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An Examination of the Utility of Shareholder Agremmentin Nigeria: The Imperative to give it a Statutory Leverage

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Abstract. The mode of management of a company and the rights of its shareholders is provided by statute while the internal relationship between the shareholders inter se and between the shareholders and the company as well as its operation, management and corporate governance structure upon, its incorporation, are provided for in its Article of Association. Too often people set up companies with friends and relatives but do not contemplate protecting their interests in the company until it is too late. In practice lawyers, in an attempt to cover myriad interests of shareholders, would populate the Memorandum and Articles of Association with all manner of clauses which in themselves hardly address the core issues requiring shareholder protection. The Articles of Association of the company, most times do not offer a shareholder full protection. The greatest risk an owner of a minority interest in a private company suffers is that he will be shut out of decision making. This clearly discounts the shareholder's statutory and contractual obligation to the company's sustainability. This work examines the nature of shareholders' agreement and its utility having regard to the obvious detached relationship between companies and the greater majority of shareholders in Nigeria. The paper finds a less than formalized approach to shareholder agreement structure in Nigeria and advocates for a legislative action to make it an incorporation document as a component of shareholder protection regime in Nigeria.

1. Introduction

The internal affairs of a company are governed by its Articles of Association. As a practice all Articles are required to be in the form contained in the template set out in the schedule to the Companies and Allied Matters Act. A standard format of Articles, particularly in private companies, in most cases do not provide for future issues which are otherwise unforeseen at the time of incorporation. It is therefore common in practice for the shareholders to complement the constitutional document of a company by entering into a shareholders' agreement.

A shareholders' agreement is an arrangement among a company's shareholders describing, at the outset, how the company should be operated and the shareholders' rights and obligations. Usually it includes specifics on the regulation of the shareholders' relationship, the management of the company, ownership of shares and privileges and protection of shareholders. It defines members' rights and responsibilities; obligations of the company in respect of its existing members and new investors. It outlines clearly the terms of business relationships between members and protects their basic economic interest. Usually it is a key tool to commit shareholders to the shared venture as co-founders and focuses on the business plan for the future.

This paper examines the utility of this specialized device as further a line of shareholder protection and advocates for a legislative affirmative action to incorporate shareholders' agreement, where it exists, as an instrument for company registration.

2. Constraints of Existing Framework

Good corporate governance practice is expressed in a situation where the shareholders in a company are separate from its board of directors; where no single shareholder or groups of shareholders have absolute control of the board. In such cases the directors, having the necessary expertise, are brought in by the shareholders to manage the business of the company on their behalf. Even if the directors have shares in the company, they are expected to be motivated to act in the best interests of the shareholders and the company as a whole and not in the interest of any largest single shareholder. In public quoted companies in Nigeria the separation of the office of the Managing Director and the Chairman of the Board is more prevalent in the banking sector and coming only after the introduction of the Central Bank's Code of Corporate Governance.

The situation in private companies is diametrically different. Generally there are usually few shareholders, and the shareholders are often the directors in the company. Most private companies at incorporation file pre-drafted templates of The Articles and Memorandum of Association of the company which, usually, which do not offer full protection to the shareholder as they hardly provide for, in clear terms, matters relating to consideration, obligations of parties, transfer of shares, pre-emption rights, dividend policy, fair value, third party rights, and so on and shareholders hardly make input to these documents nor familiarize themselves with their content. Eberechi provides a rightful insight to the thrust of this paper:

…many shareholders proceed to incorporate companies with their partners without reducing terms into writing and never a shareholder agreement. On the assumption that the memorandum and articles of association (M & A) sufficiently protects their interest, shareholders proceed to execute more complex documents with third parties, even while the company has no code guiding the shareholders' business relations. Thus, a very common cause of action in various Nigerian courts is the breach of oral pre- incorporation contracts amongst shareholders. Unfortunately for many, with nothing more than the M & A, they are forced to compensate their fellow shareholders who may have contributed nothing beyond their signature at the time of the company registration.

A shareholder agreement is essentially a contract inter se the members of the company. Under the law where there is a provision in the Articles or the Memorandum of the company restricting the powers or capacity of the company to carry on its authorized business or object, such restriction is to be relied on for the purpose. In this regard a shareholder agreement is viewed under the law as inferior to the articles in the event of a conflict.

Companies incorporated in Nigeria are regulated by Nigerian laws thus matters affecting such companies including interpretation of shareholders agreements and the question of jurisdiction over disputes are vested in Nigerian courts. The objective of shareholder equality and fairness is achievable only when the judiciary deploys its powers in a manner consistent with the intendment and the spirit of the law. Current judicial attitude suggests that the courts have elevated "personal and particular interest" above the quest to protect each shareholder's business interest within the company and to regulate the company's dealings with third parties. The courts demand that litigant shareholders show that their particular interests have been injured. By placing emphasis on the need to show personal, individual or particular interest, the courts have unwittingly introduced an extra element to locus as a requirement for shareholder actions even when the suit is at the instance of a bona fide member of the company.

The principle enunciated in the case of MacDougall & Gardiner with regards to rectifiable and non-rectifiable wrongs relating to

the rule in Foss v Harbottle still hounds our body of case law which the shareholder is subject to under our laws. To start with the courts have not developed any discernible principles or consistent rules of court to guide them as to when to apply and when not apply the rule in Foss v Harbottle. Secondly it is equally not discernible what forms of conduct are rectifiable and what forms are not rectifiable. This confusion leaves the shareholder in some quandary. The result, more often than not, is that the courts will apply the doctrine of locus standi and the shareholder, as Professor Sealy puts it, is time and again sent away with no answer, as often as not, with a rebuke for troubling the court.

Cox, J.D, in his work "Equal Treatment for Shareholders: An Essay" found that a true commitment to equal treatment of shareholders require more than a firm commitment to the commands of governing corporate statutes as expressed by the courts. This assertion, it is contended aptly defines the constraints of our existing frame work. The existing constitutional documents of companies, the CAMA as well as judicial intervention have not restrained the board from visiting disparate impact on the minority since it has been so imbued by the commands of the statute.

(a) Utility of a Shareholders' Agreement

A company's articles of association and the provisions of the Companies Act, only provide a broad framework for the operation of a company; they do not deal with the specifics of a company's management or the regulation of the internal affairs of the company. It is these aspects that are usually the subject of shareholders' agreement. A shareholder agreement being the product of the desires of the parties, thereto, is intrinsically more flexible than by-laws and allows more room for the shareholders to provide for a wider range of preferences, alternatives and special circumstances. In entering into shareholders' agreements, the shareholders are able to take into consideration situations that were not contemplated by the Articles. A shareholder agreement is a convenient tool in setting out the following major key issues:

(b) Company Governance Considerations

The CAMA requires that a company maintains an actual board of directors that is properly constituted. Specifically, the board, even if it does not possess any meaningful powers, must continue to meet the statutory residency requirements. Often times the size of the board and the composition of shareholders is such that deadlock in decision making is unavoidable. In such circumstance a shareholders' agreement becomes handy to give direction to how deadlocks can be resolved. Mediation and arbitration are other mechanisms included in some shareholder agreements to resolve disputes. Shareholder agreements may also provide for how directors are to be elected and for the pattern of voting for the nominees of all shareholders, subject to the agreement.

(c) Funding Considerations

A Company will require access to capital. This may require that the shareholders agree to contribute more equity in the future by means of further share subscriptions. Generally the shareholders will wish to have equal rights to subscribe for more shares so that they are not diluted. In addition to such pre-emptive rights, in some cases the shareholders also agree that in circumstances where it is determined as governance matter that the company needs more equity, the shareholders will be obligated to invest more equity. While it is possible that the proceeds of share subscriptions and general operating revenues will fully finance the company, typically a company will also require access to some sort of debt financing. If such debt financing is to come from the shareholders, the relevant terms need to be set out in the shareholder agreement. If debt financing is to come from banks and other third parties, guarantees may be required and, in such circumstances, the shareholders should provide for a sharing of liability in the shareholders agreement. To the extent that the financing needs of the company impose contractual obligations on the shareholders to either advance funds or provide guarantees, the shareholder agreement is needed to deal with the

consequences of a particular shareholder's failure to meet its obligations.

(d) Share Transfers and Liquidity Issues

The CAMA stipulates that there must be a restriction on the transfer of the shares of private companies and that such restriction must be stipulated in Articles of Association of the company. Thus under the Act shares or other interests of a member in a company shall be property transferable only in the manner provided in the Articles of Association of the company. It is typical for there to be a primary rule in the Articles, therefore, that no shares may be transferred without prior approval of the directors. The negative consequence of this primary rule, if not complemented by a shareholders' agreement, is that a shareholder that wishes to exit needs to obtain such prior approval from the board and there will be no certainty that such approval will be forthcoming.

(e) Fair deal

All major executive decisions by the directors are made by a majority, including decisions to change the nature of the business. A single director with majority shares can outvote others. Even if the Articles was made to protect shareholders, it can be amended by a simple majority in which case they could take any protection away from a minority shareholder in the articles, by passing a special resolution. The fragile state of a minority is summed up in the words of Mellish, LJ. in Mac Dougall v. Gardiner

"... if the thing complained of is a thing which in substance the majority of the company are entitled to do... there can be no use having litigation about is the ultimate end of which is only that a meeting has to be called and then ultimately, the majority gets its wishes".

In Adenuga v. Odumeru the Supreme Court reiterated this reasoning when it held thus:

"... when a decision has been irregularly taken on behalf of a company, it will be futile for the minority shareholder to take legal steps to oppose it since if it is a decision the company or corporation can take the majority shareholders can easily ratify it... "

It is submitted that it is quality strategy to have such detailed provisions set out in Shareholders Agreement as an integral part of the constitutional documents of a company at incorporation.

(f). Ease of Corporate Participation

Contractual arrangements are generally cheaper and less formal to administer, revise or terminate. From the shareholders' perspective, the agreement provides a manual for situations where they need to assess what rights they have as a shareholder, or assess under what circumstances they can transfer their shares to a third party. A shareholder agreement provides the shareholders with the opportunity to voice their expectations of the company, for example, requesting a dividend policy be put in place to provide beneficial protection for minority shareholders.

4. Imperative of Making Shareholder Agreement an Incorporation Document

Generally the content of a shareholder agreement would be based on prescriptive or anticipatory risks associated with company operations and would seek to address such issues as maintenance of critical operations with regards to company management, shareholders' rights and obligations, regulation of sales of shares in the company as well as establishment of fair and transparent relationships between shareholders and so on. There is, however, no guarantee that these agreements would be inviolable given the penchant for rascality that has defined Nigeria's corporate landscape in recent times. A case in point is the Econet Wireless limited debacle. At incorporation the 22 shareholders signed a shareholders' agreement wherein it was agreed, amongst other things, that in the event of sale, transfer or disposal of one's shares in the company a member must first offer them to other members who have the right of first refusal and can sell them to an outsider if the other members either decline or fail to pay within 30 days. In contravention of this agreement some members of the company purported to cancel the shares of

others and sold the company out rightly without reference to those whose shares were "cancelled". It took ten (10) years, spanning all cadres of our superior courts, before this capricious act was set aside.

Reference to the above case is to demonstrate that a shareholder agreement, as desirable as its utility has been canvassed in this article, without more, may be Pyrrhic victory in actuality. It is in this regard that we advocate for a legislative action to make it part of the body of documents to be filed for the purpose of incorporation of a company. In the United Kingdom shareholders' agreements do not necessarily have to be filed at Companies House (the public register of companies in England and Wales). However, where the shareholders' agreement is specifically mentioned in the articles of association or if the shareholders' agreement contains terms which would otherwise affect the company's constitution it is required, by law, to be filed along with other documents of incorporation. In the United States of America state laws regard shareholders agreement as an enhancer of company constitution. Specifically section 706(a) of the Delaware Code of the expressly allows agreements to be made to define how shares will be voted, both in respect of election of board members and as to other matters section 418 of this law requires that the applicability of voting provisions be conspicuously noted on the certificates evidencing shares subject to them, or in transaction statements relating to such shares if they are not certificated. Under the South African Companies Act a shareholders' agreement occupies a pre-eminent position in company formation. By the Act, provisions contained in shareholders' agreements prevailed over the provisions of the Articles of Association and Memorandum of Association of a company, to the extent that any such provisions in the shareholders' agreement did not conflict with legislation.

A minority shareholder in a private company is particularly a vulnerable person. This is partly because control of the company vests in one or two persons. There is generally no market for the shares of a private company, and a shareholder who is unhappy at the way the company is being run does not have the option of selling those shares. The concentration of control in one or two shareholders can lead to abuse of power, even where no single shareholder holds a majority. Though there are remedies in the CAMA to prevent such unfair conduct towards a minority shareholder, however, these remedies are most times not certain and can prove to be extremely costly. It is far better to prevent the situation arising in the first place. This is where a minority protection shareholders' agreement becomes paramount. It is in such circumstance that a shareholders' agreement becomes helpful to secure the interest of shareholders in ways which are not covered in the Articles of Association of the company ; to safeguard, to give protection to shareholders and to provide for what happens if 'things go wrong' between the shareholders.

5. Conclusion

The quest for Nigeria to take its rightful place among emerging markets of the world is predicated on a greater ease in doing business and investor confidence in the quality of protection afforded on under our laws. It is contended that Nigeria adopts the trending convention by giving shareholder agreement statutory toga; a place superior to the provisions of the Article of Association. It is advocated that Nigeria adopts the South African approach to make shareholder agreement, where it exits, a document of incorporation under the Act to provide a broad framework for the operation of companies and to deal with fluid and changing aspects such as share ownership structure, corporate governance, asset dealing and appointment of directors which have lately become bastions of oppression of the minority and impunity of the majority. This, it is submitted, will provide a further line of shareholder protection and fortify of the provisions of the Companies Act and the Articles in that regard.

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