Shareholders' Conflict Management for Promoting Corporate Governance in Close Companies of Pakistan

1. Dr Asim Iqbal, Assistant Professor
   Department of Law, IIU, Islamabad
   Email drmaiqbal@live.com

2. Dr Tauseef Iqbal, Senior Assistant Professor,
   Department of Law, Bahria University, Islamabad
   Email tauseef_adv@hotmail.com

3. Dr IkramUllah, Assistant Professor,
   Dept. of Law, IIU, Islamabad
   Email ikram.mahar@gmail.com

Abstract

The present article evaluates the effectiveness of the goodpractices of corporate governance to manage minority shareholders' conflicts in close companies of Pakistan.Corporate Governance Guide prepared by Pakistan Institute of Corporate Governance (PICG), Institute of Chartered Accountants of Pakistan (ICAP) and Center for International Private Enterprise (CIPE) recommended certain good governance practices to manage conflicts in family owned companies of Pakistan. These recommendations are evaluated in the light of the research conducted by the author regarding management of minority shareholders' conflicts through preventive and resolving measures for promotion of corporate governance in close companies of United Kingdom (UK) due to similar legal traditions of the both jurisdictions. It is endeavored to appraise the both researches and their findings to propose the best possible future course of action in this regard for Pakistan.

Keywords: Corporate Law, Business, companies, shareholders, conflicts, prevention, resolution.

1. Introduction:

It is globally acknowledged that the performance of family owned companies has been significantly influenced by good governance.[1]In recent times, globally family-owned undertakings have been paying more responsiveness to firming up mechanisms of corporate governance, in order *inter alia* to decreasefamily clashes arising from business.[2]Unlisted family owned companies in Pakistan have been increased in number that fuelled the development of private sector in Pakistan and made good governance of these businesses a need of the present time.[3]Therefore, it is more acute in Pakistan as family owned undertakings are a very widespread business model in the country and best standards of corporate governance are vague in practice.[4]Pakistan Institute of Corporate Governance (PICG), Institute of Chartered Accountants of Pakistan (ICAP) and Center for International Private Enterprise (CIPE) has arranged the Corporate Governance Guide for family owned companies of Pakistan.[5]CIPE envisions that this guide would provide information and awareness concerning the benefits of best practices of corporate governance in family owned companies.[6]In the Corporate Governance Guide it is acknowledged that "encouraging elementary principles of good governance for family owned companies it is necessary in supporting the growth of a solid economic sector".[7]It is claimed that "by good corporate governance practices companies become able to reduce disputes".[8]Good governance *inter alia* integrates the strengths of family and businesses by improving shareholders' relationships by operational communication and management of their conflicts regarding affairs of the company.[9]Governance principles to improve effective communications and to manage conflicts can be applied through family constitutions and family councils that will create space between emotions and business.[10]The Guide may be improved considering the

[1] The Corporate Governance Guide – Family Owned Companies, PICG, ICAP, CIPE 2008, see Rationale can be accessed at www.cipe.org/publications/search (hereinafter 'The Guide')
[2] Safeguarding the Legacy: Corporate Governance and Longevity in Family-Owned Enterprises, CIPE 2011 can be accessed at www.cipe.org/publications/search. (hereinafter 'The Case Studies') See Preface.
[3] The Guide. Securities and Exchange Commission of Pakistan has reported in 2007 that there are more than 50,000 family owned businesses in Pakistan.
[4] See the Case Studies, Preface.
[5] International best practices were observed while examining the Feedback from the stakeholders, and further it was incorporated in the Guide accordingly.
[6] See the Case Studies, Preface.
[7] See the Guide, Rationale.
[8] The Guide, Scope.
[9] See the Guide, Rationale.
[10] See the Guide, Scope.

necessities of individual businesses as it "includes various recommendations for different kinds of family undertakings on the basis of their size, age, kind of business, the arrangement of shareholders and family dynamics".[11]As provided in the guide "it is the main version of the Guide and incoming years should be observed as a 'live document' to be established, amended and enhanced".[12]

Therefore in this article it is endeavored to critically evaluate the proposals made in this guide for Pakistan in the light of the research conducted by author regarding management of shareholders' conflicts in UK[13]due to their similar legal tradition particularly in this area of company law. The research will mainly consider the private family owned companies of Pakistan in comparison to that of UK due to their comparable nature. The research finally concludes the best possible future course of action in this respect for promoting the good corporate governance practices in these companies of Pakistan. These companies are also called close companies, owner-managed or quasi-partnerships the affairs of which are controlled by shareholders having close personal relationships and their shares are not publically traded.[14] In the beginning of Corporate Governance Guide it is provided that family owned companies in Pakistan are characterized as organizations in which shareholders are the same family and take part in the management of the company.[15]Close companies or family owned companies are designed on the foundation of mutual trust and individual affiliations of friends and family members.[16]In Pakistan personal and business conflicts of interest among family members in family owned companies disrupt company business and it is observed that "individual conflicts are the central cause of splintered family-owned companies".[17] These different conflicts of interest situations[18] end the mutual trust and result in relational breakdown in close companies. The relational breakdown that may has various underlying causes gives rise to squeeze-out behavior of majority shareholders due to

[11] See ibid.
[12] See ibid.
[13] For the research conducted by author regarding the management of shareholders conflicts in UK See Iqbal, M. A., *An English Solution to a Universal Close Corporation Problem: An Evaluation,* 2012 Federal Law House, Pakistan (hereinafter 'Iqbal's').
[14] See Iqbal's ch 1.
[15] See the Guide.
[16] See *Shahbazud din vs Services Industries* PLD 1988 Lah 1 and authorities mentioned there. See also *LadliParsadvsKarnalDistrillery Co. Ltd,* PLD 19 SC 221*; In Re MaqboolElahi*PLD 1970 Lah 539.
[17]See the Guide, Good Governance Practices, 2. Family Governance para 2.3.
[18] See below para 4.2.

general application of majority rule[19] in company law to an extent that the minority shareholder prefers to leave known as 'exit' here we call them 1st type conflicts.[20] The preference for exit causes the conflicts regarding terms of exit from the company known as 'valuation disputes' due to restriction on transfer of shares in close companies[21]here we call them 2nd type conflicts.[22]

In this situation to manage these two types of conflicts it is preferable to enter into such businesses considering them a purely commercial enterprise and take necessary preventive and resolving measures accordingly. Here preventive measures mean, 'protection of rights through contractual stipulations' and resolvent measures mean, 'resolution of disputes through mutual negotiation'. It is directed in the Guide that "Shareholders should together guarantee the continuousness and company sustainability".[23]As it is validly asserted that "observing shareholder rights is necessary for a company to function and grow".[24] In Corporate Governance Guide it was provided that "all shareholders should have the opportunity to obtain effective redress for violation of their rights, including a mechanism for the resolution of disputes".[25]The article will discuss the management of minority shareholders' conflicts in close companies in a timely and cost effective manner through preventive and resolvent measures without resorting to courts. This effective management of conflicts would be in the interests of all stakeholders including the company itself and would promote good governance in these companies. It evaluates the nature, significance, function and limitations of the preventive and resolvent measures to manage these conflicts for protecting minority shareholders to promote good corporate governance in these close companies. After discussing the legal nature, significance and function of preventive measures like contractual stipulations in shareholders' agreements and resolvent measures like negotiating with the assistance of third party like family council the article discusses the limitations of these measures. The evaluation is conducted considering the

[19] In companies decisions are made with the consent of majority shareholders of the company. See Iqbal's ch 1.
[20] See *M HussainvsKhiali Paper & Board Mills (Pvt) Ltd*(2005) CLD 636.
[21] See The Companies Act 2017, section 2 sub section 49.
[22]In any conflict minority desires to leave the company because it becomes hard for minority to continue with the majority, in the company. Restrictions on transfer of shares in private companies cause exit dispute.

[23] See the Guide, Good Governance Practices 2, Family Governance para 2.5.
[24] See ibid para 2.1.
[25] See ibid para 2.2.

nature of minority shareholders' conflicts in close companies[26] and analysing in depth the available precedents of shareholders' agreements and the interviewees' responses carefully collected both in Pakistan and UK[27] in this regard.

It is concluded that these measures as to prevention and resolution can be useful in this regard but owing to certain limitations it is not always possible to completely defend the benefits of minority shareholders through these measures at relational breakdown in close companies. Accordingly, shareholders have to recourse to the conventional means of resolution such as courts under general law that is the most common method of conflict resolution in these conflicts. However, owning to nature of these minority shareholders' conflicts where minority shareholders have to prove oppressive[28] or unfair prejudicial conduct[29] of majority shareholders, resolution of conflicts by courts is often lengthy and therefore expensive process. As it is required to prove that the relevant law is applicable and that demand detailed investigation into the affairs of the company that often prolong the legal proceedings.[30]Resolvent measures such as family council and other methods of Alternative Dispute Resolution (ADR) like mediation can be functional as they would assist to separate emotion from business and may aid to resolve conflict in timely and cost effective manner but their specific role in these disputes is still required to be explored in the context of Pakistan.

2. Nature and significance of preventive and resolvent measures:

It is observed in the case studies of Pakistan that structured way of doing business generally assist to avoid conflicts and bring growth to the business. These case studies show that owing to their unique facts there is no single strategy behind successful family businesses however *inter alia* strong organization, clarity in roles of owner-managers and honest communication can prevent shareholders' conflicts and enhance the growth of a family owned business.[31]In this regard preventive and resolvent measures can add strength to the structure of the business

[26] Nature of these conflicts in UK is discussed in detail in Iqbal's ch 3.
[27] Iqbal's ch 4.
[28] See section 286 of the Pakistani Companies Act 2017, previously section 290 of the Companies Ordinace 1984.
[29] See section 994 of the UK Companies Act 2006, previously section 459 of the Companies Act 1985.
[30] See Iqbal's, ch 5.
[31] See The Case Studies.

therefore help to manage the conflicts in these businesses. In the coming paragraphs nature and significance of these both measures is evaluated separately.

2.1 Nature and significance of preventive measures:

The significance of shareholders' agreements in the background of protection of minority shareholders' interests in close companies has been widely discussed in legal literature and their use has been recommended by both practitioners and academics here in Pakistan as well as in UK.[32] Chiu provided that there is a possibility for private contractual arrangements in shareholder relations for resolution of their disputes.[33] Copp discussed that many company disputes could be avoided if the parties have entered into express contractual provision for these disputes.[34] In case study 4 conducted by CIPE in Pakistan it was learnt that "clearly identifying roles and responsibilities for each family owner leads to effective business management".[35]Shareholders may anticipate and agree in advance through shareholders agreements having contractual effect the method to conduct business and conflicts shall be resolved in companies and may get professional legal assistance in this regard. It provides an opportunity at the beginning of the business ties, to reflect the scope and direction of the future relations of shareholders in that particular business.

In Pakistan in a case study 1 conducted by CIPE it was learnt that early adoption of a professional business approach in a family business has positive influence on business growth.[36] It was provided that defining clear cut roles and responsibilities for family members managing the business has assisted in maintaining family and professional relationship. Successful family businesses follow a same pattern the first generation develop the values that guide the family business and its management then the business refine its practices which eventually evolve into professional policies and procedures. In this case study for instance, Dr D and Dr S developed

[32] See Stecher, M. W (ed) *Protectionof minority shareholders,* 1997, Kluwer Law International Ltd, London. General Report at 1; Cadman, J., *Shareholders' Agreements*, 4thed, 2004, Sweet & Maxwell, London,chapters 1-4; Boros, E.,
[33]See Chiu, I.H., 'Contextualising Shareholders' Disputes – A Way to Reconceptualise Minority Shareholder Remedies' (2006) Journal of Business Law 312, 313.
[34]See also Copp S., 'Company Law and Alternative Dispute Resolution: An Economic Analysis' (2002) 23(12) Company lawyer 361, 368.
[35] See The Case Studies, Case Study 4 p. 18.
[36]See The Case Studies, p. 2.

and implemented professional management procedures and policies from the start in their successful business venture.[37]As in case study 1 it was acknowledged that "Corporate governance has been the key to our success, as sticking to business ethics has resulted in carving out our identity".[38]In successful businesses as in MM Hospital "there is an established system to document decisions and procedures related to professional ethics and practices". In a case study 1 it was provided that after setting the goals the key to success is that family has always adhered to its founding principles and involved in long term planning regarding the business.[39] In case study 2 it was learnt that "adhering to identified family policies has helped avoid family conflicts and has facilitated business growth".[40]

A comparative study of different jurisdictions has shown that the use of shareholders' agreements is widespread.[41] In close companies at practical level shareholders are commonly advised to protect their right through contractual stipulations.[42]The courts also prefer to enforce these contractual stipulations at the event of conflict.[43]The UK Law Commission also observed that shareholders in these companies often enter into these agreements to ensure better protection for themselves.[44]

Nowadays practicing lawyers in Pakistan as well as UK often emphasize and recommend shareholders' agreements in close companies. Elson claimed that "the best protection that can be extended a client about to enter into a corporate venture is a well-drawn agreement between shareholders designed to safeguard their interests on a mutually fair basis".[45] During the empirical investigation conducted by author both in Pakistan and UK[46] interviewee Y in Pakistan stated that "shareholders' agreements protect minority shareholders and we always advise our

[37] Ibid.
[38] See The Case Studies, p. 5.
[39] See ibid p. 7.
[40] See ibid p. 8
[41]Stecher, M. W (ed) *Protectionof Minority Shareholders* 1997, Kluwer Law International Ltd, London, 12.
[42]Ibid 20.
[43] See *Rayfield v Hands* [1960] Ch 1. See Iqbal'sch 4.
[44]SeeThe Law Commission Consultation Paper, Shareholders' Remedies', Law Com No 142, 1996 can be accessed at www.lawcom.gov.uk hereinafter *the Consultation Paper*paras 3.3, 3.4 and 3.17.
[45]Elson, A., 'Shareholders' Agreements, A Shield for Minority Shareholders of Close Corporations' (1967) 22 Bus Law 449, 451.
[46] See below Annex 1. See also for details as to empirical investigation Iqbal's, ch 2 and ch 4.

clients to use them" [Y].[47] Interviewee X a senior corporate lawyer in Pakistan asserted that "shareholders' agreements are significant in protecting minority shareholders from the oppressive behavior of majority shareholders" [X]. Interviewee H in UK acknowledged, "if you have a shareholders' agreement where the parties' expectations are spelt out in words there is much less scope for arguments. Shareholders' agreements really sort matters and make life a lot easier" [H].[48]

2.2 Nature and significance of resolvent measures:

As nature and objectives of businesses are generally different therefore approach to handle those businesses is also different. As stated that each family owned business studied during case studies is unique in terms of its family values that reflect how the family has conducted its business and avoided conflict.[49] Therefore preventive measures cannot foresee each and every future eventuality[50] accordingly often there is need to resolve the conflicts through resolvent measures to secure the business from further harm. In Corporate Governance Guide it was provided that "ownership and exercise of rights of all shareholders, including minority shareholders should be respected and protected by forming a functional family council" in family owned companies.[51]As to structure of this family council it was provided in the guide that "all segments and branches of the family should be represented on this council after developing consensus amongst the family on the size, membership and leadership of the council".[52]Furthermore it was recommended that the council if necessary may seek the services of a professional mediator to resolve these conflicts.[53]Therefore, considering an attractive option alternative means of resolving these conflicts are recommended as an alternative to conventional means of resolution of these conflicts through courts, that is often lengthy therefore an expensive legal process.[54]

[47] In Pakistan interviewees were asked as to utility and significance of shareholders' agreements in these conflicts. See also below Annex 1.
[48] For details see Iqbal's ch 4.
[49] See The Case Studies, p. 25.
[50] See below para 4. Limitations of these measures.
[51] See The Guide, Good Governance Practices, 2. Family Governance.
[52] See ibid para 2.2.
[53] See ibid para 2.3.
[54]See below 4.8 Enforcement. SeealsoIqbal'sch 5.

3. Function of preventive and resolvent measures to manage shareholders' conflicts:

As stated above the relational breakdown that has various underlying causes gives rise to squeeze-out behaviour of majority to an extent that the minority prefer to exit that further causes the disputes regarding terms of exit from the company.[55]As evident from Pakistani and UK case law squeeze out techniques employed by majority shareholders against minority shareholders in close companies of both jurisdictions are similar.[56]In practical terms shareholders' agreements firstly anticipate conflicting issues that are type 1 and type 2 conflicts[57]and secondly manage in advance those anticipated conflicting issues[58] for minority protection and to promote corporate governance in those companies.[59]The study of the available precedent shareholders' agreements,[60] in Pakistan and UK suggests that theoretically these agreements can prevent squeeze-out behaviour[61] and grant an exit to minority in already stipulated situations. As one interviewee stated that "I think a lot of these disputes could be avoided in small private companies if the parties had actually thought at an early stage how the business was going to be run and how the possibility that one party might wish to exit would be handled" [M].[62]As to function of these agreements interviewee E shared that "Good agreements can prevent disputes from arising in the first place since you have already agreed the way the company should be run. Shareholders' agreements are not so much about speedy and cost effective resolution but to prevent disputes from arising in the first place" [E].[63]

The study of precedents shareholders' agreements suggests that contractual stipulations are basically of two kinds. These agreements firstly declare the rights of the shareholders and

[55] See above 1. Introduction.
[56] See below 3.1.1 - 3.1.5 and the case law mentioned there. For nature and kinds of these squeeze out techniquesin UK see also Iqbal's, ch 3.
[57] See above para 1. Introduction.
[58] See Iqbal'sch 3 para 3.4.1.3 Identification of squeeze-out techniques: empirical evidence.
[59] See SeeStecher, M. W (ed) *Protectionof Minority Shareholders* 1997, Kluwer Law International Ltd, London, 251; for shareholders' agreements see Cadman, J., *Shareholders' Agreements* (4th ed Sweet & Maxwell, London 2004)chapters 1, 4; Boros, E.,*Minority Shareholders Remedies*, 1995, Clarendon Press, Oxford, chapter 4.3 and Introduction to Thomas R., and Ryan C., *TheLaw and Practice of Shareholders' Agreements.* (Butterworths, London. 1999).
[60]These collected precedents are sample agreements that resemble to actual bespoke agreements and can be altered if required, according to the needs of the shareholders in any particular business.See Iqbal's, ch 2 Methodology para 2.2 Legal scholarship.
[61] See Copp S., 'Company Law and Alternative Dispute Resolution: An Economic Analysis' (2002) 23(12) Company lawyer 361, 370.
[62] See Iqbal's ch 4.
[63] See Iqbal's ch 4.

secondly, by controlling the strength of majority rule enhance the voice of the minority through extra voting power in anticipated conflicting situations.[64] In case study 4 it was observed that in successful businesses strategic decisions –whether big or small-require the consent of each family member.[65]However, the enhanced voice of minority shareholders by extra voting power in contractual stipulations may avoid the squeeze-out behaviour but can create the deadlock in companies.[66]

Moreover during case studies it was identified that communication is highly significant and regular family and board meetings improve coordination and decision making and mitigate conflicts.[67] Therefore, the function of family council in close companies could not be ignored in this regard who can enhance coordination by arranging meetings of shareholders and would possibly be useful in separating the emotions from the realities of business.[68] As to function of the family council it was stated that the family council should guarantee that minority shareholder objections are properly redressed on time.[69] It intend to aid as a basis for shareholders for communication and discussion regarding the family business and to deliver direction to directors representative of family about the family's interest in the guidelines adopted or planned to be implemented by the company.[70]The council would resolve conflicts and issues concerning succession guaranteeing that succession is prearranged before any prospective administration deviations.[71] The council would decide and nominate the family members able to follow election of board of directors in the company.[72] Regarding the function of council it is further provided that the council shall warrant that firstly, possible disputes are pre-empted and

[64]Like those partnerships in which willingness of all the partners is necessary for decision making. these two kinds of stipulations can be overlapped as minority shareholders' voice can be heightened concerning the rights fixed already to them enforcement of agreements that wanting the permission of minority shareholders' these cannot be modified . For more description see Iqbal's Ch 4.
[65]The Case Studies, Case Study 4, p. 18.
[66] See below para 4.7 Deadlock. See also *Khursheed Ismail vs.Unichem Corporations (Pvt) Ltd* 1996 CLC 1863.
[67] The Case Studies, p. 26. See also Case Study 4.
[68] See The Guide, Scope.
[69] See The Guide, Good Governance Practices, 2. Family Governance, para 2.5.
[70] See ibid para 2.2.
[71] See ibid para 2.2 and 2.7.
[72] See ibid para 2.6.

disallowed from upsetting business and secondly all disputes relating to the family's business are decided through negotiations and discussions in appropriate way.[73]

3.1 Prevention and resolution of squeeze-out behaviour of majority shareholder:

Preventive measures like shareholders' agreements may protect the interests of minority shareholders from 1st type conflicts known as squeeze-outs by minimizing the ambiguity regarding the legal relationship of shareholders. As evaluated below to handle the majority rule these stipulations firstly, declare the rights and secondly, raise the voice of minority by enhanced voting power in corporate decision making and theoretically assist to cope with the common squeeze-out behaviour of majority shareholders identified by the Pakistani and UK case law.[74]In the light of the case law squeeze out techniques are mainly divided into five kinds.[75]Secondly, resolvent measures can be advantageous at the event of squeeze out behaviour by bringing shareholders together at one table to listen to the concerns of one another and endeavouring to resolve their conflicts effectively with minimum time and costs without recourse to court. In the coming paragraphs the preventive and resolvent measures are applied upon the identified squeeze out techniques.

3.1.1 Exclusion from management:[76]

Exclusion from management can be either full or partial.[77] In full exclusion majority may exclude the minority from management of the company by simply informing him that he is not allowed to contribute in the organization of the company. Secondly, in partial exclusion majority takes the corporate decisions without consulting the minority and does not provide him the necessary information regarding the company affairs. In Corporate Governance Guide it is stated that minority shareholders in a family ownership companies typically discover it hard to take part

[73] See ibid para 2.3.
[74]See below 3.1.1 - 3.1.5 and the case law mentioned there. For nature and kinds of these squeeze out techniquesin UK see also Iqbal's, ch 3.
[75] See below 3.1.1 - 3.1.5 and the case law mentioned there.
[76] See Iqbal's, ch 4. For minority shareholder complaint as to exclusion from management in Pakistan see *Khursheed Ismail vsUnichem Corporations (Pvt) Ltd* 1996 CLC 1863; *Shahbazud din vs Services Industries* PLD 1988 Lah 1.
[77] See Iqbal's ch 3 para 3.4.1.1.1 Disregard of minority shareholders' participation in the company.

in the decision making process because of their deficiency of access to appropriate information and revelations.[78]

Exclusion from management can be disallowed by stating in shareholders' arrangement that all shareholders shall fully participate in the administration of the company.[79]To avoid full or partial exclusion, shareholders' participation can be further ensured by raising the voice of minority shareholder by granting him veto power that no corporate decision can be made regarding certain identified matters without the consent of minority shareholder.[80] Minority shareholders' complaints of controlled access to information regarding the corporate affairs for informed decision making can be prevented by clearly declaring in agreements that majority shareholders will provide the minority full information regarding the corporate affairs.[81]

3.1.2 Excessive or low remuneration:

Minority often complaint that majority shareholder who is also director of company is paying to himself excessive remuneration.[82]Advance declaration of method of determination of remuneration can theoretically prevent the minority shareholders' complaints regarding the excessive or low remuneration of directors of company. Directors' remuneration must be fair as in case study 1 it was provided that one reason behind successful business is that the company compensates Dr D for his services appropriately considering his educational background and professional experience.[83]Such required provision may state that: "the corporation will not short of the previous sanction of all shareholders pay any reward to any person other than as appropriate payment for services rendered or effort done regarding business".[84]

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[78] See The Guide, Good Governance Practices, 2. Family Governance, para 2.4.

[79]Moreover, different nature and types of shares may allotted a right to take part in the administrationbe granted to minority and entitlement to appoint at least one director. For detailed discussion see Iqbal's, ch 4.

[80]LexisNexis Butterworth's, Butterworth's Corporate Law Services - Encyclopedia of Forms and Precedents (hereinafter 'Butterworths') 291 Shareholders' agreement for minority protection clause 3 and Cadman, J., *Shareholders' Agreements*, 4thed2004, Sweet & Maxwell, London (hereinafter 'Cadman') Precedent A, Minority Protection Agreement, clause 12. See appendix 1inIqbal's, para 2 Matters requiring consent of both parties.In*Re Cumana Ltd* [1986] BCLC 430, pursuant to the agreement the minority was entitled to be consulted on all major matters concerning the affairs of the company. See Iqbal'sCh 3 para 3.4.1.1.1.

[81] For detailed discussion regarding nature of such clause see SeeIqbal's,ch 3 and ch4.

[82]For minority shareholder complaint as to remuneration in Pakistan see*Shahbazud din vs Services Industries* PLD 1988 Lah 1. See also Iqbal's, ch 3 para 3.4.1.2.1 Misappropriation of company's assets and proceeds.

[83] The Case Studies p. 5.

[84] See Cadman's, Precedent A, Minority Protection Agreement, clause 12(1)(h). See Iqbal's appendix 1 para 5 Matters requiring directors' approval.

3.1.3 Dividend policy:[85]

Complaints of minority shareholders regarding slight or no contribution in company's profits can be prevented by declaring in advance the express dividend policy of company.[86] Such provision may declare that: "the company shall distribute by way of dividend in respect of each financial year, certain profits of the company".[87]This can be further ensured by providing in shareholders' agreement that no change in the policy can be introduced without the consent of the minority shareholders.

3.1.4 Misappropriation of assets:[88]

In close companies minority shareholders often complaint regarding the misappropriation of company assets by majority shareholders that is against the interests of minority.[89] Theoretically, such conduct might be controlled by providing in advance in shareholders agreements that the corporate assets utilized for the collective benefit of company and not for the personal advantage of majority shareholders. In this regard range of provisions can be stipulated such as:(i) "majority shareholders as directors of company shall not involve themselves in a situation that will conflict with the interests of the company"[90]; (ii) "assets can only be disposed of for the best price obtainable in particular circumstances"[91] and (iii) "the company shall not incur any borrowing in excess of a certain amount".[92]It can be further reinforced by declaring in shareholders' agreements that majority cannot transact any deal regarding the corporate assets without the consent of minority.

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[85]For minority shareholder complaint as to dividend policy in Pakistan see *M. Masood vs S.M. Corporation (Pvt) Ltd* 2011 CLD 496. See also Iqbal's ch 3 para 3.4.1.2.1 Misappropriation of company's assets and proceeds.
[86]See Cadman's, Precedent A, Minority Protection Agreement, clause 9.
[87] See 'Butterworths' Precedent 8, clause 8.3. See Iqbal's, appendix 1 para 7 Dividend policy.
[88] For minority shareholder complaint as to misappropriation of assets in Pakistan see *Light Metal (Pvt) Ltd vsSarfrazQaudri*2011 CLD 1485. See also Iqbal's, ch 3 para 3.4.1.2.1 Misappropriation of company's assets and proceeds.
[89] For details see Iqbal's,ch 4.
[90] Ibid.
[91] See Cadman's, Precedent A, Minority Protection Agreement, clause 12(1)(o). SeeIqbal'sappendix 1 para 5 Matters requiring directors' approval.
[92] See Cadman's, Precedent A, Minority Protection Agreement, clause 12(1)(l)(m)(n). See Iqbal's appendix 1 para 5 Matters requiring directors' approval.

3.1.5 Dilution of investment or voting power:[93]

Dilution of minority shareholder investment or voting power in the company can be avoided by granting the shareholders firstly, extensive preemption rights in proportion to their existing shares and secondly, veto rights over any new issuance of shares. As that, "no alteration, rise or decrease can affect any issued share capital of the company before the sanction of all the shareholders of the company".[94]

3.2 Prevention and resolution of exit conflicts of minority shareholders:

In close companies squeeze-out behavior cause type 2 known as exit conflicts due to restriction upon transfer of shares.[95]Shareholders may seek to anticipate 2nd type conflicts known as exit conflicts by providing in advanceman exit strategy for minority shareholders. The UK Law Commission favored the exit at will for shareholders in close companies stating that "it is hoped that by encouraging the parties to make provisions for a future breakdown in their relations…allow parties to manage the break down in such a way as to cause the minimum disruption to the business itself".[96]In Corporate Governance Guide it is provided that in family owned companies incapability of injured shareholders to take away any security from the corporation at relational breakdown or squeeze out further complicates the matter owing to limitations on transfer of shares and unavailability of the right price of the shares.[97]Shareholders agreements may initially, provide that minority has a right to leave subsequently a reasonable assessment of his shares at the event of relational breakdown[98] and may additionally afford the method of transfer and valuation of shares.[99]Then secondly, the situations that will initiate the

[93]For minority shareholder complaint as to dilution of his power in company see *English Biscuits (Pvt) Ltd vs Associated Biscuits Intl Ltd* 2005 CLD 430; *Khursheed Ismail vsUnichem Corporations (Pvt) Ltd* 1996 CLC 1863; *Associated Biscuits Intl LtdvsEnglish Biscuits (Pvt) Ltd,*2003 CLD 815. See also Iqbal's Ch 3 para 3.4.1.2.2 Dilution of minority shareholders' investment or voting power in the company.
[94] See Cadman's, Precedent A, Minority Protection Agreement, clause 12(2)(a). See Iqbal's appendix 1 para 6 Matters requiring Shareholders' approval.
[95] See above para 1. Introduction. See also Iqbal's, Ch 3 para 3.4.3 for nature of these exit disputes.
[96] See The Law Commission Report, 'Shareholders' Remedies', Cm 3769, Law Com No 246, 1997 can be accessed at www.lawcom.gov.ukhereinafter The Law Commission Report para 5.8.
[97] See The Guide, Good Governance Practices, 2. Family Governance para 2.4. See also above para 1. Introduction.
[98] See *English Biscuits (Pvt) Ltd vs Associated Biscuits Intl Ltd* 2005 CLD 430; *TasnimvsRustom Ali* PTCL 2000 CL 336.
[99] See article 7 of the Articles of Association of the company as provided in *Re a Company (No 006834 of 1988) ex parte Kremer* [1989] BCLC 365, 367. For details see Iqbal's ch 4.

transfer of shares[100]if any, as transfer can be without any triggering circumstances.[101]Transfer can be subject to certain conditions or restrictions[102]such as prohibition as to transfer of shares to particular types of individuals like bankrupt or person of unsound mind. On non-compliance of exit provisions winding up of the company can be stipulated.

In close companies minority shareholders invest not only money but their time and effort as well and have made an emotional investment in these companies hence, find it hard to departure. Therefore at the time of exit they consider valuation as fair and more satisfying when all their investments in the company are fully compensated. Minority shareholders may employ resolvent measures to resolve these exit conflicts.[103] In this regard role of family council can be beneficial if the role is played in a structured and well considered manner to develop the consensus of conflicting parties upon the fair price of shares.[104] However there are limitations associated with these preventive and resolvent measures that cause doubt upon the effectiveness of these measures for managing the both 1st and 2nd type of conflicts.

4. Limitations of preventive and resolvent measures to manage shareholders' conflicts:

Theoretically, preventive and resolvent measures can manage shareholder conflicts by settling in advance by what method the business will be managed smoothly without any noxious disruption. However these measures cannot prevent the relational breakdown that give rise to squeeze outs and then exit conflicts but can only lessen the impact of relational breakdown. Advance contractual stipulations and family council can minimalize the possibility for squeeze-out behavior and can put the minority shareholders in a comparatively secure position at the event of squeeze-outs and may lead to cost-effective resolution by means of swift exit[105]yet they are not ultimate solutions owing to associated limitations. As in case study 3 it was observed that strong governance arrangements that deter conflicts and preserved personal relationships are rarely seen in family businesses at early stages.[106]Interviewees were generally in favor of these preventive

[100]In the light of available precedents there are certain circumstances that are often included as triggers for the transfer of shares. For detail see Iqbal's ch 4.
[101] See *Re a Company (No 006834 of 1988) ex parte Kremer* [1989] BCLC 365, 367.
[102] See Cadman's, Precedent A, Minority Protection Agreement, clause 13(1).
[103] See The Guide, Good Governance Practices, 2. Family Governance, para 2.4.
[104] See below para. 4.1.
[105]Boros, E., *Minority Shareholders Remedies*, 1995, Clarendon Press, Oxford, 105. See also Iqbal's.
[106] See The Case Studies, Case Study 3, p 14.

and resolvent measures and consider them beneficial but recognized certain limitations and mentioned that it depends upon how decent the businessmen were and were they inclined to abide by agreement as 'bad behavior is bad behavior'.[107]These limitations are discussed below in detail.

4.1 Election and capability of family council:

Family council is comprised of family members in order to mainly enhance coordination among the family members. Coordination can be really useful as it would bring the parties together and provide them the opportunity to listen to one another at the event of 1st type and 2nd type conflicts. However, family council can note completely effective in preventing or controlling the underlying causes of relational breakdown that may result in squeeze out and further give rise to exit conflicts.[108] Moreover, effective role of family council in these minority shareholders conflicts is still required to be explored such as *inter alia* who would be the family council enjoying the trust of the whole family. Secondly, at the event of conflict whether the parties to conflict having emotional and financial interests in the company would listen to family council and would behave appropriately and ethically as mentioned above 'bad behavior is bad behavior'.[109]Thirdly, whether the family council would be capable of handling such sensitive nature of minority shareholders conflicts or they need some professional assistance. As interestingly, admitting the limited potential of such family council to resolve shareholders' conflicts it is provided in Corporate Governance Guide that the council may get the services of a professional mediator.[110] In presence of professional mediator what would be the function of family council in resolving these conflicts. These significant questions have not been answered by the Corporate Governance Guide and require further research in this regard.

4.2 The potential to manage underlying factors of relational breakdown:[111]

It is difficult to contend that these preventive and resolvent measures can address the underlying factors that cause relational breakdown in close companies.[112]Business is commonly started on

[107] See also below para 4.8 Enforcement and see Iqbal's, ch 4 para 4.6.
[108] For kinds and characteristics of shareholders disputes see Iqbal's ch 3. See also below para 4.2.
[109] See above 4. Limitations.
[110] See The Guide, Good Governance Practices, 2. Family Governance, para 2.3. see also above para 2.2.
[111] For details see Iqbal's ch 4.

the basis of shareholders' mutual trust and personal relationship. In case study 2 the business is using traditional trust based family management system that is its foundation.[113] The smooth flow and growth of the business are closely linked with the maintenance of these family relationships and it is a crucial factor in all family businesses and leads to sustainable growth of business.[114]The distress of rational breakdown is intrinsic in any type of close individual association like family and marital relationships. These measures can supposedly defend minority shareholders from squeeze-outs and can resolve exit conflicts but relational breakdown could not be effectively managed by these means. As practically these actions cannot afford for every prior possibility contributing relational breakdown and at relational breakdown resolvent measure might not prove effective.[115]An interviewee stated that "shareholders' agreements could not cover every situation, since shareholders could not legislate for every conceivable eventuality" [C].

In fact, the scope of these measures is very limited to avoid underlying factors of these conflicts.[116]Corporate disputes may come up because of diverse methodologies of participants headed for the administration and future way to business. Personal conflicts come up due to shareholders' diverse personalities and personal goals in life.[117]Shareholders commence business with passion but may turn out to be neglectful, disinterested or in effective concerning the business that may cause relational breakdown.[118]The uncontrolled self-interested attitudes of shareholders in business could generate greed and jealousy among them and have an impact upon their fair business choices.[119]The fact mentioned in case law and interviewees responses recommend that in these close companies most of the relational conflicts occur in the next generation of the organisers of company. As next generation shareholders do not have choice to select their fellow shareholders and to negotiate with them in advance as they enter into these

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[112] See also Iqbal's Ch 3. See also F.H. O'Neal and R. Thompson, *O'Neal'sOppression of Minority Shareholders*, 2nded1985, Callaghan.chapter 9 para 9:01.
[113] See the Case Studies, p. 8.
[114]See the Case Studies, p. 9.
[115] See above para 4.1
[116] For details regarding the underlying factors of these conflicts see Iqbal's ch 3 para 3.3.1.
[117] See Iqbal's, ch 3 para 3.3.1.1 Personality clashes and family quarrels.
[118] See *S Qureshi vs Hi Tech Construction (Pvt) Ltd* 2004 CLD 640;*M. Masood vs S.M. Corporation (Pvt) Ltd* 2011 CLD 496. See also Iqbal's ch 3 and ch 4.
[119] See Iqbal's, Chapter 3 para 3.3.1.2 Self-interested behaviour.

companies by legacy.[120]Furthermore, owing to aftertaste of these relational breakdowns it is not easy to bring these relations back to their previous healthy condition through the assistance of family council. As provided in Corporate Governance Guide that "any form of conflict leaves an aftertaste" therefore it cannot be confidently stated that family council can be proved effective in this regard.[121]Therefore, because of these motives it does not appear to be useful to tackle these primary factors by preventive and resolving measures.

4.3 Optimistic behavior:

As the mutual trust and confidence remained the basis to establish close companies and shareholders may be quiet over-confident and over-optimistic and excited about their association may not consider future conflicts and the need for advance contractual arrangements. Later on, conflicts arise when shareholders try to run the business considering their own personal as well as business objectives. One interviewee said that: "these agreements are like pre-nuptial agreements to whom people say no at the time of the marriage because they think why do we need a pre-nuptial agreement… we are never going to fall out and corporate divorce is similar" [M]. Moreover if the parties are concerned about their future relationship and want to document all conceivable eventualities then it is better for them not to start business together as it indicates their lack of mutual trust. As prominent Wisconsin lawyer shared that, "when clients who come to him to form a closely held enterprise are so concerned about possible future disagreements that they want binding agreements in advance to resolve such difficulties, he may advise them not to go into business together".[122]

4.4 Drafting costs:

Negotiating and drafting of shareholders' agreements under the supervision of experienced lawyers is a technical, lengthy and therefore expensive exercise. As to protect the interests of their clients lawyers conduct negotiations and while drafting try to cover all possible future contingencies in the specific business that enhance the transaction costs for the shareholders. The

[120] See also F.H. O'Neal and R. Thompson, *O'Neal'sOppression of Minority Shareholders*, 2nded1985, Callaghan, chapter 2 para 2:02.
[121] See The CaseStudies, p 21.
[122] Professor J. A. C. Hetherington, Special Characteristics, Problems, and Needs of the Close Corporation, 1969 U Ill LF 1, 17, n 65 as quoted by F.H. O'Neal and R. Thompson, *O'Neal'sOppression of Minority Shareholders*, 2nded, 1985, Callaghan.chapter 9 para 9:01, n 3.

more inclusive the agreement is the superior those operations costs would be that may deter concerned persons from entering into these agreements. The point was acknowledged by three interviewees one in Pakistan and two in UK by stating those shareholders' agreements can be useful but negotiating these agreements is a considerably expensive process.[123]

The above discussed limitation regarding optimism and drafting costs can be handled by providing articles of association with default rules in of the company.[124]During empirical research interviewees discuss the use of default rules to prevent and resolve the shareholders' conflicts but raised question as to the nature of these rules and what these rules should provide on standard basis.[125]As the UK Law Commission indicated, that easy exit in rules can be economically damaging for companies, as shareholder may demand exit at the first sign of conflict.[126]

4.5 Over-protection of minority shareholder:

Lawyers areaways influenced by the interests of the clients and endeavour to secure them as far as possible. As one interviewee stated that before drafting "you have to look whether you are drafting for majority or for minority. It is very difficult to strike a balance between majority and minority. I don't know the perfect shareholder agreement" [G]. Majority shareholders are generally concerned that the agreements may over-protect the minority by granting them a veto power and a right to exit at will as that may operate against their interests.

Owing to threat that minority might not use this power always in good faith majority would not be willing to grant these powers to minority and would prefer the application of majority rule. As the provision as to 'exit at will' can resolve the conflicts but majority would not prefer such exit provision as minority may demand exit at a time when majority's financial position would not permit them to buy-out minority.[127]The Law Commission mentioned that exit notice might

[123] See Iqbal's,ch 4 para 4.6.3.
[124] See The Law Commission's Report Part 5 paras 5.4-5.32.
[125]For details see Iqbal's Ch 4, para *4.6.3.1 The significance of default rules.*
[126]The Law Commission's Report para 5.7.
[127] See *Phoenix Office Supplies Ltd v Larvin* [2003] 1 BCLC 76 para 30. See Iqbal's,ch 4.

enable minority to exercise improper pressure upon majority.[128] Interviewee G shared the concern that minority may exercise 'exit at will' to serve his personal interests.

4.6 Shareholders' unequal bargaining position:

The issue of over-protection of shareholders depends upon the relative bargaining positions of the shareholders. In close companies' shareholders are not always on equal footing and therefore have different bargaining strengths. Shareholders bargaining position at the time of commencing the business is a significant factor in deciding minority shareholder protection in future business of the company. If minority shareholder owing to his minority holding does not have the required bargaining strength the majority would not allow them to be well protective through preventive and resolvent measures in future business and would call his concerns as over protection. Minority shareholders' cannot respond effectively to majority in this regard owing to their weak bargaining position. As majority shareholders having strong bargaining position would always prefer an effective majority rule in companies. Interviewee G shared that often the minority shareholder does not have the required bargaining strength to protect himself. Therefore, unequal bargaining positions of shareholders can limit the scope and potential of preventive and resolvent measures in close companies.

4.7 Deadlock:

In companies majority rule assist to run the affairs of the company in a speedy manner as in decision making only the consent of majority is required. The requirement of obtaining unanimous consent by providing minority veto power not only slow the decision making but may create deadlock that is against the interests of all stakeholders of the company. The enhanced voice also takes flexibility out of the management of the business that provides room for independence and may help to prevents conflicts in companies.[129]A deadlock is a situation, in which an agreement cannot be reached as either no party has sufficient majority voting power to take decision or when decisions requiring unanimous consent cannot be taken owing to

[128]The Law Commission's Report para 5.7.
[129] See The Case Studies, Case Study 2.

opposition of a single shareholder.[130] Deadlock situations can give rise to winding up of the company on just and equitable grounds.[131]

Deadlock situation can provide minority an opportunity to be heard by majority. Agreements may provide that shareholders will resolve deadlock in companies through sincere negotiations or by referring the conflict to an independent third party. At deadlock when parties are not ready to change their stance and listen to one another these negotiations can be more successful if carried out with the support of a third party who understands the sensitivity of these disputes such as a family council carrying the trust of whole family, experienced mediator or an arbitrator[132].Furthermore, if the negotiation to resolve the dead lock could not prove successful shareholders' agreements commonly provide share transfer provisions known as an exit mechanism as a means of resolving deadlock situations[133] that may further result in valuation conflicts and may take the parties to court.

4.8 Enforcement:

Theoretically, these measures as to prevention and resolution can assist to protect the interests of minority but cannot be completely effective unless there is strict implementation of these measures.[134] Majority shareholders would not honour contractual provisions and role of third party unless there would be strict enforcement of those provisions by courts. For instance, when the minority has right under contract to be part of the management and his exclusion occurs and family council fails to resolve the conflict then agreement is required to be enforced by the courts. The matter is easier to resolve if the contractual provisions are clear regarding the rights of parties at the event of conflict as all that is required is enforcement of those provisions under principles of contract law. Moreover, these contractual provisions could also be enforced through statutory remedy available for minority protection under section 286 of the Companies

[130] See *Khursheed Ismail vsUnichem Corporations (Pvt) Ltd* 1996 CLC 1863.
[131] See section 301 of thePaksitani Companies Act 2017.
[132]It may be described by the Shareholders' agreements that endeavor to resolve the deadlock shall be conducted by sending the disputed matter to third party arbitration under Arbitration Act 1996.
[133] See Cadman's, Precedent E, clause 13. For details see Iqbal's ch 4. See also above para 3.2.
[134]See Iqbal's, ch 4.

Act2017[135] in Pakistan and section 994 of the Companies Act 2006[136] in UK when breach of the contractual provision is oppressive or dishonorably harmful to their benefits.[137]

However, enforcement of contractual provisions by courts might not be straight forward and obstacles like application, fairness and interpretation of the specific contractual provisions in specific situations needed to be addressed by courts.[138] Such as whether the majority's decision to issue shares at a time when minority has no funds to buy new shares to diminish the utility of pre-emption right of minority shareholders is fair?[139] Interviewees shared that these contractual provisions often give rise to more arguments like shareholder may take the stance that it was unfair to apply agreement in these circumstances like whether the exit provisions actually applicable in these particular circumstances or that the valuation of shares was wrong.[140] These arguments may prolong the enforcement proceedings and outcome in long and costly legal process. In *Guinness Peat Group plc v British Land Co plc*,[141] it was stated that the valuation of shares is an unclear question of fact and merits a full hearing.

5. Conclusion:

In Pakistan family owned close companies are shaped on the foundation of joint family trust or friends. Relational breakdown of family and friends often precipitates squeeze out behavior that further cause exit conflicts. The Corporate Governance Guide encourages shareholders conflict management firstly, by considering and declaring in advance future business polices as preventive measure and secondly, effective resolution of conflicts through resolvent measure mainly through family council to manage business without noxious disruption. The previous research of the author regarding the effectiveness of preventive measures to avoid minority shareholders' conflicts in close companies of UK also encouraged these preventive measures to avoid conventional methods of conflict resolution owing to their length and expense. As in the absence of effective preventive and resolvent measures shareholders may have to resort to courts to avail remedies available to them under law for protection of their interests. The present

[135] Previously section 290 of the Companies Ordinace 1984.
[136] Previously section 459 of the Companies Act 1985.
[137] See *O'Neill v Phillips* [1999] 2 BCLC 1.
[138] See Iqbal's.
[139] See *A Company* [1985] BCLC 80; *Re Cumana Ltd* [1986] BCLC 430.
[140] See *ReAbbey Leisure Ltd* [1990]BCLC 342 and *Re Benfield Greig Group plc*[2002] 1 BCLC 65. See Iqbal's ch 4.
[141] [1999] 2 BCLC 243, 253-254.

research has evaluated in depth the previous two researches to propose the best possible future course of action for Pakistan.

It is concluded that the preventive and resolvent measures can theoretically control squeeze-out behavior by succeeding the powers of the majority and by providing minority a possible chance of exit on fair terms through negotiation therefore can mitigate the repercussions of relational breakdown. However, these measures cannot eradicate the basic factors that actually cause relational collapse that result in type 1 and type 2 conflicts. Practically, the actual prevention and resolution of disputes be contingent upon the basis of these agreements. The range of other limitations[142]associated with these measures cause doubt upon the effectiveness of these measures to manage the conflicts of minority shareholders in the close companies of Pakistan. The valuable specific role of family council with or without the assistance of mediator for effective management of these shareholders' conflicts still require comprehensive investigation and therefore strongly proposed to be explored in future for promotion of corporate governance in close companies of Pakistan.

Annex I

Table of Conducted Interviews[143]

No.	Profession	Name/ Code	Date interviewed	Location
1	QC	A	13-02-07	London
2	Junior Barrister	B	13-02-07	London
3	Junior Barrister	C	14-03-07	London
4	QC	D	15-03-07	London

[142] See above para 4.
[143] See also Iqbal's ch 2 Methodology.

5	QC	E	15-03-07	London
6	QC	F	26-03-07	London
7	QC	G	28-03-07	London
8	Junior Barrister	H	04-04-07	London
9	QC / Mediator	J	25-04-07	London
10	QC	K	26-04-07	London
11	Junior Barrister	M	01-05-07	London/ Birmingham
12	QC	P	17-05-07	London
13	Junior Barrister	R	18-05-07	London
14	QC	S	30-05-07	Bristol
15	Junior Barrister	T	07-06-07	Leeds
16	Advocate	X	02-09-17	Islamabad
17	Advocate	Y	10-10-17	Islamabad
18	Advocate	z	18-11-17	Islamabad