ultimate power problem internally will result in the same outcome. It is also clear that any protection cannot merely rely on one aspect, such as the minority shareholder’s voice or the contract. Rather, for minority shareholder protection to be effective and comprehensive, it needs to cover all dimensions in order to safeguard all the rights and interests of the minority shareholder.

### 2.2.2 The majority shareholder’s interests should always be a priority.

Some continue to insist that, as long as the majority shareholders invest more, and thereby have more power, then their rights and interests should be prioritised and favoured. Means has responded to those writers by drawing their attention to statistics

---

<sup>119</sup> B, Means., A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, *Georgetown Law Journal*. 2009, 97 (5), pg: 24.

<sup>120</sup> This means that the minority shareholders may be allowed to participate in management and to have their say, but it does not mean that their views must be taken into account.

which show that most companies are privately held in America (as they are in the UK, Saudi Arabia and most other jurisdictions). This means that effective minority shareholder protection therefore has the potential to impact on the vast majority of American businesses.<sup>121</sup> In many of these private companies the majority shareholders are fewer in number than the minority shareholders so those who make up greater numbers among shareholders deserve, without doubt, more protection to safeguard their interests and rights. Otherwise, any deficiency in the law to address this overwhelming majority of minority shareholders would cause instability and uncertainty in the marketplace.

Another argument is that, because of the significance of majority shareholders in the company, this group should always enjoy more returns and benefits as they bear the costs associated with the substantial monitoring of the affairs of the company. In line with this argument, majority shareholders should have more interests, rights, powers and authority compared with minority shareholders who are able to free-ride on the majority shareholders' monitoring efforts. Moreover, Kim and others agree with this view by saying that since majority shareholders throw so much money into the company and dedicate a great deal of time and effort towards it, then they deserve to be treated differently from the minority shareholders who may often have small shares in many other companies.<sup>122</sup> In response to this line of reasoning, it is true to say that the majority shareholder, in most cases, works harder and spends more time and effort in relation to the affairs of the company, and very often is key to the running the company. However, this is not to say that priority or preference should be given to the majority shareholders in the law, as they already have more power and authority within the company through corporate democracy, unlike the minority shareholder who has nothing but the law to provide him/her with protection for his/her interests and rights. Obviously, if the majority shareholder acts appropriately then his/her control will not be challenged and therefore the minority shareholder will not be able to complain and would certainly not be able to bring legal proceedings. However, there should always be

---

<sup>121</sup> B, Means., A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, *Georgetown Law Journal*. 2009, 97 (5), pg: 10.

<sup>122</sup> K, Kim. J, Nofsinger & P, Kitsabunnarat-Chatjuthamard., Large Shareholders, Board Independence, and Minority Shareholder Rights: Evidence from Europe, *Journal of Corporate Finance*. 2007, 13(5), pg: 862. It is further noted in their article that the benefit of minority shareholders owning a diversified portfolio is that they can diversify their money in funds representing shares that involve a substantial number of companies, in order to dilute the risk.

a remedy for the minority shareholder to pursue if the majority shareholder acts otherwise.

Another claim is that the majority shareholders' interests may not always be aligned with those of minority shareholders and therefore the majority shareholder's rights and interests should be favoured in decisions.<sup>123</sup> This view seems to be based on the traditional theory<sup>124</sup> which says that the company's money is in the hands of the majority shareholders and it is up to these shareholders to give it away.<sup>125</sup> If this view is accepted, then other interests and rights in the company may be neglected. It is believed that the company's decisions should not favour the interests of either the majority or minority shareholders, but rather should be based on the company's interests (which will not necessarily correspond with the interests of all shareholders individually).<sup>126</sup> Accordingly, any decision that results in benefit to the company will, directly or indirectly, benefit shareholders as a whole.

A further argument which sees the majority shareholder as being entitled to a superior position has been put forward by Dalley who claims that, whatever trouble a minority shareholder gets into, there is no justification whatsoever for imposing fiduciary duties on the majority shareholders and holding them accountable for these duties.<sup>127</sup> This argument holds that, even if the minority shareholder faces oppression, unfairness and abuse, he/she should not have the right to litigate against the majority shareholder because the majority shareholder has more wealth in the company. If this suggestion is followed and the minority shareholder is not given any option to remedy wrongs and abuse when they occur, minority shareholders will be very reluctant to get involved in

---

<sup>123</sup> K, Kim. J, Nofsinger & P, Kitsabunnarat-Chatjuthamard., Large Shareholders, Board Independence, and Minority Shareholder Rights: Evidence from Europe, *Journal of Corporate Finance*. 2007, 13(5), pg: 861.

<sup>124</sup> This theory existed under English common law where the courts were reluctant to interfere unless a very clear case of fraud occurred. See: 2.5.1 for more detail.

<sup>125</sup> Unfortunately, this theory did not respect other parties' interests in the company. The company consists of various parties, i.e. (stakeholders) such as minorities, employees, suppliers, creditors, potential investors, public members and others, who should all have their interests equally recognized.

<sup>126</sup> In the English case *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656, it was established that directors (majority shareholders) have to act 'bona fide' in the interests of the shareholders as a whole. It is argued, however, that it is not always correct to say that the company's interests are constantly equivalent to the interests of the majority shareholders in the company. This is because sometimes proceeding a corporate claim can benefit the company's interests as a separate entity, but not necessarily benefit a particular group of shareholders, e.g. the majority.

<sup>127</sup> See Dalley, *The Misguided Doctrine*, at 176, cited In: B, Means., A Contractual Approach to Shareholder Oppression Law. *The Fordham Law Review*. 2010, 79(3), pg: 8.



businesses because they will be scared of getting trapped as long as there is no law to assist them.<sup>128</sup>

In sum, it is believed that the law should recognize and reserve the interests and rights of minority shareholders in the statute to ensure that the majority shareholder considers them in every decision and does not prioritize only their own rights and interests. The next section will now justify why having an effective minority shareholder protection is so important.

### **2.3 Justifications for protecting the minority shareholder**

Several factors can come together to help to formulate strong justification for the minority shareholder to be given protection. It is important to examine each of these reasons in detail to appreciate why there is always a need to protect the minority shareholder in the company. This section is divided into two main points which deal, firstly, with the economic aspect and, secondly, with how the principles of justice and fairness provide that protection for the minority shareholder is required.

#### **2.3.1 The economic aspect**

Some people do not realise that there is a link between minority protection and the economy. It is even suggested in these lines that having effective minority protection might well improve the economic strength of companies because this will provide a degree of confidence necessary for the proper functioning of a market economy. Where such effective protection is in place, the cost of capital is lower and companies are encouraged to use resources more efficiently, thereby underpinning growth.<sup>129</sup> This is attributable to the fact that the system which regulates minority protection is only part of the larger economic context in which companies operate. The system in this context deals with a set of relationships involving managers, boards, minority shareholders,

---

<sup>128</sup> This is a situation where the majority shareholder may owe a fiduciary duty to the minority shareholder. However, the US imposes fiduciary duties on all shareholders if the majority shareholder is acting as a director.

<sup>129</sup> Organisation for Economic Co-operation and Development (OECD) 2004, at 11. Another Final Report in consultation with the OECD was issued in 2009, but it mainly addresses Protection of Minority Shareholders in Listed Issuers.

majority shareholders, creditors, employees and other stakeholders and can be likened to a net in which each element relies on the others. Protection which is able to attract such shareholders is critical because, unless shareholders are drawn to invest in a company, that company will not be able to grow easily. Instead, it will be starved of capital because lenders and suppliers are unlikely to be very forthcoming in providing credit to that company.<sup>130</sup>

Minority shareholder protection encourages the development of financial markets. This is due to the fact that, when minority investors are protected from expropriation and other such actions, they are more inclined to pay a greater sum for shares, which in turn provides more capital for companies when the shares are first issued.<sup>131</sup> It is believed that countries which protect minority shareholders have more valuable stock markets, larger numbers of listed shares and higher rates of capital demand in the market than countries where their protection is lacking.<sup>132</sup> Several surveys in this respect have found that protection contributes to economic growth.<sup>133</sup> Furthermore, a study undertaken by Levine and Zervos confirmed the finding that protection of financial investments promotes economic growth.<sup>134</sup> Finally, La Porta et al. have shown that countries with poor investor protection, particularly with regard to private companies, have significantly less liquidity and smaller markets.<sup>135</sup> Judge<sup>136</sup> has reached an identical conclusion, but from a different standpoint, pointing out that when the liability of the majority shareholder is uncertain within the company, this leads to their carrying out of their duties carelessly, which could only harm minority shareholders and the economy as a whole. He also suggests, from an economic point of view, that adopting effective minority shareholder protection encourages both directors and shareholders to act in a way which promotes transparency, accountability and investor confidence, and which consequently benefits the economy.

---

<sup>130</sup> L, Sealy. & S, Worthington., *Cases and Materials in Company Law*. 8<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 371.

<sup>131</sup> R, La Porta & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), pg: 879.

<sup>132</sup> R, La Porta & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), pg: 879.

<sup>133</sup> R, King. & R, Levine., Finance and Growth: Schumpeter Might Be Right, 1993, cited In: R, La Porta. & Others., Law and Finance, *Journal of Political Economy*. 1998, 106(6), pg:1152.

<sup>134</sup> R, Levine & S, Zervos., Stock market, banks and growth, *American Economic Review*. 1998, 88, pg: 540-542.

<sup>135</sup> R, La Porta. & Others., Legal determinants of external finance. *Journal of Finance*. 1997, 52, pg: 1146-1147.

<sup>136</sup> S, Judge., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2008, pg: 140.

It is claimed<sup>137</sup> that minority shareholder protection can influence economic growth in three ways. First of all, it can enhance savings. Secondly, it can channel these savings into real investments. Thirdly, it promotes more productive uses of capital, and thereby improves the efficiency of money. All three of these can, in principle, lead to economic growth. In fact, it is believed that having an effective minority shareholder protection system that regulates how the minority shareholder litigates when wrongdoing or oppression occurs, stabilises the economy and prevents the affairs of companies being conducted improperly. Another point which proves that effective minority shareholder protection can promote economic and financial stability, certainty, trust and confidence in the market appears in a report by Enriques who claimed that, because the UK and the US apply effective protection, their accounting rules and standards are stronger than those in Continental-European countries which have less minority shareholder protection and, as a result, suffer more manipulation of accounts.<sup>138</sup>

Therefore, in summary, there is a strong relationship between having effective minority shareholder protection that restricts the majority shareholder's ability to engage in wrongdoing and unfairness, and the development of the economy. Furthermore, it should be recognised that the more effectively the minority shareholder is protected, the more investments are made, and the more the economy grows. However, if the protection or its enforcement is weak, majority shareholder will manipulate the company's affairs and use it exclusively in his/her favour. If this negative practice occurs, then there is the potential for loss of confidence and trust in the market and for discouraging the minority shareholder from investing, which will in turn impact negatively on the general economy. It is contended that, from an economic point of view alone, minority shareholders are perfectly justified in desiring effective protection that can offer them safeguards as it will also contribute to the stabilisation of the commercial environment.

### 2.3.2 Justice and fairness necessitate protection for the minority shareholder

---

<sup>137</sup> R, La Porta & others., Investor protection and corporate governance, *Journal of Financial Economics*, 2000, 58(1-2), pg: 880.

<sup>138</sup> L, Enriques., The Law on Company Directors' Self-Dealing: A Comparative Analysis, *International & Comparative Corporate Law Journal*. (Vol. 2, 2000), available at: <<http://ssrn.com/abstract=271591>> accessed 7 November 2009, pg: 298.

It seems incomprehensible that a minority shareholder who has a percentage of shares in a company's capital can be denied protection, recognition, distinctiveness, independence, dignity, participation and any respectable rights or interests, simply because he/she has a smaller percentage of shares than the majority shareholder in the company. Certainly, this does not comply with what justice and fairness seek to promote. In this part of the research, the claim that the principles of justice and fairness can together formulate a strong justification for the minority shareholder to have protection is discussed.

It is very important to appreciate that when vulnerability exists, there is an obligation on the basis of justice and fairness to provide protection. To justify providing protection to minority shareholders, minority shareholders must be clearly vulnerable in the sense that they cannot protect their rights and interests and are subject to abuse and oppression from the majority shareholder. Rock and Wachter stress the fact that, because of the very strong connection between the directors and majority shareholders which is usually found in a close corporation (it is ultimately the majority shareholders who elect the directors), minority shareholders are particularly vulnerable. The minority shareholders in a private company are locked into their investments to a much greater extent than would be the case in either a partnership or a publicly traded company.<sup>139</sup> Goddard also claims that minority shareholders are vulnerable because exiting the company is often not possible, and they are left with no alternative but to deal with majority shareholders. He adds that this may put minority shareholders at constant risk, and therefore they are highly likely to be vulnerable.<sup>140</sup> Lazarides further emphasizes the vulnerable status of the minority shareholder by stating that indeed the minority shareholder is even susceptible to expropriation from the majority shareholder once it is known that the minority shareholder has been forced to stay in the company.<sup>141</sup> Thus it appears that there is a certain amount of agreement among legal commentators that the minority shareholder can be seen as vulnerable within private companies.

---

<sup>139</sup> E, Rock. & M, Wachter., Waiting for the Omelet to Set: Match Specific Assets and Minority Oppression in the Close Corporation, *Journal of Corporation Law*. 1999, 24(4), pg: 5.

<sup>140</sup> R, Goddard., Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985, *Company Lawyer*. 1999, 20(3), pg: 70.

<sup>141</sup> T, Lazarides., Minority Shareholder Choices and Rights in the New Market Environment. (July 10, 2009), Available at: <<http://ssrn.com/abstract=1432672>> accessed 24 February 2010, pg: 3.

In any jurisdiction, vulnerable parties, such as beneficiaries of trusts or clients of solicitors, tend to acquire somewhat more protection than non-vulnerable parties. The common ground that classifies these people as vulnerable is that they are weak, and subject to the power of another party. So the law, out of justice and fairness, provides vulnerable individuals with more protective rights and interests in order to safeguard them from potential abuse or oppression. The same case can be made for the minority shareholder in a company, as he/she is also often in a weak position, unable to obtain help and subject to potential abuse. As long as this is the case, the law, out of justice and fairness, should also provide protection for the minority shareholder to safeguard his/her interests and rights.

It may be acceptable for the majority shareholder, who has paid more and therefore has more shares, to be more involved with the company's decisions and affairs, but what is not acceptable is if the majority shareholder chooses to ignore completely the minority shareholder's rights and interests in the company. It is important to mention that, even if the majority shareholder has say 60%, 70%, or even 90% of the shares in the company, it does not mean that he/she can effectively control 100% of the shares by disregarding the interests, benefits and rights of the minority shareholder. This is not to say, however, that the majority shareholder may not represent the company fully when there is a need to do so, but rather to say that the majority shareholder should consider other shareholdings when he/she represents the company or acts on its behalf. Justice and fairness should require the majority shareholder to take into account the interests of the remaining shareholders in all actions and decisions and, at the same time, the law should grant the minority shareholder a device to protect his/her interests in the company in the event that the majority shareholder violates them.

In investigating the reasons behind the majority shareholder's potential ability to abuse and oppress the minority shareholder in certain jurisdictions, it may be found that this is due to a lack of a sense of justice and fairness which recognises the minority shareholder's interests and rights as being as valuable as those of the majority shareholder. This is not to say that minority shareholders should be totally equal to majority shareholders, but that they should also have certain interests and rights acknowledged and protected. The potential for abuse is marked in a jurisdiction where its legal system allows majority shareholders to exercise a high level of control which

does not correspond to the level of protection conferred on the minority shareholder.<sup>142</sup> In these circumstances, the only option for such a minority shareholder is to turn to the law for help and the law, out of concern for justice and fairness, should furnish remedies for such cases in which power has been abused. Consequently, it should be always agreed that ultimate and complete power cannot be allowed to rest in the hands of the majority shareholder without corresponding accountability.<sup>143</sup> This is, in part, what fairness and justice stand for; to guarantee that all shareholders are to be treated equally and that the law does not allow a single overriding power to be held by the majority shareholder.<sup>144</sup> To this end, the OECD<sup>145</sup> has urged all countries to adopt a framework that ensures equitable treatment of all shareholders, including minority shareholders. The result of this equality being applied is that all shareholders will have the opportunity to obtain effective redress for violation of their rights and interests.

In sum, justice and fairness, in many circumstances, justify a form of protection for minority shareholders being in place as long as they are in a vulnerable position. In fact, there is some acknowledgment (unfortunately not everywhere) that the principles of justice and fairness constitute a strong argument for the minority shareholder to be afforded legal protection.<sup>146</sup> It is then important for those jurisdictions which do not already afford protection to minority shareholders to adopt protection if for no other reason, then at least for the sake of justice and fairness.<sup>147</sup>

## **2.4 What is it exactly that needs to be protected for the minority shareholder? And what is the court's role in ensuring this protection?**

---

<sup>142</sup> Organisation for Economic Co-operation and Development (OECD) 2004, pg: 42. Another Final Report in consultation with the OECD was issued in 2009, but it mainly addresses protection of minority shareholders in listed companies.

<sup>143</sup> L, Sealy. & S, Worthington., *Cases and Materials in Company Law*. 8<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 501.

<sup>144</sup> E, Ferran., *Company Law and Corporate Finance*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 1999, pg: 319.

<sup>145</sup> Organisation for Economic Co-operation and Development (OECD) 2004, the Corporate Governance Principles, pg: 40.

<sup>146</sup> J, Abugu., A comparative analysis of the extent of judicial discretion in minority shareholder protection litigation: the United Kingdom and United States, *International Company and Commercial Law Review*. 2007. 18(5), pg: 181.

<sup>147</sup> It can be argued that majority shareholders always deserve a fair degree of control because of what they have contributed to the capital of the company. However, this research is trying to prove that this control should be restricted and made subject to litigation.

The main purpose of this section is to show how the law can play a major part in recognising and reserving the rights and interests of the minority shareholder, and also have a role in defining the court's power, jurisdiction and capability to judge in such cases. This section is divided into two parts. The first is concerned with detailing the categories of potential rights and interests which could be recognised and protected for minority shareholders so that it can be understood which aspects need to be protected. The second part of this section outlines the court's actual role and the extent of its power when dealing with minority shareholder cases.

#### 2.4.1 The rights and interests of the minority shareholder which need to be protected

The following section not only outlines the minority shareholder's interests and rights, but also shows how they should be reserved (stated in the statute) and protected. The starting point is when investors finance companies, typically obtaining certain rights, interests and powers that need to be protected. Investor protection is defined as a set of regulations and laws that protect investors' rights and interests and the strength of the legal institutions that facilitate law enforcement.<sup>148</sup> Since the minority shareholder is classified as one of those investors, the law must furnish certain rights and interests, and endeavour to protect them. Generally speaking, minority shareholders are more likely, one would think, to invest in a company if there are mechanisms which they can use to obtain a remedy, in the event of their rights or interests being infringed.<sup>149</sup> Of course, the law and the quality of its enforcement will be important determinants of which rights and interests each shareholder has and how well these rights and interests are protected.<sup>150</sup> So the question which arises here is what are these rights, interests and powers which are attached to each share obtained by a shareholder (including a minority shareholder)?

---

<sup>148</sup> M, DeFond. & M, Hung., Investor Protection and Corporate Governance: Evidence from Worldwide Ceo Turnover, *Journal of Accounting Research*. Sep 18, 2003, at: (Abstract).

<sup>149</sup> L, Miles. & M, He., Protecting the rights and interest of minority shareholders in listed companies in China: challenges for the future, *International Company and Commercial Law Review*. 2005, 16(7), pg: 281.

<sup>150</sup> R, La Porta. & Others., Law and Finance, *Journal of Political Economy*. 1998, 106(6), pg:1114.

Before answering this question, it is important to provide a clear description of the relationship between the investors and their rights and interests within the company. Ferran has described a shareholder as an investor who pays a sum of money into a company with the hope of earning a return.<sup>151</sup> This sum of money is turned into a financial interest in the company itself but it does not amount to a direct interest in the company's assets. These assets belong to the company, which is a separate legal entity.<sup>152</sup> In other words, once a shareholder invests in a company, his/her investment is exchanged for rights, interests and powers that can be exercised in relation to the company's capital and affairs.

According to the OECD's Principles on Corporate Governance,<sup>153</sup> basic shareholder rights should include the right to (1) secure methods of ownership registration; (2) transfer new shares; (3) obtain relevant information on a regular basis; (4) participate and vote in meetings; (5) elect and remove members of the board; and (6) share profits. In addition to this list, the minority shareholder should also have the right (7) to sue directors or majority shareholders for any suspected expropriation against the company or him/herself, and finally, have (8) a clear mechanism to exit at a fair price. It may be presumed that all these rights and interests come automatically with each share purchased, unless contrary provision is made in the articles or constitution at the point when the shares are issued.

A company which wants to issue shares with alternative rights and interests must have the power to do so stated within its agreement or articles. However, Rock and Wachter feel that the right as to access to information should depend on what the courts provide, as they believe that this right should not be unrestricted. This view, however, neglects the fact that this right will be much clearer and easier for the minority shareholder to understand (and as a result to exercise) if it is statutory, rather than being left to the court to decide how to enforce it.<sup>154</sup> It is also important to understand that, since the minority shareholder needs information on a regular basis to enable him/her to exercise

---

<sup>151</sup> E, Ferran., *Company Law and Corporate Finance*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 1999, pg: 315.

<sup>152</sup> *Salomon v Salomon* [1897] AC 22 HL.

<sup>153</sup> Organisation for Economic Co-operation and Development (OECD) 2004, pg: 9. Another Final Report in consultation with the OECD was issued in 2009, but mainly concentrated on public companies.

<sup>154</sup> E, Rock. & M, Wachter., Waiting for the Omelet to Set: Match Specific Assets and Minority Oppression in the Close Corporation, *Journal of Corporation Law*. 1999, 24(4), pg: 36.



other rights, this right in particular should be regulated by a reserved provision in the law which guarantees that the minority shareholder will always be able to exercise it.<sup>155</sup> In fact, all of these rights and interests should be reserved in a statutory list to avoid any omission, misconception, misinterpretation or ignorance and to simplify the process of protecting them.

An absence of effective and reserved rights and interests may mean, for instance, that majority shareholders may be motivated to engage in activities that advance their own interests at the expense of minority shareholder interests and rights.<sup>156</sup> It is believed that, if the rights and interests are clearly stated, the minority shareholder will have a better understanding of what remedy to seek when any one of them is violated. For example, in the English case of *Clark v Cutland and Others*,<sup>157</sup> the minority shareholder was unsure which remedy to seek as it was not clear to him which interest or right was violated. In this case the majority shareholder had misappropriated funds and taken remuneration from the company without authority. The Court of Appeal held that this was an abuse by the majority shareholder and he was ordered to return the money to the company. Nonetheless, the minority shareholder had in fact filed two proceedings (one seeking to enforce corporate interests and the other personal interests) in this case. Although the court eventually granted the minority shareholder what he sought, the minority shareholder had been forced to file two claims out of confusion, leaving it to the court to decide which right or interest had actually been violated. Another example of confusion was seen in the Scottish case of *Anderson v Hogg*<sup>158</sup> where the Lord Ordinary dismissed the personal interest claim on the basis that the minority shareholder had failed to prove unfairness under s459 of the Companies Act 1985, but the same judge noted the potential for an action if brought on behalf of the company itself. Nevertheless, the Inner House (on appeal) held that the judge was wrong in dismissing the claim as there was a potential personal interest as well as a corporate one. Dine has commented that there is no clear guidance as to what exactly each interest and right serves, and accordingly this may have the effect of confusing the minority shareholder

---

<sup>155</sup> R, La Porta & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), pg: 875.

<sup>156</sup> R, La Porta & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), pg: 875.

<sup>157</sup> [2003] EWCA Civ 810.

<sup>158</sup> (Scotland CSess Extra Div 2001) [2002] S.L.T. 353.

over which kind of behaviour could be the subject of litigation.<sup>159</sup> Similarly, Attenborough has claimed that a problem will occur if the minority shareholder faces practical difficulty in establishing a clear fact or ground for his/her interest or right.<sup>160</sup> As a result of this, several rights and interests which should be protected for the minority shareholder, may not be, simply because they are not clearly identified.

In addition to the rights and interests which should come with each share, the concept of legitimate or reasonable expectations should also be recognized and reserved as an interest for the minority shareholder.<sup>161</sup> In England, the doctrine of legitimate expectations was made a critical element by the House of Lords in response to a claim for unfair prejudice in the leading English case of *O'Neill v Phillips*.<sup>162</sup> This is an important interest and it should also be acknowledged and protected by the law, in line with the other stated or reserved rights and interests which are granted to minority shareholders. The law here should pay regard to the equitable consideration of “legitimate expectation” and loss of trust or confidence between shareholders as interests for the minority shareholder (Full detail is given about this doctrine in Chapter 5, Section 5.1.2.9.3).

Although it may be difficult for the statute to cover all types of interests and rights in an exhaustive list, it is believed that the law can, nevertheless, state a non-exhaustive list of interests and rights. The advantage of this is that minority shareholders will be familiar with which kind of rights and interests they can litigate over, and recognise where other potential rights and interests may exist. The benefits will also extend to judges who will be clear about the types of particular interests or rights that can be pursued. Furthermore, another advantage which can be noted for the company and its shareholders (if a non-exhaustive list of interests and rights is stated) is that a clear distinction can be made between corporate and personal interests and rights.

In sum, the fundamental aim behind highlighting these rights and interests is for the statute governing company law to recognise and acknowledge them on behalf of

---

<sup>159</sup> J, Dine., *Company Law*. 5<sup>th</sup> ed. Palgrave Macmillan, New York, 2005, pg: 261.

<sup>160</sup> D, Attenborough., How directors should act when owing duties to the companies' shareholders: why we need to stop applying Greenhalgh, *International Company and Commercial Law Review*. 2009, 20(10), pg: 345.

<sup>161</sup> See para 2.1.3.

<sup>162</sup> [1999] 1 WLR 1092.

minority shareholders, rather than just assuming that they come automatically with each share. It is argued that the statute is the only reliable source which can protect these rights and interests. Alternatively, the law may state a non-exhaustive list of interests and rights and then go on to define and categorise the grounds and principles that can give rise to any new potential right or interest that does not feature on the original list. The next part will detail the court's role in this matter.

#### 2.4.2 The court's role when dealing with minority shareholder cases

It is clear that it is very difficult for minority shareholders to seek a remedy from within the company when any wrongdoing is committed against them, due to the majority shareholders' power and influence which allows them to run the company as they wish. Therefore, there must be an external body which has the capacity to judge and resolve any dispute on request. This external body cannot be other than the court, which could grant a relief on any ground whenever justice so requires, and particularly when an otherwise helpless minority shareholder is in need of assistance.<sup>163</sup> The court is the appropriate body to address disputes between shareholders because it is the only entity that is independent, just and disinterested in any conflict, plainly making it more capable than any other body to pass judgment in this respect.

However, the court may find itself 'handcuffed' in certain jurisdictions (including SA and Dubai) if the majority shareholder has abused the interests of the minority shareholder but is still acting within the provisions of the equivalent to the articles and memorandum of association.<sup>164</sup> The court, under these circumstances, is more likely to be unable to deliver justice when a dispute or wrongdoing occurs in the company and, for this reason, there must be an alternative principle for the law to apply in order to justify the court's interference in bringing justice in the company's or minority shareholder's favour.

There are three possible responses that can be identified as to how courts deal with complaints from shareholders concerning majority shareholders' abuse of company

---

<sup>163</sup> *Pavlides v Jensen* [1956] 2 All E.R. 518.

<sup>164</sup> J, Abugu., A comparative analysis of the extent of judicial discretion in minority shareholder protection litigation: the United Kingdom and United States, *International Company and Commercial Law Review*. 2007. 18(5), pg: 184.

rights. The first is the court's traditional position of non-interference.<sup>165</sup> With this response, the court does not interfere in the company's management and this may well mean that unfairness, oppression, misuse and abuse are going unchecked. The second possible response is to freely open all cases to the courts according to the minority shareholder's wishes, so that the latter can simply bring an action in regard to any conduct they are not happy with, and they do so using company funds (where the action is brought on behalf of the company). This response is the exact opposite of the first, as it opens all doors for the minority shareholder to litigate and allows the court to interfere in management without any restrictions whatsoever. The possible consequence of this position being adopted, however, would be that the minority shareholder might either misjudge whether litigation is in the best interests of the company,<sup>166</sup> or act vexatiously. Moreover, the minority shareholder is not always in the best position to judge whether or not to commit the company's resources to the costly process of litigation and, accordingly, could waste the company's money.<sup>167</sup> Therefore, it is clear that neither the court's stance of non-interference nor the free and open scenario are appropriate options to deal with concerns over the company's interests, as each response produces extreme results. For that reason, there must be another alternative which would bring justice in such cases. This third response involves giving the court the discretion to investigate matters on a case by case basis, with the incorporation of a preliminary stage to consider whether it should allow the minority shareholder to proceed.<sup>168</sup> This strategy emanates from an understanding of the conflict of interests which the majority shareholder carries, between the desire to have complete freedom to run the company and the desire to prevent the minority shareholder from litigating.<sup>169</sup> The court here attempts to balance the wish of the majority shareholder to have control over litigation and the minority shareholder's desire to have no restriction whatsoever placed on their ability to

---

<sup>165</sup> This was the position under English common law, as illustrated in *Carlen v Drury* (1812) 35 E.R. 61, that "the court is not required on every occasion to take over the management of every playhouse and brew house in the kingdom".

<sup>166</sup> A, Reisberg., Judicial control of derivative actions, *International Company and Commercial Law Review*. 2005, 16(8), pg: 337.

<sup>167</sup> As stated by the Court of Appeal in the case *Prudential Assurance Co Ltd v Newman Industries Ltd* [1982] Ch 204.

<sup>168</sup> This scenario has been adopted in the Companies Act 2006, s260, the statutory 'derivative action'.

<sup>169</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. March 1999, pg: 101.

litigate.<sup>170</sup> While this means that the court will be more involved with companies' internal management over litigation, it is only done to ensure that justice occurs.

a. The court's involvement in commercial and litigious decisions:

For the court to judge whether the directors of a company have acted wrongly, there is a requirement for it to be more involved in the company's internal management. Inevitably, this involvement has been criticised on the basis that it is not practical for the court to position itself to assess whether or not litigation is in the company's interest.<sup>171</sup> In response to this criticism, however, it is important to understand that the court, when exercising its discretion, will examine the majority shareholder's conduct on both objective and subjective levels to ensure the most thorough comprehension of the matter.<sup>172</sup> The court's greater involvement with commercial decisions is for a superior purpose, which is to bring justice to companies when necessary and, at the same time, it ensures that nonsensical minority shareholder claims are not able to be pursued.

One role the court may play, if involved with commercial and litigious decisions, is in having the power to redirect minority shareholders' claims from being pursued on the grounds of corporate rights to being taken up on the grounds of personal rights, or vice versa. As mentioned already, there are two main grounds that minority shareholders can use in order to establish an action. The first is the corporate ground which is associated with corporate rights, as in the case of abuse or fraud committed against the company itself. The second is the personal ground which is attached to the shareholder's own rights and interests. The main purpose of the role of redirecting minority shareholders' claims is for the court to select the correct legal format for each case, as several effects will ensue accordingly. This is an issue where there is uncertainty, as demonstrated above. Therefore, it should not be left to minority shareholders (or even lawyers) to choose which ground to use according to their wishes,<sup>173</sup> because proceedings based on

---

<sup>170</sup> T, Boyle., The new derivative action, *Company Lawyer*. 1997, 18(8), pg: 255-257.

<sup>171</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, Mar 2005, pg: 191-193.

<sup>172</sup> M, Almadani., Derivative actions: does the Companies Act 2006 offer a way forward?, *Company Lawyer*. 2009, 30(5), pg: 138.

<sup>173</sup> At the start of any claim, it is initially open to the minority to bring it on any ground he/she chooses, but the court then has a role which enables it to redirect the claim on the basis of what it believes to be the most appropriate ground.

the corporate ground, for example, bring certain advantages that are not available to proceedings based on personal grounds. For instance, using corporate grounds as the basis for an action will allow the minority shareholder to use the company's name in the claim and perhaps to seek indemnity for costs if the case succeeds.<sup>174</sup> If the court has the ability to redirect cases to be pursued on their correct grounds, there will be benefits for minority shareholders, and also for the company, as the court will always ensure that action is taken on the most appropriate grounds.<sup>175</sup> One benefit in particular is that the court would not penalise a minority shareholder if he/she proceeded on the wrong basis. Thus, for the court to fulfil its role efficiently, it should have discretion to monitor, guide, direct, resolve, enforce the law and safeguard the minority shareholder and the company. However, some legal commentators question the court's ability to deliver.<sup>176</sup>

b. Scepticism of the court's capacity to judge in minority cases:

One of the criticisms levelled at the court's ability to judge directors' decisions surrounds the fact that courts may make their judgments on the basis of the tangible results of these decisions and, accordingly, they are more likely to hold the directors accountable. This happens because the court has access to evidence of what has occurred as a result of the directors' decisions but not of what led to those decisions. Arguably, this may lead the court to hold that directors (or majority shareholders) could have acted in a different manner or could have done more for the company's benefit. This presumption might render majority shareholders anxious that the court is not a suitable body to judge on business matters - especially those made in the past - as it may not possess a comprehensive awareness of the prevailing conditions at the time in which a particular decision was reached. In response to this argument, however, Keay has pointed out that courts do appear to have been vigilant concerning this possibility, and have warned about using hindsight or "second guessing" to judge the past actions of directors.<sup>177</sup> He reached this view after studying several English cases dealing with

---

<sup>174</sup> B, Hannigan., Drawing boundaries between derivative claims and unfairly prejudicial petitions, *Journal of Business Law*. 2009, 6, pg: 610-611.

<sup>175</sup> S, Mayson. D, French. & C, Ryan., *Company Law*. 24<sup>rd</sup> ed. Oxford: Oxford University Press, 2007-2008, pg: 678.

<sup>176</sup> Some may query whether the court should have to guide parties in proceedings. This guidance might seem unusual in the common law system. However, it may be appropriate in a civil law system where the court is always empowered to be more involved in such cases.

<sup>177</sup> A, Keay., Wrongful trading and the liability of company directors; a theoretical perspective, *Legal Studies*. Sep 2005. 25(3), pg: 440.

claims for wrongful trading and breach of the duty of care by directors. It was said by the judge in the English case of *Re Sherborne Associates Ltd*,<sup>178</sup> for example, that it is dangerous to assume that “what has in fact happened was always bound to happen and was apparent”. A similar view was also taken by Lewison J in the English case of *Secretary of State for Trade and Industry v Goldberg*.<sup>179</sup> Thus, courts have demonstrated recognition that directors must make difficult decisions, often in challenging circumstances, and matters might not have been as clear for them at those moments as they are when they can see the outcome of their decisions.

Similarly, there have been questions asked of the court’s capability to solve these types of cases. It is suggested by certain commentators that courts lack the experience and ability to pass judgement when it comes to commercial and business decisions.<sup>180</sup> This is to say that the directors themselves are the best placed to judge from a commercial point of view on matters related to the company’s affairs, and that there is no need for the minority shareholder to request the involvement of the court in every dispute as it is not capable of judging in the same way. Oesterle is one of those who believe that, because judges lack business experience, the court is not the appropriate forum for considering whether or not directors have acted properly.<sup>181</sup> However, this argument is challenged by Keay, who asserts that the claim does not accord with the only empirical evidence from UK law, namely the reported decisions.<sup>182</sup> Keay draws attention to the decision in the case of *Re Continental Assurance Co of London plc*.<sup>183</sup> Although in this case the judge described the financial system which the directors had overseen as antiquated, he did not criticise the directors for not having had a better one in place,<sup>184</sup> and therefore appeared to be acting leniently. A similar picture arises from the English

---

<sup>178</sup> [1995] BCC 40.

<sup>179</sup> [2004] 1 BCLC 597, pg: 613.

<sup>180</sup> For example, Cheffins in (B, Cheffins., *Company Law: Theory, Structure and Operation*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 1997, pg: 543). Also, Wishart in (D, Wishart, ‘Models and Theories of Directors’ Duties to Creditors’, *New Zealand University Law Review*. 1991, pg: 340-341).

<sup>181</sup> D, Oesterle., ‘Corporate Directors’ Personal Liability for “Insolvent Trading” in Australia, “Reckless Trading” in New Zealand and “Wrongful Trading” in England: A Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders’, cited In: I, Ramsay & Others., *Company Director’s Liability for Insolvent Trading*. 1<sup>st</sup> ed. Centre for Corporate Law and Securities Regulation, the University of Melbourne, Australia, 2000.

<sup>182</sup> A, Keay., Wrongful trading and the liability of company directors; a theoretical perspective, *Legal Studies*. Sep 2005. 25(3), pg: 439.

<sup>183</sup> [2001] BPIR 733.

<sup>184</sup> A, Keay., Wrongful trading and the liability of company directors; a theoretical perspective, *Legal Studies*. Sep 2005. 25(3), pg: 440.

case of *Re Purpoint Ltd*,<sup>185</sup> where the judge (even though he admitted having some doubts as to whether a reasonable director would have permitted the company to have commenced trading at all due to the existence of clear critical factors against trading) did not conclude that the company had been doomed from the outset.

A point which proves the courts' competence to judge in minority cases is that some jurisdictions have specialised courts that are dedicated to judging in commercial cases. This commercial speciality has made judges within such courts perfectly able to comprehend and appreciate the facts of every minority case, and therefore deliver fair judgments. However, even if courts in these jurisdictions do appear to be weak in their ability to judge fairly in minority cases, they will usually be presented with evidence from professional experts and this will help guide them. Therefore, the court can indeed be seen as capable of showing understanding of the directors' position as well as minority perspectives, and it can be now said with confidence that courts are able to make fair judgments.

c. Clear criteria to guide the court:

It is strongly believed that if the minority shareholder is given efficient protection, courts will make concerted efforts to solve disputes fairly for all parties. The question of whether or not the courts are qualified to comprehend business or commercial decisions does not remain unanswered as courts have proved themselves able to do so. Meanwhile, it is suggested that, for the sake of increasing confidence and trust in the court's ability yet further, certain clear criteria to guide the court should be drawn up in the statute. The statute may compel the court to take these criteria into account in order to decide whether or not to interfere and whether to allow the action by the minority shareholder to proceed.<sup>186</sup> Thus, the statute should not only list minority shareholders' rights and interests and provide their protection, but should also offer guidance and direction to judges on how to apply the law. This will enhance trust in the court's ability to judge in such cases.

---

<sup>185</sup> [1991] BCLC 491; [1991] BCC 121.

<sup>186</sup> These criteria have been set for the court to follow in the English Companies Act 2006, s263 (2). They are not only important to guide the court, but also for lawyers and shareholders.



Consequently, minority shareholder protection is positively related to the court's role as it is the only true refuge that the minority shareholder can take in order to seek justice.<sup>187</sup> For this reason, the statute should first recognise the rights and interests of the minority shareholder, and then provide a mechanism for the court to ensure the protection of these rights and interests. It should be noted that having clear criteria to follow in the statute does not only benefit the court, but also benefits lawyers, shareholders, directors and others. However, it is accepted that offering guidance and direction for the court in the statute is not an easy task, but the benefit that is received from having one in place outweighs anything else.

## **2.5 What would be the ideal way to produce efficient protection for minority shareholders?**

This section of the chapter outlines what would have to be the minimum protection available for the minority shareholder in order to offer sufficient safeguards. The section is divided into three parts. The first discusses the principles of corporate governance. The second section calls for making the best use of the grounds which the minority shareholder has available to establish their cases. The third recommends a practical and efficient model of minority shareholder protection.

### **2.5.1 Corporate governance.**

#### **a. Its definition and scope:**

Minority shareholder protection can emanate from many sources, including statutory provisions, the judicial system, external mechanisms of control, voluntary adoption of an internal company code, ethics, shareholders' agreement or corporate governance principles and regulation.<sup>188</sup> However, corporate governance as a whole can prove more important and useful than the remainder of these sources as it does not just provide protection for the minority shareholder, but also offers a comprehensive system of benefits for everyone dealing with the company. There is a vast literature on corporate

---

<sup>187</sup> B, Means., A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, *Georgetown Law Journal*. 2009, 97 (5), pg: 3.

<sup>188</sup> T, Lazarides., Minority Shareholder Choices and Rights in the New Market Environment. (July 10, 2009), Available at: <<http://ssrn.com/abstract=1432672>> accessed 24 February 2010, pg: 1.

governance but there is no single accepted definition of it. The term was first coined around 20 years ago so it is relatively new and, surprisingly, since then its meaning has not been analysed in-depth. It has been generally defined as “the system by which companies are directed and controlled”.<sup>189</sup> However, this definition seems too broad to account for its actual meaning. Most recently, du Plessis has offered a more carefully considered explanation which seeks to reflect all aspects and functions of the corporate governance role:

“It is the process of regulating and overseeing corporate conduct and of balancing the interests of all internal stakeholders and other parties....who can be affected by the corporation’s conduct in order to ensure responsible behaviour by the corporation and to achieve the maximum level of efficiency and profitability for the corporation”.<sup>190</sup>

This is a much more appropriate and accurate definition, and can better serve the purpose of this research. It shows that corporate governance is a complete system concerned with the rights and interests of all shareholders and other stakeholders, and utilizes different areas of the law for the same purpose. This can be seen, for example, when corporate governance refers to Contract Law<sup>191</sup> to regulate negotiated agreements, and to Company Law to list (and where necessary adopt) certain rights and interests for both the majority and minority shareholders. These fields of law, and the quality of their enforcement by the regulators and courts, are essential elements of corporate governance.<sup>192</sup>

Nonetheless, this recent definition has not specified any role for corporate governance in furnishing litigation remedies and would be much more comprehensive if it were to expand corporate governance’s scope to reach beyond the internal environment of the company. More to the point, if corporate governance does not pay attention to providing an adequate remedy when the rights and interests of minority shareholders are harmed,

---

<sup>189</sup> The UK Cadbury Report (1992) and the South African King Report (1994). These reports tried to define corporate governance and were mentioned in the article (J, Du Plessis., Corporate law and corporate governance lessons from the past: ebbs and flows: but far from “the end of history.....”: Part 1, *Company Lawyer*. 2009, 30(2), pg: 43).

<sup>190</sup> J, Du Plessis., Corporate law and corporate governance lessons from the past: ebbs and flows: but far from “the end of history.....”: Part 1, *Company Lawyer*. 2009, 30(2), pg: 44.

<sup>191</sup> This does not contradict the principle that says parties have freedom of contract to write what they wish. Instead, it suggests that the government should state certain rights and interests with certain procedures in the statute for any agreement of this type, in order to reserve them and make them contractual for the minority shareholder.

<sup>192</sup> R, La Porta & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), pg: 879.

there is no assurance of protection at all.<sup>193</sup> Before discussing the purpose and aims of corporate governance below, it is important to make clear that it is wrong to assume, as some seem to,<sup>194</sup> that strong minority shareholder protection is key to creating an environment that fosters effective corporate governance. This viewpoint confounds the reality that minority shareholder protection is just one aspect of corporate governance and not the other way around. The minority shareholder is but one stakeholder; corporate governance serves all stakeholders.<sup>195</sup> Any definition should therefore involve the idea that effective corporate governance can create an environment which fosters minority shareholder protection.

b. Its general aims:

The aim of corporate governance in this context is to construct effective minority shareholder protection by balancing conflicting interests and tensions, and offering remedies in relation to disputes. For corporate governance to serve minority shareholder protection in this way, it is believed that it should ensure the following:

1. That the minority shareholders must be treated fairly and have their rights and interests protected.<sup>196</sup>
2. That the procedures and mechanisms to litigate are clearly and plainly designed in the law for the minority shareholder to exercise.
3. The availability of a remedy for each and every type of wrongdoing and unfairness.
4. That the minority shareholder can sell his/her shares for a fair price when he/she wishes to exit the company.

c. Its role to provide remedies

---

<sup>193</sup> L, Miles. & M, He., Protecting the rights and interests of minority shareholders in listed companies in China: challenges for the future, *International Company and Commercial Law Review*. 2005, 16(7), pg: 277.

<sup>194</sup> DeFond and Hung in their paper (M, DeFond. & M, Hung., Investor Protection and Corporate Governance: Evidence from Worldwide Ceo Turnover, *Journal of Accounting Research*. Sep 18, 2003, pg: 10) analysed a number of studies and came to such a conclusion.

<sup>195</sup> Stakeholders can include majority shareholders, minority shareholders, employees, directors, creditors, suppliers, public members and others.

<sup>196</sup> Organisation for Economic Co-operation and Development (OECD) 2004, pg: 40. Another Final Report in consultation with the OECD was issued in 2009, but mainly focused on public companies.

What should always stand out from the list of aims is the responsibility of corporate governance to ensure the availability of legal devices which help obtain a remedy in cases of wrongdoing or oppression. This, indeed, is a major role as it grants minority shareholders certain litigation remedies, rather than leaving them to rely solely on internal mechanisms within the company. In order to reach this level and produce this result, the corporate governance framework should distribute responsibilities and accountabilities among shareholders.<sup>197</sup> However, holding the wrongdoer or oppressor accountable for any misuse or unfairness may not be possible unless the minority shareholder has clear and defined procedures and remedies on which to act. Lazarides has commented that, for corporate governance to serve minority shareholder protection effectively, it needs to explicitly state the rights and interests of minority shareholders and then furnish an efficient regulatory, legal, judicial and penalty system that guarantees the availability of clear remedies for the minority shareholder to exercise as necessary.<sup>198</sup>

It is important to note that the role of corporate governance in ensuring the availability of litigation remedies in the law does not only serve the minority shareholder but also the court, as it must be clear for the court which remedies can be applied in each case. If the statute does not make explicit provision to this effect, the court may not find itself freely empowered to judge and bring justice. This was clearly illustrated in the American case of *Wheeler v Pullman Iron & Steel Co*,<sup>199</sup> where the court held that the power to order winding up of the company must be statutory before the courts can deliver such a remedy.<sup>200</sup> Any failure to statutorily specify both the choice of remedies available and the court's power, results in uncertainty and unpredictability in the law as far as both shareholders and judges are concerned.<sup>201</sup>

---

<sup>197</sup> Organisation for Economic Co-operation and Development (OECD) 2004, pg: 29. Another Final Report in consultation with the OECD was issued in 2009, but mainly focused on public companies.

<sup>198</sup> T, Lazarides., *Minority Shareholder Choices and Rights in the New Market Environment*. (July 10, 2009), Available at: <<http://ssrn.com/abstract=1432672>> accessed 24 February 2010, pg: 6.

<sup>199</sup> III. 197; 32 N.E.420.

<sup>200</sup> In the United States, the court cannot bring justice without an actual statutory footing to do so. The statute should always empower the court to order winding-up when needed as the court may not grant a remedy that is not statutory.

<sup>201</sup> J, Abugu., A comparative analysis of the extent of judicial discretion in minority shareholder protection litigation: the United Kingdom and United States, *International Company and Commercial Law Review*. 2007. 18(5), pg: 188.

The corporate governance mechanisms will therefore be pointless if they do not include a statutory mechanism which offers clear litigation remedies.<sup>202</sup> Concentrating exclusively on listing the rights and interests of the minority shareholder without arming them with remedies to deploy when necessary, does not produce protective, practical and efficient corporate governance. Thus, it is important to realise that once the majority shareholder knows that corporate governance grants the minority shareholder certain power to pursue any wrong or oppression through litigation, he/she will be more likely to comply with the law.<sup>203</sup>

In sum, minority shareholder protection is a major part of corporate governance. For corporate governance to serve minority shareholder protection effectively, it should facilitate and clarify at least the following: legal remedies, empowerment of courts and minority shareholder participation in management. Undoubtedly, both corporate governance and minority shareholder protection are positively related in a way that means, if effective corporate governance is in place, it is highly likely to be reflected in the effectiveness of minority shareholder protection. Nevertheless, the role of corporate governance can be made absolutely redundant if there are no grounds in the law to remedy each and every type of wrongdoing and unfairness. Thus, it is very important for an effective corporate governance system to have broad grounds which can accommodate all categories of majority shareholder misconduct. The next sub-section will discuss the grounds available currently and demonstrate the need for there to be more grounds to litigate upon.

### **2.5.2 Grounds on which to establish an action for corporate interests**

For the minority shareholder to bring an action, he/she should have to attribute the misconduct to a ground which is specified and acknowledged by the statute. One common ground is fraud. What is interesting is that in certain jurisdictions (e.g. Saudi Arabia) “fraud” is the only clear ground on which the minority shareholder can rely in order to establish a claim. The problem starts for the minority shareholder when a wrong is committed against the company which does not amount to fraud. In these

---

<sup>202</sup> T, Lazarides., *Minority Shareholder Choices and Rights in the New Market Environment*. (July 10, 2009), Available at: <<http://ssrn.com/abstract=1432672>> accessed 24 February 2010, pg: 3.

<sup>203</sup> D, Schlimm. L, Mezzetti & B, Sharfman., *Corporate Governance and the Impact of Controlling Shareholder*, *Corporate Governance Advisor*. 2010, 18(1), pg: 6.

circumstances, the minority shareholder still needs to establish “fraud” as a ground, even if the wrong actually gives rise to other grounds, such as pure negligence, abuse, misuse etc, for which there are no stated remedies.<sup>204</sup>

It is possible to take traditional UK common law<sup>205</sup> as an example of a system which used to only allow fraud as a ground for a case brought by a minority shareholder. This was after UK courts created a common law device called the ‘derivative action’. In this circumstance, the minority shareholder was permitted to bring an action on behalf of the company, but only where clear fraud had occurred.<sup>206</sup> This sole ground of “fraud” placed extremely strict limitations on the conduct which could be attributable to it because all wrongdoing and miscount had to amount to “fraud”. Relatively speaking, very few claims were reported under common law, as seen from their infrequent appearance in case law.<sup>207</sup> It was difficult to bring an action as the minority shareholder had no power to access information which might have been able to prove the fraud and could have been used as evidence in court. Also, the minority shareholder had to establish that the wrongdoers were in control of the company to establish fraud. An example of how important it was to establish fraud can be seen in the English case of *Pavrides v Jensen*,<sup>208</sup> where the minority shareholder failed to establish the alleged negligent disposition of assets as fraud, and so the case failed. However, in *Daniels v Daniels*,<sup>209</sup> the court allowed a derivative action where no clear fraud was alleged, only negligence. The judge in this case seems to have been influenced by the fact that a majority shareholder made a considerable profit at the expense of the company, which was self-serving negligence and could therefore be considered as fraud. In fact, this weak, complicated and incomplete ground allowed many instances of wrongdoing and

---

<sup>204</sup> These grounds serve the corporate interest to obtain a remedy, but for the oppression of minority ‘personal interest’ there is another remedy, already mentioned in 2.1.a and 2.1.b.

<sup>205</sup> This is no longer the case in English company law as this device has been moved to the statute under the Companies Act 2006, instead of common law. This new law will be discussed in Chapter 5.

<sup>206</sup> A, Reisberg., Judicial control of derivative actions, *International Company and Commercial Law Review*. 2005, 16(8), pg: 337.

<sup>207</sup> M, Almadani., Derivative actions: does the Companies Act 2006 offer a way forward?, *Company Lawyer*. 2009, 30(5), pg: 135.

<sup>208</sup> [1956] 2 All ER 518. Fraud affecting the minority was also seen in *Daniels v Daniels* [1978] Ch. 406; [1978] 2 All E.R. 89 Ch D.

<sup>209</sup> [1978] Ch 406.

misconduct to go unpunished because of its narrow scope and problematical application.<sup>210</sup>

It was only towards the end of the twentieth century that reviews<sup>211</sup> were conducted which concluded that limiting all types of misconduct to one ground only, namely “fraud”, was detrimental. At this point, recommendations and proposals were put forward with the aim of widening the scope of liability in order to accommodate many more types of wrongful conduct besides fraud and also to abolish any need to establish the fact that the wrongdoers were in control of the company. Indeed, this is what was adopted in the UK Companies Act 2006. The position under the new law is that a derivative action can be launched when there is any breach of duty, breach of trust, default, misuse, abuse or negligence, besides fraud. It is no longer important to establish fraud in any of these grounds but, instead, each ground has the ability to stand on its own to constitute a claim.

In sum, the knowledge gained from the UK’s long experience should be taken into consideration by those jurisdictions which still apply “fraud” as the sole ground on which to base an action. They should be acquainted with the need for listing several grounds, besides fraud, for the minority shareholder to deploy, as these grounds will benefit the company itself. However, if they do not do so, many instances of misconduct and wrongs may escape liability and the company will be first to suffer.

### **2.5.3 The ideal model of protection**

It is important to realise that the vast majority of jurisdictions apply one of only two models when dealing with minority shareholder protection. The first model is that of French-civil-law countries, a legal family which includes many jurisdictions besides France, such as Spain, Italy, the Netherlands, the UAE and SA. The second model is that of common-law countries (the Anglo-Saxon countries) such as the UK, Canada, the United States and India, whose laws are modelled on UK law. It has been found by La Porta et al that common-law countries confer on shareholders stronger protection,

---

<sup>210</sup> M, Almadani., Derivative actions: does the Companies Act 2006 offer a way forward?, *Company Lawyer*. 2009, 30(5), pg: 132.

<sup>211</sup> Law Commission Report 1997 & Company Law Review, Developing the Framework, 2000.

relatively speaking, than the French-civil-law countries which provide the weakest protection of all legal systems.<sup>212</sup> This is specifically because common-law jurisdictions have a law that protects oppressed minority shareholders. However, the pre-emptive right<sup>213</sup> (which is intended to protect shareholders from dilution of their shareholding and to prevent the issue of shares at below-market prices) is not particularly protective in common-law jurisdictions and the French-based countries have better pre-emptive rights than those systems based on common-law. But generally speaking, the Anglo-Saxon countries offer more effective protection for minority shareholders. Lazarides believes that this effectiveness of protection in the Anglo-Saxon countries may be due to the explicit legal protection for the minority shareholder, whereas the markets in the other models do not have the same legal capacity to monitor and control companies.<sup>214</sup>

Broadly speaking, it is true to say that the Anglo-Saxon systems, relative to other jurisdictions, indeed have a package of laws that offer the best protection for minority shareholders.<sup>215</sup> The main cornerstone, which has made the common-law countries so strong in this respect, is the availability of certain mechanisms for minority shareholders to exercise. For example in the UK, these mechanisms are as follows. Firstly, a minority shareholder can bring a “personal action” if his/her personal rights have been infringed.<sup>216</sup> The second device, namely the derivative action, is intended for the minority shareholder to exercise when the company’s interest is harmed.<sup>217</sup> Thirdly, the unfair prejudice/oppression action is a further device, specifically designed to deal with any act by the company that harms the shareholder’s interests in his/her capacity as a member.<sup>218</sup> Fourthly, it is also possible for minority shareholders to seek a winding-up order when it is just and equitable to do so.<sup>219</sup> Finally, the minority may request that the

---

<sup>212</sup> R, La Porta. & Others., Law and Finance, *Journal of Political Economy*. 1998, 106(6), pg: 1116.

<sup>213</sup> Pre-emptive rights generally either allow the shareholders within a particular company to be given priority to purchase any new shares, or those of a shareholder who wishes to sell his/her shares, before they are made available to the public or require board approval for a transfer.

<sup>214</sup> T, Lazarides., Minority Shareholder Choices and Rights in the New Market Environment. (July 10, 2009), Available at: <<http://ssrn.com/abstract=1432672>> accessed 24 February 2010, pg: 4.

<sup>215</sup> R, La Porta. & Others., Law and Finance, *Journal of Political Economy*. 1998, 106(6), pg: 1129.

<sup>216</sup> This action in particular is still available under English common law and will be discussed in detail in chapter 5. See, e.g. *Smith v Croft No 2* [1988] Ch 114, and *Prudential Assurance Co. Ltd v Newman Industries Ltd (No.2)*, [1982] Ch 204.

<sup>217</sup> This action used to function under English common law but was made a statutory action under the Companies Act 2006.

<sup>218</sup> This action used to be under s459 of the CA 1985 but now comes under s994 of the CA 2006.

<sup>219</sup> For example, see s122(1)(g) Insolvency Act 1986. This is the last option available to the minority shareholder but he/she must first prove that it is just and equitable to do so.



company should be investigated because its affairs are being handled improperly (this remedy in particular has been mostly used in public companies).<sup>220</sup>

After looking at the types of protection which some jurisdictions offer, it is believed that, in order to produce an ideal model of minority shareholder protection, a jurisdiction should take into account a few key principles. It is expected that if these principles are considered, the minority shareholder will then have the minimum protection that safeguards his/her investment. I would suggest these principles or guidelines as follows:

1. Furnishing clear legal devices and mechanisms for a minority shareholder to litigate when he/she has reasonable grounds to believe that his/her rights or the company's rights have been violated.<sup>221</sup>
2. Widening the grounds on which the minority shareholder may be able to bring an action on behalf of the company, in order to include a broad range of types of misconduct.
3. Activating the court's role, discretion and power when dealing with shareholder disputes in order to have the ability to interfere and bring justice when necessary.
4. Withdrawing the power to make decisions over litigation from the majority shareholder and granting it to the court when a shareholder seeks to enforce rights owed to the company or when the company's interests are being abused, but with the court being able to ensure that the minority shareholder is not bringing nonsense claims.
5. Designing a clear mechanism for exiting the company at a reasonable price without unnecessary delay.
6. Reviewing and assessing, on a regular basis, how minority shareholder protection laws work in practice in order to offer immediate reforms when needed.

It is important to state that, in order for these guidelines to produce efficiency, legislators and regulators should sincerely consider them when addressing minority

---

<sup>220</sup> The action has a base in CA 1985, S431 (1) & (2). Some amendments were made to the Companies Act 2006 in order to give the power of investigation to the Secretary of State under s1177.

<sup>221</sup> Organisation for Economic Co-operation and Development (OECD) 2004, at 40. Another Final Report in consultation with the OECD was issued in 2009, but mainly focused on public companies.

shareholder protection in the statutory provisions. Meanwhile, it will remain difficult for the regulators and legislators to strike the right balance when they are faced with the fact that majority shareholders need space and freedom to run the company, while the minority shareholder needs protection that will sometimes restrict the majority shareholder's actions.<sup>222</sup> In other words, there will always be a dilemma for regulators in determining how they should frame legislation to ensure the various interests in the company are equally considered. This requires legislators to engage in a balancing exercise. Similarly, judges will also face difficulty when attempting to achieve balance in cases where the minority shareholder has a right to litigate, but the case may not benefit the company's interests should it succeed.<sup>223</sup>

## 2.6 Conclusion

In order to understand the positions of both the majority and minority shareholders in the company, it was necessary to begin this chapter by revealing how the power and authority within a company is handled by the majority shareholder and to what extent this power can be unrestrained. Thus, the first section demonstrated the majority shareholder's power, and also highlighted the weak and limited position of the minority shareholder in the company.

The second section contested the views of those who dispute the importance of minority shareholder protection, while the third section put forward certain justifications for the existence of minority shareholder protection to prove that activating minority shareholder protection can contribute to both business prosperity and accountability. The fourth section illustrated precisely which interests and rights need to be protected and detailed the court's role in dealing with minority shareholder cases. The fifth section considered an ideal model of protection in order to see what might help to produce an efficient system of minority shareholder protection in reality.

Dealing broadly with the issue of minority shareholders, this chapter has shown how a company or a minority shareholder can be maltreated by majority shareholders who

---

<sup>222</sup> L, Sealy. & S, Worthington., *Cases and Materials in Company Law*. 8<sup>th</sup> ed. Oxford: Oxford University Press, 2008, pg: 371.

<sup>223</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, Mar 2005, pg: 194.

would normally enjoy full domination within the company. If they are not restricted, this can harm many parties including the company itself and, therefore, also its minority shareholders. The result can be financially harmful to the minority shareholder since the majority shareholder, taking advantage of his/her power, may be effectively “maximizing the controlling shareholder's utility,” but not necessarily “maximizing the value of the corporation”.<sup>224</sup> For this reason, this chapter has concluded that the majority shareholder’s power needs to be monitored and controlled by granting the minority shareholder certain statutory protection. This statutory protection should acknowledge the minority shareholder’s rights and interests, and should be sufficient to arm him/her with remedies that allow the protection of these rights and interests if violated.

The chapter concludes with certain recommendations and proposals that, if considered, may help to produce an ideal model of minority shareholder protection. These general guidelines should be taken into consideration by any jurisdiction which intends to reform the minority shareholder protection within its company law, as they should guarantee the minimum basic protection for the minority shareholder. The next chapter addresses the position of minority shareholder protection in Saudi Arabia and Dubai.

---

<sup>224</sup> D, Schlimm. L, Mezzetti & B, Sharfman., *Corporate Governance and the Impact of Controlling Shareholder*, *Corporate Governance Advisor*. 2010, 18(1), pg: 6.

## Chapter 3

### An examination of minority shareholder protection in Saudi Arabia and Dubai

#### Introduction

It would seem that in order to protect minority shareholders, laws need to be developed to discourage directorial misconduct. This will enhance the minority shareholders' confidence, promote transparent accountability and contribute to national economic growth. Unfortunately, there is no ready-made model of minority shareholder protection that can be transplanted to all jurisdictions. It is therefore vital to undertake a detailed study of each country's company law, examining its characteristics to gain a better understanding of what reforms are needed and to what extent they should be implemented. This is because important influential factors including the constitution, laws, customs, conventions, creeds, language, roots, culture and economic potential will vary from one country to another. Thus, for a study conducted in a particular country to be beneficial and effective, it should investigate all aspects of doing business, such as transactions, the quality of infrastructure, security from theft and looting, the transparency of regulation, liquidity, accountability and enforcement of law, so that it can deliver a clear picture of the company system.<sup>225</sup> These are the factors which matter most in deciding whether to invest, as the potential investor ultimately wants to ensure that an effective protection exists to safeguard the investment. It is reported<sup>226</sup> that the availability of effective protection is an important consideration for up to 73% of investors. Thus, law-makers have a key interest in reforming the law on a continuous basis in order to reinforce investor protection. In the context of developing countries, and of SA and Dubai in particular, this interest is shown by the governments' intention to make the economy more attractive for foreign investors to do business. However, this is less likely to happen in the absence of effective regulations and reliable corporate practices which can guarantee the safety of an investment. Confidence and trust in the

---

<sup>225</sup> The World Bank and International Finance Corporation, *Doing Business 2010 Saudi Arabia*, 1<sup>st</sup> ed. The International Bank for Reconstruction and Development / The World Bank, 2009, pg: 1.

<sup>226</sup> The World Bank and International Finance Corporation, *Doing Business 2010 Saudi Arabia*, 1<sup>st</sup> ed. The International Bank for Reconstruction and Development / The World Bank, 2009, pg: 28.

market and the system must be visible and tangible for national and local investors first and can then be extended to international investors.

The particular aim of this chapter is therefore to investigate relevant company law and commercial legislation in SA and Dubai as examples of Arab and Islamic countries. This will involve an examination of the present doctrine in SA and Dubai as far as minority shareholder protection is concerned. It is designed to identify any weak and inefficient aspects of laws dealing with minority shareholders, not merely to prove that the laws regarding minority shareholder protection are weak, but also to diagnose where exactly the problem lies in order to offer correct and workable reforms. Phrased differently, this chapter will identify the shortcomings of the legal position as far as minority shareholders are concerned in Saudi Arabia (“SA”) and Dubai and establish what is in greatest need of reform.

This chapter will be more concerned with SA than Dubai because of its greater potential for attracting foreign investment, the higher circulation of money and greater number of transactions in its market,<sup>227</sup> as well as its surprisingly greater need for legal reform compared with Dubai (discussion of the Dubai law and Bill is delivered towards the end of this chapter). The chapter is divided into the following six sections: the first gives background data concerning SA, the second sets out what SA company law states regarding minority shareholder protection and the third explains the role that Sharia law (Islamic jurisprudence) plays in protecting minority shareholders. The fourth section discusses the new SA Company Law Bill in an attempt to identify what elements of it would be beneficial to minority shareholders, if any. The fifth section considers the position of minority shareholder protection under Dubai Company Law and its Bill. Finally, there is a conclusion.

### **3.1 General outline of Saudi Arabia**

SA is a Muslim country, all of whose citizens are Muslims. Thus, it is part of the Muslim world, which is often stereotyped, according to Miles and Goulding, as backward and with high illiteracy rates, corrupt rulers and much terrorist activity. If all

---

<sup>227</sup> See section 1.1 of the first chapter.

of this were true, these factors would reduce the attractiveness of Muslim countries as markets in which to do business.<sup>228</sup> Nonetheless, the same authors emphasise the recent growth of worldwide academic interest in studying the commercial and company law of the region because of the substantial trade between Islamic countries and the West. It is estimated that only 13% of the trade of Muslim countries takes place among themselves, while 87% is conducted with the rest of world.<sup>229</sup> This figure indicates that there are very many potential business partners and shareholders whose existence cannot be ignored or neglected, especially at a time of great diversity in global markets.

Among the developing Muslim countries, SA stands out for its political stability, the quality of its infrastructure, its light tax regime, the low cost of its manpower and energy, as well as the financial incentives and liquidity which it offers to its private business sector. As a result of its wealth in petroleum and gas,<sup>230</sup> SA is one of the most dynamic and creditworthy markets in the world.<sup>231</sup> In any discussion of SA, it is inevitable that oil will feature prominently. With approximately 244.7 billion barrels of oil reserves – which is estimated to be more than a quarter of the world’s total and two thirds of the Middle Eastern supply – and up to 1 trillion barrels of ultimately recoverable oil, the Kingdom has no global rival in oil-based industries.<sup>232</sup> The wealth of its oil legacy is mirrored in every aspect of life in the country, underpinning the provision of a healthy environment which fosters liquidity and volume in the Kingdom and thereby strengthens investors’ confidence in the Saudi business market.<sup>233</sup>

There is no doubt that this liquidity factor attracts investors to SA, as El Sheikh notes, because their main concern is to generate profits, which are likely to be more easily obtained in a rich country such as SA, whose huge financial resources enable it to

---

<sup>228</sup> L, Miles. & S, Goulding., *Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?*, *Journal of Business Law*. 2010, 2, pg: 137.

<sup>229</sup> K. Ahmad, “*The Challenge of Global Capitalism: An Islamic Perspective*” cited In: L, Miles. & S, Goulding., *Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?*, *Journal of Business Law*. 2010, 2, pg: 128.

<sup>230</sup> It is estimated that Saudi Arabia is the world’s largest exporter and the third largest producer of oil.

<sup>231</sup> J, Bancal., *Legal, tax and fiscal engineering for industrial co-operation in Saudi Arabia*. *International Business Law Journal*. 1993, 6, pg: 687.

<sup>232</sup> International Energy Agency (IEA), by country, Saudi Arabia, 2008. Available at: <[http://iea.org/country/n\\_country.asp?COUNTRY\\_CODE=SA&Submit=Submit#bottom](http://iea.org/country/n_country.asp?COUNTRY_CODE=SA&Submit=Submit#bottom)> accessed 16 February 2010.

<sup>233</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 47.

construct an infrastructure consistent with the highest international standards. Hence, foreign investors will not be required to make significant contributions to overall infrastructural costs, i.e. public expenditure on roads, power stations, telecommunications systems etc, because they pay little or no tax.<sup>234</sup>

One would assume, given all these advantages of investing in SA, that there would be no impediment to national or even foreign investment, as everything would seem to be working effectively and efficiently. Unfortunately, however, this is not the whole picture, because there is one major obstacle that is the Saudi commercial and company law, particularly as it applies to the protection of minority shareholders in private companies. Current Saudi company law was enacted in 1965 and came into force prior to the recent explosion of commercial activity in the country. It seems that its provisions are modelled indirectly on civil law and that company and commercial law in SA have the effect of partially impeding foreign and national investment, to the extent that an English or American lawyer would find it difficult to advise clients operating there, without the assistance of local lawyers.<sup>235</sup> This factor alone may reduce the attractiveness of business-makers who intend to invest in SA, who are now more aware of legal systems and the uncertainties surrounding their provisions.<sup>236</sup> The next section will explore Saudi company law and show how the statute deals with minority shareholders (whether foreign or national), illustrating the extent of any existing protection.

### **3.2 Saudi Arabian Company Law and minority shareholder protection**

Saudi Commercial Code originated from the French system. However, there are some who claim that the Gulf States adopted a modified version of this system which was passed on by the Ottoman Empire, which used to control the region.<sup>237</sup> This may

---

<sup>234</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 24. SA does levy varying amounts of tax on foreign companies, but they may seek exemptions under certain conditions.

<sup>235</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 76.

<sup>236</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 137.

<sup>237</sup> J, Burgoyne., "Specific Problems and Unique Aspects of Doing Businesses in Saudi Arabia", cited In: F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 76.

explain why Saudi company law does not contain the exact provisions of the French company law of the time and why SA law provides for many types of corporate institution that do not exist in French civil-law jurisdictions.<sup>238</sup> It is also important to note that Egyptian legal scholars further refined and adapted the French commercial system after the Ottoman modifications, creating the so-called French/Egyptian model, which was taken by SA as the basis on which to enact company law.<sup>239</sup> This does not mean that existing SA company law corresponds exactly to the French/Egyptian model, since the Saudi law-makers selected what they believed would most closely fit within the Saudi commercial environment. Another significant factor which has played and will continue to play a dynamic role in formulating Saudi company law is Sharia law (Islamic jurisprudence), which establishes the general principles of every aspect of the law.<sup>240</sup> Thus, Saudi company law has developed under a number of successive and overlapping influences (French, Ottoman, Egyptian, Saudi and Sharia) which have modified its provisions and its operation.

At the same time, it must be noted that it has always been the intention of the SA law-makers and relevant councils (Panel of Experts, *Shura* (consultatory) Council and Council of Ministers)<sup>241</sup> to improve the commercial environment in order to diversify the country's economic activity away from a dependence on oil.<sup>242</sup> This is seen in the flexibility and practicality of the Foreign Capital Investment Law 2000,<sup>243</sup> which marked a considerable improvement in conditions for foreign capital investment in the Kingdom. The main aim of this law was to encourage, attract and facilitate foreign investment to make the country an open market for potential shareholders.

As well as clear improvements to the law regarding foreign investment, Saudi company law has also sought to provide effective protection to shareholders of *public* companies,

---

<sup>238</sup> To understand the differences between the two dominant systems, see section 1.1 of Chapter 1 & 2.5.3 of Chapter 2.

<sup>239</sup> R, Lewis., & C, Mallat., Commercial Law in the Middle East. *Centre of Islamic & Middle Eastern Law*, Available at: <<http://www.soas.ac.uk/Centres/Isalmiclaw/Materials.html>> accessed 12 February 2009.

<sup>240</sup> The influence of Sharia on SA company law will be discussed in the next section.

<sup>241</sup> The process of making a law starts with the Panel of Experts within the *Shura* (consultatory) Council who will debate and discuss the proposed draft of the law in to see if any changes or amendments are needed. Otherwise, the draft will be sent to the Council of Ministers for final review and then approval.

<sup>242</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 22.

<sup>243</sup> This law was approved by the cabinet on 10 April 2000 to replace a complicated investment law which restricted foreign capital investment to certain narrowly limited economic sectors.



granting them the statutory right to bring legal action against directors.<sup>244</sup> According to sections 76, 77 & 78 of the SA Company Law 1965:

(76): The directors are jointly liable for compensation to the company or its shareholders or others if their management of the company's affairs cause abuse, misuse or wrongdoing.

(77): The company may file a "liability action"<sup>245</sup> against the directors if they have caused damages to all shareholders. In this case, the action should be on behalf of the company.

(78): Each shareholder has the right to bring a "liability action" against the company's directors if their wrongdoing caused particular damage to the shareholder. The shareholder may do so only if the company's right to litigate is still valid. The shareholder must notify the company of his intention to bring a case.

Therefore, shareholders in a *public* company can sue the directors on the basis that they have violated either the statutory law or the company's internal code (s76 is even broader than that, as the directors may be liable to a third party). In this case, all directors may be held accountable for such violation, but a shareholder will not be responsible as long as his/her refusal to approve the action was recorded at a board meeting. The shareholder in a public company can also bring a liability action in relation to a wrongdoing that harmed him/her personally, but he/she needs to prove that the company has also a right to litigate. It is also interesting that the Saudi Company Law, when dealing with public companies, does not require a shareholder to obtain the court's permission to instigate legal proceedings against directors as long as the relief obtained goes to the company.<sup>246</sup> Moreover, shareholders in a public company can sue the directors collectively on the basis of mismanagement if their action has harmed either the company or any of its shareholders.<sup>247</sup> Gross negligence can also be seen as a solid ground for a legal action against directors.<sup>248</sup>

---

<sup>244</sup> Ss 76, 77 and 78 of the Company Law 1965 which deal with the shareholders' right to litigate against the directors based on a variety of reasons.

<sup>245</sup> "Liability action" is the translation from Arabic to English of the action available in public companies.

<sup>246</sup> s76 of The Saudi Company Law 1965.

<sup>247</sup> s76 of The Saudi Company Law 1965. However, as mentioned by Al-Jeber (M, Al-Jeber., "*The Saudi Commercial Law*" cited In: F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal*

Therefore, it is evident from some provisions in the foreign investment law and also from some provisions regarding public companies that there are at least minimum safeguards which offer some sort of confidence and trust in the Saudi commercial environment, both helping to attract foreign business-makers to invest and encouraging domestic investors to remain and not to take their capital to other jurisdictions. However, it is important to note that about 80% of foreign investors who choose to do business in SA do so by establishing mixed enterprises and joint (private) companies with Saudi nationals, while very few establish an enterprise on their own.<sup>249</sup> This may be because foreigners do not wish to be present in the country to run such companies themselves, and because engaging a national would facilitate the running of the company and any dealings with officials. Also, a national can provide a better understanding of the market or help the firm to compete. Or another reason might be that the foreign investor is seeking to avoid paying the, albeit modest, taxes levied on 100% foreign-owned companies.<sup>250</sup> Whatever the explanation, considerable number of foreign investors in SA forms private companies with nationals. This is not to say that a Saudi partner is required at any stage, as there is no legal limitation on the percentage of foreign ownership according to the Foreign Capital Investment Law 2000.<sup>251</sup> However, it is assumed that, in most cases, foreign investors will be minority shareholders and nationals will hold the majority of shares in these private companies, so the latter will have more power in running the business.

All minority shareholders, whether foreign investors or nationals, will be directly affected by laws which govern the protection of minority shareholders and regulate

---

*Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 240), Saudi courts have not yet developed any consistent criteria on which an action can be deemed mismanagement; it is still left to the judge's discretion to decide.

<sup>248</sup> M, Al-Jeber., *The Saudi Commercial Law*. 3<sup>rd</sup> ed. King Fahd National Library, Riyadh, 1996, pg: 341.

<sup>249</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 52.

<sup>250</sup> There has always been a small amount of tax regularly paid by foreign investors, subject to the rate officially announced from time to time. s14 of the Foreign Capital Investment Law 2000 states that "all foreign investments licensed under this Law shall be treated in accordance with applicable tax provisions and amendments thereto in the Kingdom of Saudi Arabia". The government announced recently that foreign companies in Saudi Arabia can pay less investment tax if they employ more nationals. E, Baxter., Saudi plans tax cuts for foreign companies, Arabian Business.com. (October 19, 2009), Available at: <<http://www.arabianbusiness.com/570928-saudi-plans-tax-cuts-for-foreign-companies>> accessed 18 February 2010.

<sup>251</sup> See also: Ali & Partners., *Doing Business in Saudi Arabia*, (2004), Available at: <[http://www.mideastlaw.com/middle\\_eastern\\_laws\\_saudi\\_arabia.html](http://www.mideastlaw.com/middle_eastern_laws_saudi_arabia.html)> accessed 18 February 2010.

relationships between shareholders. It is disappointing that, despite the efforts of the Saudi Arabian regulators to improve the commercial environment, when it comes to private companies, the legal status of minority shareholders and the protection provided for them is different from the situation in public companies. It is admittedly very rare for Saudi commercial or company law literatures to discuss the protection of minority shareholders' rights and interests in private companies, making it difficult to evaluate the impact of the relevant statute. Basically, Saudi Company Law leaves it open to the shareholders to state in the shareholder agreement what they wish to establish in terms of rights, interests, profit distribution, management, liability, authority, power, protection and so on, as long as it does not contradict any of the statutory provisions.<sup>252</sup>

In terms of appointing or dismissing directors in private companies, one of two scenarios will apply. Under the first, where the director (whether a minority or majority shareholder) has been appointed by a specific clause in the shareholder agreement, then dismissing him/her from management requires a unanimous resolution by all shareholders and not just those attending the meeting.<sup>253</sup> Alternatively, an order can be sought from the court by a majority of shareholders to dismiss such a director.<sup>254</sup> The court will not grant such an order, however, unless it is satisfied that the director is no longer fit to act for the company.<sup>255</sup> The statute here does not clarify what is really meant by 'no longer fit to act for the company'. Alshareef and Alqurashi believe that in this case the court will seek to find an existing reasonable ground to order dismissal; otherwise it will reject the case and allow the director to remain in post.<sup>256</sup> The second scenario is where the director was appointed by a resolution rather than by a specific clause in the shareholder agreement. In this case, his/her dismissal requires only a majority resolution.<sup>257</sup>

On the other hand, if the shareholders have not specified (in the shareholder agreement) or agreed (by a resolution) on who shall be appointed as a director, then the statute here

---

<sup>252</sup> s24 to s34 of The Saudi Company Law 1965.

<sup>253</sup> s27 of The Saudi Company Law 1965.

<sup>254</sup> s33 of The Saudi Company Law 1965.

<sup>255</sup> s33 of The Saudi Company Law 1965.

<sup>256</sup> N, Alshareef., & Z, Alqurashi., *Commercial Law*. 1<sup>st</sup> ed. HAFIZ, Jeddah, 2007, pg: 183. The authors also elaborate further on this by saying that the discretionary power of judges can assess the capability and actions of the director in question in order to see whether or not he/she is valuable to the company.

<sup>257</sup> s33 of The Saudi Company Law 1965.

considers all shareholders to have a role in management and also considers any action by an individual shareholder to bind the remaining shareholders.<sup>258</sup> In other words, all shareholders will be deemed directors if there are no specially appointed directors. However, the same statutory provision gives any shareholder the right to complain to the majority shareholders over any conduct that concerns them, and it is then for the majority shareholders to decide whether to ratify the action or not.<sup>259</sup> Even though the statute allows such complaints, it restricts them to being made prior to the completion of the conduct that is impugned; otherwise the right to complain is denied. It is claimed by one academic scholar that the purpose of this provision is to keep power and control over the company's affairs in the hands of the majority shareholders. He also believes that the law intends here to grant the majority shareholders the ultimate say on disputed matters rather than allowing the minority the chance to destabilize the company on every issue.<sup>260</sup>

Furthermore, there are certain grounds designed in the statute for any shareholder to bring a legal action against the directors of the company, who in most private companies are the majority shareholders or are appointed by a majority shareholder. These grounds are for use when the company is acting or about to act ultra vires or illegally.<sup>261</sup> This provision is more beneficial to minority than majority shareholders as it grants the minority shareholders the right to litigate on the grounds of ultra vires or illegality. This is because, while the majority shareholders can use their power within the company to pass a resolution to stop an action which they do not agree with, minority shareholders must use the grounds of ultra vires or illegality to prove such a claim to the court. The issue of lack of good faith is an important element in upholding such a claim, especially where a third party (external to the company) is involved.<sup>262</sup> Hamd Allah assumes that, if the company acted ultra vires or illegally, then the third party will be protected only if he acted in good faith in his dealings with the company. This is to protect what appears to the third party to be proper transactions with the company. In this case, the transaction remains valid as far as the third party is

---

<sup>258</sup> s28 of The Saudi Company Law 1965.

<sup>259</sup> s28 of The Saudi Company Law 1965. It is important to note that the statute here does not define the types of conduct which the majority has authority over and to what extent. It is also not clear for the minority shareholder as to when he/she can involve the court in disputes or complaints.

<sup>260</sup> H, Hamd Allah., *Saudi Commercial law*. 1<sup>st</sup> ed. ANNAHDAH, Cairo, 2003, pg: 260 &261.

<sup>261</sup> H, Hamd Allah., *Saudi Commercial law*. 1<sup>st</sup> ed. ANNAHDAH, Cairo, 2003, pg: 270.

<sup>262</sup> s29/3 of The Saudi Company Law 1965.

concerned, but the company can have the right to pursue the director for compensation and may dismiss him/her.<sup>263</sup> It is noteworthy to stress that the Saudi statute does not clarify who can act on behalf of the company in such cases, and, similarly, does not specify the options which may be available for the minority shareholder if the company does not intend to pursue any compensation.

Another statutory right that is designed for those shareholders who have no role in management is the right to give advice to those who are involved in management (directors or majority shareholders) in such a way that is considered to be in the best interests of the company.<sup>264</sup> This right entitles the shareholders who are non-directors to have their say on matters related to the company even if they are not directors. The same statutory provision gives the right to all shareholders to access, on request, any type of information, statistics, data and reports that are relevant to the company's affairs.<sup>265</sup> It is assumed that the appointed director should facilitate the granting of such a request, so that other shareholders can be always informed of the company's progress. It is also assumed that this right is not subject to negotiation and cannot be denied, as it is reserved in the statute for any shareholder to utilize.<sup>266</sup> The shareholder may litigate to have this right enforced if the director in control fails to comply. However, the statute does not provide a mechanism to show which procedures to follow in making such a claim. Furthermore, the statute also does not specify what ground the shareholder should use or even which remedies are available when prosecuting such a claim.

Another possible right for the minority shareholder in private companies has been suggested by Almadani,<sup>267</sup> who believes that the "liability action", which is originally provided in the statute to serve the minority shareholder in public companies, should be also used in private companies. He has taken this concept from s168(1)<sup>268</sup> which states that directors (majority shareholders) are liable for compensation for any harm which they have caused to the company or its shareholders, and no ratification can prevent such an action. It is true that such an action is available under this section, but it does not relate to private companies. In fact, this action is related to a separate category of

---

<sup>263</sup> H, Hamd Allah., *Saudi Commercial law*. 1<sup>st</sup> ed. ANNAHDAH, Cairo, 2003, pg: 271.

<sup>264</sup> s24 of the Saudi Company Law 1965.

<sup>265</sup> s24 of the Saudi Company Law 1965.

<sup>266</sup> H, Hamd Allah., *Saudi Commercial law*. 1<sup>st</sup> ed. ANNAHDAH, Cairo, 2003, pg: 272.

<sup>267</sup> H, Almadani., *Saudi Commercial Law*. 5<sup>th</sup> ed. ALMADANI, Jeddah, 2001. pg: 313.

<sup>268</sup> Saudi Companies Law 1965.

companies that are not classified as either private or public companies.<sup>269</sup> This third category of company has mixed features; some in common with the public companies (especially in its financial aspect) and some are in common with private companies (especially with regard to the quasi-partnership or personal relationship between shareholders). In practice, the “liability action” is often limited in use to the public and mixed companies and is unknown in relation to purely private companies.

Having examined what is relevant in the Saudi statute for the protection of minority shareholders, it can be claimed that the statute creates overlaps and interrelations which have undoubtedly caused inconsistency and uncertainty. There are many circumstances which can occur in private companies which the statute does not address clearly or at all, such as misuse, abuse, negligence, breach, fraud, expropriation, infringement and oppression committed by directors or majority shareholders, and even the court’s exact role in dealing with minority shareholders is unclear. It is even believed that the current statute, rather than offering legal assistance, guidance and protection to minority shareholders, has served to increase the degree of difficulty, confusion and uncertainty, not only among foreign shareholders, but also among Saudis. Most financial, legal, economic and political studies, which have examined the Saudi minority shareholder protection laws from different perspectives, have found a marked disregard for the rights of minority shareholders.<sup>270</sup> Indeed, most of the statutory provisions have weak characteristics and so cannot protect minority shareholders appropriately.

The statutory provisions which specifically deal with minority shareholders in private companies are very few, incomplete, ambiguous and unbalanced. They afford little protection, as they grant overall power in almost all circumstances to the majority shareholders - who have the ultimate say on almost all issues - without giving a clear right to the minority shareholder to litigate and involve the court in disputes. In other words, Saudi company law does not have a detailed and sufficient code that is related to

---

<sup>269</sup> The Saudi Company Law 1965 classified companies to three categories: listed companies, non-listed companies and mixed companies, which share certain factors with the first two categories. The Limited Partnership in Shares is one of few companies which come under this third category.

<sup>270</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 299. The researcher also says that other systems, in particular those using civil codes, offer less protection and thus afford corporate managers and directors (majority shareholders) a freer hand to manage their companies without great fear of any involvement, interference or challenge. In Saudi Arabia, this is almost always the case.

the protection of minority shareholders in private companies. The statute seems to grant the majority shareholders excessive power that is completely unrestricted and may result in harm, not just to the minority shareholders, but also to the company.

Added to the fact that the legislation is vague and difficult to understand, is that there is no distinct legislative body which can investigate and identify the need for reforms.<sup>271</sup> This is to say that there is no Saudi Law Commission or other body that is dedicated to reviewing continuously how company law works in practice in order to make reforms. To all intents and purposes, Saudi minority shareholder protection is wholly lacking from top to bottom, starting with the failure to recognize the rights and interests of minority shareholders and ending with the lack of remedies for them to use when necessary.<sup>272</sup>

Some argue that this deficiency in Saudi company law may emanate from the contradictory interaction between the modern legal institutions and traditional Islamic applications.<sup>273</sup> However, this is not true, because certain recent legislation produced by the Saudi law-makers has met international standards in its sophistication and quality, while Islamic principles have not prevented or hindered its creation.<sup>274</sup> In fact, Islamic principles have never prevented modern institutions from creating new laws that may benefit society; on the contrary, Islamic principles have worked side by side with the law-makers since the establishment of the Kingdom. The next section will show how these Islamic principles work to fill gaps in modern legislation, just as aspects of the common law do in jurisdictions like the UK.

### **3.3 The role of Sharia law in protecting minority shareholders<sup>275</sup>**

---

<sup>271</sup> A, Layish., "Saudi Arabian Legal Reforms as a Mechanism to Moderate Wahhabi Doctrine", In: F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 154.

<sup>272</sup> N, Sfeir., The Saudi Approach to Law Reform, *The American Journal of Comparative Law*. 1988, 36, pg: 734.

<sup>273</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 140.

<sup>274</sup> The Foreign Capital Investment Law 2000 is a classic example of the ability to produce a high standard legislation.

<sup>275</sup> This section has been published as a whole in: M, Almadani., The Role of Sharia Law in Protecting Minority Shareholder in Private Companies, *International Company and Commercial Law Review*. 2010, 21(12), pg: 395-402.

### 3.3.1 Background

One of the distinctive characteristics of Islamic states (like SA) is that they apply what is known as Sharia law. This provides a set of rules and principles which have a history going back 1,400 years,<sup>276</sup> and which pertain to all aspects of life. It is vital for any researcher who intends to study law in a Muslim country to understand the influence of Sharia. Even when investigating the commercial concepts of the contemporary world, the juridical stance of Sharia remains necessary for most Muslim countries. The Arabic word *Sharia* generally means “the Way” and denotes the system which governs the lives of Muslims and their relationships with society. Sharia has a very complex system of jurisprudence that outlines the methods by which Muslims conduct their lives according to Islamic teachings.<sup>277</sup> It wields a significant influence over every aspect of life, including the political, social, commercial, public and private.

Indeed, Sharia has recently become the subject of global academic interest and is considered by those who seek to investigate and study the commercial framework of those jurisdictions which base their laws on Sharia due to the increasing trade between Islamic countries and the West.<sup>278</sup> Al-Rimawi notes that, unlike Western legal systems, which have long separated religious principles from secular laws, Sharia principles continue to constitute essential sources of legislation in the majority of Muslim jurisdictions.<sup>279</sup> Sharia, in this context, can be defined as a body of religious laws and principles which provide direction in relation to rules of conduct for Muslims, and they must be adhered to.<sup>280</sup>

---

<sup>276</sup> Sharia was founded in the age in which Prophet Muhammad, peace be upon him, came with his revelation and prophethood, after he was sent to all mankind with a message calling for the oneness of worshiping one God.

<sup>277</sup> A, Ali., The role of Islamic jurisprudence in finance and development in the Muslim world, *Company Lawyer*. 2010, 31(4), pg: 121.

<sup>278</sup> According to Miles and Goulding in their paper (L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 128 & 129.), only 13 per cent of the trade of Muslim countries takes place among themselves, while 87 per cent is conducted with the rest of the world. This justifies the growing interest in studying this topic, especially given the existence of some Sharia-based jurisdictions which are of particular interest to foreign investors, such as Malaysia, the UAE and Saudi Arabia.

<sup>279</sup> L, Al-Rimawi., Relevance of Sharia in Arab securities regulation with particular emphasis on Jordan as an Arab regulatory model. *Company Lawyer*. 2006, 27(8), pg: 227.

<sup>280</sup> H, Hajjaji., Shareholders' agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 556.



### 3.3.2 Sources of Sharia

Sharia is derived from primary and secondary sources. The former are the Quran (the Holy book for Muslims) and the *Sunna* (the deeds and citations of the Prophet Muhammad, peace be upon him), while the secondary sources are *Ijtihad* (the human interpretation of the Quran and *Sunna*, undertaken by qualified Islamic scholars and jurists) and *Ijma* (the consensus or unanimous agreement of all the Islamic jurists of an age).<sup>281</sup>

The widely recognised schools of thought (for *Ijtihad* and *Ijma*) are the *Hanafi*, *Hanbali*, *Maliki* and *Shafi* schools, each of which has a distinctive methodology of observing fundamental principles (i.e. primary sources) when addressing each issue or case. Thus, each school may apply similar relevant principles to each issue or case, but may reach slightly different conclusions. It is important to indicate that both the Quran and *Sunna* are considered perfect and immutable, while human comprehension of them may be imperfect and faulty.<sup>282</sup> It is believed that Islamic law has been revealed to regulate people's lives, no matter where or when they live, as Islamic doctrines are applicable at all times and in all places.<sup>283</sup>

According to Sharia, the criteria for distinguishing right from wrong are found in the primary sources.<sup>284</sup> The substance of the Quran as a primary source of legislation emerges from its role not only as a collection of spiritual rites, but most importantly as a set of legal duties, as it is believed by Muslims that the Quran is the word of God and that He is best able to regulate their activities, dealings, relations and so on. Thus, the Quran contains many legal injunctions of several types. One important type that is

---

<sup>281</sup> Al-Rimawi in (L, Al-Rimawi., Relevance of Sharia in Arab securities regulation with particular emphasis on Jordan as an Arab regulatory model. *Company Lawyer*. 2006, 27(8), pg: 229) divides these sources into two groups: revealed and non-revealed. The former are the Quran and *Sunna* while the latter are *Ijtihad* and *Ijma* because they rely on the interpretation of qualified Islamic scholars are therefore not fixed.

<sup>282</sup> H, Abdul Jabbar., 'Islamic finance: fundamental principles and key financial institutions', *Company Lawyer*. 2009, 30(1), pg: 23. The author also mentions that the possibility of imperfect comprehension causes a divergence of opinion among Islamic jurists on some matters as each may reach a different conclusion.

<sup>283</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 145.

<sup>284</sup> God says in the Holy Quran Chapter 7, verse 157 that "He will enjoin on them that which is right and forbid them that which is wrong. He will make lawful for them all good things and prohibit for them only the foul; and He will relieve them of their burden and the fetters that they used to wear".

relevant to the subject of this research are the legal rules which govern business activity, the economy, commerce, trade, and, more specifically, mortgages, deeds of sale, trusts, contracts etc.<sup>285</sup> The *Sunna* then elaborates on the principles established in the Quran. As a source of authority, it is second in position to the Quran and its mission is not only to deliver the verses of the Quran, but also to explain them to the people and to teach them how to live by them.<sup>286</sup>

As for the secondary sources of Sharia (*Ijtehad* and *Ijma*), there is a major drawback in that not all Islamic law is expressed in the form of legislation. Indeed, the most substantial part of the law is to be found in the scholarly literature written by Islamic legal scholars over the centuries. In most cases, these books and references are not available in different languages, as very many of them have not yet been translated from Arabic.<sup>287</sup>

### 3.3.3 The application of Sharia

The existence of principles and rules produced by Sharia does not mean that there is no space for governments to regulate human activity whenever there is a public interest in doing so. This applies to Muslim governments (especially SA), which may produce new laws or even adopt new principles, regardless of their origins, as long as these laws or principles do not violate the Islamic legislation established by Muslim scholars in light of the Holy Quran and the *Sunna*. It is even commanded in the Quran that people must comply with the regulations and legislation laid down by their rulers, as long as they do not contradict what God and His messenger have already legislated. The Quran says:

“O you who believe, obey God, and obey the messenger and those of you who are in authority; and if you have a dispute concerning any matter, refer it to God and the messenger....”<sup>288</sup>

---

<sup>285</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 146.

<sup>286</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 146.

<sup>287</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 76.

<sup>288</sup> Holy Quran, Chapter 4, verse 59.

The interpretation of this verse shows that people are obliged to follow rulers' laws, regulations, legislation and guidelines as long as these do not require disobedience to God and his messenger.<sup>289</sup> Another aspect of this verse is that Sharia law allows any ruler to exercise originality, creativity, inventiveness and imagination in the interests of the people and of society.

It is important to understand that the main functions of Sharia when it comes to transactions and commercial dealings are to fill gaps and to serve as the foundation for any new law, leaving the detail to be developed by other means.<sup>290</sup> For instance, the Saudi legislature follows this principle by taking Sharia as the basis for any new legislation. Indeed, instances of the adoption of such a guide to the provision of general laws and principles are not limited to Muslim countries; England, for example, has common law principles that provide non-codified legal obligations.<sup>291</sup> It is important to note that Sharia tends to draw wide-ranging and general principles when it comes specifically to commercial codes. Therefore, there has always been an opportunity for Muslim governments to create contemporary statutes dealing with specific issues, where there is no inconsistency with Sharia.

A close examination of the role of Sharia law in building the foundation of commercial dealings and in shaping their operation reveals that Sharia urges Muslims to be ethical in conducting transactions and forbids cheating, deception, the manipulation of weights and measures and dealing in stolen goods. It makes clear that Muslims must trade on the basis of free mutual consent, so that a sale under compulsion is not acceptable. Taking advantage of buyers and charging disproportionate prices are forbidden. Sharia law requires Muslims to always be truthful in describing the quality of their merchandise. Furthermore, any Muslim who intentionally conceals defects in goods that he offers for

---

<sup>289</sup> Ibn Kathir, I., *Tafseer Ibn Katheer: Interpretation of Quran*. 1<sup>st</sup> ed. Dar Taibah, Almadina, 2002, Vol (2), pg: 326.

<sup>290</sup> L, Al-Rimawi., Relevance of Sharia in Arab securities regulation with particular emphasis on Jordan as an Arab regulatory model. *Company Lawyer*. 2006, 27(8), pg: 228.

<sup>291</sup> J, Makdisi., "The Islamic Origins of the Common Law," *North Carolina Law Review* 77' 1999, cited In: F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 149.

sale “risks losing the blessing of God on his/her business dealings.”<sup>292</sup> Thus, Sharia law sets the foundation of company law by stipulating the manners, ethics, morals, principles, values, standards and ideal attitudes which Muslims must follow in conducting their business.

#### 3.3.4. Sharia protects the weaker party

In respect of the subject matter of this research, Sharia makes no direct and specific mention of the regulation of modern companies or the protection of minority shareholders in any of its writings, notwithstanding the existence of a body of Islamic literature on transactions and commerce. However, Sharia does contain many general principles addressing the protection of the weaker party in contracts and commercial dealings.<sup>293</sup> To provide an example of the principles of Sharia in protecting the weaker party, safeguarding others’ interests and encouraging all to act with honesty, one verse of many in the Quran says:

“And do not swallow up your property among yourselves by false means, neither seek to gain access thereby to the judges, so that you may swallow up a part of the property of men wrongfully while you know”.<sup>294</sup>

The interpretation of this verse is that God commands Muslims not to take others’ money by deception, denial of rights or in any other unjust or illegal way.<sup>295</sup> The Prophet Muhammad, peace be upon him, also says (in one of many such references) regarding the dealings between people and the protection of the rights of one Muslim over another:

“...a Muslim.... does not oppress his brother nor abandon nor humiliate... every Muslim is protected, his blood, his wealth, and honour”.<sup>296</sup>

---

<sup>292</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 133.

<sup>293</sup> L, Al-Rimawi., Relevance of Sharia in Arab securities regulation with particular emphasis on Jordan as an Arab regulatory model. *Company Lawyer*. 2006, 27(8), pg: 228.

<sup>294</sup> Holy Quran, Chapter 2, verse 188.

<sup>295</sup> Ibn Kathir, I., *Tafseer Ibn Katheer: Interpretation of Quran*. 1<sup>st</sup> ed. Dar Taibah, Almadina, 2002, Vol (1), pg: 521.

<sup>296</sup> Narrated by Imam Muslim.

It is important to note that Sharia urges Muslims to act upon these principles not only when dealing with other Muslims, but also in order to protect the wealth and property of non-Muslims, where there is a recognised contract between parties.<sup>297</sup> Sharia allows a Muslim party to enter into a shareholders' agreement with a non-Muslim party, but certain conditions must be met. For example, any such agreement must be confirmed as Sharia-compliant before it is signed.<sup>298</sup> Therefore, entering into an agreement with non-Muslims is, in principle, allowed by Sharia as long as the agreement does not contradict Sharia in its terms or objectives, such as by trading in alcohol, pork or prostitution; otherwise the whole agreement will be considered void and impermissible in the eyes of a Sharia court.<sup>299</sup>

Prophet Muhammad, peace be upon him, is also quoted as saying that God states: "I am a third partner of those who form partnership; unless one of them betrays the other, I leave them alone".<sup>300</sup> The general interpretation of this citation is that a business partnership will be blessed by God if it is built on honesty, truthfulness and sincerity. However, if any of the partners engages in cheating, deception, oppression, betrayal or unfaithfulness against another, then God will withdraw his blessing, compassion and protection from the business. This means that problems of all kinds are more likely to afflict such a business, since God does not support cheats, oppressors or deceivers.<sup>301</sup> This citation alone has a very strong impact on Muslim business owners in that it makes them think twice before doing anything in bad faith, advancing their own interests against those of others, practising oppression, or any form of abuse. In other words, these verses can be seen to protect the weaker party, who may be vulnerable to abuse, misconduct or oppression on the part of a stronger party in authority if the power of the latter is not restricted. This applies to relations between minority and majority shareholders.

---

<sup>297</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 121.

<sup>298</sup> H, Hajjaji., Shareholders' agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 557.

<sup>299</sup> A contradiction Sharia may be within the agreement's terms where the parties agree against the Sharia requirement of sharing risk and profit. However, in this case, the Sharia courts will not consider the whole agreement void, but only such a term.

<sup>300</sup> Narrated by Abu Dawood.

<sup>301</sup> A, Salem., *Book of Sales*. Islamweb.net. (2006), Available at: <http://audio.islamweb.net/audio/index.php?page=FullContent&audioid=135007#135009> accessed 2 April 2010, at: Chapter (1); Company and Agency.

Another principle developed from secondary Sharia sources (where Islamic scholars have taken verses of the Quran and citations from the *Sunna* like those above and applied them in different contexts) to protect the weaker party is that of *Ghabn* or *Gharar*, one of whose meanings is to prevent the gain of money, property or opportunity by cheating.<sup>302</sup> Sharia forbids such gain, regardless of its magnitude, if it is achieved through fraud.<sup>303</sup> Thus, if a shareholder tries to take advantage of others or advance his/her own interests over those of others, this will be considered under Sharia as cheating or fraud. Another application of *Ghabn* or *Gharar* has been in relation to contracts, where it prohibits uncertainty, ambiguity or deception.<sup>304</sup> The use of having deliberately open terms in contracts which convey more than one meaning is prohibited under Sharia. In other words, any type of ambiguity that may give rise to doubt in the contract will be considered to render it void.<sup>305</sup> Therefore, “contracts should clearly specify the nature of goods to be sold, and clearly define the rights and obligations of buyer and seller so as to avoid any disputes;”<sup>306</sup> otherwise, the potential for abuse may exist, especially by a stronger party over a weaker one.<sup>307</sup> It is worth mentioning that according to Abd Jabbar, *Ghabn* or *Gharar* under Sharia is wider than the principle of uncertainty under secular law because, although uncertainty in a contract may render it void under secular law, “some ambiguity is permitted as long as it can be resolved by interpretation or by examining the intention and conduct of the parties to the contract”.<sup>308</sup> The demands of Sharia are that there is to be complete certainty in respect of all of the fundamental terms of a contract.<sup>309</sup>

---

<sup>302</sup> The prohibition of *Ghabn* or *Gharar* is evidenced by a number of Quranic verses and *Sunna* citations that mention the word no less than 50 times.

<sup>303</sup> Islamic Research and Training Institute, IRTL., *Islamic Capital Markets: Products, Regulations & Developments*, 1<sup>st</sup> ed. Islamic Development Bank, Jeddah, 2008, pg: 286.

<sup>304</sup> Saleh has noted in (“*Unlawful Gain and Legitimate Profit in Islamic Law*” 1992, cited in: H, Abdul Jabbar., ‘Islamic finance: fundamental principles and key financial institutions’, *Company Lawyer*. 2009, 30(1), pg: 25.) that what is prohibited is not uncertainty as to the business risk or the business outcome of a transaction, because business risk is what sometime justifies the profit. What is actually prohibited is uncertainty related to the main elements which constitute the transaction.

<sup>305</sup> H, Abdul Jabbar., ‘Islamic finance: fundamental principles and key financial institutions’, *Company Lawyer*. 2009, 30(1), pg: 24.

<sup>306</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 133.

<sup>307</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 133.

<sup>308</sup> H, Abdul Jabbar., ‘Islamic finance: fundamental principles and key financial institutions’, *Company Lawyer*. 2009, 30(1), pg: 25.

<sup>309</sup> H, Abdul Jabbar., ‘Islamic finance: fundamental principles and key financial institutions’, *Company Lawyer*. 2009, 30(1), pg: 25.

When relating the principle of *Ghabn* or *Gharar* to the subject matter of this research, its first application will be the prevention of any monetary gain, or benefit in terms of property or opportunity, by means of cheating or fraud. The second application requires any shareholder agreement to be Sharia-compliant,<sup>310</sup> safeguarding the weaker party from *Ghabn* or *Gharar* in any transaction and ensuring that he/she has adequate knowledge of the contractual details,<sup>311</sup> otherwise, he/she has the right to bring a legal action on this ground. This does not mean that Sharia restricts creativity or innovation in the business between parties; on the contrary, contractual clauses, under Sharia, are always open to the inclusion of newly developed commercial ideas, as long as they comply with the limits set by Sharia. Indeed, it is believed that the principles of free will and freedom of contract were well-established among Muslim scholars and jurists in the eighth century AD, long before they were recognised under Western law.<sup>312</sup>

### 3.3.5 Sharia and the protection of minority shareholders

Sharia generally defines a partnership as “a company in which each partner contributes a sum of money in exchange for which such partner benefits from a right to manage the assets of the company, provided that the profits are distributed pursuant to the agreement binding the partners and the losses are borne by each partner proportionally to its interests in the company’s share capital”.<sup>313</sup> Sharia does not require any specific structure of ownership. However, the overwhelming majority of companies within the Arab world exist in the form of joint ventures with the government, public and/or private companies.<sup>314</sup> It is the law which affects the manner in which companies are structured. Taking the existing law in the UAE as an example, foreign investors are only allowed to own up to 49% of the shares within a company.<sup>315</sup> In SA, about 75% of

---

<sup>310</sup> H, Hajjaji., Shareholders’ agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 556.

<sup>311</sup> L, Al-Rimawi., Relevance of Sharia in Arab securities regulation with particular emphasis on Jordan as an Arab regulatory model. *Company Lawyer*. 2006, 27(8), pg: 228. The author clarifies further the concept of *Ghabn* or *Gharar* by saying that it can refer to a number of things, including uncertainty, excessive risk, chance, speculation and lack of control over the subject-matter.

<sup>312</sup> M, Al-Zarka., *Al-Figh Al-Islami fi thawbihi Al-Jadid*. cited In: H, Hajjaji., Shareholders’ agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 561.

<sup>313</sup> H, Hajjaji., Shareholders’ agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 558.

<sup>314</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 449.

<sup>315</sup> A, Ferasat. & Others., Middle East, *The International Lawyer*. 2008, 24(2), pg: 1078 & 1079. The law does not allow, for example, foreigners to trade in petroleum.

companies are owned by founding families and relatives and the rest are owned by others and the Government.<sup>316</sup> Thus, there is no particular type of ownership that Sharia imposes, but rather it is up to the regulators to monitor it.

Let us now consider specifically what Sharia says in relation to the protection of minority shareholders. In fact, as already noted, Sharia does not address this matter directly. However, it must be said that Sharia, from the general definition given above, seems to treat every person investing in a company as a holder of an interest in the capital and the holder of a proportional ownership right over the assets of the company.<sup>317</sup> Thus, Sharia here recognises, in principle, both the rights and interests of the minority shareholder as long as he/she invests in the company, and these rights and interests must, accordingly, be protected. This is an efficient foundation for the whole system of minority shareholder protection to build upon. Acknowledging diverse interests and rights in the company, rather than favouring those of the majority over all others, is a practical and useful start to providing protection for these rights and interests.

The role of Sharia in protecting minority interests can be seen when it teaches business owners to exercise a “moral duty of trust, equity and benevolence towards their stakeholders (employees, suppliers, buyers, consumers and the environment),”<sup>318</sup> which applies a fortiori to minority shareholders, who are more involved in the business and have contributed as much, if not more, to the company than other stakeholders.<sup>319</sup> Majority shareholders are obliged under Sharia to take care of the welfare of everyone associated with the company, especially minority shareholders. They must also act pastorally towards their associates, providing care and direction to such persons in order to ensure that the values of Islam are applied within the company.<sup>320</sup>

---

<sup>316</sup> J, Solomon., *Corporate Governance and Accountability*. 2<sup>nd</sup> ed. Wiley, Chichester, 2007, pg: 218.

<sup>317</sup> H, Hajjaji., Shareholders’ agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 563.

<sup>318</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 134. Employers are obliged under Sharia to take care of the welfare of their employees and treat them with kindness. Islam advances the same principle to be applied to any relationship between partners, fellows, shareholders, colleagues and so on.

<sup>319</sup> This is a highly debatable issue and involves pitting the shareholder primacy theory against the stakeholder theory. This research is only concerned with consideration of the position of minority shareholders.

<sup>320</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 134.



Nevertheless, in practice, not everyone in the Islamic commercial environment behaves ethically. Grais and Pellegrini argue that the full commitment of concerned business owners to Islamic religious principles cannot be taken for granted.<sup>321</sup> Although Muslims believe that minority shareholders can be guaranteed efficient protection if Sharia principles are precisely followed, reality shows that not all Muslim business owners comply with these principles, because people sometimes neglect ethics in pursuit of their own selfish interests.<sup>322</sup> Therefore, the key issue which underlies this problem is the gap between the Sharia framework as it exists in principle, and its implementation in reality. On this point, Hirschman contends that:

“under any economic, social, political (or religious) system, individuals, business firms, and organizations in general are subject to lapses from efficient, rational, law-abiding, virtuous, or otherwise functional behaviour”.<sup>323</sup>

The commercial enforcement of Islamic law is no exception. In fact, several breaches of fiduciary responsibilities and different types of wrongdoing occur in Sharia-based jurisdictions. The history of Islamic commerce shows that there have been several cases of practical tension, such as collusion of the board of directors with management, external and internal audit failure, neglect of minority shareholders' interests or rights, imprudent lending and excessive risk taking by management.<sup>324</sup> Thus, the Sharia principles alone cannot protect minority shareholders in private companies and there is a need for additional provisions to cover any missing features. Furthermore, Sharia principles, when it comes to minority shareholder protection, do not contain detailed enforcement machinery that could determine “when” and “how” to enforce specific performance or compensation when a dispute occurs.<sup>325</sup>

---

<sup>321</sup> W, Grais. & M, Pellegrini., Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options, *World Bank Policy Research Working Paper*. No. 4052, (November 1, 2006), pg: 6.

<sup>322</sup> Of course, sometimes there might be disagreement between parties to a contract or business arrangement as to what constitutes good ethics.

<sup>323</sup> A.O., Hirschman., (1970) *Exit Voice and Loyalty: Responses to Decline in Firms, Organizations and States* (Harvard University Press, Cambridge, Massachusetts, USA), cited In: W, Grais. & M, Pellegrini., Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options, *World Bank Policy Research Working Paper*. No. 4052, (November 1, 2006), pg: 6.

<sup>324</sup> W, Grais. & M, Pellegrini., Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options, *World Bank Policy Research Working Paper*. No. 4052, (November 1, 2006), pg: 6.

<sup>325</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 354.

Sharia leaves it open to the shareholders to state in the shareholder agreement what they wish in terms of rights, interests, profit distribution, management, liability, authority, power, protection and so on, as long as its principles are not contradicted. However, as mentioned in Chapter 2, the contractual relationships cannot be the sole provider of such protection as this would neglect the recognised fact that all contracts are incomplete,<sup>326</sup> in that the parties are not able to foresee the future in definite terms and so cannot make complete provisions in a contract for every eventuality.<sup>327</sup> This is because there will be problems (such as the majority shareholder seeking to engage in opportunistic behaviour) that cannot be foreseen by the minority shareholder at the time of signing the contract.<sup>328</sup> Therefore, shareholder agreements under Sharia may assist in protecting the minority shareholder to a certain extent, but they are never able to provide complete protection. It is strongly believed that the company statute is the appropriate provider of complete protection, and any other source has only a secondary role.

### 3.3.6 The role of company statute in regulating protection alongside Sharia

El Sheikh has confidently stated that there are no written statutory provisions in the company law of many Islamic jurisdictions that are designed specifically to protect minority shareholders against illegal expropriation. The learned commentator went on to say that such protection is accommodated within Islamic law, which is the main provider of commercial principles in such jurisdictions.<sup>329</sup> This statement is correct in only one respect: that Sharia indeed contains principles that may protect minority shareholders from potential abuse or misuse. Nonetheless, it merely provides general and indirect principles, leaving the detailed mechanisms, legal grounds and remedies for the lawmakers to formulate according to the requirements of contemporary commercial and company law. For example, under the general principles of Sharia law, shareholder agreements may confer the right to exit the company, but the detailed application of the principle which monitors this right is not specified under Sharia. In this sense, it is left to

---

<sup>326</sup> I, MacNeil., *Company Law Rules: An Assessment from the Perspective of Incomplete Contract Theory*, *Journal of Corporate Law Studies*. 2001, 1(1), pg: 107.

<sup>327</sup> A, Keay. & H, Zhang., *Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors*. *Melbourne University Law Review*. 2008, 32(1), pg: 154.

<sup>328</sup> A, Keay. & H, Zhang., *Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors*. *Melbourne University Law Review*. 2008, 32(1), pg: 154 & 155.

<sup>329</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 122.

the law-makers to provide and then to regulate plainly the mechanisms and legal procedures to clarify its application. The right of shareholders to exit the company may bring the enforcement of other related rights, such as those of pre-emption, transferring shares to a third party and the valuation of shares. But it would seem that there are not sufficient provisions in the legislation of Islamic jurisdictions to deal adequately with the protection of minority interests. Thus it is very important to understand that, even if Sharia and the current company statutes of some Islamic jurisdictions are taken together, they still do not deliver the high standards of protection to minority shareholders that would be consistent with the international demand to protect minority shareholders, because the statutes are not sufficiently detailed.

Unfortunately, in some Sharia-based jurisdictions (like SA) no clear rights and interests are recognized for minority shareholders in the statute and, therefore, they are not adequately protected. This is because there are no clear procedures to follow concerning how one can bring an action if any abuse, misuse or oppression occurs. And, while Sharia might provide some basis for minority shareholders to complain, it does not provide any procedures which enable such shareholders to take action. So, when it comes to the enforcement of the company law in some of these jurisdictions, it is found that their out-of-date company laws obstruct minority shareholder protection and create gaps which result in uncertainty, and even injustice. The enforcement of existing provisions that deal with minority oppression are, for the most part, neither workable nor efficient in these jurisdictions because they are not consistent with modern company law.<sup>330</sup> Concerned minority shareholders have no specific avenue that they can follow to obtain adjudication in relation to their complaints.

Most importantly, there is no statutory guidance as to the grounds on which the victim may bring an action. Furthermore, no remedies are identified for the minority shareholder when a wrongdoing occurs in the company. These detailed procedures and mechanisms, together with their application and enforcement, are factors which determine whether or not the laws of a country provide strong protection for minority

---

<sup>330</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 74. The author here stressed that “the enforcement of law in most of the Sharia-based jurisdictions suffers from this uncertainty and ambiguity because their laws were enacted a long time ago during the colonial period, and for this reason they are not well adapted to the complexities of the modern business institutions.”

shareholders. In the case of some Islamic jurisdictions, the statute does not contain proper provisions to guarantee the minimum required protection for minority shareholders. A classic illustration of this point is the acceptability under Sharia law of the issuing of preferred voting rights for a shareholder,<sup>331</sup> while there is no statutory provision of exhaustive mechanisms or devices to afford protection if this right is abused or misused.

This deficiency in protecting minority shareholders in private companies is not attributable to Sharia, as its role is to provide general principles, not specific detail when it comes to company law;<sup>332</sup> it is rather the statute of such a jurisdiction that is to blame for not giving much greater detail and not providing remedial mechanisms. If the statute did so, then there would be instruction and guidance for business owners (foreign and national) and for judges, who would be more aware of the remedies which could be applied, and which would be the most appropriate in each particular case.

Overall, Sharia and statutory structures can complement each other in strengthening minority shareholder protection. Together they can contribute to greater transparency and provide effective protection for minority shareholders. In Sharia-based jurisdictions, the law and its provisions cannot merely rely on one and neglect the other; instead, Sharia and the statute should work shoulder-to-shoulder to furnish general principles and detailed mechanisms. However, it is essential to comprehend that Sharia is not very likely to develop its principles and provide detailed procedures when it comes to company law, whereas the statute of any Islamic jurisdiction can converge along the lines of the Anglo-Saxon model of minority shareholder protection. Miles and Goulding<sup>333</sup> note that the adoption of such a model has become an important means of ensuring high standards of corporate governance, effective protection and enhanced investor confidence, even by those countries, such as Islamic jurisdictions, which do not share the culture, tradition or system in which it operates. They further assert that the Anglo-Saxon model is the only practical one and should be copied by all countries in

---

<sup>331</sup> Sharia Standards for Islamic Institutions 2008, cited In: H, Hajjaji., Shareholders' agreements and Islamic financing, *International Business Law Journal*. 2009, 5, pg: 564.

<sup>332</sup> Sharia provides full detail and complete guidelines when it comes, for example, to family law or inheritance.

<sup>333</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 127 & 128.

order to increase competitiveness and attract foreign investment.<sup>334</sup> In fact, it has been found by La Porta, Lopez-de-Silanes, Shleifer and Vishny that Anglo-Saxon countries confer on minority shareholders stronger protection, relatively speaking, than the French civil code countries, which provide the weakest protection of all legal systems.<sup>335</sup>

It is important to emphasise that most Sharia-based jurisdictions, if not all, are heavily influenced either by the Anglo-Saxon common law (based on the US and UK models) or the French civil code, as long as the relevant law is compliant and consistent with Sharia principles.<sup>336</sup> This would include company law in SA and, therefore, it is difficult to understand why the same scheme or model has not been adopted by SA when dealing with minority shareholder protection. In other words, if SA has already adopted the Western model of company law, after some adaptation, why has minority shareholder protection not also been embraced? In fact, there does not appear to be any clear answer to this question. However, one can argue that the possible justification for not providing defined and specific protection in the company law in SA may be attributable to the government's intention to liberalise or widen the judges' power by allowing them to rule in such cases with broad discretion. It may be assumed, from the perspective of legislatures, that if all remedies were specified under the statute, then judges would be restricted or limited to them and could not go beyond them when required to deliver justice. The current position in SA may give more room for judges' discretion because remedies and their functions are not taken from the statute, but from general Islamic jurisprudence, justice, fairness, equality and commercial conventions, which enables judges to apply more remedies and bring justice to cases on broader terms. Another possible reason as to why certain Sharia-based jurisdictions (including SA) have not adopted the Western minority shareholder protection system in their company law may be ascribed to the insignificance of minority shareholders' input in the market or due to them being relatively few in number. However, this argument, in particular, is very weak because reality shows that most companies are privately held, as they are in

---

<sup>334</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 128.

<sup>335</sup> R, La Porta. & Others., Law and Finance, *Journal of Political Economy*. 1998, 105(6), pg: 1116.

<sup>336</sup> M, Sourial., Corporate Governance in the Middle East and North Africa: An Overview. *Egyptian Ministry of Foreign Trade*. (February 28, 2004), pg: 10.

countries like the UK.<sup>337</sup> This means that effective minority shareholder protection, therefore, has the potential to impact or affect the vast majority of companies and their shareholders.<sup>338</sup>

It is believed that the easiest and most effective way of introducing a practical system of protection in Sharia-based jurisdictions (including SA), is by following in the footsteps of the Anglo-Saxon minority shareholder protection model (with, perhaps, some adaptation) as long as it does not contradict Sharia. It is also believed that the minority shareholder protection in SA cannot be subject only to general principles or commercial conventions any longer as it has now become a necessity to codify all remedies and reliefs for minority shareholders in the company law statute.<sup>339</sup> Any resistance to the idea of codification may basically contribute to the unpredictability and uncertainty of the court's decisions and, generally, to the commercial and legal environment.

### **3.4 The Bill for a new Saudi Arabian Company Law**

It is only recently that a tangible intention to reform the existing out-of-date commercial and company statutory law has been demonstrated by the Saudi Arabian government. As far as this research is concerned, it is the current minority shareholder protection, in particular, which is in real need of reform because of the considerable ambiguity within its provisions. In addition, other aspects of company law suffer from this uncertainty and complexity as they are inadequate for modern commercial transactions.<sup>340</sup> It is believed that reform cannot be directed towards only one aspect of company law, but rather towards the whole, as the statutory provisions of company law relate to and depend on each other. It has taken the Saudi legislative authority too long to realise that company law reform has become necessary in order to comply with international standards and to create a competitive commercial environment. However, the reform and refinement have

---

<sup>337</sup> It is probably the same case in every jurisdiction (including SA), as private companies are always greater in number than public companies and, consequently, this may also suggest that minority shareholders are more numerous than majority shareholders.

<sup>338</sup> B, Means., A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, *Georgetown Law Journal*. 2009, 97 (5), pg: 10.

<sup>339</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 166.

<sup>340</sup> F, El Sheikh., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. 1<sup>st</sup> ed. Cambridge, University Press, 2003, pg: 74.

been delegated to the relevant authority (the Law Reform Commission in the *Shura* Council)<sup>341</sup> which will seek to revise the law and to draft a bill for a new company law. It is hoped that the Law Reform Commission will take into consideration the necessity of building strong minority shareholder protection to overcome the deficiencies and weaknesses of the current law.

Nevertheless, it has been some years now since the Law Reform Commission was first tasked with reforming the company law, but no final approval has so far been reached. A draft Bill has been published recently, most probably for legal practitioners, analysts and scholars, and those who deal with company law on a daily basis to have their say on what they think is appropriate and what is not. It is true that the Bill has not yet been finalised, but this draft is probably very similar to what the final draft will contain. Therefore, a valuable opportunity exists to examine this Bill and see how the law-makers address the complexities of minority shareholder protection.

The Bill<sup>342</sup> contains more provisions than the existing law and generally seems to give more detail and guidance than the Company Law 1965. However, many of the existing provisions are transferred to the Bill unchanged, but in a different sequence, and, unfortunately, this means that once again minority shareholder protection in private companies has no specific section setting out all of its provisions in one place. For example, the Bill contains certain sections applying to private companies, which restate, that any decision regarding the amendment of the shareholder agreement must be agreed unanimously.<sup>343</sup> But this provision is currently available under s25 of the Saudi Company Law 1965, so no new addition is represented here. Another example is where the Bill reaffirms that a director (or majority shareholder) cannot do business with the company for his/her own benefit (conflict of interest) unless it is declared and agreed unanimously by all shareholders. Furthermore, it states that the director/majority

---

<sup>341</sup> *Shura* Council is the main legislative authority in Saudi Arabia. Its role is to introduce regulations, laws, projects and so on. Prior to the introduction of any law, the *Shura*'s members (who are experts) need to discuss it in detail. They then pass it to the Council of Ministers for approval and execution.

<sup>342</sup> The draft Bill is available from Twisyat.net, 2004. Available at: <<http://twisyat.net/forum/showthread.php?t=197>> accessed 22 March 2010. In addition, J, Almalki., *Almadina* Newspaper. (14. February. 2011), Available at: <<http://www.al-madina.com/node/288033>> accessed 15. February 2011, has confirmed that the Bill has 226 sections and 12 chapters.

<sup>343</sup> It is believed that several drafts of the Bill have been published and each version is slightly different from the others. Therefore, it is not helpful to mention the numbers of clauses as the reader will not be aware of which draft in particular this research refers to. It is thought that it is better to discuss what the clauses state without referring to the clause numbers as what matters most is the contents of the Bill.

shareholder is liable to pay compensation to the company, other shareholders or a third party for his/her breach of the shareholder agreement, and any agreement otherwise is not valid. The same provisions are set out in sections 31 and 32 of the Saudi Company Law 1965. Therefore, there is no tangible change in the draft Bill which positively protects the minority shareholder in private companies.

It appears, regrettably, that while the Bill is concerned with various new issues not covered in the 1965 Act, minority shareholder protection in private companies is not one of them. The most important change in the Bill is perhaps towards public companies. For instance, the new Bill activates a practical, effective system of corporate governance and, for the first time, requires public companies to have supervisory boards (observers) separate from the shareholders and management, who examine how the company works and to ascertain if any problems have occurred.

It is believed that, although such a huge project is undoubtedly a step forward in reforming the company law, only time will tell if the objectives of the reform have been met.<sup>344</sup> Nonetheless, as far as minority shareholder protection is concerned, the Bill fails to address many of the deficiencies and weaknesses that have been identified in this research. Disappointingly, the proposed legislation simply does not provide clear power for the minority shareholder to litigate in private companies and thus a number of questions remain unanswered: Firstly, what are the grounds on which the minority shareholder may litigate? Secondly, who pays the costs of litigation? Thirdly, what remedies can be sought? Additionally, how is one to distinguish between the shareholder's right to litigate on his/her own behalf, and the right to litigate so as to protect the corporate interest? Finally, which of the minority shareholder's rights and interests should be protected? As long as these matters are not dealt with efficiently, it remains hard to advise minority shareholders as to what their rights are, how they can exercise them, and whether they are likely to obtain any justice.<sup>345</sup>

---

<sup>344</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 166.

<sup>345</sup> L, Miles, & M, He., Protecting the rights and interest of minority shareholders in listed companies in China: challenges for the future, *International Company and Commercial Law Review*. 2005, 16(7), pg: 280.



It is seriously hoped that the Bill does not become finalised in its current state, as it seems not to have been drafted with sufficient care and consideration towards minority shareholders in private companies. If the Bill is adopted as it is, no fundamental changes will be introduced for minority shareholder protection, and minority shareholders may find it difficult to challenge decisions which harm their rights and interests.<sup>346</sup>

### 3.5 The position of minority protection in Dubai

As mentioned at the beginning of this chapter, the key aim here was to investigate relevant company law and commercial legislation, mainly in SA and briefly in Dubai. In particular, we wish to examine the status of minority shareholder protection in both jurisdictions. The provision in SA has already been analysed in detail throughout the previous sections of this chapter and now we turn to investigate how minority shareholder protection works in Dubai, and to identify any weak and/or inefficient aspects of the law, so that it might be possible to offer some workable reforms.

Dubai is one state of a federation of seven emirates (states), the United Arab Emirates, in which each state is governed by a separate federal authority and slightly different laws.<sup>347</sup> Dubai has been chosen in this research from among the other states in the UAE because of its significant attraction to foreign investors, its current rapid development and, to a certain extent, because of the availability of some reliable materials that reflect the reality there and are useful for the purpose of this study. According to the official Dubai Statistics Centre, foreign investment in 2006 in Dubai alone reached over \$11.5 billion and this figure increased further in 2007.<sup>348</sup> Broadly speaking, the majority of countries in the Middle East are seen by Tricker<sup>349</sup> as having emergent, small and illiquid capital markets which consequently result in poor corporate control. However,

---

<sup>346</sup> L, Miles, & M, He., Protecting the rights and interest of minority shareholders in listed companies in China: challenges for the future, *International Company and Commercial Law Review*. 2005, 16(7), pg: 280. The authors in this article also studied the reform of the company law provisions in China, which was similar to the draft Bill in Saudi Arabia in its failures.

<sup>347</sup> M, Blair. & J, Orchard., Legal issues arising in the new Dubai International Finance Centre, *Journal of International Banking Law and Regulation*. 2005, 20(5), pg: 207. It is important to be aware that the UAE is divided into a number of small states ruled by independent laws. However, in this research the focus will be solely on Dubai and the commercial company law of 1984 that operates within it.

<sup>348</sup> P, Terblanche., United Arab Emirates: UAE company law overview, *Taylor Wessing (Middle East) LLP*. (27 May 2009), Available at: <<http://www.mondaq.com/article.asp?articleid=80106>> accessed 5 May 2010.

<sup>349</sup> B, Tricker., *Corporate Governance*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2009, pg: 207.

he considers Dubai (along with a few other countries in the region) as an exception to such general observations. This is because Dubai intends to become an international commercial centre and is making every effort to do so.

### 3.5.1 A general overview of company law and regulation in Dubai

Company law in Dubai is governed by a federal statute, the UAE Commercial and Company Law 1984.<sup>350</sup> One particularly interesting feature is that the law applies the 51/49 rule<sup>351</sup> when dealing with foreign investors (that is, foreign investors are allowed to have no more than 49% of the shares in a company and are therefore always in the minority). The only alternative is for foreign investors to establish businesses in one of the Dubai Special Zones where they can obtain any level of ownership without restriction.<sup>352</sup> However, the 51/49 rule has provoked the development of an illegal practice whereby UAE nationals set up companies then enter into so-called “side agreements”<sup>353</sup> with foreign shareholders, which allow the foreigners to own shares in excess of what the law permits them to acquire. This means that nationals are acting as illegal proxies for foreign companies so as to manipulate the law and benefit along with foreign investors.<sup>354</sup> Those foreign investors who do choose to comply with the law usually form a limited liability company (Ltd) with a UAE national.<sup>355</sup>

We will now begin to investigate the protection for minority shareholders in private companies in Dubai, no matter whether these minority shareholders are foreign investors or UAE nationals. Thus, it is not important to identify who the minority shareholder (either foreign or national) is, but what matters is the protection which the law offers to a minority shareholder in the commercial environment. However, it can be argued that,

---

<sup>350</sup> This company law applies to all Emirates in the UAE, but each Emirate has the capacity to produce further regulations and amend some practices according to what it sees fit for its own circumstances.

<sup>351</sup> UAE Commercial and Company Law 1984, section 22.

<sup>352</sup> Dubai promotes foreign investment by setting up specialised economic zones in which foreign investors are entitled to 100% ownership and profits with 0% taxes. Each zone has its own regulations and specialisation, such as the Dubai Technology and Media Free Zone Private Companies Regulations 2003. See: <http://www.tecom.ae/law/index.htm>.

<sup>353</sup> This “side agreement” is a hidden agreement which foreign investors make with nationals to allow them to own 100% of the company. When registering the company they produce a shareholders’ agreement which complies with the law in terms of the 51/49 rule but, in reality, the nationals do not have any shares in the company. This practice is totally illegal.

<sup>354</sup> P, Terblanche., United Arab Emirates: UAE company law overview, *Taylor Wessing (Middle East) LLP*. (27 May 2009), Available at: <<http://www.mondaq.com/article.asp?articleid=80106>> accessed 5 May 2010.

since Dubai company law forces foreign investors to always become minority shareholders, it must provide, at the same time, an efficient system for them to protect their rights and interests from being abused or oppressed.

An empirical study was not conducted in Dubai, but it is assumed that the situation there is very similar to that of SA, especially because of the following similarities between the two jurisdictions. Firstly, Dubai company law is also somehow based on Sharia (although not to quite the same extent).<sup>356</sup> Secondly, it is also a system which is derived from the French (civil law) model. Thirdly, the two regions have a number of similar statutory provisions in their company law legislation, including their provision for minority shareholder protection. Finally, like SA, Dubai has no case law system that can guide the judges and lawyers.<sup>357</sup> These general similarities between the two countries in terms of the law and its practice allow us to make reasonable assumptions about how minority shareholder protection works in the Dubai market. It cannot be said that the empirical study reflects the situation in Dubai as accurately as in SA, but it can still give a good indication as to the position of minority protection in Dubai.

Generally, it is true to say that the UAE Commercial and Company Law 1984 is more detailed, functional, modern, and workable than the Saudi Company Law 1965. To exemplify this, s240 of the UAE company law requires shareholders, if their number exceeds seven, to have some sort of internal monitoring and the establishment of an independent supervisory board consisting of at least three shareholders to observe how the company is managed and if any governance issues exist.<sup>358</sup> Thus, it is admitted, that, in general, Dubai company law is a few steps ahead of its Saudi Arabian equivalent.

### 3.5.2. Advantages and disadvantages of minority shareholder protection provisions in Dubai

---

<sup>356</sup> Y, Mubaydeen., *Legal aspect of project finance transactions under the laws of the United Arab Emirates, Journal of International Banking Law and Regulation*. 2003, 18(5), pg: 219.

<sup>357</sup> Y, Mubaydeen., *Legal aspect of project finance transactions under the laws of the United Arab Emirates, Journal of International Banking Law and Regulation*. 2003, 18(5), pg: 220.

<sup>358</sup> The same section requires the re-appointment of the members of the supervisory board after the expiry of the said period.

When it comes to minority shareholder protection in particular, Dubai may be, to some extent, in a slightly better position than SA.<sup>359</sup> Laubach and Khan describe in general terms the position of minority shareholder protection in Dubai:

“In the case of abuse of minority shareholder interests, the Regulations give the courts great discretion to determine the most appropriate course of action to protect such interests, including amending a company’s by-laws and/or changing its capital structure.”<sup>360</sup>

However, this statement is very broad as it does not say how the courts would do so, or what regulates this discretion. Is it perhaps totally subject to the judges’ opinion as it seems to be in SA? Mubaydeen, rather, sees the extent of judges’ discretion in the UAE as positive, stressing their ability to provide compensation equal to any loss suffered.<sup>361</sup> Furthermore, section 231<sup>362</sup> has a device that may be considered advantageous to minority shareholders, since it regulates the statutory right of pre-emption. If a minority shareholder in a private company intends to sell his/her shares to a third party, other shareholders must be notified of such an intention and the majority shareholder is required to act within thirty days of receiving such notice if he/she wishes to acquire the shares. If the majority shareholder does not use his/her right to buy them, the minority shareholder has the right to sell the relevant shares to a non-shareholder.<sup>363</sup> This statutory provision is particularly beneficial to the minority shareholder as it offers him/her both a fair exit strategy and, arguably, the chance to obtain an undiscounted

---

<sup>359</sup> According to Watts, the Dubai Companies Law is similar in some of its protection of shareholders’ rights and interests to that which exists under the United Kingdom legislation. See G, Watts., The shareholder’s legal toolkit. Minority shareholder rights under UAE law. *Al Tamimi & Company*. (19 April 2010), Available at: <<http://www.thefreelibrary.com/The+Shareholder%27s+Legal+Toolkit+Minority+Shareholder+Rights+under+UAE...-a0224273778>> accessed 10 May 2010.

<sup>360</sup> C, Laubach., & A, Khan., UAE: Saadiyat zone – further regulations, *Journal of International Financial Markets*. 1999, 1(7), pg: 79.

<sup>361</sup> Y, Mubaydeen., Legal aspect of project finance transactions under the laws of the United Arab Emirates, *Journal of International Banking Law and Regulation*. 2003, 18(5), pg: 222. The author has come to this perspective from ss. 389 and 390 of the UAE Civil Code 1987.

<sup>362</sup> UAE Commercial and Company Law 1984.

<sup>363</sup> In the case of a difference over the price, the company’s auditor shall evaluate the price as of the date of the redemption. However, as long as the legislation allows a third party to be involved, then it is assumed that the company’s auditor will take into account the price offer produced by the third party in the evaluation report. If the third party’s offer is considered reasonable, then it is believed that the majority shareholder would be asked to offer the same price.

price for shares.<sup>364</sup> What distinguishes this method is that the law here provides an option for the minority shareholder to leave the company if he/she is not happy with the way it is run.<sup>365</sup> However, even this strategy cannot always offer an ideal outcome because sometimes no third party is willing to buy minority shares, especially if the majority shareholders are suspected of being guilty of misuse, abuse and oppression, and there is no effective law that allows the minority shareholder to seek relief and remedy for such treatment.

By exploring and examining minority shareholder protection in Dubai in detail, we have found that, similar to the position in SA, the UAE Commercial and Company Law 1984 has no specific section or separate package of provisions that provides for minority shareholder protection in private companies. However, the law does contain a few provisions here and there regarding minority shareholder protection. For instance, section 37 states that decisions in a joint liability company shall be made by unanimous agreement of the shareholders unless the shareholder agreement provides that the opinion of the majority of shareholders shall suffice. However, a decision relating to the amendments of the shareholder agreement shall never be valid unless adopted by the unanimous agreement of the shareholders. This provision is a safeguard for the minority shareholder in this type of company as it makes the rule of unanimous agreement of all shareholders a requirement, so that the majority shareholder cannot make sole decisions. On the other hand, and also similar to the position in SA, s39 of the UAE Commercial and Company Law states that if there are several directors and no specific function is assigned to each of them in the shareholder agreement, then each of the directors may perform any management functions, provided that the others are entitled to object to the performance of any action before it is completed. In this circumstance, the majority shareholder's opinion shall prevail. It should be remembered that even if the minority shareholder complains before the conduct is completed, he/she needs to make the complaint to the majority shareholder who has the ultimate power to decide whether to react to the complaint or not. It is believed that if there is no clear fraud, and the majority

---

<sup>364</sup> If a dispute between the shareholders occurred over the price for shares, usually the parties refer the matter to the court and the court, in most cases, value the shares according to the market value of shares.

<sup>365</sup> Watts in his article (G, Watts., The shareholder's legal toolkit. Minority shareholder rights under UAE law. *Al Tamimi & Company*. (19 April 2010), Available at: <<http://www.thefreelibrary.com/The+Shareholder%27s+Legal+Toolkit+Minority+Shareholder+Rights+under+UAE...-a0224273778>> accessed 10 May 2010) has said that it is not always open for the minority shareholder to sell the shares to a third party as the majority shareholder may restrict this.

shareholder declines to do anything about the complaint, even the court may not investigate the matter complained of because the matter has been already decided by the majority shareholder.<sup>366</sup>

Therefore, it may be claimed that, in some respects, Dubai company law offers better protection for minority shareholders than that of SA but, in reality, this is not necessarily the case. In fact, majority shareholders in Dubai are firmly in control, while the statute does not provide necessarily sufficient and specific protection to minority shareholders to remedy any misuse, negligence, fraud, unfairness or oppression. Thus, it can be concluded that both jurisdictions (SA and Dubai) are lacking statutory mechanisms, procedures, grounds, remedies and recognition of specific interests and rights for the minority shareholder.

### 3.5.3 Proposed solutions and recommendations

This weak position of minority shareholder protection in Dubai has been acknowledged by a number of legal practitioners and researchers, who have proposed certain solutions to overcome the inadequacies. Watts<sup>367</sup> has suggested that the best way to provide protection for minority shareholders is by having them engaged in the board. He also proposes that all major decision-making and critical issues should come to the board for discussion and approval. He believes that minority shareholders can be protected by involvement in the company's management for the following reasons: Firstly, they will have total access to confidential information. Secondly, they will have knowledge of all dealings, transactions and commitments so they could use a defensive action whenever protection of their interests is necessary. Thirdly, if involved in the board, minority shareholders would be able to control the appointment of key signatories. In response to this proposed solution, however, it should be borne in mind that the law should protect a minority shareholder even if he/she is not involved in management. In fact, it is unreasonable to make the protection of a minority shareholder dependent on his/her

---

<sup>366</sup> It is believed that this section is not fair because it does not grant the minority shareholder a clear mechanism to complain after the completion of an action. Rather, the section blocks the way for the minority shareholder to complain to the court once the majority shareholder ratifies the conduct or it is completed.

<sup>367</sup> G, Watts., *The shareholder's legal toolkit. Minority shareholder rights under UAE law. Al Tamimi & Company.* (19 April 2010), Available at: <<http://www.thefreelibrary.com/The+Shareholder%27s+Legal+Toolkit+Minority+Shareholder+Rights+under+UAE...-a0224273778>> accessed 10 May 2010.

involvement in management. It is assumed that substantial numbers of minority shareholders invest in companies of which they cannot be involved in the management but, despite this, they will expect the law to protect their interests and rights. Even if the proposal to have involvement in the company's management is taken on board, practically it may not offer adequate protection to a minority shareholder if the majority shareholder's percentage is enough to pass resolutions or ratify decisions.

Another strategy to overcome weakness in protecting minority shareholders in private companies has been put forward by Laurence, Robinson and Gunson<sup>368</sup> who believe that the shareholders' agreement can grant protection to the minority shareholder if it contains protective provisions which expand the rights already guaranteed by the law.<sup>369</sup> For instance, the shareholders' agreement could contain a list of "reserved matters" which require a higher percentage of votes to be approved, and the majority shareholder's percentage alone would not enable him/her to grant approval, unless the particular shareholder had an unusually high percentage of shares. In response to this suggestion, it has been proven by the empirical study undertaken in SA that, although the shareholders' agreement can provide, to a certain extent, some protection for the minority shareholder, it cannot replace the statute in providing a list of all rights and interests and also in providing a comprehensive practical mechanism to protect these rights and interests.<sup>370</sup> It is wrong to assume that once the shareholders' agreement contains a list of "reserved matters" which have to be approved by a particularly high percentage of votes, the minority shareholder is well protected. In fact, there are other activities which the majority shareholder may engage in, such as misuse, abuse, negligence, fraud, breach, default and unfairness or oppression, which can give rise to the need for protection. It is argued that the only way of obtaining comprehensive protection is by introducing a statute that contains efficient safeguards, and that other sources of protection (shareholders' agreement, involvement in management and internal company code) remain secondary.

#### 3.5.4 New Company Law in Dubai

---

<sup>368</sup> P, Terblanche., United Arab Emirates: UAE company law overview, *Taylor Wessing (Middle East) LLP*. (27 May 2009), Available at: <<http://www.mondaq.com/article.asp?articleid=80106>> accessed 5 May 2010.

<sup>369</sup> Something that is done frequently in the UK.

<sup>370</sup> See Chapter 4, Section 4.3.2.3.

It has been officially confirmed that Dubai is about to produce new companies legislation which may revise the ownership limitation on businesses established by foreign companies in the jurisdiction. It is expected that the amendments to the law will allow foreign shareholders to acquire 100 per cent ownership of a company's shareholding even outside of the allocated free zones. Terblanche speculates that lifting this obstacle to foreign ownership will improve the commercial environment further in Dubai and will attract even more foreign investment.<sup>371</sup> Nonetheless, local experts and legal analysts predict that the new law would never allow 100 per cent ownership by any foreign company. Saidi,<sup>372</sup> an economist, believes that the new law will merely allow foreign companies to have more than the current 49 per cent, but still not full ownership, and that this will maximise investments in Dubai as it will provide more opportunities for small and medium businesses to be established.<sup>373</sup> However, it is important to realise that whether the new law allows foreign investors to have more than 49 per cent of ownership or not is not the actual issue in the current study, because what really matters is the protection for minority shareholders which applies regardless of whether they are foreigners or nationals.

It is believed that even the newly proposed law will only address superficial or external issues and neglect fundamental matters when it comes to minority shareholder protection. Similar to the draft Bill for a new company law in SA, the legislative authority in Dubai has not given substantial consideration to many of the deficiencies and weaknesses which are seen to exist in the present commercial environment. It is also unfortunate that the proposed law is to be drafted without addressing the following questions: What are the interests and rights of the minority shareholder that should be protected? What grounds may the minority shareholder use to litigate on behalf of the company or on his/her own behalf? Who bears the cost of litigation (indemnity)? What

---

<sup>371</sup> P, Terblanche., United Arab Emirates: UAE company law overview, *Taylor Wessing (Middle East) LLP*. (27 May 2009), Available at: <<http://www.mondaq.com/article.asp?articleid=80106>> accessed 5 May 2010.

<sup>372</sup> N, Saidi., Chief Economist of the Dubai International Financial Centre, cited In: F. Mehmood, U.A.E. unlikely to allow 100% foreign company ownership, *TopNews Arab Emirates*. (24 March 2010), available at: <<http://topnews.ae/content/21851-uae-unlikely-allow-100-foreign-company-ownership>> accessed 5 May 2010.

<sup>373</sup> This new law is expected to obtain approval and to come into effect by the end of 2011. The main aim of this new law is to create flexibility in foreign ownership to allow more worldwide investors' money to flow into the country.



remedies can be sought? How can one distinguish between shareholders' interests and the corporate interests?

Watts<sup>374</sup> has emphasised three matters under the current Dubai company law which would need reform in any forthcoming law. He believes that if these requirements are dealt with in the new company law, minority shareholder protection in Dubai could be considerably improved. They are: firstly, to enforce a specific remedy for conduct amounting to excessive prejudice and oppression; secondly, to allow minority shareholders with a clear right to access corporate information; and thirdly, to provide a device that enables the minority shareholder to limit illegal or *ultra vires* actions. In other words, Dubai company law urgently needs legal instruments to remedy all types of misconduct and unfairness, together with a clear mechanism that facilitates doing so. These instruments and their mechanisms cannot be offered through any other means than the statute. It is hoped that the new proposed company law in Dubai will address the issue of minority shareholder protection appropriately, and thus comply with what the market demands, before it is put into effect.

### 3.6 Conclusion:

The aim of this chapter has been to investigate the relevant company law, mainly in SA, as far as minority shareholders are concerned. Unfortunately, it is thought that one of the major obstacles which tends to limit the flow of capital into SA is the protection of minority shareholders. This may be because current Saudi company law is not up to today's international standards. Although some provisions provide the minimum safeguards and protection to minority shareholders when it comes to public companies, there are no provisions which grant the same level of protection when it comes to private companies.

Therefore, it was necessary for this chapter to examine and investigate the present status of minority shareholder protection in SA in practice to understand where the problems emanate from. Starting with what is relevant in the Saudi statute, it has been found that

---

<sup>374</sup> G, Watts., The shareholder's legal toolkit. Minority shareholder rights under UAE law. *Al Tamimi & Company*. (19 April 2010), Available at: <<http://www.thefreelibrary.com/The+Shareholder%27s+Legal+Toolkit+Minority+Shareholder+Rights+under+UAE...-a0224273778>> accessed 10 May 2010.

there are many circumstances which may arise in private companies, such as abuse of power, negligence and oppression committed by directors or majority shareholders, which are not addressed clearly or at all. It has been demonstrated that even the court's exact role in dealing with minority shareholders is uncertain.

The chapter has shown that the role of Sharia in Saudi company law is merely to provide general principles regarding company law, while it leaves the detailed mechanisms, devices and remedies for the legislature to provide for in the statute, to ensure that the requirements of contemporary company law are met. Therefore, any deficiency in protecting minority shareholders cannot be attributable to Sharia, as providing specific detail when it comes to company law is not one of its roles. Rather, the statute is to blame for not offering much more detail and for failing to provide remedial mechanisms.

This chapter has also discussed the draft Bill to reform the existing out-of-date commercial and company law in SA. Eventually, the Saudi legislative authority has realised that company law reform has become necessary in order to comply with international standards and create a competitive commercial environment. Nonetheless, this Bill places very little focus on minority shareholder protection when compared with other aspects of company law. The Bill fails to address many of the deficiencies of minority protection in private companies. It is hoped that this Bill is not approved in its current form as it seems not to have been drafted with sufficient care and reflection. If the Bill is enacted as law in this form, minority shareholders may still find it difficult to challenge decisions which harm their rights and interests.

It was also decided to investigate minority shareholder protection in Dubai within this chapter. It has been assumed that its position in practice in Dubai is very similar to that of SA. Generally speaking, it is true to say that Dubai law in this respect is more detailed, modern and practical than its Saudi equivalent. Nevertheless, when examining minority shareholder protection in Dubai closely, it has been found that the provision is almost the same as in SA, as there are no specific sections in the law that provide for minority shareholder protection. In fact, both jurisdictions are lacking sufficient statutory devices, mechanisms, grounds, remedies and recognition of specific interests and rights for the minority shareholder in private companies.

It has been officially confirmed that Dubai is about to produce new contemporary company legislation. However, it is believed that even the new proposed Bill only intends to address superficial or external issues and will neglect fundamental matters when it comes to minority shareholder protection in private companies. Similar to with the proposed new company law in SA, the Dubai legislature has not given substantial consideration to many of the deficiencies and weaknesses which are seen to exist in its present commercial environment.

Therefore, there is clear weakness and deficiency in SA and Dubai laws and their ability to provide protection for the minority shareholder. However, to offer reform to such a region, there is a necessity to have a better understanding of the area and what the position is in practice. For this reason, the next chapter will seek to study different reliable source that can reflect the reality and enable us to comprehend this area of law more. Hence, an empirical study was conducted in SA to investigate the doctrine of minority shareholder protection in practice.

## Chapter 4

### An empirical study of minority shareholder protection in Saudi Arabia

#### Introduction

Any legal research intended to contribute to the field and offer valuable results should first place the matter at hand in a broad context and identify its problems. To do this, it should examine legislation, cases, academic literature, legal reports, reviews of the work of relevant councils etc, in such a way that it can paint a very clear picture of the area investigated. In the case of SA, there is a shortage of such legal materials and references. If all that exists was made available, it would enable this research to be based on a full understanding of the area, but unfortunately a good portion of it is not available to the public.<sup>375</sup> It has therefore been necessary to fill in the gaps by seeking another reliable source upon which to build the facts, results and contributions of this research. This source is an empirical study that was conducted in SA.<sup>376</sup>

This chapter will involve an examination and analysis of the present doctrine as far as minority shareholder protection is concerned in SA. It is designed to identify any weak and inefficient aspects of the law to diagnose exactly where the problem lies in order to offer correct and workable reforms. The chapter is divided in a number of sections. The first section addresses the question of why it is essential to conduct an empirical study and the second details the approval process for the study. The third offers a detailed analysis of the empirical study that was carried out in SA (during October-December 2009) into how minority shareholder protection truly works in the marketplace, while the fourth contains a full assessment of, and reflections on, its results in order to diagnose exactly where the weaknesses lie in the existing law. The fifth section contains the conclusion.

---

<sup>375</sup> SA is not only lacking legal materials and references in this study field to a certain extent, but some data and information are also not accessible by the public for general purposes.

<sup>376</sup> It is true that this empirical study has been only conducted in SA and not Dubai, but it may give a general indication of the legal position in Dubai since all the Gulf States have similar laws.

#### 4.1 Why conduct an empirical study?

In the present case it was considered essential to conduct an empirical study in SA to investigate the doctrine of minority shareholder protection in practice. In fact, there was no real alternative method which could exhaustively reflect the reality of the situation in the same way and this is critical, as reforms should address the problems which actually exist in real life. The necessity to carry out such an empirical study has provided the opportunity to add more value to this research. It is important to make clear that the aim of the study was to collect information and data regarding the relevant protections and standards in SA, regardless of whether they emanated from the statutory provisions or Sharia principles, and to ascertain if the lack of minority protection, which has been highlighted in this thesis thus far, is a problem. In order to achieve these aims, the study was designed around a set of questions which were to be put to participants in interviews (the full set of questions is set out in the Appendix). The questions were divided into three groups, the purpose of the first of which was to identify the problems of minority shareholders in practice, the second to reflect the current remedies available to minority shareholders and the third to gather any proposals from participants by eliciting their views on what would work better and to what extent. The face-to-face interview was chosen as the method for conducting the study, rather than distributing written questionnaires for candidates to complete on their own. It was thought that the face-to-face interview was more advantageous because it would allow the researcher more freedom to engage in open discussion with interviewees. It would also allow the researcher to provide further explanation or interpretation of any difficult or potentially ambiguous questions, as well as being able to clarify answers given. The questions were delivered to the professional respondents in a semi-structured interview format designed to last 30 minutes if answered straightforwardly.

The intention from the beginning was to select candidates on the basis of their careers and positions, and their understanding of company law issues. Moreover, candidates had to be conversant with the law of minority shareholder protection and its impact. This target was met, as all candidates were carefully chosen from amongst those holding posts which enabled them to be in very close touch with the issue of minority shareholder protection and they were therefore able to reflect the true situation and share their experience. Examples of posts held by interviewees are those of regulator,

judge, lawyer, businessperson (sole trader), minority shareholder, majority shareholder, law-maker and academic researcher.<sup>377</sup> The aim was to interview a total of about twenty five persons from all categories.<sup>378</sup> Some of the arrangements with the candidates relied on personal contacts, while judges, officers and officials, for example, were selected and contacted on a random basis. Each official institution provides a list of the specialized people working for it and their functions, and this helped in selecting interview candidates.

#### **4.2 Obtaining approval for the empirical study**

Since this research was conducted under academic supervision at Leeds University School of Law, ethical approval was required for the empirical study. The AREA Faculty Research Ethics Committee at the University was asked to grant such approval and, having been informed about the subject matter of the research and the purpose of the empirical study, it specified certain standards and instructions with which the study must comply. One of the most important of these was that all data and information collected had to be kept confidential. Therefore, all opinions, comments, remarks and information given by the participants, together with their names, have been kept private. The only people with access to this data are the thesis supervisors and the researcher and no names or personal information are mentioned in the thesis itself. A copy of the findings will be made available to all participants in order to inform them of the results.

The second important condition set by the committee was that an information sheet should be given to every participant stating the title of the research and its purpose, explaining its subject matter and describing how the empirical study would add value to the research. Furthermore, this sheet explained to participants their right to withdraw at any stage without giving a reason. Attached to it was a consent form to be completed by each candidate to confirm that they had read the information sheet and understood their

---

<sup>377</sup> This empirical study has not surveyed the position of Saudi public companies because the shareholder in a public company has more remedies and reliefs made available to him than the minority shareholder in a private company. Furthermore, the minority shareholder in a public company always has the exit option.

<sup>378</sup> This number was thought sufficient to reflect reality on the ground. It was also thought to be much better to have valuable comments and statements from a few specialists than to seek contributions from non-specialists.

rights. Once the committee's requirements had been fulfilled, approval was granted for the empirical study to be conducted in SA.<sup>379</sup>

### **4.3 Analysis of the empirical study**

The interview protocol had five pages (with some blanks), divided into three groups of questions, as mentioned above. There were a total of fifteen questions, all in English but with Arabic translations.<sup>380</sup> The data collected from the interviews was subjected to qualitative analysis based on a coding approach, where participants were divided into categories in order to expose each group's opinions and perspectives in a comparable way. Having done this, the results were analysed. It is important to note that this analysis could not include all the information gathered from the responses of the twenty-five interviewees, but instead involved a filtering of the data in order to use the most relevant. It is admitted that this data may carry some shortcomings, especially because the sample interviewed was small. However, it was thought that this number would provide a valuable glimpse of the reality on the ground. Thus, the small sample was in fact deliberately targeted in order to concentrate on the quality of the information and data collected, rather than the quantity of participants. The number of participants in each professional category and their individual identifying codes are given in the Table (3.xx) below.

---

<sup>379</sup> The Chair of the AREA Faculty Research Ethics Committee at Leeds University granted the approval to carry out the empirical study on 21st August 2009.

<sup>380</sup> Just so there is no doubt, the language of SA is Arabic.

**Table 3.xx: Interviewees and their coding references**

Categories	Number of participants	Coding reference
Businesspersons (Sole traders) <sup>381</sup>	5	A, B, C, D, E
Majority shareholders	3	F, G, H
Lawyers	4	I, J, K, L
Academic staff	2	M, N
Judges <sup>382</sup>	3	O, P, Q
Minority shareholders	5	R, S, T, U, V
Others <sup>383</sup>	3	W, X, Y
<b>Total: 25</b>		

A review of published material shows that this empirical study is the first to publicly discuss the issue of minority shareholder protection in SA. It is unsurprising that, because this issue has never before been subject to investigation or even public discussion, people have not given it a lot of deep thought. Therefore, the empirical study alerted the interviewees to this fact and gave them the opportunity to offer the benefit of their experience. Despite the fact that these participants were aware of what went on in practice, they had not specifically considered the concept of minority shareholder protection previously. Thus, the questions in this empirical study started by addressing the actual problem, the remedies currently available and participants' recommendations and proposals. The questions were designed to help participants to visualize the problem in several dimensions and to enable them to assess the effectiveness of the present legal position and existing remedies. It was intended to ascertain whether the participants felt that the current law was deficient in some particular areas and whether they could make valuable recommendations and proposals for reform.

---

<sup>381</sup> The term 'businessperson' here refers to a person who is the only shareholder in the company.

<sup>382</sup> The judges who participated in this empirical study were all from the Commercial Division of the Board of Grievance, which is one of its three main divisions.

<sup>383</sup> These other participants were also chosen on the basis of their professions. One was a legal consultant at the Ministry of Commerce, another was a Human Resources (HR) officer at the Chamber of Commerce and the third was an officer in the Investment Opportunity Department of the Chamber of Commerce.



### 4.3.1. The Problem

#### 4.3.1.1. Existence of oppression and wrongdoing:

The first question in the interview protocol was: *Do minority shareholders face abuse, fraud, infringement, negligence, breach or oppression from majority shareholders in Saudi Arabian companies? If so, how?* Responses indicate that only a little over 60% of all participants felt that there was clear abuse and oppression of minority shareholders by majority shareholders taking place in companies. However, participant S and some others did not acknowledge any actual or potential abuse or oppression by majority shareholders. In fact, participant S emphasized the fact that Saudi private companies are mostly built on strong relationships between parties:

“Any potential wrongdoing or oppression is subject to the shareholders’ morality and ethics, so a potential shareholder would make careful inquiries about whom he would have shares with in a company.”

Those participants who did recognise a problem, on the other hand, were also able to report experience of certain incidents in which a majority shareholder had used his/her power for his/her own interests alone or oppressed those of minority shareholders, such as by:

- Controlling the making of all decisions, especially those regarding whether to distribute profits and dividends; or whether to reinvest profits as capital.<sup>384</sup>
- Using ratification of board decisions only in their own interests.<sup>385</sup>
- Controlling the approval of the balance sheets and financial reports.<sup>386</sup>
- Appointing acquaintances or relatives to sensitive positions within the company to advance their own interests exclusively.<sup>387</sup>
- Preventing the minority shareholder from accessing important information.<sup>388</sup>

---

<sup>384</sup> Stated by businessperson A and lawyer K. In addition, minority S believed that only the majority shareholders have the power to circulate the profits into the capital, while the minority cannot do anything to stop this.

<sup>385</sup> Minority shareholder participant U, who also said that majority shareholders would employ ratification only according to what benefits them the most and not according to what benefits the company as a whole.

<sup>386</sup> Minority shareholder participant T.

<sup>387</sup> Judge P. Majority shareholder H also mentioned this point.

- Passing resolutions to withdraw authority or power from minority shareholders.<sup>389</sup> For example, preventing the minority from signing cheques, so that only the majority shareholder could do so; again, serving their own interests.<sup>390</sup>
- Stealing money in an indirect way, such as by making the company pay for the majority shareholder's personal expenses, rent or private schooling for their children.<sup>391</sup>
- Increasing his/her own remuneration for participation in management.<sup>392</sup>

Participants generally agreed that minority shareholders had the right to go to court and bring legal actions against majority shareholders in the event of misconduct against the company or oppression of shareholders. However, a dissenting view was expressed by a few participants, namely majority shareholders H, F and G and businessperson B, who did not think that minority shareholders should be eligible to represent the company in such cases since they hold less than 50% of the shares and therefore represent merely their own interest in the company and not the company as a whole.<sup>393</sup> Participant B went even further, arguing that “the minority shareholders should not have a direct right to litigate until they had exhausted all ways of complaining within the company”.<sup>394</sup>

#### 4.3.1.2. Minority complaints:

The second question was as follows: *What are your views on s.28 of the Saudi Company Law,*<sup>395</sup> *which allows a minority shareholder to complain to the majority shareholder*

---

<sup>388</sup> Said by lawyer L, who also illustrated that this information in most cases is very important and can prove the actual affairs of the company and how it is being run behind the scenes.

<sup>389</sup> Minority shareholder participants V and R agreed on this issue.

<sup>390</sup> This particular example was given by judge Q who dealt with similar cases.

<sup>391</sup> Participant X, who is a legal consultant at the Ministry of Commerce, and also said by businessperson D.

<sup>392</sup> Academic participant N, and also the majority shareholder F.

<sup>393</sup> Only 2 participants (8%) adopted this view. They seemed not to understand the concept of representing the company in order to litigate on its behalf so that any compensation would go to the company itself. This point will be discussed in detail in section 3.6.

<sup>394</sup> Some may consider it reasonable that all ways of complaining within the company are exhausted first, before the minority has a direct right to litigate. However, this requirement may be too harsh if it means the minority shareholder has to follow certain procedures and waste time, only in order to obtain the right to litigate.

<sup>395</sup> When the shareholders have not specified (in the shareholder agreement) or agreed (by a resolution) who shall be appointed as a director, then the statute here considers all shareholders to have a role in management.

*over any conduct, but which also entitles the majority shareholder to decide whether to ratify the conduct or not. Does it cause any problems in real business life?* In response to this question, almost 64% of participants said they were in favour of the section, because they felt that its higher purpose was to stabilize the company and ensure that a final decision could always be reached within it. Furthermore, some participants (M, E, L, R and S) who agreed with this section assumed that minority shareholders would, in most cases, not be present most of the time, meaning that decision-making would be negatively affected if the majority shareholder did not have the ultimate power to conduct the company's business. An academic participant (M) stressed that, although the law grants power over decision-making to the majority, it also protects the minority shareholder by requiring unanimity of votes from all shareholders in certain circumstances. One example of these few circumstances is in the making of decisions to amend the company's contracts (the shareholder agreement or articles) will not be valid unless passed unanimously.<sup>396</sup>

Nonetheless, a small group of participants (minority shareholders T and V), believed that this section caused great hostility between the majority and minority shareholders by allowing the former to cover up their own misconduct. Participant V stated that "the consequences of this section are that any conflict would remain unsolved and might enlarge". Unexpectedly, all participants categorised as majority shareholders (H, F and G) were among those who disagreed with s.28, considering it useless because, although it gives the minority the right to complain, any such complaints will be received by the majority shareholders, who will ultimately favour their own interests. The judges (O, P and Q), on the other hand, unanimously agreed that even if complaints were not dealt with satisfactorily by the majority shareholder within the company, minority shareholders retained the right to litigate, and then it would be for the court to decide whether a valid case existed or not.<sup>397</sup> It is significant here that, although the judges were aware that minority shareholders always have the right to litigate against majority shareholders, this right is not clearly stated in the statute and so is not widely recognised. This point will be discussed in detail in sub-section 4.4.

---

<sup>396</sup> s.25 of The Saudi Company Law 1965 states that "all decisions require a majority of votes unless the company's shareholder agreement provides otherwise. However, decisions to amend the company's contracts are valid only if passed unanimously".

<sup>397</sup> Two of the 3 judges agreed with the section, but all believed that it served merely to grant the majority control over daily decision-making. However, all three judges considered the court an effective option for minority shareholders who believe that misconduct or oppression has occurred.

#### 4.3.1.3 Theory adopted by the Act:

The third question asked of participants was: *What hypothesis or theory has the Saudi Company Law adopted as a basis for granting the majority shareholder this ultimate power over the company?* This was the only question in the whole of the empirical study on which there was 100% agreement among interviewees in admitting that indeed the existing law favoured the majority shareholder over the minority in terms of power, interests and rights. Participants replied that the law gives the majority shareholder more power because it considers that whoever spends more will care more for the company. They elaborated by saying that the law seeks to protect capital, so those who invest more obtain greater rights and interests, which must accordingly be enhanced and exercised through greater authority and control. One of the most convincing explanations was put forward by lawyer (L), who believed that:

“the law adopts this principle because it sees majority shareholders as first and most strongly affected by the profits and losses of the company, hence they are more eligible to have control and be protected”.

Another reflective justification was given by academic M who indicated that the law sees majority shareholders as uniquely able to sustain strong performance and keep companies running smoothly. The vast majority of participants attributed this theory to the so-called “philosophy of interest”.<sup>398</sup> Although all participants could understand why the law would adopt such a bias, only two participants (businessperson C and minority shareholder R) explicitly stated that by doing so the law would neglect other existing interests in the company such as those of minority shareholders. Participant C in particular suggested that it was understandable for the law to favour the majority shareholders’ interests and rights, but not for it to neglect to specify any protected rights and interests for minority shareholders and others in the company.

#### 4.3.1.4. Absence of protection causes problems:

---

<sup>398</sup> This is an Arabic expression commonly used to suggest in this context that the majority shareholder has more interests in the company and is thereby entitled to greater authority and protection.

The fourth question was: *Do you think that the lack of minority protection causes any problems? Why?* In response, 92% of participants clearly considered problems to be the inevitable results of deficiency in the law. The minority shareholders (R, S, T, U and V) had the strongest opinions regarding this question, as they were mostly directly affected by it. Participants U and V believed that the lack of protection or of clarity in the law caused disputes, conflicts and dissatisfaction among shareholders, particularly the minority. Moreover, R and T believed that it put them in a very vulnerable position to the extent that they did not know what to do or even to whom the problem should be referred when misconduct or oppression occurred. Similarly, academic participants M and N claimed that the lack of protection for minority shareholders empowers majority shareholders to do what they wish, knowing that there is no legal mechanism to stop them or to enable questions to be asked about their actions. However, N disagreed with the minority shareholders (R, S, T, U and V) as to who would suffer the most, stating that research shows that a lack of protection causes uncertainty and instability within companies and accordingly it is the company which suffers foremost, not the minority shareholders.<sup>399</sup> N elaborated by saying that this is because any problem between shareholders will be reflected in the running of the company.

There was also some agreement among the other participants (lawyers, majority shareholders, businesspersons and others) who felt that the lack of minority protection would deplete the company's resources and divert concentration away from its affairs, with negative consequences for all concerned. Participant W<sup>400</sup> agreed with majority shareholder F that the harm caused by this lack of minority protection in the law extended to negatively affect majority shareholders as well. Indeed, W went so far as to suggest that majority shareholders were the only parties who might suffer from the lack of minority protection, because the absence of legal clarity allowed the minority to cause disruption and destabilize the company. That is, the deficiency in the law will encourage minority shareholders to fight for poorly-defined rights and interests, causing chaos and detracting from the company's reputation, whereupon the majority shareholder would be the first to suffer. According to this view, minority shareholders benefit in either scenario (i.e. whether protection is available or not), because if there is

---

<sup>399</sup> It is almost impossible to find any research or specific book covering the area of minority shareholder protection in private companies in Saudi Company Law, but the academic participants meant that they had come to this conclusion from their readings and studies, not from any published reference.

<sup>400</sup> HR Officer at the Chamber of Commerce.

no law to protect their interests then they are likely to be moved to cause disruption to claim their rights, while, if there is a law in place, then they are protected. This view is countered by the argument that, in the absence of statutory protection for the minority shareholder, no other option would really uphold his/her rights and interests, while any disruption to the company would affect the interests of the minority shareholder too.

Finally, there were just two respondents who argued that the lack of minority shareholder protection in the company law did not cause a problem. Judge O said:

“Generally the Saudi Company Law is transparent and comprehensive and if hypothetically there is a lack of protection in the statute, there are other different resources which can still provide the minority shareholder with protection, such as the company’s internal code or the shareholder agreement”.

However, the judge here has neglected to note the fact that the company’s internal code and the shareholder agreement can still be heavily influenced by, and weighted in favour of, the majority shareholder, who can include or exclude clauses according to what benefits him/her the most. He has also neglected the fact that the statute is the main provider of protection and that no other sources can replace its fundamental role or even be equal to it. It seems that the comments of judge O fell into line with his job interests as it may be in his interests to describe the current company law as transparent and comprehensive so he can always have unlimited discretion in dealing with such cases. However, the two other judges (P and Q) held views totally opposite to those of judge O. Judge P claimed that the lack of minority shareholder protection disrupted the smooth running of the company and likewise, judge Q assumed that since the law lacked guidance, protecting minority shareholders would be left to personal interests and efforts and this would cause problems.

#### 4.3.1.5. Impact on the economy and investment:

Question five was an extension of the previous question: *Does this lack of minority protection have any impact upon the general economy and upon local and foreign investments?* Participants were divided into two groups when it came to evaluating the first part of the question, concerning the impact on the general economy. The first

group, comprising slightly less than 25% of all participants, believed that the lack of minority shareholder protection would have no effect on the general economy because they (minority shareholders) are not numerous and their inputs are not large anyway. For example, one member of this group was minority S, who did not think that the lack of protection would affect the economy because the law was designed to satisfy majority shareholders, whose impact on the economy is greater. Participant R supported this idea by saying that minority shareholders would have no impact on the general economy because of the small number of people who hold minority shares. Thus, according to this group, if minority shareholders lack protection, this will not affect the general economy, which is subject to more substantial factors having much greater influence than the protection of minority shareholders.<sup>401</sup>

The second group, on the other hand, looked at the matter from a wider perspective. They maintained that minority shareholders play an important role in the general economy, which is ultimately like a network in which each party relies on the others. This group believed that, as long as company shareholdings can be divided into minority and majority holdings, all shareholders must enjoy appropriate protection, regardless of who they are. They argued that minority shareholder protection is essential for the economy to grow because if shareholders are not attracted to invest in them, companies will not be able to grow so easily and, as a consequence, the general economy will be negatively affected. Businessperson E acknowledged that:

“the lack of minority shareholder protection might negatively impact upon the economy, by hindering the early discovery of abuse, which might in turn lead to the collapse of many companies in Saudi Arabia”.

If there were practical protection for minority shareholders, it would assist in remedying companies' problems in a quick and effective way, as minority shareholders would then have the legal capacity to protect their companies from any wrongdoing or oppression, thereby safeguarding the general economy. Judge Q backed this idea, asserting that defects in minority shareholder protection would directly affect the circulation of money in the general economy. Additionally, academic N argued that the number of insolvent

---

<sup>401</sup> Participants R, S, W & F gave examples of factors that are more influential on the general economy than minority shareholder protection, such as specialisation of courts and ease of setting up a company.

companies would increase because the law which regulates their relations is not clear and shareholders would accordingly have no solutions for their disputes, which would in turn affect the commercial environment.

When it came to the second element of the fifth question, which concerned the impact of the lack of minority protection on local and foreign investment, almost all participants believed that there was a positive relationship between minority protection and investment in that more effective protection would lead more minority shareholders to invest in companies. Majority shareholder H admitted that people would not invest their savings because of their inability to protect their investments in a company, since the law provides no assurance for these small inputs. He further argued that what is more worrying is that people may lose trust in each other and, as a result, people with few investments will tend to set up small independent businesses or projects or even leave the money in banks in an attempt to avoid having to go into business with others, because no existing clear law can cover them once they become minority shareholders. Participant Y<sup>402</sup> felt that the lack of protection for minority shareholders caused reluctance to enter the market and invest. Similarly, academic N and lawyer I argued that few would be willing to become minority shareholders because of the high risk of losing their investments; accordingly, they would refrain from investing in the majority / minority model and would look for a different type of investment. For example, the potential investor may invest in a public company which always offers the exit option or may set up a company with another investor, in which each shareholder has equal shares (50/50 shares). Academic M noted that the same applied to foreign investors considering joining a company as minority shareholders.<sup>403</sup> Indeed, he said that the protection of minority shareholders' rights and interests may be of more concern to foreign investors, who in most cases live abroad, than to local residents or nationals, because the foreign investors must rely on Saudi law to protect their rights and interests, while the nationals have other options, such as accessing up-to-date information on the company's progress or seeking friendly reconciliation.<sup>404</sup>

---

<sup>402</sup> Officer in the Investment Opportunity Department of the Chamber of Commerce.

<sup>403</sup> M argued that foreign investors would be less likely to be attracted to SA in light of the weak rights and interests of minority shareholders.

<sup>404</sup> Reconciliation, as certain points later will show, has proven to work effectively in SA. There are influential businesspersons who always offer to intervene to solve disputes in order to keep the commercial environment working smoothly.



It is remarkable that almost all participants appreciated the impact of the lack of protection upon local and foreign investors, but did not all agree that it would also affect the economy. This suggests that some failed to understand that there is, based on evidence, a very strong relationship between the level of local and foreign investment and the general economy.<sup>405</sup> Thus, if something prevents people from investing, the general economy will be immediately affected because it is ultimately constituted by the totality of such investments. This makes it difficult to understand how some participants could recognise the negative effect of having no minority protection on potential local and foreign investments, but could not see the same effect on the general economy. A possible explanation for this apparent inconsistency is that they considered that minority shareholders, being relatively small in number, would not make a major contribution to the economy and would therefore be less important to the market than the majority shareholders. This point will be discussed in detail in sub-section 4.4.

#### 4.3.1.6. Undiscounted payout:

The sixth question was: *Do you think that it is possible for a minority shareholder to seek an undiscounted payout, if the minority shareholder is not happy with the way the company is being run?* It is important to note that according to Saudi company law<sup>406</sup> the majority shareholder has a pre-emption right to buy the minority shareholder's shares, so the price offered for the shares comes from the majority shareholder who would, in most cases, favour his/her own interests.<sup>407</sup> Minority shareholder U confirmed that majority shareholders use their power to force minority shareholders to sell and then offer an unfair price. In fact, the overwhelming majority of participants believed that minority shareholders would be unable to obtain a fair price reflecting the true value of the shares unless an independent expert or specialist were available to value them. Indeed, a small group of participants (U, V and H) argued that, even where a third

---

<sup>405</sup> Islamic Research and Training Institute, IRTI., *Islamic Capital Markets: Products, Regulations & Developments*, 1<sup>st</sup> ed. Islamic Development Bank, Jeddah, 2008, pg: 324 & 324.

<sup>406</sup> The pre-emption right has its original basis under Sharia but the first application of it involved neighbours since prophet Muhammad, peace be upon him, cited that "a landlord has a pre-emption over his/her neighbour's property" (in the case of a sale). (As narrated by Abo Dawood and others). The same concept was later extended to cover different types of relationships, the relationship between shareholders in a company being one of them.

<sup>407</sup> According to Saudi company law and Sharia, the minority shareholder can sell his/her shares to an outsider only if the majority shareholder shows no interest in buying them. Furthermore, according to majority shareholder F, even if an outsider showed such an interest, he/she would offer less than the full value, knowing that a dispute was going on within the company.

party was involved, the minority shareholder would never obtain a fair price. Participants U and V, as minority shareholders, stated from their own experience that in all cases the price based on a valuation would not be satisfactory. H, a majority shareholder, explained that majority shareholders would always have influence over the expert assessor, who would therefore rule in their favour. Judge O, on the other hand, stated that:

“any minority shareholders disagreeing with such a valuation could always refer the whole matter to the court, which would do its best to grant the minority shareholder an undiscounted price”.

It is absolutely critical here to indicate that the option of going to court after the valuer has ruled was not known to a large number of participants, as they believed that once an independent specialist had become involved, no further action could be taken. This matter will be discussed in detail in sub-section 4.4.

#### 4.3.1.7. The provision of criteria to be followed:

The seventh and final of the first group of questions was: *What guidelines or criteria do you follow when dealing with minority cases, since there is an absence of common law and accordingly no case law?* In answering this question, participants listed certain reference points which they considered to be resources setting out principles, rules and guidance to assist and direct them in minority shareholder cases. For example, there was total agreement amongst all participants that the first reference is commercial and company statutes. Nine participants<sup>408</sup> then agreed that the second reference is the General Islamic jurisprudence (Sharia). Eight participants<sup>409</sup> said that the legal advice from specialised official entities comes next as a reference point. Five participants<sup>410</sup> believed that the reports and opinions of professional third parties or arbitrators, such as expert valuers, are also an important resource. However, only four participants<sup>411</sup> clearly saw the shareholder agreements (between parties) as a reliable point of reference which can guide them in such cases. As well as the low number of those who believed in the

---

<sup>408</sup> (Judges P, O and Q, Majority F, Academic N, Minority S and V, Lawyer I).

<sup>409</sup> (Businesspersons B, E, A and D, Majority H, Academic N, Minorities R and V).

<sup>410</sup> (Judge O, Majority H, Academic N, Lawyer K, Businessperson A).

<sup>411</sup> (Businessperson B, Academic M, Lawyers K and L).

reliability of the shareholder agreement, only four participants<sup>412</sup> claimed that the experiences of neighbouring countries which have similar status for minority shareholders and more resources to refer to when dealing with such cases can also be viewed as a trustworthy reference. Merely three participants<sup>413</sup> thought that corporate and commercial conventions can also be a very useful as a source of guidance. Finally, only two participants<sup>414</sup> believed that academic books and articles which cover this area in detail can provide constructive and detailed guidance and criteria to be followed.<sup>415</sup>

All three judges (O, P and Q) added case law to these resources. Judge Q said that case law in this context means a body of cases dealing with similar issues where new decisions have been reached or a new principle developed. He indicated that case law, which is also known in the Saudi commercial environment as “judicial precedents”, is not something that judges have to follow or even to consider, but that it is available to them simply to provide guidance and direction. It is very surprising that none of the other participants mentioned that they considered case law a source of guidance or criteria in such cases. It is yet more surprising that even the four lawyers (I, J, K and L), who would deal with legal cases every day, did not mention case law as a reference point for guidance and direction. It is true that judges indicated that they refer sometimes to case law to seek guidance, but it seems that judges would prefer not to have binding case law as it may result in a reduction in their power and limit their discretion, so it may be in their interests not to have the case law systemised.

Judge P pointed out that case law in this respect is a very important reference, but it is not organised in a way that facilitates reference to it and is subject to personal interpretation by each judge. It is believed that the main reason for other participants not mentioning case law as a source of guidance is that it is not easily accessible by the

---

<sup>412</sup> (Other “HR” Y, Majority F, Minorities S and U). They also emphasized that this can include any case law or principles that can offer guidance.

<sup>413</sup> (Majority F, Judge Q, Lawyer J).

<sup>414</sup> (Majority F, Other Y).

<sup>415</sup> Participant Y, who was a Human Resources (HR) officer at the Chamber of Commerce, stated that knowledge and guidance regarding this issue can be also sought from the international standards of company law which most countries follow. The majority shareholder G agreed with this suggestion and said that guidance and knowledge can be also taken from the USA and UK who have dealt with this issue, even though they lack a common basis with Saudi Arabia.

public.<sup>416</sup> It is worth noting, as minority shareholder S said, that conventional and traditional cases in Sharia are always available and can be used as reference points.<sup>417</sup> However, such cases cannot function like modern ones, because the issues, facts, principles and other factors being disputed in courts today are largely quite different from traditional cases as society has changed.

#### 4.3.2 Current remedies available

While the first part of this empirical study sought to identify the problems related to minority shareholder protection from different perspectives, the second part was designed not only to examine the remedies available to minority shareholders under Saudi company law, but also to identify the bodies or entities which can be involved in such cases.

##### 4.3.2.1 Available remedies:

The first question was: *What practical remedies are available for the minority to seek if there is wrongdoing or abuse done to the company?* Importantly, no category of participants agreed on a sequence to follow when referring a dispute to an independent body. However, the majority shareholders and businesspersons tended to favour initial attempts to solve disputes not through the court, but instead via arbitration or friendly reconciliation. Businessperson E, for instance, suggested that “when a dispute occurs between shareholders, the court is not the best option to refer the matter to, but rather reconciliation and intercession is the way forward”. Similarly, majority shareholder F preferred that disputing shareholders first attempt to solve the matter by negotiation and then involve the court if this fails (The next question has sought to find out how the court can be involved and to what extent it has discretion).

It is possible that majority shareholders and businesspersons specifically tend not to favour the court as the first step because they know that its involvement would be costly

---

<sup>416</sup> This issue of having no public accessibility to case law while judges take it as a reference point will be discussed in detail in the next section.

<sup>417</sup> What S meant here was certain well known cases from Islamic jurisprudence and convention. These are accessible to the public but in most cases provide only general principles and not detailed guidelines like the modern cases.

for the company in terms of time and money. Majority shareholders and businesspersons, in most cases, will also care more for the company's reputation and therefore prefer disputes to be kept confidential. Another very important reason for majority shareholders in particular to prefer arbitration or reconciliation is that they can always use their power, control and authority in negotiations with minority shareholders to obtain better deals, for example by making a buy-out offer at less than the market price. On the other hand, minority shareholders R, S, U and V favoured going to court immediately, rather than wasting time and effort in trying to solve the dispute amicably. This view seems unreasonable to some, but it is most probably preferable for minority shareholders because they know that any attempt to solve the problem within the company might well end up in deadlock. Participant S stressed that once legal advice is sought and it is evident that the case has potential for success, it would be better to refer it directly to the court for a ruling. It is important to stress here that a real guarantee of success is not possible because there are no clear guidelines for courts to follow in such cases and accordingly it is difficult for lawyers to advise in advance on the success of any case.

Perhaps minority participants held firmly to the court option because they realised that the majority shareholder is always able to press for his/her own interests outside of court. Participant T, who alone among the minority shareholders did not favour the court option, proposed another option to solve disputes: seeking the involvement of well recognised businesspersons who could pressure the majority shareholder to offer a fair deal. In other words, the minority shareholder would invite such influential businesspersons to intercede. This option could be effective because the majority shareholder, who might well be junior in terms of age or business standing, would respect what the well-established businesspersons said and accept their judgement, in case he might later need their assistance and experience in the market. In fact, this option has proved successful in the Saudi commercial environment, but is gradually disappearing because the commercial market is expanding and new faces are entering every day. Thus, although this option may offer some help in certain cases, it cannot be relied upon in every dispute; therefore the court option is still preferred by the majority of minority shareholders as a first step.

#### 4.3.2.2 The court's role:

The next question was: *What role does the court play in cases where minority shareholders allege oppression or wrongdoing? Does the court strictly apply the Act or does it go beyond the law when it is necessary to bring justice?*<sup>418</sup> In response to the first part of this question, 64% of participants saw the court's role in dealing with minority shareholders as weak. However, when it came to applying the law, 56% of participants believed that the courts applied the law strictly, not going beyond its formal requirements in any case. All minority shareholders were among those who saw the court's role as weak and also among those who believed that the courts would apply the law strictly even if justice required otherwise. For example, participants T & U specifically considered the courts' role to be weak either because of deficiencies or because there is no clear law for the court to follow, as a result of which each judge will exercise his discretion differently, based on his background, experience and the way he looks at each case. U elaborated by saying that the first thing which the court will do is to refer to the statute and, if this is not detailed, then the rulings will be subject to each judge's discretion. Both T and U felt that the courts were limited to the law, while V offered the following explanation for this strict application of the law:

“the court will strictly stick to the Company Law Act even if justice is not served, because the court is a body that is only concerned with implementing the law rather than legislating new provisions”.

For his part, majority shareholder H indicated that in minority shareholder cases, judges lack experience, knowledge, guidance and direction, which leads to confusion in the judicial system. Academic N argued that the absence of clarity in the law, and the lack of knowledge and experience on the part of judges, will make it very difficult for lawyers and others to understand the criteria and standards by which cases are decided and thus to predict their outcome. This makes it very difficult for them to give advice to companies and shareholders. Businessperson C came to the same conclusion as N, but from a different perspective as he considered that:

---

<sup>418</sup> It is important here to note initially that s.28 of the Saudi Company Law 1965 grants majority shareholders the right to investigate any conduct complained of by minority shareholders and to adjust it or approve it. So if the court applies the law strictly, it may tend to favour the majority shareholders' decisions.

“the court’s performance is inefficient because it takes a very long time to solve any dispute, which will have a negative effect on the running of any business. It is unfortunate that judges always blindly implement the law as it is, because there is little space for creativity”.

Interestingly, majority shareholder F stated that the courts recognise this lack of knowledge and experience in dealing with minority shareholder cases and, as a consequence, push hard for friendly settlement or reconciliation so that such cases do not have to be judged in court.

On the other hand, all participating judges strongly believed the court to have an active role in dealing with minority cases. Judge Q stated that the court applies the Act, which is in favour of the majority shareholder, but if there is a clear wrongdoing or oppression, then it has the power to exercise its discretion. Judge P agreed that the court will sometimes go beyond the codified law if justice requires it, stating that it also has the power to reject or amend any clause in a contract or shareholder agreement if it is adjudged unfair to a minority shareholder. Remarkably, judge O confidently asserted that the court always has the power to invalidate, if necessary, the majority shareholder’s decision and grant compensation to the minority shareholder, or force the majority shareholder to endure the consequences of the decision alone. One of the few other participants who backed the court’s role in such cases was academic M, who considered it very significant when dealing with minority cases because judges have to understand not only the wording of the statute, but also its intention, in order to dispense justice.

It is important to stress here the significant difference in responses between judges and other categories of respondent, who doubted the court’s ability to deliver justice in minority shareholder cases, because of a clear deficiency in the law which causes others to distrust the court’s ability and weakens confidence in the judicial system. Businessman D clearly stated his perception of the present position:

“The law is not well detailed or even clear regarding minority shareholder protection. Provisions are not obvious or comprehensive, and for this reason there

is a huge space for judges to rely on their personal understanding and interpretation to deal with such cases.”

#### 4.3.2.3 Shareholder agreement’s role:

Question three was: *To what degree does the shareholder agreement protect the minority shareholder? If the shareholder agreement was the only source to provide protection for the minority, do you think that this would be adequate? What about including rights and interests in a statutory form rather than stating them in the shareholders agreement?* This set of questions aimed to discover whether a shareholder agreement is sufficient as the only source of protection for minority shareholders. The overwhelming majority of participants agreed on the importance of the shareholder agreement to protect the minority, but they disagreed on the extent of this protection. For instance, judge Q said that a shareholder agreement can protect minority shareholders to a great extent, but needs to be well detailed and to cover as many eventualities as possible. Minority shareholder V also indicated that the agreement is an essential ground for determining the obligations and rights of each party.

A few participants did not believe that the shareholder agreement can provide sufficient protection to minority shareholders. For example, both minority shareholder U and businessperson A felt that it provides inadequate protection because it is ultimately an extension of the statute, which itself is not clear. Majority shareholder H said:

“in percentage terms, I think that the shareholders’ agreement can offer only 65% protection at the very maximum, because most contracts are written by majority shareholders, who tend to serve their own interests first”.

Lawyer L supported this view by saying that the majority, in most cases, dictate their conditions in the agreement and as a result minority shareholders are forced to sign the shareholder agreement as it is. Nonetheless, there was unanimity among participants that the shareholder agreement cannot function instead of the statute or replace it. Lawyer K argued that it was absolutely fundamental for the statute to reserve powers, rights, interests, obligations etc clearly for each party. Likewise, minority shareholder V said that protection of everything related to the minority shareholder should always be clearly



reserved in the statute in order to prevent misinterpretation. V also noted that, if the minority shareholders' rights and interests are left to the shareholder agreement, the majority shareholder will use them as a pressure device to negotiate what to include and exclude in the agreement. Businessperson A emphasised this point by saying that the statute is the best device to protect minority shareholders' rights and interests, otherwise these rights and interests will be subject to inclusion in, or exclusion from the shareholder agreement. Interestingly, judge Q, quoted above as saying that the shareholder agreement should be as comprehensive as possible, later conceded that statute can cover more possibilities, rights and interests than any shareholder agreement and thereby benefit minority shareholders more. Therefore, as majority shareholder F argued, the shareholder agreement cannot replace the statute, but instead they can work together to protect the interests and rights of minority shareholders.<sup>419</sup>

### 4.3.3 Participants' recommendations

#### 4.3.3.1 Rights and interests:

The first and second parts of this empirical study have been used to identify the problem with minority shareholder protection and to consider the currently available remedies and protections. The third part invited participants to make recommendations for the reform of the Saudi minority shareholder protection statute in order to address its deficiencies. The first question in this last series was: *What rights and interests, in your opinion, should be reserved in the statute for minority shareholders and protected by the law?* When participants answered this question, some of them initially recommended that the statute should:

- Specify certain matters that cannot be passed unless through unanimous resolutions, so that the majority shareholder cannot have the ultimate say on all matters.<sup>420</sup> (it is important to note here that one of the few advantages of the Saudi Company Law 1965 in protecting minority shareholders is the requirement

---

<sup>419</sup> Judge O stated that if any clause in the shareholder agreement contradicts the statute, as in the example of not allowing the minority to litigate against the majority shareholder, the court will still grant this right to the minority shareholder to represent him/herself and the company. It is very important to note that, according to O, the court always makes the company's interests a priority.

<sup>420</sup> (Businessperson A, Academic N, Judge O, Majority shareholder F).

of the law to have unanimous resolutions regarding certain specific matters. But participants recommended that further matters should be specified as having the same requirement).

- Require the majority shareholder to be liable personally for the damages, rather than the company, when he/she has taken the wrong decision.<sup>421</sup>
- State certain criteria and standards for directors to comply with when running a company.<sup>422</sup>
- Clarify and simplify the grounds, mechanisms, procedures, devices and remedies that can be utilised by minority shareholders to exercise their litigation rights and other rights.<sup>423</sup>

However, when it came to listing rights and interests, interviewees said that the statute should reserve or codify at least the following rights:

- The right for the minority shareholder to have his/her signature required for the issuing of a cheque if he/she asks for such a right.<sup>424</sup>
- The right for a minority shareholder to bring a legal action at any time either on behalf of the company or him/herself. This right should be protected with a clear statutory mechanism which enables the minority shareholder to exercise it.<sup>425</sup>
- A right for the minority shareholder to represent the company in litigation without the need to obtain permission from the majority.<sup>426</sup>
- A right to compensation for the minority shareholder if it is proved that the majority shareholder has caused harm to him/her.<sup>427</sup>
- The right to have a transparent exit system where the shareholder would be given a fair price for his/her shares.<sup>428</sup>
- The right to attend all meetings and participate in all decision-making.<sup>429</sup>

---

<sup>421</sup> (Minority shareholder S, Judge P, Majority shareholder F).

<sup>422</sup> (Businessperson D, Majority shareholder H).

<sup>423</sup> (Minority shareholder U).

<sup>424</sup> (Judge Q).

<sup>425</sup> (Participants Y and W “officers at the Chamber of Commerce”, Minority shareholders V and T, Lawyers I and L, Businessperson A, Participant X “legal consultant at the Minister of Commerce”).

<sup>426</sup> (Judge P, Majority shareholder H, Minority shareholder U).

<sup>427</sup> (Minority shareholder S, Judge P, Majority shareholder F).

<sup>428</sup> (Participants Y and W “officers at the Chamber of Commerce”, Academic N, Minority Shareholder V, Businessperson C).

- The right to have equal votes if the company has only two shareholders, even if they hold different percentages of shares.<sup>430</sup>
- Clear right of access to information, documents and financial reports.<sup>431</sup>
- The right for the minority to know of any conflict of interest on the part of the majority shareholder.<sup>432</sup>

It was noticeable from the answers to this question that participants particularly valued two main rights: to participate in decision-making and to have a simple litigation procedure. However, majority shareholder F noted here that these two rights would have to be carefully monitored in order to protect the stability and running of the company, for, if they were left unrestricted, the company would be likely to suffer. Majority shareholder G was the only participant who did not recommend the granting of any more rights and interests for the minority shareholder other than are already enshrined in the current Saudi law because he thought that to do so would harm companies. This participant ignored the benefit which the company may obtain if litigation is facilitated so that the minority shareholder can pursue any type of wrongdoing or misuse which occurs in the company. Nor did he accept that each minority shareholder has rights and interests in the company that need to be recognised and protected just like those of the majority shareholder. It seems that this majority participant might have come to this view because he had interests and rights in a company which he did not want to be withdrawn or minimised, as would be the case if the minority shareholder had more rights and interests.

Two other participants recommended rights and interests for the minority shareholder that were somewhat different. Lawyer I proposed that the power to investigate any complaint by a minority shareholder should be completely withdrawn from the majority shareholder and delegated to an independent body, while businessperson E suggested that minority shareholders should have the right to have any action that is subject to a disputed resolution suspended until it has been fully investigated by the court. It can be

---

<sup>429</sup> (Majority shareholder F, Judge P, Participant Y “officer at the Chamber of Commerce”, Minority shareholders U and R, Lawyers I, K and L, Businessperson D, Participant X “legal consultant at the Minister of Commerce”).

<sup>430</sup> (Minority shareholder S).

<sup>431</sup> (Businesspersons E and D, Majority shareholder H, Lawyer K).

<sup>432</sup> (Businessperson B).

argued, however, that neither of these recommendations would benefit the stability, efficiency and smooth running of the company if put into effect. The first fails to recognise that leaving the power to investigate a complaint initially in the hands of the majority shareholder will always provide an opportunity to resolve the matter internally. Likewise, the second, which is similar to obtaining an injunction in English law, fails to appreciate that if minority shareholders had an unrestricted right to suspend any disputed resolution, then the company would suffer by losing many opportunities to complete transactions and make profits. Alternatively, the minority shareholder might have the right to ask the court, by way of urgent application, to suspend the disputed resolution before it is put into practice and, in this case, the suspension would come from the court if it considered it inappropriate.

#### 4.3.3.2 Extra remedies and a healthy environment:

The second question in this third part of the empirical study was: *Do you think that further remedies, solutions, reliefs and protections should be available under the statute? If so, what would you suggest?* The third question extended this point by asking: *What could create a healthy protective environment that accommodates the minority shareholder's needs?* The suggestions made by participants in response to these two questions were put into different categories (statute, court, company and others). Participants believed that, if the following suggestions were adopted, Saudi minority shareholder protection would be improved accordingly.

##### Statute:

- Codifying all remedies and reliefs in the statute.<sup>433</sup>
- Adopting related provisions and remedies from other jurisdictions with experience in this field.<sup>434</sup>
- Empowering judges statutorily to compensate the minority shareholder from the majority shareholder's own money.<sup>435</sup>

##### Court:

---

<sup>433</sup> (Participant X “legal consultant at the Ministry of Commerce”, Businessperson C, Lawyer K, Minority shareholders T and S, Academic N, Participant Y “officer at the Chamber of Commerce”, Majority shareholder F).

<sup>434</sup> (Businessperson A, Minority shareholders R and U, Judge P).

<sup>435</sup> (Judge Q).

- Creating a commercial court specialising in company law with experienced judges.<sup>436</sup>
- Prioritising company interests in all cases.<sup>437</sup>
- Punishing those who commit wrongdoing and oppression by naming and shaming them.<sup>438</sup>
- Activating case law as a source of guidance and criteria.<sup>439</sup>
- Ensuring the enforcement of the court's decisions.<sup>440</sup>

#### Company:

- Producing an ideal model of an internal code for all companies to follow, guaranteeing minimum protection for minority shareholders.<sup>441</sup>
- Producing a model shareholder agreement to guarantee the minimum protection of minority shareholders' rights and interests.<sup>442</sup>
- Applying corporate governance in a way that it can monitor companies and the way their decisions are made.<sup>443</sup>
- Ensuring that each party knows that the company is an entity which benefits them equally and has a role to play in social responsibility.<sup>444</sup>
- Favouring the general interests (company interests) over individual interests (shareholders' own).<sup>445</sup>

#### Others:

- Promoting arbitration and designating a specialised and empowered third party who can rule professionally on disputed matters.<sup>446</sup>
- Encouraging research to continuously investigate the rights and interests associated with companies and minority shareholders.<sup>447</sup>
- Spreading the culture of justice and fair treatment among shareholders.<sup>448</sup>

---

<sup>436</sup> (Participants W and Y "officers at the Chamber of Commerce", Businesspersons C, A and E, Lawyer J, Minority shareholder T, Judge Q).

<sup>437</sup> (Lawyer I).

<sup>438</sup> (Businessperson E, Judge Q).

<sup>439</sup> (Lawyer J).

<sup>440</sup> (Businessperson C, Majority shareholder F).

<sup>441</sup> (Businesspersons A and D, Lawyer L, Minority shareholder R, Academic N, Judge O).

<sup>442</sup> (Businessperson A, Minority shareholder V, Judge Q).

<sup>443</sup> (Lawyer I, Judge O).

<sup>444</sup> (Businessperson D, Lawyer J).

<sup>445</sup> (Lawyer I, Minority shareholder S).

<sup>446</sup> (Lawyers L and J, Academic N, Majority shareholder H, Participant Y "officer at the Chamber of Commerce", Judge O).

<sup>447</sup> (Minority shareholder S, Majority shareholder G).

<sup>448</sup> (Lawyer L, Minority shareholder V, Majority shareholder F)

- Educating and training shareholders constantly about their rights, interests, powers, obligations and liabilities towards the company and each other.<sup>449</sup>

The clear majority of participants believed that, if the above suggestions were adopted and acted upon, Saudi company law might then be able to offer practical and effective protection to minority shareholders. It is noteworthy that more than half of the participants stated that the current company law has many inadequacies, defects, inaccuracies and loopholes, so that the best way forward would be to reform the entire company law (generally and not only in relation to minority protection) in order to redefine all the rights and interests of minority shareholders and others in the company. Judge P was one of these. He said,

“All the problems emanate from the statute, which is outdated and does not meet contemporary standards. There is now an urgent need to produce a new comprehensive statute that can avoid all these overlaps, lack of protection, domination by certain parties and ultimate control which exist under this old law”.

In addition to judge P’s suggestion, participant X, a legal consultant at the Ministry of Commerce, recommended that the company law should be reformed in its entirety to recognise the various interests and rights of all vulnerable parties, especially minority shareholders. Another significant suggestion was made by judge Q: that there should be a higher judicial committee assigned to review from time to time how the law works in practice, in order that it can be improved and developed accordingly.

In response to this question, it is unsurprising that the two most strongly opposed responses came from a minority (V) and a majority shareholder (G). The former suggested that a good way to safeguard minority shareholders’ rights and interests would be for the courts to treat them in the same way as orphans or minors, acting as a legal guardian to protect them from oppression and wrongdoing by majority shareholders, while the latter argued that there was no need at all for new remedies or solutions to be granted to minority shareholders under the statute, as these would damage the corporate world by giving minority shareholders enough power to destabilise their companies.

---

<sup>449</sup> (Participant W “officer at the Chamber of Commerce”, Participant X “legal consultant at the Ministry of Commerce”, Lawyer J, Minority shareholders V, R and U, Businessperson E, Majority shareholder F).

Both of these extreme positions can be considered wrong, in that V's idea exaggerates the vulnerability of minority shareholders, while G's rejection of reform ignores the proven need of minority shareholders for greater protection. It should be understood that each of these participants was arguing solely to protect their own interests while totally ignoring the others'.

#### 4.3.3.3 Adoption and adaptation of remedies:

The final question in this section of the study sought opinions as to the question: *Which UK remedies could work effectively in the Saudi commercial environment if adopted?* The UK remedies were explained to participants. It is important to be aware that none of the UK remedies are explicitly provided for in the Saudi company statute. However, some participants said that similar ones are available under the Saudi judicial system, but by other names. Thus, it was essential here to elicit from participants which remedies (or similar functions) they thought were implemented in practice and which ones were not. The Table (3.xxx) below shows their responses regarding the availability of the UK remedies (or similar functions) in the current Saudi commercial environment.<sup>450</sup>

---

<sup>450</sup> The function and role of each remedy was clearly explained to participants, so that they could decide whether a similar remedy, even if under a different name, was available in the Saudi law or judicial system.

**Table 3.xxx: Are UK remedies available in SA?**

UK remedies	Minority (5)		Majority (3)		Business-persons (5)		Lawyers (4)		Academics (2)		Judges (3)		Others (3)	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
Personal action	1	4	-	3	2	3	-	4	1	1	2	1	1	2
Derivative action	3	2	1	2	-	5	4	-	1	1	3	-	2	1
Unfair prejudice petition	2	3	2	1	5	-	4	-	2	-	3	-	3	-
Winding-up order	2	3	-	3	-	5	1	3	1	1	3	-	1	2

It is clear from the table that responses varied in all categories of participants, none of whom agreed on the availability of all the UK remedies. Nonetheless, the three judges were in full agreement on the availability of three of them (derivative action, unfair prejudice petition and winding-up order), while they did not agree on the availability of personal actions. It is a remarkable finding that none of these categories of participants, who were selected as being likely to be in very close touch with the law and its implementation, were able to agree on which of these remedies are available. This suggests strongly that there is something missing from the statute, whose function would be to provide guidance as to what remedies are available and which is the most appropriate in any particular case.

Approximately two-thirds (68%) of all participants did not believe that the winding-up order existed as a remedy in relation to minority shareholder protection in SA. Furthermore, over two thirds of these respondents thought that there would be no benefit in adopting the winding-up order in the Saudi system, as it would grant minority shareholders a very powerful weapon that they might abuse. For example, minority shareholder V stated that:



“allowing the minority to apply to wind up a company would not be beneficial to the corporate environment because it would disrupt the smooth running of many businesses”.

However, these participants, who formed a significant percentage, were mistaken in believing that the winding-up order was not available in the Saudi system. All of the judges (O, P and Q) were able to confirm that a minority shareholder in any company has the right to pursue a winding-up order, although a winding-up application needs to be based on reasonable grounds to proceed.<sup>451</sup>

This question also exposed considerable confusion as to the correct names of these remedies, with participants attributing many different names to one particular remedy. To exemplify this, when the function of the UK remedy of derivative action was explained to all participants, 56% of them said that the same function existed in Saudi law, but they differed on its name. Judge O said that it existed under the name of “contest claim”, while Judge Q stated that a remedy with this function existed, but that it had no particular title. Minority shareholder T and lawyer J, for their part, recognised it under the name of “misuse of the company”, while academic participant M said that this type of remedy was well known as “claims against the company” and lawyer L called it “misfeasance or liability claim”. Thus, notwithstanding broad agreement on the role of this remedy (such as for claiming against the majority or management and that any compensation would go to the company), there was no agreement as to its name. From a practical point of view, this inconsistency of nomenclature must have a negative effect and cause confusion for everyone dealing with minority shareholder protection.

It is evident that all of this confusion (even among judges) as to whether a particular remedy exists and, if so, what it is called is due to a lack of clarity in the statute. While it is reassuring to know that the Saudi system, according to the judges, has similar, and in fact more, remedies to those which exist under UK company law,<sup>452</sup> it is also very

---

<sup>451</sup> This winding-up order has a statutory basis in some sections related to private and public companies. However, it is totally up to judges to grant it or not depending on their discretion and on whether there is a reasonable ground.

<sup>452</sup> There was justification for not creating specific remedies under the statute, which was put forward by the judges, that if all remedies were specified under the statute, then judges would be restricted to them and could not go beyond them when required to deliver justice. The current position, on the other hand, gives more room for discretion because remedies and their functions are not taken from the statute, but

unfortunate that these remedies are not systematically organised on a statutory footing in a way that simplifies their application and ensures that all participants in the justice field and all those in corporate life are able to refer easily to the same thing.

#### 4.4 Assessment and reflection

After analysing the data and information collected by this empirical study, I am now more able to observe and pass judgment on the causes which have led to Saudi minority protection provisions being deficient and weak, and also in a better position to see the consequences of the absence of an effective protection system being in place. The negative effect of this upon many aspects of business life<sup>453</sup> is now much clearer than before and can be evaluated and assessed on the basis of facts and evidence which allow accurate reflection to take place.

First of all, it is realised that the failure of the statute to provide clear guidance and criteria to be followed when dealing with minority cases confuses people, including those who work with the law on a daily basis. It is not an exaggeration to say that no one knows exactly which rights, interests, powers and remedies are available to the minority shareholder under the law. Only judges seemed to understand any detail of minority shareholder protection whereas other people, including lawyers, were ignorant or confused. Surprisingly, the empirical study shows that even judges were uncertain about the availability of some remedies, and referred to the remedies by different names. Therefore, they can be also considered, to a certain extent, unsure or confused about what is actually available.

It is important to emphasize here that, when judges were interviewed, their responses to almost all questions gave the impression that the minority shareholder can always go to court if not satisfied with any matter and it will then be up to the court to investigate it. The problem, however, is that there are no detailed provisions in the statute to guide judges in such cases, as one minority shareholder might be permitted a hearing, while another may not. It leaves open the possibility of partiality, inconsistency and injustice.

---

from general Islamic jurisprudence, justice, fairness and commercial conventions, enabling judges to apply more remedies and bring justice to more cases.

<sup>453</sup> Commercial environment, shareholders, local and foreign investments and the general economy.

However, even if this right (right to litigate) is always granted by judges, it is not secured in the statute and thus is not well known among those who deal with company law from day to day. It is also important to note that, even if a judge allows a minority shareholder to bring any matter to the court's attention, it is still not clear on what criteria or grounds the minority shareholder may do so. It is very unfortunate that certain participants did not know that this right exists and even those who knew about it were not aware of how to exercise it. This is because the right is not clearly stated in the statute in a way which clarifies the grounds, mechanisms, procedures and remedies which the minority shareholder may use. Even more regrettable is the way in which Almajid has described the enforcement of the law in terms of Saudi minority protection. He has pointed out that, although the minority shareholder may be allowed under the Saudi legal system to litigate against the majority shareholders, enforcement of the law is weak enough to prevent minority shareholders from suing majority shareholders for breach, misuse, wrongdoing or oppression.<sup>454</sup> This may be due to the ineffective legal protection in place, which also makes it very hard to predict outcomes.

The deficiency of the law in protecting minority shareholders was evident since the participants listed several other reference points, beside the statute, which enable them to judge whether there is potential for successful litigation regarding a particular matter. This indicates that the statute alone is not able to provide clear answers, which is why people tend to refer to other sources to provide them with what the statute lacks. This is not necessarily a bad thing, but it does produce uncertainty. Another negative effect of this absence of clear guidance in the law is that the outcome of similar cases can differ, subject to each judge's discretion, as there are no comprehensive guidelines, criteria and legislative authority for judges to follow in such cases.

Secondly, the empirical study proves that neither the shareholder agreement nor the company's internal code is adequate in protecting the minority shareholder. Admittedly, both the shareholder agreement and the company's internal code may assist in protecting the minority shareholder to a certain extent, but they are never reliable enough to provide complete protection even by working together. It is strongly believed that it is

---

<sup>454</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 241 & 242.

the statute which should be the provider of primary protection, and any other source has only a secondary role. Therefore, any reform must be made to the statute itself by adding appropriate provisions and providing correct enforcement devices. The statute can also provide alternative options for the minority shareholder to use rather than merely relying on a litigation process, which may ultimately waste the parties' and company's time and money. In this sense, the statute could, for example, offer certain professional arbitration bodies to solve disputes within a short time and with little cost. Furthermore, the statute could provide a practical exit option which would ensure that a fair price is paid for shares when the minority shareholder wishes to leave the company. Thus, the statute does not have to concentrate only on delivering provision of litigation if it is even more beneficial to all to offer other alternatives for the minority shareholder to use.

Thirdly, from a practical point of view it is observed that the notion of representing the company and litigating on its behalf to protect its rights and interests is not understood by a large number of people. This should not be a surprise because, if the law is to adopt a policy of preferring the majority over the minority shareholder in all statutory provisions (as it does so now), then in practice the former will have much more space to engage in excessive misuse and oppression, while the latter will have less opportunity to litigate, as the law will always support what the majority shareholder does.

Having talked about the practicality of the Saudi minority protection, it should be also noted that Sharia traditional case law can provide general guidance and direction, but not to a very great extent, because modern business involves new facts, issues, principles and circumstances requiring detailed specification which can be obtained only from recent cases. Therefore, there should be a systematic case law in place in order to offer effective protection to the minority shareholder.

Fourthly, it seems from this empirical study that judges may not be in favour of codifying all remedies and reliefs for minority shareholders in the statute. This is something which came out in their answers throughout. For instance, one or two participants from each category of participants<sup>455</sup> recommended codification of all remedies and reliefs in the statute when answering question 4.3.3.2., except judges who

---

<sup>455</sup> Participant X "legal consultant at the Ministry of Commerce", Businessperson C, Lawyer K, Minority shareholders T and S, Academic N, Participant Y "HR" and Majority shareholder F.

did not mention anything in this respect. This may be due to the loss of discretion which the judges will suffer if the statute deals with the area. The possible resistance of judges to the idea of codification has also been noted by Almajid<sup>456</sup> who states that judges' refusal to accept the idea of codification will basically contribute to the unpredictability of court decisions. In fact, he stresses that codification as a way of consolidating the grounds, devices, principles and remedies under statutory minority shareholder protection would assist judges in being more consistent in their adjudications.

Finally, it may be worth mentioning that, although a few people still think that minority shareholders do not need effective protection in SA, there is a general awareness of the deficiency in the law and the problem caused by giving the majority so much power and authority, while no effective protection is available to the minority. This suggests that there will be a strong and positive reception to statutory provisions, especially from those who work directly with cases related to minority shareholder protection. It is true that a few people still hold the view that minority shareholders are not large in number and make little contribution towards the economy, making them less important to the market than majority shareholders. However, this view is questionable, as it would seem likely that minority shareholders actually outnumber majority shareholders and that their contribution is no less important to the market, and therefore needs efficient protection.

#### **4.5 Conclusion**

What has made this chapter unique is the discussion of the results of an empirical study that provides an indication of the true picture in SA. The face-to-face interview was chosen as the method for conducting this study and the participants were judges, lawyers, businesspersons (sole traders), minority and majority shareholders and academics. Having collected and analysed the data, there are a number of things that can be concluded. Firstly, we have found that the failure of the statute to provide clear guidance with respect to minority cases confuses people, even those who work with the law on a daily basis. Secondly, it has been suggested, on the evidence obtained and the state of law, that neither the shareholder agreement nor the company's internal code can

---

<sup>456</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 166.

overtake or replace the need for statutory provision in protecting the minority shareholder. Thirdly, it has been observed that the notion of representing the private company and litigating on its behalf to protect its rights and interests is not understood by a large number of people. Fourthly, it has been assumed that judges may not be in favour of codifying all remedies in the statute, because they tend to have unfettered discretion and do not wish to be restricted by the statute. Finally, it is predicted that there would be a positive reception from stakeholders for any attempt to reform the current provisions, as they realise that there is a problem that needs urgent attention.

In conclusion, improvement of the law in this area in both SA and Dubai demands more study and research that may identify the overall structure and effectiveness of legal mechanisms.<sup>457</sup> Phrased differently, Muslim jurisdictions may not advance if there is no efficient legal framework in place that is able to monitor the decision-making and enhance transparent and workable laws and accountability within private companies.<sup>458</sup> Probably one way of doing this, as Miles and Goulding<sup>459</sup> have suggested, is by following in the footsteps of the Anglo-American (Anglo-Saxon) minority shareholder protection model. It is believed that the adoption of this model could ensure high standards of governance and increase investors' confidence, even in jurisdictions that do not share the culture, traditions, customs or systems of those countries which apply the Anglo-Saxon conventions.

Conducting a comparison between the development processes of company and commercial law in the Western jurisdictions and the Muslim countries (such as SA and Dubai) will definitely underline the similarities and differences to assist in exchanging experiences and sharing concepts across jurisdictions and creating efficient reform if needed.<sup>460</sup> In fact, Saudi law-makers have already been willing to adopt certain

---

<sup>457</sup> Islamic Research and Training Institute, IRTI., *Islamic Capital Markets: Products, Regulations & Developments*, 1<sup>st</sup> ed. Islamic Development Bank, Jeddah, 2008, pg: 324.

<sup>458</sup> Islamic Research and Training Institute, IRTI., *Islamic Capital Markets: Products, Regulations & Developments*, 1<sup>st</sup> ed. Islamic Development Bank, Jeddah, 2008, pg: 324.

<sup>459</sup> L, Miles. & S, Goulding., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, pg: 127 & 128.

<sup>460</sup> Islamic Research and Training Institute, IRTI., *Islamic Capital Markets: Products, Regulations & Developments*, 1<sup>st</sup> ed. Islamic Development Bank, Jeddah, 2008, pg: 324.

commercial, company and economic principles which were originally designed in the USA and the UK, as long as they do not contradict Sharia.<sup>461</sup>

Therefore, the next chapter will embark on the second stage of this research by studying English company law in terms of minority shareholder protection in order to observe and examine the developments and processes which have created the present position in providing statutory protection for minority shareholders. The aim of this second stage is to explore whether, and to what extent, SA and Dubai could adopt English provisions to good effect.

---

<sup>461</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 52.

## **Chapter 5**

### **An examination of minority shareholder protection in UK Company Law**

#### **Introduction**

This chapter addresses the second stage of the present research, and is concerned with the UK Companies Act 2006 and its provisions regarding minority shareholder protection. It aims to observe and examine the developments and processes which have led to the present provision of efficient statutory protection for minority shareholders in the UK. Thus, its purpose is not merely to describe the current legal provisions in this respect, but the primary aim is to study and analyse the development, reform and improvement, which has brought the statute to its current level of sophistication. This is done whilst bearing in mind whether, and to what extent, UK law might be employed in Saudi Arabia and Dubai.

The most recent development in UK company law was reached after a number of studies and reviews proposed certain reforms to the traditional system of protection, which was considered inefficient. The current UK company law has passed through many stages, each involving changes, and at every stage the protection of minority shareholders has gradually improved, to the point where it might be argued that the Companies Act 2006 offers the most efficient and practical protection to minority shareholders. This valuable UK legacy could usefully be shared by other jurisdictions.

The value of taking UK company law as a model for both Saudi Arabia and Dubai is that it can offer them direction and guidance as to how to deal with minority shareholder protection in an effective way. In fact, some of the deficiencies and uncertainties which used to exist under the old English law were somewhat similar to those applying now under the SA and Dubai company laws. Therefore, it would be very useful for these two jurisdictions to understand how the development of English law has addressed these problems and whether they have done so successfully. This chapter takes a descriptive



and exploratory approach (accompanied by analysis) to the study of the functioning of the former English provision for minority shareholder protection and the ways in which it has been reformed. It is, however, important to note here that the author does not recommend that the present English company law be adopted unreservedly as a model for reform, for two reasons. Firstly, there are certain concerns regarding some aspects of the English protection of minority shareholders that would need slight modification. Secondly, SA and Dubai cannot adopt the English provisions without an initial assessment of which provisions can be utilized exactly as they are and which of them would need adaptation in order to be compliant with local traditions, needs, culture and conventions, and especially the requirement of Sharia.

This chapter comprises four main sections, the first of which outlines the protection offered to minority shareholders under common law and statutes prior to 2006. This will illustrate the difficulties and complexities which minority shareholders faced and which discouraged them from pursuing actions against anyone committing a wrong against the company. The second section examines what the Law Commission and the Company Law Review Group recommended and proposed in order to address the failure of minority shareholder protection under common law and previous statutes. The third section shows the results of these recommendations as reflected in the Companies Act 2006. This section compares and contrasts derivative actions under common law with the newly introduced statutory derivative action; it also describes the other remedies available under the statute (unfair prejudice). Thus, the great majority of the materials and references in this section date from the period after 2006. The chapter concludes with a summary.

## **5.1 Minority shareholder protection under common law and pre-2006 company law**

### **5.1.1 Common Law**

As mentioned several times in this research, English law is seen as a leading model within common-law countries (the Anglo-Saxon countries), such as Canada, the United States, Malaysia and India. Minority shareholder protection has been in existence under

English law since the development of exceptions to the rule in *Foss v Harbottle*<sup>462</sup> and was left in place for over 160 years under common law. However, under common law the minority shareholder faced problems which prevented him/her from claiming in relation to a wrong done to the company, since the majority shareholder was entitled to ratify.<sup>463</sup> In those cases, the help that minority shareholders could receive was very limited as the courts were extremely reluctant to interfere on their behalf.

The traditional position was based on a very old principle which did not allow minority shareholders to sue for wrongs done to their company or to complain of irregularities regarding its internal affairs.<sup>464</sup> This principle came from *Foss v. Harbottle*, but was clearly stated by Lord Davey in *Burland v Earle*,<sup>465</sup> who divided the principle into two main limbs. The first stated that the courts would not interfere in the internal management of companies, as courts regarded the majority shareholders as being in a far better position than judges to decide what should be done.<sup>466</sup> The second limb stated that, when a wrong was done to a company, the proper claimant was the company itself and not any individual shareholder, namely the minority shareholder. Therefore, it was clear from these rules that there were harsh restrictions placed upon minority shareholders, while majority shareholders could have complete control over decision-making and litigation. Many problems arose as a consequence of this power being in the hands of majority shareholders. Having recognised these problems, the courts developed certain exceptions to the rules in *Foss v. Harbottle* to allow a minority shareholder to bring an action when a wrong was done to the company. These exceptions were:

- (1) When the complaint was that the company was acting or about to act ultra vires<sup>467</sup> or illegally.<sup>468</sup> No ordinary majority could sanction such an act.<sup>469</sup>

---

<sup>462</sup> [1843] 2 Hara 461.

<sup>463</sup> However, in some cases the minority shareholder could challenge the majority's action if the action was fraud, as seen in *Cook v Deeks* [1916] 1 A.C.

<sup>464</sup> *MacDougall v Gardiner* (1875) 1 Ch D 13, at 25.

<sup>465</sup> [1902] AC 83, PC, and also *Edwards v Halliwell* [1950] 2 All ER 1064.

<sup>466</sup> B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005. pg: 213.

<sup>467</sup> The doctrine of ultra vires applies to transactions which are outside the corporate powers of a company which are stated in the memorandum of association, as seen in *Rolled Steel Products v British Street Corporation* [1984] 2 WLR 908.

<sup>468</sup> Illegality, as clarified in (A, Boyle. J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007. pg: 675), should in this context be understood as meaning either 'contrary to company law' or 'so plainly illegal that the directors have acted in abuse of their powers'.

- (2) When the act complained of did not have the sanction of a required special or extraordinary resolution.<sup>470</sup>
- (3) Where it was alleged that the personal rights of the minority shareholder had been infringed.
- (4) Fraud on the minority, when those who controlled the company were perpetrating fraud on the minority shareholder. No resolution could justify the minority being the victim of fraud. This was a particularly important exception to the rule in *Foss v. Harbottle*.

It is important to note that these exceptions were developed by the courts to ensure that justice could be brought to cases when needed. Accordingly, litigation was exercised by minority shareholders under common law only through the exceptions to *Foss v. Harbottle*. These exceptions were categorised into two types: personal actions and derivative actions. However, many academics and practitioners have held the view that fraud on the minority was the only true exception to the rule in *Foss v Harbottle*, which indeed served and benefited the company and the minority shareholder.

#### 5.1.1.1 Personal actions

The personal action was always available for the minority shareholder to pursue in order to protect him/herself personally. The action was simply called a personal action when a minority shareholder was claiming that some of his/her personal rights were infringed. However, there was no attempt to define what was really meant by personal rights under common law. Instead, it was left to the courts to decide what counted as a personal right and what did not, with the result that such rights were not clearly identifiable. Case law appears to show that an action was treated as a personal action only when the shareholder could be seen to have some cause for action vested in him/her personally. From what was held in *Prudential Assurance Co. Ltd v Newman Industries Ltd (No.2)*,<sup>471</sup> it is understood that the court allowed the minority shareholder to bring a personal action only in respect of matters which were not regarded as associated with

---

<sup>469</sup> Nevertheless, in *Smith v Croft* No 2 [1988] Ch 114 it was stated that the minority shareholder had no right to sue if a majority of the shareholders who were independent did not want the action to continue.

<sup>470</sup> See *Edwards v Halliwell* [1950] 2 ALL ER 1064 at: 1067.

<sup>471</sup> [1982] Ch 204.

the company's rights. Therefore, it is evident that the first three exceptions to the rules in *Foss v Harbottle* (namely ultra vires, failing to meet requirements of special or extraordinary resolution and infringement of member rights) were most closely related to personal rights,<sup>472</sup> whilst the fraud on the minority was associated with the company's rights and was therefore not related to personal action.

In practice, the minority shareholder could bring a personal action to prevent the company from altering the articles in a manner that might be considered oppressive to minority shareholders personally. In *Sidebottom v Kershaw, Leese and Co. Ltd*,<sup>473</sup> the court decided to prevent the company from altering an article which, if allowed, would have granted the majority shareholder more power. In these types of cases, the company was the defendant and damages or an injunction could be granted against it in favour of a minority shareholder. To illustrate, the minority shareholder was able to bring a personal action in respect of:

- a) A decision which failed to meet the required majority of votes to pass a special or extraordinary resolution and was therefore passed without the minority's vote being counted, as demonstrated in *Yong v South African and Australian Exploration and Development Syndicate*<sup>474</sup> and *Edwards v Halliwell*.<sup>475</sup> In such cases, the minority shareholder would have been denied his/her voting rights and accordingly would have been harmed personally by the decision.
- b) A decision by majority shareholders to allot shares, as occurred in *Fraser v Whalley*,<sup>476</sup> *Punt v Symons and Co. Ltd*<sup>477</sup> and *Residues Treatment and Trading Co Ltd v Southern Resourced Ltd*.<sup>478</sup> In such cases, the majority's decision would lessen the position of minority shareholder as they were not offered fresh shares; their portion of the overall shareholding of the company was reduced.

---

<sup>472</sup> S, Mayson, D, French. & C, Ryan., *Company Law*. 23<sup>rd</sup> ed. Oxford: Oxford University Press, 2006-2007. pg: 678.

<sup>473</sup> [1920] 1 Ch 154.

<sup>474</sup> [1896] 2 Ch 268.

<sup>475</sup> [1950] 2 All ER 1064.

<sup>476</sup> [1864] 2 Hem & M 10.

<sup>477</sup> [1903] 2 Ch 506.

<sup>478</sup> [1988] 51 SASR 177.

As *Percival v Wright*<sup>479</sup> showed, because the directors owe a duty to the company and not to the shareholders individually (the same applying under s170 of the Companies Act 2006), it was impossible for the minority shareholder to bring a personal action for breach of duty by the directors. Thus, the type of conduct which might have given rise to a personal action was very narrowly defined and required personal harm to have been suffered. In sum, the availability of personal action under common law did not properly serve the minority shareholder, as it was limited to protecting his/her personal rights. This meant that it was either not applicable in many cases or sometimes difficult to prove. Another disadvantage of personal actions was that case law rarely involved them and there was accordingly little judicial guidance and direction, which made such personal actions neither identifiable nor favourable.

#### 5.1.1.2 Derivative actions under common law

The second category of litigation under common law was the derivative action, a device which was created by the courts to allow minority shareholders to bring a claim against those in control of a company where there was a fraud on the minority. In these circumstances, the minority shareholder was not enforcing a right which belonged to him/her, but rather one vested in and therefore derived from the company.<sup>480</sup> The minority shareholder had to litigate on behalf of the company and any compensation recovered would go to the company, so the derivative claim could be brought by the minority shareholder only to enforce the company's rights.<sup>481</sup> In sum, the minority shareholder in a derivative action would be acting in the capacity of a representative of the company, as was held by Chadwick J in *Cooke v Cooke*.<sup>482</sup>

##### a. How to prove fraud on the minority under common law

It was understood that the minority shareholder should have to prove that the wrong involved fraud on the minority to ensure a successful derivative action, so the minority shareholder had to establish the existence of fraud in the wrong, which meant

---

<sup>479</sup> [1902] 2 Ch 421.

<sup>480</sup> *Percival v Wright* [1902] 2 Ch 421, stated that the directors' duties were owed to the company and not to members.

<sup>481</sup> It is claimed in (N, Shulman. & M, Simmons., *The Liability of the Dotcom Lifestyle*, *The Lawyer*. 2000, 14(29), pg: 15) that in the US it is easier to bring derivative actions, as directors owe fiduciary duties to their shareholders, whereas in the UK the duty is owed to the company.

<sup>482</sup> [1997] 2 BCLC 28.

something as serious as appropriating the assets of the company.<sup>483</sup> Lord Davey, in *Burland v Earl*,<sup>484</sup> ruled that fraud on the minority would only occur when “the majority are endeavouring directly or indirectly to appropriate to themselves money, property or advantages which belong to the company or in which other shareholders are entitled to participate”. As well as establishing fraud, the minority shareholder was also required to prove that the majority shareholder, who was also the wrongdoer, was in control of the company.<sup>485</sup>

However, it could also be understood that for a wrong to constitute fraud on the minority, actual deceit did not need to occur, as abuse or misuse of power alone might have been sufficient if it carried a clear element of fraud. For example, in *Clark v Cutland and Others*,<sup>486</sup> the majority took remuneration from the company without authority so the minority shareholder initiated a derivative action, but it failed in the first instance. Subsequently, the minority shareholder appealed and the Court of Appeal found the conduct to be a breach of duty owed to the company and accordingly allowed the minority’s appeal, holding that the company was entitled to trace the payments and claim them back. Although consideration of what constitutes fraud was not the key ground in this case, a form of abuse and misuse of power was apparent and sufficient to prove the fraud.

Therefore, for the minority shareholder to succeed under common law, he/she had to establish fraud as a cause of the wrong, and this could take the form either of bad faith or of abuse of power.<sup>487</sup> The minority shareholder was required to establish fraud even if the case included other types of misconduct, such as default, negligence, breach of duty or breach of trust. An example of how important it was to establish fraud can be seen in the case *Pavlides v Jensen*,<sup>488</sup> where the minority failed to establish that the

---

<sup>483</sup> C, Timmis, *Company Law: In good company?* *Law Society Gazette*, 2006, 103(13), pg: 16.

<sup>484</sup> [1902] AC 83.

<sup>485</sup> Which means: making decisions on behalf of the company or in the position of directing and running the company.

<sup>486</sup> [2003] EWCA Civ 810.

<sup>487</sup> Nonetheless, in *Estmanco Kilner House Ltd v GLC* [1982] 1 WLR 2, Magarry J allowed the exception of “fraud on the minority” to be applied. Although there was neither bad faith nor abuse by the majority shareholder, he tried to change the purpose for which the company was formed, and accordingly caused injury to the minority shareholder’s interests.

<sup>488</sup> [1956] 2 All ER 518. Fraud on the minority was seen in *Cook v Deeks* [1916] 1 A.C. 554 PC (Can). Abuse of power was seen in *Rolled Steel Products Ltd v British Steel Corp* [1985] 2 W.L.R. 908 CA.

alleged negligent disposition of assets constituted fraud.<sup>489</sup> However, in *Daniels v Daniels*,<sup>490</sup> the court allowed a derivative action where no obvious fraud was alleged, only negligence (taking the form of gross undervalue of company property) but the judge seems to have been particularly influenced by the fact that the majority made a considerable profit from their negligent actions, and at the expense of the company, and this effectively constituted fraud.

It was within the power of the majority shareholder to ensure that a wrong was ratified. Of course, utilising ratification in this way restricted the scope of derivative actions and accordingly did not serve the company's interest, as it could prevent the company from receiving justice when needed.<sup>491</sup> However, there were few circumstances in which the court might allow the minority shareholder to bring a derivative action even if the wrong was ratified.<sup>492</sup> Specifically, these were if clear fraud existed<sup>493</sup> or if the company was close to, or actually in, insolvency,<sup>494</sup> as seen in *Multinational Gas and Petrochemical Co. v. Multinational Gas and Petrochemical Services Ltd.*<sup>495</sup>

So, generally speaking, cases under common law showed that many acts of misconduct and wrongs were prevented from being brought to justice because of the majority shareholders' power to ratify any misconduct.<sup>496</sup> However, as mentioned earlier, if a clear case of fraud existed, then there were certain requirements, as Dine points out, which the minority shareholder had to meet to bring a derivative action under common law.<sup>497</sup>

---

<sup>489</sup> It has been said in (B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 460.) that mere negligence, even when it causes significant losses to the company, is ratifiable and cannot amount to a fraud on the minority exception.

<sup>490</sup> [1978] Ch 406.

<sup>491</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, 2005, March, pg: 185-186.

<sup>492</sup> A, Reisberg., Judicial Control of Derivative Actions, *International Company and Commercial Law Review*. 2005, 16(8), pg: 337& 338.

<sup>493</sup> As held in *Menier v Hooper's Telegraph Works* (1874) 9 Ch App 350 and *Estmanco Ltd v Greater London Council* [1982] 1 All ER 437, [1982] 1 WLR 2. See also *Cook v Deeks* [1916] 1 AC 554.

<sup>494</sup> J, Payne., A re-examination of ratification, *Cambridge Law Journal*. 1999, 58(3), pg: 618.

<sup>495</sup> [1983] Ch. 258, 280.

<sup>496</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 221.

<sup>497</sup> J, Dine., *Company Law*. 5<sup>th</sup> ed. Palgrave Macmillan, New York, 2005, pg: 253.

1. The minority was required to establish fraud in the case of any wrong, even if the wrongdoing did not appear to involve any fraud (e.g. negligence or breach of duty).
2. The minority was required to prove that the company suffered an actual loss as a result of this alleged fraud.<sup>498</sup>
3. The minority was required to prove that the majority had benefitted personally from the fraud, as the case of *Daniels v Daniels* showed.<sup>499</sup>
4. The minority was required to prove that the majority was in control of the company, i.e. “wrongdoers’ control”, as stated in *Burland v Earle* and *Edwards v Halliwell*.<sup>500</sup>
5. The minority was required to have ‘clean hands’ and have acted in good faith, as shown in *Towers v African Tug Co*<sup>501</sup> and *Nurcombe v Nurcombe*.<sup>502</sup>

#### b. Difficulties with derivative actions under common law

When examining derivative action under common law, it can be clearly seen that extreme limitations were placed on the circumstances and conduct which could be subject to it since, in fact, fraud was the sole ground on which such an action could be established. Therefore, very few claims were reported under common law, as seen from their infrequent appearance in case law.<sup>503</sup> There were several reasons for this: first, the minority shareholder had no power to access information regarding the management of the company, in order to prove the wrongdoing and accordingly to build a strong case. Secondly, if the litigation under the derivative claim succeeded, the principal beneficiary of the action would be the company, in whose favour judgment would be given. This raises the question of why the minority shareholder would bother to bring such an action if he/she could obtain no direct personal benefit from it, while there was

---

<sup>498</sup> A, Reisberg., Judicial Control of Derivative Actions, *International Company and Commercial Law Review*. 2005, 16(8), pg: 335 to 339.

<sup>499</sup> This condition came from *Daniels v Daniels* [1978] Ch 406, which stated that directors could not be sued under the derivative action unless it was shown that they had profited themselves.

<sup>500</sup> *Edwards v Halliwell* [1950] 2 All E.R. 1064 CA, and *Pavlides v Jensen* [1956] 1 Ch. 565 Ch D. In these cases it was the right of the majority to bar the minority action whenever they lawfully ratified alleged misconduct.

<sup>501</sup> [1904] 1 Ch 558.

<sup>502</sup> [1985] 1 W.L.R. 370. In both cases, the minorities had no clean hands and accordingly the court refused the action. The action must be brought *bona fide* for the benefit of the company.

<sup>503</sup> M, Almadani., Derivative actions: does the Companies Act 2006 offer a way forward? *Company Lawyer*. 2009, 30(5), pg: 135.



a risk of having to pay the costs of loss if the litigation did not succeed.<sup>504</sup> The third reason was that it was clear from *Smith v Croft*<sup>505</sup> that a majority amongst the minority shareholders might be able to prevent the remaining minority shareholders from continuing with the action. For instance, if there were three minority shareholders in a company and two of them did not want to continue with the action, the action might not go ahead because the court would accede to the wishes of the two dissenting minority shareholders. Finally, the court would usually not allow a derivative claim to proceed if another adequate remedy could be sought, as shown in *Cooke v Cooke*<sup>506</sup> and *Mumbray v Lapper*.<sup>507</sup>

It was argued that litigation under common law was deliberately characterised by confusion and complexity in order to restrict actions; otherwise the courts would have been unable to cope with the volume of litigation.<sup>508</sup> This is illustrated by *Barrett v. Duckett*,<sup>509</sup> when the court refused to allow a derivative action to proceed because the claim was not being pursued bona fide on behalf of the company. Although the minority shareholder had the potential to succeed in this case, the court did not allow the action to continue, simply because the minority lacked good faith. Thus, the court wanted to spread the message that a minority shareholder should not have an automatic right to bring a derivative action on the company's behalf if he was not acting in good faith.<sup>510</sup>

### c. Indemnity in derivative claims

It is believed that the infrequency of derivative action cases under common law may have been attributed to the issue of funding. It is difficult to see why a minority shareholder would risk his/her own time and funds in proceeding with a derivative action, when the result in terms of pecuniary recovery was always uncertain.<sup>511</sup> Indeed, it has been pointed out that the successful minority shareholder would not have been

---

<sup>504</sup> Pettet has answered this question (B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005. pg: 220) by saying that the shareholders as a whole will indirectly get a *pro-rata* benefit from any compensation to the company.

<sup>505</sup> (No.2) [1988] Ch 114.

<sup>506</sup> [1997] 2 BCLC 28.

<sup>507</sup> [2005] EWHC 1152 (Ch).

<sup>508</sup> B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005. pg: 213.

<sup>509</sup> [1995] 1 B.C.L.C 243.

<sup>510</sup> A, Reisberg., Judicial Control of Derivative Actions, *International Company and Commercial Law Review*. 2005, 16(8), pg: 337.

<sup>511</sup> Q, Bu., The Indemnity Order in a Derivative Action, *Company Lawyer*. 2006, 27(1), pg: 3.

better off than fellow shareholders who made no effort to support the proceedings.<sup>512</sup> Cheffins also commented that when a minority shareholder knew that the company and other shareholders would free-ride on his/her efforts, he/she would have had no incentive to litigate, even in situations where litigation would have increased the total value of shares.<sup>513</sup> Therefore, it was very important to allow ways to fund the derivative action so that minority shareholders could remedy any wrongs which occurred in the company.<sup>514</sup>

This financial dilemma in bringing a derivative action was initially recognised and positively dealt with in *Wallersteiner v Moir*,<sup>515</sup> where Lord Denning MR in the Court of Appeal stated that:

“The minority shareholder, being an agent acting on behalf of the company, is entitled to be indemnified by the company against all costs and expenses reasonably incurred by him in course of agency... But what if the action fails? Assuming that the minority shareholder had reasonable grounds for bringing the action he should not himself be liable, because he was acting for it and not for himself. In addition, he should himself be indemnified by the company in respect of his own costs even if the action fails.”

Accordingly, the minority shareholder in this case was given the right to be indemnified by the company without the probable success of the claim being considered, because the rights being vindicated were those of the company and recovery would flow to it.<sup>516</sup>

On the other hand, Walton J in *Smith v Croft*<sup>517</sup> insisted that the minority shareholder would be able to gain indemnity from the company only in the “clearest, obviously just case”. This meant that the court would need to examine all of the facts to decide whether to grant an indemnity order at an early stage or to delay the order. Prentice

---

<sup>512</sup> Q, Bu., The Indemnity Order in a Derivative Action, *Company Lawyer*. 2006, 27(1), pg: 3.

<sup>513</sup> B, Cheffins., Reforming the Derivative Action: The Canadian experience and British Prospects, *Company Financial and Insolvency Law Review*. 1997, 1(2), pg: 257 - 260. Also, see T, Boyle., The new derivative action, *Company Lawyer*. 1997, 18(8), pg: 253

<sup>514</sup> A, Reisberg., Derivative Actions and Funding Problem: The Way Forward, *Journal of Business Law*, 2006, (Aug), pg: 447.

<sup>515</sup> [1974] 1 WLR 991.

<sup>516</sup> It was established in *Wallersteiner v Moir* [1974] 1 WLR 991 that the individual shareholder was not enforcing a right which belongs to him but which was rather vested in and therefore derived from the company, and accordingly he was entitled to an indemnity order.

<sup>517</sup> (No. 2) [1988] Ch. 114.

agreed with *Smith* because the procedure laid down in it would probably improve the operation of the *Wallersteiner* procedure.<sup>518</sup> However, it is important to note that although *Smith v Croft* sought to ensure that all derivative actions be brought in good faith and for the best interests of the company, the case did not establish to what degree the evidence given to the court by the minority shareholder at an early stage should be sufficient to grant him/her indemnity.<sup>519</sup> Eventually, the indemnity cost order was refused in *Smith v Croft* and it was held that such orders should not be made until it was established that the case was well founded.<sup>520</sup>

A major criticism of *Smith v Croft* is that it is very difficult for judges to decide at an early stage whether or not the case has been brought on reasonable grounds, unless it is extremely obvious. More importantly, *Smith* did not define or clarify the meaning of ‘reasonableness’ or ‘clearly just’ in this context and therefore left this area of law without criteria by which to judge any action. However, no matter what the exact meaning of ‘reasonable ground’ is, it cannot be clearly seen early on in many cases. In reality, examining all the legal issues and facts pertaining to the case at an early stage, in order to identify a potentially reasonable ground on which to justify the indemnity order, is impractical and unachievable. Furthermore, what if the case appears to be brought on a reasonable ground and the indemnity order is granted, but subsequently the case is not successful for some reason?

To overcome this financial dilemma, it has been suggested<sup>521</sup> that a conditional fees agreement should apply in such cases. Thus, lawyers would agree to take a case on the understanding that if it is lost they will not charge their clients for the work they have done,<sup>522</sup> while if the case is won they are entitled to charge a success fee calculated from their normal cost structure.<sup>523</sup> This approach is flawed as cases would be dependent on the potential for success as a criterion for lawyers who would then be concerned only with how much reward they could obtain from each case. In other words, lawyers would

---

<sup>518</sup> D, Prentice., *Wallersteiner v Moir: a decade later*, *Conveyancer and Property Lawyer*. 1987, May-June, pg: 169.

<sup>519</sup> Q, Bu., *The Indemnity Order in a Derivative Action*, *Company Lawyer*. 2006, 27(1), pg: 5.

<sup>520</sup> This more restrictive approach to *Wallersteiner* orders was not followed in *Faybird Group Ltd v Greenwood* [1986] BCLC 319 at 327.

<sup>521</sup> A, Reisberg., *Derivative Actions and Funding Problem: The Way Forward*, *Journal of Business Law*, 2006, Aug, pg: 447 & 448.

<sup>522</sup> W, Emons., *Conditional versus Contingent Fees*, *Oxford Economic Papers*. 2007, 59, pg: 91&92.

<sup>523</sup> D, Marshall., *Conditional Fee Agreements*, *New Law Journal*. 2001, 151 (6995), pg: 1187.

approach such cases from a commercial point of view and would never take cases unless they were able to foresee a clear profit, unlike the minority shareholder, whose primary interest will always be to remedy the wrong done to the company.<sup>524</sup> This would be far from achieving the original purpose for which the derivative action was designed. Furthermore, derivative action under common law was known for its uncertainty and unpredictability, making it even more difficult for lawyers to risk their time and effort for unpredictable outcomes.

It can be reasonably argued that the indemnity procedure should openly follow the rule in *Wallersteiner v Moir* to indemnify the minority shareholder regardless of the outcome, because he/she is acting in the company's interest and any reward will go to the company itself. It is pointless for the court to try to establish whether the minority shareholder has the right to be indemnified or not, since to do so will lengthen the case and its cost might then exceed the benefit that the company could possibly receive. Thus, the basic principle should be that the minority shareholder has a right to be indemnified by the company in a derivative action,<sup>525</sup> unless it is clear that the action brought is unnecessary.

d. Comments on the functioning of the derivative action under common law

Making it difficult to institute a derivative action under common law has sometimes been seen as having had a number of advantages. One advantage is that it eliminated wasteful litigation by those bringing vexatious actions and trying to harass or bargain with the company.<sup>526</sup> Nonetheless, there were also several disadvantages. First, requiring the minority shareholder to establish “fraud” and “wrongdoer (majority) control” to bring a derivative action did not help the minority shareholder to promote the company's interest. In fact, these harsh requirements placed extreme limitations on such cases, as seen from the lack of case law.<sup>527</sup>

---

<sup>524</sup> This is clearly seen, in practice, in the United States.

<sup>525</sup> Or at least at the end of the proceedings an order for costs may be made on a common fund basis if the result of the case is beneficial to shareholders generally, as seen in *Re A Company* [1987] BCLC 82.

<sup>526</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 459.

<sup>527</sup> See *Cook v Deeks* [1916] 1 A C 554 (PC). A classic example of abuse of power was seen in *Rolled Steel Products Ltd v British Steel Corporation* [1985] 2 WLR 908(CA). Gross undervalue was held in *Daniels v Daniels* [1978] Ch 406.

Secondly, it was mistakenly believed by a large number of judges that fraud as a ground was wide enough to accommodate all types of wrongdoing and misconduct, so that there was no need to consider other grounds, as shown in *Estmanco (Kilner House) Ltd v Greater London Council*.<sup>528</sup> But this was not true, because there were several types of misconduct other than fraud which could not lead to the bringing of proceedings.<sup>529</sup> In fact, what was experienced in practice was the opposite, as limits on the initiation of derivative action under common law allowed majority shareholders to escape liability on many occasions and justice was not brought to all cases.

Thirdly, corporate wrong cases (derivative cases) could be brought under s459 of the Companies Act 1985 as well as under common law. This meant that the court sometimes allowed a shareholder who presented an unfair prejudice petition to pursue a corporate wrong which was obviously a derivative action.<sup>530</sup> In fact, s459 facilitated and served derivative cases more effectively than common law itself.<sup>531</sup> This better treatment of corporate wrong cases under s459 was due to there being fewer requirements to meet when establishing an action under the section. For example, s459 did not require of the minority shareholder 'clean hands' in order for an action to be brought,<sup>532</sup> while common law would not allow the same action to proceed if the minority shareholder was not proven to have clean hands.<sup>533</sup>

## **5.1.2 Statutory personal rights for minority shareholders before 2006<sup>534</sup>**

### **5.1.2.1 Background**

It is thought absolutely essential to study the history and background of this particular area of English law to see how the process has been developed and improved throughout, especially in the case of this research, where reform of the position in SA

---

<sup>528</sup> [1982] 1 W.L.R.2. Also see R, Reed., *Derivative claims: the application for permission to continue*, *Company Lawyer*. 2000, 21(5), pg: 156 & 157.

<sup>529</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 460.

<sup>530</sup> Basically, for any wrong that was done to the company, the derivative action was what to pursue. But there were only a few cases in which the courts allowed the minority shareholder to pursue an unfair prejudice petition instead to remedy such a wrong.

<sup>531</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 460.

<sup>532</sup> The minority shareholder was not required to have clean hands in *Nurcombe v Nurcombe* [1985] 1 W.L.R 370, because s459 was brought to remedy the wrong in this case.

<sup>533</sup> J, Payne., *Clean hands in derivative actions*, *Cambridge Law Journal*. 2002, 61(1) pg: 81.

<sup>534</sup> The latest law is contained in ss994-996 of the Companies Act 2006. The Companies Act 2006 came into force completely in 2009.

and Dubai is sought through the example of minority shareholder protection under English law.

According to the statutory law, prior to 1948, the court could offer only a winding-up order on the just and equitable ground when a dispute occurred between shareholders. In many ways this was an unsatisfactory remedy, as the shareholder might not have wanted to wind up the company, but rather to seek a remedy that could keep the company going. Unsurprisingly, this led to the termination of many businesses, because the winding-up order was the only solution to all types of dispute. Therefore, Parliament reformed the law and introduced the ground of “oppression” under the Companies Act 1948, whereby alternative remedies came into effect. In this Act, s210(1) stated that “any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself), may make an application to the court by petition for any order under this section”. However, practice demonstrated that even this alternative remedy did not offer relief in all types of cases. For example, no remedy was available when there was disagreement regarding the distribution of dividends, and there was no remedy which could be used when the shareholder had legitimate expectations to participate in management but those expectations were never met. The term “oppression” in the 1948 Act was not clearly defined. Relatively few cases were brought and even fewer were successful. Therefore, this unsatisfactory and insufficient application of the law led Parliament again to seek further reform to address the difficulties.<sup>535</sup> Eventually, Parliament amended the Companies Act 1948 and adopted the term “unfair prejudice” in the Companies Act 1980, instead of oppression. This provision was reproduced in 1985 and became section 459. This introduced much greater flexibility.

As stated above, this new provision<sup>536</sup> included the concept of “unfair prejudice”.<sup>537</sup> The section stated that:

---

<sup>535</sup> A, Hicks., & S, Goo., *Cases and Materials on Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2004, pg: 400.

<sup>536</sup> According to the Jenkins Committee (1962), the drawbacks of the old law (before s459) were: (a) an order could only be made if the facts could be the basis of a winding-up order on just and equitable grounds.

<sup>537</sup> The provisions were contained in ss459-461 of the Companies Act 1985 and slightly amended in 1989.

“A member of a company may apply to the court by petition for an order on the ground that the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interest of its members generally or some part of the members (including at least himself)”.

When this new concept replaced the old one, judges were flexible and innovative in their use of the new section. By the late 1980s there had been several reported cases. This greater number of cases was due to the fact that the wording of s459 was broad and unrestricted and that its categories were open. Indeed, this led minority shareholders to use s459 as an effective device for bringing majority shareholders to court, even if it was not necessary. Gradually, it was realised that the availability of the new remedy was capable of being oppressive towards the majority shareholder because the minority shareholder could use it when it was unnecessary. At that time, certain judges tried to develop ways of restricting the number of cases being brought.<sup>538</sup> This was seen in *Re Saul Harrison*,<sup>539</sup> where an action was brought by the minority shareholder to have the company wound up on the grounds that the majority shareholders were running it in their own interest, and not acting bona fide in the best interests of the company. The minority shareholder also claimed that he was not receiving dividends and was also unlikely to in the future. Although the action was dismissed in the first instance, the minority shareholder appealed. The Court of Appeal dismissed the appeal, holding that the minority shareholder could not prove that the majority shareholders were acting in a wholly unreasonable manner and in bad faith in continuing to operate the company purely to provide themselves with salaries. This case in particular attempted to restrict the circumstances in which a remedy could be granted under s459, because, in previous cases, the minority shareholder had been able to obtain a remedy easily once it was proved that no dividends had been distributed. Paterson<sup>540</sup> has commented that the judgment in this case was influential in the development of the unfair prejudice remedy, as it was generally regarded as a leading case in restricting the use of s459, to the extent that it was frequently referred to in subsequent decisions. Thus, it was sensed in later cases that judges tended to restrict the capacity to apply

---

<sup>538</sup> B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005. pg: 233.

<sup>539</sup> [1994] BCC 475.

<sup>540</sup> This case limited the criteria by which the court is to determine whether the conduct complained of amounts to unfair prejudice. See: P, Paterson., A Criticism of the Contractual Approach to Unfair Prejudice”, *Company Lawyer*. 2006, 27(7), pg: 209.

s459 in order to limit its excessive use.<sup>541</sup> The case *O'Neill v Phillips*<sup>542</sup> emphasised this restriction even more (full discussion of this case appears later in this chapter).

### 5.1.2.2 The meaning of s459 (conduct of the company's affairs)

Section 459 of the Companies Act 1985 uses particular wording which needs to be clarified at this point, as it mentions the fact that a shareholder might apply "...to the court by petition for an order on the ground that the company's affairs are being or have been conducted in a [certain] manner". This means that the conduct complained of must relate to the conduct of the affairs of the company.<sup>543</sup> In *Re Legal Costs Negotiators Ltd*<sup>544</sup> the company had four shareholders with equal holdings. Three of the four dismissed the fourth as an employee and he resigned as director. Having failed to persuade the fourth member to sell his shares to them, the majority shareholders brought a claim under s459 to force him to do so. The Court of Appeal rejected their claim, holding that this action did not relate to the conduct of the affairs of the company and that the majority were in a position to resolve any prejudice being inflicted on the company as they had control.<sup>545</sup>

In the same way, in *Arrow Nominees Inc v Blackledge*<sup>546</sup> the majority shareholder lent considerable sums to the company at a high interest rate and this was regarded by the minority shareholder as unfair. The minority shareholder commenced proceedings, but they were struck out on the ground that lending to the company at that rate of interest could not in itself amount to unfair or prejudicial conduct of the company's affairs under s459. However, the court's decision in this case is difficult to understand since the fact that the majority shareholder lent a significant amount of money to the company at a higher interest rate than was prevalent at that time can be seen to be an abuse of power which aimed to further his own interest. Although this conduct might

---

<sup>541</sup> It is important to know who had the right to claim under this section. Relief under s459 was available to a person to whom the shares had been transferred or transmitted by operation of law. However, in *Atlasview Ltd. V. Brightview Ltd* [2004] EWHC 1056 (Ch) the claim was brought by individuals who held only the beneficial interest in shares in the company. The judge, however, adopted a flexible approach and held that the beneficial shareholders had an indirect right to claim.

<sup>542</sup> [1999] 1 WLR 1092.

<sup>543</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 413.

<sup>544</sup> [1999] 2 BCLC 171.

<sup>545</sup> The Company Law Review, *Completing the Structure* (2000), para 5.102 notes that it should be made clear that the section does apply to exercising the minority's powers to block company decisions.

<sup>546</sup> [1994] 1 BCLC 609.



not have related to the company's affairs, it did affect the minority's interest as a member of the company and it should have been considered unfair conduct and prejudicial to the minority's interest.

Section 459 has another dimension which needs to be considered, which is that the company's affairs must be current or have been conducted at a certain time. That is, the conduct should either be in progress or have occurred in the recent past because, otherwise, it will be difficult to challenge. Nevertheless, in *Lloyd v Casey*<sup>547</sup> a past act was accepted as the subject of a claim because the court felt that it would be unsatisfactory if present shareholders were unable to complain against conduct which they considered unfair. However, if the decision made in this case was consistently followed, it might cause a lot of instability or uncertainty in companies because past conduct could then always be subject to challenges.<sup>548</sup> It is believed that past conduct should not be subject to a claim, unless it has harmful consequences which remain in effect at the time when proceedings are brought.

Future acts or proposed acts which, if carried out or completed, would be prejudicial to the interests of the minority shareholder might also be the subject of a claim. However, in *Re Astec (BSR) plc*<sup>549</sup> the minority shareholder was very quick to bring an action at a time when the majority had only made statements relating to steps which they might have taken in the future, but none of those steps had been taken up until the time of the claim and accordingly the claim was rejected. Things were different, however, in both *Re Kenyon Swansea Ltd*<sup>550</sup> and *Whyte, Petitioner*<sup>551</sup> where resolutions were passed to amend articles which, if carried, would have had unfairly prejudicial consequences for minority shareholders. In both cases the courts restrained the majority shareholders from carrying the amendments.<sup>552</sup>

---

<sup>547</sup> [2002] 1 BCLC 454.

<sup>548</sup> It is fair to allow the minority shareholder to claim against a past wrong, but it should be limited to a particular time to protect the company's stability and settlement. In *Re a Company* (No 001761 of 1986) [1987] BCLC 141, Harman J stated that it was no defence to a s459 claim to say that the conduct about which a complaint is made had ceased six months before the petition was presented.

<sup>549</sup> [1998] 2 BCLC 556 at 577-578.

<sup>550</sup> [1987] BCLC 514.

<sup>551</sup> [1984] SLT 330.

<sup>552</sup> However, the minority shareholder had to prove that there was potential for unfair prejudice to occur in the future. In *Hawkes v Cuddy and others* [2007] All ER (D) 27 (Aug) the court could not order in favour of the minority shareholder when he failed to prove for certain that the unfair prejudice would occur.

### 5.1.2.3. The concept of unfair prejudice in s459

The concept of unfair prejudice in s459 is wider than the concept of oppression in s210 of the old Companies Act 1948. In *Re Saul D. Harrison and Sons plc*,<sup>553</sup> Neill LJ said in clarifying “unfair prejudice” that the words are general and flexible in order to meet the circumstances of many cases. However, the same judge in the case stressed that the conduct being complained of must be both prejudicial and unfair in order to comply with the requirements of the provision. Thus, the conduct may be unfair without being prejudicial or prejudicial without being unfair<sup>554</sup> and it is not sufficient if the conduct satisfies only one of these requirements. Therefore, the minority shareholder must establish that the conduct which forms the basis of the claim is both prejudicial, in the sense of causing harm to the relevant interests, and unfair.<sup>555</sup> For instance, in *Rock Ltd v RCO plc*<sup>556</sup> the minority shareholder claimed that shares were sold by the majority shareholder at an undervalue. The judge, in the first instance, found that the sale was not made at an undervalue and that, in consequence, the minority shareholder had suffered no unfair prejudice and therefore the petition was dismissed. The minority shareholder appealed, but the Court of Appeal rejected the appeal, holding that, although the directors had breached their fiduciary duties, the minority shareholder had not suffered prejudice and, even though the conduct was improper and unfair, it was not seen as unfairly prejudicial within s459. Although it is important to establish both unfairness and prejudice to show unfair prejudice, it is not necessary to show that the act complained of is improper or illegal.<sup>557</sup>

Parliament chose the unfairness test as the criterion in s459 which the court must use to decide whether it has jurisdiction to grant relief after examining whether the action is

---

<sup>553</sup> [1995] 1 BCLC 14.

<sup>554</sup> Also in *Re Marco v Thompson* [1994] 2 BCLC 354, the court had to answer the question of whether the conduct was prejudicial to the members’ interests, and if so, if it was also unfair. The court ordered the majority to purchase the minority shares when it was found that the conduct was both unfair and prejudicial.

<sup>555</sup> J, Lowry., The pursuit of effective minority shareholder protection: s459 of the Companies Act 1985, *Company Lawyer*. 1996, 17(3), pg: 68.

<sup>556</sup> [2004] EWCA Civ 118.

<sup>557</sup> A, Hicks., & S, Goo., *Cases and Materials on Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2004, pg: 409.

unfairly prejudicial or not.<sup>558</sup> This was set out in *Anderson v Hogg*,<sup>559</sup> when it was held that the minority shareholder could succeed if he/she could show that the action complained-of in the company satisfied the test of unfairness in s459, notwithstanding that the action might be lawful. Moreover, the court in this case refused to apply a subjective test and applied the objective test of unfairness.<sup>560</sup>

Furthermore, Lord Hoffmann said in *O'Neill v Phillips*,<sup>561</sup> “fairness is a notion which can be applied to all kinds of activities; its content will depend upon the context in which it is being used”. Thus, the context and background of every such case is very important. In *Bermuda Cablevision Ltd v Colica Trust Co. Ltd*,<sup>562</sup> all of the factors which were relevant to the claim were taken into account to examine whether or not the action was unfairly prejudicial. Some of the issues which the court will take into account are, for instance, the minority shareholder’s conduct and his/her prior knowledge of the matters complained of. However, there is no requirement of good faith on the part of the minority shareholder who brings such a claim.

#### **5.1.2.4 The minority shareholder’s interest in the company**

Section 459 aims to protect the interests of members and not merely their rights. While s459 does not prohibit actions in relation to public companies and large private ones, it is in relation to quasi-partnerships where most actions occur. This is because it is only in these circumstances that the shareholders will have the particular rights which s459 protects, such as legitimate expectations, and trust and confidence in each other. In an attempt to clarify the traditional definition of quasi-partnerships, an examination of the Partnership Act 1890 shows it to provide that, in such companies, all shareholders have the right to participate in management and the duty to maintain good faith between one another. Therefore, s459 tends to serve and protect the interests of the minority

---

<sup>558</sup> M, Hemraj., Maximising shareholder’s wealth: legitimate expectation and minority oppression. *Company Lawyer*, 2006, 27(4), pg: 125 & 126.

<sup>559</sup> (Scotland CSess Extra Div 2001) [2002] SC 190.

<sup>560</sup> Also see, *Re R.A. Noble & Sons (Clothing) Ltd* [1983] BCLC 273.

<sup>561</sup> [1999] 1 WLR 1092.

<sup>562</sup> [1998] AC 198.

shareholders of a company in a broad sense and to this extent it can be described as a very powerful weapon.<sup>563</sup>

However, the prejudice mentioned in s459 must be harmful in a commercial sense, not merely in an emotional sense.<sup>564</sup> Nor is a minority shareholder entitled to complain of prejudice to any other interest not relating to his/her shareholding.<sup>565</sup> In sum, s459 serves the minority shareholder's interests in two ways: where there is wrongful conduct by the directors or majority shareholders and where the majority shareholder's conduct is lawful but breaches the minority shareholder's legitimate expectations.

#### 5.1.2.5 The remedies available under s461

If the court is satisfied that a claim under s459 is well founded, it is empowered by s461 to make such an order as it thinks fit in respect of the matters complained of. More particularly, under s461 (2), the court may order any of the following. First, it may regulate the conduct of the company's affairs in the future, including by altering the company's memorandum or articles or by preventing the company from making any alteration to the constitution without the court's leave.<sup>566</sup> Secondly, it may force the company to refrain from carrying out or continuing an act complained of by the minority shareholder. For instance, in *McGuinness v Bremner plc*<sup>567</sup> the court ordered that an extraordinary general meeting should be held on a specified date. Thirdly, the court may authorize civil proceedings to be brought on behalf of the company by such person or persons and on such terms as it deems appropriate. This provision in particular, Hannigan argues, was intended to allow the minority shareholder to commence a derivative action under s459. However, as she also notes, it is unlikely that a minority shareholder, who would be in a position to obtain a direct personal remedy through s459, would ask the court for permission to commence a derivative action.<sup>568</sup>

---

<sup>563</sup> A, Hicks., & S, Goo., *Cases and Materials on Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2004, pg: 409.

<sup>564</sup> See *Re Unisoft Group Ltd* (No.3) [1994] 1 BCLC 609.

<sup>565</sup> S, Mayson. D, French. & C, Ryan., *Company Law*. 22<sup>nd</sup> ed. Oxford: Oxford University Press, 2005-2006. pg: 644.

<sup>566</sup> For example, in *R & H Electric Ltd v Haden Bill Electrical Ltd* [1995] 2 BCLC 280, the court ordered the company to repay loans made to it by the minority shareholder because he had a legitimate expectation that he would participate in the management as long as the company owed him money.

<sup>567</sup> [1988] SCLR 226.

<sup>568</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 429.

There are few reported cases where the minority shareholder has used s459 instead of a derivative action in order to seek a remedy for the company itself; examples are *Re Saul D. Harrison & Sons plc*<sup>569</sup> and *Anderson v Hogg*.<sup>570</sup> Fourthly, the court may provide for purchase of the shares of any member(s) of the company by other members or by the company itself. There are other orders that may be made under s461, but they will not be covered here.

The most common order made under s459 is the last mentioned,<sup>571</sup> where the majority shareholders would be ordered to buy the minority shareholder's shares. McGee<sup>572</sup> points out that, although it is evident that as many as 90% of claims made under s459 have sought the buyout remedy, it should not be assumed that this was always a matter of free choice. This is because the court judges whether a purchase of shares is the best option or not. Therefore, the minority shareholder must specify the relief sought, which must be appropriate to the conduct complained of, but then it is up to the court to decide what is most appropriate at the time of the hearing.<sup>573</sup> It is very unusual for the court to order the minority shareholder to purchase the majority shares, but this did occur in *Re Brenfield Squash Racquets Club Ltd*.<sup>574</sup>

#### 5.1.2.6 The winding-up order

Basically, the winding-up order is not available as a remedy under s461, but the court occasionally believes that the remedies under s461 are not applicable or will not be able to achieve justice in a particular case, so it may make a winding-up under s122 (1)(g) of the Insolvency Act 1986. For example, in *Re Full Cup International Trading Ltd*<sup>575</sup> the court refused to grant relief under s461, and made a winding-up order. The Insolvency Act 1986 s125 (2) requires the court to decide whether it is just and equitable for the company to be wound up. If the court believes this to be the case, then it should make a

---

<sup>569</sup> [1995] 1 B.C.L.C 14.

<sup>570</sup> (Scotland CSess Extra Div 2001) [2002] S.L.T. 353.

<sup>571</sup> s461(2)(d) of the Companies Act 1985.

<sup>572</sup> A, McGee., Exit Mechanisms in Private Companies, *The Company Financial and Insolvency Law Review*. 1999. 3 (1), pg: 54 & 56.

<sup>573</sup> S, Mayson. D, French. & C, Ryan., *Company Law*. 22<sup>nd</sup> ed. Oxford: Oxford University Press, 2005-2006. pg: 654.

<sup>574</sup> [1996] 2 BCLC 184.

<sup>575</sup> [1995] B.C.C. 682, Ch.D.

winding-up order unless there is evidence that the minority shareholder has acted inappropriately in seeking such an order. Thus, the granting of a winding-up order is entirely at the discretion of the court, which may allow it despite the applicability of one or more remedies under s461. This was seen in *Re R.A. Noble & Sons (Clothing) Ltd*,<sup>576</sup> where the winding-up order was favoured over s459 in the court's judgment (the claim sought remedies under both s459 and s122(1)(g)). The judge held that the conduct of majority shareholders had been the "substantial cause" of the lack of mutual confidence between the parties and accordingly dismissed the claim for s459 relief and made an order for the winding up of the company on the just and equitable ground.

It has been argued that if no winding-up request is made in the minority shareholder's claim, the court has no power under s461 to make a winding-up order, because it is not available.<sup>577</sup> This argument came from *Practice Direction (Chancery 1/90)*,<sup>578</sup> which demonstrated that the court was unwilling to enforce the winding-up order because it was not available as a remedy under s461, and also because the minority did not ask for it. This argument, however, is correct in only one respect: that the winding-up remedy is indeed not specified under s461. However, s461 empowers the court to "make such order as it thinks fit for giving relief in respect of the matters complained of". The words "as it thinks fit" surely make clear that the court is empowered to grant any remedy, even if it is not expressly stated in the section.<sup>579</sup> However, the court will never grant a winding-up order unless there is just and equitable ground on which to do so. For example, in *Re Full Cup Ltd*<sup>580</sup> the court told the minority shareholder to bring a winding-up order instead of a claim under s459. Currently, following the restrictions and limitations which were advanced by the decision in *O'Neill v Phillips*,<sup>581</sup> the courts are reluctant to grant a winding-up order if they can find any alternative suitable remedy under s459.<sup>582</sup>

### 5.1.2.7 The valuation of shares

---

<sup>576</sup> [1983] BCLC 273.

<sup>577</sup> B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005. pg: 248.

<sup>578</sup> [1990] 1 WLR 490.

<sup>579</sup> As already shown in *Re R.A. Noble & Son (Clothing)* [1983] BCLC 273.

<sup>580</sup> [1995] BCC 682.

<sup>581</sup> [1999] 1 WLR 1092.

<sup>582</sup> This point will be discussed further when the impact of *O'Neill v Phillips* is examined. See next subsection.

Whenever share purchase, the most common remedy, is ordered, problems regarding the valuation of the minority shareholder's shares arise. Nourse J acknowledged in *Re Bird Precision Bellows Ltd*<sup>583</sup> that where there is a quasi-partnership and there has been unfairly prejudicial conduct, the shares should be valued on a pro rata basis and not discounted. He stated that the minority shareholder here was being forced to sell and it was not fair to put that shareholder in the same position as someone selling freely. The Court of Appeal, in this case, held that it was fair for the valuation to be undiscounted, and ever since it has been generally regarded as the prima facie norm in unfair prejudice cases. More importantly, the Court of Appeal in *Re a Company*<sup>584</sup> stated that even if a price was fixed in the articles, which would depreciate the value of the minority shareholder's interest, then the terms of the articles would not be used to ascertain the price and the court would value the shares on a pro rata (undiscounted) basis. However, an exception to this principle can be found when a quasi-partnership between shareholders does not exist, and the minority shareholder cannot benefit from the principle of selling in full and obtaining the undiscounted value. This was well established in *Elliott v Planet Organic Ltd*,<sup>585</sup> where it was held that the company, which was owned by nine shareholders, could not be regarded as a quasi-partnership and accordingly the shares had to be subject to a discounted valuation. Similarly, in *Irvine v Irvine*,<sup>586</sup> the court did not consider the company a quasi-partnership and therefore the shareholdings were not valued on a pro rata basis.

As well as the necessity to establish the existence of a quasi-partnership between shareholders to apply the principle of selling at the full and undiscounted value, the minority shareholder must be being forced to leave the company and should not be leaving because he/she has chosen to do so. This was seen in *Phoenix Office Supplies Ltd v Larvin*,<sup>587</sup> where, because the Court of Appeal recognized that the minority shareholder was leaving his position of his own will, he was not entitled to have his shares bought out at their full undiscounted value. This decision was heavily criticised

---

<sup>583</sup> [1984] 3 ALL ER 444.

<sup>584</sup> [1987] BCLC 94.

<sup>585</sup> [2000] 1 BCLC 366.

<sup>586</sup> [2006] EWHC 583 (Ch); [2007] 1 BCLC 445.

<sup>587</sup> [2002] EWCA Civ 1740.

by Taylor,<sup>588</sup> who argued that it was based on a relatively narrow view of what constituted the shareholder's interest. This criticism is reasonable because it is understood that once a quasi-partnership exists between shareholders and conduct which amounts to unfair prejudice takes place, the principle of buyout with full and undiscounted value should be applied irrespective of whether the minority shareholder is forced to leave or does so willingly. On the other hand, some have agreed with the decision in this case, arguing that, even if the articles of association specify the right to full and undiscounted value, the right should not be absolute, because guaranteeing the minority shareholder the full value of his/her shareholding might be totally ruinous for the company.<sup>589</sup> Thus, it may be considered better for the company, and indeed for the minority shareholder, if the principle of it being up to the court's discretion to determine whether the minority shareholder is entitled to the full and undiscounted value, and if so, whether the company can afford it.

According to *Profinance Trust SA v Gladstone*,<sup>590</sup> the date of the valuation is usually the date of the claim, but it is a matter of the court's discretion to decide on any alternative valuation date. In fact, it was stated in *Re OC (Transport) Services Ltd*<sup>591</sup> that the court may order a valuation of shares on the date on which the unreasonable conduct started. Nevertheless, there is no clear standard or guidance to follow when setting the valuation date or when dealing with other aspects of valuing the shares, such as the extent of the company's obligation to pay the undiscounted value and the assessment of quasi-partnership. Many of these matters are subject to the court's discretion in each case. Furthermore, it is not clear what valuing the shares at a full and undiscounted rate really means; it is only assumed that the full and undiscounted value should cover all the preferences and privileges attached to each share.<sup>592</sup>

#### 5.1.2.8 The impact of *O'Neill v Phillips*<sup>593</sup> on s459

---

<sup>588</sup> B, Taylor., The Rights of Outgoing Investors and Directors in Private Companies, *Company Lawyer*. 2003, 24(7), pg: 221. In this case, the minority shareholder expressed a desire to exit. If this had not been the case, then the minority shareholder would have been entitled to undiscounted value.

<sup>589</sup> Anon, Not Every Quasi-Partnership Relation Entitles the Shareholder to Claim under s459, CA 1985, *Finance and Credit Law*. 2003, 1 Jan, pg: 4&5.

<sup>590</sup> [2002] 1 BCLC 141 CA.

<sup>591</sup> [1984] BCLC 251.

<sup>592</sup> This could include the shares, remuneration, dividends and any other good that could be valued in monetary terms and could be associated with the shareholders' shares.

<sup>593</sup> [1999] 1 WLR 1092.



#### a. Introduction

It is true to say that the inclusion of sections 459-461 in the Companies Act 1985 granted minority shareholders broad opportunities to litigate and obtain relief. Nevertheless, the section failed to identify and define clearly the circumstances in which proceedings could be brought. For example, the range of conduct covered by the notion of unfair prejudice in s459 was not satisfactorily clear. As a result, minority shareholders found many opportunities to use the section improperly by bringing unnecessary and unjustified actions, until the case of *O'Neill v Phillips* came to define and clarify the ambit of the section. It is believed that the statements in *O'Neill v Phillips* as to the use of s459 reduced the number of minority shareholder actions and provided guidance for the courts to follow.

#### b. Background to *O'Neill v Phillips*

In *O'Neill v Phillips*, the whole company was originally owned by the majority shareholder, Phillips, who first employed the minority shareholder, O'Neill, as a manual worker in 1983. Phillips was impressed by O'Neill's ability and promoted him gradually. Phillips also conferred on O'Neill 25% of the shares and appointed him as a director in 1985. Later in the same year, Phillips informally promised O'Neill 50% of the company's profits and an increase in his shareholding and voting rights to 50% when certain targets were reached. However, this promise did not come to fruition. In 1991, after a downturn in the company's financial position, Phillips told O'Neill that he was no longer to be managing director and he would no longer receive 50% of the profits. Subsequently, when Phillips also failed to comply with his promise in terms of increasing O'Neill's shareholding, the latter claimed that he had behaved unfairly and prejudicially. O'Neill sought an order<sup>594</sup> under s459 that his shares should be purchased at a fair value fixed by the court or, alternatively, an order that the company be wound up.

---

<sup>594</sup> The minority shareholder (O'Neill), in seeking both remedies, was relying on to *Re Saul D Harrison & Sons plc [1995] 1 BCLC 14*, at 19-20, which sought both the just and equitable winding-up remedy and the unfair prejudice remedy.

The court, in the first instance, dismissed the claim, holding that the majority shareholder had not committed himself permanently and unconditionally to equal profit-sharing or to granting more shares and that the minority shareholder had accordingly not suffered in his capacity as a shareholder. However, the Court of Appeal allowed the appeal and ordered the majority shareholder to purchase the minority shares, holding that the minority shareholder had a legitimate expectation that he would receive more shares and 50% of the profits when the targets were reached, and that the fact that this did not happen meant that O'Neill had suffered unfair prejudice as a shareholder. Subsequently, the majority shareholder appealed against the decision of the Court of Appeal to the House of Lords, which allowed the appeal, thereby agreeing with the court at first instance. In reaching this decision, the House of Lords had to consider a number of issues which subsequently led to a redefining and reinterpreting of the principles underpinning s459, such as the type of conduct which amounts to unfair prejudice and clarification of the concept of legitimate expectation.

### c. Unfair prejudice and legitimate expectation in *O'Neill v Phillips*

In examining the conduct in the case to see whether it was unfairly prejudicial, Lord Hoffmann used the term 'good faith' to cover the terms 'just', 'equitable' and 'unfairness' which had been used in previous cases involving the provision.<sup>595</sup> He introduced 'good faith' by stating that "unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith".<sup>596</sup> He explained that there were two circumstances which should be considered contrary to good faith. The first would be when there was a breach of the terms by which the minority and majority shareholders agreed that the affairs of the company should be conducted. The second was when there was a breach by the majority of equitable considerations (legitimate expectations) which exist between shareholders. Thus, according to Lord Hoffmann, if one of these two circumstances existed, the majority would be regarded as acting contrary to good faith, which would thereby justify a case under s459. This was the approach applied in *O'Neill v Phillips* and it was

---

<sup>595</sup> In examining these principles and doctrines (unjust and inequitable or unfair) Lord Hoffmann had to consider old cases like *Bisset v Daniel* (1853) 10 Hare 493, to distinguish between the legal and equitable approaches to the use of power.

<sup>596</sup> *O'Neill v Phillips* [1999] 1 WLR 1092, pg: 1099 & 1100.

held that nothing contrary to good faith had occurred and that there had accordingly been no unfair prejudice.

Boyle<sup>597</sup> heavily criticised Lord Hoffmann's application of the term 'good faith', arguing that minority shareholders should not need to prove bad faith when dealing with the company's interest.<sup>598</sup> Boyle added that it was clear that a breach of fiduciary duties, even if it did not involve bad faith, may justify relief under section 459 in certain circumstances. Thus, the intention of the conduct was not a factor that should need to be established; what mattered most was the consequence of that conduct and whether it was unfairly prejudicial towards the member's interests.

The concept of legitimate expectation<sup>599</sup> was also affected by *O'Neill v Phillips*. In this case Lord Hoffmann redefined the term 'legitimate expectation'<sup>600</sup> by limiting it to circumstances where there was understanding among shareholders, at the time of setting up the company, that they would participate in its management. In such a case it would usually have been considered unjust, inequitable or unfair for a majority to use its voting power to exclude a member from participation in the management without giving him/her the opportunity to remove his/her capital upon reasonable terms. Thus, if a breakdown in relations caused the majority shareholder to remove a minority shareholder from participation in management, where the minority shareholder had a legitimate expectation of such participation as an essential reason for investing in the company, this would have been regarded as unfair.

In *O'Neill v Phillips* Lord Hoffmann found no basis to hold that the majority shareholder was behaving unfairly in withdrawing from the negotiations with the minority and not allowing him to have more shares, because the latter had no legitimate

---

<sup>597</sup> A, Boyle., "Unfair Prejudice" in the House of Lords. *Company Lawyer*. 2000. 21 (8), pg: 253.

<sup>598</sup> A, Boyle. J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007. pg: 697. It is thought that using the term 'good faith' to cover justice, equity and fairness is unfortunate. See *Westbourne* [1973] AC 390, at 379, where the House of Lords specifically rejected the test of 'bad faith' as the basis for just and equitable winding up.

<sup>599</sup> Originally, the recognition of legitimate expectation came from the word "interests" in s459, which was wider than "rights", as "rights" emanate merely from the company's agreements or articles. But shareholders may have different interests even if their rights as members are the same. Lord Hoffmann in *Re Saul D Harrison & Sons Plc* [1995] 1 BCLC 14 said that legitimate expectation arises from fundamental understanding, but is not put into contractual form.

<sup>600</sup> Lord Hoffmann noted that he himself had used the phrase 'legitimate expectations' in this case and even in *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14, but he conceded that this use was probably a mistake.

expectation of that at the time he initially invested in the company. Similarly, Lord Hoffmann found that there was no legitimate expectation as to the sharing of profits because, as he explained, no promise to share the profits equally was made at the time of investing in the company and it was therefore not inequitable or unfair for the majority to refuse to carry on doing so. Thus, Lord Hoffmann stressed the view that, as no conclusive agreement was reached in the case, there could accordingly be no reasonable legitimate expectation sufficient to be taken into consideration. Indeed, Lord Hoffmann reformed and redefined the grounds which constitute legitimate expectation. It is no longer possible to rely on a general notion of unfairness or to found a petition on reasonable expectations unless there has been some breach of a recognized agreement or of an equitable principle.

Lord Hoffmann's statement in relation to the concept of legitimate expectation (if there was no conclusive agreement between shareholders, then there could be no reasonable legitimate expectation) has faced criticism. Clark has pointed out that this limitation of the concept of legitimate expectation restricts its interpretation and causes different outcomes from those on which previous cases were based.<sup>601</sup> Similarly, Hirt has criticised the restriction of legitimate expectation in this case by saying that applying this restriction would deny recognition to all sorts of informal agreements or understandings.<sup>602</sup> On the other hand, Hemraj is in favour of applying the legitimate expectation in this way because he believes that it may prevent minority shareholders from pressing too far for their rights in seeking to say that every expectation they have is a legitimate expectation.<sup>603</sup>

In sum, the case of *O'Neill v Phillips* has indeed contributed to the field by designing new guidance and direction to replace the ease and simplicity of pursuing an unfairly prejudicial case, especially in cases like this where the minority shareholder had been removed from management as a director.<sup>604</sup> Although the court should have allowed

---

<sup>601</sup> B, Clark., Unfairly Prejudicial Conduct: A Pathway through the Maze. *Company Lawyer*. 2001. (22).6, pg: 173.

<sup>602</sup> H, Hirt., In What Circumstance Should Breaches of Directors' Duties Give Rise To a Remedy Under SS.459-461 of the company Act 1985? *Company Lawyer*. 2003. 24 (4), pg: 101 & 102.

<sup>603</sup> M, Hemraj., Maximising shareholder's wealth: legitimate expectation and minority oppression. *Company Lawyer*, 2006, 27(4), pg: 126.

<sup>604</sup> B, Clark., Unfairly Prejudicial Conduct: A Pathway through the Maze. *Company Lawyer*. 2001. (22).6, pg: 175.

him to exit at a fair value on the basis of a relationship breakdown and loss of mutual trust and confidence,<sup>605</sup> the court deliberately intended to deliver a message to minority shareholders that unfair prejudice provisions are not a cure-all remedy for shareholders who are not satisfied with the way in which the company is run.<sup>606</sup> Consequently, the only option left to the minority shareholder in *O'Neill* was to accept the purchase of his shares, but not at an undiscounted fair value.

#### d. Changes delivered by *O'Neill v Phillips*

Certain researchers see this case as having contributed to a clearer interpretation and illustration,<sup>607</sup> while others believe that it has failed to deliver any new criteria or guidance and that accordingly it neither extends nor restricts the range of circumstances which may amount to unfair prejudice.<sup>608</sup> However, this latter opinion in particular is extreme, as the case has indeed redefined and restated certain concepts and principles, such as legitimate expectation and breakdown of confidence and trust. It may be true to say that before *O'Neill v Phillips*, a few facts were enough to constitute an unfairly prejudicial case,<sup>609</sup> but after this case some criteria, such as a mere breakdown in relationships, cannot alone constitute grounds for action. Admittedly, *O'Neill v Phillips* has restricted this area of law.<sup>610</sup> The following points, among others, can be seen as resulting from the decision in this important case.

First, Lord Hoffmann stated in the case that “legitimate expectation should not be allowed to lead a life of its own”.<sup>611</sup> Notably, this is a rejection of the concept of legitimate expectation as a stand-alone basis for an application under section 459<sup>612</sup> and certainly does not confer recognition on an informal arrangement or understanding. If

---

<sup>605</sup> Because the majority shareholder did not fulfill his promise.

<sup>606</sup> D, Keenan. & J, Bisacre., *Smith and Kennan's Company Law*. 13<sup>th</sup> ed. Longman, Essex, 2005. pg: 299.

<sup>607</sup> A, Boyle., “Unfair Prejudice” in the House of Lords. *Company Lawyer*. 2000. 21 (8), pg.: 254.

<sup>608</sup> A, Boyle. J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007. pg: 698.

<sup>609</sup> Certain cases in the past showed that these bases could be used as grounds for obtaining relief under s459, such as *Re Full Cup Ltd* [1995] BCC 682, where the court told the minority shareholder to bring a winding-up order instead of s459. However, in *O'Neill* it was held that legitimate expectation should not be allowed to lead a life of its own.

<sup>610</sup> It was argued in (D, Keenan. & J, Bisacre., *Smith and Keenan's Company Law*. 13<sup>th</sup> ed. Longman, Essex, 2005. pg: 571) that the decision in *O'Neill* restricts the ability of shareholders of smaller companies to take action under s459 and therefore will discourage minority shareholders from litigating and might lead to unfairness.

<sup>611</sup> *O'Neill v Phillips* [1999] 1 WLR 1092, pg: 1102.

<sup>612</sup> D, Keenan. & J, Bisacre., *Smith and Kennan's Company Law*. 13<sup>th</sup> ed. Longman, Essex, 2005. pg: 571.

this view is applied strictly, the minority shareholder may no longer point to some sort of informal arrangement.

Secondly, since *O'Neill v Phillips*, it is now very clear that the dismissal of a minority shareholder from management is capable of constituting an unfairly prejudicial case, if the minority shareholder's legitimate expectation of being able to participate in management was an essential reason for investing in the company.<sup>613</sup> Nonetheless, *O'Neill v Phillips* expressly establishes that a mere breakdown in relations between shareholders, even if it makes it impossible for them to work together, is not in itself unfairly prejudicial conduct. Moreover, such an incident would not in itself be a reason for the type of loss of confidence and trust which allowed relief to be sought under s459.

Finally, there was always substantial overlap between the remedies of section s459 and the winding-up remedy under s122 (1)(g) of the Insolvency Act 1986. Even *O'Neill v Phillips* did not draw a line between the two remedies to eliminate this overlap. Although s459 turned out not to be applicable in *O'Neill v Phillips*, there was no consideration of whether s122 was applicable. However, Clark<sup>614</sup> argues that the mere fact that there had been a breakdown of trust and confidence between shareholders in a quasi-partnership company would have given rise to a winding-up order under s122 on the basis that it would not be fair for a disaffected member to be locked into a company where trust and confidence did not exist anymore. It is proposed that the winding-up order should be added as a remedy under s461,<sup>615</sup> so the court can have the power to apply it where it thinks fits.

---

<sup>613</sup> However, this will not be taken into account if the dismissal was caused by the minority shareholder's own misconduct, as shown in *Woolwich v Milne* [2003] EWHC 414 (Ch), where the minority shareholder had been removed from the board as a result of his aggressive and bullying conduct, and the court approved that.

<sup>614</sup> B, Clark., Just and equitable winding up: wound up?, *Scots Law Times*. 2001, 12, pg: 110.

<sup>615</sup> B, Clark., Unfairly Prejudicial Conduct: A Pathway through the Maze. *Company Lawyer*. 2001, (22)6, pg: 174.

## **5.2 Proposals to reform minority shareholder protection (Law Commission and Company Law Review Group)**

### **Introduction**

Following the realisation that there were certain drawbacks and failings in the functioning of minority shareholder protection under common law and in the statute, there have been many attempts to diagnose and identify the causes. It is important to emphasise that there was no tangible and detailed study that reflected how minority shareholder protection worked in practice until 1996, when the Law Commission produced an analysis of the problems and offered some possible solutions. This was followed by an extensive nationwide consultation which led to the so-called *Shareholder Remedies* report in 1997. A very important role was played in these analyses in 2000 and 2001 by the Company Law Review Group, which concentrated on addressing the problems from a practical point of view.

Therefore, the problems of minority shareholder protection in UK law were not fully acknowledged until these and other studies were undertaken. Similarly, the problems of minority shareholder protection in Saudi Arabia and Dubai will not be acknowledged until substantial research is conducted into how this area of law functions in practice and what can be done to improve it. This section of the chapter will thus be very beneficial for both Saudi Arabia and Dubai, showing how researchers and practitioners of UK law diagnosed the problems and then offered recommendations for reform.

### **5.2.1 Proposals regarding common law**

#### **5.2.1.1 Recommendations to reform personal action**

The Law Commission intended in its study to cover all aspects of minority shareholder protection and therefore started with personal actions under common law. Its proposals<sup>616</sup> did not give extensive consideration to personal actions outside of the unfair prejudice ground as they are not the main concern in minority litigation.

---

<sup>616</sup> Law Commission Report 1997, paras 7.2-7.10 & 7.12.

However, the Law Commission considered, but rejected, the inclusion of a non-exhaustive list of personal rights to be enforceable under any new Act. The reason for this rejection<sup>617</sup> was the inability to deliver a comprehensive list of enforceable personal rights. Further, it was argued that there was no evidence that the absence of a list of enforceable personal rights would cause difficulties in practice.<sup>618</sup>

Later, the Company Law Review (CLR)<sup>619</sup> revisited the issue of producing a list of personal rights by opening up the debate on whether a non-exhaustive list of personal rights might be included in any new legislation.<sup>620</sup> The Review referred to the personal rights which were identified by case law in order to compile such a list. However, this step was rejected by the legal professions, who argued that there were no practical problems in respect of personal rights and that these rights were already available to individual shareholders depending on particular constitutional arrangements.<sup>621</sup> The CLR noted in its Final Report<sup>622</sup> in respect of this matter that the majority of its members favoured the listing of personal rights in any forthcoming statute and thus it was included in its recommendations. However, Hannigan argued that if these recommendations were put into practice, shareholders would be likely to exclude the enforcement of personal rights from the constitution (article of association) and, as a result, other shareholders in the future might find it even more difficult to enforce their rights.<sup>623</sup> The CLR did not deny this possible disadvantage, but nonetheless concluded that the advantages of its proposals, in terms of the clarity they offered, outweighed it.<sup>624</sup>

It is very hard to understand why the CLR showed such concern over personal rights, given that they appeared to be functioning without difficulty and no problems were evident. The mere fact that case law reveals that very few cases have been brought on personal grounds throughout the history of company law does not necessarily mean that there is a problem in the protection of personal rights that requires reform. A further

---

<sup>617</sup> See Law Commission Report, para 7.10.

<sup>618</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 456. See Law Commission Report, paras 7.2 - 7.10 – 7.12.

<sup>619</sup> Company Law Review. *Developing the Framework*, 2000.

<sup>620</sup> Company Law Review, *Developing the Framework*, 2000, paras 4.72-4.99.

<sup>621</sup> See Company Law Review, *Completing the Structure*, 2000, para 5.72.

<sup>622</sup> Company Law Review. *Final Report*. vol. 1, 2001, para 7.34.

<sup>623</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg: 456.

<sup>624</sup> Company Law Review. *Final Report*. vol. 1, 2001, para 7.36.



argument that must not be neglected is that idea of changing the law where there is stability, settlement and certainty may itself create many problems, rather than offering improvement. It is also regrettable that the Law Commission and the CLR gave little priority to defining the grounds and principles of personal rights so that they would be easy for minority shareholders to identify and, accordingly, to exercise.<sup>625</sup>

### 5.2.1.2 Recommendations to reform derivative actions

#### 5.2.1.2.1 Law Commission

The Law Commission concluded in its report, *Shareholder Remedies*,<sup>626</sup> that the exceptions to the rule in *Foss v Harbottle*<sup>627</sup> were uncertain and that the procedures to follow were very complicated and could amount to a mini-trial.<sup>628</sup> In reaching this conclusion, the Law Commission examined reported cases over a period of 150 years. The Commission believed that most of the problems in derivative actions emanated from the requirement that wrongs had to amount to fraud on the minority and that a majority shareholder was able to ratify the action. Both factors placed heavy restrictions on derivative actions, meaning that they did not function effectively. Thus, the Report recommended replacing the narrow concept of fraud<sup>629</sup> with a more open principle which would make a wider range of conduct subject to litigation. Therefore, the Law Commission proposed that common law should be replaced with a statutory derivative procedure equipped with more modern, flexible and accessible criteria for determining whether a shareholder could pursue an action.<sup>630</sup> Besides fraud, this proposed statutory derivative procedure would include negligence, default, breach of duty and breach of trust.<sup>631</sup>

The Law Commissioner, Diana Faber, said that the aim of the proposed changes to the concept of fraud was to provide speedy, fair and cost-effective mechanisms for

---

<sup>625</sup> It is still difficult for certain legal practitioners to distinguish the grounds related to derivative actions from those related to personal rights. See: *Latchford Premier Cinema Ltd v Ennion* [1931] 2 Ch 409 and *Oliver v Dalglish* [1963] 1 WLR 1274.

<sup>626</sup> Law Commission, *Shareholder Remedies*. (1997, Cm 3769).

<sup>627</sup> [1843] 2 Hara 461.

<sup>628</sup> Law Commission Report, para 6.4.

<sup>629</sup> Law Commission Report, paras 6.51-6.55.

<sup>630</sup> Law Commission. *Shareholder Remedies*. 1997. para 6.15.

<sup>631</sup> Law Commission, *Shareholder Remedies*. 1997. paras 6.23 – 6.49.

resolving various types of dispute between minority shareholders and those running the company.<sup>632</sup> In other words, the Law Commission's main concern was to achieve a balance between the ability of the majority shareholder to run the company effectively on a day-to-day basis and the need to protect minority shareholders.<sup>633</sup> More importantly, the Commission made clear that the courts should prioritise the company's interests, even if this went against the wishes of the directors/majority shareholder, who may not want to pursue the action. To this end, the Commission proposed that permission<sup>634</sup> from the court should be required in order to continue a derivative action. In deciding whether to grant permission, the court should take into account all the relevant circumstances, including the good faith of the minority shareholder<sup>635</sup> and the company's interests.<sup>636</sup> The Commission stated that the wording should make plain that the discretion was wide and that the factors set out were only examples of the circumstances to which the courts should show regard.<sup>637</sup> In other words, the Law Commission recommended that the court should be given full discretion to consider other factors which were not listed.

This strategy of granting permission came from the Law Commission's recognition that there is a conflict of interest when the majority shareholder makes a decision over whether or not to litigate. However, it is also the right of the majority shareholder to have freedom from unnecessary shareholder interference. Therefore, the question arises: who should be the judge of this?<sup>638</sup> It appears that the Law Commission's proposal has answered this important question by withdrawing the power over litigation from the majority and granting it to the court, which has full discretion to examine each case before permitting the derivative action to proceed.<sup>639</sup> Thus, the court will permit the action to go ahead according to certain criteria and, most importantly, the company's interests.

---

<sup>632</sup> Summary of the Law Commission Consultation Paper No. 142.

<sup>633</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 101.

<sup>634</sup> Law Commission Report, paras 6.66-6.69; see also Law Commission Consultation Paper, para 16.18.

<sup>635</sup> Law Commission Report, paras 6.75-6.76.

<sup>636</sup> The Law Commission (1997, para: 6.73) proposes a list of factors which the court should take into account when ruling. It is important for the court to have flexibility in examining these factors, then reject the claim if it is not satisfied that it is in the company's interest.

<sup>637</sup> Law Commission Consultation Paper, para 16.44.

<sup>638</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 101.

<sup>639</sup> T, Boyle., The new derivative action, *Company Lawyer*. 1997, 18(8), pg: 254.

Nevertheless, the proposal has been criticised as allowing the court too much involvement in companies' internal management.<sup>640</sup> It seems unfair to some that the court is required to become more involved in the company's commercial decision-making, while it is not appropriate for the management to assess whether the litigation is for or against the company's interests.<sup>641</sup> This proposed role for the court thus creates a dilemma for judges when considering whether the action should be allowed because the minority shareholder may have a potential claim, but where the litigation is not in the company's interest.<sup>642</sup> However, the court may in such cases prioritise the company's interest as being more important than the minority shareholder's protection. Therefore, it is contended that the court is the best entity to judge between shareholders in order to achieve what is best in the company's interest.

The Law Commission also proposed that the court should require a minority shareholder who intends to bring a derivative action to notify it of such an intention, specifying the cause of action and stating that, if the company does not take proceedings in respect of the cause of an action within 28 days,<sup>643</sup> a derivative action will be commenced.<sup>644</sup> This proposal was very constructive and practical because it has given the majority shareholder the opportunity to avoid litigation by correcting the misconduct complained of.<sup>645</sup>

Pettet<sup>646</sup> warned of some problems which might occur if the Law Commission's proposals for producing statutory derivative action replaced common law. He believed that it would be difficult for the court to remain detached from developing or applying principles which had already been developed in common law. The situations with which the court would be faced, he argued, were not likely to be any different under the new

---

<sup>640</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 101 to 103.

<sup>641</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, 2005, March, pg: 167.

<sup>642</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, 2005, March, pg: 161 & 162.

<sup>643</sup> Law Commission Consultation Paper, paras 16.15-16.17.

<sup>644</sup> Unexpectedly, this requirement has not been stated in the statutory derivative action in the Companies Act 2006 although it is very important for preventing any misuse or abuse of the action.

<sup>645</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 104.

<sup>646</sup> B, Pettet., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005. pg: 229.

statute from those which had formed the substance of shareholder litigation for the century and a half since *Foss v. Harbottle*<sup>647</sup> was decided. However, it does not seem right to argue that the situation would be unlikely to change from the traditional position because, once the new statute has created new grounds, procedures, mechanisms and requirements to establish a derivative action, cases and situations would certainly be different from those under the common law.<sup>648</sup>

#### 5.2.1.2.2 Company Law Review

The Company Law Review broadly supported the approaches proposed by the Law Commission,<sup>649</sup> but it set in motion further work and consultation in several areas. The first consultation proposed by the CLR was to consider further the issue of effective ratification, which was not covered by the Law Commission. This followed the realisation by the CLR that a derivative claim could never be brought in respect of an act which could be ratified or was even ratifiable by the majority shareholder's votes.<sup>650</sup> The CLR acknowledged that even if reform was made to facilitate the use of wider grounds accommodating more wrongs, majority shareholders could still prevent a minority shareholder from pursuing litigation if the power remained in their hands to ratify any wrong or misconduct. Therefore, if actual reform were to take place, the application of ratification and ratifiability under common law should be considered first.<sup>651</sup>

Therefore, the CLR proposed<sup>652</sup> that the question of the validity of ratification or ratifiability by the majority shareholders precluding the pursuit of a wrong should depend on whether the necessary majority had been reached without the need to rely

---

<sup>647</sup> [1843] 2 Hara 461.

<sup>648</sup> However, lawmakers usually try to cover all the important issues in the statute in order to achieve a balance regarding the extent to which the court is free to develop some areas of the law. This is exemplified by the statutory derivative action ss170-177 of the Companies Act 2006, which states that the directors must pay regard (among other matters) to six factors, leaving the court to decide or develop what else should be considered.

<sup>649</sup> See Company Law Review, *Developing the Framework* (2000), paras 4.112-4.139, especially para 4.115.

<sup>650</sup> H, Hirt., Ratification of breaches of directors' duties: the implications of the reform proposal regarding the availability of derivative actions, *Company Lawyer*. 2004, 25(7), pg: 200.

<sup>651</sup> The ratification position under common law was stated in *Prudential Assurance Co. Ltd v Newman Industries Ltd* (No.2) [1981] Ch 257 at: 307; that there was no limit to the power of the majority to authorise or ratify an act or transaction.

<sup>652</sup> Company Law Review, *Final Report* (2001), para 7.46; *Completing the Structure* (2000), para 5.85; *Developing the Framework* (2000), para 4.126.

upon the votes of wrongdoers, of those who were substantially under their influence, or of those who had a personal interest in condoning the wrong. However, this particular proposal was criticised since it was thought that shifting away from a consideration of the nature of the wrongdoing itself to an analysis of those who voted to ratify the wrong and those who actually committed it, would not be helpful in clarifying the law on ratification.<sup>653</sup> Moreover, giving more importance to the wrongdoers than to the wrong itself might not serve the interests of the company, as it would be very difficult to identify the wrongdoers or to differentiate them from those involved in influencing, or who had been influenced by, the majority. For example, the test of influence would be particularly difficult to apply in the context of family-structured companies.<sup>654</sup>

In its second recommendation, the CLR agreed with the Law Commission that there should be a statutory derivative action<sup>655</sup> to include actions based on fraud, negligence, default, breach of duty and breach of trust. Indeed, the CLR went further, recommending the extension of the derivative action to all breaches of directors' duty of care and skill, thus going beyond the category of self-serving negligence that could be proceeded against under common law. The CLR concluded that these changes in the law relating to the duties of care and skill should have their counterpart in policing procedures.<sup>656</sup>

### 5.2.2 Proposals towards the statutory protection under s459

It is true to say that when s459 arrived, there was excessive use of this action due to the generality of the wording of the 1985 Act, which invited minority shareholders to raise any issue even if it was not relevant in support of an action. Despite the overuse of the section by minority shareholders, however, they were actually not confident as to whether they had the right to litigate under the section or not, because the outcome was always uncertain. This absence of clarity in defining certain principles, doctrines,

---

<sup>653</sup> B, Hannigan., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2003. pg 464.

<sup>654</sup> D, Prentice. & J, Payne., The corporate opportunity doctrine, *Law Quarterly Review*. 2004, 120 (Apr), pg: 201. The application of such a test (differentiating the wrongdoers or influencers from those who have been influenced) was seen in *Salomon v Salomon* (1897) A.C. 22, which concerned a family-structured company, and it turned out to be unworkable.

<sup>655</sup> Modern Company Law for a Competitive Economy Final Report (London: DTI, 2001) paras. 6.19 – 6.40.

<sup>656</sup> Company Law Review, *Developing the Framework* (2000), paras 4.127.

grounds and issues was not foreseen in the early days of s459. However, after more than twenty years of litigation under the section, there was a clear and critical need for reform in order to improve and develop this area of law so that lawyers would be able to advise their clients as to whether or not a claim was likely to succeed. Therefore, proposals were put forward by the Law Commission and the CLR to reform s459.

#### 5.2.2.1 The Law Commission

The Law Commission aimed to provide authoritative guidance on the meaning of unfair prejudice, because the concept was not easily understandable and was not associated with a certain outcome.<sup>657</sup> The Commission came to realise, however, that the benefit of the general, flexible nature of the concept of unfair prejudice outweighed the uncertainty that might be inherent in the existing meaning. Nonetheless, Ferran argued that such uncertainty made it even more difficult for persons who were not specialists in company law to identify clearly the types of conduct which should be alleged if they were to demonstrate a good case for relief under s459.<sup>658</sup> Furthermore, this applied even to specialists such as lawyers and judges, who might also have found it difficult to identify conduct which counted as unfair and prejudicial, because there were no clearly identifiable grounds for unfair prejudice.

The majority of the work of the Law Commission<sup>659</sup> emphasised the excessive length and costs of many proceedings and the amount of litigation brought under s459. The Commission proposed that these problems should be dealt with primarily by active case management in the context of the new Woolf rules of court procedure.<sup>660</sup> Nonetheless, there was a potential risk in giving full case management powers to courts, as it might lead to uncertainty due to an increased reliance on the exercise of judicial discretion.<sup>661</sup> Another recommendation to reduce the length and cost of proceedings under s459 was to limit the period for the minority shareholder to litigate. The Law Commission

---

<sup>657</sup> Law Commission Report, *Shareholder Remedies*. 1997.

<sup>658</sup> E, Ferran., *Shareholder Remedies: The Law Commission Report. The Company Financial and Insolvency Law Review*. 1998. 2 (2), pg: 237-240.

<sup>659</sup> Law Commission, *Shareholder Remedies*. (1997, Cm 3769) Law Com No 246.

<sup>660</sup> These are the Civil Procedure Rules 1998. According to these Rules (paras 1.1 and 1.4), active management by the court will encourage the parties to co-operate with each other to ensure that the trial proceeds quickly and efficiently.

<sup>661</sup> D, Sugarman., *Reconceptualising company law: reflections on the law Commission's Consultation Paper on shareholder remedies: Part 2. Company Lawyer*, 1997, 18(9), pg: 276.

believed that such a limitation would result in greater certainty for business.<sup>662</sup> In response to this proposal, it was argued that the minority shareholder must be given a reasonable opportunity to discover and consider the relevant circumstances, and that it is often difficult to ascertain a particular moment in time when the cause of action occurred.<sup>663</sup>

In a further attempt to reduce the length and cost of proceedings, the Law Commission recommended that the court should be given the power to dismiss any claim, part of a claim or defence which, in its opinion, had no realistic prospect of success at full trial.<sup>664</sup> Such a rule would have had a noticeable impact on section 459 proceedings, by eliminating weak or unimportant allegations, thereby reducing the duration and cost of claims.<sup>665</sup> However, this was not an easy task, as one of the problems of s459 was the generality of its wording,<sup>666</sup> leaving judges, let alone shareholders, unsure of what was included under unfair prejudice and what was not.<sup>667</sup> The Law Commission did not address the court's jurisdiction under s459 to grant the minority shareholder an indemnity order.<sup>668</sup> The deficiency of such an order would allow the problem of excessive costs to remain unsolved.

The Law Commission also sought to address the overlap between the remedies under s461 and the Insolvency Act 1986, s122 (1)(g). Undeniably, case law showed that it was common for applications for s459 relief to include winding up as an alternative remedy for the same claim. Therefore, the Commission proposed in this regard that the winding-up order should be added to the list of remedies available to the minority shareholder under s461 of the Companies Act 1985.<sup>669</sup> However, this proposal of the Law Commission to include the creation of a winding-up order in s461 was criticised

---

<sup>662</sup> For a member to be able to claim on the basis of a single act of the company, whether past or future, would be prejudicial. See Law Commission, *Shareholder Remedies*. 1996, Consultation Paper, paras: 20.9-20.14.

<sup>663</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 55.

<sup>664</sup> Law Commission, *Shareholder Remedies*. (1997) para. 2.18.

<sup>665</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 46.

<sup>666</sup> Consultation Paper, 1996, para. 14.5. Also see paras: 4.19 and 4.23 of the reports.

<sup>667</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 53.

<sup>668</sup> D, Sugarman., Reconceptualising company law: reflections on the law Commission's Consultation Paper on shareholder remedies: Part 2. *Company Lawyer*, 1997, 18(9), pg: 277.

<sup>669</sup> Law Commission, *Shareholder Remedies*. 1996, Consultation Paper no.142. See paras: 20.24 & 20.28 of the Consultation Paper.

because each of the actions serves different objectives.<sup>670</sup> Furthermore, the separation of the two actions did not limit the court's power to grant either when needed.

The Law Commission recommended that appropriate provisions should be included in a firm's articles of association<sup>671</sup> in order to encourage shareholders to specify areas of potential dispute and to identify the "exit option" with a clear mechanism to use if such disputes should occur. This would facilitate the exit of a shareholder from a private company following a dispute, without the need to litigate under s459.<sup>672</sup>

McGee<sup>673</sup> agreed with the Law Commission's recommendation, arguing that the inclusion in articles of such exit mechanisms should be strongly encouraged, since this would help shareholders to focus their minds on what might go wrong at a time when they still had some chance of thinking more or less rationally about the subject. While this argument may be valid to the extent that shareholders would open their minds in advance to find a mechanism to exit from the company in the event of a dispute, there would remain the more difficult problem of the valuation of shares. Case law<sup>674</sup> shows that many cases have been brought on the grounds of a dispute over the value of shares, since they continually fluctuate. Thus, it is believed that the exit mechanism should consider how the shares would be valued in case of such a buyout.

#### 5.2.2.2 The Company Law Review

The Company Law Review considered almost all the recommendations put forward by the Law Commission<sup>675</sup> and strongly supported the proposal for stronger case management to address the issues of length and cost. However, the CLR rejected the proposal for inclusion of an exit option in the articles of association on the basis that it would be impracticable to prescribe a fair exit regime in advance and for the full

---

<sup>670</sup> P, Roberts. & J, Poole., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, pg: 53 & 54.

<sup>671</sup> The model or template articles (standard form) which apply to all companies registered under the 1985 Act.

<sup>672</sup> See Law Commission Report, paras 5.1-5.32.

<sup>673</sup> A, McGee., Exit Mechanisms in Private Companies, *The Company Financial and Insolvency Law review*. 1999. 3 (1), pg: 59.

<sup>674</sup> In *Elliot v Planet Organic Ltd* [2000] 1 BCLC 366, and *Irvine v Irvine* [2006] WL 901106, there was debate as to whether the court should consider the quasi-partnership in order to value the shares on a *pro rata* basis.

<sup>675</sup> Company Law Review, *Developing the Framework* (2000), para 4.102 – 4.106.



diversity of companies.<sup>676</sup> This rejection by the CLR does not seem to have had a strong justification, because allowing shareholders to have a clear exit option with an effective mechanism to value the shares in their articles of association would have been rather practical and effective. It is true that shareholders would not be able to foresee all the circumstances that might occur in the future, as their contracts would be incomplete, but such a system would at least provide remedies for some disputes.

On the question of adding winding up to the possible remedies available under s461, the CLR concluded that no such reform was necessary, because enabling minority shareholders to claim such a remedy would risk the viability and stability of companies and consequently it was appropriate for winding up to be the subject of a separate action under the Insolvency Act 1986, s122 (1)(g).<sup>677</sup> In fact, it is believed that even if winding-up had not been among the remedies available under s461, the court would still have had the power to decide whether to grant such relief as the court would have remained empowered to rule as it saw fit.<sup>678</sup> This was demonstrated in *Re R.A. Noble & Sons (Clothing)*,<sup>679</sup> where the court held that an order would, if necessary, be made to wind up the company. In addition, in *Re Full Cup Ltd*<sup>680</sup> the court instructed the minority shareholder to bring a winding-up claim instead of a claim under s459.

As well as addressing the Law Commission's proposals, the CLR considered the impact of *O'Neill v Phillips*<sup>681</sup> on this area of law and consulted on whether to recommend the statutory reversal of the decision in this case, as it was perceived by some as having unduly narrowed the scope of s459. In addition, it consulted on whether it needed to be replaced with a broader remedy which would be available in cases of unfairness.<sup>682</sup> The CLR took the view that the decision in *O'Neill v Phillips* should not be reversed,<sup>683</sup> noting that any widening or extension of the limited principles in the judgement would lead to lengthy and expensive proceedings and unjust outcomes.<sup>684</sup> Nonetheless, it is

---

<sup>676</sup> Company Law Review, *Developing the Framework* (2000), para 4.103.

<sup>677</sup> Company Law Review, *Developing the Framework* (2000), para 4.105.

<sup>678</sup> According to s461 (1) of the CA 1985, the court is empowered to make such order "as it thinks fit" for giving relief in respect of the matters complained of.

<sup>679</sup> [1983] BCLC 273.

<sup>680</sup> [1995] BCC 682.

<sup>681</sup> [1999] 1 WLR 1092.

<sup>682</sup> Company Law Review, *Developing the Framework* (2000), para 4.106-4.111.

<sup>683</sup> Company Law Review, *Completing the Structure* (2000), paras 5.70-5.78.

<sup>684</sup> Company Law Review, *Completing the structure* (2000), para 5.78.

believed that it would always be better to follow Arden J's view in *Re BSB Holdings Ltd*<sup>685</sup> that the wording of s459 was wide and general and that, therefore, the categories of unfair prejudice were not closed. The minority shareholder should be allowed to bring a legal action based on a wide range of conduct, and it should subsequently be up to the court to see whether the claim is valid and legitimate.

A final question considered by the CLR was whether arbitration could take place between shareholders, instead of litigation. The CLR did not recommend that arbitration should be compulsory for shareholders' disputes, but it considered whether there might be scope to encourage its greater use as an alternative to litigation.<sup>686</sup>

### **5.3 Minority shareholder protection under the Companies Act 2006<sup>687</sup>**

This section concentrates on the working of the new minority shareholder protection under the Companies Act 2006 ('the Act'). It will critically examine the extent of simplicity and flexibility which have been brought by the Act and what improvement it offers. In particular, this section of this Chapter will address the questions: what effect has the Act had on the grounds of the statutory derivative action? Does the Act mean that there will be greater litigation of directors' duties?<sup>688</sup> Has the Act created certainty and stability by introducing the statutory derivative action? And, if so, to what extent? Does the Act deliver a better derivative action to the minority shareholder? And, finally, does the Act change the unfair prejudice ground?

#### **5.3.1 Derivative action under the Companies Act 2006**

##### **a. Statutory derivative action**

---

<sup>685</sup> (No.2) [1996] 1 BCLC 155.

<sup>686</sup> See Company Law Review, *Developing the Framework* (2000), paras 7.44-7.69; and Company Law Review, *Completing the Structure* (2000), para 2.28.

<sup>687</sup> This section has been published in (M, Almadani., Derivative actions: does the Companies Act 2006 offer a way forward? *Company Lawyer*. 2009, 30(5), 131-140.)

<sup>688</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 205.

Following the investigations of the Law Commission and the Company Law Review,<sup>689</sup> it was realised that the rules in *Foss v Harbottle* were complicated and not sufficiently wide, and accordingly, the scope of the exceptions to the rules was uncertain and shareholders had difficult procedures to work through. As noted earlier, common law required the minority to establish “wrongdoer control”<sup>690</sup> and “fraud on the minority” as grounds to bring a derivative action, and neither of these helped the minority shareholder to bring an action for the company’s interest. In fact, they actually placed extreme limitations and difficulties on the right to bring a derivative action. Therefore, replacing common law with a “new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue an action” was recommended.<sup>691</sup> Consequently, the Companies Act 2006 introduced a statutory right for minority shareholders to bring derivative claims on behalf of companies. Currently, a statutory derivative action under s263 may be brought in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by directors of the company.<sup>692</sup> In other words, the statute allows the minority shareholder to bring a case in respect of a wide range of misconduct and wrongdoing.

The government’s objective when producing the statutory derivative action in the 2006 Act in this way was to ensure that shareholders could bring valid claims whilst no disturbance was caused to businesses by unnecessary or speculative claims.<sup>693</sup> Therefore, the Act can be said to have achieved a balance as it serves all interests within the company at the same time. In any case, irrespective of what the true intention of the government was in producing the statutory derivative action, codification by itself has been a great achievement which has provided efficient guidance and direction to directors, shareholders, lawyers, and even judges.<sup>694</sup>

---

<sup>689</sup> Law Commission, *Shareholder Remedies*. (1997, Cm 3769).

<sup>690</sup> *Burland v Earle* [1902] AC 83; *Edwards v Halliwell* [1950] 2 All ER 1064; *Pavlides v Jensen* [1956] 1 Ch 565. In these cases it was the right of the majority to bar the minority action whenever they lawfully ratify alleged misconduct.

<sup>691</sup> Law Commission, *Shareholder Remedies*. (1997) (para 6.15).

<sup>692</sup> Companies Act 2006, s263(1) and (2).

<sup>693</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 205.

<sup>694</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 214.

The number of matters providing a potential ground to bring a derivative action is now considerably greater under the statute since the grounds for conduct that permits the bringing of a derivative action have been widened and the court has been empowered, with free discretion,<sup>695</sup> to put itself into the position of a reasonable director of the company.<sup>696</sup> Although the court now has statutory provisional stages and a filtering process to refine any misuse or abuse of the action, it faces a considerable dilemma when exercising its discretion in dealing with an action which should be allowed, but for which litigation is not in the company's interest.<sup>697</sup> However, the statute maintains the principle that only the company can litigate, which was a cornerstone of common law. Therefore, ratification (but not ratifiability) is still an essential determinant in whether to allow an action to proceed.

#### b. Ratification under the statute

Traditionally, under common law, it was for the shareholders as a whole<sup>698</sup> to decide whether to enforce derivative actions, since the majority shareholder could ensure ratification in order to restrict the scope of actions under common law. The CLR<sup>699</sup> realised this, and proposed that a company's decision to pursue a wrong should depend on whether the majority needed to ratify had been reached without the need to rely on the votes of the alleged wrongdoers, or those who were substantially under their influence.<sup>700</sup>

The statute followed this proposal and made a major change to the principles of ratification under the statutory derivative action. Currently, any decision by a company to ratify a director's conduct must be taken by the members, without reliance on votes in favour from the directors or any person connected to the wrongdoing in question.<sup>701</sup>

Although it remains a complete bar to a derivative claim that the alleged wrong has

---

<sup>695</sup> Companies Act 2006, s263(2) and (3) empower courts, for the sake of granting permission, to be more involved in order to determine the circumstances alleged.

<sup>696</sup> A, Alcock, J, Birds. & S, Gale., *Companies Act 2006*. 1<sup>st</sup> ed. Jordans, Bristol, 2007. pg: 166.

<sup>697</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, 2005, March, pg:, 159-208.

<sup>698</sup> In the case *Allen v Gold Reefs of West Africa [1900] 1 Ch 656* it was established that directors have to act 'bona fide' in the interests of the company as a whole.

<sup>699</sup> Company Law Review, DTI Consultation Document, *Developing the Framework*, March 2000.

<sup>700</sup> Company Law Review, Final Report (2001), para 7.46; Completing the Structure (2000), para 5.85; Developing the Framework (2000), para 4.126.

<sup>701</sup> Companies Act 2006, s239.

been effectively ratified by the company, being able to obtain ratification without the wrongdoers' votes is a significant change, and one which will allow more opportunities to bring derivative claims, whilst reducing the possibility of ratification.<sup>702</sup>

Another change is that the mere fact that an alleged wrong is ratifiable but has not actually been ratified, may no longer be a complete bar to the statutory derivative claim, as was previously the case under common law.<sup>703</sup> However, under the statute, the court is required to consider the fact that the alleged wrong could be, and in certain circumstances, would be, likely to be ratified by the company.<sup>704</sup> Keay and Loughrey believe that, as long as the question of whether a wrong has been, or could be, ratified remains the determining factor for the court in deciding whether to grant permission to allow the derivative action to proceed, the position of ratification in the statute is no different to that of common law.<sup>705</sup> The authors derive this conclusion from *Franbar Holdings v Patel*,<sup>706</sup> where it was confirmed that the statute has not altered the common law position of ratification when there are wrongs that can be ratified by the majority. Hannigan also sees that the position of ratification under the statute makes no substantive change to the general principle of majority rule which used to give control to majority shareholders over ratification under common law, as the majority may remain empowered to ratify a wrong even under the statute.<sup>707</sup> Nonetheless, these authors have overlooked the fact that what makes ratification under the statute less of a bar to minority shareholders is that it is now more likely to be achieved without the wrongdoers' votes.

On the other hand, this new position of ratification has also received heavy criticism for creating the possibility that any shareholder connected to the wrongdoer may not be allowed to vote. In fact, if every shareholder connected to the wrongdoers was not allowed to vote, the limit on ratification may be seen as a wide-reaching provision with the potential to disenfranchise shareholders from their right to vote even if they have no

---

<sup>702</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 221 & 222.

<sup>703</sup> Companies Act 2006, s260(1) and (2).

<sup>704</sup> D, Lightman., The Companies Act 2006: A Nutshell Guide To The Changes To The Derivative Claim, *Civil Justice Quarterly*, 2007, 26 Jan, pg: 37-39. See also: Companies Act 2006, s263(2) (b), (c).

<sup>705</sup> A, Keay. & J, Loughrey., Derivative proceedings in a brave new world for company management and shareholders, *Journal of Business Law*. 2010, 3. pg:162.

<sup>706</sup> [2008] EWHC 1534 (Ch).

<sup>707</sup> B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 448.

personal interest in the matter.<sup>708</sup> This argument has merit, as it underlines the potential withdrawal of the right to vote from certain shareholders connected to the wrongdoers. In private companies, shareholders and directors always have connections with each other, and denying the shareholder's right to ratify any wrong simply because he is somehow connected to the wrongdoer seems inappropriate.

c. How to establish a derivative action under the statute

Establishing a derivative action under common law was surrounded by difficulty. Firstly, it was required, for the most part, to prove that the directors had committed a "fraud on the minority", which meant something as serious as appropriating the assets of the company.<sup>709</sup> Secondly, it had to be established that the wrongdoers were in control of the company. Thirdly, the action had to be brought *bona fide* for the benefit of the company and with its name.<sup>710</sup> Furthermore, it had to be established that the company had suffered a loss and that it was unfair for wrongful conduct to be ratified.<sup>711</sup> Finally, it was necessary to demonstrate that the alleged wrongdoing had benefited the wrongdoers.<sup>712</sup> Thus, many difficult and complex requirements under common law restricted potential claims from benefiting from the derivative action and from achieving the purpose for which the action was originally designed.

In contrast, almost all of these difficult requirements have been reformed in the new statutory derivative action in order to make it easier for the minority shareholder to establish an action. Under the statute, it is no longer necessary to show that the alleged wrongdoers are themselves in control of the company.<sup>713</sup> This has been confirmed in *Wishart v Castlecroft Securities Ltd*<sup>714</sup> when Lord Reid, from the Inner House of the Court of Session in Scotland, disagreed with Lord Glennie in the first instance, when the latter required the minority shareholder to establish wrongdoer control in order to proceed with the derivative action. It is believed that Lord Reid was correct in doing so,

---

<sup>708</sup> D, Nambisan., Commercial and Chancery; Insider Dealing, *The Lawyer*, 2006, 11 September, pg: 33.

<sup>709</sup> C, Timmis., Company Law: In good company? *Law Society Gazette*. 2006, 103(13), pg: 16.

<sup>710</sup> See the case *Barrett v Duckett* [1995] 1 B.C.L.C 243.

<sup>711</sup> A, Reisberg., Judicial Control of Derivative Actions, *International Company and Commercial Law Review*. 2005, 16(8), pg: 335-339.

<sup>712</sup> J, Dine., *Company Law*. 5<sup>th</sup> ed. Palgrave Macmillan, New York, 2005, pg: 253.

<sup>713</sup> Companies Act 2006, s260(3).

<sup>714</sup> Scottish case: [2009] CSIH 65 (IH (Ex Div)).

because removing such a requirement is what the Parliament intended.<sup>715</sup> Moreover, Davies explains that the real purpose of removing such a requirement is so that the court can grant permission, even if the alleged wrongdoers are not in control of the shareholders' meeting.<sup>716</sup> Fundamentally, according to the Act,<sup>717</sup> it is no longer necessary to establish that the wrongdoers themselves benefited from the alleged misconduct.<sup>718</sup> What is more interesting in the new requirements is that no defence of acting in good faith by the directors or wrongdoers will be accepted. This means that the claim can be successful even if the majority shareholder acted in good faith, as the court will give priority to the company's interest.<sup>719</sup>

Another advantageous factor which may also smooth the progress of the derivative action is that the statute empowers the court, with free discretion,<sup>720</sup> to put itself into the position of a member of the board of the company.<sup>721</sup> In doing so, the court will judge whether a reasonable hypothetical board of the company would pursue such an action. For example, in *Airey v Cordell*,<sup>722</sup> prior to the Act, the test which was applied was to judge whether a reasonable independent board could decide whether it was appropriate to pursue a derivative action. Although the court in this case had to assert its own view of how the board ought to proceed, it was satisfied that such a hypothetical board could take the decision to pursue the derivative claim, and thereby the permission to bring a derivative action was granted. Another example, decided after the Act was enacted, was seen in *Stainer v Lee*<sup>723</sup> where the minority shareholder brought a derivative action against the majority shareholder, who had made a substantial interest-free loan to a company he owned. The court granted the minority shareholder permission to continue the action after applying the test of the reasonable hypothetical board and finding that it would have pursued such an action. However, as Sykes states, there is no indication as to how, in practice, the court can distinguish the actual views of the theoretical

---

<sup>715</sup> D, Cabrelli., Statutory derivative proceedings: the view from the Inner House, *Edinburgh Law Review*, 2010, 14(1), pg:117.

<sup>716</sup> P, Davies., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell, London, 2008, pg: 619.

<sup>717</sup> Explanatory Notes of Companies Act 2006, 8 Nov 2006 para: 491. pg: 74.

<sup>718</sup> D, Lightman., The Companies Act 2006: A Nutshell Guide to the Changes to the Derivative Claim, *Civil Justice Quarterly*, 2007, 26 Jan, pg: 37-39.

<sup>719</sup> B, Cain., Members' rights and derivative actions, *Company Secretary's Review*, 2006, 30(2), pg: 9&10.

<sup>720</sup> Companies Act 2006, s263(2) and (3) empower courts, for the sake of granting permission, to be more involved in order to determine the circumstances alleged.

<sup>721</sup> A, Alcock. J, Birds. & S, Gale., *Companies Act 2006*. 1<sup>st</sup> ed. Jordans, Bristol, 2007. pg: 166.

<sup>722</sup> (2007) B.C.C 785.

<sup>723</sup> [2010] EWHC 1539 (Ch).

independent board. The lack of criteria in earlier cases, and the statute, itself, means that it is not an easy task for the court to predict whether any reasonable hypothetical independent board would decide to pursue such an action.<sup>724</sup>

#### d. Stages and filtering process in the statutory derivative action

It was realised that the main difficulty of bringing a derivative claim under common law was due to the wrongdoer's control of the board. When the Law Commission recognised this conflict of interest in the board's making of the decision to litigate, they recommended that power should lie with the court instead. This power should be exercised by the court in granting permission to continue a derivative action without allowing the board to have any more control over the litigation decision.<sup>725</sup> This reform tries to strike a balance between protecting majority shareholders from nonsense claims, while protecting the minority shareholder's right to pursue wrongdoing.<sup>726</sup>

The government, in the Act, followed this recommendation and empowered the court to grant permission to proceed with the action. So the Act<sup>727</sup> has withdrawn the power from the board and transferred it to the court, in the form of general discretion to decide whether to allow an application to proceed.<sup>728</sup> Therefore, any minority shareholder can bring a derivative action without reverting to the board, and it is then up to the court to grant permission if the claim is strong enough.<sup>729</sup>

However, the Act has not left the court without criteria, guidance and direction to follow when exercising its power in this respect. Rather, the Act has provided several stages and filtering processes in order to try to ensure that no misuse or abuse of the action is allowed. The aim of the Act, in creating these stages, was to provide safeguards to protect the companies from nonsense and disruptive claims which do not serve the

---

<sup>724</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 222 & 223.

<sup>725</sup> The Law Commission 1997, para: 6.73 recommended that the court should take into account all the relevant circumstances without limit when analyzing the facts in order to grant permission.

<sup>726</sup> B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 447.

<sup>727</sup> Companies Act 2006, s261(1).

<sup>728</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 215.

<sup>729</sup> The criteria in considering whether to grant permission is that the court must take into account whether the applicant is acting in good faith as well as satisfying s172 of the Companies Act 2006 test (duty to promote the success of the company).



company's interests.<sup>730</sup> These stages give the court specific power to dismiss unmeritorious cases at an early stage without the need to involve the company.<sup>731</sup> Most researchers and practitioners, if not all, believe that there should only be two stages in this procedure. However, in practice, there seem to be three.

In the first stage, the court must be satisfied that it is a *prima facie* case. For this, the court will consider the applicant's evidence alone without involving the directors, the majority shareholder or the company. The court must dismiss the application and make a costs order against the minority shareholder if the case does not disclose a *prima facie* case.<sup>732</sup> In fact, it is believed that this stage is truly an excellent reform of the position in common law, as it protects the company from being embroiled in disruptive cases. For example, in *Mission Plc v Sinclair*<sup>733</sup> the court refused to grant permission at the *prima facie* stage because it considered the alleged damage somewhat speculative, and that it did not present a *prima facie* case. Although the *prima facie* test was used under common law, Keay and Loughrey feel that the meaning of the term is indefinable. They also believe that no court has ever discussed in detail the actual meaning of the concept, and exactly how to establish it in a case.<sup>734</sup> This concern seems to be well-founded, as in *Wishart*<sup>735</sup> and other recent cases no effort was made towards defining the term and again the area was left without the judicial guidance that is sorely needed. Keay and Loughrey also state that this first stage has not been given sufficient thought by either the Parliament or the court, and that it should be limited only to ensuring that a claim is not nonsense and that the wrongdoing is related to grounds set out in the legislation, and nothing else.<sup>736</sup> Furthermore, Hannigan argues that the courts should be willing at this stage to allow the minority shareholder to proceed at least to the next stage, bearing in mind that the court will still be able to refuse permission further down the line.<sup>737</sup>

---

<sup>730</sup> A, Keay. & J, Loughrey., Derivative proceedings in brave new world for company management and shareholder, *Journal Business Law*. 2010, 3. pg: 153.

<sup>731</sup> B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 451.

<sup>732</sup> Companies Act 2006, s261 (2)(b).

<sup>733</sup> [2008] EWHC 1399 (Ch).

<sup>734</sup> A, Keay. & J, Loughrey., Derivative proceedings in brave new world for company management and shareholder, *Journal Business Law*. 2010, 3. pg: 154. The authors here think that, in order for the minority shareholder to establish *prima facie* case, he/she should be able to establish a greater than 50% chance of success.

<sup>735</sup> Scottish case: [2009] CSIH 65.

<sup>736</sup> A, Keay. & J, Loughrey., Derivative proceedings in brave new world for company management and shareholder, *Journal Business Law*. 2010, 3. pg: 157.

<sup>737</sup> B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 451.

However, it remains to be seen how the courts would apply this stage in practice, as no case so far has made this clear.

In the second stage (the stage which many researchers do not acknowledge) the court may require evidence to be provided by the company.<sup>738</sup> This stage has been created to give the minority shareholder the opportunity to access information to prove the wrongdoing. It is believed that this stage is likely to be efficient as long as the court restricts the company to answering specific questions and providing specific evidence. In contrast, this stage may prove neither useful nor efficient if there is an opportunity for the company to respond to the claim. One concern that needs to be noted here is that, since the majority shareholders who are in control will represent the company in any response, they will provide the court with what is right from their perspective. Therefore, in practice, the majority shareholders will, most probably, provide the court with evidence that is not going to hold them accountable for any misconduct. In this second stage, it is assumed that the court may not allow the action to proceed if the evidence provided by the company does not help to prove the misconduct claimed of, as the court is empowered to dismiss the claim at any stage. It is also believed that the court would hold the case until the company provides the requested evidence and the court may also demand further evidence from the company if what was originally provided did not comply exactly with the request.

In the third stage,<sup>739</sup> the court opens the application for a hearing involving both parties. It has been argued that, if the court concludes that either the claim is unlikely to succeed at a full hearing, or that the recoverable compensation from the wrongdoers is outweighed by the costs of the litigation, the court will refuse permission.<sup>740</sup> Therefore, the court is empowered to dismiss the claim at this stage, but it is believed that the court is less likely to make any such order here, because the aim of the costs order is to stop applications which do not disclose a *prima facie* case from progressing at the first stage. However, in the third stage the reasons for dismissing the application may be different. For example, the court may dismiss the claim because it would not benefit the

---

<sup>738</sup> Companies Act 2006, s261(4)(a).

<sup>739</sup> Companies Act 2006, s261 (4). On hearing the application the court may:(1) give permission to continue the claim as it thinks fit; (2) refuse permission and refuse the claim; or (3) adjourn the proceedings on the application and give such directions as it thinks fit.

<sup>740</sup> A, Boyle. J, Birds. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007. pg: 683.

company's interest even if it succeeded. For instance, in *Franbar Holdings Ltd v Patel*<sup>741</sup> the judge investigated several factors when deciding to grant permission, including the potential for success, the value of compensation recovered, the cost of the proceedings, and the damage which would be caused to the company in the case of failure.<sup>742</sup> Davies notes that this stage, particularly, offers an advantage to the court, as it answers the question of whether the claim is in the interests of the company.<sup>743</sup> However, this is not always true, as the court may refuse permission which, if allowed, would benefit the company, but this benefit would be smaller than the costs of litigation.

A criticism has been put forward relating to the court's examination of the alleged conduct in the third stage (by which point the court would be deeply involved with consideration of the company's affairs, and therefore the company's commercial decisions). It is believed that the court may not have the ability to correctly predict the decision of a reasonable board of a company because it is still an external body.<sup>744</sup> This argument may be true, as there is variation from one company to another in terms of its activity, objectives, targets, etc, and it may be difficult for the court to put itself in the position of every company, as there is no single standard to apply.<sup>745</sup>

Furthermore, in this third stage the court will take into account whether an s994 (unfair prejudice) petition can be pursued instead of a derivative claim.<sup>746</sup> Cabrelli believes that the English courts are not prepared to grant permission to continue a derivative action if a remedy under s994 is available.<sup>747</sup> For instance, one of the reasons for refusing to grant permission in *Franbar Holdings Ltd v Patel*<sup>748</sup> was the ability of the minority shareholder to pursue the same claim under s994.

---

<sup>741</sup> [2008] EWHC 1534 (Ch). The permission in the case was refused holding that the applicant had not shown that the hypothetical board would have pursued such a claim.

<sup>742</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 223.

<sup>743</sup> P, Davies., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell, London, 2008, pg: 614 & 615.

<sup>744</sup> H, Hirt., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, 2005, March, pg: 159-208.

<sup>745</sup> Also see sub-section: 5.4.3.1.c How to establish a derivative action under the statute.

<sup>746</sup> Companies Act 2006, 263 (3) (e).

<sup>747</sup> D, Cabrelli., Statutory derivative proceedings: the view from the Inner House, *Edinburgh Law Review*. 2010, 14(1), pg:121.

<sup>748</sup> [2008] EWHC 1534 (Ch).

Although it is very important for the court to have the power to grant permission, it does not make sense to have three stages in practice, simply to allow the minority shareholder to speak out. These stages should be reduced to a single stage that entitles the court to decide whether to grant the minority shareholder permission, rather than wasting time and money going through these separate stages. If the case is proved to be valid in the court's eyes at the *prima facie* stage, then permission should be granted. However, it is believed that the third stage in the Act, opening the application for a hearing, may be a total waste of time. This is because the case will never provide, at this early stage, a full picture which enables the court to see clearly the potential for success, as many issues will arise throughout the duration of the proceedings.

e. Concerns about the statutory derivative action

Since the Act came into force, there have been many concerns and worries regarding the practical working of the statutory derivative action. The first concern regarded the possibility that the new statutory derivative action would facilitate the way for too many cases to be brought.<sup>749</sup> The new development has been negatively described as a “massive lowering of the hurdle which will make it very easy for shareholders to commence claims. They [shareholders] will simply have to just make an allegation of negligence”.<sup>750</sup> In the same way, Dodd has expressed his suspicion that a company's directors may be exposed to an unacceptable degree of scrutiny and an increased threat of claims being brought by militant minority shareholders.<sup>751</sup> Furthermore, Wild and Weinstein have also raised this concern in saying that the new statutory derivative action will open the floodgates for litigations.<sup>752</sup> Others take it to an even more extreme level and believe that the new derivative action is totally anti-business, and that it has a great potential to create a society of litigation culture just like in the US.<sup>753</sup>

---

<sup>749</sup> Brocklesby assumes in his article (N, Brocklesby., Derivative claims under the Companies Act 2006, *In – House Lawyer*, 2007, February, pg: 94-97) that this clause will retain the ‘majority rules’ principle exactly as enshrined in the case *Foss v Harbottle* [1843] 2 Hare 461.

<sup>750</sup> C, Timmis., *Company Law: In good company?* *Law Society Gazette*. 2006, 103(13), pg: 16.

<sup>751</sup> A, Dodd., *Directors’ duties and derivative actions*, *Company Secretary’s Review*, 2007, 30 (19). pg: 145.

<sup>752</sup> C, Wild. & S, Weinstein., *Smith & Keenan’s Company Law*. 14<sup>th</sup> ed. Longman, Harlow, 2009. pg: 264.

<sup>753</sup> J, Sykes., *The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006*, *Civil Justice Quarterly*. 2010, 29(2), pg: 222.

Nonetheless, it is believed that all these threats and dangers are more theoretical than real.<sup>754</sup> Sykes states that, despite these fears, there is no evidence to support such a bleak picture emerging. In fact, as he also adds that initial evidence shows that the courts are not completely shifting from their traditionally adopted approach.<sup>755</sup> Likewise, Hannigan also notes that it is a mistake to conclude that the introduction of the statutory derivative action could significantly increase the risk to directors, as it is, in effect, unlikely that there will be any considerable rise in the number of proceedings.<sup>756</sup> Thus, it is contended that any belief which states that the new derivative action is a reason for alarm, is overstated, because the Act has included in its design certain stages and a filtering process to ensure that no worthless or self-interested claims take place. Davies emphasised this particular point by noting that Parliament, when producing the Act, recognised that companies may be distracted from more important commercial matters by having to clarify in court why such a claim should not be allowed to proceed any further, and therefore the Act contains stages whereby claims can be filtered without even having to involve the company.<sup>757</sup>

The second concern is over how a court gauges the manner in which a director acting pursuant to s172 would proceed.<sup>758</sup> Section 172 is rather a complex provision. The problem with it is that there are no clear criteria or definite standards for the court to follow when dealing with the section in derivative action.<sup>759</sup> In fact, the Act does not seem to provide any clear framework to ensure that directors are held accountable for their decision-making processes under derivative action. Nonetheless, it is believed that the Act has deliberately left many areas open in order for the court to have discretion and be allowed to develop principles so it can bring justice when it is needed.<sup>760</sup>

#### f. Matters still remaining unreformed under the Act

---

<sup>754</sup> D, Lightman., Boards Beware! Lawyers Loom, *The Times*. 2006, 12 September, pg: 6.

<sup>755</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 222.

<sup>756</sup> B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 451.

<sup>757</sup> P, Davies., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell, London, 2008, pg: 620.

<sup>758</sup> Section 172 require directors to have regard for all six factors in every decision according to s172.

<sup>759</sup> A, Keay., Section 172 (2) of the Companies Act 2006: An Interpretation and Assessment, *Company Lawyer*, 2007, 28(4). pg: 109.

<sup>760</sup> A, Alcock. J, Birds. & S, Gale., *Companies Act 2006*. 1<sup>st</sup> ed. Jordans, Bristol, 2007. pg: 166.

The first reform that should be made to the current Act is in respect of the three stages which are designed to drive the minority shareholder through a lengthy and impractical process in order to be granted permission. These stages slow down the efficacy and effectiveness of the claim, as it takes a long time to allow the minority shareholder to bring a derivative action. In fact, the Law Commission only proposed there to be one stage that the minority shareholder should go through to be granted permission.<sup>761</sup> Thus, the permission stages should be combined, enabling the minority shareholder to obtain permission instantly or at least much more quickly.

The second reform regards the indemnity order. It is understood that there has been no change in the court's power to indemnify the minority shareholder against any liability in respect of costs incurred in the claim.<sup>762</sup> The Act does not seem to solve this problem, which existed for a long time under common law, and which proved not to be in the company's interests. Therefore, the Act has left the derivative action lacking a critical procedure upon which many cases may depend.<sup>763</sup> Wrongdoers may take advantage of this by committing wrongs, knowing that there is only a small risk of an action being brought against them because of the financial burden.<sup>764</sup> It is admitted that it may not be fair to give an indemnity order to the minority shareholder as soon as he/she brings a derivative claim, as this may give an opportunity to a troublesome minority shareholder to abuse or misuse the action and waste the company's money on baseless claims.<sup>765</sup> However, it is assumed that the permission stage provides the best opportunity to grant the minority shareholder an order for indemnity, as long as he/she is granted permission to proceed with the action. Consequently, the Act should add the right to obtain an indemnity order once the minority shareholder is granted permission, regardless of the result of the case, as stated in *Wallersteiner v Moir*.<sup>766</sup>

---

<sup>761</sup> The Law Commission: *Shareholder Remedies*: 1997, para 6.4.

<sup>762</sup> D, Lightman., *The Companies Act 2006: A Nutshell Guide To The Changes To The Derivative Claim*, *Civil Justice Quarterly*, 2007, 26 Jan. pg: 38.

<sup>763</sup> A, Reisberg., *Derivative Actions and Funding Problem: The Way Forward*, *Journal of Business Law*, 2006, Aug, pg: 445-467.

<sup>764</sup> J, Sykes., *The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006*, *Civil Justice Quarterly*. 2010, 29(2), pg: 226.

<sup>765</sup> D, Cabrelli., *Statutory derivative proceedings: the view from the Inner House*, *Edinburgh Law Review*. 2010, 14(1), pg:120.

<sup>766</sup> [1975] QB 373.

The third reform of the Act should be to require the minority shareholder to provide written notice to the company, identifying the wrongdoing and the remedial action to be undertaken.<sup>767</sup> Although the Civil Procedure Rules expect the minority shareholder to hand a notice to the company before commencing an action, there is no requirement in the statute for him/her to do so. If this requirement were adopted, it would prevent any misuse or abuse by the minority shareholder and would give the directors a chance to remedy the wrongdoing without going through lengthy and expensive litigation. Sykes assumed that the government's aim in choosing not to adopt the 28-days prior notice in the Act was to prevent the majority shareholder's "wrongdoer control" over litigation, since this may delay claims being brought, as was the case under common law.<sup>768</sup> However, Jonathan Djanogly MP argued in Parliament that empowering the minority shareholder to commence litigation against the majority shareholders without consulting or informing the board would increase the chances of tactical litigation.<sup>769</sup> Therefore, it is believed that the Act should require the minority to give written notice to the majority in advance, stating that he/she will proceed with a claim if no remedial action regarding the wrongdoing is undertaken.

Another amendment that should be made to the Act is in respect of the requirement for clean hands to bring a claim. It is clear from cases under common law<sup>770</sup> that the clean hands condition did play a major role in certain cases being refused. The Act has not resolved this unsuitable requirement, and it can be argued that the same requirement remains.<sup>771</sup> In fact, it is hard to understand why the Act has done this, since the important issue for the court is doing justice for the company and not for the minority shareholder.<sup>772</sup> Therefore, the way that the minority shareholder has acted should be irrelevant in this type of litigation. It is contended that, once the Act adopts this requirement, the majority could always abuse it by claiming that the minority shareholder did not have clean hands, and that the action was the result of a hidden

---

<sup>767</sup> This proposal, put forward by the Law Commission (*Shareholder Remedies*, 1997), was that the derivative claimant should give notice to the company, and only 28 days after that the minority shareholder should be entitled to claim.

<sup>768</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*, 2010, 29(2), pg: 222.

<sup>769</sup> Hansard Deb H.C. 17 October (2005-06) [Speech].

<sup>770</sup> *Towers v African Tug Co* [1904] 1 Ch. 558 CA, and *Nurcombe v Nurcombe* [1985] 1 W.L.R 370 CA (Civ Div).

<sup>771</sup> A, Keay., & J, Loughrey., Derivative proceedings in brave new world for company management and shareholder, *Journal Business Law*, 2010, 3, pg: 168.

<sup>772</sup> J, Payne., Clean hands in derivative actions, *Cambridge Law Journal*, 2002, 61(1) pg: 76.

purpose. Therefore, the correct principle should be, as Roberts and Poole suggested, that when a claim is likely to benefit the company's interest, the court should allow it even if the minority shareholder does not have clean hands.<sup>773</sup> Similarly, in *Wishart v Castlecroft Securities Ltd*<sup>774</sup> Lord Glennie stated that it was not clear why a company could not benefit from a claim simply because the minority shareholder had an ulterior reason to bring it.

Finally, it is also clear that no concern has been given in the Act to the personal rights which functioned under common law as well as the derivative action. In fact, the Law Commission<sup>775</sup> and the CLR<sup>776</sup> debated whether to state a non-exhaustive list of personal rights in any new legislation but, in the end, the Act does not state a non-exhaustive list of personal rights. It is believed that the Act has done the right thing in not changing the status of personal rights, as any change in the law when there is stability and settlement may create problems rather than offer a positive reform. Nonetheless, the Act should have made some effort to define the personal rights, grounds and principles that the minority shareholder can identify and exercise.<sup>777</sup> It is claimed that leaving the personal actions without clarification and guidance to follow may create confusion and puzzlement in some cases. Talbot has noted that the minority shareholder is likely to be confused now when complaining against an ultra vires action, as it is not clear whether to bring a personal action under common law or a claim against the directors for a breach of s171 (via a derivative action) for failing to observe the company's constitution.<sup>778</sup> It is true that the grounds of personal rights, in practice, may be better served by other remedies, such as s994, and therefore may gradually

---

<sup>773</sup> P, Roberts & J, Poole., Shareholder remedies corporate wrongs and the derivative action, *Journal of Business Law*. 1999, Mar. pg: 107.

<sup>774</sup> Scottish case: [2009] CSIH 65 (IH (Ex Div)).

<sup>775</sup> Law Commission Reports, *Shareholder Remedies*. (1997)

<sup>776</sup> Company Law Review. *Developing the Frame Work* (2000). Also, Company Law Review. *Final Report*. Vol.1 (2001).

<sup>777</sup> There is still confusion in the law over exercising the personal rights. It is not clear where the line is drawn between enforcing personal rights and derivative rights. This confusion appeared from time to time under common law in cases such as *Latchford Premier Cinema Ltd v Ennion* [1931] 2 Ch 409 and *Oliver v Dalglish* [1963] 1 WLR 1274. It was argued in each case whether derivative rights or personal rights should have been exercised. Recently, more confusion occurred in cases like *Johnson v Gore Wood & Co* [2001] 1 All ER 481.

<sup>778</sup> L, Talbot., A contextual analysis of the demise of the doctrine of ultra vires in English company law and the rhetoric and reality of enlightened shareholders, *Company Lawyer*. 2009, 30(11), pg: 325.



disappear.<sup>779</sup> However, it is still important to clarify the personal rights, as it is indeed difficult now to establish whether a personal right exists.<sup>780</sup>

### 5.3.2 Unfair prejudice under the Companies Act 2006

Unfortunately, the Companies Act 2006 has not included any changes to s459 of the Companies Act 1985. This means that the Act has not addressed the deficiency and uncertainty which the Law Commission and CLR identified. Many recommendations and proposals were put forward to improve the law in this area, but they all seem to have been ignored. To prove that s994 still carries a certain lack of clarity, in the recent case of *Wilson v Jaymarke Estates Ltd*,<sup>781</sup> the majority shareholder allegedly committed unfair prejudice by withdrawing a sum of money from the company's bank account without the minority shareholder's consent. However, the shareholder's lawyers were not sure which grounds to bring an action upon, and were not able to advise the minority shareholder whether the case had potential for success under s994. Lord Hope, in the House of Lords, was not happy with the legal consultation given to the minority shareholder in this case. Nonetheless, the confusion and doubt of the lawyer in this case was expected because there is no clear guidance or criteria for lawyers to follow in order to establish a clear case under s994.

Moreover, Goddard believes that, although both unfairness and prejudice are important factors for establishing a case under s994, neither is properly defined.<sup>782</sup> Therefore, all the concerns and alarms raised under s459 will be raised again under s994. In addition, it is claimed that there are many new questions about the unfair prejudice remedy that need to be answered. For example, what makes excessive remuneration unfair within the framework of the section? These concerns and others have been raised in *Irvine v Irvine*<sup>783</sup> and *Fowler v Gruber*,<sup>784</sup> but they have not yet been addressed. As a result, it is argued that s994 is expected to produce certain difficulties and complexities in some cases that may not be easy to tackle.

---

<sup>779</sup> B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 465.

<sup>780</sup> S, Judge., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2008. pg: 148.

<sup>781</sup> Scottish case: [2007] UKHL 29; 2007 S.C (H.L) 135 (HL).

<sup>782</sup> R, Goddard., The unfair prejudice remedy, *Edinburgh Law Review*. 2008, 12(1), pg: 94.

<sup>783</sup> [2007] 1 BCLC 349.

<sup>784</sup> [2009] CSOH 156.

On the other hand, despite all of the obscurity and lack of clarity in s994, it is widely admitted that it is still the most preferred action for minority shareholders. Sykes emphasises that it was not right to anticipate that the introduction of the statutory derivative action would prevail over s994, as cases show that unfair prejudice remedies are still regularly sought.<sup>785</sup> This is exemplified by certain recent cases, such as *Callard v Pringle*<sup>786</sup> and *O'Donnell v Shanahan*,<sup>787</sup> where the minority shareholders preferred to use s994 to remedy wrongs which also had the potential to be brought under the derivative action process. Therefore, the usage of s994 is still favoured, not only to serve the criteria under s994, but it would still, as Cabrelli indicated, achieve all that could be achieved by the statutory derivative action, and even more.<sup>788</sup> This particular point was seen in *Gamlestaden Fastigheter AB v Baltic Partners Ltd*,<sup>789</sup> where the minority shareholder brought s994 proceedings regarding a wrong done to the company, which was the basis for a classic derivative action, and the court held that, although the majority shareholder applied to strike out the claim on the basis that s994 should benefit only the minority shareholder in his capacity as a member, the majority shareholder was ordered to pay damages to the company. Thus, it can be claimed that s994 will still protect personal and corporate rights and interests effectively. This popularity of s994 is due to its effectiveness in remedying wrongs and having easier requirements to meet, even though the section has its flaws.<sup>790</sup>

#### 5.4 Conclusion

This chapter has explained and examined the developments and processes which have led to the present protection for minority shareholders in the UK. It would be very useful for Saudi Arabia and Dubai to understand how the development of UK law has addressed its problems, and whether it has done so successfully. Therefore, this chapter has outlined the protection offered to minority shareholders under common law and the old company law prior to 2006, examined what the Law Commission and the CLR

---

<sup>785</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), pg: 224.

<sup>786</sup> [2007] All E.R. (D) 91.

<sup>787</sup> [2009] EWCA Civ 751.

<sup>788</sup> D, Cabrelli., Statutory derivative proceedings: the view from the Inner House, *Edinburgh Law Review*. 2010, 14(1), pg:119.

<sup>789</sup> [2007] UKPC 26.

<sup>790</sup> P, Davies., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell, London, 2008, pg: 707.

recommended and proposed in order to address the failure of minority shareholder protection under common law and the old statute, and showed the results of these recommendations as reflected in the Companies Act 2006.

Under common law, litigation was exercised by minority shareholders only through the exceptions to *Foss v. Harbottle*. These exceptions were categorised into two types: personal actions and derivative actions. However, minority shareholders were faced with difficulty when bringing a personal or derivative action under common law. When it came to derivative action, the minority shareholder had to establish “fraud” and “wrongdoer (majority) control” which did not help the minority shareholder to promote the company’s interest. This was because not all wrongdoings necessarily amounted to fraud. Consequently, these harsh requirements placed extreme limitations on such personal and derivative actions under common law.

On the other hand, s459 of the Companies Act 1985, “unfair prejudice”, functioned with much greater flexibility. The wording of s459 was broad and its categories were open, to the extent that minority shareholders were driven to use the device even if it was not necessary. Gradually, it was realised that the availability of the new remedy was capable of being oppressive towards the majority shareholder. At that time, certain judges tried to develop methods of restricting the number of cases being brought. The case of *O’Neill v Phillips* played a major role in restricting the ease and simplicity of pursuing an unfairly prejudicial case.

The Chapter discussed the attempts by the Law Commission and the Company Law Review Group to diagnose the causes of certain failings in the functioning of minority shareholder protection in common law and in the statute. From their findings, they concluded that the rules under common law were complicated and not sufficiently wide and, therefore, they recommended replacing common law with a new derivative procedure with more modern, flexible and accessible criteria. They also delivered certain recommendations and proposals regarding s459, “unfair prejudice”.

It has been shown that the Companies Act 2006 introduced a statutory derivative action that is flexible, and that can be brought not only in respect of fraud, but also of other misconduct. The Act has also empowered the court to grant permission to proceed an

action after subjecting the claim to certain filtering processes to ensure that no misuse or abuse of the action is allowed. Although it can be claimed that the statutory derivative action has introduced flexibility and guidance, the chapter has highlighted certain matters which still require reform.

It has been also demonstrated in this section that the Companies Act 2006 has not introduced any change to the position of unfair prejudice, but rather has transferred s459 of the Companies Act 1985 as it is to s994 of the new Act. This means that the Act has not addressed the deficiency and uncertainty which the Law Commission and Company Law Review emphasised under s459 and, thus, many recommendations and proposals seem to have been ignored.

## Chapter 6

### Solving the problems of Saudi Arabia and Dubai

#### Introduction:

After having diagnosed where the problems lie and identifying the weak and inefficient aspects of minority shareholder protection in SA and Dubai in chapter 3 and 4, it is now important to offer appropriate and workable reforms. At this stage, the research should be able to prescribe changes in minority shareholder protection in SA and Dubai that address identified problems and flaws, and it will do so by taking some inspiration from the UK experience. As has been discussed in previous chapters, the UK minority shareholder protection system has gone through many revolutionary stages which have improved its functions and practicalities to the extent that it can now be confidently taken as a guide for any jurisdiction that seeks to reform the law in this respect. What makes UK company law advantageous is that it has been the subject of a great deal of investigation as attempts have been made to discover what is, in practice, most appropriate, before reform has been implemented. Consequently, UK minority shareholder protection does not offer theoretical recommendations or hypothetical proposals that are far-removed from reality. For UK protection to arrive at this level of sophistication in protecting minority shareholders, numerous devices and mechanisms have been tested thoroughly to see which can offer real protection and which cannot. Therefore, it is thought that, if any developing jurisdiction seeks to reform its law in this respect, it will be much better for it to learn from the valuable experience of UK law, rather than starting again “from scratch”. UK protection may offer a strong foundation for any jurisdiction which seeks to engage in reforming its minority shareholder protection.

As outlined above, Saudi and Dubai legislators may, when reforming their minority shareholder protection, be able to learn from the UK experience and study its practice in order to see what can be borrowed or adopted. However, this is not to say that the two jurisdictions should follow the UK example blindly and take whatever UK law offers, because, as has been shown in chapter 5, UK law still carries a certain degree of

deficiency, and SA and Dubai are jurisdictions with very different legal systems. Instead, this chapter will indicate which statutory provisions can be adopted and to what extent they need adaptation for effective and efficient application in SA and Dubai. To put it another way, this chapter will demonstrate the possibility and probability of SA and Dubai borrowing and adopting certain devices and mechanisms from those workable, practical and actionable remedies under UK law, in any future reform of their company law.<sup>791</sup>

This chapter is divided into a number of sections, each one addressing an existing problem within minority shareholder protection in SA and Dubai. Once the problem is identified and diagnosed, the same section will outline how UK law can address it and to what extent it can do so. Thus, an overview of the problems in SA is given in the first section, while the second section focuses on the problem of having no statutory provisions, its effect and how to solve it. The next section attempts to draw a balance between the wish of judges to have unrestricted discretion and the necessity to have a statutory footing to regulate minority shareholder protection. The fourth section deals with the problem of costs when litigating and the fifth section discusses how Saudi and Dubai law should adopt grounds which permit the shareholder to bring proceedings for harm done to their personal interests and what needs to be adapted for these to become more workable. The next section reveals the rights and interests of the minority shareholder which SA and Dubai should include in their statutes. The seventh section discusses certain alternative remedies that may support the statute in providing efficient protection, and the eighth recommends Dubai company law, in particular, to follow the recommendations and proposals which have been delivered by this research. The final section is the conclusion.

### **6.1 Outlining the Saudi problem:**

It is important to begin this chapter by recapping the current position of Saudi law in regard to protecting minority shareholders. Saudi company law was enacted in 1965 and therefore came into force prior to the recent explosion of commercial activity in the country. The provisions which specifically deal with minority shareholders in private

---

<sup>791</sup> What makes this research so unique and valuable are the reliable results of the empirical study, which was conducted in SA to investigate the doctrine of minority shareholder protection in practice.

companies are very few, incomplete and afford little or no protection.<sup>792</sup> For example, there is a statutory provision which gives the minority shareholder the right to complain to majority shareholders over any conduct, and it is then for the majority shareholders to decide whether the action complained about should be ratified or not,<sup>793</sup> meaning that the law here entitles the majority shareholders to act as judges in their own case.<sup>794</sup> It also restricts complaints to being made prior to the completion of the conduct; otherwise the minority shareholder's right to complain is denied. This provision, then, is deliberately designed to keep power and control over the company's affairs in the hands of the majority shareholders.

Another example which proves the deficiency of the law in this respect is when Saudi law allows minority shareholders to bring a legal action against the directors of the company (who in most private companies are the majority shareholders) if they are acting or are about to act *ultra vires* or illegally (especially outside its corporate objectives).<sup>795</sup> However, the law does not clarify who can act on behalf of the company in such cases, and also does not specify the options which may be available for the minority shareholder if the company does not intend to pursue any compensation. A further example which highlights the absence of practical protection is seen when the law gives minority shareholders the right to advise and recommend matters to directors (majority shareholders),<sup>796</sup> but without stating how to do so, and without clarifying which action can be brought if the majority shareholder does not take the advice on board and damage is done as a result. The same provision gives all shareholders (including the minority) the right to access, on request or by themselves, any type of information, statistics, data and reports that are relevant to the company's affairs.<sup>797</sup> However, the statute does not provide a mechanism to indicate which procedures to follow in making such a request. Furthermore, the statute does not specify which

---

<sup>792</sup> See Chapter 3, Section 3.2. In this section the current position of the law when it comes to minority shareholder protection has been discussed in detail.

<sup>793</sup> s28 of the Saudi Company Law 1965. It is important to note that the statute here does not define the types of conduct which the majority has authority upon and to what extent. It is also not clear for the minority shareholder as to when he/she can involve the court in disputes or complaints.

<sup>794</sup> See Chapter 2, Section 2.1.4.

<sup>795</sup> See Chapter 3, Section 3.2.

<sup>796</sup> s24 of the Saudi Company Law 1965. This right entitles minority shareholders, who are non-directors, to have their say on matters related to the company even if they are not directors.

<sup>797</sup> s24 of the Saudi Company Law 1965.

grounds the shareholder should rely on or even which remedies are available when prosecuting such a claim.

Although Sharia law contains some principles that may protect minority shareholders from potential abuse or misuse, it merely provides general and indirect principles, leaving the detailed mechanisms, devices, legal grounds and remedies for the statute to formulate according to the requirements of contemporary commercial and company law.<sup>798</sup> Thus any deficiency in protecting minority shareholders in private companies is not attributable to Sharia (as its role is to provide general principles, not specific detail, when it comes to company law).<sup>799</sup> It is, rather, the statute that is to blame for not giving much more detail and for not providing remedial mechanisms.

Having examined what is relevant to the protection of minority shareholders in the Saudi statute, it can be claimed that there are many circumstances which the Saudi statute does not address clearly or at all, such as abuse of power, negligence, breach of duty, fraud, expropriation, or oppression, when committed by directors or majority shareholders. In fact, it is believed that the current statute, rather than offering legal assistance, guidance and protection to minority shareholders, has served to increase the degree of difficulty and confusion, not only among potential foreign shareholders, but also among Saudis.<sup>800</sup> In reality, most of the statutory provisions have weak characteristics and so cannot protect minority shareholders appropriately. Thus, the Saudi statute creates overlaps that lead to inconsistency and uncertainty when it comes to minority shareholder protection since there is no statutory guidance as to the grounds on which the minority shareholder may bring an action. Furthermore, no remedies are identified for the minority shareholder to use when misconduct occurs in the company, and harms the minority, and accordingly the Saudi statute does not guarantee the minimum required protection for minority shareholders.

As a result of the lack of effective protection offered by the Saudi statute, it is undeniable that Saudi minority shareholder protection is wholly lacking from top to

---

<sup>798</sup> See Chapter 3, Section 3.3.5, where the role of Sharia in protecting minority shareholder has been discussed in full.

<sup>799</sup> Although Sharia seems only to provide general principles when it comes to company law and its functions, Sharia provides full detail and complete guidelines when it comes, for example, to family law or inheritance.

<sup>800</sup> See Chapter 3, Section 3.2.



bottom, starting with the failure to recognize the rights and interests of minority shareholders and ending with the lack of remedies for them to use when necessary. In effect, it is found that out-dated Saudi company laws obstruct minority shareholder protection and contain gaps which may result in uncertainty, ambiguity and even injustice.<sup>801</sup> This means that Saudi law is not suitable for dealing with contemporary corporate issues, especially in relation to protection of minority shareholders in private companies.

This chapter aims to examine ways of creating a system that deals justly and fairly with the protection of the minority shareholder in SA (and also Dubai), and it is believed that this can be achieved by following in the footsteps of the Anglo-Saxon model as long as it does not contradict Sharia principles or critical legal, cultural or political constraints. It is also believed that minority shareholder protection in SA and Dubai cannot be subject only to general principles or commercial conventions any longer; it has now become necessary to solve the problems and provide a thorough and effective protection.<sup>802</sup> Every proposed solution to the problem of protection in SA emanates from UK law, which is a leading model amongst Anglo-Saxon jurisdictions, but certain adaptations are suggested so that their particular problems may be dealt with appropriately.

## **6.2 The problem of having no statutory provisions**

The first problem is that, while it has been proven<sup>803</sup> that, indeed, minority shareholders in SA and Dubai do face certain types of misconduct from majority shareholders in private companies when the latter commit fraud, abuse, infringement of rights, negligence, breaches of duties and trust, unfair prejudice and oppression, there is no codified statutory system to protect minority shareholders against each and every one of these types of misconduct. The types of misconduct are similar to those which exist under UK law, but what differs is that Saudi and Dubai laws lack statutory grounds that can enable the minority shareholder to pursue every instance of wrongdoing. Another negative impact which comes from the lack of having a codified system to regulate minority shareholder protection is the confusion that minority shareholders face in

---

<sup>801</sup> See Chapter 3, Section 3.3.6, where the role of the company statute in regulating protection alongside Sharia is explained.

<sup>802</sup> See Chapter 3, Section 3.3.6.

<sup>803</sup> See Chapter 3, section 3.3.1.1, and also 3.6.2.

understanding the difference between corporate and personal actions. This confusion occurs in SA and Dubai because there is no clarity as to what each action (corporate and personal) serves. As previously mentioned, minority shareholder protection in SA and Dubai cannot merely be subject to general principles or commercial conventions any longer, as it has now become clear that the absence of a detailed statutory code leads to uncertainty and ambiguity. It was ascertained from the empirical study that certain commercial practitioners (among them lawyers) did not know the potential grounds which may be used when seeking to remedy a wrong committed against the company.<sup>804</sup> This is because the right is not clearly stated in the statute in a way that is accessible to the minority shareholder. There is therefore a necessity to codify minority shareholder protection in the company law statute.<sup>805</sup> Thus, it is strongly recommended that SA and Dubai company law introduce a comprehensive statutory code that can provide for minority shareholder protection and manage its grounds and actions.

UK law has produced such a code by designing five different actions, mostly statutory, that guide the minority shareholder to establish specific grounds and meet certain requirements when wishing to remedy a particular case of misconduct. In fact, having statutory footings also provides efficient guidance and direction to directors, shareholders, lawyers, and even judges.<sup>806</sup> In both SA and Dubai, codification would allow courts to be deeply involved, with much greater confidence, in all commercial disputes between shareholders, and not only where there is clear fraud as in current practice. Codification would also help to promote understanding of the idea of litigating on behalf of the company and for its interests, something which UK law has offered through derivative actions, but SA and Dubai lack.<sup>807</sup> Thus, the best way to solve this lack of codification of minority shareholder protection in both SA and Dubai is to learn from the UK statute and see which of its features can be adopted. The table below contains a summary of the UK actions to show how each one functions, what it services and requires, and what remedy it offers. In fact, this information could provide Saudi and Dubai law-makers with a much better understanding of how to codify their laws.

---

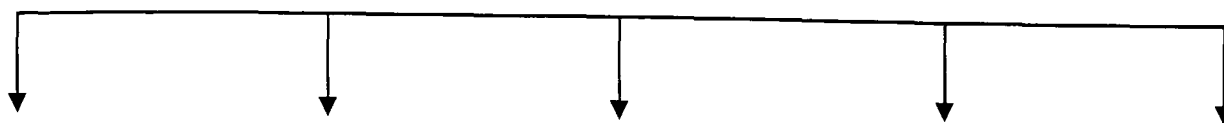
<sup>804</sup> Chapter 4, Sections 4.4.4.

<sup>805</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. at 166.

<sup>806</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29 (2), pg: 214.

<sup>807</sup> See Chapter 4, Section 4.3.1.1, and also 4.4.4.

## UK minority shareholder protection



Action:	Personal actions under Common Law	Statutory derivative action s260	Unfair prejudice s994	Winding-up order s122 Insolvency Act 1986	Investigation of the company and its affairs by the Secretary of State s431 of CA 1985
<b>Serves:</b>	The minority personally	The company's interests	The interest of the minority shareholder	The minority shareholder	The company and its shareholders. Usually made in relation to public, not private, companies.
<b>Grounds:</b>	Ultra vires, failing to meet a requirement of special or extraordinary resolution, or infringement.	Fraud, negligence, default, breach of duty, or breach of trust.	The company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the member's interest.	The action is pursued when there is a breakdown the in relationship or confidence and trust between shareholders.	If directors or majority shareholders have been guilty of fraud, misfeasance or other misconduct towards the company or its members. Or if the company's members are not given all the information about its affairs which they might reasonably expect.
<b>Requirements:</b>	The minority shareholder only needs to establish that he has been personally harmed to pursue this action.	Prima facie case. Clean hands. Obtain permission to proceed with the claim.	He/she needs to establish that the conduct of the majority shareholder is unfairly prejudicial to his/her interests.	The minority shareholder needs to establish that it is just and equitable to wind up the company.	The application shall be supported by such evidence as the Secretary of State requires. The applicant must have good reason for requiring the investigation.
<b>Remedy or damages:</b>	Personal damages to be awarded to minority shareholder	Damages go to the company	Regulate the conduct. Require the company to refrain from action. Authorize civil proceedings (derivative action). Order of purchase by other members or by the company itself.	Winding up the company	Give information as to those interested in shares, etc. Impose restrictions on shares and debentures

It is important to note that none of the UK remedies, in the table above, are explicitly stated in either the Saudi or Dubai company statutes. However, a number of participants in the empirical study confirmed that similar remedies are available under the Saudi judicial system, but are known by other names (and one may assume, similarly, that this is most probably the case for Dubai).<sup>808</sup> For example, the empirical study shows that the idea of taking personal action because of unfair prejudice does currently exist, but is not codified. Interestingly, interviewees in the empirical study, despite being selected on the basis that they were likely to be in very close contact with the law and its implementation in this area, were not able to agree on the availability of such personal actions, nor on which remedies exist in relation to them. This strongly suggests that there is something missing from the SA and Dubai statutes, whose function should be to provide guidance as to what remedies are available, and which of them are most appropriate in any particular case. Thus, it is thought that the UK approach may provide the organisation needed if it were adopted.

A significant advantage which stands to be gained in SA and Dubai if a codified system is adopted is that minority shareholders will be prevented from becoming confused as to the correct titles of remedies. This is important since the empirical study proved that participants (including judges) were attributing many different descriptions to a particular remedy.<sup>809</sup> From a practical point of view, this inconsistency of nomenclature must have a negative effect and cause confusion for everyone dealing with minority shareholder protection.<sup>810</sup> This is not to say that the Saudi and Dubai laws should adopt exactly the same names as the UK actions, but rather to say that the two jurisdictions clearly need to make a formal distinction between actions, to enable minority shareholders to differentiate between them and succeed in choosing to exercise the most appropriate one for each case.

All these existing problems which have been identified in minority shareholder protection in both SA and Dubai most probably stem from a lack of clarity, guidance

---

<sup>808</sup> The results of the empirical study regarding this issue were analysed in Chapter 4 Section 4.3.3.3.

<sup>809</sup> Also see Chapter 4 Section 4.3.3.3.

<sup>810</sup> See Chapter 4 Section 4.3.3.3. To demonstrate that there is so much confusion when it comes to names of the actions, participants in the empirical study agreed that a similar function to the UK derivative action existed under Saudi law, but they differed in the names they gave it.

and criteria in the statute. Thus, even if the Saudi system does have certain existing remedies, as some interviewees claim,<sup>811</sup> they are worthless if not systematically organised on a statutory footing in a way which simplifies their application and ensures that all minority shareholders are able to exercise the actions properly. Therefore, it is suggested that the two jurisdictions under discussion need, at the outset, to borrow the actions in the table above so they can be codified in any future reform.

Nonetheless, this borrowing of UK actions cannot take place without considering what would work if adopted completely and what would first require certain adaptations for it to become workable. As mentioned previously, SA and Dubai may only adopt a reform that is compliant with their needs, traditions, customs, norms, ethics, principles, values, standards and, above all, with Sharia, so any adoptable model should be altered in accordance with these standards first. Thus, the following sections will outline the adaptations which need to be applied to any adoption of the UK actions in order to produce a code that is suitable for SA and Dubai.

### **6.3 The problem of restricting judges' discretion:**

The empirical study seems to suggest that judges, amongst others, see no reason for the need to codify minority shareholder protection. This may be because judges believe that it is always better for grounds to remain unlimited, rather than restricting the minority shareholder to attributing certain causes to certain grounds. Surprisingly, judges hold the belief that the current situation in SA allows the minority shareholder to pursue any matter that he/she is not satisfied with, and it will then be up to the court to investigate it.<sup>812</sup> However, judges are not aware that such a situation can cause problems and confusion. This is because if all cases are only subject to the judges' discretion, there will never be an understanding of why one minority shareholder's claim is successful, and why another is not. It is also important to note that even if a judge allows a minority shareholder to bring a matter to the court's attention according to his discretion, it is still not clear by what criteria or on what grounds the minority shareholder may do so.

---

<sup>811</sup> See the table in Chapter 4, Section 4.3.3.3.

<sup>812</sup> See Chapter 3, Section 3.4.4.

In sum, judges in SA tend to be moved to support the argument against making specific grounds and remedies under the statute, especially regarding actions on behalf of the company because they feel that if all remedies were specified and stated under the statute, they would be restricted to these grounds and remedies and could not go beyond them when required to deliver justice. They also believe that the current position gives more room for discretion because remedies and their functions are not taken from the statute, but from general Islamic jurisprudence, justice, fairness and commercial conventions, which enable them to apply more remedies and bring justice to more cases on broader terms.<sup>813</sup> However, this point, in particular, has been discussed in the English case of *O'Neill v Phillips*<sup>814</sup> where Lord Hoffmann emphasises that a balance has to be struck between the breadth of the discretion given to the court and the principle of legal certainty. He also states that it is highly desirable that lawyers are able to advise their clients as to whether or not a petition is likely to succeed. Accordingly, if no statute is in place to provide guidance, a greater lack of consistency in the courts' decisions can be expected compared with where there are well-drafted statutory provisions.

It is thought that the best way to balance these two different interests (namely, specifying grounds and remedies in the statute, and giving discretion to judges) is by adopting the grounds designed by the UK statutory derivative action when dealing with cases related to the company's interests, but not restricting judges to them exclusively. The grounds which Saudi and Dubai law should consider adopting are: fraud, negligence and breach of duty and trust. However, the adaptation is that the courts should not only apply these grounds, but some room would be granted in the statute for the courts to develop and create other grounds that are not specified in the statute but, nevertheless, would be required by justice. This combination of specifying some grounds and allowing some discretion is very likely to satisfy judges in SA and Dubai since the new statute would not stop them drawing on the long heritage of traditional principles to develop new ones when needed. It may seem odd to consider that any proposed law should have to satisfy the judges, particularly in SA. However, it is not being claimed that judges' satisfaction is a goal which the law in SA should primarily be concerned with, but rather it is recognised that judges in SA are acting as guardians

---

<sup>813</sup> This impression was taken from judges who were interviewed in the empirical study. Analysis of their responses and their opinions was delivered in Chapter 4, Section 4.4.4.

<sup>814</sup> [1999] 1 WLR 1092.

of Sharia and the proposal ensures that any new law does not restrict justice and fairness, and, of course, any company law must be compatible with Sharia. In practice, however, judges may find themselves not using their discretion to develop new grounds, because almost all the grounds will already be specified if SA and Dubai adopt the statutory derivative action found under UK law.

#### **6.4 The problem of costs:**

It has become evident (after examining the statutes and analysing the empirical study) that current SA and Dubai laws (even the proposed Bills)<sup>815</sup> have not clearly addressed the issue of costs, and therefore many questions are left unanswered when it comes to funding the claim of a minority shareholder, especially in relation to derivative actions. For instance, who pays the costs of litigation? How should indemnity costs be paid? At what stage of the litigation should indemnity be granted? Is the court empowered to order the company to fund claims? To what extent should the company become financially involved in disputes between shareholders?

It is true to say that the courts in both SA and Dubai tend to apply a principle similar to that found in the English case of *Smith v Croft*<sup>816</sup> when dealing with indemnity, or indeed are stricter, as they almost never grant indemnity orders at an early stage and very rarely grant a costs order to the shareholder at the end of proceedings, even if the minority shareholder succeeds. It is not an exaggeration to say that many minority shareholders do not want to risk their own time and funds in proceeding with actions, when the result in terms of pecuniary recovery is always uncertain in SA and Dubai. Therefore, it is thought that both Saudi and Dubai laws need to adopt this concept of indemnity in more detail, but not with the strict application provided for *Smith v Croft*.

As mentioned in previous chapters, UK company law has addressed the costs issue in more detail than SA and Dubai laws, so it is logical that SA and Dubai should seek to learn from the UK experience. However, this is not to say that UK law has addressed all the issues regarding indemnity perfectly, but rather to say that, in order for SA and Dubai to improve their indemnity provisions, they may receive guidance from UK law.

---

<sup>815</sup> See Chapter 3, Section 3.4, and 3.5.4.

<sup>816</sup> (No. 2) [1988] Ch. 114. See comments and analysis of this case in Chapter 5, Section 5.1.1.2.3.

In fact, it is evident that UK law does not seem to offer a clear solution to the indemnity problem,<sup>817</sup> as the recent Companies Act 2006 omits a critical procedure upon which many cases may depend.<sup>818</sup> As a consequence, the majority shareholders, under UK law, know that there is only a small risk of an action being brought against them due to the heavy financial burden it entails, and at the same time the court is reluctant to order the company to indemnify the minority shareholder.<sup>819</sup> Equally, this scenario exists in SA and Dubai.

Thus, it is suggested that any reformed statute in SA and Dubai should entitle the minority shareholder in a derivative action to be indemnified by the company once it is determined that he/she is acting in the company's interests, and any benefits from the litigation would go to the company itself. Of course, this is not to say that the minority shareholder should be entitled to indemnity as soon as they purport to represent the company, but the courts in both jurisdictions should have discretion as to how and when to apply the indemnity rule and in deciding who is entitled to obtain it. Thus, the statute should include the right to indemnity, but make the issue of how to enforce it subject to the judges' discretion. Subsequently, the statutory rule should be that the minority shareholder has a right to be indemnified by the company when representing it in a derivative action, unless it is clear that the action brought is unnecessary, which, of course, is ultimately an issue for the court to decide.<sup>820</sup> If this rule is adopted in any new statute in SA and Dubai, it will be similar to the rule in the English case of *Wallersteiner v Moir*<sup>821</sup> which held that the minority shareholder should be indemnified regardless of the outcome, because he/she is acting in the company's interest, and any benefit from the action will go to the company itself.

### **6.5 The need for establishing personal grounds as a basis for minority shareholder action:**

---

<sup>817</sup> See some analysis of the current position of indemnity under the Companies Act 2006 in Chapter 5, Section 5.3.1.(f).

<sup>818</sup> A, Reisberg., Derivative Actions and Funding Problem: The Way Forward, *Journal of Business Law*, 2006, (August), pg: 452.

<sup>819</sup> J, Sykes., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29 (2), pg: 226.

<sup>820</sup> See Chapter 5, Section 5.1.1.2.3.

<sup>821</sup> [1975] QB 373.



The empirical study demonstrated that there is a need in SA for the specification of grounds which can enable the minority shareholder to bring an action when his/her personal interests in the company are dealt with in an unfairly prejudicial way.<sup>822</sup> If SA and Dubai genuinely intend to reform their minority shareholder protection effectively, they should not only give consideration to grounds and actions related to the company's interests, but also to grounds and actions that relate to the minority shareholder personally, in order to allow the minority shareholder to protect his/her own rights and interests in the company, for the reasons given in Chapter 2. UK law, which acts as a role model in this research, has designed a statutory action under s994 that deals with this particular concern and could be adopted by both Saudi and Dubai law. However, there are certain adaptations which would need to be made to this section, not only to fit within the two jurisdictions' commercial environments, but also because UK law in this respect is surrounded by ambiguities and difficulties. It is evident that this section provides little coherent guidance for UK courts to follow (as discussed in Chapter 5).<sup>823</sup> Therefore, in order to make it workable and actionable in SA and Dubai, and also to allow these two jurisdictions to derive maximum benefit, there are some amendments and modifications which should be made to it first.

First of all, it is believed that once the unfair prejudice petition is adopted, other personal actions, of the type which exist under UK common law, do not need to be included in separate provisions. Although personal action under UK common law is generally wider than unfair prejudice (as it may protect a wider array of shareholder rights provided for in the statute, such as the right to enforcement of the terms of the articles of association or the right to pursue dividends that have been declared), the proposed version of unfair prejudice for SA and Dubai, is modified to also cover these interests and rights. It is better for SA and Dubai only to have one action which serves such interests and rights because, if two similar actions were to operate at the same time, people would be likely to find themselves confused, especially in SA and Dubai where minority shareholder protection is being introduced for the first time. In other words, it is thought that it is better to select only one action to operate, but one which will operate widely. Thus, whichever interests and rights relate to the minority

---

<sup>822</sup> See Chapter 4, Sections 4.3.3.3.

<sup>823</sup> See Chapter 5, Section 5.3.2.

shareholder personally, the new proposed version of unfair prejudice should be broad enough to cover them.<sup>824</sup>

Secondly, Saudi and Dubai laws should adopt UK unfair prejudice but provide greater flexibility. This can be done by entitling the minority shareholder to bring a legal action against a wide range of conduct, without having strict requirements to meet.<sup>825</sup> It is believed that Saudi and Dubai laws should not apply the same harsh restrictions as in UK law, which requires that the conduct complained of must be both unfair and prejudicial.<sup>826</sup> In reality, the conduct may be unfair without being prejudicial or prejudicial without being unfair, but under UK company law it is not sufficient for the conduct to satisfy only one of these – it must be both unfair and prejudicial. However, it is thought that the Saudi and Dubai statutes should enable the minority shareholder to litigate against a wide range of conduct, leaving the court to have discretion in deciding whether or not the claim is legitimate and valid. In other words, the Saudi and Dubai courts should allow a petition that is only unfair to the interests of the minority shareholder but not prejudicial, and vice versa. For such a new version of unfair prejudice to work in SA and Dubai, the courts will need to apply the unfairness test and if the conduct amounts to unfairness towards the minority shareholder, then the shareholder should be allowed to initiate proceedings. However, one of the dangers with this could be that nonsense claims could proliferate and so the courts would need to use a great deal of discretion to prevent such claims.

Thirdly, the SA and Dubai laws should adopt speedy and economically attractive exit routes which would allow the minority shareholder to leave the company with shares of an undiscounted value.<sup>827</sup> It is agreed that the exit option is indeed the main concern of s994 of the UK law but, unfortunately, while providing for flexibility, UK law does not provide a clear procedural mechanism, particularly for exiting.<sup>828</sup> Surprisingly, even the

---

<sup>824</sup> In fact, it is believed that even the personal actions under UK common law may be gradually abandoned as personal grounds, in practice, may be better served by other remedies, such as the s994 unfair prejudice petition as mentioned in B, Hannigan., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009. pg: 465. Also see Chapter 4, Section 4.3.1.(f).

<sup>825</sup> It is believed that this is the best way for unfair prejudice to operate in both SA and Dubai, as long as it is up to the court to judge whether the claim is valid and legitimate.

<sup>826</sup> Judges in UK cases stressed that the conduct being complained of must be both prejudicial and unfair in order to comply with the requirements of the provision. See Chapter 4, Section 4.1.2.4.

<sup>827</sup> A, Dignam. & J, Lowry., *Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2009. pg: 236.

<sup>828</sup> P, Davies., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell. 2008, pg: 707.

compulsory purchase under s996 is not a right, but only a discretionary remedy that minority shareholders cannot insist upon.<sup>829</sup> However, the SA and Dubai statutes should facilitate the exit of a minority shareholder from a private company following a dispute, without the need to litigate. This adaptation in particular would seem to be workable if adopted in SA and Dubai because, if their statutes had a clear exit mechanism for use when needed, the shareholder would not be affected by having to go to the court to seek such an exit even if there was an existing dispute. This can be done, for example, if the statute provides a clear route to exit the company by stating that the minority shareholder should give notice to the majority shareholder by declaring his/her intention to the board to exit the company (three months) in advance. Then, if this period ends without him/her obtaining an offer from the majority shareholder to purchase the shares, the minority shareholder should be allowed to search for an outside buyer for another limited period. If no outside buyer wishes to buy the minority shares, the statute should allow the minority shareholder to seek a winding-up order. However, disputes may arise between shareholders as to the value of shares so the courts could step in, valuing the shares according to their market value, or may direct the shareholders to specialised professionals who could also value the shares fairly. Therefore, the minority shareholder should always have the right to be bought out with an undiscounted value of shares if he/she was somehow forced to leave the company.<sup>830</sup> The burden of proof is on the minority shareholder to show that he/she is indeed being forced to leave the company rather than simply leaving of his/her own free will.

The fourth adaptation concerns the fact that, despite having shown that the winding-up remedy does exist in SA, the majority of interviewees in the empirical study were mistaken in believing that it was not available in the Saudi system.<sup>831</sup> In fact, the interviewees were not only mistaken in not recognising its availability but, interestingly, they also did not want it to be available to minority shareholders.<sup>832</sup> Their justification

---

<sup>829</sup> For example, in *Phoenix Office Supplies Ltd, Re* [2003] 1 B.C.L.C. 76, CA, the Court of Appeal rejected the minority shareholder's claims to have his shares purchased at an undiscounted value, even though he was removed from management by the majority shareholder, who breached the minority shareholder's legitimate expectation.

<sup>830</sup> See Chapter 4, Section 4.3.1.6, where a discussion has been undertaken regarding the need for Saudi law and any jurisdiction alike to offer an exit strategy to the minority shareholder with an undiscounted value.

<sup>831</sup> The empirical study showed that two-thirds (68%) of all interviewees did not believe that the winding up order existed as a remedy in the Saudi commercial environment.

<sup>832</sup> See Chapter 4, Section 4.3.3.3.

was similar to that expressed by Dignam and Lowry<sup>833</sup> regarding the inclusion of the winding-up remedy in the UK's s996. Dignam and Lowry argue that the facts which satisfy the grounds and tests under s994 are different from the grounds and tests under the winding-up remedy. They also think that, if adopted, it would allow minority shareholders to put the maximum amount of pressure possible on the majority shareholders to enforce their wishes, thus enabling minority shareholders to destabilize businesses.<sup>834</sup> Similarly, over two thirds of the interviewees in SA thought that there would be no benefit in codifying the winding-up order in the Saudi system, as it would grant minority shareholders a very powerful weapon which has great potential for abuse. Nonetheless, the position taken here is that the remedy of winding-up should be available in SA, as long as the court has total control over it. This can be done if there is a requirement for the court's leave to be obtained before a winding-up order can be sought.<sup>835</sup> It is assumed that once the seeking of a winding-up remedy is subject to the court's leave, nonsense claims are likely to be eliminated, as the court will refuse permission if it is found that the minority shareholder sought the remedy only to apply unjustified pressure on the majority shareholder or was acting unreasonably in seeking such a claim.<sup>836</sup> It can be argued that minority shareholders could still use the winding-up remedy as a pressure tactic to force the majority shareholder to obey their demands. However, the court's discretion should always make the winding-up order a last resort, since the court has to insist on all other remedies first (for example the buyout order), and will only allow it if all other remedies are deemed not applicable. Therefore, if this adaptation is followed in SA and Dubai law, the concerns that adding the winding-up remedy to those available under unfair prejudice may shake the stability of companies, seem to be overstated.

A fifth proposal is that, even though Saudi and Dubai laws should borrow the concept of legitimate expectations from the UK system in relation to unfair prejudice claims,

---

<sup>833</sup> A, Dignam. & J, Lowry., *Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2009. pg: 231 & 232.

<sup>834</sup> A, Dignam. & J, Lowry., *Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2009. pg: 231 & 232.

<sup>835</sup> R, Cheung., The statutory minority remedies of unfair prejudice and just and equitable winding up: the UK Law Commission's recommendations as models for reform in Hong Kong, *International Company and Commercial Law Review*. 2008, 19(5), pg: 160 & 161.

<sup>836</sup> R, Cheung., The statutory minority remedies of unfair prejudice and just and equitable winding up: the UK Law Commission's recommendations as models for reform in Hong Kong, *International Company and Commercial Law Review*. 2008, 19(5), pg: 160 & 161.

certain modifications should be made to it. At present in SA and Dubai, only formal and written agreements between shareholders are recognised by the courts, which are very reluctant to recognise incomplete or informal agreements, even when there is evidence of legitimate expectation at the time of investing in the company. Although the UK concept of legitimate expectation is an important feature which protects the interests of the minority shareholder, it is surrounded by ambiguity in practice. Therefore, for SA and Dubai to adopt it, there should be an elimination of reliance on terms that are not clearly defined, such as “good faith”.<sup>837</sup> It was Lord Hoffmann (when examining the conduct in the English case of *O’Neill v Phillips*<sup>838</sup>) who used the term ‘good faith’ several times to replace terms like ‘just’, ‘equitable’ and ‘unfairness’.<sup>839</sup> He introduced ‘good faith’ by stating that “unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith”.<sup>840</sup> However, this application of the term ‘good faith’ has encountered a great deal of criticism based on the argument that it is not practical. For this reason, the new version of legitimate expectation which should be adopted by SA and Dubai ought to exclude the term ‘good faith’ or any other imprecise terms.<sup>841</sup> This adaptation of the legitimate expectation would not make Saudi and Dubai courts recognise any other right or obligation for shareholders other than what both (minority and majority) really intended to assume.<sup>842</sup> Therefore, the Saudi and Dubai statutes, when adopting legitimate expectation, should give a broader meaning to it in order to reflect all parties’ objective intentions at the time of setting up the company and while running it, even if the agreements are incomplete or informal.<sup>843</sup>

---

<sup>837</sup> B, Means., Contractual Approach to shareholder Oppression Law, *The Fordham Law Review*. 2010, 79(3), pg: 41. The author has suggested that the equitable contract theory should function alongside reasonable expectation in order to eliminate, as much as possible, the reliance on the term “good faith”, as it is not clearly defined.

<sup>838</sup> [1999] 1 WLR 1092.

<sup>839</sup> See Chapter 5, Section 5.1.2.9.3.

<sup>840</sup> *O’Neill v Phillips* [1999] 1 WLR 1092, pg: 1099 & 1100.

<sup>841</sup> See Chapter 5, Section 5.1.2.9.3., where the arguments against Lord Hoffmann’s suggestion of applying “good faith” have been discussed.

<sup>842</sup> Robert in (A, Robert., Shareholder Rights and Remedies in Close Corporations: Oppression, Fiduciary Duties, and Reasonable Expectation, 2003. In: B, Means., Contractual Approach to shareholder Oppression Law, *The Fordham Law Review*. 2010, 79(3), pg: 42.) has said that UK legitimate expectation functions in a way that may lead courts to only consider the minority shareholder’s expectations and neglect the expectations of the majority shareholders.

<sup>843</sup> B, Means., Contractual Approach to shareholder Oppression Law, *The Fordham Law Review*. 2010, 79(3), pg:42.

The sixth adaptation relates to the use of unfair prejudice to remedy a corporate wrong. It has been observed in English cases such as *Callard v Pringle*<sup>844</sup> and *O'Donnell v Shanahan*<sup>845</sup> that the minority shareholders preferred to use s994 to remedy corporate wrongs which also had the potential to be brought by way of derivative action. Therefore, it seems that the use of s994 is still favourable in the UK environment, not only to serve the criteria under s994, but also to achieve all that can be achieved by the statutory derivative action, and more.<sup>846</sup> This particular point is illustrated in *Gamlestaden Fastigheter AB v Baltic Partners Ltd*,<sup>847</sup> where the minority shareholder brought a s994 petition regarding a wrong committed against the company (which was a classic derivative action), but the court allowed the claim and, although the majority shareholder applied to strike out the claim on the basis that s994 should benefit only the minority shareholder in his capacity as a member, the majority shareholder was ordered to pay damages to the company. Thus, under the UK system, it can be claimed that s994 unfair prejudice will still protect personal and corporate rights and interests.<sup>848</sup>

Nonetheless, there is no clear guidance for UK courts that can be followed when applying s994 for corporate relief.<sup>849</sup> So if SA and Dubai were to precisely mirror the UK application of s994 in remedying corporate wrong (i.e. derivative action), there would be a high possibility of creating confusion rather than offering a worthwhile reform. It is always much better for each action to specialise in serving only one aspect as far as interests or rights are concerned. Importantly, this is not contrary to what was suggested earlier in relation to the first recommendation of this section, namely to bring all personal actions under the unfair prejudice ground, by having the unfair prejudice ground drafted widely. It must be noted that the system of minority shareholder protection will be introduced for the first time to SA and Dubai in this level of detail, so the system must be easy to comprehend, flexible, defined, detailed and, above all,

---

<sup>844</sup> [2007] All E.R. (D) 91.

<sup>845</sup> [2009] EWCA Civ 751.

<sup>846</sup> D, Cabrelli., Statutory derivative proceedings: the view from the Inner House, *Edinburgh Law Review*. 2010, 14(1), pg:119.

<sup>847</sup> [2007] UKPC 26. (Commonwealth Country)

<sup>848</sup> P, Davies., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell. 2008, pg: 707.

<sup>849</sup> Lord Scott stated in *Chime Corporation, Re* in [2004] HKCFAR 546 (PC (UK)) that corporate relief, if sought through S994, should only be allowed if it is clear that the directors are liable, and if the order to be made is equal to an order which the company could have obtained through derivative action. However, it has been assumed by Hannigan (B, Hannigan., Drawing boundaries between derivative claims and unfairly prejudice petitions, *Journal of Business Law*. 2009, 6, pg: 623.) that this approach put forward by Lord Scott is not workable because it is not an easy task to predict the possible circumstances of the case if it has been brought instead under the derivative action's grounds.

practical. This contrasts with UK law which has had minority shareholder protection in place and in operation for over 160 years. Thus, it is proposed, as mentioned earlier, that the Saudi and Dubai statutes should include both unfair prejudice and derivative action, each of which would be designed to serve different interests and achieve different objectives. Accordingly, the requirements and criteria for each of these devices would be totally separate. It would not be efficient or practical to allow unfair prejudice to serve the aim of derivative actions or vice versa, as this may cause a puzzling overlap. Thus, it is suggested that the Saudi and Dubai statutes should never allow this overlap to occur as long as there is another existing device which delivers the same remedy.

### **6.6 The need for statutory rights and interests:**

One of the major problems with Saudi and Dubai company law is that the law does not recognise and acknowledge statutory rights and interests for minority shareholders who require protection. It is strongly recommended that SA and Dubai specify a non-exhaustive list of rights and interests for minority shareholders, and then design statutory actions that allow those shareholders to protect these rights and interests. It is noted that UK law does not state specific rights or interests for the minority shareholder in the statute but, at the same time, it is thought that it would be more appropriate and convenient for the Saudi and Dubai commercial market and business environment to have a certain number of listed rights and interests for minority shareholders which the law would be capable of protecting.<sup>850</sup> The innovation of listing shareholder rights and interests in SA and Dubai statutes, as mentioned earlier, stems from the introduction of the new system of minority shareholder protection. This system carries new concepts, doctrines, grounds etc which will require greater detail and specification to enable people to understand and access them more easily. If the statute catalogues the rights and interests to which minority shareholders are entitled, it will provide them with a better sense of what can be protected so that they know precisely what to expect.

To draw up such a list, this section will refer back to the participants in the empirical study to see what they had to say in answer to the question, *What rights and interests do*

---

<sup>850</sup> s172 of the UK Companies Act 2006. Also see Chapter 4, Section 4.3.1.(e). It is thought that UK law can still offer certain criteria and standards as a model for directors in SA and Dubai to comply with when running a company, such as the fact that the UK Company Law 2006 (s172) requires the director to promote the success of the company through having regard for certain factors in every decision.

*you think should be reserved in the statute for minority shareholders and protected by the law?*<sup>851</sup> Participants proposed many rights and interests, but only those considered most appropriate and efficient are mentioned here. In fact, these recommendations concerning rights and interests are amongst the most valuable outcomes of this research. The rights and interests which should be included in any future reform in SA and Dubai are:

1. The right to specify certain matters in the statute that cannot be passed unless by way of unanimous resolutions, so that the majority shareholder cannot have the ultimate say on all matters.<sup>852</sup>
2. A clear right to represent the company (when litigating on behalf of the company), subject to court permission, without the need to obtain permission from the majority shareholder.
3. The right to have a transparent exit system where the shareholder would be given a fair price for his/her shares. The statute here should provide a mechanism to produce a fair valuation of shares by consulting the court or a specialist professional.
4. The right to attend all meetings and participate in all decision-making if the minority shareholder understood that this would be the case when setting up the company.
5. A clear right of access to information, documents and financial reports. For this, the statute should provide a mechanism that forces the majority shareholder to provide any information regarding the company to the minority shareholder on request. The statute here should also provide a remedy, such as seeking a court order, for the minority shareholder if the majority shareholder does not cooperate.

It is believed that if these minimum rights and interests are reserved and protected in Saudi and Dubai company statutes, there will be a significant improvement in the protection of minority shareholders offered by each of these jurisdictions. It should be

---

<sup>851</sup> See Chapter 4, Section 4.3.3.1, where full analysis of the participants' proposals of interests and rights have been stated.

<sup>852</sup> It is important to note here that one of the few advantages of the Saudi Company Law 1965 in protecting minority shareholders is the requirement of the law to have unanimous resolutions regarding certain specific matters. However, participants recommended specifying even more matters which require this.



emphasised once again that this list of rights and interests is a non-exhaustive list since some room should be left for the court to develop and recognise other rights and interests which are not specified in the statute for the minority shareholder, but which may also need protection. For example, the shareholders may agree to include extra rights or interests in the shareholder agreement, which the court would also have to recognise. The court may also develop new ones in case law (if case law becomes a source of guidance in both jurisdictions) which would thereby become protected just like the statutory ones. However, it is thought that these rights and interests listed above are the most important for the minority shareholder that any effective law should protect. Once SA and Dubai company laws give recognition to such rights, they will also have to provide actions to allow the minority shareholder to defend them.

### **6.7 Alternative remedies:**

Alternative remedies are other options which protect the minority shareholder alongside the statute. This is not to say that there are remedies which can replace the benefit of the statute, but rather that they should work together with the statute to deliver the most effective protection possible to the minority shareholder. It is strongly felt that it is the statute which should be the provider of primary protection, with any other source playing only a secondary role. Therefore, the alternative options, namely arbitration, and the provision of benefits in both the company's internal code and in a shareholder agreement, may only support the statute to achieve its target of providing effective protection. Their role would revolve around building an environment that protects the minority shareholder from every direction as each one of these alternatives has a small role to play, but one which may contribute, overall, to the protection of minority shareholders. These alternative remedies are detailed below.

Firstly, it is interesting to note that going to arbitration was recommended by the Company Law Review (CLR) to improve the protection of minority shareholders under UK law, but was never adopted.<sup>853</sup> The CLR did not recommend that arbitration should be compulsory for shareholders' disputes, but it did consider whether there might be scope to encourage its greater use as an alternative to litigation. However, within the

---

<sup>853</sup> See Company Law Review, *Developing the Framework* (2000), paras 7.44-7.69; and Company Law Review, *Completing the Structure* (2000), para 2.28.

commercial environment of SA and Dubai, it would seem that arbitration in minority shareholder cases would work efficiently if adopted. This is clear since the empirical study, which was conducted in SA and discussed in Chapter 4, showed that there is great public demand for arbitration as an alternative way of solving disputes between shareholders.<sup>854</sup> Interviewees tended to prefer arbitration over court hearings due to the fact that it offers speed, lower costs and professional judgment. Thus, any future reform of company law in the two jurisdictions should promote, activate and give space for arbitration to play an effective role. For example, arbitration could be activated if the statute had a provision that directs disputes to arbitration in the first instance.

Secondly, the shareholder agreement can be seen as another option that could also provide effective protection to the minority shareholder alongside the statute. However, the empirical study demonstrated that only a very small number of participants believed that the shareholder agreement would be sufficiently reliable as the only source of protection for minority shareholders.<sup>855</sup> Although it is true to say that a shareholder agreement can protect minority shareholders, they are only protected by it up to a certain extent. Shareholder agreements are never well-detailed and cannot cover all possible eventualities because, like all contracts, they are always incomplete.<sup>856</sup> It has to be understood that the statute is the essential ground for determining the obligations, rights, interests and powers of each party. The shareholder agreement cannot function instead of the statute or replace it; otherwise these rights and interests would be subject to inclusion in, or exclusion from, the shareholder agreement. In other words, the inclusion or exclusion of rights and interests would be subject to what the majority shareholder dictates. The fact that needs to be established here is that the shareholder agreement should only act as an extension of the statute which functions along the lines of its provisions.

Again, the shareholder agreement in SA and Dubai cannot replace, or have a greater role than, the statute, but instead the two should work together to protect the interests and rights of minority shareholders. This is not to say that the shareholder agreement has no

---

<sup>854</sup> See Chapter 4, Section 4.3.3.2, as interviewees suggested the activation of arbitration in order to establish a healthy commercial environment.

<sup>855</sup> See Chapter 4, Section 4.3.2.3.

<sup>856</sup> See Chapter 2, Section 2.2.1, where an argument has been made to prove that the shareholder agreement cannot be the sole provider of such protection, because all contracts are incomplete.

important role to play in protecting the minority shareholder. This role can be seen, for example, if the shareholder agreement includes a clause which makes provision for arbitration in any dispute occurring between the shareholders, to prevent it going to litigation. In these cases the court should enforce the shareholder agreement, compelling the shareholders to go to arbitration and not to the court first. However, the arbitrators cannot pass fair judgment unless the statute provides clear rights and interests for the minority shareholder together with effective protection. The problem is that, because the statutes in SA and Dubai do not protect minority shareholders efficiently, arbitration may mean a speedy resolution at a lower cost, but does not provide fair judgment as it is a reflection of the weak protection in the statute. Another example of the role which the shareholder agreement may play is to state specific rights and interests for the minority shareholder that the statute has not stated. As mentioned previously, the statute cannot provide an exhaustive list of all interests and rights, so there is always space for the shareholder agreement to include more. Therefore, any future reform in SA and Dubai company law should also give the shareholder agreement a role to play in protecting minority shareholders.

Thirdly, the company's internal code should work alongside the statute. In fact, the empirical study demonstrated that the company's internal code on its own is inadequate in protecting the minority shareholder if the protection does not emanate essentially from the statute. If there is no statutory protection, then the company's internal code will be heavily influenced by, and weighted in favour of, the majority shareholder, who can include or exclude clauses according to what benefits him/her the most. Nonetheless, participants in the empirical study suggested a way to use the internal code for protection; that is, by producing an ideal model of an internal code, for all companies to follow, which guarantees minimum protection for minority shareholders.<sup>857</sup> The internal code may include detail on the rights and interests of the minority shareholder, how decisions should be taken in practice, what procedure the minority shareholder must follow when complaining internally against misconduct, and how the minority shareholder can bring the case to the court if a wrong has been committed against either the company or against him/her personally. The role of the company's internal code role

---

<sup>857</sup> See Chapter 3, Section 3.4.3.3.2. This suggestion was made by certain participants who believed that an efficient internal code can provide effective alternative remedies alongside the statute and can help to create a healthy commercial environment.

will be slightly different to the statute in this respect as it will provide more detail and specification of how procedures are followed (especially internally).

In sum, it is important to understand that, to improve minority shareholder protection as a whole in SA and Dubai, many aspects of company law should work effectively together. It is true to say that changing only the statute may protect minority shareholders to a certain extent. However, the mechanisms discussed above can still contribute to improvement of this protection. In other words, the company law statute is one aspect of protection and, while it may be the most important one, there are still other factors that can also make a positive contribution to the reform, such as the shareholder agreement, arbitration and the company's internal code.

### **6.8 Recommendations regarding the reform of Dubai Company Law:**

All of the above recommendations and proposals are suitable for reforming company law in both SA and Dubai since their company laws are similar and this would suggest that their deficiencies and inadequacies are also similar. Although, in general, Dubai company law is a few steps ahead of Saudi Arabian law,<sup>858</sup> the status of minority shareholder protection in Dubai is more or less the same as that in SA as there is no specific section or separate package of provisions in its companies' statute that provides protection for the minority shareholder in private companies.<sup>859</sup> It is believed that even the recently proposed Bill for Dubai company law will only address superficial or external issues and neglect fundamental matters when it comes to minority shareholder protection in private companies. The proposed Bill does not give substantial consideration to many of the deficiencies and weaknesses which are seen to exist in the present commercial environment in Dubai. For example, the following questions remain unanswered:<sup>860</sup> What are the interests and rights of the minority shareholder that should be protected in private companies? On what grounds may the minority shareholder litigate? Who bears the cost of litigation (indemnity)? What type of remedies can be sought? How can we distinguish between shareholders' personal interests and corporate interests?

---

<sup>858</sup> See Chapter 3, Section 3.5.1.

<sup>859</sup> See Chapter 3, Section 3.5.2.

<sup>860</sup> See Chapter 3, Section 3.5.4.

On the other hand, some claim<sup>861</sup> that, if a certain limited number of proposals were adopted in Dubai, the minority shareholder would have the minimum level of protection. These proposals are firstly, to enforce a specific remedy for conduct amounting to excessive prejudice; secondly, to allow minority shareholders a clear right to access corporate information on demand; and, thirdly, to provide a device that enables the minority shareholder to challenge illegal or *ultra vires* acts. Nonetheless, I still believe that even if these proposals or similar ones are adopted by Dubai company law, they will not be enough to provide efficient protection. It should be understood that Dubai company law, like Saudi law, requires comprehensive reform to all of its provisions related to minority shareholder protection. This is to avoid short-term and deficient solutions which can only fill gaps temporarily and do not tackle the actual root of the problem once and for all. If the problems of minority shareholder protection in Dubai are not addressed fully and systematically, there will be always the possibility of these problems recurring. Thus, the best option to enable Dubai company law to provide efficient protection for minority shareholders is to follow and adopt what has also been recommended for Saudi law.

## 6.9 Conclusion

This chapter has identified the problems which affect Saudi and Dubai law as far as minority shareholders are concerned and has discussed how these jurisdictions can learn from the UK experience in protecting minority shareholders. To do this, the chapter has shown how the lack of codification can be addressed by examining the UK statute and selecting which of its features should be adopted.

This chapter also sought to provide a balance by suggesting a means to satisfy judges by not restricting them only to the statute, but also allowing them to develop other grounds if justice so requires. In addition, the need for SA and Dubai to adopt personal grounds that provide for personal actions has been discussed, but it was also highlighted that many adaptations are required to make these reforms workable in the two jurisdictions.

---

<sup>861</sup> G, Watts., *The Shareholder's Legal Toolkit: Minority Shareholder Rights under UAE Law*, Al Tamimi & Company. (19 April 2010), pg: 8. Available at: <http://www.thefreelibrary.com/The+Shareholder%27s+Legal+Toolkit+Minority+Shareholder+Rights+under+UAE...-a0224273778> accessed 10 May 2010. Also see Chapter 3, Section 3.6.4.

To address this issue, the chapter has recommended a (non-exhaustive) list of rights and interests which should be included in any future statute.

The chapter also considered certain alternative remedies that may support the statute in providing efficient protection. However, it has been stressed that these alternative options will only assist the statute, and cannot replace it. The chapter concluded by offering recommendations to Dubai company law in particular since, because the status of minority shareholder protection in Dubai is more or less equal to its status in SA, Dubai law needs to follow and adopt the advice which has been offered throughout this research to SA

Finally, it is worth mentioning that the empirical study suggested that there is general awareness among the public in SA of the shortcomings in company law, especially surrounding the fact that the majority shareholders are awarded so much power, while no effective protection is available to minority shareholders. This suggests that there will be a positive reception to any new statutory reform, especially from those who suffer the most from the law's inadequacies.

## Chapter 7

### Conclusion

#### a. Summary

There has long been a need for the Gulf States to develop and improve their company law, not only to meet domestic demands to do business, but also to keep up with international trends to attract foreign investments. This is particularly relevant in relation to the protection of minority shareholders in private companies in Saudi Arabia and Dubai, a subject that has not been studied in detail prior to this research.

The study has only taken two Gulf States jurisdictions as examples. The jurisdictions, namely SA and Dubai, were chosen because they have expressed an intention to reform their laws in order to diversify their oil-reliant economies by opening up their commercial sectors. They understand that this target cannot be met unless they create regulations, and reform certain existing ones, to facilitate the influx of foreign investments.

In fact, both regions are rated as being the best places in the Arab world for conducting business, and Saudi Arabia, in particular, ranks amongst the top twenty countries in the world in this respect.<sup>862</sup> It might be assumed that Saudi Arabia and Dubai are considered two of the best areas in the world for doing business because they have comprehensive, practical and convenient company law systems which protect all parties' rights and interests. This belief, however, does not reflect what is actually taking place in practice when it comes to minority shareholder protection and the problem which exists, specifically, is that the law grants the majority shareholder unrestricted power within the company, while failing to recognise rights and interests for the minority shareholder which should be protected.

This research has sought to answer numerous critical questions. Do existing minority shareholders in Saudi Arabia and Dubai suffer any type of abuse of power or oppression from controlling majority shareholders? Does the statutory law, or do the courts, furnish

---

<sup>862</sup> See chapter 1, section 1.1.

any legal mechanisms to remedy any wrongdoing or unfairness which occurs? Is UK company law, with its extensive commercial experience and knowledge, able to provide a way forward for the reform of both SA and Dubai's laws? The main aim of the research was therefore to propose and recommend a practical system of minority shareholder protection that would provide an efficient, healthy and practical commercial environment, able to offer effective protection for the minority shareholder in both locations.

The introductory chapter of this thesis dealt with the agendas, objectives and methodologies of the research. The second discussed minority shareholder protection in general and addressed the question of why there is a necessity to protect the minority shareholder. Chapter three examined the situation in Saudi Arabia and Dubai in terms of what the law says about minority shareholder protection, then chapter four offered detailed analysis of an empirical study that was carried out in SA to reflect how minority shareholder protection truly works in the marketplace. Chapter five of the thesis discussed the UK context and how its laws and processes play a role in protecting minority shareholders. The reason for exploring UK law in this research was because it is thought that jurisdictions like SA and Dubai can learn from its long experience of addressing minority shareholder protection, which has made it a leading model in this respect. Chapter six examined the possibility of SA and Dubai borrowing and adopting certain devices from those workable and practical remedies which exist under UK law, to employ in any future reform. Finally, this chapter seeks to draw conclusions and makes comments relevant to any future study that is needed.

It was necessary to begin this research with an examination of the theoretical and philosophical justifications behind the need to protect the minority shareholder. It is important for anyone who intends to gather information about minority shareholder protection to obtain a clear picture of how the minority shareholder is generally treated by the majority shareholder and how the minority shareholder may suffer if no effective safeguards are in place. This is because, once the voting procedure is applied, corporate democracy will award the majority shareholder ultimate power over the affairs of the company. However, what is worrying is that majority shareholders may simply view the company as a mere extension of their own interests. This can even go further, to the



point where the majority shareholder either expropriates company property, which will harm the minority shareholders' interests and rights, or seeks to oppress the minority.

There are a number of ways in which majority shareholders can take advantage of their position in order to serve their own individual interests but, unfortunately, not all of these ways are acknowledged by all jurisdictions. One example is oppression of the minority. This type of misconduct, in particular, has been recognised and defined by certain jurisdictions and denied by others. The result which may occur if no redress is provided when such misconduct occurs within the company, is that the majority shareholder may escape liability, and thus prospective shareholders may be very reluctant to invest because no safeguard exists to protect their investments in the company.

Some jurisdictions (like SA and Dubai) still insist on having no comprehensive system of minority shareholder protection, in the belief that this will protect companies against a single vexatious shareholder who might waste the company's money if allowed to litigate on its behalf. Another reason is a desire to ensure courts do not get overwhelmed by a high volume of actions. Furthermore, it is said that, as long as the majority shareholders invest more, and thereby have more power, then their rights and interests should be always prioritised and favoured over those of the minority shareholders.

However, this research has argued that the benefits which are gained from having an effective system of minority shareholder protection far outweigh any of the disadvantages which have been cited. For example, the presence of an effective system of protection can help to provide the degree of confidence which is necessary for the proper functioning of a market economy.<sup>863</sup> In fact, it has been proven that the more effectively the minority shareholder is protected, the more investments are made, and the more the economy grows. Moreover, it is also suggested that the principles of justice and fairness demand the minority shareholder to have protection since minority shareholders are vulnerable.

---

<sup>863</sup> See Chapter 2, Section 2.2.1.

The law and the quality of its enforcement are potentially important determinants of which rights and interests each shareholder will have and how well these rights and interests are protected. However, to guarantee these rights and interests for minority shareholders and ensure that they are protected, there must be an external body which has the capacity to fulfil such a role on request - namely, the court. Nonetheless, some have doubted the court's capability to resolve these types of cases. This is to say that the courts may not be the best judge, from a commercial point of view, when it comes to matters related to the company's affairs. However, this research has presented evidence that courts have indeed shown understanding of minority cases. Meanwhile, it has been argued that the court cannot offer assistance to the minority shareholder if the statute does not allow it to do so. For this reason, the law should first recognise the rights and interests of the minority shareholder, and then provide a mechanism for the court to ensure the protection of these rights and interests.

It is believed that the best way to offer effective protection for minority shareholders is through corporate governance mechanisms, which do not just provide protection for the minority shareholder, but also offer a comprehensive system of benefits for everyone who deals with the company. This system will not only serve the minority shareholder but also the court, as it will be clear for the court which remedies can be applied in each case. If the statute does not make explicit provision to this effect, the court may not find itself freely empowered to bring justice. Therefore, there should always be several grounds, besides fraud, on which the minority shareholder might rely. Otherwise, many cases of misconduct and wrongs may escape liability and it is possible that it will be the company itself that is harmed.

The main reform which this research has sought to offer relates to the position of minority shareholder protection in Saudi Arabia and Dubai. It has thus been essential to highlight the shortcomings of the current legal position, as far as minority shareholders are concerned, in these two countries in order to understand exactly what needs to undergo reform. First of all, it has been found that the law in SA is accused of creating overlaps which have caused inconsistency and uncertainty when it comes to minority shareholder protection. Some argue that this deficiency in Saudi company law may emanate from the contradictory interaction between modern legal institutions and

traditional Islamic applications.<sup>864</sup> However, this research has found that this is not the case because Sharia does not contain detailed enforcement mechanisms which would be able to determine “when” and “how” to implement specific actions or remedies when a dispute occurs within a company. Therefore, this deficiency in protecting minority shareholders in private companies cannot be attributable to Sharia, as its role is to provide general principles, not specific detail, when it comes to company law.<sup>865</sup> Rather, it is the statute that is to blame for not giving much more detail and not providing remedial mechanisms.

When it comes to Dubai, this research has acknowledged that, in general, its company law is more detailed, modern, and practical than Saudi company law. However, Dubai law is not completely free of deficiencies when it comes to minority shareholder protection. Both jurisdictions have recently produced Bills which attempt to reform and improve the function of the existing company law. Unfortunately, however, the Bills in both countries fail to address many of the deficiencies and weaknesses which have been identified throughout this research, and many questions remain unanswered. For example, what are the grounds on which the minority shareholder may litigate? What remedies can be sought? Which of the interests and rights of the minority shareholder should be protected? As long as these matters and others are not dealt with efficiently, it is still very hard to advise minority shareholders as to what their rights are, how they can exercise them, and whether they should be able to pursue a successful case.

The most unique aspect of this research is the empirical study which set out to investigate the area of minority shareholder protection in greater depth in order to diagnose where exactly the problems lie in SA so that appropriate and workable reforms could be offered. After approval was granted from the University of Leeds, the empirical study, for which the method of face-to-face interviews was adopted, took place in October-December 2009. Candidates, for example, judges, lawyers, businesspeople (sole traders), and minority and majority shareholders, were carefully

---

<sup>864</sup> F, Almajid., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK. pg: 140.

<sup>865</sup> Although Sharia seems to only provide general principles when it comes to company law and its functions, it provides full details and complete guidelines when it comes, for example, to family law or inheritance.

chosen and included.<sup>866</sup> After analysing the data and information collected by this empirical study, I was able to identify the factors which have caused the Saudi minority protection system to be deficient. The study found that, firstly, the failure of the statute to provide clear guidance with respect to minority cases confuses people, including those who work with the law on a daily basis. Secondly, it was said that neither the shareholder agreement nor the company's internal code can overtake or replace the need for statutory provision which protects the minority shareholder. Thirdly, it was shown that the concept of litigating on behalf of the company to protect its rights and interests is not understood by a large number of people. Fourthly, it was concluded that judges may not be in favour of codifying all remedies and reliefs for minority shareholders in the statute. This may be because judges tend to have unfettered discretion and do not wish to be restricted by the statute.

This research chose to study the UK model as far as minority protection is concerned because it has been through successful development and improvement in protecting minority shareholders. The model is one which both Saudi Arabia and Dubai can be expected to obtain guidance from, given its experience in dealing with minority shareholder protection in an effective way. It is important to say that some of the deficiencies and uncertainties which used to exist under the old UK law were somewhat similar to those which apply now under SA and Dubai company law. Therefore, it would be very useful for these two jurisdictions to understand how the development of UK law has addressed these particular problems. It is true to say that minority shareholder protection has been in existence under UK law for over 160 years as part of common law. However, under common law the minority shareholder was faced with problems which prevented him/her from claiming for a wrong committed against the company. This difficulty was acknowledged by the Law Commission and the Company Law Review when the problems were analysed, and some possible solutions were offered. Consequently, the UK Companies Act 2006 was introduced to replace the old law with new, modern, flexible criteria with which a minority shareholder could pursue an action. However, there are matters which remain unreformed in the Act. For

---

<sup>866</sup> The empirical study did not survey the position of Saudi public companies because (as mentioned in this thesis many times) the shareholder in a public company has more remedies and reliefs made available to him than the minority shareholder in a private company. Furthermore, the minority shareholder in a public company always has the exit option, which is not applicable to the minority shareholder in a private company. As a consequence, interviewees were made aware that this research concerned only private companies.

instance, it is thought that the Act should have added the right to obtain an indemnity order once the minority shareholder is granted permission to continue a derivative action, regardless of the final result of the case. Also, the Act should have abolished the requirement for clean hands before being able to bring a derivative action, since the issue for the court is doing justice for the company and not judging the minority shareholder. In addition, the Act has not changed anything regarding the position of unfair prejudice, but rather it has transferred s459 of the Companies Act 1985 exactly as it was to s994 of the new 2006 Act. This means that the Act has not addressed the deficiencies which were identified in relation to the former section.

**b. The reform and outcome which this research has offered to SA and Dubai:**

After having diagnosed where the problems lie regarding minority shareholder protection in SA and Dubai, and also after studying the merits of UK law as a model to learn from, this research has sought to prescribe proposals for reform of the law relating to minority shareholder protection in both jurisdictions. As identified early on, the main problems in both countries emanate from the lack of statutory grounds which can enable the minority shareholder to pursue every instance of wrongdoing. Indeed, minority shareholders in SA and Dubai do face certain types of misconduct from majority shareholders, but there is no codified statutory system to protect minority shareholders against each and every one of these types of misconduct. It is thought that the best way to solve this deficiency is to codify minority rights and remedies. This codification of minority shareholder protection in both SA and Dubai should follow the UK statute, but not in every respect. The code should allow judges to be unrestricted, as judges in the two jurisdictions do not normally tend to be limited to the statute. This may allow the courts to develop and create other grounds that are not specified in the statute but, nevertheless, would be required by justice.

SA and Dubai statutes should also give consideration to personal grounds and actions, in order to allow the minority shareholder to protect their own rights and interests in the company. However, in order to make this workable in SA and Dubai, and also to obtain maximum benefit, there are some modifications that should first be made to UK law in this respect.

Firstly, the unfair prejudice ground provides the same remedies and achieves similar results to those available under the personal action of common law, and the proposed version of unfair prejudice to be adopted for SA and Dubai should cover these interests and rights too. Secondly, it is believed that Saudi and Dubai laws should not apply the same harsh restrictions as UK law, which requires that the conduct complained of must be both unfair and prejudicial. In reality, the law should enable the conduct that can be complained about to be unfair without being prejudicial or prejudicial without being unfair, and the court should be left to exercise its discretion in deciding whether or not the claim is legitimate and valid. Thirdly, the Saudi and Dubai system should create speedy and economically attractive exit routes which would allow the minority shareholder to leave the company with a price for his/her shares that is undiscounted. Fourthly, it is suggested that the winding-up remedy can safely operate under an unfair prejudice ground if there is a requirement that the court's leave needs to be obtained. Fifthly, any version of legitimate expectation that is applied should exclude the term 'good faith' or any other imprecise terms.<sup>867</sup> The sixth adaptation relates to the possible use of unfair prejudice in UK law to remedy a corporate wrong. It is believed that SA and Dubai cannot follow this UK practice because there will be a high possibility of creating confusion and complexity.

It is believed that one of the major problems with Saudi and Dubai company law is that the law does not recognise and acknowledge statutory rights and interests for minority shareholders who require protection. This research has recommended a non-exhaustive list of rights and interests for minority shareholders that should be included in any future reform:

1. Specifying certain matters in the statute that cannot be passed unless through unanimous resolutions.
2. The right to litigate on behalf of the company when needed.
3. The right to have a transparent exit system with the payment of a fair price.
4. The right to attend all meetings and participate in all decision-making.
5. A clear right of access to information, documents and financial reports.

---

<sup>867</sup> See Chapter 5, Section 5.1.2.8.c.

It is also believed that concentrating only on statutory provisions for minority shareholder protection may not produce efficiency as there are some alternative remedies which may also have a positive part to play in protecting minority shareholders. These alternative options -namely, arbitration, the company's internal code and the shareholder agreement - may assist in achieving the most effective protection so SA and Dubai should consider them in any future reform to ensure that minority shareholders are as well-protected as possible.

### **c. Recommendations and comments**

It would seem that this research is the first to deal with minority shareholder protection in SA and Dubai. Surprisingly, no Law Commission or other public body in either SA or Dubai has devoted itself to reviewing how well minority shareholder protection in private companies works in practice. However, having completed this investigation, it is obvious that company law in both jurisdictions is deficient when it comes to minority shareholder protection, from its failure to recognize the rights and interests of minority shareholders to the lack of remedies for them to use when necessary. The study has attempted to contribute to the field and build a foundation which can offer clear guidelines to those researchers who might investigate the subject further. In other words, allowing for the fact that this subject matter has so far very rarely been discussed, it is hoped that this work can serve as a reference point for any future studies.

It is strongly believed that any jurisdiction which intends to reform its minority shareholder protection system should follow in the footsteps of the Anglo-Saxon model. This is because the adoption of such a model would be an important means of ensuring high standards of corporate governance, effective protection and enhanced investor confidence and it may be appropriate even when a jurisdiction does not share the culture, tradition or system in which it operates. This thesis has emphasised that Anglo-Saxon countries confer on minority shareholders in private companies stronger protection than many other countries. However, it is important to note that it should always be possible for any jurisdiction to amend and adapt the Anglo-Saxon model in order to make it suitable for its own commercial environment. It is also believed that the minority shareholder protection in SA and Dubai cannot only be subject to general

principles or commercial conventions any longer and it has now become a necessity to codify remedies and relief for minority shareholders in the statute.

If the UK model which has been discussed and adapted in this research is adopted by SA and Dubai, then minority shareholder protection will be introduced in detail for the first time. This means that the system introduced must be easy to comprehend, flexible, clear and well defined, thus helping to avoid any misconception or misinterpretation. Therefore, it is suggested that the law in SA and Dubai should be unambiguous and not overly strict when it comes to the requirements to be fulfilled in order to bring proceedings. However, control over who should monitor these types of cases, to ensure that the company's interest is always prioritized, should be in the judges' hands. It is believed that this, and not a law providing harsh criteria or difficult requirements to be met, is what would produce efficiency and justice in SA and Dubai.

Finally, it should be noted that, after conducting the empirical study in SA and having had the opportunity to interview candidates, I gained the impression that there would be a strong, positive reception from the public for any future attempt by the law-makers in SA to reform the current position of minority shareholder protection in private companies, as almost all of them realise that this is an area which needs urgent reform.



## Bibliography

### Books:

- Alcock A. Birds J. & Gale S., *Companies Act 2006*. Jordans, Bristol, 2007.
- Al-Jeber M., *The Saudi Commercial Law*. 3<sup>rd</sup> ed. King Fahd National Library, Riyadh, 1996.
- Almadani H., *Saudi Commercial Law*. 5<sup>th</sup> ed. ALMADANI, Jeddah, 2001.
- Almajid F., *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D Thesis. 2008. University of Manchester: UK.
- Alshareef N., & Alqurashi Z., *Commercial Law*. HAFIZ, Jeddah, 2007.
- Boyle A. Birds J. & Others., *Boyle & Birds' Company Law*. 6<sup>th</sup> ed. Jordans, Bristol, 2007.
- Cheffins B., *Company Law: Theory, Structure and Operation*. Oxford: Oxford University Press, 1997.
- Davies P., *Principles of Modern Company Law*. 8<sup>th</sup> ed. Sweet & Maxwell, London, 2008.
- Dignam A. & Lowry J., *Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press. 2009.
- Dine J., *Company Law*. 5<sup>th</sup> ed. Palgrave Macmillan, New York, 2005.
- El Sheikh F., *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*. Cambridge, University Press, 2003.
- Ferran F., *Company Law and Corporate Finance*. Oxford: Oxford University Press, 1999.
- Hamd Allah H., *Saudi Commercial law*. ANNAHDAH, Cairo, 2003.
- Hannigan B., *Company Law*. Oxford: Oxford University Press, 2003.
- Hannigan B., *Company Law*. 2<sup>nd</sup> ed. Oxford: Oxford University Press, 2009.
- Hicks A., & Goo S., *Cases and Materials on Company Law*. 5<sup>th</sup> ed. Oxford: Oxford University Press, 2004.
- Hicks A. & Goo S., *Cases and Materials on Company Law*. 6<sup>th</sup> ed. Oxford: Oxford University Press, 2008.

Ibn Kathir, I., *Tafseer Ibn Katheer: Interpretation of Quran*. Dar Taibah, Almadina, 2002, Vol (2).

Islamic Research and Training Institute, IRTI., *Islamic Capital Markets: Products, Regulations & Developments*. Islamic Development Bank, Jeddah, 2008,

Judge S., *Company Law*. 1<sup>st</sup> ed. Oxford: Oxford University Press, 2008.

Keenan D. & Bisacre J., *Smith and Keenan's Company Law*. 13<sup>th</sup> ed. Longman, Harlow 2005. pg: 299.

Mayson S. French D. & Ryan C., *Company Law*. 22<sup>nd</sup> ed. Oxford: Oxford University Press, 2005-2006.

Mayson S. French D. & Ryan C., *Company Law*. 23<sup>rd</sup> ed. Oxford: Oxford University Press, 2006-2007.

Mayson S. French D. & Ryan C., *Company Law*. 24<sup>th</sup> ed. Oxford: Oxford University Press, 2007-2008.

Naciri A., *Corporate Governance Around the World*. Routledge, London, 2008.

Othman A., *Essential Trade Law*. Kuwait University, Kuwait. 1995.

Pettet B., *Company Law*. 2<sup>nd</sup> ed. Pearson Education Limited, London, 2005.

Ramsay I. & Others., *Company Director's Liability for Insolvent Trading*. Centre for Corporate Law and Securities Regulation, the University of Melbourne, Australia, 2000.

Reisberg A., *Derivative actions and corporate governance: theory and operation*. Oxford, New York, 2007.

Sealy L. & Worthington S., *Cases and Materials in Company Law*. 8<sup>th</sup> ed. Oxford: Oxford University Press, 2008.

Solomon J., *Corporate Governance and Accountability*. 2<sup>nd</sup> ed. Wiley, Chichester, 2007.

Szudoczky R., *Takeover Regulations and Protection of Minority Shareholders: A comparison between the European and US approach*. Lambert Academic Publishing, Koln, 2009.

The World Bank and International Finance Corporation, *Doing Business 2010 Saudi Arabia*. The International Bank for Reconstruction and Development / The World Bank, 2009.

Tricker B., *Corporate Governance*. Oxford: Oxford University Press, 2009.

Wild C. & Weinstein S., *Smith & Keenan's Company Law*. 14<sup>th</sup> ed. Longman, Harlow. 2009.

## Articles:

Abdul Jabbar H., 'Islamic finance: fundamental principles and key financial institutions,' *Company Lawyer*. 2009, 30(1), 23.

Abugu J., A comparative analysis of the extent of judicial discretion in minority shareholder protection litigation: the United Kingdom and United States, *International Company and Commercial Law Review*. 2007, 18(5), 181.

Ali A., The role of Islamic jurisprudence in finance and development in the Muslim world, *Company Lawyer*. 2010, 31(4), 121.

Almadani M., Derivative actions: does the Companies Act 2006 offer a way forward?, *Company Lawyer*. 2009, 30(5), 131.

Almadani M., The Role of Sharia Law in Protecting Minority Shareholder in Private Companies, *International Company and Commercial Law Review*. 2010, 21(12), 395.

Al-Rimawi L., Relevance of Sharia in Arab securities regulation with particular emphasis on Jordan as an Arab regulatory model. *Company Lawyer*. 2006, 27(8), 227.

Anon, Not Every Quasi-Partnership Relation Entitles the Shareholder to Claim under s459, CA 1985, *Finance and Credit Law*. 2003, 1 Jan, pg: 4.

Attenborough D., How directors should act when owing duties to the companies' shareholders: why we need to stop applying Greenhalgh, *International Company and Commercial Law Review*. 2009, 20(10), 339.

Bancal J., Legal, tax and fiscal engineering for industrial co-operation in Saudi Arabia. *International Business Law Journal*. 1993, 6, 685.

Blair M. & Orchard J., Legal issues arising in the new Dubai International Finance Centre, *Journal of International Banking Law and Regulation*. 2005, 20(5), pg: 207.

Boyle A., "Unfair Prejudice" in the House of Lords. *Company Lawyer*. 2000. 21 (8), 253.

Boyle T., The new derivative action, *Company Lawyer*. 1997, 18(8), 256.

Brocklesby N., Derivative claims under the Companies Act 2006, *In – House Lawyer*, 2007, February, 94.

Bu Q., The Indemnity Order in a Derivative Action, *Company Lawyer*. 2006, 27(1), 2.

Cabrelli D., Statutory derivative proceedings: the view from the Inner House, *Edinburgh Law Review*. 2010, 14(1), 116.

- Cain B., Members' rights and derivative actions, *Company Secretary's Review*. 2006, 30(2), 9.
- Cheffins B., Reforming the Derivative Action: The Canadian experience and British Prospects, *Company Financial and Insolvency Law Review*. 1997, 1(2), 227.
- Cheffins B., Minority shareholders and corporate governance, *Company Lawyer*. 2000, 21(2), 41.
- Cheung R., The statutory minority remedies of unfair prejudice and just and equitable winding up: the UK Law Commission's recommendations as models for reform in Hong Kong, *International Company and Commercial Law Review*. 2008, 19(5), 156.
- Clark B., Just and equitable winding up: wound up?, *Scots Law Times*. 2001, 12, 108.
- Clark B., Unfairly Prejudicial Conduct: A Pathway through the Maze. *Company Lawyer*. 2001. (22).6, 170.
- Dalley, *The Misguided Doctrine*, at 176, cited In: B, Means., A Contractual Approach to Shareholder Oppression Law. *The Fordham Law Review*. 2010, 79(3), 1116.
- DeFond M. & Hung M., Investor Protection and Corporate Governance: Evidence from Worldwide Ceo Turnover, *Journal of Accounting Research*. Sep 18, 2003, 269.
- Dodd A., Directors' duties and derivative actions, *Company Secretary's Review*, 2007, 30 (19), 145.
- Du Plessis J., Corporate law and corporate governance lessons from the past: ebbs and flows: but far from "the end of history.....": Part 1, *Company Lawyer*. 2009, 30(2), 71.
- Emons W., Conditional versus Contingent Fees, *Oxford Economic Papers*. 2007, 59, 89.
- Ferasat A. & Others., Middle East, *The International Lawyer*. 2008, 24(2), 1143.
- Ferran E., Shareholder Remedies: The Law Commission Report. *The Company Financial and Insolvency Law Review*. 1998. 2 (2), 235.
- Goddard R., Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985, *Company Lawyer*. 1999, 20(3), 66.
- Goddard R., The unfair prejudice remedy, *Edinburgh Law Review*. 2008, 12(1), 93.
- Grais W. & M, Pellegrini., Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options, *World Bank Policy Research Working Paper*. No. 4052, (November 1, 2006), 1.
- Hajjaji H., Shareholders' agreements and Islamic financing, *International Business Law Journal*. 2009, 5, 556.

Hannigan B., Drawing boundaries between derivative claims and unfairly prejudicial petitions, *Journal of Business Law*. 2009, 6, 606.

Hemraj M., Maximising shareholder's wealth: legitimate expectation and minority oppression. *Company Lawyer*, 2006, 27(4), 125.

Hirt H., In What Circumstance Should Breaches of Directors' Duties Give Rise To a Remedy Under SS.459-461 of the company Act 1985? *Company Lawyer*. 2003. 24 (4), 100.

Hirt H., Ratification of breaches of directors' duties: the implications of the reform proposal regarding the availability of derivative actions, *Company Lawyer*. 2004, 25(7), 197.

Hirt H., The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest, *Journal of Business Law*, Mar 2005, 159.

Key A., Wrongful trading and the liability of company directors; a theoretical perspective, *Legal Studies*. Sep 2005. 25(3), 431.

Key A., Company directors behaving poorly: disciplinary option for shareholders, *Journal of Business Law*. 2007, Sep, 656.

Key A., Section 172 (2) of the Companies Act 2006: An Interpretation and Assessment, *Company Lawyer*, 2007, 28(4), 106.

Key A. & Loughrey J., Derivative proceedings in a brave new world for company management and shareholders, *Journal of Business Law*. 2010, 3, 151.

Key A. & Zhang H., Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors. *Melbourne University Law Review*. 2008. 32(1), 141.

Kim K. Nofsinger J. & Kitsabunnarat-Chatjuthamard P., Large Shareholders, Board Independence, and Minority Shareholder Rights: Evidence from Europe, *Journal of Corporate Finance*. 2007, 13(5), 859.

Klapper L. & Love I., Corporate governance, Investor protection, and Performance in Emerging Markets, *Journal of Corporate Finance*. 2004. 10, 703.

La Porta R & Others., Legal determinants of external finance. *Journal of Finance*. 1997, 52, 737.

La Porta R. & Others., Law and Finance, *Journal of Political Economy*. 1998, 106(6), 1113.

La Porta R. & Others., Investor protection and corporate governance, *Journal of Financial Economics*. 2000, 58(1-2), 3.

- Laubach C., & Khan A., UAE: Saadiyat zone – further regulations, *Journal of International Financial Markets*. 1999, 1(7), 77.
- Levine R & Zervos S., Stock market, banks and growth, *American Economic Review*. 1998, 88, 537.
- Leuz C. Nanda D. & Wysocki P., Earnings Management and Investor Protection: An International Comparison, *Journal of Financial Economics*. 2002, September, 505.
- Lightman D., Boards Beware! Lawyers Loom, *The Times*. 2006, 12 September, 1.
- Lightman D., The Companies Act 2006: A Nutshell Guide To The Changes To The Derivative Claim, *Civil Justice Quarterly*, 2007, 26 Jan, 37.
- Lowry J., The pursuit of effective minority shareholder protection: s459 of the Companies Act 1985, *Company Lawyer*. 1996, 17(3), 67.
- MacNeil I., Company Law Rules: An Assessment from the Perspective of Incomplete Contract Theory, *Journal of Corporate Law Studies*. 2001, 1(1), 107.
- Marshall D., Conditional Fee Agreements, *New Law Journal*. 2001, 151 (6995), 1186.
- Means B., A Voice-Based Framework for Evaluating Claims of Minority Shareholder Oppression in the Close Corporation, *Georgetown Law Journal*. 2009, 97 (5), 1207.
- McGee A., Exit Mechanisms in Private Companies, *The Company Financial and Insolvency Law Review*. 1999. 3 (1), 52.
- Miles L. & He M., Protecting the rights and interest of minority shareholders in listed companies in China: challenges for the future, *International Company and Commercial Law Review*. 2005, 16(7), 275.
- Miles L. & Goulding S., Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?, *Journal of Business Law*. 2010, 2, 126.
- Millon D., Communitarians, Contractarians, and the Crisis in Corporate Law, *Washington and Lee Law Review*. 1993, 50, 1373.
- Moll D., Shareholder Oppression & 'Fair Value': Of Discounts, Dates, and Dastardly Deeds in the Close Corporation. *Duke Law Journal*. 2004, 54(2), 293.
- Moll D., Shareholder Oppression in Texas Close Corporations: Majority Rule Isn't What It Used to Be, *Houston Business and Tax Law Journal*. 2008, Vol. IX, 33.
- Mubaydeen Y., Legal aspect of project finance transactions under the laws of the United Arab Emirates, *Journal of International Banking Law and Regulation*. 2003, 18(5), 219.
- Nambisan D., Commercial and Chancery; Insider Dealing, *The Lawyer*, 2006, 11 September, 1.

- Paterson P., A Criticism of the Contractual Approach to Unfair Prejudice, *Company Lawyer*. 2006, 27(7), 204.
- Payne J., A re-examination of ratification, *Cambridge Law Journal*. 1999, 58(3), 604.
- Payne J., Clean hands in derivative actions, *Cambridge Law Journal*. 2002, 61(1), 76.
- Payne J., Section 459-461 Companies Act 1985 in flux: The Future of Shareholder Protection. *Cambridge Law Journal*. 2005, 64(3), 647.
- Reed R., Derivative claims: the application for permission to continue, *Company Lawyer*. 2000, 21(5), 156.
- Reisberg A., Judicial Control of Derivative Actions, *International Company and Law Review*. 2005, 16(8), 335.
- Reisberg A., Derivative Actions and Funding Problem: The Way Forward, *Journal of Business Law*, 2006, (Aug), 445.
- Roberts P. & Poole J., Shareholder remedies – corporate wrongs and the derivative action, *Journal of Business Law*. 1999, March, 99.
- Rock E. & Wachter M., Waiting for the Omelet to Set: Match Specific Assets and Minority Oppression in the Close Corporation, *Journal of Corporation Law*. 1999, 24(4), 201.
- Prentice D. & Payne J., The corporate opportunity doctrine, *Law Quarterly Review*. 2004, 120 (Apr), 198.
- Prentice D., Wallersteiner v Moir: a decade later, *Conveyancer and Property Lawyer*. 1987, May-June, 167.
- Schlimm D. Mezzetti L. & Sharfman B., Corporate Governance and the Impact of Controlling Shareholder, *Corporate Governance Advisor*. 2010, 18(1), 1.
- Schwartz A., Relational Contracts in the Courts: An Economic Theory of Default Rules, *Journal of Legal Studies*. 1992, 21, 597.
- Sfeir N., The Saudi Approach to Law Reform, *The American Journal of Comparative Law*. 1988, 36, 729.
- Shulman N. & Simmons M., The Liability of the Dotcom Lifestyle, *The Lawyer*. 2000, 14(29), 15.
- Sourial M., Corporate Governance in the Middle East and North Africa: An Overview. *Egyptian Ministry of Foreign Trade*. (February 28, 2004), 1.

Sugarman D., Reconceptualising company law: reflections on the law Commission's Consultation Paper on shareholder remedies: Part 2. *Company Lawyer*, 1997, 18(9), 274.

Sykes J., The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006, *Civil Justice Quarterly*. 2010, 29(2), 205.

Talbot L., A contextual analysis of the demise of the doctrine of ultra vires in English company law and the rhetoric and reality of enlightened shareholders, *Company Lawyer*. 2009, 30(11), 323.

Taylor B., The Rights of Outgoing Investors and Directors in Private Companies, *Company Lawyer*. 2003, 24(7), 220.

Timmis C., Company Law: In good company? *Law Society Gazette*, 2006, 103(13), 16.

Wishart D., 'Models and Theories of Directors' Duties to Creditors', *New Zealand University Law Review*. 1991, 14, 323.

### **Web References:**

Ali & Partners., *Doing Business in Saudi Arabia*, (2004), Available at: <[http://www.mideastlaw.com/middle\\_eastern\\_laws\\_saudi\\_arabia.html](http://www.mideastlaw.com/middle_eastern_laws_saudi_arabia.html)> accessed 18 February 2010.

Almalki J., Almadina Newspaper. (14. February. 2011), Available at: <<http://www.almadina.com/node/288033>> accessed 15. February 2011,

ANON., *Companies under the UAE Commercial Company Law* [online]. ALTAMIMI & Company, Available at: <[http://www.tamimi.com/site\\_1024/pdf/Complaw.pdf](http://www.tamimi.com/site_1024/pdf/Complaw.pdf)> accessed 14 February 2009.

ANON., *Foreign direct investment in Saudi Arabia up 33%* [online]. (2008) AME Info. Available at: <<http://www.ameinfo.com/176732.html>> accessed 15 December 2008.

Baxter E., Saudi plans tax cuts for foreign companies, *Arabian Business.com*. (October 19, 2009), Available at: <<http://www.arabianbusiness.com/570928-saudi-plans-tax-cuts-for-foreign-companies>> accessed 18 February 2010.

Cesari A., Expropriation of Minority Shareholders and Payout Policy. (May 12, 2009), Available at: <<http://ssrn.com/abstract=1403202>> accessed 27 July 2009.

Cooper R., *How Do You Protect Your Shareholding?*. Rtcoopers. (2005), Available at: <[http://www.rtcoopers.com/pdf/benefit\\_of\\_a\\_well\\_drafted\\_shareholders\\_agreement.pdf](http://www.rtcoopers.com/pdf/benefit_of_a_well_drafted_shareholders_agreement.pdf)> accessed 18 October 2008.

Enriques L., The Law on Company Directors' Self-Dealing: A Comparative Analysis, *International & Comparative Corporate Law Journal*. (Vol. 2, 2000), available at: <<http://ssrn.com/abstract=271591>> accessed 7 November 2009.



Foxwell A., *UAE Climbs in world Ease of Business Rankings*. The National. (2008). Available at: <http://www.thenational.ae/article/20081110/BUSINESS/555050371/1118/rss> accessed 15 January 2009.

International Energy Agency (IEA), by country, Saudi Arabia, 2008. Available at: [http://iea.org/country/n\\_country.asp?COUNTRY\\_CODE=SA&Submit=Submit#bottom](http://iea.org/country/n_country.asp?COUNTRY_CODE=SA&Submit=Submit#bottom) accessed 16 February 2010.

Lazarides T., *Minority Shareholder Choices and Rights in the New Market Environment*. (July 10, 2009), Available at: <http://ssrn.com/abstract=1432672> accessed 24 February 2010.

Lewis R., & Mallat C., *Commercial Law in the Middle East. Centre of Islamic & Middle Eastern Law*, Available at: <http://www.soas.ac.uk/Centres/Isalmiclaw/Materials.html> accessed 12 February 2009.

Moll D., *Shareholder Oppression and Reasonable Expectations: Of Change, Gifts, and Inheritances in Close Corporation Disputes*, *Minnesota Law Review*. (2002), available at: <http://ssrn.com/abstract=297503> or DOI: 10.2139/ssrn.297503, accessed 24 February 2010.

Saidi N., Chief Economist of the Dubai International Financial Centre, cited In: F. Mehmood, U.A.E. unlikely to allow 100% foreign company ownership, *TopNews Arab Emirates*. (24 March 2010), available at: <http://topnews.ae/content/21851-uae-unlikely-allow-100-foreign-company-ownership> accessed 5 May 2010.

Salem A., *Book of Sales*. Islamweb.net. (2006), Available at: <http://audio.islamweb.net/audio/index.php?page=FullContent&audioid=135007#135009> accessed 2 April 2010, at: Chapter (1); Company and Agency.

Sambidge A., *Foreign Investment in GCC Rockets* [online]. (2008) Arabian Business.com. Available at: <http://www.arabianbusiness.com/526019-foreign-investbtment-in-uae-rockets?ln=en> accessed 2 January 2009.

Terblanche P., *United Arab Emirates: UAE company law overview*, *Taylor Wessing (Middle East) LLP*. (27 May 2009), Available at: <http://www.mondaq.com/article.asp?articleid=80106> accessed 5 May 2010.

Watts G., *The shareholder's legal toolkit. Minority shareholder rights under UAE law*. *Al Tamimi & Company*. (19 April 2010), Available at: <http://www.thefreelibrary.com/The+Shareholder%27s+Legal+Toolkit+Minority+Shareholder+Rights+under+UAE...-a0224273778> accessed 10 May 2010.

## Appendix

### Empirical Study Questions

#### General detail

معلومات عامه

- **Participant's name:** الإسم:
- **Date of interview:** / /2009 التاريخ:
- **Category:** ( ) businessperson رجل أعمال ( ) minority shareholder شريك بنصيب الأقلية  
( ) majority shareholder شريك بنصيب الأكثرية ( ) foreign investor مستثمر أجنبي  
( ) regulator مشرع ( ) judge قاضي  
( ) lawyer محامي ( ) officer موظف حكومي  
( ) academic staff أكاديمي ( ) other أخرى.....

- **The interview questions:**

**The problem:**

1. Do minority shareholders actually face abuse, fraud, infringement, negligence or breach from the majority in SA and UAE? If so, what sorts of wrongdoings are you aware of?

Do you at the outset see that there is a need, under certain circumstances, for the minority to act on behalf of the company and protect it from the majority's abuse or wrongdoing? Why?

هل بالفعل الشريك بنصيب الأقلية يواجه سوء في المعامله أو خداع أو تعدي أو ظلم أو إهمال لحقوقه من قبل الشريك بنصيب الأكثرية في الشركات الخاصة في السعوديه و دبي؟ ماهي أعمال التعديات الممكن حصولها في هذا الإطار؟ هل ترى بأن هناك إحتياج ، في بعض الظروف ، لشريك الأقلية من تمثيل الشركه ورفع دعوى ضد الأكثرية لحماية الشركه من سوء إستغلالهم لها أو إستخدامها؟ ولماذا؟

2. According to S28 of the Saudi Company Law, "The minority has the right to complain to the majority over any wrongdoing and it is then for the majority to decide whether to ratify or not".

What is your view of this section? Does it cause any problems in real business life?

المادة 28 من نظام الشركات تنص "..... لأي من الشركاء ، الإعتراض على أي عمل قبل تمامه ، ولأغلبية الشركاء الحق في رفض هذا الإعتراض". مضمون هذه المادة هو إعطاء الأغلبية القرار النهائي في البت في كل الشكاوي والإعتراضات. هل توافق مع هذه المادة من النظام؟ ما هي المشاكل التي يمكن أن تكون نتيجة لهذه المادة في الشركات من الناحية العملية؟

3. What hypothesis or theory, do you think, the company law has adopted as the basis for granting the majority the ultimate power over the company? And why?  
ماهي النظرية أو الفكرة التي بنا عليها قانون الشركات السعودي القاعدة التي تمنح الأغلبية حق السيطرة الكاملة على الشركة؟ ولماذا؟
4. Do you think that the lack of minority protection causes any problem? Why?  
هل تعتقد بأن نقص التشريعات والقوانين في حماية شركاء الأقلية تسبب نتائج سلبية؟ وماهي ولماذا؟
5. Does this lack of minority protection have any impact upon the general economy and the local and foreign investments?  
كيف يؤثر الضعف في قانون حماية شركاء الأقلية على الإقتصاد العام والإستثمار المحلي والأجنبي؟
6. Do you think that it is possible for a minority shareholder to seek an undiscounted payout, once the minority shareholder is not happy with the way the company is being run?  
بالنظر الى ما يحدث في أرض الواقع داخل الشركات ، هل من السهل الحصول على سعر عادل عندما يريد شريك الأقلية بيع حصته في حالة رغبته في الخروج من الشركة؟

7. What guide or criteria do you follow when dealing with minority cases, since there is an absence of common law and accordingly no case law?  
ماهي المعايير أو القواعد المتبعه عند التعامل مع هذا النوع من القضايا علما بأنه لا يوجد سوابق قانونية أو قضائية متوفرة تسهل إمكانية الإستناد إليها والإستفادة من تجربتها؟

**Current remedies available:**

1. What practical remedies are available for the minority to seek if there is a wrongdoing or abuse done to the company?  
ماهي الحلول القانونية المتوفرة لمثل هذه الأنواع من القضايا والتي يسوء فيها شريك الأكتريه التصرف في إستخدام الشركة؟
2. In reality, what role does the court play in cases where minority shareholders allege oppression? Does the court strictly stick to the Act or does it interfere when it is necessary to bring justice? To what extent do courts get involved? Elaborate?  
ماهو دور المحاكم في هذه القضايا على أرض الواقع؟ هل المحاكم تطبق القانون القاضي بتسلط الأغلبية بحذافيره أم تتدخل عند الضروره لتحقيق العدالة؟ والى أي مدى يكون هذا التدخل؟ مع التفصيل؟

3. To what degree does the shareholder agreement protect the minority shareholder? What happens if the agreement contradicts the statutory power granted for the majority and grants instead the minority more rights? If the shareholder agreement was the only source to provide protection for the minority, do you think that this is adequate? What about including rights and interests, in a statutory form?

الى أي درجة ممكن أن يحقق عقد الشركاء حماية لشريك الأقلية؟ كيف يكون الوضع قانونياً إذا نص عقد الشركاء حقوقاً للأقلية تتعارض مع النظام (كالحق في رفع قضية ضد الشركة في أمور تم التصويت عليها من الأغلبية)؟ إذا كان عقد الشركاء هو الجهة الوحيدة التي يمكن أن تضمن لشركاء الأقلية حقوقهم ، ألا تعتقد بأن عقد الشركاء غير مؤهل لأن يتم الإعتماد عليه كلياً لحفظ هذه الحقوق وذلك لإحتمال أن يغفل عن ذكر أحدها ، أما إن كانت هذه الحقوق منبعها النظام فإنها محفوظة دائماً للأقلية؟

4. According to S28, "If the conduct or act has been completed, then the minority has no right to complain to the majority to assess or review the conduct".

What do you think that the minority should do after the completion of some wrongdoing?

في شرح المادة 28 من قانون الشركات " يكون للشركاء أولاً أي منهم ، حق الاعتراض على أي عمل قبل تمامه. إلا أنه منعا للإضطراب والفوضى مما قد يضر بالشركة ، يجوز لأغلبية الشركاء رفض هذا الإعتراض وإقرار العمل" كيف يمكن لشركاء الأقلية أن يعترضوا على أي فعل بعد إتمامه خاصة إذا كان ضاراً للشركة ولهم؟

### Your recommendations and proposals:

1. What rights and interests, do you think, should be reserved in the statute for minority and protected by the law?  
ماهي الحقوق والمصالح القانونية التي يجب أن تكون منصوصه ومحفوظه في القانون لتكفل حماية هؤلاء الأقليات من الشركاء في الشركات الخاصة؟

2. Do you think that extra remedies should be available under the statute? If so, what would you suggest?  
ما هو العلاج أو النظام من وجهة نظرك الذي يمكن أن يتم توفيره في قانون الشركات ليفيد شركاء الأقلية؟

3. What could create a healthy protective environment that accommodates the minority shareholders' needs?  
كيف يمكن تشكيل بيئة حمايه تجاريه تستوعب إحتياجات شريك الأقلية في الشركات؟

4. Would any of the following UK remedies work, if adopted, in SA and Dubai:  
هل أي من الإجراءات و الدعاوي التاليه يمكن أن يطبق في السعودية أو دبي إذا تم تبنيه:

a. **Personal action:** related to infringement of personal rights.  
دعاوي شخصيه: متعلقه بالتعدي على الحقوق الشخصيه.

b. **Derivative action:** a device for a minority to exercise if the company's interest is harmed.

الدعوي المشتقه: متعلقه بالدعاوي التي يحصل فيها تعدي على حقوق الشركة نفسها. في هذه الدعوي يستطيع الشريك المدعي من استخدام اسم الشركة ورفع الدعوي تمثيلا عنها ضد الأكثرية في الشركة الذين قاموا بسوء استخدام لها.

c. **Unfair prejudice petition:** specifically designed to deal with any act by the company that harms the shareholder's interests.  
دعوي الضرر: متعلقه بقضايا التعدي على مصالح الشريك في الشركة.

d. **Winding up order,** it is for minority shareholders to seek, when it is just and equitable to do so.

دعوي التصفية: وهي الدعوي التي يرفعها أي من الشركاء لتصفية الشركة عند وجود أساس عادل ومشروع لذلك.