

# **PROTECTION OF MINORITY SHAREHOLDERS**

- Controlling shareholders benefit of their control (control premium - price differential for high-vote shares) frequently at expenses of minority shareholders

- Corporate law should provide adequate protection for minority shareholders, preventing majority from *expropriating* minority.

Empirical studies show that controlling shareholders systematically extract private benefits of control, such as related-party transactions, preferential access to information, and appropriation of corporate opportunities. These private benefits are reflected in control premia in many jurisdictions. Strengthening minority protection therefore ensures not only fairness but also more efficient capital markets.

The following are the common risks of minority shareholders to be considered:

- **Ordinary resolutions** – majority voting rights means the ability to pass ordinary resolutions at general meetings, affecting vital control functions such as dividend payments, appointing directors, and approving transactions.
- **Board of director control** – majority shareholders can control the board of directors by electing board members who align with their interests. This gives them significant influence over company strategy and decision-making.
- **Dividend policy** – the ability to influence the distribution of profits by proposing and voting for preferred dividend payment schedules. Where majority shareholders are also directors they may manipulate the position so that they receive payment as directors but no dividend is paid.

- **Financial control** – the ability to decide on highly significant financial transactions such as borrowing, investments, or acquisitions, without reference to all shareholders.
- **Dilution** – the ability to potentially dilute minority shareholders' ownership percentage by issuing new shares or raising capital, especially if pre-emption rights are not present.
- **Information** – where the majority shareholders are also directors or effectively appoint the directors, they will have access to information on the day to day running of the business and finances which can be denied to minority shareholders.
- **Appointment and removal of directors** – the ability to appoint and remove directors, potentially weakening the voice of minority shareholders by removing those representing their interests.
- **Control on value of minority shareholders shares** – can be impacted by the majority shareholders deciding to issue preferential shares or other different classes of shares or manipulating the position so that on sale of the company, the minority do not receive fair value for their shares.

# APPOINTMENT RIGHTS

+ Minority shareholders appointment rights are very uncommon

Possible tools to protect minority shareholders:

- reserving board seats for minority or over-weighting minority votes in the election of directors
- through its appointed directors, minority can gain access to information and can have the opportunity to form coalition with independent directors
- appointment of “minority directors” can be granted:
  - by charter or shareholders agreements
  - by law (cumulative voting)

*Cumulative voting is a system of voting, as in some corporate and legislative elections, in which each voter is allowed as many votes as there are offices to be filled and may freely allocate them among the candidates, even by giving all the votes to one candidate*

Although cumulative voting increases the probability that minorities elect at least one director, its use is limited across jurisdictions. Even where available, controllers often neutralize it by using shareholder agreements or by dispersing share ownership among minorities

- only Italy and Brazil mandate minority directors in listed company (147/3 TUF): in practice, the effectiveness of minority directors depends heavily on their access to information and their ability to form coalitions with independent directors. In some jurisdictions (e.g., UK premium listing), minority investors even receive an expressive veto on the appointment of independent directors

Minority directors may have key committee roles or veto rights over certain board decision implicating a majority shareholders interest

Nevertheless, minority-appointed directors face structural disadvantages: they may be excluded from informal decision-making networks, and their monitoring capacity is constrained unless they receive full and timely access to board information

## HOW TO LEVERAGE VOTING RIGHTS

- **Dual class shares/circular shareholding/pyramidal structure, no jurisdiction bars all of these strategies. Evidence from several jurisdictions (e.g., Italy, France, Brazil) shows that separation between cash-flow rights and voting rights increases the risk of minority expropriation, especially through intra-group transactions and tunneling**
- **US-UK permit different classes of shares with any combination of cash flow and voting rights**

**Germany and Brazil ban multiple voting shares, as well putting a 50% cap on the issue of non/limited-voting shares. By contrast, the U.S. and UK allow corporate groups to adopt any combination of voting and cash-flow rights, although premium listing rules in the UK increasingly discourage dual-class structures**

- **Suspensions around separation of cash flows from voting rights: a rationale of the banning of pyramidal ownership structures?**
- **Fidelity shares, voting rights doubled for those shareholders holding the shares at least 24 months (art. 127 quinquies Italian tuf), only on opt-in basis. In France the same rule but on a default basis**
- **Even if dual classes of shares are permitted in US and in other jurisdictions, the one share one vote is considered as the principal system almost everywhere**
- **Voting caps (opt-in possibility except for Germany and Japan)**

# DECISION RIGHTS

- Majority of the minority shareholders allowed to bring lawsuits in the corporations name v. directors or other parties! These “majority-of-the-minority” mechanisms ensure that the approval of conflicted transactions cannot be engineered solely by the controller. They are widely used in the U.S. for freeze-outs and in Europe for related-party transactions
- Majority of the minority to approve fundamental transactions between controlling shareholders and their corporations
- Supermajority approval over fundamental corporate decision. However, the relevant threshold varies significantly: some jurisdictions require two-thirds approval, others 75%, and some permit blocking minorities as low as 25%

– Range of fundamental decisions and thresholds vary !

- Merger

- supermajority approval

- minority (e.g. 25%) statutory blocking rights

U.S. law typically requires approval by a majority of outstanding shares, while EU jurisdictions often require supermajorities. But even supermajority rules fail to protect minorities if the controlling shareholder already owns a high percentage of shares

- decision rights are used in all jurisdictions to protect minority against expropriation via major transactions (mergers)!

# INCENTIVE STRATEGIES

- Independent directors. Independent directors are expected to act as trustees for shareholders as a whole. Nonetheless, in many jurisdictions they are selected or influenced by controlling shareholders, raising doubts about their real independence. Moreover, independent directors often lack the authority to initiate major decisions independently

- equal treatment of shares

Trusteeship strategy and independent director

who is an independent director?

**who appoint (and remove) independent directors?**

- **self appointed (Netherlands)**

- **by savvy investors (venture capital)**

- **by majority shareholders**

- **basic trusteeship strategy: only directors, under their liability, can initiate some relevant corporate operations (merger)**

# EQUAL TREATMENT RULE

- controlling majority shareholders in order to act in the interest of shareholders as a class, hence protecting also the minority shareholders
- Pursuant to the principle of equal treatment, all shares carry equal rights in a company, unless otherwise stipulated in the charter
- Such rule strongly enforced only in the area of corporate distributions (dividends or share repurchase). Civil law jurisdictions (Germany, Japan) treat equal treatment as a general principle of corporate law, applying it broadly beyond distributions. By contrast, U.S. and UK law apply equal treatment only in specific statutory contexts, which gives controlling shareholders ample room for discriminatory behaviour unless self-dealing rules apply
- Application of the rule in the law of groups (Germany, Italy, France and Brazil provide great protection for minority shareholders), allowing an *ex post* evaluation of the fairness of intra-group deals in aggregate. Courts increasingly evaluate group transactions on an aggregate basis, focusing on whether the entire set of intra-group dealings is fair over time rather than examining each transaction individually

# **CONSTRAINTS AND AFFILIATION RIGHTS**

- legal standards (duty of loyalty- fairness)
- abuse of majority voting
- minority oppression standards. Oppression remedies are most common in closely held corporations, where minority shareholders cannot easily exit. Courts intervene when majority conduct is “burdensome, harsh, or wrongful,” including squeeze-outs, withholding of dividends, or exclusion from management

**SHAREHOLDER OPPRESSION:** whenever the majority shareholders act unfairly and prejudice the minority interest. It most commonly occurs in close corporations, because the lack of a public market for shares leaves minority shareholders particularly vulnerable, since minority shareholders cannot escape mistreatment by selling their stock and exiting the corporation. The majority shareholders may harm the economic interests of the minority by refusing to distribute dividends or attempting a squeeze out.

- disclosure. Mandatory disclosure reduces the informational advantage of controllers, especially in related-party transactions. In some markets, enhanced disclosure of control structures allows investors to price the costs of control more accurately

- exit. Strong exit rights exist mainly in connection with major corporate transformations or egregious abuses of power, such as mandatory bid rules (EU and Brazil) and appraisal rights triggered by mergers or squeeze-outs