SHAREHOLDERS' UNDER THE COMPANY LAW OF THE STATE OF KUWAIT: AN EVALUATION OF EXISTING LAWS AND PROPOSALS FOR REFORM

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LLB, University of Kuwait, Kuwait 1992

LLM, American University, Washington DC 1995

A Thesis Submitted to
The University of Glasgow
For the Degree of

Doctor of Philosophy

UNIVERSITY
of
GLASGOW

FACULTY OF LAW AND FINANCIAL STUDIES

Dedication

To the Memory of My Father, Rasheed
To My mother, My wife and children
Rasheed, Muath, Khawlah, and Sara

Acknowledgements

My sincere thanks are due to all who have given me their generous help in completing this thesis. In particular I would like to mention my special appreciation to my supervisor, Ms. Charlotte Villiers, who helped me considerably throughout the period of my research. The thesis would not have been completed without her guidance, suggestions and critical comments.

The generous assistance of the head of Law Department Professor Fraser Davidson is highly appreciated.

I must also express my thanks to the Government of the State of Kuwait for the financial support without which the present study would never have been achieved.

I wish also to convey my profound gratitude to my brothers Meteib, Mubarak, Mohammed and Khalid for their meaningful assistance and encouragement.

Finally, I am very grateful to all of my mother, wife, brothers, sisters and relatives for their love, support and prayers during my study.

Abstract

This thesis is an extensive study which concentrates on the shareholders' equity rights in joint stock companies under the Company Law of the State of Kuwait No. 15/1960. At the same time the thesis looks at the companies law of other counties, mainly at the UK Companies Act. The aim of examining foreign company laws is so that these might be used to improve company law in Kuwait. The main purpose of this thesis is to define the rights and role of shareholders. The thesis also attempts to identify the position, role and powers of the body of shareholders in joint stock companies by dedicating a chapter focusing on the topic of company theory. This study is divided into a number of chapters. The first chapter is an introductory chapter which concentrates on the legal system and the kinds of companies in Kuwait. The second chapter focuses on the theory of the company and nature of shareholders roles according to such a theory. The third chapter focuses on the definition of shares and shareholders in joint stock companies. The fourth chapter deals with shareholders financial rights. Chapter five is devoted to a discussion of shareholders' right to knowledge of what took place and is going on in the company and the board's duty to disclose all facts and details about the company's affairs. The sixth chapter concentrates on the auditors' role. The auditor acts on behalf of the shareholders to verify the credibility of the disclosed information and the validity and soundness of directors' acts. Chapter seven is concerned with shareholders' rights at the general meeting. Chapter eight deals with shareholders remedies. The thesis concludes with some proposals for reform of the Kuwait Company Law.

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ABBREVIATIONS

A.C	Appeal Cases
Accounting and Business Res	Accounting and Business Research
Accounting Rev	Accounting Review
AGM	Annual General Meeting
All ER	All England Law Reports
ALQ	Arabic Law Quarterly
BCC	British Company Law Cases
British Accounting Rev	British Accounting Review
B.C.L.C	Butterworths Company Law Cases
Bus. L. Rev	Business Law Review
CA	Court of Appeal
C.D.D.A	Company Directors Disqualification Act 1986
Ch	Chancery Division Law Reports
Ch. App	Chancery Appeals, 1865-1875
Ch. D	Chancery Division
C.L.J	Cambridge Law Journal
Colum L. Rev	Columbia Law Review
D.L.J	Duke Law Journal
D.T.I	Department of Trade and Industry in the UK
EGM	Extraordinary General meeting
E.R	English Reports
GCC	Gulf Corporation Council
GM	General Meeting

Hare	Hare's Reports, Chancery
Harv. L. Rev	Harvard Law Review
H.L	House of Lords
I.A	Insolvency Act
I.C.L.Q	International and Comparative Law Quarterly
J. Fin. Econ	Journal of Financial Economics
J. L. & Econ	Journal of Law and Economics
J. Legal St	Journal of Legal Studies
J.of Accting. Res	Journal of Accounting Research
J. L. H	Journal of Legal History
J.B.L	Journal of Business Law
JSC	Joint Stock Company
KCL	Kuwaiti Company Law
KD	Kuwaiti Dinar
KNA	Kuwait National Assembly
KSEM	Kuwait Stock Exchange Market
L. Q. R	Law Quarterly Review
LSEM	London Stock Exchange Market
MCI	Ministry of Commerce and Industry in the State of Kuwait
Mich. L. Rev	Michigan Law Review
New L.J	New Law Journal
QB	Queen's Bench
UK CA	UK Companies Act 1985
UK CJA	Criminal Justice Act 1993
Univ. of Chi. L. Rev	University of Chicago Law Review

Yale L.J	Yale Law Journal
WTO	World Trade Organisation

Introduction

Companies in general have increasingly become a very important element in people's lives. Every day most individuals deal with companies, often as buyers and consumers of a company's product. There are many kinds of companies but the most important are joint stock companies (hereafter JSC). JSCs usually carry out major economic projects in all countries of the world. It is the type of company most able to consolidate capital. Many people choose to invest their money through the possession of a company's shares, where their responsibility for the debts of the company does not extend beyond the nominal value of their shares.[1]

Hence, JSCs play a major role in the concentration of capital, which enables them to have an important role in economic, political and social life. Due to the importance of JSCs and their economic influence, it is very important for all countries to continue organising these companies by means of legislation, which will achieve the highest interests of the companies as well as those of the states.

A JSC is an artificial person; thus it has to be managed by a board of directors with the help of a number of employees. The board of directors carry out a management role in the interest of the company and they are subject to control and supervision of the shareholders in the General Meeting (hereafter GM) as well as the company auditors.[2] The company's GM is significant because it represents an

[1] Al-melhem, Ahmed, Privatisation and Protection of Investors in Kuwait, *ALQ*, (1998) p. 191.

[2] Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 1st edn, Kuwait: Author Publishing, (1999), p. 368.

opportunity for shareholders' opinions to be delivered to the board of directors.[3] However, one weakness of companies' GMs is that many companies have given the boards of directors the chance to exercise wide powers in their companies. Moreover, they can exceed the powers stipulated for them by the law or under the Memorandum and Articles of Association.[4] This can have a detrimental result for companies, their shareholders and creditors. Sometimes, the GMs of JSCs come to resemble family meetings and pleasant places in which to authorise the directors' actions during the last financial year. Such a GM is sometimes called "the absent parliament".[5]

This thesis discusses shareholders' rights in JSCs under the Kuwaiti Companies Law no.15/1960 (hereafter KCL). The main purpose of this study is to examine the rights and role of shareholders in JSCs under the KCL. An attempt will also be made to answer a number of questions: What is a shareholder? What are the rights of shareholders? What role do shareholders play in JSCs? Do they actually and effectively carry out that role? If no, what obstacles prevent them from doing so? Are they accorded all the rights which shareholders should possess in order to carry out their role effectively? What causes the perception that shareholder may not pay enough attention to the affairs of their companies or, in other words: Why might they not be sufficiently interested in participating in their companies? If shareholders are not given all or some of the rights, which enable them to exercise their powers in the company, is this due to defects in the KCL? Do flaws in the application of the Law by the Ministry

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[3] *Gowers' Principles of Modern Company Law*, Paul Davies ed, 6th edn, London: Sweet & Maxwell Publishing, (1997), p. 583.

[4] Abou Zied, Radwan, *Shareholding Companies in Public Sector*, Cairo: Dar Al-fker Al-Arabi Publishing, (1983), p. 27.

[5] *Ibid.*

of Commerce and Industry (hereafter MCI) deprive shareholders of such rights, or do the shareholders themselves not care about their companies and fail to attend and vote at GMs. This is something that can results in a weakness of these GMs, which, along with shareholders funds, fall under the domination of the board's directors.

The study is divided into eight chapters. Each chapter shall examine one of these rights although it should be borne in mind that each right is related to the one preceding it. The rights of the shareholders complement each other. Thus, such rights cannot be viewed in isolation. Arguably the principal feature is that each shareholder shall enjoy his financial rights in the company. These interests and rights require other rights to protect, maintain and ensure the increasing of these material rights (or the decreasing of them). After the financial right, is the shareholder's right to be acquainted with what goes on in the company, and commit the board to a duty to provide information through the reports issued annually (see chapter 5).

Such information regarding companies' conditions and status are useless if what is expressed in these reports, issued by the board through the company, does not have enough credibility, accuracy and detail to enable shareholders to perform their role correctly. They seek to monitor the board and protect their interest in the company based on information about the company's status and financial position. A shareholder who participates in the GM, based on incorrect information, is not expected to use his authority and rights in the meeting in the correct way. Nevertheless, the credibility required in the information provided cannot be proven or denied by most shareholders with their humble credentials. Therefore, it follows that the right succeeding the previous right for shareholders, is having an auditor to work for the benefit of the shareholders and produce a report that explains to shareholders the accuracy and credibility of the information provided by the board.

After focusing on the shareholders' rights and the presence of auditors, the role of shareholders' rights in all kinds of GM will then be discussed. When a shareholder is acquainted with his financial rights and the company's status through practicing his right in reading the reports, knowing what goes on in the company and making sure whether this information is correct or not, through the auditor's report, then comes the turn of studying and knowing shareholders' rights in the GM of the company. As will be seen in this study, the GM has the highest authority in the company and is the appropriate place for shareholders to protect their rights and to hold the board answerable. The decisions made by shareholders are of no use unless they are fully informed by an accurate understanding of the company's position.

Another extremely relevant issue is that of shareholders' remedies. Each one share in the Kuwaiti law entitles one vote in the GM – the device that makes the decisions committing the board and shareholders. Those who possess a majority of votes, in reality, possess the authority for making decisions, and those in the majority are required to use that authority to achieve the companies' and shareholders' interests. However, this is not always the case, as the majority can sometimes be under the influence of the board. Such a situation could lead to problems and negation of the minority's rights. The question that is to be posed is: What are the rights of shareholders' minority pursuant to the Kuwaiti law? These are important rights, not only for the protection of interests and rights for this minority, but also because one or a few of the shareholders may adopt an action or procedure for the company's protection, especially if the majority in the GM of the company is under the board's control.

The question that imposed itself in this research is: Does the board in this kind of company have any relation with the subject of shareholders' rights? In other words, is it necessary to discuss the subject of the board, and the role it shall play in the company, even though the study focuses on shareholders' equity. In response to this question the first observation is that, there is a direct, basic and inseparable relation between the board and the subject of shareholders' rights. All the authorities and powers given to the board could hinder the effectiveness of the rights granted to the shareholders by the company law. In any JSCs, there are two main bodies; these are the board and shareholders and they work through the GM. Thus, when discussing the subject of shareholders' equity, we shall discuss the subject of the board will also be discussed and the role it plays regarding shareholders' rights (see 2.5).

The Kuwaiti Stock Exchange Market (hereafter KSEM) crash in 1982 provides clear evidence about the damage that occurred to the national economy of the State and to shareholders and their investments in the JSCs. The consequences of this crash were partly a result of the directors of many JSCs working outside of the law. The Kuwait Cabinet inspected the affairs of about 39 of the companies involved in the crash. It discovered that the problem occurred mainly because of the illegal actions of the directors of these companies. Its report provided, for example, that some directors of these companies had contracts with the companies without the permission of the GM as provided in the KCL in Article 151. The directorship of some directors was invalid because they had not deposited the qualification shares as provides in Article 139 of the KCL. The boards of directors of some companies had increased their capital of the companies without any respect to the legal procedure mentioned in the KCL.[6] Many directors had taken personal loans from the national banks by

[6] Such as Kaḥema Real Estate company, the report provided that this company increased its capital without respecting the legal persuaders that must be followed in the case according the KCL.

guaranteeing their companies' capitals.[7] Some accountancy firms colluded with the boards of directors to submit inaccurate reports on their financial position, and some auditors presented false statements and balance sheets that showed profits where there were not any.[8] In addition, some of the boards of directors paid dividends of 15 or 20 per cent by drawing from the capital of the company.[9] The report also provided that the transactions of some companies had been carried out in the name of the presidents of the boards of directors personally and not in the name of their companies. After all these breaches of law and the contracts of the companies and rules of ethics by the directors of companies, the maximum punishment would be a mere penalty of KD 200 (£400) as provided in Article 184 of the KCL (see chapter 8).

Therefore, as will be seen in this study, among the rights supposedly enjoyed by shareholders, is the expectation that board members acquire a certain extent of efficiency, that the board shall work to achieve the highest interest of the company, shareholders, and all those who have an interest therein, and the board shall also explore any private interests of its members in the company. Shareholders are also entitled to establish an explicit legal rule that holds the board members accountable for their delinquency (see chapter 8). If board members are not qualified to perform the duties of the company's management, or are not trustworthy enough to keep the company's capital, the only subsequent result is the loss for all those who have an

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[7] One of the chairmen of Kuwaiti companies took personal loan from the company without getting permission from the GM and without telling the board's members or the auditor of the company, for more information see Alanba'a Newspaper, Kuwait: 16/11/1992.

[8] Abdrheem, Ali and Aljumah, Haider, The Accountancy Policy and the Crash of Souq AL-Manakh, 60 *Journal of Gulf Studies and the Aribain Island* (1989) p. 23.

[9] For more information see the report of the committee that established by the Kuwaiti Cabinet on 13/03/1983 by Cabinet resolution no. 10 meeting 11/1983 to inspect the affairs of number of companies; also see Darwiche, Fida, *the Gulf Stock Exchange Crash the Rise and Fall of the Souq AL-Manakh*, London: Croom Helm Publishing, (1986), p. 90; AL-hayyan, Abdullah M., *Company*

interest in the company, and shareholders shall be the first. The relation between the main organs in the company (the board and shareholders) is strong. Hence, any study on shareholders' equity shall directly include the board and authorities possessed thereby in the company, as well as distribution of powers and duties between the board and the shareholders in the company.

The main objectives of this study are; first, to enumerate the rights of shareholders in the JSCs. Second, to point out the weakness of the KCL on the issue of shareholders' rights. Third, to put forward certain recommendations to rectify these defects, in order to keep up with the current developments in company law world-wide.

In Kuwait, there are a few studies concerning JSCs, all of which concentrate on the board of directors. Despite the importance of the topic of shareholders' rights in these kinds of companies, there is not even one study in Kuwait about them. Therefore, the subject of shareholders' rights has not received its due attention and examination. This study will, therefore, disclose the function of the regulations in company law, and aims to provide access to a range of different solutions to the problems related to shareholders' rights.

This study cites most of the articles of KCL and explains them. It then tries to identify any problems or issues that arise. At the same time, it looks at the companies laws of other countries, mainly the UK's Companies Acts. Reference is made to many sections of the UK CA 1985 and other Acts. The aim of examining foreign Company laws is so that these might be used to improve the Kuwait position in the case of

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Directors' in Kuwaiti Companies: An Evaluation for Existing Laws and Proposals for Reform, Ph.D. Thesis, Aberystwyth University of Wales, (2000), p. 8.

shareholders' rights and position. Therefore, in summary, this study will concentrate on the position and rights of shareholders under the KCL 15/1960 with reference to the UK Companies Act 1985.

One may ask, why focus on the UK to conduct this research or use it as a base for this study. In fact, there are many reasons:

(1) The relationship between the UK and State of Kuwait started a long time ago, with the Amir of Kuwait in 1899 and a treaty of protection with the UK. Therefore, there is a historical link between these two countries, and this might be useful in this research.

(2) The UK is one of the pioneer countries in the field of company law worldwide. Commercial companies, specifically JSCs, have been known for a very long time. Therefore, these kinds of companies have played a major role in the growth and development of this country. Furthermore, such a deep-rooted law has enabled it to be the main source of benefit for all other countries, especially developing countries.

(3) The legal forms of business organisation in use in both the UK and Kuwait are currently similar. These can be arranged into four major categories: Sole trader, Partnership, Companies and Public Companies. Therefore, the UK Companies Legislation can be taken as a model to improve the KCL.

(4) It is noted that many of the basic principles of the UK Companies Acts are not embodied in Statutes, as the common law influence is still strong at the present time. In other words, precedent is recognised as a source of law. Precedent is law created by an adjudicative body (courts). Therefore, there are two main sources of law in the UK. Hence, the legal system in the UK is flexible, sophisticated and can be developed easily without following long procedures. By contrast, in the Kuwaiti

system, precedent is not recognised as a source of law at all, where the source of law is codes; that is, the rules are written and the task of the courts is to implement them. Thus, if there is a real need to amend the KCL, there are many procedures that must be respected, and that means the legal system in Kuwait is a rigid system that cannot be improved easily. The UK is a common law jurisdiction. This means that it has a different legal system from Kuwait which is civil law country. This differentiation between the two legal systems may enrich the study, and give new ideas to solve those legal problems in Kuwait's company law.

(5) In the UK, there have been a whole series of Companies Acts. The principal UK statutes applying to company law are: the Companies Act 1985 and 1989, Insolvency Act 1986; Financial Services Act 1986; Company Directors Disqualification Act 1986; Business Names Acts 1985, Criminal Justice Act 1993.

(6) The UK is a member of the European Union (EU), and this membership leads to further development due to the influence of the European Community harmonisation programme.

(7) The UK, unlike Kuwait, is characterized with many publications and reference books in the field of companies and shareholders' equities. The DTI also has many reports and studies issued, in which all the concerned parties in the field of companies participate, No doubt, this access to information is deemed very important and useful for every researcher in this field to enrich their study. Examples include: (a) *Shareholders, Remedies: A Consultative Document*, DTI November 1998, URN 98/994; (b) Hampel Committee, *Final Report on Corporate Governance* (Gee: London, July 1998); (c) *Directors' Remuneration : A consultative Document*, DTI July 1999, URN 99/923; (d) *Greenbury Committee, Report on Directors' Remuneration* (Gee: London, July 1995) and many more.

The researcher's presence in the UK is considered as an opportunity that shall be exploited. However, this shall not eliminate acknowledgment of other laws, that shall be useful and enriching to this study.

This study is divided into eight chapters. The first chapter is the **introductory chapter**. It is necessary in this chapter first to give an outline of the judicial system in the state of Kuwait, followed by an outline of the history of the Kuwaiti Commercial Companies Law and the types of companies thereunder. This provides a background for the discussion on shareholders' rights.

In chapter II it is necessary before proceeding to the main chapters, to identify the role of shareholders in the JSCs. This helps in understanding their rights. There then follows a section which focuses on the theory of the company, in order to identify the nature of shareholders' roles under such a theory and understand their position in these kind of companies. This chapter also deals with distinction of powers in the company between the company's board and the shareholders through the annual GM. It defines the powers which shareholders have vis a vis the board and evaluates their effectiveness. This chapter has a special importance, as it will help us go into further detail. It will address important matters and answer many questions concerning JSCs and shareholders, such as the nature of the JSC: is it a contract or an institution? What is the position of the shareholders? what is their role in this type of company? Are they owners of the company or just providers of capital and eventually gain a profit? What is the distribution of power in the company? What are the shareholders' actual powers? Finally, the powers which they should possess but which Kuwaiti laws fails to provide for will also be discussed, it will also be established whether these powers are activated by the shareholders themselves or if they just exercise them to protect their rights in the company.

In chapter III, it is necessary to give a definition of shares and shareholders in JSCs, and know when a person becomes a shareholder and when he loses this status. Kinds and classes of shares and shareholders will be described in addition to the characteristics and advantages of shares which make them distinct from other stocks.

Chapter IV will deal with shareholders financial rights in JSCs or the rights they should exercise under the Kuwait Companies Law. These rights are: the right to dispose of their shares by selling or any other means by which ownership is transferred to other persons; priority in subscription to any new shares issued by the company; receiving dividends at the end of every financial year and liquidation or termination of the company.

Chapter V is devoted to a discussion of shareholders' right to knowledge of the company and the board's duty to disclose all facts and details about the company's affairs. It will determine the information which shareholders may have access to before during or after the annual GM. The reports published by the company will also be discussed. These include directors and auditors' reports, the account balance sheet and profit and loss statements. The importance of these reports, and their significance as far the shareholders (in particular) are concerned, will be highlighted. It is also determined whether these reports under the Kuwaiti laws are adequate and comprehensive enough for shareholders to rely upon in taking future decisions concerning their investment in the company. This of course, depends on the credibility and accuracy of the information.

The person who acts on behalf of the shareholders to verify the credibility of the disclosed information and the validity and soundness of directors' acts is the auditor.

In view of the importance of the role of auditors for shareholders, **chapter VI** is devoted to this matter, including the auditors' appointment and powers and the significance of the report they issue at the end of each financial year. It will also discuss their independence, the subsequent reliability of their report and finally their removal and the need to regulate so that their independence is not compromised.

Chapter VII is concerned with shareholders rights at the GM and the importance of the GM as well as the types and duties of GM. The discussion covers in detail shareholders' rights at the annual GM, including the right to attend in person or by proxy, the right to discuss any matter on the agenda and ask questions and the right to vote.

Chapter VIII deals with shareholders' right to file a lawsuit against the board because of errors committed by the directors. An account of the types of action that may be filed by a shareholder in his personal capacity or in the name of the company is given. A discussion of the board's civil and criminal liability follows.

In the conclusion of the thesis, the most important point that appeared in this study will be discussed. Recommendations will also be made in relation to the shareholders' rights in the JSCs.

Chapter One

1. Introduction:

This introductory chapter first outlines the legal system, and the laws organizing companies in the State of Kuwait. The kinds of companies according to the KCL No. 15/1960 will then be explored, especially JSCs. It will also be looking at company law in the UK, and briefly kinds of companies under the UK Companies Act 1985. Attention will also be given to legal problems in the KCL.

1.1 Legal System of the State of Kuwait

Kuwait existed in the eighteenth century when its necessary factors as a State were completed.[1] Kuwait indirectly remained part of the Ottoman Empire[2] until 1899 when the ruler of Kuwait signed a treaty with Great Britain. Kuwait then fell under British mandate until its independence on 19 June 1961.[3]

Islamic Law dominated all the Arab States for more than thirteen centuries (Shari'a).[4] The first written law that applied to Kuwait in 1938 was the Judicial Provisions Magazine on Civil and Commercial dealings according to Islamic Law. The Magazine was the official law of the Ottoman Empire.[5] In the middle of this century

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[1] Ministry of Information, *Kuwait Facts and Figures*, 5th edn, Kuwait: the Ministry Publication, p. 23.

[2] The Ottoman Empire is now the Republic of Turkey.

[3] Abdul Rasoul, Abdul Reda, A Summary of the Legal and Judicial System in the State of Kuwait, 6 *ALQ* (1991) p. 267.

[4] Islamic Law means all the rules and regulations that are laid down in the Qur'an (the words of God), and the Sunnah which is formed, as generally agreed, by the deeds, utterance and unspoken approvals of the Prophet Mohammed.

[5] The Magazine judicial provisions was enacted in 1876 and divided into 16 sections.

and due to oil production, Kuwait witnessed a very fast growth in its urban communities and, after it had completed its full independence on 19 July 1961, it adopted a constitutional system.[6] Kuwait is a civil law country, and its system is based on French and Egyptian models.[7] The majority of codes in Kuwait were inspired by the French system and consist of the work of Egyptian and Kuwaiti legal scholars. However, the Islamic Law still forms an essential part of the legal system.[8]

Anybody may ask, why this is study being conducted in a state with a different legal system than that of the State of Kuwait. It could have been conducted in France, as Kuwait is affected by its civil law system.

First, it should be noted that this study is not the first one of the kind conducted in the UK by Kuwaiti researchers, and shall not be the last. The reason behind that is the richness of the deep-rooted legal system. Second, The world especially after the foundation of the World Trade Organisation (WTO) has become a small village, which led to the large interpenetration in the commercial life among many states which have different legal systems, such as the State of Kuwait. In addition to the foregoing, each member in the organisation is obliged to develop its laws especially commercial laws in order to be more developmental and flexible, which is applied in Kuwait also, in its capacity of a member in the organisation. In the course of carrying out this development, it shall seek developed legal commercial systems, and the most flexible. As we shall explain in the next point, this is not done properly in the French legal system with which the State of Kuwait is affected upon the establishment of the same.

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[6] The State of Kuwait as the Constitution of Kuwait provides in Art. 6: "The System of Government in Kuwait shall be democratic, under which sovereignty resides in the people, the source of all powers. Sovereignty shall be exercised in the manner specified in this Constitution".

[7] Gerald, John O., Legal Aspects of Doing Business in Kuwait, 6 *ALQ* (1991) p. 321.

[8] The sources of law in Kuwait are three: Legislation, Custom, and Islamic Law.

Third, As the State of Kuwait has been affected by the French legal system, which is being followed for many years, it is a rigid inflexible system, and suffers from many problems as proven in some of the studies. Hence, why shall the state affected with this system stay within its limits.

After taking a look at some of the researches presented by La Porta and others[9] in the field of protecting shareholders and investors as they are comparative studies between different legal laws, such as the French and British and other 47 counties. Porta provided in the conclusion of his article that;

> In this paper, we have examined law governing investor protection, the quality of enforcement of these laws, and ownership concentration in 49 countries around the world. The analysis suggests three broad conclusions. First...countries whose legal rules originate in the common law tradition tend to protect investors considerably more than the countries whose law originate in the civil-law, and especially the French-civil-law, tradition. Second,... law enforcement is strong in common-law countries as well, whereas it is the weakest in the French-civil-law countries.[10]

He provided also on the same article that, "companies in counties with poor investor protection have more concentrated ownership of their shares,[11] and good accounting standards and shareholders protection measures are associated with a lower concentration of ownership, indicating that concentration is indeed a response to poor investor protection"[12]

Therefore, the states following the French system, are in fact less protective of shareholders and investors in general in JSCs, and also it has the weakest quality of law enforcement and weakest quality of accounting. In return, these studies have

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[9] La Porta, Rafael and others, "Law and Finance", 154(4) *Jnl of Politcal Economy* (1998) p. 1113

[10] *Ibid.*, p.1151

[11] *Ibid.*, p. 1145

[12] *Ibid.*, 1141.

discovered that the states applying the common law system, e.g. UK, are more efficient and capable of protecting shareholders and investors. They are also successful in applying the commercial laws, and imposing the respect of these laws. As result of the aforementioned facts, markets at these states are more active and expanding than the stock markets of the states following the French legal system. Why shall we in the small states affected by the French system remain locked within its borders, as they do not provide us with any addition to our legal commercial system. Hence, why not seeking to solve our problems in another state, such as UK, for the purpose of developing our laws and protecting companies' shareholders through taking what is proper for application in our state. This is Kuwait's orientation, as researchers in all science fields are sent to many developed countries -from which among is UK- in order to contribute in building this state in all fields, of which among is the commercial legal field indeed.

1.2 Constitution of Kuwait

The permanent Constitution of Kuwait was issued on 11 November 1962, being laid down by a constituent assembly of 20 members elected by the nation.[13] The Constitution is based on democratic principles and its basis includes the sovereignty of the state, public freedom, and equality before the law.[14]

The constitution of Kuwait is composed of 183 articles divided into five chapters; the State and the System of Government, The Basic Constituents of Kuwait Society, Public Rights and Duties, Powers, and General Provisions.

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[13] Ministry of Information, *Supra note* 1, p 44.

1.3 Components of the System of Government

The system of government in Kuwait is based on a separation of powers. The legislative power is vested in the Amir (the head of the state)[15] and the National Assembly; the executive powers are vested in the Amir, the Cabinet, its the ministers; judicial power is vested in the courts in the name of the Amir. The Constitution of Kuwait in Art. 50 provides that:

The system of government is based on the principle of separation of powers functioning in co-operation with each other in accordance with the provisions of the constitution. None of these powers may relinquish all or part of its competence specified in this constitution.

1.3.1 National Assembly

The National Assembly[16] is a unicameral house composed of fifty members who are elected directly by universal suffrage and secret ballot.[17] The members are elected for a four-year term.[18]

Members are free to express any views or opinions in the Assembly or its committees.[19] Every member has the right to introduce bills.[20] Any bill passed by the

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[14] See Constitution of the State of Kuwait Articles 6,7 and 8.

[15] The present Amir is His Highness Sheikh Jaber AL-Ahmad AL-Jaber AL-Sabah.

[16] The first parliamentary election in Kuwait was held on 23 January 1963.

[17] Constitution of the State of Kuwait Article 80.

[18] Article 51 of constitution of Kuwait provides "legislative power shall be vested in the Amir and the National Assembly in accordance with the constitution".

[19] Constitution of the State of Kuwait Article 110.

[20] *Ibid.*, Article 109.

National Assembly will not become a law until ratified by the Amir.[21] The Assembly is empowered with approving the state budget and its final accounts. The Assembly also oversees the government through different means, like submitting questions, requesting the tabling of any subject for discussion, questioning of ministers, and the setting up of committees of inquiry.[22]

1.3.2 Government

The executive power consists of the Cabinet: Prime Minister and Ministers.[23] The Amir appoints and dismisses the Prime Minister; he also appoints and dismisses ministers upon the recommendation of the Prime Minister. The Cabinet has control over state institutions, and plans the government's general policy and pursues its execution. While every minister is responsible for the affairs of his ministry, the Prime Minister and the ministers are accountable to both the Amir and the National Assembly.[24]

1.3.3 The Judiciary

The judicial power is the third component of the system of government. The constitution of Kuwait stipulates that the judiciary is independent, and judges are not subject to any authority.[25] The right of litigation to the courts is guaranteed to all.[26]

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[21] *Ibid.*, Article 79.

[22] *Ibid.*, Article 99.

[23] *Ibid.*, Article 123.

[24] *Ibid.*

[25] Constitution of the State Kuwait in Article 163 provides: "In administering justice judges shall not be subject to any authority. No interference whatsoever shall be allowed with the conduct of justice. Law shall guarantee the independence of the Judiciary and shall state the guarantees and provisions relating to judges and the conditions of their irremovability".

Therefore, according to the legal system of the State of Kuwait, any law must be enacted by the National Assembly because producing bills is one of its duties. As will be proved later in this study later there is a real need for a new Company Law. Therefore, the National Assembly should implement its duty and present this new law.

1.4 History of Company Law in Kuwait:

In Kuwait, the company, as an entity, existed within a limited scope and in a form commensurate with the Kuwaiti's economic life at that time, which was based on fishing, diving for pearls in the Arabian Gulf, and travelling to Africa and India for trade.[27]

The Ottoman Empire ruled all states in the Arabian Gulf, directly or indirectly, during the eighteenth and nineteenth centuries, and the first half of the twentieth century.[28] While Kuwait was under the rule of the Ottoman Empire, it began, in 1938, to implement the articles of the Justice Magazine, it was then introduced in all Arabian Gulf countries.[29] As already stated, the Magazine was issued by the Ottoman Empire in 1876. The Justice Magazine was the official law of the Ottoman Empire. All its

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[26] Law of Judiciary No. 19 of 1959.

[27] Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn, Dar Al-Kitab Al-Hadeeth Publishing, (1978), p. 10.

[28] Mohammad, Al-Moqatei, Introducing Islamic Law in the Arab Gulf State: A Case Study of Kuwait, 4 *ALQ* (1989) p. 139.

[29] Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 3ed edn., Kuwait: Author Publishing, (1999), p. 27.

articles were taken from the Islamic Shari'a law.[30] The Magazine was comprised of 1851 articles and 16 books. One of these was on companies.[31]

The major development in Kuwait with respect to commercial life was the discovery of oil in the 1930s. Thus, economic and human resources increased, and the major corporations for oil exploitation were established in Kuwait at that time.[32] Proceeds from oil brought about new characteristics in the Kuwaiti economy. New plans for government machinery were drawn up, including the enactment of written legislation and reforms of the judicial system. In the early 1950s, the Kuwaiti joint stock companies began to be incorporated; e.g., the Kuwait National Bank in1952, the Kuwait National Cinema Company in 1954, the Kuwait Airways Corporation in 1954, and the Kuwait Oil Tankers Company in 1955.[33]

The KCL has been set in 1960, and was subjected to some amendments, which did not touch the basic points of defects therein, specifically to determined shareholders equities. After reading this law, we have discovered that it only includes 234 legal articles, as this number of legal materials is very little and cannot cover all the firm's affairs with all its types. As for the legal articles which focus directly on shareholding companies, it does not exceed 115 articles and it surely cannot cover all

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[30] *Ibid.*

[31] *Ibid.* In Islam there are three types of companies: the Proprietary Partnership (Sharikat Mulk); Contractual Partnership (Sharikat Aqd) and the Allowance Company (Sharikat Ebahah). First, Proprietary Partnership is the joint ownership of property created expressly or by implication without its joint exploitation: for example the joint ownership of a house. Second is a contractual partnership. In this kind of company the joint ownership is not an element necessary for the establishment of the partnership. The emphasis is rather on the joint exploitation of capital and the joint participation in profits and losses. Third Company is the Allowance Company. This company includes everything permissible for people to make use of it together. For more information see Tamma, Supra note 25, p. 28.

[32] *Ibid.*, p 37.The first foreign oil were company incorporated in1934 by the US Gulf Oil Corporation, and the Anglo Iranian Oil Company.

[33] Tamma, *supra* note 29, p. 35.

the affairs of this type of large companies with the special importance among all kinds of companies. In consideration to the legal articles tackling shareholders rights, unfortunately they do not exceed three or four articles of this law. Hence, there is a grave defect in the law, which is clear before reading the substance thereof.

Why development shall be brought about now? As previously indicated that some attempts were carried out for the sake of development, yet, they were all defective, and had not any real additions. Specialised people in the area of company law demand the comprehensive development, but this demand was not met with attention up till now. Currently, this matter has become more persisting and the situation in the world has developed in a quickly. Kuwait as a small developing state, cannot catch with this progress, unless by modernising its laws and being aware of the laws and systems of other countries, such as the UK, to assist us in bringing about this development. This development in laws and systems is one of the demands of WTO, in which Kuwait has joined, leading to obliging it to develop its laws to be more flexible and modern.

Also, there is an orientation in the State of Kuwait to eliminate dependence on the public sector (governmental), and give the private sector the opportunity to play the role required therefrom. This matter cannot be achieved unless this sector is given this opportunity to perform the expected role. Accomplishing the same requires flexible laws, and non-intervene from the part of the state in all the commercial life affairs, so as this sector can attract capitals. Therefore, laws regulating the private sector shall be developed, of which among the companies' law of course.

Regarding the form of development required in Kuwait, the JSCs and specifically shareholders rights, it shall be as follows: In fact, as will be explained in the second chapter- any company of which its contract is governed by its memorandum of association and companies' law, as the company is not founded by a special pure contract, in the same time it is not a governmental establishment. Thus, any development in the commercial life and companies shall contain a company contract, meaning its memorandum of association or constitution, and the development of companies' law as well. Also, We must indicate that there is many laws related to the same, for example, the stock market laws, as they are important and vital laws, which shall be taken in consideration upon any development, as we have explained in the fifth chapter. These laws are concerned with shareholders and investors in general.

KCL No. 15/1961 covers all types of companies which are recognised in Kuwait. Traditionally differentiation is made between people companies and capital companies. People companies are the companies where the personality of the associates is fundamental. However, in capital companies, the personality of the associates is, in principle, irrelevant. Their capital is divided into shares which are to be freely transferable.

1.5 Lawful form of Companies under the KCL

A company is defined as a contract in which two or more persons undertake to participate in a financial project with a view to profit, each contributing money or services and dividing the profits or losses resulting from the project.[34] The classification of companies within the KCL is based on French law adopted in Egypt

[34] Kamal, Mustafa, *Commercial Companies*, Dar Al-jama Al-jadeeda Publishing, (1998), p. 15.

and other countries in the Middle East. All permitted types of companies enjoy independence and legal personality except joint ventures.[35]

The forms of companies authorised in the State of Kuwait include General Partnership, Limited Partnership, Joint Venture, Closed Joint Stock Company, Limited Liability Company, and Joint Stock Company.

1.5.1 General Partnership

A general partnership is established between two or more persons under a certain title, to carry out some commercial activities. It is a company in which all members are personally, severally and jointly liable for the debts and obligations of the company.[36] Therefore, the creditors of such a company may execute against the personal assets of a partner only after serving notice of the claim against the partnership; in other words, this liability may extend to each partner's personal wealth when the partnership fails to pay its debts.[37] However, the personal creditors of one of the partners may not recover the sum owed from the capital of the partnership.

According to the Company Law of Kuwait, the memorandum of general partnership should contain the following:[38]

> (1) The name of the company; (2) The headquarter of the company; (3) The object of the company; (4) The names of the members, one of them must be a Kuwaiti national; (5) The names of the managers of the company; (6) The capital of the company, the share of each member, and the proportion of

[35] Article 2 of the KCL provides that "with the exception of Joint Ventures all companies shall be endowed with legal personality."

[36] Article 4 of the KCL.

[37] *Ibid.*, Article 22 provides that "The creditors of a partnership are entitled to have recourse to the partnership's assets as well as to the personal assets of a partner who was, at the time of contracting, a member of the partnership; all partners shall be jointly liable to the creditors of the partnership; however, execution may not be effected against the personal assets of a partner unless notice has been served on the partnership, which has failed to pay within the reasonable time limit fixed by the creditor."

[38] Article 5 of the KCL.

Kuwaiti capital in the company capital shall be not less than 51 per cent; (7) The method of distribution of the profits and losses among the partners; (8) The duration of the company; (10) Any other specific thing which the members think should be included in the memorandum.

The name of the general partnership consists of the name/names of one or more partner followed by the phrase "and Co"[39]. The bankruptcy of the partnership means the personal bankruptcy of all partners.[40] In a general partnership company, a partner cannot transfer his interest in the company until he attains the approval of all partners in the partnership.[41]

As stipulated in the partnership's memorandum, a partner may appoint one or more managers to manage the company. These managers may be chosen from the partners themselves or from the public. The manager may perform all normal acts of management in order to achieve the objects of the company.[42] However, managers and partners should not carry on any business that is similar to the business of the partnership unless they are authorised to do so by the partners.[43]

A general partnership is dissolved when one of the general liquidation causes occurs, as mentioned in Article 24 of the KCL.[44]

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[39] *Ibid.*, Article 7.

[40] *Ibid.*, Article 11.

[41] Article 12 of the KCL provides that "Unless the memorandum of association of the company otherwise provides, no member of the company may transfer the property in his share thereof to a non-member except with the consent of all the (other) members, and no transfer of his share by a Kuwait member in a company formed after the coming of this law into force, to a non-Kuwait, shall be valid, if it shall cause the capital of the Kuwaiti members (in that company) to fall below 51% of its capital. The formalities as to publicity, prescribed by the provisions of the Commercial Register Law, shall be complied with.
A member, however, may transfer to a third party the benefits and fruits of his share of the company, but such a transfer shall have no effect except as between the parties to it.

[42] Article 15 of the KCL.

[43] *Ibid.*, Article 20.

[44] *Ibid.*, Article 24.

1.5.2 Limited Partnership

This kind of organisation has three sorts of partners: limited partner(s), sleeping partner(s) and general partner(s). The limited partner enjoys limited liability. Therefore,[45] he is liable for the debts and obligations of the company only to the extent of his share in the capital of partnership, and he is banned from participating in the management of the company. However, the general partners who manage the company are personally and jointly liable for the debts and obligations of the company, and this liability may extend to personal property.

The memorandum of the limited partnership must indicate the name of the partnership as well as the names of the general and limited partners. One general partner at least must be of Kuwaiti nationality and own at least 51 per cent of the company capital.[46]

If a limited partner participates in management he will then be in the same position as a general partner, and cannot then enjoy limited liability.[47] Furthermore, a limited partner will lose the benefit of limited liability when his name appears in the name of the partnership.[48]

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[45] *Ibid.*, Article 42.

[46] *Ibid.*, Article 47.

[47] *Ibid.*, Article 46.

[48] *Ibid.*, Article 45 provides that "the name of the company shall include the name of its active partners only, and where there is only one partner whose liability extends to all of his property, his name shall be followed by the word(s) 'and partners'.
A sleeping partner shall not allow his name to be included in the title of the company, otherwise he would be liable as a active partner towards a bona fide third party.

In all other respects, such as management, winding up and liquidation, the limited partnership is governed by the same rules that apply to general partnership.[49]

1.5.3 Joint Venture

The KCL provides that the "joint venture is confined to the relationship between the partners and shall not be valid in regard to the third parties".[50] The joint venture agreement is entered into by two or more parties for the purpose of carrying limited operations, and need not be registered with the authorities and need not disclose their identity to the public.[51] A joint venture exists just between the partners. Therefore, this kind of association does not enjoy an independent legal personality,[52] and it may not issue negotiable shares or debentures.[53]

1.5.4 Limited Liability Company

A Limited Liability Company is formed by two or more persons, but not more than thirty persons,[54]each of which is liable only to the extent of his contribution to capital. The minimum capital required to form this kind of company is KD 7,500 (15,000 pounds); the capital is not represented by shares and must be fully paid up in

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[49] *Ibid.*, Article 44 provides that "Subject to the provisions hereinafter stated, "limited partnership" shall, as to its formation, management, winding up and liquidation, be regulated by the rules which govern 'general partnership' even as regarding its sleeping members."

[50] *Ibid.*, Article 56 provides that "A joint venture is a commercial company formed (by and) between two persons or more, but has no existence except as between its partners. It shall not be binding on a third party."

[51] *Ibid.*, Article 57.

[52] *Ibid.*, Article 59.

[53] *Ibid.*, Article 62 provides that "A joint venture may neither issue negotiable shares nor debentures."

[54] *Ibid.*, Article 185.

cash or in kind,[55] and at least 51 per cent of the capital must be owned by a Kuwaiti.[56] However, a participant's share in a limited liability company may not be transferred to third parties except by the permission of the other members who have the right to refuse the transfer to the third party. In other words, any member who wants to sell his portion must tell the other members and wait one month. If nobody among the other members is interested, he has the right to sell his portion in the company to non-members.[57] A limited liability company cannot raise additional capital by public subscription and issue negotiable shares or bonds.[58] Also, it is prohibited from investing in banking, insurance or financial activities.[59] The company's name may be derived from its purpose or from the name of one or more of its members,[60] and the name must be followed by the term "Limited".

One or more managers manage a limited liability company,[61] and Articles of Association should determine the power of the managers.[62] The manager may or may not be a member.[63] The management of this company is similar to the management of the JSC regarding the liability of the directors,[64] the shareholders and the third parties.

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[55] *Ibid.*, Article 193.

[56] *Ibid.*, Article 197.

[57] *Ibid.*

[58] *Ibid.*, Article 186.

[59] *Ibid.*, Article 187.

[60] *Ibid.*, Article 188.

[61] *Ibid.*, Article 201.

[62] *Ibid.*, Article 203.

[63] *Ibid.*, Article 201.

1.5.5 Closed Joint Stock Company

This kind of company, as a general rule, is subject to the rules governing JSCs. However, they have especial characteristics which make them different from open JSCs and other kinds of companies. The Closed Company must include not less than five shareholders who subscribe for its capital which is divided into shares. This company cannot resort to public subscription in order to cover its capital, but the intending founders of the company should take all of the shares of the company. Moreover, to establish this kind of companies there is no need to issue an Amiri decree like in a public JSC.[65]

1.6 Joint Stock Company

A JSC is a company in which the capital is divided into equal and transferable shares and in which the shareholders are liable for company debts only to the extent of the nominal value of their shares.[66]

1.6.1 Incorporation Procedure

The incorporation procedure of a JSC depends, according to the KCL, on whether a company is a public joint stock company or a private joint stock company. The difference between them is that, in a JSC the capital is offered to the public, whereas a private joint stock company's entire share capital must be subscribed by the founders of the company.[67]

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[64] *Ibid.*, Article 204.

[65] *Ibid.*, Article 94.

[66] *Ibid.*, Article 63.

[67] *Ibid.*, Article 94.

The company name must be obtained from its purpose and be followed by the term: "joint stock company". A company can change its name but a resolution must be passed concerning this at its extraordinary general meeting, and this change should not affect its rights and obligations.[68]

The founders of the company must be five or more.[69] Kuwaiti legislature does not give any definition of a founder, but it is generally recognised that a founder is any person who effectively takes part in the incorporation of a company with the intention of bearing any resulting responsibilities.[70] According to the KCL, the founders shall file an application in the government department concerned in the MCI in order to obtain a decree to incorporate the company.[71] The requests of incorporation go along with the Memorandum of Association and Articles of Association.

The governmental concerned department in the MCI shall make sure that the proposed company does not go against public policy or the rules of morality and is not in conflict with the provisions of laws of the country.[72] Also, this department should examine the feasibility study of the proposed company.[73] After issuing and publishing the decree of incorporation in the Official Gazette, the company becomes a legal person separate from its founders.[74]

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[68] *Ibid.*, Article 66.

[69] *Ibid.*, Article 70.

[70] Tamma, *supra* note 29, p. 267; see also Mustafa, Kamal, *Commercial Companies*: General Provisions on Companies, Cairo: Dar Al-jama Al-jadeeda Publishing, (1997), p 146.

[71] Article 71 of the KCL.

[72] *Ibid.*

[73] *Ibid.*, Article 72.

[74] *Ibid.*, Article 74.

In the second stage of incorporation, the founders offer an invitation to the public to subscribe for shares in their company.[75] The subscription operation shall remain open for a minimum period of ten days, and a maximum period of three months.[76] The subscription normally takes place in one or more of the approved banks. To ensure the integrity of the founders, Kuwaiti legislature requires the founders to subscribe not less than 10 per cent of the total number of the company's shares.[77]

The third stage of incorporation starts when the subscription operation has been finished. The founder, within three months, must serve an announcement to the subscribers to attend the constituent meeting.[78] In this meeting, a report concerning all the operations of the incorporation should be presented by the founders of the company.[79] Then, the shareholders in this meeting will elect the first board of directors and the first auditors.[80]

1.6.2 Share Capital

The capital of a public joint stock company must be at least KD 37,500 (150,000 pounds).[81] The capital of the company is to be divided into nominal shares of equal value.[82] The value of the shares should be determined by the founders but should not

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[75] *Ibid.*, Article 76.

[76] *Ibid.*, Article 77.

[77] *Ibid.*, Article 81.

[78] *Ibid.*, Article 88.

[79] *Ibid.*, Article 89.

[80] *Ibid.*, Article 90(1) provides that "the general constituent meeting shall elect the first board of directors and the first auditors, and proclaim that the incorporation of the company has become final."

[81] *Ibid.*, Article 98.

[82] *Ibid.*, Article 99.

be less than 100 fils (20 pence) and not more than KD 75 (150 pounds).[83] The value of the shares should be paid in cash in one single payment or in instalments, by paying 20 per cent of the share value the first time; the remaining value should be paid within five years starting from the date of the incorporation decree.[84] If the company has shares in kind (not in cash) it should be ascertained that assessment is correct and made sure that their value was not over-estimated.[85] The shares of the new JSC are not negotiable before the publication of the first balance sheet after at least one complete financial year.[86]

A Company may increase its capital by issuing new shares after the instalments on the first shares have been completely paid up.[87] The new shares must be of the same value as the shares already in existence.[88] A shareholder of the company has priority to subscribe in the new shares equal with the number of shares he holds (see 4.2).[89] After issuing the resolution of an extraordinary GM, the company can also reduce its capital, if the capital that the company has is more than meets its requirements, when it has lost part of its capital and when it wants to reduce the capital to the amount really available.[90]

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[83] *Ibid.*

[84] *Ibid.*, Article 102.

[85] *Ibid.*, Article 105.

[86] *Ibid.*, Article 106.

[87] *Ibid.*, Article 110.

[88] *Ibid.*

[89] *Ibid.*, Article 111.

1.6.3 Membership of the Company

The promoters as well as the subscribers, who have subscribed to the company's shares, are members of the company and they have equal rights and are subject to the same obligations.[91] In other words, a person becomes a member when he subscribes to the shares of the company and enters his name in the Shareholders' Register[92]. Any person can think of becoming a member, except that the Company Law or the Articles Association imposes some restrictions (see 3.4.2).

According to KCL, every JSC incorporated in Kuwait will be of Kuwaiti nationality. All shareholders shall be Kuwaiti and the company's headquarter should be in Kuwait.[93] Therefore, foreign shareholding is inadmissible, unless there is a need for investing foreign capital or experience.[94] In this case, the approval of the concerned government authorities must be given, and foreign shareholding should not exceed 49 per cent of the capital, except for insurance companies and banks where the foreign shareholding does not exceed 40 per cent.[95]

When a person's name is entered in the register of the company, he becomes a member of that company, and he enjoys some rights. These include the right to share the profit,[96] the right to share the company's assets upon dissolution,[97] the right to

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[90]*Ibid.,* Article 112 provides that "A JSC may reduce its capital if: (a) it is in excess of its requirements, (b) a loss occurs and the company deems (it advisable) to reduce the capital to the amount actually available. Such reduction shall be authorised by a resolution of the EGM."

[91]*Ibid.,* Article 130.

[92] *Ibid.,* see also Morse, Geoffrey, *Charlesworth & Morse Company Law*, 15th edn, London: Sweet & Maxwell Publishing, (1995), p. 210.

[93] Article. 68.

[94] Ahmed, Al-Melhem, Privatisation and Protection of Investors in Kuwait, 13 *ALQ* (1998) p. 184.

[95] *Ibid.*

[96] Article. 131(1) of the KCL.

[97]*Ibid.,* Article. 131(2).

obtain a printed "booklet" containing the balance sheet of the company,[98] and the right to supervise the board of directors and GM in accordance with the Articles of Association.[99] A shareholder can also start actions against the directors, apply for the nullification of a resolution taken by the GM, and be in contact with the law, public policy, Memorandum or Articles of Association.[100] Furthermore, a shareholder has the right to dispose of his shares and has priority to subscribe for new shares.[101] However, a shareholder is subject to some legal obligations, such as paying instalments that are due and paying the interest in the case of a delay, compensating the company for expenses that it paid during the recovery of the instalments or doing anything that may cause harm to the company. Moreover, a shareholder should implement any resolution passed by the GM of the company.[102]

As will be seen later in this study, the articles in the KCL that concentrate on the rights of shareholders in the JSCs are limited. Therefore, shareholders of a JSC in Kuwait do not necessarily enjoy all of their rights and this affects their role in these kinds of companies.

1.6.4 Board of Directors

Every company acts through two main organs. These are the GM and the board of directors. Each organ has obligations to the company, and they have to work together to achieve the company's aims. The board of directors consists of a group of

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[98] *Ibid.*, Article 131(3).

[99] *Ibid.*, Article 131(4).

[100] *Ibid.*, Article 131(5).

[101] *Ibid.*, Article 131(6).

[102] *Ibid.*, Article 132.

shareholders, and their duty is to manage the company (see 2.5.1). The Memorandum of Association determines the appointment and the number of directors. One of the main problems which affects the interests of shareholders and other interested groups in the JSCs in Kuwait is that many members of the boards of the companies act outside of their powers and current legislation does not help to control them.[103]

A director, according to the KCL, should own one per cent of the company's capital. However, it is sufficient also that a director own a number of shares with a nominal value of K.D 7500 (£15,000),[104] unless the company's Articles of Association are otherwise provided for. The qualifying shares shall be deposited into an approved bank within one month from the date of his appointment. They are not negotiable until the membership term expires, and until approval of the balance sheet of the last financial year during which the member of the board carried out his work.[105]

Directors of a JSC are elected by the GM of shareholders by secret ballot and may be re-elected unless the Articles of Association provide otherwise.[106] At the first meeting of the board of directors, the directors shall select a chairman and a vice-chairman.[107]

The directors should carry out all duties of management of the company,[108] the powers of the board should be mentioned in the Memorandum of Association.[109] The

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[103] For more information see the report of the committee that established by the Kuwaiti Cabinet on 13/03/1983 by Cabinet resolution no. 10 meeting 11/1983 to inspect the affairs of number of companies; also see Alwatan Daily News Paper, Kuwait, 26.9.82.

[104] Article 139 of the KCL.

[105] *Ibid.*

[106] *Ibid.*, Article 141.

[107] *Ibid.*, Article 145.

[108] *Ibid.*, Article 146

board of directors is responsible to the company, the shareholders and any third party and for all acts of their management, such as cheating, abuse of power, violation of the law, or the Articles of Association or any other fault in management (see 2.5.1).[110] Furthermore, a director of a company should not have any personal interest in any contracts or transactions made with the company, unless these interests are authorised by the GM (see chapter 7).[111]

The directors may receive remuneration for their work.[112] The Articles of Association of a company should determine the method of fixing the remuneration. The total of such remuneration should not be more than ten per cent of the net profit, after deduction of depreciation reserves and the distribution of not less than five per cent of the capital to the shareholders (see 5.3.4.3).[113]

A director may be dismissed by resolution of a GM. The proposal of dismissal must be made by a number of shareholders who own not less than 25% of the shares subscriber.[114]

1.6.5 General Meeting

A GM is the highest authority in a JSC. The will of the shareholders of a company is normally expressed at the GM, when they vote for or against any resolution that is proposed, and the decision of the GM is a decision of the company. Every shareholder has a number of votes equal to the number of shares he or she holds

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109 *Ibid.*

110 *Ibid.*, Article 148.

111 *Ibid.*, Article 151.

112 *Ibid.*, Article 150.

113 *Ibid.*

and resolutions are passed by the absolute majority of the shares represented in the meeting (see chapter 7).[115]

The board of directors may convene a GM at any time but must meet at least once a year.[116] General notice of a meeting should be sent to all shareholders at least one week before the date of the meeting, and published in two Arabic newspapers at least twice.[117]

AGMs address all matters that are not reserved to the EGM (see 7.1.1),[118]such as the directors' report with regard to the activities and the financial situation of the company and the auditors' report concerning the balance sheet of the company. It may also discuss and authorise the accounts and determine the dividends to be distributed to the shareholders of the company. It elects the directors and auditors of the company, discusses the proposals concerning the increasing of the company's capital, the issue of debentures, borrowing, mortgages and guarantees.[119]

There are some matters which the Kuwaiti legislature reserve for the EGM (see 7.1.2).[120] These are, for example, the amendment of the Memorandum or the Articles of Association, the sale or disposal of a project carried out by the company, the dissolution of the company, amalgamation with another company and reduction of the company's capital.[121]

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[114] *Ibid.*, Article 152.

[115] *Ibid.*, Article 156.

[116] *Ibid.*, Article 154.

[117] *Ibid.*

[118] *Ibid.*, Article 157.

[119] *Ibid.*

[120] *Ibid.*, Article 158.

[121] *Ibid.*

The EGM will not be valid to carry out its business without the presence of shareholders representing three-quarters of the company's shares. Otherwise, notice for another meeting should be served, and this meeting will be valid if a total of half of the shares of the company is represented.[122]

GMs in the JSCs are the highest power in the company, therefore, the board of directors are subject to the control and supervision of these meetings. Also, the GM is a good place for shareholders to express their opinions to the board of directors. Unfortunately, as a result of the weak impact of these meetings, the shareholders lose their chance to hold the directors to account with the remit that the boards are given more power that what has been stipulated for them by the law and articles of association (See 7.4).

1.6.6 Accounts of the Company

A JSC must have at least one auditor.[123] The GM of the shareholders has the right to appoint him and determine his fees. The auditor's job is to audit the company's accounts, and he has the right of access to all the company's books, register and documents.[124] The auditor has to attend the GM and produce his report,[125] which should be accurate otherwise he will be responsible, and every shareholder has the right to discuss and ask the auditor about any point in his report (see chapter 6).[126]

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[122] *Ibid.*, Article 160.

[123] *Ibid.*, Article 161.

[124] *Ibid.*, Article 163.

[125] *Ibid.*, Article 164.

[126] *Ibid.*, Article 165.

The existence of an auditor is one of the shareholders rights in the company. Auditors under the KCL unfortunately do not have enough power and are not sufficiently qualified to play their role (see 6.4)

1.6.7 Liquidation

The KCL stipulates the circumstances in which a company may be wound up. A JSC is liquidated when the company has achieved the objective for which it was established; with the expiry of a fixed period for which the company was established; at the declaration of the company's bankruptcy; with the dissolution of the company according to the law; and when a judicial judgement is issued to wind up the company.[127] Moreover, if the company has lost three-quarters of its capital, the board of directors must convene an extraordinary GM to discuss either the liquidation of the company or the reduction of its capital. If the board of directors fails to convene this meeting, or a quorum is not present at the meeting, or the shareholders in the meeting refused to liquidate the company, the government department concerned and every shareholder may introduce legal proceedings to force liquidation (see 4.5).[128]

1.7 Company Law in the UK

Earlier to this time companies were created by Royal Charter (a special authorisation from Crown) or by a special Act of Parliament.[129] UK company law is mainly concerned with the creation and operation of registered companies, that is,

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[127] *Ibid.*, Article 170.

[128] *Ibid.*, Article 171.

[129] *Gower's Principles of Modern Company Law*, Paul L. Davies (ed.), 6th edn, London: Sweet & Maxwell Publishing, (1997), pp. 18-35

companies with separate legal personality created by the process of registering them with the registrar of companies under the Companies Act 1985. This facility of creating companies with limited liability simply by registration has been available in England since the Joint Stock Companies Act 1844.

JSCs became common in the 16th century and were so-called because their members contributed merchandise or money.[130] At first these companies were colonial companies, created mainly to open up trade with new colonies, but by the late 17th century nearly all of the new companies were created for domestic enterprises. At this time, there was also considerable growth in the numbers of large partnerships which were using various legal devices to make them as much like the chartered and statutory companies as possible. In the beginning of 18th century there were many speculative flotations of different types of company and a stock market collapse. This reached a climax in 1720 when the share price of the South Sea Company collapsed; this event was known as the South Sea 'Bubble' because once it burst, there was nothing left of its assets.[131] Legislation was then passed which was designed to prevent the large partnerships from acting as though they were companies. Known as the Bubble Act, it was not repealed until 1825[132], by which time it had been realised that it was economically desirable to permit the easy creation of companies. It also soon became necessary to clarify the status of the many partnerships which had now begun to prosper. In England, legislation in 1844 permitted incorporation by registration for the first time and limited liability was made obtainable in 1855.[133] These provisions were

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[130] *Ibid.*, p.20.

[131] *Ibid.*, p. 24.

[132] *Ibid.*, p. 33.

[133] *Ibid.*, p. 40.

then re-enacted in the Joint Stock Companies Act 1856.[134] In 1862 this and other following legislation was consolidated in the Companies Act 1862.[135] Then, the growth of company law followed a pattern which remains to the present day. In the years following a consolidating Act more reforms are established, either as a result of an inquiry into company law by an expert outside committee appointed by the government department responsible for companies, the Department of Trade and Industry (DTI) or, as is more common these days, as a result of policy decided by the DTI itself. The proposed reforms then become legislation and after many years of this process, another consolidating Act is passed. For a few years thereafter all the statutory material on company law is available in one consolidated Act. The latest of these is the 1985 consolidation.[136]

The present statutes governing companies are Companies Act 1985 and 1989, Insolvency Act 1986; Financial Services Act 1986; Company Directors Disqualification Act 1986, Criminal Justice Act 1993. In the UK at the present time, there are three basic types of incorporated company - statutory, chartered and registered.

1.7.1 Chartered companies

Chartered companies are incorporated by the grant of a charter from the Crown. In previous centuries trading concerns were granted Royal Charters and some of these companies are still in existence at the present time, such as the Bank of England. Charters are used now to incorporate non-commercial bodies, universities and colleges.

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[134] *Ibid.*, p. 46.

[135] *Ibid.*

There is no restriction on the number of members in this type of company, and unless otherwise stated, the members are not personally liable for the company's contracts. The creditors' remedy lies against the company.

1.7.2 Statutory companies

Statutory companies are formed by a special Act of Parliament. This method of company formation was frequently used in the past for the formation of public utilities such as railway, gas, canals, electricity and water companies. These companies often required special powers, such as compulsory purchase of land, and were usually granted a monopoly in a particular locality. As a result of nationalisation most statutory companies have been taken over by Public Boards, and by Corporations set up by Public Acts.

A statutory company must have a minimum of two members. A member whose shares are not fully paid up may be liable for the company's debts if the company has insufficient assets to satisfy its creditors.

1.7.3 Registered companies

The term "registered company" means a company incorporated by registration under the companies Acts. The major Act is the Companies Act 1985. A registered company may or may not have a share capital, for although a share capital is essential for a trading company, it may not be required by other companies.

The Act provides for three basic types of registered company; company limited by guarantee, unlimited companies and companies limited by shares.

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[136] *Ibid.*, p. 50.

A company limited by guarantee is a registered company in which the liability of member is limited to such amount as they respectively undertake to contribute to the assets of the company in the event of its being wound up.[137] The majority of companies limited by guarantee are formed to incorporate professional, trade and research associations, or clubs supported by annual subscriptions.

An unlimited company is defined as a company not having any limit on the liability of its members.[138] Therefore, every member is liable for the debts contracted by the company while a member but the liability will only arise if the company is wound up and is unable to meet its debts. All unlimited companies are private companies.

A company limited by shares has the liability of its member limited by the memorandum to the amount, if any, unpaid on the shares held by them. No further liability attaches to the holder of a fully paid shares. Should the company become insolvent, he will not be required to contribute to the payment of its debts. The promoters of a company have to decide whether a company should be formed as a private or public company.

A public company is a limited company with a share capital which has a memorandum stating that it is a public company and which has been registered or re-registered as such.[139] A company which is not a public company is a private company.

There are three requirements for registration of a company as a public company;

(1)It must state it is a public company both in its memorandum and by its name, there must be a clause to that effect in the memorandum[140] and its name must end with

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[137] S.1(2) (b) the UK CA1985..

[138] *Ibid.*, S. 1(2) (c)

[139] *Ibid.*, S. 1(3).

[140] *Ibid.*

words "public limited company" (frequently abbreviated to 'plc').[141] A private company uses the traditional 'Limited' or 'Ltd' at the end of its name.[142]

(2) The memorandum must be in the form specified in Table F of the Companies (Table A to F) Regulations 1985).[143]

(3) The company must have an authorised capital figure (the amount of shares it may issue to the public) of at least the authorised minimum, currently 50,000 pound.[144]

The minimum number of member for a public company is two but one will suffice for a private company[145] and a public company must have at least two directors whereas a private company need only have one.[146]

A private company with only one member is known as a single member company. The fact that it only has one member must be recorded in the company's register of members, but not on the public register.[147] in general terms, the provisions of the Act are to apply to single member company in the same way as to other companies, with such modifications as are necessary there are, however, special provisions for meetings and resolutions of such companies.[148]

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[141] *Ibid.*, S. 25 (1).

[142] *Ibid.*, S. 25(2).

[143] *Ibid.*, S. 3.

[144] *Ibid.*, Ss. 11 and 118.

[145] *Ibid.*, S. 1 (1) (3A).

[146] *Ibid.*, S. 282.

[147] S. 352A.

[148] The Companies (senegal member private Limited Companies) Regulations 1992 (S.I. 1992 No. 1699), Art. 2(1).

1.8 Conclusion

In the State of Kuwait the source of law is codes enacted by Parliament. Therefore, the rules are written and the task of the courts is to implement them. Precedent is not recognised as a source of law at all. Consequently, if there is a real need to amend or develop any law there are many procedures that must be respected. In the UK legal system the precedent is recognised as a source of law. Precedent is a law created by an adjudicative body (courts). Therefore, there are two main sources of law in the UK. Hence, the legal system in the UK is flexible, sophisticated and can be developed easily without following long procedures. Because of this inflexibility of the legal system in Kuwait, the codes of the country, including the laws that organised the commercial life such as the Companies Law, cannot be developed easily.

The JSC, as a legal person, acts through two main organs (See chapter 2); these organs are the shareholders and the board of directors. Some of the powers of the company are exercised by the shareholders and some are reserved for the board of directors. This distribution of power within the company now exists in every company law. However, in KCL this kind of distribution of power between these two main organs does not exist clearly. Also, the role of shareholders, as will be seen later in this research, is not sufficiently clear, and, because of this, shareholders do not enjoy most of their rights in JSCs. Hence, they do not play their primary role as one of the main organs in the company. The question that must therefore be answered here in this study, before discussing the rights of shareholders is; what is the position and role of shareholders in JSCs? Also, what are the reasons for the weak role of shareholders in Kuwaiti JSCs? (see chapter 2.)

The main reason is believed to be that of the KCL itself. This law was enacted in 1960, and, despite the many adjustments that have been made since 1960, this law is still underdeveloped and lacking in sufficient detail. It fails to address many of the issues relating to shareholders' position and rights in the JSCs. As a result, the role of shareholders is not clear. This situation gives the board of directors the opportunity to act outside of the company law in order to achieve their personal interests.

Also, in Kuwait, we are in need of being acknowledged with concentrated ownership structures and how many companies' shares do natural or institutional shareholders own, for the sake of being aware of their strengths, then determine the role required from the same. We also need to know how many shares owned by the JSC's boards of directors, for the purpose of knowing their strength at holding the company's GMs. Finally, this kind of study help to know the link between concentrated ownership structures and weak protection of minority shareholders.[149]

This research will seek, first, to discuss the nature of the position of shareholders in JSCs in theory and law and after identifying the position of shareholders, will concentrate on the rights of shareholders (see chapter 2).

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[149] In fact, since my first year of carrying out this study, I have exerted several attempts to acquire the information required from the companies and Ministry of Commerce, to be aware of the distribution and dissemination of companies' shares in Kuwait among shareholders of different types, such as ordinary and institutional shareholders, and how many shares shall companies board members own in order to understand the concentrated ownership structures. Unfortunately, I have faced many difficulties, such as the confidentiality of this information for some companies, or receiving insufficient information from the same, which we cannot depend on, in our way of seeking a reliable result. Therefore, I have deemed it suitable to give this matter the adequate time, by conducting it as an independent research in cooperation with a number of researches in the near future. This subject is one of the recommendations emerging from this study for other future researches.

Chapter Two

The Position of Shareholders in the JSC

2. Introduction

In trying to understand the position and role of shareholders in a company it is useful to take a look at the topic of company theories. There are two main theories regarding the nature of the company, and each theory places the shareholders in a different position in the company. This chapter attempts to establish the basic position of shareholders in order to identify their role and rights in the JSC. A number of questions concerning JSCs and shareholders will be dealt with such as the nature of a company; is it a contract or an institution created by the state? What is the role and position of shareholders in both cases? Are shareholders the owners of the company or are they just providers of capital in order eventually to gain a profit? What is the distribution of power within the company? Who are the main players in the JSC? Who has the residual power in the company? What are the shareholders' actual powers? The answers to these questions will assist in understanding the position of shareholders in JSCs and then the rights they should enjoy because of this position.

2.1 Theoretical Framework

There are several theories that relate to the concept of the company. Such theories also provide the foundation for identifying the role and position of shareholders in the JSCs. The rights and authorities possessed by shareholders may differ according to their position in the company. Some theories consider the company as a contract, and the shareholders as the company's owners. Other theories consider the company as an institution founded by the state, and shareholders are only funding the company, by providing the company's capital, thus entitling them to a number of rights. Therefore, the rights and powers of shareholders may differ according to each theory.

The two main theories are the contractual theory and the institutional theory. The contractual theory treats a company as a private contract between a group of people and the shareholders are the owners of the company. The institutional theory considers a company as an institution created by the State and shareholders are one of the interested groups in the company.

2.1.1 Contractual Theory

This theory is one of the oldest theories in explaining the nature of the company. The contractual theory is based on the notion that a company is incorporated by an agreement between a number of persons who agreed to create an association, with a view to sharing the possible profit,[1] and such an agreement is nothing but a private contract.[2] Thus, a JSC is borne by the agreement of all shareholders; each shareholder, when he participates in this contract, is in fact giving funds and receiving some rights in exchange. Therefore, the corporate charter should be available simply upon compliance with certain generally applicable requirements that have been mentioned in the regulations.

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[1] Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn, Cairo: Dar Al-fker Al-rabi Publishing, (1978), p. 19.
[2] Jamal-adeen, Ali, Commercial Company, Cairo: Dar AL-nahdah Publishing, (1961), p. 15.

The traditional meaning of this theory is that it treats a company as a private contract when the need arises to modify the contract of the company (a company contract is embodied in the Memorandum and Articles of Association).[3] The contract is subject to the general provisions of Civil Law. As with any private contract the law states that, all parties of any contract must give their consent on any modification related to their contract.[4] Therefore, when a JSC wants to increase or decrease the capital of the company, issue bonds and increase shareholders' liability or any other modification, the approval of all shareholders in the company is required for any such modification to take place. It is hard to imagine in the case of a JSC, whose shareholders may exceed tens of thousands, that the objection of one shareholder would be enough to defeat any attempt to modify the contract of the company. In this situation, it is not necessary to enact legal provisions to protect the minority in the company, because, the minority protection as such does not exist since the rule of unanimity is required to execute any change in the company's contract (see chapter 8).

Due to this major defect in the traditional meaning of the contractual theory, French scholars sought to alleviate the intransigence of the meaning by allowing the inclusion in the Articles of Association of any JSC a clause empowering the GM to modify the Memorandum or Articles of Association by consent of the majority of shareholders.[5] Thus, the Articles of Association of a company could be modified by

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[3] See section 113 of the Civil Code in France which holds contracts to be unalterable except with the consent of all contracting parties.

[4] Abid-Alfdal, Ahmad, Protection of minority of shareholders, 2 *Journal of Legal and Economic Research* (1987) p. 201.

[5] *Ibid.*, p. 202.

the consent of the majority of shareholders and each shareholder should consent when entering the company to submit to the rule of the majority.[6]

After this major modification to the traditional meaning of the contractual theory (the submission to the rule of the majority), Professor Thaller[7] in 1893 put forward his theory of the "basic rights of shareholders", which states that the decision to modify the contract of a company is the right of the majority.[8] However, this right is subject to the condition that it should not prejudice the basic rights of the shareholders. Thus, the authority of the majority is not absolute in a JSC.

This development emerged, in order to solve some of the negative aspects of the contract theory as it focuses on the fact that there are basic rights that cannot be touched by the majority in any case. At the beginning the law did not determine these rights, which led to leaving this determination to scholars of company law, which in turn led to a diversity of opinions regarding what is considered a basic right or not. But generally, one can say that basic rights of shareholder are:[9]

(1) The right to receive the deed proving his rights in the company;

(2) The right to acquire profits;

(3) The right to dispose of his share at any time and by any means of disposition, and is also entitled to reject the increase of his commitments in the company.

(4) The right to remain in the company as a shareholder who presented a part of the company's capital;

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[6]Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 1st edn, Kuwait: Dar Al-ktab Publishing, (1986), p. 80.

[7] Abid-Alfdal, *supra* note 4, p. 204.

[8] *Ibid.*

(5) The right to participate in the company's management;

(6) The right to hold a responsibility according to the capital paid by him;

(7) The right to have access to information that enable them to read specific documents, data and reports sent to him, or be put under his disposition at certain appointments and occasions;

(8) The right to attend and vote in the GMs;

(9) The right to demand abrogation or dissolution of the company, if there is a legal reason for that;

(10) The right to start an action in the name of the company to defend its interests or in his own name, to defend his own interests in the company.

Therefore, in contractual theory, a company is run by a series of private contracts; consequently, the role of the State should be limited. In other words, the State should not interfere with the freedom of private contracts, and also should not impose any restrictions on the principle of free contracting. The role of law should be, for example, as a public service announcing a standard form of contract. To explain why the State has no role in the contract that establishes a company, we have to look at the classification of laws in civil law contracts. There are two main branches of law, public law and private law. Public law governs relations in which the State is a party, while private law governs the relations, duties and rights of private natural or artificial persons. Company law is part of private law because all of the parties of the company

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[9] *Ibid.*

contracts are private, therefore, the contracts that establish a company are private and so, the role of the State should be minimal.[10]

The nature of the relationship between the owners (shareholders) of the company and the directors is based on the agency's nature. Thus, it is a relationship between principals and agents and these agents are required to execute some services on behalf of their principals. They have to carry out their duty in the best interest of their principals. Therefore, the right of shareholders in their company is supreme, and the company's interests are, in fact, equated with the interests of the shareholders because they are the owners of the company.

2.1.2 Institutional Theory

Another group of company jurists asserts that the contractual theory has begun to retreat; they say that a company is not a contract but a legal institution. A company as a collective being would not find an explanation within the traditional rules of public law. It would have to be thought of as institutional.[11]

The institutional theory started at the beginning of the last century in France. It considers a company to be an institution set up for a specific purpose, a legal institution whose statutes are drawn up by the legislature.[12] Hence, a company is a creation of the State. The role of the individuals (shareholders) is limited to declaring their intention to join the company and subscribe according to the rules made by the

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[10] The major areas of public law are constitutional law, administrative law, criminal law and financial law. The major areas of private law are: civil law, commercial law, labour law and family law.

[11] Jean, Paillusseau, the Nature of the Company, in Robert R. Drury and Peter G. Xuereb (eds), *European Company Laws*, (1991), p. 22.

[12] Mustafa, Kamal, *Commercial Companies: General Provisions in Companies*, Alexandria: Dar Al-jama Al-Jadeeda Publishing, (1997), p. 15.

legislature.[13] Thus, the process of subscription is not a contract and those who sign subscription papers do not sign a contract; the subscribers are actually asking to get a benefit or take advantage of a company created by the State.

As a rational result, shareholders are not the owners of the company, and the idea of delegating power from the owners to the board of directors would disappear in this theory.[14] A JSC according to this theory is a company in which, for example, the GM is unable to step on the board of directors' powers. Therefore, it considers the board of directors, shareholders, auditors and employees of the company to be an organ of the collective being and, when they carry out their duties, they are, in fact, practising their own power as organs of the company.[15] The source of these powers and rights of the organs of the company, including shareholders, is the law. Consequently, there is no more delegation of power from one group to another. This separation of power within the company, leads many company jurists who advocate this theory to assert that a JSC appears like a small parliamentary State.[16] In this State citizens would be represented by shareholders, the executive power would be represented by the board of directors, and the legislative power by the GM. This State should be a democratic State; it should hold a GM every year to discuss its budget, hear the auditors' opinion, hear the board of directors' report, and discuss the company's affairs.[17] Therefore, shareholders like a citizen in a State have a number of

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[13] Sami, Fawzi, *The Explanation of Commercial Law*, Jordan: Maktabt Dar Al-Thgafah Publishing, (1997), p. 22.
[14] *Ibid.*, p. 23.
[15] Mustafa, *supra* note 12, p. 51.
[16] Sami, *supra* note 13, p. 23.
[17] *Ibid.*

rights in their company not because they are the owners but because they are one of the organs who enjoy these rights.

According to this theory the board of directors and the GM of a company are bound to exercise their powers, not as provided in the contractual theory in the interest of shareholders, but used solely in the interests of the company. Moreover, because the company is a creature of the State by its law, this law regulates all of the affairs of the company and shareholders, and other groups in a company must act according to the law. However, company law nowadays regulates certain aspects of the companies' affairs and lays down rules of general guidance but still there are many affairs regulated by the companies through their board of directors and GMs.

It is clear from this theory that the institutional conception of the company tends to abandon the traditional principles of private law and substitute them with principles from public law.

One might ask, if the shareholders are one of the company's organs, what are their rights in the company according to this theory? As provided above, according to this theory the company is a creature of the state and the company law controls it from the beginning till the end. Therefore, the company law also decides the rights and powers of shareholders and the other organs as well.

2.2 The Nature of a JSC under the KCL

Kuwaiti legislature does not specify the nature of the company in a straightforward way. However, many scholars of law are agreed that a company, according to the KCL, is nothing but a contract.[18] Article 78 of the KCL provides:

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[18] Tamma, *supra* note 6, p. 83.

> Subscriptions shall be in writing, giving the number of shares subscribed for and stating that the subscriber accepts the memorandum and articles of association of the company...

It is clear from this article that the operation of subscription according to the KCL is a contract between a company and its subscribers. In other words, the KCL considers the subscription operation as a contract between a company on the one side, and subscribers on the other. The subscription prospectus is considered as an offer from the company, and the subscription of the subscribers as an acceptance from them.[19]

It should be stated that JSCs in Kuwait (or in any country) are established not just by one contract between the company and its shareholders or between the founders and the subscribers; JSCs actually consist of many contracts with shareholders, employees, suppliers, creditors, and consumers. All these groups have important roles in running their company and they have interests in the company, which should be protected. Among all these contracts in JSCs one is given priority and has the main role in the process of establishing and running the JSCs. This contract is the contract between the company and the shareholders in the process of subscription. Because of the importance of this contract the shareholders have more rights and authority in the company than other interested groups.

A contract establishing a company has to comply with the general legal requirements common to all contracts. Accordingly, all parties to any contract must give their consent freely and must have the required legal capacity.[20] Also, the

[19] *Ibid.*, p. 86.

[20] See Article 147 of Kuwaiti Civil Law No. 67/1980.

objective of a company must be lawful and achievable.[21] Furthermore, the reasons for establishing a company must also be lawful.[22]

Moreover, as mentioned above, the contract of any company, especially a JSC, is different from others.[23] Therefore, the contract establishing a company must meet certain requirements that apply specifically to it. First, a company should have at least two persons agreeing to participate in it.[24] Second, each member should make a contribution to the company's assets, in return for which he receives one or more shares in it; members may participate in a company by cash or in kind.[25] Sometimes this may consist of a promise to work, e.g. a promise to manage the company's business.[26] Third, all shareholders should have the intention of acting together on an equal footing to achieve the company's goals. Furthermore, the aim of a company must be to make gains that are to be shared between its shareholders. Finally, they must contribute to the losses incurred by the company.[27]

When looking at law in some civil law countries we will find that there is no doubt that, in general, a company is a contract. For example, in France, a company is

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[21] Tamma, *supra* note 6, p. 272.

[22] *Ibid.*, p. 91.

[23] Younes, Ali, *Commercial Companies*, Egypt: Dar-Al-feker Al-Araby Publishing, (1991), p. 29.

[24] See the KCL Articles No. 4, 42, 56, 70 and 185; this research focus on commercial companies because, in general, there are two kinds of companies – civil company and commercial. A commercial company is determined by its form and its objects. In other words, a company that has neither a commercial form nor commercial objects is a civil company.

[25] See Art. 110 of Kuwaiti Commercial Law.

[26] *Ibid.*, p. 100.

[27] *Ibid.*, p. 113.

described as a contract between two or more persons, as Article 1832 of French Civil Law provides:[28]

> Company is a contract between two or more persons agreeing to constitute a common stock with intent to sharing any profit arising therefrom.[29]

This means that all the business associations are defined in Article 1832 of French Civil Law in terms of a contract.[30] Also, all Arabic countries directly or indirectly describe a company as a contract. For example, Egyptian, Oman, and Saudi Company Laws describe a company as being a contract, and all of these countries agree on the definition. A company is a contractual agreement between two persons or more who undertake to work together in an enterprise with profit as the motive, each one of these persons contributes a share of the capital in the form of money or services, with a view to sharing any profits or losses resulting from the enterprise.[31]

At this point the following questions arise: Who organises the company shareholders through the GM and boards of directors by carrying out the contract of the company or the company law? What are the organisational techniques that must be used? Who is in charge of choosing these techniques, the parties to the contract or the law or both? In fact, company law gives the parties of the company contract a number

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[28] Article 19 of French Commercial Law 1966 that provides "A partnership is established by a contract between the partners. However, a de facto Partnership may be found to exist whenever the following there basic features are present, i.e., contribution by the partners, sharing of profits and losses.."

[29] See Church, Edgar, *Business Associations under French Law*, London: Sweet & Maxwell Limited Publishing, (1960), pp. 192-4.

[30] Le Gall, Jean-Pierre & Morel, Paul, *French Company Law*, 2ed edn , Longman Publishing, (1992), p. 1-3; see also Drury, R., The Relative Nature of A Shareholder's Right to Enforce the Company Contract, 45 *C.L.J* (1986) p. 220.

[31] For example, Saudi Company Law provides in the first article: "a company is defined as a contract under which two or more persons undertake to participate in an enterprise for profit, with each contributing a share in the form of money or services, with a view to dividing any profits or losses as a

of powers, and at the same time, gives the State a number of powers to enable it to play a major role in establishing and running the companies. Therefore, a company is not a pure private contract between private parties. This can be seen easily in the KCL. According to the KCL, the application of incorporation of the proposed company will be presented to the government department involved in the Ministry of Commerce and Industry. This department will ensure that the proposed company does not contravene public policy or the rules of morality and is not in conflict with the provisions of the laws of the country.[32] Also, this department will examine the feasibility study of the proposed company, and it has the right to reject the proposed company.[33] All these requirements must be placed before the issuance of the Emir's Charter. The State still has to play a major role even after the issuance of the incorporation certificate. For example, the company shall submit an application to the ministry for capital reduction, capital increase, the amending of the objectives of the company; also, any modification for the Memorandum or Articles of Association cannot be implemented without the consent of the Ministry of Commerce and Industry.[34]

In summary, each theory places shareholders in a different position and as a result their rights and powers are different. The contractual theory treats them as the owner of the company. Therefore, the company should be managed in their interest first, and as owners they enjoy a wide powers and rights within the company. The institutional theory treats the shareholders as an organ among a number of organs in

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result of such enterprise"; see first the article of Oman Company Law, and Art. no. 505 of Egyptian Civil Law.

[32] Article 71 of the KCL.

[33] *Ibid.*, Article 73.

[34] *Ibid.*, Article 135.

the company. Therefore, the company is not managed for their interest alone because they are the owners of the company. Shareholders also have a limited number of powers and rights as mentioned in the Company Law (see 2.4).

2.3 Nature of a Company and the Role of Shareholders in the UK

In the UK Companies Act of 1985 provisions (supplemented by case law) exist which concern the nature of a company. The first section is S. 1(1) that provides:

> Any two or more persons associated for a lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration form an incorporated company.

Also, one of the important sections in the CA of 1985 that will help in analysing the nature of the company in the UK is S. 14(1) that provides:

> Subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.

In these two provisions of the UK Companies Act of 1985, the legal relationship that exists between the members and the company is a contractual relationship as a result of the operation of subscription. The contract is embodied in the Memorandum and Articles of Association.[35] Thus, the normal legal analysis of the nature of a collective entity is in terms of a contract. In *Bratton Seymour Service Co. Ltd v Oxborough* [1992] BCLC 693, Steyn LJ at p. 698 said:

[35] Prentice, Graham N., The Enforcement of Outsider Rights, 1 *Co. Law* (1980) p. 179.

> The contract between a company and its members formed by the company's articles derives its binding force not from a bargain struck between the parties but from the terms of the statute...[36]

However, the contract formed by the Articles of Association is unique. It is not like others, for example, a sale contract. It does not force each party to carry out a particular list of obligations that must be fulfilled by the end of the contract. This contract provides the rules or methods controlling decision-making in the company. It is a contract that may be altered by a three-quarters majority of the members.[37] The contract above mentioned of, and which is clear in the wording of s.14 (1) of the UK CA 1985, is a subscribing contract between the company and its shareholders. This contract is not the only contract which a company has; any company has five participants: shareholders, directors, managers, employees and creditors, and all play a significant role in either financing or executing the economic activities which the company undertakes. Each participant is tied to his company by a contract. Therefore, many real contracts lie behind the subscription contract that exists between a company and the shareholders. These contracts have a major role in establishing and running a company, such as, a contract between the company and its employees (suppliers of labour) or a company and suppliers of goods or services.

The discussion so far about the nature of the JSC agrees in many aspects with economic theory. Coase (1973) defines a firm as "An umbrella that enables private

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[36] See also *Conservative & Unionist Central Office v Burrell* [1982] 1 WLR 552 at p. 525 Lawton LJ said; "The bond of union between the members of an unincorporated association has to be contractual".

[37] The UK CA 1985, S. 9 (1).

individuals to contract with each other more efficiently by limiting the costs of the transactions between them."[38]

In his article, Coase says that a company is created by private contracts, not by the State's will, and the role of the State should be limited to the announcing of a standard form of contract or any other provisions that do not impose restrictions on the principle of free contracting.[39]

This theory treats the company as 'a nexus of contracts'.[40] These contracts create a web of contractual relationships between the company's elements. The advocates of this theory regard a company as a basket of different suppliers of inputs,[41] i.e. shareholders provide equity capital, supervise and monitor the act of board of directors, board of directors manages the business of the company, employees provide labour, and creditors provide debt capital. All these input suppliers should act together to produce goods or services.[42] These contracts determine the rights and obligations of the various interested groups in the company.[43] Also, this theory assumes that the directors of the company are agents of the company; thus, all input owners should surrender the use of their inputs to the agents.[44] According to this theory, shareholders are not the owners of the company, they are just one of the company's input owners,

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[38] Coase, R., The Nature of the Firm, 4 *Economica*, (1937) p. 386; see also Wright, Mark J., Corporate Governance and Directors' Social Responsibilities: Responsible Inefficiency or Irresponsible, 17 *B.L.R* (1996) p. 174.

[39] See Bratton, William W., The New Economic Theory of the Firm: Critical Perspectives from History, 41 *Stanford Law Review* (1989) p. 1471.

[40] Jensen, M. and Meckling, W., Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure, 3 *J. Fin .Econ* (1976) p. 310; see F. H. Easterbrook and D. R. Fischel, The Economic Structure of Corporate Law, Cambridge: Harvard University Press, (1991), p. 21.

[41] Wright, *supra* note 38, p. 178.

[42] Easterbrook, F., and Fischel, D., The Corporate Contract, 89 *Colum. L. Rev* (1989) p. 1429.

[43] Jensen, *supra* note 40, p. 310.

and their rights should be determined by the set of contracts that created the company.[45] They own the shares of the company. Consequently, their position in the company is as the owners of the company's shares, and the source of their powers and rights are the contract of the company (Articles of Association and Memorandum) and the company law.

2.4 The Nature of a Shareholder Position in the Company and the Basis of his Rights

Among all these input suppliers or interest groups or participants in a JSC the questions that this section will try to answer are: What is the nature of the shareholder's position in a company? Are shareholders the owners of the company? If not, what they are? Do certain shareholders have more rights in their company more than others? What is the basis of these rights? Finally, what about the other groups that have interests in the company?[46]

There is no doubt that a company, as an artificial person, "owns" itself. Thus, it is completely separated from its shareholders.[47] According to the KCL and after issuing and publishing the decree of incorporation in the Official Gazette, the company becomes a legal person separate from its founders and subscribers as is provided in Article 74 of the KCL. Also judicial decisions in the UK before the end of the 19th century made clear without doubt, that shareholders of a company under the Acts have

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[44] Cheung, Steven N., The Contractual Nature of the Firm, 26 *J.L.&Econ* (1983) p. 3.

[45] Millon, David, Theory of the Corporation, *D.L.J* (1990) p. 229.

[46] Worthington, Sarah, Shares and Shareholders: Property, Power and Entitlement part 1, 22 *Co. Law* (2001) p. 258.

[47] Ireland Paddy, Capitalism without the Capitalist: Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality, 17 *J.L.H* (1996) p. 41.

no legal interest in any part of the company's assets, and the company is the only owner of all the property vested in it. As Lord Macnaghten in *Salomon v. A Salomon & Co Ltd* [1897] said "the company is at law a different person altogether from the subscribers to the memorandum...".[48] The shareholders' part in any JSC is to put their money in equities and not in anything else, such as bonds, because they believe the return of equities to be more attractive. Therefore, shareholders of a company are not joint owners of its property because the company is a separate person in law and property is held in the name of the company.[49] Moreover, the common definition of a share in the UK is that of Justice G. Farwell in the case of *Boland's Trustee v. Steel Brother & Co Ltd.*[50] Mr. Justice Farwell said:

> A share is an interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place and of interest in the second place but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with s.16 of the Companies Act 1862 (now CA 1985, S.14). The contract contained in the articles of association is one of the original incidents of a share.[51]

A share, according to the judge's definition, means the shareholder's interest in the company evaluated in an amount of money. Such interest makes the shareholder responsible for the debt of the company to the extent of his shares on the one hand, and a titleholder on the other.[52] A share is not an amount of money but an interest measured by a sum of money, based on the various rights contained in the memorandum – including

[48] [1897] AC 22.

[49] See Ireland, Paddy, Company Law and the Myth of Shareholder Ownership, 62 *M.L.R* (1999) p. 32; Mayson, Stephen W., *Company Law*, 15th edn, London, Blackstone Publishing, (1998), p. 175.

[50] (1901) 1 Ch 279 at p. 288.

[51] See also *Inland.Revenue Commissioners. v. Crossman* [1937] A.C. 26, 66. In this case Lord Russell described the share as "an interest being composed of rights and obligations which are defined by the Company Act and by the memorandum and articles of association of the company."

the title to an amount of money more or less than the share value. Therefore, the shareholder's rights in his company are no longer seen as a result of his position as owner. The rights that the shareholder enjoys in the company are a result of the ownership of shares, and these rights are limited to the rights mentioned in the Company Act or in the Memorandum and Articles of Association of the company.[53]

Moreover, s.182 (1) of the UK CA provides that, "The shares or other interest of any member in a company; (a) are personal estate". A share represents the interest of the shareholder in a company. Shares in a JSC could be treated as the property of the shareholders, because they can do what they want with them, however, ownership of the shares is separate from ownership of the company.[54]

If the shareholders are not the owners of their company, who are they? Why do we always try to give them a privileged position in the company? The answer is simple: shareholders are the providers of the company's capital and residual risk-bearers,[55] therefore, they should enjoy a special position in their company. Many see the only purpose of the company as enhancement of the shareholders' investments. For example Professor Berle in one of his articles said:

> All powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessary and at all times exercisable only for the rateable benefit of all the shareholders as their interest appears. That, in consequence, the use of the power is subject

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[52]Grantham, Ross., The Doctrinal Basis Of The Rights of Company Shareholders, *C.L.J* (1998) pp. 562-3.

[53] *Ibid.*

[54] See Worthington, *supra* not 46, p. 259; also *Gower's Principles of Modern Company Law*, Paul L. Davies (ed.), 6th edn, London, Sweet & Maxwell Publishing, (1997), p. 301; L. S. Sealy. *Cases and Materials in Company Law*, 5th edn, London: Butterworth, (1992), p. 413; S. Mason, D. French and C. Ryan, *Company Law*, 17th edn., London: Blackstone Press, (2000), p. 178.

[55] E.F Fama and M.C. Jensen, Separation of Ownership and Control, 26 *J. L. & Econ* (1983) p. 301.

> to equitable limitation when the powers have been exercised to the detriment of such interest.[56]

A company's directors are primarily accountable before their shareholders through the GM,[57] and the duties imposed on directors under the Companies Act are to give priority to the interests of the body of shareholders.[58] Hence, many consider that the sole purpose of the company is the making of money for its shareholders.[59]

Nevertheless, some legal scholars such as Professor E.M. Dodd do not see that making money should be a company's sole aim.[60] They say that a company is not just shareholders and their directors, and that the company has responsibilities to the non-shareholder groups and also to the community.[61] In other words, the company is not just a contract between the company and its shareholders; there are many real contracts between the company and other participants in the company, such as employees, creditors, suppliers, and others. They demand taking the interests of non-shareholders into account.[62] Thus, the interests of the company contain not only the interests of the

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[56] Adolf, Berle A., Corporate Powers as Powers in Trust, 44 *Harv.L.Rev* (1931) p. 1049.

[57] Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury) para.3.4.

[58] See Adolf, Berle A., For Whom Corporate Manager Are Trustees: A Note, 45 *Harv. L. Rev* (1932) p. 1365; see also Proctor, Giles & Miles, Lilian, Cutting the Mustard: Stakeholders in the Boardroom? 19 *B.L.Rev* (1998) p. 172.

[59] See for example, Committee on Corporate Governance: Final Report (the Hampel Report) para 1.16 provides "single overriding objective…is the preservation and the greatest possible enhancement over time of the shareholders investment"; see also Davies, *supra* not 54, p. 602.

[60] See Dodd, E., For Whom Are Corporate Managers Trustees? 45 *Harv. L. Rev* (1932) p. 1145.

[61] Millon, *supra* note 45, p. 236.

[62] E. M. Dodd, For Whom Are Corporate Managers Trustees? 45 *Harv.L.Rev* (1932) p. 1148; see also Coffee, John C., Shareholders Versus Manager: The Strain in the Corporate Web, 85 *Mich. L. Rev* (1986) p. 84.

shareholders but also the interests of the company's non-shareholders, such as creditors[63] and employees.[64]

The interests of non-shareholders in any JSC cannot be ignored; they play major roles in their companies, therefore, they are fully capable of protecting their interests in the company. However, this does not mean they are in the same position as shareholders. Shareholders bear the risk of venture failure; they are paid at the end, after creditors, employees, and others who have fixed claims, and shareholders in a JSC have the residual claim because they get what is left over.[65] Consequently, many scholars, such as F. Easterbrook and D. Fischel, describe the shareholders as "residual risk-bearers":

> We believe...that shareholders are residual claimants to the firm's income. Bondholders have fixed claims, and employees generally negotiate compensation schedules in advance of performance. The gains and losses from abnormally good or bad performance are the lot of the shareholders, whose claims stand last in the end.[66]

Because of the special position of shareholders as "residual risk-bearers", company legislation universally mentions them more than any other participants in company law, and gives them many rights that the others do not enjoy. For instance, the right to attend and vote in a GM, the right to file a case against the board of directors in some circumstances on behalf of their company,[67] and the right to remove the board of directors from their office by ordinary resolution.[68] There are many other

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[63] See *Lonrho Ltd v. Shell Petroleum Co.* Let [1980] 1 WLR 627.

[64] UK CA 1985, S. 309.

[65] Cheffins, Brian R., *Company Law: Theory, Structure, and Operation*, Oxford: Clarendon Press, (1997), p. 54.

[66] Easterbrook, F. & Fischel, D., Voting in Corporate Law, 26 *J. L. & Econ* (1983) p. 403.

[67] See *Foss v. Harbottle* (1843) 2 Hare 461.

[68] UK Company Act 1985, S.303.

matters for which the approval of shareholders in the GM is required. Consequently, according to the legal provisions, shareholders have real power over corporate affairs but their real involvement does not agree with the legal role that they have.

If there are many interested groups, and shareholders comprise one of these groups, enjoying a special position in the company, should the law protect the interests of those other than shareholders? In fact, there are many ways in which their interests could protected. In respect of employees of JSCs, their interests could be protected by statute. In the State of Kuwait, the Labour Law protects the rights of employees in the private sector and here in the UK, S.309 (1) of the CA 1985 provides that:

> Matters to which the directors are to have regard in the performance of their functions include the interests of the company's employees… .

This means that the board of directors should keep in mind the interests of employees. So, if directors fail to take into account the employees' interest they will be in breach of their fiduciary duties to the company.[69] Also, there are usually many provisions that arrange the position of creditors of the company and protect their rights, for example Article 128 of the KCL provides that:

> Representatives of the debenture holders may attend the GMs of the company; the company shall send to them the same notice of meetings which it sends to the shareholders; such representatives may take part in the deliberation but may not vote.

Furthermore, there are many provisions and cases demanding that the board of directors include the interests of the company's creditors among their duties. Take for

[69] However, in the UK, they are arguing that S.309 is "statutory provision without teeth". Because this section does not specify the interest of the employees that must be protected, and it does not give the employees the right to sue the directors even if they prove that directors did not have regard to their interest; for more information see Villiers, Charlottee, Section 309 of the Companies Act 1985: Is it time for a reappraisal? *Legal regulation of the employment relation* (2000) p. 593.

example, the case of *Lonrho v. Shell Petroleum Co Ltd*[70]. In this case Lord Diplock explained that the board of directors of a company have to act in the best interest of the company and said:

> These are not exclusively those of its shareholders but may include those of its creditors.

Furthermore, every State should always have laws to protect anyone who has any kind of relation with a company, e,g., an Environment Law to protect the environment from pollution and a Consumer Law to protect customers of the company. Finally, according to the theories mentioned above, the relationship between the company and its non-shareholders is contractual; thus, their interests should be protected by these contracts that link them with their companies.

In the previous sections the position of shareholders in JCSs was identified in order to understand the powers and rights they enjoy in the companies. However, the shareholders are not the main players in the JSCs. There are also those who control the affairs of the companies. The next section of this chapter will concentrate on the distribution of powers between shareholders and directors.

2.5 Shareholders and the Board of Directors: Distribution of Powers

A company, as a creature of a commercial contract or the State or both, is an artificial person. It is an independent legal person, it owns its property, has rights and obligations, and it has a separate identity from its directors and shareholders. This legal person acts through two main organs. These organs are the shareholders in the

[70] [1980] 1 WLR (HL) 627.

GM and the board of directors. Each organ has obligations to the company, they have to work together to achieve the company's aims. The board of directors' duty is to manage the company. Shareholders in GMs have a number of duties toward the company. Greer L.J. provided in *John Shaw & Son Ltd v. Shaw*[71]

> A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in the GM. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove they can remove the directors now by ordinary resolution according to CA 1985, s.303). They cannot themselves usurp the powers which by articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.

However, legal tradition everywhere divided the powers in JSCs between the two main organs, the directors and the shareholders. Therefore, some powers are exercised by the board of directors and some powers may be reserved for the shareholders in the GM.

2.5.1 Board of Directors

As mentioned at the beginning of the chapter, there are two theories about the nature of JSCs in civil law countries. Each theory with its ideology on the nature of the relationship between the board of directors and shareholders has raised much controversy between law scholars. Supporters of the contractual theory have said that a company is a contract, created by agreement between a group of people. Thus, a company owes its existence to a contract between individuals. This theory treats

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[71] [1935] All E. R. 456 at 464; Powell-Smith, Vincent, *The Law and Practice Relating to Company*

directors of the company as agents of the company. The company, as a principal, determines the authorities of the agents.[72] Supporters of the institutional theory say that a company is a creature of the State, and that it has many organs. The board of directors is one of these organs. Thus, the board of directors is connected with the company by legal ligature, and directors of the company have their authorities or powers from the law of the State and have not formed a contract that created the company.[73]

The KCL does not define a director, nor does it specify the nature of the role of a director in a company, is he an employee, agent or trustee? Furthermore, there are no special provisions that manage the relationship between the company and the board of directors. Therefore, we restored the provision of an agency in the Civil Law in order to explain this kind of relation; Civil Law treats this relation as a relationship between agent and principal.[74]

According to the KCL, directors need no special qualifications for office. In other words, anyone can be a director. There is no educational requirement. It could be argued that it is one of the shareholders' rights and in the interest of the company that directors should comply with certain qualification requirements. It should not be agreed that if shareholders appoint unqualified or bad directors, they must take the consequences.[75]

Directors, London: Butterworths, (1969), p. 102.

[72]Al-Shemmari, Tammah, *The Board of Directors of Joint Stock Company: Comparative Study Between Law of Kuwait and the Laws of USA*, 1st edn, (1987), p 102- 3; See also Radwan, *supra* note 1, p. 451.

[73] *Ibid.*

[74]Abou Zied, Radwan, *Joint Stock Companies and Public Sector*, Cairo: Dar Al-fker Al-Arabi publishing, (1976), p. 41.

[75] See Neville J. in *Brazilian Rubber Plantation and Estates Ltd* [1911] 1 Ch. 425 in this case it provided that "a director is, I think not bound to bring any qualifications to his office. He may

The directors are those who manage the company. They run the company for the benefit of the company as a whole, as Article 138 of the KCL.

The Kuwaiti legislature in above article decided that the powers of management are vested in the directors, and they alone can exercise these powers. In other words, the board of directors is responsible for carrying out the day-to-day business of their company and shareholders should not intervene in management affairs.

The KCL has defined the powers the board of directors have and the rights of shareholders. In article 146of the KCL Kuwaiti legislature gives the board of directors very wide powers for managing their company in order to achieve the company's objectives. Therefore, the board of directors' duty is all of the managerial functions, such as performing business of the company, dealing with the outsiders and suing in the name of the company.

However, Kuwaiti legislature has imposed four compulsory restrictions on the powers of the directors that must be respected, otherwise they will be Ultra Vires and responsible for what they have done. First, directors should work within the objectives of the company as determined in Memorandum and Articles of Association.[76] Therefore, the board of directors should carry out their duties within these objectives. In other words, the board of directors cannot engage in activities that were not expressed in the object clause of the company. Second, the board of directors should obey the provisions of Company Law that place restrictions on directors. For instance, Article 151 in the KCL says that any member of the board of directors, directly or indirectly, may not have any personal interest in any contract or transaction made with

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undertake the management of a rubber company, in complete ignorance of everything connected with rubber without incurring responsibility for mistakes which may result from such ignorance."

[76] Radwan, *supra* note 1, p. 449.

the company unless these interests are expressly authorised by a GM of the company.[77] Third, the board of directors should do their duties within the powers given to them under the Memorandum and Articles of Association. Fourth, the board of directors has to obey the resolutions of the GM of shareholders. A GM can impose some restrictions upon the board's powers.

In UK companies, the division of powers between the board of directors and the shareholders in a GM depends entirely on the constitution of the company (the Memorandum and the Articles of Association). Where some powers are vested in the board, the body of shareholders in the GM cannot interfere in the business of the board unless the board is working contrary to the provision of the Company Act or the constitution of the company.[78] In addition to the constitution of the company, Article 70 of Table A[79] grants the board of directors the power of management of the company and provides:

> Subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company...

This provision provides that the board should manage the company, and it may exercise all the powers it has to execute its duties. However, the board should never act inconsistently with the provisions of the Companies Act and Articles of Association; also, it is subject to the directions given by special resolution. The affairs of the management of the company can be exercised only by the board of directors.

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[77] See also Articles 139, 140, and 162 of the KCL.

[78] See *John Shaw & Son Ltd v. Shaw* [1935] All E. R. 456 at 464; also see *Scott v. Scott* [1943] 1 All E. R. 582.

[79] The Companies (Tables A-f) Regulations 1985 (which were made using powers in Sections 3 and 8 of the Companies Act 1985) specify forms of memorandum and forms of articles for the different categories of registered companies. Table A sets out articles for the commonest category of registered

The board, therefore, should always practice its powers entirely free from the interference of shareholders or the GM. Thus, in *Automatic Self-Cleansing Filler Syndicate Co. v. Cuminghame*,[80] the company's Article of Association contained a provision similar to Article 7, of Table A; it required any intervention by the GM of the company to be by extraordinary resolution. Nevertheless, during one of the GMs of the company, an ordinary resolution was passed ordering the board of directors to sell the company's undertaking to a new company. The board refused to execute the resolution. The court held that the GM had no power to interfere with the board's power of decision.[81]

Directors are like trustees of the company's property under their control. Therefore, they owe a duty of good faith to the company.[82] At the same time, directors could be treated as agents of the company; they work on behalf of the company.[83] Hence, the acts of the board of directors become the acts of the company, and when they work within their authority they bind the company (see *Northern Court Securities Ltd v Jackson and Steeple Ltd)*.[84] However, directors of registered companies are not regarded as delegates of shareholders; shareholders cannot hold a meeting to tell the

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company-a company (public or private) limited by shares.

[80] [1906] 2 Ch 34.

[81] *Boyle & Birds' Company Law*, 4th edn, in John Birds and Eilis Ferran and others (eds), Bristol: Jordan publishing, (2000), p. 471.

[82] Sealy, L., The Director as Trustee, *C. L. J* (1967) pp. 86-7; However, we have to admit that directors are not trustees in the full technical meaning of trusteeship. For example, when directors manage their company they must take risks and the true nature of trust does not have something like this.

[83] Cheffins, *supra* note 65, p. 45.

[84] [1974] 2 All ER 625.

board of directors what to do during management of company. *A Buckley L J provided in Gramophone & Typewriter Ltd v. Stanley* [85]

> The directors are not servants to obey directions given by the shareholders as individuals; they are not agents appointed by and bound to serve their shareholders as their principals. They are persons who may by the regulations be entrusted with the control of the business, and if so entrusted, they can be dispossessed from that control only by the statutory majority which can alter the articles. Directors are not, I think, bound to comply with the directions even of all the corporators acting as individual.[86]

However, the directors should always act in the best interests of the company as a "bona fide rule". This rule can be seen in many cases.[87] Therefore, they always have to ensure that any transaction that they undergo is for a proper purpose. In *Smith & Fawcett Ltd, Re*[88] "They (directors) must exercise their discretion bona fide in what they consider — not what a court may consider — is in the interests of the company, and not for any collateral purpose." Therefore, directors will be at fault if they do not act in the interests of the company or if they act for an improper aim.[89]

2.5.2 Shareholders

Shareholders in JSCs, through the medium of GMs, also have important powers in their company. The most significant powers retained by them at a GM in the KCL

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[85] [1908] 2 KB 89, CA, at pp. 105-6.

[86] See similarly in *Regal (Hasting) v Gulliver* [1942] 1 All E.R. 378, 387, Lord Russel said "Directors of a limited company are the creatures of statute and occupy a position peculiar to themselves. In some respects they resemble trustees, in others they do not. In some respect they resemble agents, in others they do not"

[87] *Alexander v. Automatic Telephone Co.* [1900] 2 Ch 56.

[88] [1942] 1 All E. R. 542 at 543.

[89] See *Hogg v Cramphorn Ltd* [1967] Ch 254; see also Worthington, Sarah, Corporate Governance: Remedying and Rarifying Directors' Breaches, 116 *L. Q. R* (2000) p. 638.

are: they have the right to elect the board of directors and auditors;[90] they have the power to remove directors;[91] and they have the power to fix their remuneration if it is not fixed in the Article of Association.[92]

The KCL provides in Article 131 the rights of members of a JSC:

> A member shall in particular have the following rights; (c) To take part in the management of the company business whether the same is in the GMs or in the board of directors, according to the Articles of Association... .

In this provision, the legislature states that shareholders have a role in the management of the company. However, the legislature does not explain how to "take part in the management" and how shareholders can play this role. The Kuwaiti legislature should in a direct way give the shareholders the right to inspect the books and records of their company.[93] This contrasts for example, with the Company Law of Saudi Arabia, which gives the shareholders the right of access to the books of accounts and all pertinent documents of the company.[94]

The KCL provides in Article 148:

> (1) The chairman of the board and the directors are liable to the company, to the shareholders and to third parties for all acts of cheating and misuse of powers as well as for any violation of the law or of the articles of association and for any fault in the management.
>
> (2) A ballot by the GM discharging the directors of liability shall not bar the initiating of proceeding for liability.

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[90] Article 157(4) of the KCL.

[91] *Ibid.*, Article 152 provides "the GM may dismiss the chairman or any member of the board upon a proposal being made by the absolute majority of the board or upon application signed by a number of shareholders who hold not less than one-quarter of the capital subscribed for"

[92] *Ibid.*, Article 157(4).

[93] Tamma, *supra* note 6, p. 468.

[94] See Company Law of Saudi Arabia Article 108(5).

According to this article directors will be liable, i), if they have done any act contrary to the KCL or other law of the State; ii) if they exceed the powers and role granted to them in the Articles of Association, and iii) when they have committed any fault in the management of the company. Therefore, shareholders, according to this article, may file a liability lawsuit against the board of directors for cheating, breaking the law, and bad management (see chapter 8). The GM, voting to release the board of directors from their liabilities, cannot prevent this right.

Besides this, Kuwaiti legislature has imposed conditions on the GM for the benefit of shareholders. These conditions are very important when the GM is under the control of the board of directors.

Furthermore, the KCL provides in Article 133:

> (1) The shareholders' GM may not: (a) Increase the financial charges of a shareholder nor increase the nominative value of a share; (b) Reduce the percentage of the net profits which must be distributed to the shareholder as determined by the company's articles of association; (c) Impose new conditions other than those set forth in the articles of association, which relate to the competency of a shareholder to be present and vote at the GM (see chapter 7); (d) Restrict the right of a shareholder to institute proceedings against all or a number of the directors claiming damages according to the law; (see chapter 8)
>
> (2) However, a deviation from the above provision is permissible with the written consent of all the shareholders, or by a unanimous vote in which all shareholders participate"

This article is one of the most important articles for the protection of shareholders. It is very clear from this article that Kuwaiti legislature has intervened to protect the shareholders of the company. Also in this article, the Kuwaiti legislature has laid down a line that cannot be crossed in the company until written permission is received from all shareholders. This intervention from the legislature in the affairs of JSCs imposes these conditions on the authorities of GM because, arguably it is well known that GMs of many JSCs have become like family meetings – cosy places to make the directors' actions legal, instead of being the forum in which shareholders may practice their rights. Therefore, it is unacceptable according to the KCL for the GM to impose new conditions on shareholders other than the conditions that are usually mentioned under the Articles of Association. The GM may not add financial burdens or increase the nominal value of the shares, and it may not reduce the dividends that must be distributed as determined by the Articles of Association. Furthermore, the GM may not impose new conditions other than those mentioned in the Articles of Association relating to the competency of the shareholders to attend and vote in the GMs. In addition, it may not restrain the shareholders' right to file a lawsuit against the directors for compensation for any damages they have suffered. At the end of that article, the legislator stipulates that these conditions may only be exceeded with the written consent of all the shareholders of the company or by the "unanimous" vote of all the shareholders.

In the UK, on the other hand, shareholders in the GM of the company are given a large number of powers, which cannot be exercised by the directors. These powers, reserved to the shareholders in a GM by the UK CA 1985, include: the right to alter the Memorandum[95] and Articles of Association,[96] to alter the share capital,[97] to alter the object of the company,[98] to decide not to call the uncalled share capital,[99] to

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[95] The UK CA 1985 S. 307(1).

[96] *Ibid.*, S. 9(1).

[97] *Ibid.*, S. 121.

[98] *Ibid.*, S. 4.

[99] *Ibid.*, S.120.

authorise substantial property transactions with directors,[100] to dismiss directors,[101] and many others.

Consequently, in general, every JSC acts through two bodies. The first is the board of directors, and the second is the GM of shareholders. Each organ has exclusive powers, in theory at least, and legislature, legal committees and legal scholars of Company Law always try to balance the power between them. For example, this balance of power can be found in the Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury) in its definition of Corporate Governance in para 2.5:

> Corporate Governance is the system by which companies are run. At the centre of the system is the board of directors whose actions are subject to law, regulations and the shareholders in a GM. The shareholders in turn are responsible for appointing the directors and the auditors and it is to them that the board reports on its stewardship at the Annual GM.[102]

In fact, the way of controlling a company, and the balance of power between the board and shareholders to prevent directors from entering into unauthorised transactions, exists only in theory or on paper – the reality is very different. JSCs nowadays resemble a country on its day of independence, when it announces that it will be democratic. As is known, every democratic country has three powers, each separate from the other, and each cannot interfere in business belonging to other

[100] *Ibid.*, S. 320(1).

[101] *Ibid.*, S. 303.

[102] In the same report see also para. 6.1 which provides "the formal relationship between the shareholders and the board of directors is that the shareholders elect the directors, the directors report on their stewardship to the shareholders and the shareholders appoint the auditors to provide the external check on the directors' financial statement. Thus the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress"; see also Villiers, Charlotte and Boyle, George, Corporate Governance and Regulation, in Laura Macgregor, Tony Prosser and Charlotte Villiers (eds.), *Regulation and Market beyond 2000*, Ashgate: Aldershot, (2000), p. 221-242.

authorities. The country, when it established its associations, in reality, allows the government to play two different roles: the role of the executive authority (original role), and the role of the legislative authority. In many JSCs the same thing is happening. The boards of directors in many JSCs are effectively playing two roles – that of the GM and their original role. Therefore, the annual GMs of many companies become the place where the board of directors legality their work of the last year. Whilst, the role of the shareholders becomes merely that of putting money into the company (see chapter 7).

The question that must be asked is why the actual participation of shareholders in the company's affairs does not match the powers they have in the company. There are many reasons for this indifference shown by the shareholders toward the company's affairs. The most important are: First, the limited liability that the shareholders enjoy reinforces this indifference because each member knows that the most he may lose is what he has paid. Second, the huge sum of the company's capital compared with the amount of money the shareholder is investing causes the shareholder not to attend because he does not expect his vote to have any influence. In addition, in large companies the shares are so widely dispersed that any group of shareholders will find it very hard to control what the directors do. Furthermore, the way for of a shareholder to get out of the company and terminate his membership at any time is by selling his shares. Finally, a large number of the shareholders are, in fact, speculators and they will sell their shares directly when the market value of their shares goes up. As a result of this indifference, the board of directors effectively enjoys powers far wider than the powers that directors are given by the legislature and the Articles of Association (see chapter 7).

2.5.3 Residual Power

If every company has two main organs which of these two organs has the residual power? In fact, shareholders through the GM have the residual power in the company. This is because the GM is the superior power in the company. For example, the GM is generally regarded as having the power to act in place of the board of directors if for any reason the board cannot act, and is unable or unwilling to carry out their duties as a board of directors.[103] Besides, when the board of directors act outside its authority, it needs a resolution from the GM of the shareholders in order to legalize the board's actions.[104] Furthermore, the Articles of Association, which is one of the sources of power to the board of directors and GM, can be altered by the shareholders in the GM.[105] Moreover, shareholders in the GM may, in limited circumstances start an action on behalf of the company if the board of directors are unwilling or refuse to start it for any reason (see 8.1.2). Finally, the board of directors are appointed and dismissed by shareholders in the GM.[106] Therefore, the directors and the powers vested in them are subject to the GM and its resolutions if it is within the law and the Articles of Association of the company.

In fact, these powers are just examples of a shareholder's power in the company, and many powers will be discussed in the rest of the research to give a clear impression

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[103] See *Foster v. Foster* [1916] 1 Ch 532; *Barron v. Potter* [1914] 1 Ch 895 in this late case, the company had two directors who were given power to appoint additional director. The company's business came to a stop because one of the directors refused to attend any board meeting at which the other director was present. Warrington J. said "If directors having certain powers are unable or unwilling to exercise them – are in fact a non-existent body for the purpose – there must be some power in the company to do itself that which under other circumstances would be otherwise done. The directors in the present case being unwilling to appoint additional directors under the power conferred on them by the article, in my opinion, the company in GM has power to make the appointment"; see also S. 384(3) of the UK CA.

[104] See *Bamford v. Bmford* [1970] Ch 212, [1969] 1 All ER 969.

[105] See Article 158 (1) of the KCL.

that shareholders, through the GM, are the residual power in the company. These powers need to be activated by shareholders if they want to act in their company as owners or at least as the main interested group. Unfortunately, most of the shareholders are uninterested in involve themselves in the affairs of the company, which gives the directors the right to play all of the roles in the company.[107]

2.6 Conclusion

According to the KCL, it cannot assure that the Kuwaiti legislator has adopted one of these theories in complete. It may be noticed that the contract substance exists in this law. But this contract has a special nature as we have previously mentioned in this chapter. This law also gave the State represented in the MCI a significant role in establishing and monitoring the companies -especially JSCs. Therefore, arguably, it can be said that the Kuwaiti legislator has adopted a mixed system, and did not adopt one theory. Hence, the company is managed in the method specified in its memorandum of association, which means its constitution. This management shall be under the surveillance of shareholders and Ministry of Commerce, which play a remarkable role in monitoring these companies, in order to make sure that the board aims at accomplishing the declared objectives of the company, and that shareholders' and investors interests are maintained, and not violated. In course of the state's performance of this role, it is in fact preserving the stability of its economy, strengthening the same and directing its wheel in the right direction.

If the companies need large authorities regarding managing the same, they shall be organising their constitution. This matter is required by the commercial life which shall be flexible and quick. In the same time, this important and vital sector cannot be left completely to these companies without a balanced surveillance which does not

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[106] See S. 292 of the UK CA 1985 and 152,157 of the KCL.

affect the flexibility required in the commercial markets. Taking what has occurred in the United States as the best example, as the federal government has intervened when they found out that there is manipulation, corruption and illegal violations committed by executive managers and auditors in these companies (such as Worldom and Eron), which led to large losses, and to negative results that affected the American economy. Thus, the state can intervene as happened in the largest economies in the world at all, which is the United States', as state's interference can be in the interest of shareholders and companies in general. Therefore, the State intervention is sometimes justified since intervention will ensure that resources are allocated to more highly valued uses, thereby increasing aggregate social welfare.[108]

Both the above theories place shareholders in a different position. The contractual theory treats them as the owner of the company. Therefore, the company should be managed in their interest first, and as owners of the company they should enjoy a wide range of powers and rights. The institutional theory treats the shareholders as one of a number of organs in the company. Therefore, shareholders have a limited number of powers and rights that are mentioned in the Company Law. In fact, both assumptions about the position are rejected. The companies in all Companies Acts around the world are independent legal persons, and they own their assets, and shareholders are the owners of the company's shares, and the ownership of shares endows them with a number of powers and rights. The source of these powers and rights are the constitutions of the companies and the Company Statutes.

This position has been given to the shareholders to create some sort of balance of

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[107] See *Isle of Wight Rly Co v Tahourdin* (1883) 25 Ch D 324.

[108] Cheffins, *supra* note 65, p. 126.

power between them and board of directors, as provided above. However, this alleged balance of power only exists theoretically. This is because the role and position of shareholders in the KCL is not sufficiently clear. Therefore, most of the shareholders do not get involved as required in the company's affairs. If the role of shareholders as inspectors and monitors lessened or even ceased to exist, this could have a negative impact on the management of the company and damage the shareholders.

In the end of this chapter the body of shareholders is one of the main two organs in any JSC. The question that must be asked in the next chapter is how a person becomes a shareholder? If the answer is when he gets a share. Than what is the definition of a share? The next chapter will focus on the definition of share and shareholder; how a person becomes a shareholder and how he loses this status and the kinds and classes of shares and shareholders.

Chapter Three

Definition of Share and Shareholder

3. Introduction

As discussed in chapter two, knowing the position of shareholders in the JSCs helps to identify their role and rights. Also, to identify the position of shareholders, it is relevant to study the matter of shareholders' rights and to know that a person becomes a shareholder when he owns a share in a JSC. As a shareholder, he or she enjoys a number of rights. Also, a JSC may grant different rights with different classes of shares. The questions that should be asked here in this chapter are; what is the definition of a share and a shareholder? What are the characteristics of a share? What are the types of shares? How does a person become a shareholder, with a number of powers and rights? When does a person lose his position as a shareholder? The answers to all these questions will help to assess the matter of shareholders' rights. Therefore, this chapter will concentrate on the definitions of the share and shareholders.

This chapter is concerned with the shares and shareholders of a JSC. Before tackling the main issues of this research, it is important to examine a few things under KCL No. 15/1960. First will be the definition of a share, this will be followed by the characters of shares and types of shares. Next the definition of the shareholder will be given, i.e. the person who becomes a member of a JSC until his or her membership is terminated.

3.1 Definition of a Share

There is no definition of a share in the KCL. The legislature of Kuwait has left this matter to scholars of company law who have given various definitions. A person becomes a shareholder when he or she owns a share, so what is a share? Answering this question will be helpful in understanding the definition and position of shareholders. The share capital of a JSC represents the total amount of contributions in cash or in kind made to the company in return for issues of its shares. A share is a shareholder's portion of the company's capital and is, in the meantime, the supporting document of the shareholder.[1] Also, a share is defined as a fraction of the capital expressing the holder's proportionate financial stake in the company. According to the above definitions, every shareholder owns a part of the company's capital. Consequently, the shareholders of the company are the owner of the capital of the company. This result is not acceptable nowadays, because every company is in fact a separate legal person. Rather, a share represents a shareholder's interest in a company and entitles him to enjoy certain rights, such as dividends and sharing the remaining assets of the company upon dissolution.[2]

In the UK, the common definition of a share is that of Justice G. Farwell in the case of *Boland's Trustee V. Steel Brother & Co Ltd* (1901) 1 Ch 279 at p. 288.[3] A share, according to Justice Farwell, means the shareholder's interest in the company evaluated in an amount of money. Such an interest makes the shareholder both

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[1] Abu Zaid, Radwan, *Commercial Companies in the Kuwaiti Law*, 1st edn , Cairo: Dar AL-Fker AL-Arbi Publishing, (1978), p. 403.

[2] See Worthington, Sarah, Shares and Shareholders: Property, Power and Entitlement part 1, 22 *Co Law* (2001) p. 258; Mahmoud, Al-Sharkawi, *Commercial Companies in Egyptian Law*, Dar AL-Nhdah AL-Arbai Publishing (1986), p 167.

[3] *Gower's Principles of Modern Company Law*, Davies, Paul L (ed.), 6th edn, London: Sweet & Maxwell Publishing, (1997), p. 300.

responsible on the one hand and a titleholder on the other. A share also implies a series of reciprocal undertakings made by all shareholders among themselves as contained in the company's Articles of Association. A share is not an amount of money but an interest measured by a sum of money, based on the various rights contained in the Memorandum, including the title to an amount of money more or less than the share's value. Therefore, shares are bundles of contractual and statutory rights which the shareholders have against the company. Pennington commented on the concept of share;

> A concept of share in these terms is incomplete, because many of the important rights and obligations of a member of a registered company under the present law are conferred or imposed on him, not by the statutory contract, but directly by the Companies Act 1985, itself. Nevertheless, if account is taken of such statutory rights and obligations and they are aggregated with the members' rights and obligations under the statutory contract, the whole complex of member's right and obligations constitutes his shareholding. It follows, therefore, that because such right and obligations are the components of shares, and not distinct items of property or limitations imposed on a separate item of property (ie the funds paid to the company in consideration of the issue of shares), shares cannot themselves be subject to rules of law which invalidate certain dispositions of property, such as the rule against perpetuities. Dispositions of shares which already exist are, of course, subject to those rules of law, because shares are items of property, but the constituent contractual and statutory rights which together make up shares cannot be.[4]

According to Pennington's view, shares of a registered company are a species of intangible movable property, which comprise a collection of rights and obligations relating to an interest in a company of an economic and proprietary character, but not constituting a debt (see 2.4).[5]

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[4] Pennington, Robert, Can Shares in Companies be defined? 10 *Co. Law* (1989) p. 144.

[5] *Ibid.*

3.2 Share Features

If a share is an interest of a shareholder in the company evaluated in an amount of money, what are the features of the share? And what are the rights that may be given to the shareholders as a result of these features? A number of features will be discussed in this section. These include share transferability, the equal nominal value of shares in Kuwait, indivisibility of the share and limited liability.

3.2.1 Share Transferability

The transferability of shares is the most important feature that encourages many people to participate in this kind of company. Therefore, share transferability must neither be completely prohibited nor restricted except for consideration of higher economic interest on a temporary basis. The KCL pointed out very clearly this feature in Article 63 that provides "A JSC is formed by a number of persons who subscribe for negotiable shares".

The shareholders have, by virtue of their ownership of shares, the right to transfer them. Therefore, a shareholder can do what he or she wishes with his or her shares such as sale, donation, will, or mortgage. Shares can be transferable on the Kuwaiti stock exchanges through stockbrokers only after they have been admitted to the official stock list (see 4.1).[6]

[6] The companies listed in the Kuwait Securities Market are divided into eight sectors which are: first, the banks sector, second, the investment sector, third, the insurance sector, fourth, the real estate sector, fifth, the industrial sector, sixth, the services sector, seventh, the food sector, eighth, the non-Kuwaiti companies sector.

3.2.2 Shares are of Equal Nominal Value

Shares of JSCs under the KCL are of equal nominal value. Shares of different nominal value may not be issued according to the KCL. This is stipulated in Article 99 which provides "The capital of a company shall be divided into equal shares the nominal value of each of which is not less than 100 fils nor more than 75dinar". Article100 of the KCL provides also that "Shares shall be issued at their nominal value and may not be issued at lower value."

The nominal value of the share is the amount of money that must be paid to the company to say that it is fully paid. There are two justifications for this article. First, according to the KCL, there is just one category of share (ordinary share); therefore, it is normal for the shares of companies to be of equal nominal value. Second, the Kuwaiti legislator appears to aspire to attaining equality of rights between shareholders (especially when all shareholders have one kind of share) with respect to the attendance at the company's GMs and decision-making, distribution of profits among shareholders, and equality in bearing liabilities resulting from shareholders' possession.[7] The equality among shareholders is also clear in other articles in the KCL such as Article 156 that provides "Every shareholder shall have a number of votes equal to the number of his shares" (see 7.3.5). Article 131of the KCL provides:

> A member shall in particular have the following rights: (a) to receive the profits and interests, which are determined to be distributed to the shareholders; (b) to recover a share of all the company assets upon the liquidation of the company.

There should be a distinction between the share's nominal, commercial, and actual value. The nominal value means the value paid for a share upon subscription, the value of which in Kuwait shall be a minimum of 100 fils (about 20 pence) and a maximum of KD 75 (£150) in accordance with Kuwait law.[8] The commercial value means the share's value on the stock exchange market.[9] This value is determined by several factors including the company's dividends, assets, the strength of its financial position, and its project success.[10] There are also external factors, which would contribute to the determination of the share's commercial or market value, namely local and international economic and political circumstances as well as the investor's speculations.[11] The actual value is the value of the company's net assets upon liquidation thereof and deduction or settlement of its debts. After the company's dissolution, and liquidation and settlement of its debts, the actual value of a share of the company's net assets can be determined.[12]

3.2.3 Indivisibility of the Share

Share indivisibility means that a single share may be the joint property of several persons, for whatever reason such as donation and inheritance and wills. In this event, none of the joint owners exercises his proprietary right separately. For example, one of the joint owners cannot claim a separate instrument representing his individual right. The joint owners cannot each request payment of the dividends of part of the capital to which the share is entitled. In addition, they cannot all attend the GMs of the

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[7] Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 1st edn., Kuwait: Author Publishing, (1999), p. 307; see also Mahmoud, Al-sharkawi, *Commercial Companies in Egyptian Law*, Cairo: Dar AL-Nahdah Publishing, (1986), p. 198.

[8] Article 99 of the KCL.

[9] Radwan, *supra* note 1, p. 406.

[10] *Ibid.*,

[11] Taama, *supra* note 7, p. 308.

company.[13] These persons should either select one of themselves or a third party to represent them before the company while the rest of the partner(s) remain jointly responsible for the obligations resulting from ownership of their share.[14] A share is indivisible as clearly stipulated in Article 99 of the KCL, which provides:

> A share is indivisible: two or more persons may co-own a share where one person must represent them vis-à-vis the company: the co-owners (of the shares) shall be jointly liable on obligations derived from the said ownership.

Therefore, while a share can be owned by a number of persons, they cannot all practice the rights of this ownership. Also, a person may not subscribe or be the holder of part of a share of the company. The reason for a share's indivisibility is to facilitate the exercise of its right towards the company, especially voting rights at GMs, as this right is indivisible.

The UK CA 1985 directly provides in s. 2(5) b "No subscriber of the memorandum may take less than one share".

This means that no one can subscribe for a part of a share; thus, a shareholder shall not be a holder of a part of the share. Furthermore, Table A, Article 55 in the UK provides for jointly held shares:

> In the case of joint holders the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holder; and seniority shall be determined by the order in which the names of the holders stand in the register of the members.

Here, according to Article 55 mentioned above, shares may be allotted to two or more persons jointly, and will be registered in their names; the first named in the

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[12] *Ibid.*

[13] Mustafa, Kamal, *Commercial Companies*, Cairo: Dar Al- jama Al-jadeeda Publishing, (1998), p. 194.

register is entitled to a share certificate, a dividend, and to a vote at the general meeting.

The Kuwait National Assembly (hereafter KNA) and the government put forward suggestions for amending the law, which is now under consideration by the Assembly's Financial and Legislative Committee. This proposal suggests adding a new article to the KCL. This article, in line with current international trends, provides that JSCs listed in the Kuwait Stock Exchange (hereafter KSE) may split each share into a number of shares, subject to approval of the Exchange's administration and provided that the company in question has distributed dividends for at least two successive years. The relevant resolution is passed by an EGM of the company in accordance with the regulation set by the MCI.[15]

3.2.4 Limited Liability

One of the most important features of shares in JSCs is the limited liability of the owners. The limitation of shareholders' liability in JSCs helps these kinds of companies to grow because people want this kind of limitation of liability. This feature shifts the risk of business failure from the shareholders to the company itself. Therefore, they prefer to invest their saving in shares of the JSC rather than other kinds of companies. Again, as Hicks provides[16]

> Indeed, if there were no limited liability, such investments would hardly be made at all, except in the public sector. Thus it is not surprising that the building of railways was historically connected with the coming of limited liability.

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[14]Tamma, *supra* note 7, p. 309.

[15] See the proposal Article 99

[16] See Andrew, Hicks, Limited Liability: the Pros and Cons, in Tony Orhnial (ed.), *Limited Liability and the Corporation*, London: Croom Helm Publishing, (1982), p. 12; see also Easterbrook, Frank H., and Fischel, Daniel, R., limited Liability and the Corporation, 52 *the Uni. of Chi. L. Rev* (1985) p. 89.

The basis of this feature is that the shareholders of the company take responsibility for the company's debts if matters work out badly. The company is a separate legal entity and provides some measure of cover for the shareholder. For example, when a company enters into any contract, it enters in its capacity as a separate legal person and not on behalf of its shareholders.[17] Each shareholder shall be responsible for the company's losses to the extent of his own shares as provided in Article 63 of the KCL:

> A joint stock company is formed by a number of persons who subscribe for negotiable shares and those persons shall not be liable for the commitments of the company except to the extent of the face value of the shares subscribed for.

Therefore, when the shareholder pays the whole value of his subscribed shares, he shall not be liable for the company debts and shall have no rights except for those related to profits and the company assets upon liquidation thereof. The limited liability of shareholders in the JSC encourages people to invest their money in these kinds of company since they will not have to use their personal assets to pay their company's debts. Therefore, to ensure limited liability, the Kuwaiti legislator provides that the general meeting of any company cannot make a resolution for increasing the shareholder's liability.[18]

In the UK, the Companies Act of 1985 in S. 2(3) provides that the liability of shareholders must be limited, and this limited liability is one of the important rights of shareholders. Therefore, it cannot be increased under any kind of circumstances.[19] A

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[17]Aubrey, Diamond L., Corporate Personality and Limited Liability, Tony Orhnial (ed.), London: Croom Helm Publishing, (1982), p. 31.

[18] Article 133/1(a) of the KCL provides that "The shareholders' General Meeting may not (a) increase the financial charges of a shareholder nor increase the nominative value of a share."

[19] S. 2(3) of the UK CA 1985 provides "the memorandum of a company limited by shares or by guarantee must also state that the liability of its members is limited."

JSC is a separate legal entity providing some measure of protection for the shareholders[20], and for any of the company's obligations. The separate legal entity of a limited liability company was firmly incorporated by the House of Lords in one of the most important cases in the UK *Salomon v A Salomon & Co Ltd* [1897] AC 22.[21] Therefore, section 25(1) of the UK CA 1985 provides:

> The name of a JSC must end with the words "public limited company" or, if the memorandum state that the company's registered office is to be situated in Wales, those words or their equivalent in Welsh ("cwmni cyfyngedig cyhoeddus"); and those words or that equivalent may not be preceded by the word "limited" or its equivalent in Welsh ("cyfyngedig").

They are required to mention the word "limited" at the end of its name, and they may also use the abbreviation 'Ltd' or the Welsh equivalent. S.33 of the UK CA provides a JSC commits a criminal offence if it gives the impression that it is a private company when it is not.

3.3 Types of Shares

A JSC may grant different rights with different classes of shares.[22] Therefore, the rights of shareholders depend on the kind of shares they have. However, the question that must be asked is why do companies often have different kinds of shares? This can be justified in a number of ways. First, the ordinary shareholders usually have most voting power at GMs, and ordinary shareholders have the largest part of the profits in

[20] Gower's, *supra* note 3, p. 80.

[21] In this case Lord Macnaghten said: The company is at law a different person altogether from the subscribers to the memorandum, and, though it may be that after incorporation the business is precisely the same as it was before, the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the act.

times of prosperity.[23] If new ordinary shares were issued to new shareholders or to existing shareholders, the current balance of power within the company would be disturbed; therefore, existing shareholders may seek to ensure that the company raises its future capital by issuing preference, non-voting shares or debentures.[24] Second, a company may issue different classes of shares to attract different types of investors. An investor may be interested, for example, in preference shares; if the company does not have this kind of share, the investor is not going to invest his money in its other shares. A third possible reason is that when a company wants to raise new capital and the current market price of its existing shares is less than nominal value, the sole practicable method of raising new capital is to issue a new class of share that has preferential rights.[25]

A share may be paid in cash or in kind. For cash shares only 20 per cent of the value of each is paid upon subscription and the rest is paid up within five years of the date of issue of the formation decree.[26] Shares in kind (vendor's shares) must be fully paid. Article 105 of the KCL provides:

> A (share) company may (issue) shares otherwise than in cash: for money's worth or for chooses in action; and the founders (of the company) shall apply to the President of the High Court for appointing an expert to check whether such consideration has been rightly valued. But the evaluation shall not be final until it is sanctioned by a majority in number of the shareholders holding two-thirds of the cash shares (remaining) after excluding the cash shares owned by the contributors –

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[22] Pennington, Robert. *Company Law*, 6th edn., London: Butterworth Publishing, (1990), p. 205 .

[23] J.H. Farrar & B.M. Hannigan., *Farrar's Company Law*, 4th edn, London: Butterworths Publishing, (1998), p. 229.

[24] Pennington, *supra* note 22, p. 204.

[25] *Ibid.*, p. 202.

[26] Article 102 of the KCL provides that "the value of the share shall be paid in cash, either in one sum or by instalments; and the instalments payable on the application shall be (equivalent to) not less than 20% of the value of the share. In all cases, however, the full value should be paid up within five years from the date of the (company's) decree of incorporation."

who shall have no right to a vote in the sanctioning of the evaluation – of that consideration.

The KCL does not recognise shares in kind (such as land, equipment, etc.). However, a founder who desires to contribute in kind must apply to the President of the Competent Court to appoint an expert to verify accurate valuation and seek consent of at least two thirds of the shareholders. Once valuation of the vendor's shares is verified their owner is given nominal shares of an equivalent value as provided in Article 105 of the KCL. The KCL has established this system to ensure accuracy of valuation of shares in kind to protect shareholders. Because, founders usually offer shares in kind and would probably overestimate the value of their contribution in kind.

The main classes of share are ordinary shares, preference shares, deferred shares, and redeemable shares. However, the most common classes are ordinary and preference shares. These two classes are not terms of law; the rights and obligations affixing to ordinary and preference shares may alter from company to company. Usually, the rights and obligations attached to the shares exist in the company's Articles of Association, with the contract of allotment exactly specifying the shares and the rights and liabilities attached.[27]

3.3.1 Ordinary Shares

Ordinary shares are sometimes called equities. If a company has just one class of shares they must be ordinary shares. The holders of ordinary shares are those who

[27] Mayson, Stephen, French D. and Ryan, C., *Company Law*, 15th edn, London: Blackstone Publishing, (1998-99), p. 103.

bear the biggest share of the company's risks.[28] Also, the voting powers in the general meeting are vested in this kind of shares. (see 2.4 and 7.3.4.2)

The holders of ordinary shares have no fixed dividends as with preference shares, but ordinary shareholders get the residual profit of dividends after all preference dividends.[29] In the winding up of a company, after payment of the company's debts and before the ordinary capital is returned, the preference shareholders get the nominal value of their shares.[30] The ordinary shareholders, after the winding up, may get nothing because what is left after paying the company's debts may not be enough to return the nominal value of their shares. However, they may often get the nominal value of their shares when there are surplus assets available after getting rid of all the company's liabilities.

The most important feature of ordinary shares is that the voting powers in the ordinary general meeting or extraordinary general meeting are vested in the holders of ordinary shares. Therefore, the holders of this kind of share play the most important part in monitoring directors' actions.

According to the KCL there is only one kind of share. Therefore, all shareholders have equal rights whether with respect to distribution of profits, division of the company's assets after liquidation, or voting rights. The KCL provides in Article130 that:

> The promoters who have subscribed to the company's Memorandum and Articles of Association, as well as subscribers who have subscribed for its shares, shall be deemed to be members of the company and shall

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[28] Yacoub, Sarkhuwa, *Shares and Negotiation Thereof in the Companies Law*, Egypt: Dar Alnahda AL-Arabia publishing (1982), p. 107.

[29] *Ibid.*, p.103.

[30] Farrar, *supra* note 23, p. 229.

have equal rights and be subject to the same obligations, with due observance of the provisions of the law.

In this article it is clear that the Kuwaiti legislature wanted to grant all shareholders of any JSC equal rights and enable them to be subject to the same obligations.[31] The reason for giving equal rights to shareholders is because, as said above, according to the KCL there is only one kind of share. For this reason, the holders of these shares should enjoy the same rights and be subject to the same obligations.

Ordinary shares do not entitle their holders to any special rights. The holders of this kind of shares get their dividends after the holders of preference shares, who should receive their promised profits according to the Articles of Association of the company or the deal between them and the company. However, ordinary shareholders do not receive a particular amount of money as dividends every year. Their dividends are based on the company's financial position and how much profit the company has made in the last financial year. If the company in the last year was in boom condition, the ordinary shareholders will obtain great profits. However, if the company has not realised any gains, they may receive nothing.[32] When the company goes into liquidation for any reason, the ordinary shareholders may share the remainder of the company's assets after the debts of the company have been paid and after the return of the nominal value of preference shares to its owners.

Some legal scholars treat the owners of ordinary shares as owners of the company, because they provide the main part of the company's capital. However,

[31] Articles 131 and 132 of the KCL concentrate on the rights and obligations of shareholders.

[32] *Gower's, supra* note 3, p. 318.

where there are preference shares, the rights of ordinary shareholders are second to those of preference shareholders.

3.3.2 Preference Shares

A preference share is one to which certain preferential rights are attached. In other words, these shares give their holders priority and certain privileges. These kind of shares are considered a guaranteed investment, particularly in case of the company's expiry. Preference shares, according to the company's Articles of Association, are usually refundable after fulfilment of the company's debt and before the refunding of the ordinary capital.[33]

Preference shares have two main advantages; in other words, they entitle their holders to two rights. First, the holder of these shares is entitled to annual fixed dividend (e.g. 5 percent preference share) when a dividend is declared, and these dividends shall be paid in priority to any dividends that may be paid to other members such as ordinary shareholders. The right to preferential dividends of these shares is cumulative, if no dividend is declared on the preference share in any year, the arrears of dividend are carried forward and must be paid before any dividend is paid on the ordinary shares. For example, if no dividend is declared on 5 percent preference shares in 1996, 1997 and 1998, they would be entitled in 1999 to arrears of 20 percent before the ordinary shareholders were paid any dividend. Second, on the winding up of the company, the holder of preference shares has priority over other shareholders. If we take a look at these two advantages of preference shares we can say that the position of the holder of these shares is like that of a creditor. Usually the holder of a

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[33] Stephen, *supra* note 27, p 100.

preference share does not have voting rights at a general meeting. However, in some countries, such as Egypt, preference shares entitle their holder to more than one vote at the general meeting.

Many Arab legislators in countries such as Syria, Saudi Arabia and Lebanon permit the issuing of preference shares.[34] However, the KCL has adopted a negative attitude towards this type of share. Kuwaiti legislation does not contain any provision permitting or prohibiting issuance of such shares. This matter raises a question about the possibility of the issuance of preference shares in Kuwait. In fact, the Kuwaiti attitude in regard to preference shares is defective. Arguably, a company should not be bound to issue all its shares with the same rights; it should be able to confer different rights on different classes of shares, such as ordinary shares and preference shares.[35]

The UK CA is a good example to follow. In the UK a company may produce different classes of shares, such as the preference share with rights that seem more profitable in order to attract contributions of capital. This attitude is very clear in Table A Article 2 which provides:

> Subject to the provisions of the Act and without prejudice to any rights attached to any existing shares, any shares may be issued with such rights or restrictions as the company may by ordinary resolution determine.

From this article it is clear that a company has been given the power to issue different classes of shares in order to attract contributions of capital.

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[34] Some Arabian countries do not allow the issuance of such type of shares. For example, UAE Company Law in Art.152 (2), and Jordan in Art. 100(c); however, other countries like Saudi Arabia and Egypt do allow the issuance of this type of shares; Article 103 of Saudi Company Law provides "...in the absent of any or to convert common shares to preferred share of stock. Preferred shares may vest their holders with priority in receiving a certain dividend and/or in recovering their paid-in capital upon liquidation, or with any other benefit..."

[35] For more information see Al-Malham, Ahmed, *The Preferences Shares in the Company Law of Kuwait and Comparative Laws*, Kuwait: University of Kuwait Publishing, (2000), p. 79.

This clear failure in the KCL regarding this kind of share, has led the KNA to put forward suggestions for amending the law which is now under consideration by the assembly's financial and legislative committee. One of the suggestions put forward by the KNA is adding a new provision to the KCL through which some of the company's shares may be preference shares and entitle their owners to a portion of the company's dividends before owners of ordinary shares. The suggested provision would give owners of preference shares priority in the company's assets upon liquidation as well as the right to vote and stand for board membership. The suggested article highlights the need for equity of shares of the same type in the terms of rights and privileges. This suggested article is one of the most important provisions that needs to be adopted because it provides shareholders with many benefits, including capital increase as an incentive for investors and shareholders by issuing preference shares instead of seeking loans at such a high cost that the company may be unable to repay and the creditors may file an application for liquidation.

3.3.3 Redeemable Shares

An equity share is one whose holder is not paid its nominal value for the duration of the company, a redeemable share is otherwise, without the need to wait until the company is dissolved or liquidated, as normally is the case. Article 114 of the KCL provides that:

> A company may not buy its own shares without an authorisation to this effect from the general assembly (the company in general meeting) and the purchase price shall be paid out of the voluntary reserve and the value of the shares (purchased) shall be paid in full. Shares so purchased shall be deemed extinguished.

The general rule is that a JSC may not return the nominal value of the shares to their holders until the company is dissolved or liquidated and its assets divided.

However, a company may do so if it fears depreciation of its assets upon termination, and if it operates ships, vehicles, mines, quarries or a public utility under State concession, as all the company's property vested in the State after the agreed period, such as the case in electricity, water and oil companies. Therefore, a JSC under the KCL may buy some of its shares and give redeemable shares to the holders of the shares.

Owners of these shares have the same rights as other shareholders that hold ordinary shares, including dividends and attendance and voting at the annual general meeting. However, they may not recover the nominal value of their shares upon the dissolution and liquidation of the company and division of its assets among the shareholders because they have already redeemed the nominal value of their shares.[36]

For redemption of the company's shares to be valid, the general meeting should approve that the value of the redeemable shares be paid from the voluntary reserve. Also, the value should be paid in full. Moreover, the company should still be in existence. Finally, the company should destroy the redeemable shares and may not re-offer or sell them.

3.3.4 Classification of Shares According to the Form They Take

There are two basic varieties of shares either of which may be issued by a JSC, and either of which, may, in most cases, be requested by the shareholders. They are the nominal share and the bearer share.

[36] Article 115 of the KCL provides that "The company shall grant to the holders of shares bought (by the company) in accordance with the provision of the previous article "enjoyment shares". Holders of enjoyment shares shall be entitled to all the rights to which holders of ordinary shares are entitled with the exception of the right to recover the nominal value of the share upon the liquidation of the company.

A certificate for a share in nominal form contains the name of the shareholder. The share certificate is merely evidence of the title of the named holder. To be transferred to another person, special procedures must be respected and the name of the new holder must be entered in the shareholder's register at the company.

Bearer shares are issued to no named person, they are recognised by their numbers and are considered moveable property, as the bearer is the owner and can be transferred simply by delivery. Therefore, shares of Kuwaiti JSCs must always be registered shares not bearer shares (they are not allowed to issue bearer shares).[37] As a general rule Kuwaiti law does not allow non-Kuwaitis to subscribe for shares in JSCs. Thus, the issuing of bearer shares will allow non-Kuwaitis to be members of Kuwaiti companies.[38] That can be see as a legislative shortcoming (see 3.4.2)

3.4 Definition of Shareholder

The word 'shareholder' means a subscriber to the Memorandum of the company and every other person who agrees to become a shareholder by other means, as will be discussed later in this chapter. In the KCL, Article 130 provides a clear definition of a shareholder in a JSC; this article provides that:

> The promoters who have subscribed to the company Memorandum and Article of Association, as well as subscribers who have subscribed for its shares, shall be deemed to be members of the company and shall have equal rights and be subject to the same obligations, with due observance of the provision of the law.

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[37] The KCL provides in Article 101 "The shares of a (share) company incorporated in Kuwait shall be registered shares; and in companies to which authorisation is given to enlist non-Kuwaiti members, the shares of the Kuwaiti members shall be registered shares. But dividend coupons, the form of and the rules governing which shall be prescribed in the articles of association of the company, may be registered or bearer coupons."

[38] Tamma, *supra* note 7, p. 307.

It is clear that a person becomes a shareholder, according to the KCL, when he or she agrees to subscribe for a number of shares of the company and enters his or her name in the shareholders' register.

A person in the UK becomes a member of a JSC when he or she agrees to become a member and enters his or her name in the company's register. The definition of the shareholder is clear in CA 1985, s. 22 which provides:

> (1) The subscribers of a company's memorandum are deemed to have agreed to become members of the company, and on its registration shall be entered as such in its register of members; (2) Every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company.

According to the above, if a person's name has been entered in the company's register of shareholders it is not in itself enough to make that person a shareholder of the company. The person must have agreed to be a shareholder.

Usually a person becomes a shareholder in one of the following ways.

(1) By subscribing to the company's memorandum;

(2) By applying to the company for an allotment of shares;

(3) By buying shares from a former member; and

(4) By transmission of shares on the death or bankruptcy of a member.

3.4.1 Kinds of Shareholders

There are two kinds of shareholders; natural shareholders and institutional shareholders. Institutional shareholders are companies that invest their capital(s) in a wide variety of securities. Institutional shareholders in the UK hold about 70 per cent of all quoted securities. Therefore, they are treated with significant respect by the boards of directors of the companies in which they have invested. Examples include of major insurance companies, pension funds, banks and building societies.[39]

In Kuwait there are a number of institutional shareholders but, unfortunately no study exists about institutional investors or shareholders in the Kuwaiti market. Therefore, we do not know the extent of the shareholders' power in Kuwait. Moreover, institutional shareholders or investment funds in Kuwait are regulated by the Amiri Decree no. 31/1990, which provides how the establishment of investing funds and the trading of securities are regulated (see 7.4).[40]

3.4.2 Who May Become Shareholders?

Any natural or legal person can be a shareholder in a JSC. Therefore, a company may become a shareholder of another company if its constitution contains a provision that allows it to invest in shares of another company. However, a subsidiary company in the UK, as a general rule, may not hold shares in its holding company as provided in S. 23, unless; the subsidiary was a shareholder of its holding company before 1 July 1948, or the subsidiary held the shares in a holding company before it became a subsidiary. In this case, the subsidiary company may continue to be a shareholder but it cannot vote at the meetings of its holding company.

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[39] See Helen, Short and Kevin, Keasey, Institutional Shareholder and Corporate Governance, in Kevin Keasey and Mike Wright (eds), *Corporate Governance Responsibilities, Risks and Remuneration*, England: John Wiley & Sons Publishing, (1997), p. 23; see also also Stapledon, G. P., *Institutional Shareholders and Corporate Governance*, Oxford: Clarendon Press, (1996), p.19.

[40] Article 6 of the Amiri Decree no. 31/1990 provides "Kuwaiti shareholding companies which part of their responsibilities include investment on the behalf of others, may establish joint financial and real estate investment funds where Kuwaiti and other nationals have the right to participate in – that is after obtaining the permission issued by the Minister of the Commerce and Industry and in compliance with the approval of the Central Bank of Kuwait where the permit clarifies the policy of investing in such capital."

Shares may be allotted to two or more persons jointly, and the shares will be registered in their names, the first person named in the register is entitled to practice the right of the shares. Therefore, he attends and votes and gets a dividend on behalf of the others.

Likewise, minors (persons under the age of 18) may become shareholders in Kuwait unless the articles of the company forbid them. However, the contract of the minors to take shares in the UK is avoided before or within a reasonable time of becoming eighteen.[41]

A bankrupt may be a shareholder of a company. A shareholder does not cease to be a shareholder in his company if he becomes bankrupt. As a shareholder he is entitled to attend and vote at GMs, but usually articles provide that notice of the meetings is to be sent to the trustee in bankruptcy.[42]

Furthermore, the ownership of the shares of a deceased shareholder is transmitted to his executors or administrators (personal representative). The company will recognise the rights of personal representatives on production by an administrator of letters of administration of an estate. A personal representative is entitled to transfer the shares, attend and vote in GMs and receive all dividends and all other rights of the deceased shareholder without being registered as a shareholder in the company.[43]

Hence, any person could become a member, except where the company law or the Articles of Association imposes some restrictions. The KCL provides a restriction on persons who are not Kuwaiti nationals. Article 68 provides:

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[41] *Steinberg v. Scala (Leeds) Ltd* [1923] 2 Ch 452.

[42] Table A Article 38 of the UK CA 1985.

> Every joint stock company, which is incorporated in Kuwait, shall be of Kuwaiti nationality; all partners shall be Kuwaiti and the company's head office shall be in Kuwait. However, as an exceptional measure, a number of persons who are not Kuwaiti nationals may be partners in a joint stock company if it is necessary to invest foreign capital or use foreign expertise, provided that the capital holdings of Kuwaitis shall not be less than 51 per cent (60 per cent in banking and insurance companies) and also provided a license to that effect is obtained from the government department concerned.

According to the KCL, every JSC, which is incorporated in Kuwait, will be of Kuwaiti nationality, all shareholders shall be Kuwaiti, and the company's headquarters should be in the State of Kuwait. However, citizens of the Gulf Co-operation Council (GCC) States are permitted to practice a number of commercial activities and one of these activities is owning shares in the Kuwaiti JSCs.[44]

Foreign shareholding, other than GCC citizens, is inadmissible in the JSCs unless there is a need for foreign investment or experience. In this case, the approval of the concerned government authorities must be given, and that part of foreign capital should not exceed 49 per cent of the capital of the company, except for insurance companies and banks, where the foreign shareholding does not exceed 40 per cent.[45]

It appears at first sight that the Kuwaiti legislator is concerned with protecting national citizens from the competition of foreign investors. The Kuwaiti legislator also wants to have the control of the economy in Kuwaiti hands. Therefore, the KCL does not allow foreigners to practice commercial business without restrictions on ownership percentage.

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[43] S. 183 (3) of the UK CA 1985.

[44] See Law Decree No. 33 for 1988, permitting the citizens of the GCC to own shares in Kuwaiti companies, Kuwait Al-Youm, 1774 edn.

[45] See Article 23 (1) of the Kuwaiti Trade Law no. 68/1980 and article 68 of the KCL; see also Al-melhem, Ahmed., Privatisation and Protection of Investors in Kuwait, 13 *A.L.Q* (1998) p. 184.

Arguably Kuwait should open the door to investment in its companies to foreign funds and experience for the economy to grow. If the government is afraid of these foreign funds, it may impose reasonable restrictions on their investments. Also, it must be clear that the government cannot in the near future separate its economy from the rest of the world. The world through WTO Agreements has become a village with regard to the freedom of information available (whether via satellite dish or the Internet) and the freedom of transferring goods and services across international boundaries.

3.4.3 Register of Shareholders

Every company, and especially JSCs, should have a register of their shareholders. This register is very important; it is an instrument that can be used to identify shareholders and what their liability is. Article 134(1) of the KCL provides:

> The company shall keep a Shareholders' Register wherein shall be entered the names and addresses of the members, the number of shares held by each member, the amount paid in respect thereof, the date of registration of the member in the Register and the date and method of leaving the company. This register shall be kept at the registered office of the company and shall be open to inspection by the shareholders free of charge. It shall also be open to the inspection of any other person against a reasonable charge; and anyone concerned may apply for its correction if the name of a person is entered in or struck off it without justification.

This register should have the shareholders' names and addresses, the number of shares held by each shareholder, the amount paid for their shares, the date they registered, and the date he or she stopped being a member. The place of the register is in the company, and it should be open for inspection to all shareholders.

The same method is used in the UK; every company must keep a register of its members,[46] and a company with more than 50 members must keep an index of its members. The register and index must be open to inspection during business hours, free of charge to its members.[47]

3.4.4 Termination of Membership

A person ceases to be a shareholder when his name is legally removed from the register of the company. This can happen for the following reasons; when he transfers all of his shares to another person, when he forfeits or surrenders all of his shares,[48] or when his company sells all of his shares to enforce a lien.[49] Also, the death of the shareholder and winding up the company terminates his membership. The membership of a shareholder may also be terminated with a court order for the purchase of shares by a company,[50] and finally, with the purchase of the shares of a dissident shareholder in a take-over bid.[51]

3.5 Conclusion

In the second chapter the theory of the company was discussed and provided that a company is not an absolute contract to make the shareholders alone the owners of the company. Also it is not an institution created by the State, and the process of

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[46] S.352 of the UK CA 1985.

[47] *Ibid.*, S. 354 and 356.

[48] *Ibid.*, S. 143 (3) (d) and Table A. Articles 18 and 19.

[49] Table A Article 9 of the UK CA 1985.

[50] *Ibid.*, see Ss. 5, 54, 459-461.

[51] *Ibid.*, S. 428.

subscription is not a contract and those who sign subscription paper do not sign a contract. A company is arguably a mixture of both these theories and shareholders are not the owners of the company. They are the capital providers, residuals claimant and shares owners. This is the position of shareholders in the JSCs. A shareholder is any person who agrees to become a shareholder by having a share and their shares are their interests in the company.

A shareholder's rights depend on the kinds of shares he or she has. Therefore, this chapter concentrated on the definition of share and shareholder. The KCL was criticised for not including any definition of a share. It is proposed that the KCL should begin with the definition of the shares of JSCs because a person does not become a shareholder unless he owns a share. The KCL is also defective for not mentioning the preference share despite its importance. A shareholder should always have the right to obtain any kind of shares he wishes to acquire. The legislator should not compel him to invest his saving in one kind of share. Moreover, the existence of preference shares is vital to JSCs because it attracts different kinds of investors to subscribe in its capital. This chapter also discussed an essential issue of the rights of shareholders. That is limited liability. Limited liability must always be clear and any condition or resolution that denies it must be null and void. However, it should be recognised that when a shareholder knows his responsibility for the debts of the company is limited to the extent of his investment in the company, he may give less attention to the affairs of the company. Unfortunately, this is one of the negative aspects of limited liability. Also, the transferability of shares as features and rights that encourage people to invest their saving in JSCs may mean that they give less attention to their companies because they can easily withdraw from the company anytime by transferring their shares. This is quite true. But, it must be remembered that nowadays the individual shareholders in JSCs is, for example, the UK, control less that 30 per cent of the JSCS' shares and institutional shareholders control more that 70 per cent.[52] Therefore, even if liability is limited, the institutional shareholders should play a serious role in their companies otherwise they will incur damages or get less profits. Moreover, the institutional shareholders cannot easily withdraw from their company because the huge numbers of shares cannot be sold within a short period of time. Therefore, if they want to protect their interest in the JSCs they must not stay away from their company just because they have limited liability or the right of transferability. Also, communication between the company and the shareholders and between the shareholders themselves (individuals and institutional) should be encouraged by law and the contract of the company. This kind of communication should enable them to be highly interested in following up the company's activities as they realise that their business fortune depends on its proper management. Therefore, they will be more likely to attend the company's general meetings on a regular basis and have a significant voting group (see 7.4).[53]

Having examined the nature of shareholders' position and distribution of powers within the company in chapter 2, and the definition of share and shareholders in chapter 3, the first to be discussed in this study should be the financial right of shareholders. This right is the motivation and the main reason for a shareholder to invest in the JSCs ant it is the subject of the next chapter.

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[52] Helen, *supra* note 39, p. 23.

[53] Farrar, *supra* note 23, p. 305; Whittington, G., Corporate Governance and Regulation of Financial Reporting, 23 *Accounting and Business Res* (1993) P. 313.

Chapter four

Financial Rights of Shareholders

4. Introduction

As already discussed, shareholders are the main providers of the capital of their company and they are the residual risk-bearers. As a whole they are the main party in the company contract and one of the main two organs in the company along with the directors. This position gives them a numbers of rights. The first of the rights of shareholders to be dealt with in this chapter is financial rights.

However, it must be clear that making profit for the body of shareholders is not the only goal of the company. As mentioned in chapter two, a company is a web of contracts, and an aggregate of various inputs acting together to produce goods or services.[1] Therefore, every input provider has an interest and this interest should be protected. Thus, a company is not just a tool to make profits for the body of shareholders. As Dodd described the business corporation as, 'an economic institution which has social service as well as profit making'.[2]

It is a fact that most people buy shares and become shareholders of JSCs in order to obtain a number of rights, including financial. It is also considered as an incentive for shareholders to participate in the company, and to be more keen on knowing their full rights, which enable them to be aware of the company's position. However, shareholders cannot take advantage of these rights unless they give more

[1] Easterbrook, F. H., and Fischel D. R., the Corporate Contract, 89 *Colum. Law Rev* (1989) p. 1416.

[2] Dodd, E M., For whom are corporate Managers Trustees? 45 *H. L. Rev* (1932) p. 1148.

attention to the affairs of their companies. For example, if a shareholder wants to exercise his right to dispose of his shares, he needs information to choose the right time of disposal in order to get more profit. Likewise, a shareholder needs to inspect and understand the company's reports and attend the GM to make sure that he is going to get his full part of the dividends. This means that the financial rights should be a reason encouraging the shareholders to pay more attention to their company. On the other hand, somebody may say that the financial right may be a cause, and at the same time, it may push many shareholders away from their company especially when a shareholder knows that he is a minor shareholder whose participation in the company's capital represents a very tiny part of the company's shares. In addition, a shareholder can easily withdraw from the company by the disposal of his shares at any time, and his annual profit will not be affected whether or not he attends the GM. In this case it should be remembered that in the UK, for example, the individual shareholders control less than 30 percent of the JSCs shares, and institutional shareholders control more than 70 per cent. Therefore, the institutional shareholders cannot get rid of this huge amount of shares and withdraw from the company as easily as individual shareholders. So, because of the power the institutional shareholders have in the JSCs, they have a duty to the company and other shareholders, and the law should enforce them to play their role. The financial rights should encourage them to participate in the company's affairs.[3] With regard to the individual shareholders, if they want to have an effective role, they should communicate with each other (see 7.4).

Financial rights are important rights that must be protected by the company Act and the contract of the company. The proposed question to be answered in this

[3] Winter, Ralph K., On Protection the Ordinary Investor, 63 *Washington Law Review* (1988) p. 892.

chapter is: What are the financial rights which each shareholder shall enjoy? What are the means and obstacles facing practicing these rights? Does the Kuwaiti Law grant these rights to shareholders?

There are four major financial rights that every shareholder should have. These rights are: First, the transferability of shares is the most important financial right that all shareholders must have. This right is one of the reasons why many people choose to invest their money in shares instead of other things. Second, their financial right is the right of pre-emption. By this right a shareholder has the option to buy any newly created shares before an outsider is given the opportunity to do so. Third, a shareholder who joins a JSC should receive dividends at the end of every financial year. This is one of the rights mentioned in any company contract, stating that the profits are to be distributed at the end of every financial year. Finally, in addition to the above rights, the shareholder's application of assets on winding-up is also one of the financial rights that every shareholder must enjoy. A shareholder may redeem the nominal value of his shares from the balance remaining after settlement of the company's debts. If there is an additional surplus after the liquidation, shareholders may apportion the same as provided under law and the Articles of Association. These are the rights that will be discussed under the KCL in this chapter.

4.1 Shareholder Right to Transfer Shares

The transferability of shares is one of the most important features that encourage many people to participate in JSCs as it means that they can transfer their shares whenever they want. This right is a personal right because a share is the property of a shareholder like the right of transfer is the right of property.[4] Therefore, share transferability must neither be completely prohibited nor restricted, except for considerations of higher economic interest on a temporary basis. And shareholders should always have the right to transfer shares at any time they wish. The KCL pointed out this right very clearly in Article 63 that provides "A joint stock company is formed by a number of persons who subscribe for negotiable shares."

The shareholders have, by virtue of their ownership of shares, the right to transfer them. Therefore, a shareholder can do what he or she wishes with his or her shares such as sale, donation, will, or mortgage. Shares can be transferable on the Kuwaiti Stock Exchange through stockbrokers only after they have been admitted to the official stock list.[5] However, the KCL imposes a number of restrictions on this right, as we will see later in this chapter.

In the UK, shares of any member of a company are personal property[6] and they are transferable in the manner provided by the law and the company's Articles of Association. The UK CA 1985 provides in section 182(1)(b):

> The shares or other interest of any member in a company; (b) are transferable in manner provided by company's articles, but subject to the stock transfer Act 1963 (which enables securities of certain descriptions to be transferred by a simplified process) and to regulations made under section 207 of the Company Act 1989.

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[4] Bastin, Nigel A., The Enforcement of a Member's Rights, *J. B. L* (1971) p. 22.

[5] The companies listed in the Kuwait Securities Market are divided up into eight sectors which are: first, the banks sector, second, the investment sector, third, the insurance sector, fourth, the real estate sector, fifth, the industrial sector, sixth, the services sector, seventh, the food sector, eighth, the non-Kuwaiti companies sector.

[6] In *Moffatt v. Farquhar* (1878) Ch.D. 591 the right to transfer was considered a right of property and could therefore be protected by individual suit.

The transferee becomes a member of the company when he agrees to become a member and allows his name to be put on the register of members.[7] The essential position on share transfer, defined in *Smith, Knight & Co, Weston's Case Re* (1868) 4 Ch App 20, is that shareholders have a prima facie right to transfer their shares.[8] Therefore, a share is negotiable, i.e. it may be commercially assigned in accordance with simplified procedures facilitating the quick transfer thereof from one owner to another without being subject to the approval of other shareholders. If a share is a bearer share, it can be disposed of through delivery. If it were a nominal share, it would be disposed of through registration in the company register.[9]

4.1.1 Regulations of the Transferability of Shares

As previously mentioned, one of the main features of shares is their transferability by commercial means. In principle, owners of shares may dispose of them in any way, e.g sale, pledge, gift, will. It would be said that the transferability of shares is one of the main advantages that drive many persons to invest their saving in these kinds of companies; therefore, the company law cannot deny this right. To be valid, trading in shares in Kuwait must meet the following conditions.

4.1.1.1 Obtaining a permit from the proper government authority

Article One of Decree Law 31/1990 stipulates that no Kuwaiti or non-Kuwaiti JSCs shares or bonuses may be offered without licence from the MCI. Under

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[7] See the UK CA 1985 S. 22(2).

[8] J.H. Farrar and B.M. Hannigan, *Farrar's Company Law,* 4th edn, London: Butterworths Publishing, (1998), p. 239.

[9] Alshammiri, Tamma, *Commercial Companies Law of Kuwait,* 1st edn., Kuwait: Dar Alktab Publishing, (1999), p. 307.

Article 4 of the same law, the consent of the Central Bank of Kuwait is necessary before the said licence is granted, in respect of the companies which are subject to supervision and control of the Central Bank. These are normally banks, insurance companies and financial investment companies. The Ministry is the authority concerned with the licensing the trading of shares in the State of Kuwait and, before granting such licensing, consent of the Central Bank of Kuwait must be obtained in respect of the company under its control.

The administrative authority in charge of the day-to-day supervision and monitoring of trading in shares is the Kuwait Stock Exchange (KSE), represented by the Stocks' Committee. The Stock's Committee consists of eleven members headed by the Ministry of Commerce and Industry. The KSE registers the JSCs licensed to offer their shares, for changing hands in accordance with applicable laws and regulations. Additionally, the KSE (represented by its Stocks' Committee) has the power to transact by:[10] First, laying down regulations of dealing in shares on the premises and monitoring their application. Second, taking the necessary action in case of dubious transactions. Third, temporarily suspend trading on the stock exchange or in the shares of a particular company or companies upon the occurrence of exceptional circumstances which threaten the smooth running of business.[11]

In accordance with the views of Al-Shamairi, it is suggested that a new power be added to the KSE's, administration for the sake of uniformity in administrative authority. [12] As previously mentioned, trading in shares is subject to a licence from the appropriate government authority. This power that is granted to this government

[10] Article 5 of the Decree organising the KSE.

[11] *Ibid.*, articles 4, 6 and 8. And see article 11 of the KSE By-Laws.

authority, should be granted to the KSE's administration, rather than the Ministry of Commerce or the Central Bank. That would eliminate the clash of powers which interrupts dealing and consequently causes shareholders to suffer damage to their interests.[13] As the Stock Exchange is a corporate body, independent of government agencies, as stipulated by Article 1 of the Decree, nothing bars the Stock Exchange from having the power to authorise companies to trade their shares or bonds.

4.1.1.2 Trading of shares in a Licensed Stock Exchange Market

The KSE in accordance with Article 324 of the Commerce Law no. 68/1980, states that no stock exchange may be established without a licence from the Ministry concerned, normally at the MCI. Trading in approved shares must take place in the trading hall of the market, except in cases of inheritance, will and the cases authorised by a special committee. All shares traded on the stock exchange must be entered into its records, upon transfer of ownership of these shares from buyer to the seller, in accordance with Article 31 of the by-law of the KSE. Trading must take place during the business hours specified by the KSE's administration and must be in the presence of controllers from the exchange. The administrators of the market also collect details of the shares allowed to be traded on the market and makes them available for all traders.[14]

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[12] Tamma, *supra* note 9, p. 334.

[13] *Ibid.*, p. 334.

[14] See articles 31 to 36 of the by-law of the KSE.

4.1.1.3 Trading should be carried out by a licensed stockbroker

For trading to be legally valid, it must be conducted by a stockbroker whose name is on a list published by the Exchange's Stocks' Committee.[15] The broker does not act as agent of either party (buyer or seller). He is a neutral element whose duty it is to bring the positions of the other two parties closer. If the transaction is completed he is paid a charge or fees by the party concerned.[16] The Kuwaiti legislator established this condition for the sake of proper organization in dealing in stocks and for the protection of dealers from fraud. Fraud is likely to occur if a buyer and seller are left alone without a third party.

The stock exchange manager gives every company whose shares have been traded on the exchange a detailed statement of these transactions and the parties concerned upon completion of entry in the exchange's records. The company in question must enter these transactions in its records upon notice thereof, in order to effect transfer of ownership of the shares sold from seller to buyer.

As the above discussion shows, the regulations of transferability of shares in Kuwait, unlike those of other countries, do not allow shares to be traded outside the KSE, unless in certain exceptional cases set forth above. In other countries, such as the UK, trading may take place on or out of the Stock Exchange Market directly between buyer and seller without a middleman, in order to facilitate the process of disposal of the stocks. Kuwait laws, however, are designed to control the trading process of shares and prevent any fraud. As far as the nominal shares are concerned, a shareholder who wants to sell his shares out of the market must have this transaction

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[15] Article 328 of the Kuwaiti trade Law No. 68/1980 provides that "Transactions for Exchange Market shall not be validly concluded unless if conducted through brokers whose names are listed in a list issued by the Exchange Market Committee."

completed by the relevant company's employee, in the presence of both parties and subject to approval of the Exchange.

4.1.2 Disposal of Non Paid-up Shares

Is it permissible to sell the shares that are not paid-up? If a shareholder has paid only 40 per cent of the share value and is still required to pay the balance (when called), may he sell such shares? If yes, who is responsible to pay the remainder of the value: the transferer or transferee?

The KCL, unfortunately, has not regulated this matter in the same way that other Arab and non-Arab company laws do.[17] However, it is customary in Kuwait that to deem such a disposal valid,[18] the buyer and new owner of the shares not paid-up becomes liable to the company to pay the unpaid instalments.[19] This is logical for two reasons: First, he has bought shares lower in value than those fully paid-up. Second, he is entitled to receive dividends in respect of these shares if the sale is completed and entered in the company's registered office before the end of the financial.

4.1.3 Restrictions on the Right of Transferability

The right of the transferability of shares, according to the KCL, is subject to some temporary restrictions under Articles 106, 109, 139 and 140(2) of the KCL. When the shareholders, founders or directors breach the restrictions that are

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[16] *Ibid.*, Article 306.

[17] See for example implementation regulations of Egyptian Company Law 159/1981 article 142.

[18] Tamma, *supra* note 9, p. 361.

[19] Al Kalyoubi, Sameha, *Commercial Companies*, Egypt: Dar Alnadah Publishing, (1993), p. 274.

mentioned in the articles above, their actions will be null and void.[20] There follows an examination of restrictions and their effect on the right of the transferability of shares.

4.1.3.1 First Restriction

The first restriction is imposed on the transferability of shareholders' shares as provided in Art 106 of KCL:

> (1) Shares and provisional certificates may not be disposed of until the company has issued its first balance sheet for at least 12 months; any disposal prior to that shall be deemed to be null and void...
> (2) Disposal is permissible after the issue of the aforementioned balance sheet where the assignee must be a Kuwaiti national if the shares or their provisional certificates are owned by a Kuwaiti national.

In this article the legislature of Kuwait does not allow action to be taken on the shares of a new company until it has published its first balance sheet. Therefore, it is prohibited before the issuing of the first balance sheet, to transfer by commercial means such as transcription, delivery or endorsement, promises of shares. The Kuwaiti legislature assumes that, if the transferability of shares were to be permitted as soon as the company has been registered in the Ministry of Commerce Register, many individuals would utilise the companies' incorporation by selling their shares directly with the aim of immediate wealth.[21] This practice could result in the

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[20]Article 184 of KCL provides "Notwithstanding any heavier punishment provided for any other law, any person who violates the provision of Articles 85, 106, 109, the last paragraph of Article 77 and the last paragraph of Article 10, shall be punished with a fine not less that 10 Dinars (£20) nor more than 200 Dinars (£400); the court may decree the impounding of the shares which were the subject of the violation; any interested person may claim damage, (if appropriate) from the defaulter" that means any shareholder or member of directors who breaches the restrictions mentioned at Arts. 85, 106, 109 will be punished with a penalty of 10 KD (Kuwaiti Dinar) minimum and 200 maximum. The court may rule for confiscation of the breach subject shares. As you see here, the punishment is a fine which not less than 10 KD and not exceeding 200 KD. This is a very light punishment and it is not appropriate to act as a good deterrent.

[21] Alshammari, Taama, *Kuwait Companies law*, 1st edn, Kuwait: Dar Alktab publishing, (1987) p 348.

intensification of a speculative spirit between negotiators of the shares of newly founded companies, without deliberation or knowledge of the company's financial position. Such a position would be known only after the company's issuance of its first balance sheet, which is often at least 12 months after the company's incorporation.[22] A company's balance sheet is usually supplemented by a profit and loss account which summarises the earnings and expenditures of the company during the last year. Therefore, the Kuwaiti legislators restricted the transferability of newly incorporated companies' shares for a minimum period of 12 months. Consequently, after the issuance of its first balance sheet and the obtaining of a license from the securities committee, a company may offer its shares for negotiation on the stock exchange market.

4.1.3.2 Second Restriction

The second restriction is imposed on founders' shares. The founders of a JSC, according to the KCL, cannot transfer their shares to others for three years from the date of the company's incorporation. Also, Kuwaiti legislature enforced them to subscribe not less than 10 percent of the total number of the company's shares.[23] This restriction that is imposed on the founders' shares is found in Article 109 of the KCL that provides:

> The promoters may not dispose of their shares within three years from the date of the legal incorporation of the company. Any disposal effected otherwise than aforesaid shall be null and void. Any interested person may adduce such nullification and the court shall, of its own accord, so determine.

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[22] *Ibid.*, p. 348

[23] Article 81 of the KCL.

A founder is one who undertakes to form a company. The incorporation of any new company cannot be achieved without the activities of the founders. According to the KCL, founders may not dispose of their shares for a minimum period of three years from the company's incorporation date. The Kuwaiti legislature considers it necessary to enforce founders of a company to stay in that company for at least three years. This is because the legislator believes that the most important years for any new company are the first three years, and the most important people in a new company are its founders.[24] They are the holders of the company's incorporation idea, and in the absence of this restriction, the founders could dispose of their shares a short time after the incorporation of the company, thus opening the door for the incorporation of worthless companies or formal companies that exist only on paper, causing the speculation of shares to achieve rapid wealth. This could be achieved by the company founders, with noisy advertising pushing the public into subscribing in company shares on the company's incorporation or by fraudulent practices or techniques, encouraging negotiators to buy the shares of the new company including those of the founders. Following this, the founders could leave the company, allowing the purchasers and the company shareholders alone to bear its losses.[25]

In fact it could be argued that Kuwait's legislature is justified in imposing restrictions on the transferability of the founders' shares, because there have been many cases in Kuwait where founders disposed of their shares at the beginning of

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[24] Tamma, *supra* note 9, p 349.

[25] The Kuwait Cabinet after the Kuwait Stock Exchange crash and after examining the affairs of at least 39 of the companies involved in this crash discovered that the problem happened due to many reasons. One of these reasons was that the founders of many JSCs had sold their shares before the end

the company's life, thus affecting the company's reputation. However, three years could be considered too long a time. Most other Arabian countries impose less than three years on the transferability of the founders' shares.[26] One year is probably enough to see the financial position of the company after the publishing of its first balance sheet; also, the founders of any JSC are shareholders and they should enjoy the same rights as other shareholders.

4.1.3.3 Third Restriction

The third restriction is imposed on the board of directors who cannot transfer their qualifying shares. This restriction is mentioned in Article 139 of KCL that provides:

> He (director) shall be the holder of a number of shares constituting not less than one per cent of the company capital; however, it is sufficient for a director to hold a number of shares, the nominal value of which is equal to7500 KD (about 15,000 pound) The said number of shares shall be allocated as a security for the management and shall, within one month of the date of the appointment of the director, be deposited in an accredited bank, where it shall remain deposited and unnegotiable until the director's term of office has expired and the balance sheet of the last financial year of his directorship is approved; if a director fails to produce such a security, his directorship shall be nullified.

This article stipulates that the board director of any JSC should hold a number of shares not less than one percent of the company's capital. However, it is sufficient that a director owns a number of shares with a nominal value of KD 7500, unless the

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of the three years the companies had been established. See the report of the committee that established by the Kuwait Cabinet on 13/3/1983 by Cabinet Decree no. 10/1983.

[26] According to Article 45(1) of company law of Egypt the founders of a JSC cannot dispose of their shares for a minimum period of two years from the company's incorporation date; the restriction according to the company law of UAE in Article 173 just two years; in Jordan also two years Article 103.

company's Articles of Association states otherwise. At the appointment the qualifying shares shall be deposited into an approved bank. If the board member does not provide the qualifying shares within one month from the date of his election as a director, his membership will be deemed invalid. They are not transferable until the membership term expire and until his approval of the balance sheet of the last financial year (during which the member carried out his work). The main objective in imposing this restriction is to ensure good management and loyalty from the board of directors towards the company.[27] Moreover, these shares will be held as a guarantee against the possible liabilities of directors if they work beyond their authority and cause damage to the company.

In the UK, when the Articles of Association imposed qualification shares on directors, they were to hold these shares as provided in s. 293(1) of the UK CA 1985.[28] Qualification shares are not obligatory according to the UK CA but, when the Articles of Association impose this restriction on the directors, they have to submit to it. The qualification shares must also be held in the director's name.[29]

4.1.3.4 Fourth Restriction

The fourth restriction, according to the KCL, is the restriction imposed on directors to stop them from using the inside information to achieve personal interest; Article 140 (2) provides

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[27] Al Kalyoubi, *supra* note 16, p 285; see also Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn, Cairo: Dar Al-fker Al-Arabi Publishing (1978), p. 421.

[28] S. 291(1) of the UK CA provides that "it is the duty of every director who is by the company's articles required to hold a specified share qualification, and who is not already qualified, to obtain his qualification within 2 months after his appointment, or such shorter time as may be fixed by the articles"

> A director, even when representing a legal entity, may not take advantage of any information obtained by reason of his office, in order to obtain a benefit for himself or another, nor may he sell or purchase the shares of a company so long as he is a director of such company

Clearly this article concentrates on insider dealing. In general, insider dealing involves buying and selling a company's shares on the advice of specific information that effects the share price.[30] This article stipulates that the board director may not, even if he is a representative of a corporate person, use the information which became known to him as a result of his office for obtaining benefits for himself or any third party. Furthermore, he may not sell or purchase shares of the company of which he is a board member for the duration of his membership. As the board of directors is knowledgeable and familiar with the company's financial position, it knows whether the company is realising profits or losses and knows the possibility of future price movements.[31] Shareholders, on the other hand, know nothing about the company's position, except after the board's publishing of information at the fiscal year end.[32] The Kuwaiti legislator also aimed at preventing the abuse of unpublished inside information relating to a company for the purpose of gaining an unjust benefit in transactions including those of company shares.

The KCL is trying, by the article above, to prevent directors that are in a fiduciary relationship with their companies from making profits from insider dealing. This would lead to the following question: Who is the insider according to the KCL?

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[29] Morse, Geoffrey, *Charles worth & Morse Company Law*, 15th edn, London: Sweet & Maxwell Publishing, (1995), p 317.

[30] Brazier, Gill, Insider Dealing: Law and Regulations, London: Cavendish Limited Publishing, (1996), p. 76; see also Hannigan, Brenda, *Insider Dealing*, 2ed edn., London: Longman Publishing, (1994), pp. 2-5.

[31] Tamma, *supra* note 9, p 353.

According to the KCL, The directors are the only insiders. This mean that, other people such as shadow directors or managers of the company who have a fiduciary relation with the company and know inside information are not in question. Also, in order to protect their financial interests in the company any person is entitled to be included in the constraint stated in article 140(2) in addition to board members if he is entitled to have access to unpublished information concerning the company. That enables this person to make a profit when exploiting this information on shareholders' and the company's account, through selling or buying the company's shares. The persons that shall be subject to constraint stated in the article are the company employers, the financial auditors, the shadow directors and the relatives of board members.

Also, the article was issued in general terms, and does not mention the nature or type of information that is considered as inside information.[33] The information that is considered as insider information shall be clearly defined. Thus its exploitation shall be prohibited for achieving personal interests and harming the company's interests or those who have common interests with the company. Any legal material shall always be characterised with clarity and specification, in order to be implemented accurately. Unfortunately, this accuracy does not exist in the aforementioned article.

Moreover, the KCL does not consider a guarantee period for non-abuse of unpublished information following the end of directorship. The article mentioned

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[32] Radwan, *supra* note 27, p 421.

[33] The Company Law of the UAE No. 8 of 1989 which explained in Article 322(7) provides that "without prejudice to any more severe penalty specified by other law the punishment of imprisonment for a period of not less than three months and not exceeding two years and a fine of not less than ten thousand dirhams and not exceeding one hundred thousand dirhams or one of those to penalties shall be imposed upon; (7) each manager or member of a board of directors or member of supervisory board or advisor or expert or auditor or this assistant or employee and each person entrusted with the

above does not provide any solution to the problem of insider dealing. Also, under the KCL: What is the penalty for committing this crime? This issue must be detailed by new articles added to the KCL and other company laws can be taken as examples to follow, such as the UK CA.

Insider dealing in the UK has received the important attention it deserves. The UK first made insider dealing a specific criminal offence in 1980, and re-enacted the provisions with minor amendments in the Company Securities (Insider Dealing) Act 1985. This was then replaced by the Criminal Justice Act 1993 (CJA). According to this latest Act there are three main offences as provided in s. 52 of CJA

> (1) An individual who has information as an insider is guilty of insider dealing if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information.
>
> (2) An individual who has information as inside is also guilty of insider dealing if - (a) he encourages another person to deal in securities that are (whether or not that other knows it) price-affected securities in relation to the information, knowing or having reasonable cause to believe that the dealing would take place in the circumstances mentioned in subsection (3); or (b) he discloses the information, otherwise than in the report performance of the functions of his employment, office or profession, to another person.
>
> (3) The circumstances referred to above are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary.

In this section it is noticeable that while there is only one offence of insider dealing, it can be committed in three ways; (1) by dealing in securities, the price of which will be affected by inside information; (2) by encouraging another person so to deal; and (3) by disclosing the inside information to another person.

The CJA clearly determines the information considered to be inside information. Inside information according to the UK CA must; (a) relate to particular securities or

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inspection of a company who divulge the company's secrets he obtains in the course of his work or to a particular company or its business; (b) be specific or precise; (c) not have been made public; and (d) be such that if it were made public it would be likely to have a significant effect on the price or value of any securities.[34] In the UK, a person can have inside information; (1) by being a director, employee, or shareholder of the company which issued the shares or debentures in question; (2) by having access to the information by virtue of his employment, office or profession; or (3) by the direct or indirect source of the information being a person within (1) or (2).[35]

The penalty for insider dealing in the UK is a maximum of seven years imprisonment and/or a fine of unlimited amount. The transactions entered into in breach of the prohibitions on insider dealing are valid, despite contravention of the Act. Proceedings can only be instituted by or with the consent of the Secretary of State or the Director of Public Prosecutions.[36]

The KCL should have asked the directors to disclose all the transactions carried out by them with respect to the company's securities (see chapter 5), as in the UK CA 1985 that provides in s. 317:

> It is the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.

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make use of such secrets for his personal again on that of other parties."

[34] S. 56 of the UK CJA 1993.

[35] The individual concerned must in each of the three offences mentioned in S. 52 of the CJA have information as an insider where; (a) the information is inside information; (b) the individual has that information from an inside source; (c) the individual knows that he has inside information from an inside. See S. 57 of the UK CJA.

[36] *Ibid.* S. 61. An individual could avoid liability if he proves that (a) he did not expect that the dealing would result in a profit attributable to the fact that the information in question was price sensitive in relation to the securities; or (b) he had reasonable grounds for believing that the information had been disclosed widely; or he would have done what he did, even if he had not had the information. See S. 53 of the UK CJA.

Therefore, the board of directors should disclose and keep the company informed of all dealings and transactions carried out by them with respect to its securities. The law prevents any person from dealing with the company's securities if such dealing is made upon information given from inside the company. When one of the directors has an interest within his company, he is normally not allowed to vote at meetings of the board of directors in respect of the contract he has interests with the company.[37]

In the UK, shares of a JSC are freely transferable unless the company's articles of association impose restrictions on the transferability of its shares. In the case mentioned above, the Judge stated:

> The directors of a company have no discretionary power, independently of power expressly given to them by the articles of association to refuse to register a transfer which has been bona fide made.

Therefore, the board of directors may be given the power to refuse a transfer of shares without giving any reason for their refusal, but they should act in good faith and in the best interest of the company.[38] This kind of provision that gives the board of directors this kind of power usually exists in Articles of Association of small family companies, where the directors may not wish the shares to go into the hands of those who are not close family members. However, listed companies are not generally allowed to have transfer restrictions in their articles except in respect of partly paid shares and shares in certain communications and broadcasting companies.[39]

The Articles of Association of many large JSCs usually contain provisions that a shareholder who wishes to transfer his shares to a person who is not already a

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[37] Table A, Arts 94 and 95 of the UK CA.

[38] Farrar, *supra* note 8, p. 240.

[39] Admissions of Securities to Listing, S. 9, Ch 1, para 1.2; see also *Re Stockton Malleable Iron Co* (1875) 2 Ch D 101.

member, shall first offer them to the other shareholders. Only when the other shareholders do not wish to buy the shares, can the shareholder who wants to sell his share transfer them to a proposed transferee; this is known as a right of pre-emption.[40]

4.2 Shareholders Right of Pre-emption

The Right of Pre-emption, is the right given to shareholder of a company to have the option to buy any newly created shares before any outsider is given the opportunity to buy those shares. A shareholder should be able to protect his proportion of the total equity by having the chance to subscribe for any new shares. The question that may be asked is; why should a shareholder have the right of pre-emption? There are a number of factors that highlight the importance of this right for shareholders. First, if a shareholder does not buy from the newly created shares a number that is proportionate to his existing holding shares, his influence in the company will be reduced because he now has control over a smaller number of votes. Thus, the board of directors, usually in the absence of the pre-emption right, uses the method of issuing new shares that carry voting rights to change the balance of voting power in the company.[41] Therefore, the pre-emption rights should exist to allow shareholders the opportunity to maintain their voting power before and after the allocation of shares. By this right the shareholders can balance the powers within the company and not lose their influence in

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[40] Griffin, Stephen, *Company Law Fundamental Principles*, London: Pitman Publishing (1994), p. 98.

[41] Alkali, Aziz, *the Commercial Companies Under Jordan Law*, Amman: Dar Althaqafa Publishing, (1995), p. 400.

the GM.[42] Second, when a JSC issues a large number of new shares, these will probably affect the existing market price of the company's shares (the old and new shares). These shares of the company will be treated in the market at a price normally somewhere between the issue price and the previous market price. Thus, the market price of the existing shares will go down whilst, at the same time, the value of the new shares will go above the offer price. In this case, when the existing shareholders acquire the relevant proportion of the new shares, they will be compensated by the increase in the value of the new shares above the offer price. Otherwise, the existing shareholders will be the losers of the decision of issuing new shares, and the new shareholders (outsiders) will be the winners because they entered the company too cheaply.

The KCL requires that any JSC wishing to raise new capital to comply with the shareholders' right of pre-emption as provided in Article 131(6) of the KCL

> A member shall in particular have the following rights; (f) to dispose of the shares held by him, and to have a priority right to subscribe for new shares, according to the provision of the law.

This article of the KCL contains an important provision designed to ensure that shareholders have the right of pre-emption over any new issue of shares. Therefore, any JSC proposing to issue new shares must first offer them to existing shareholders. It is not obligatory for all shareholders to accept or refuse the offer; it is acceptable for some shareholders to accept the offer and other to refuse it. Also, a shareholder need not accept all the shares offered to him. So, if he only wishes to accept part of the

[42] Grier, Nicholas, *UK Company Law*, London: John Wiley & Sons Publishing, (1998), p. 161; in *Pierey v. S. Mills & Co. Ltd* [1920] 1 Ch. 77, 88 Patterson J. submitted that "Directors are not entitled to use their power of issuing shares mainly for the purpose of maintaining their control or the control of the company, or mainly for the purpose of defeating the wishes of the existing majority of shareholders."

offer, he must of course intimate to the company that he will be making a partial acceptance. The shares that are not taken up by the existing shareholders will then be offered to outsiders. Moreover, the KCL in Article 111 gives more details about practising this right when it provides that:

> Every shareholder shall have the right to subscribe for a number of the new shares proportionate with the number of shares he already holds, in priority.
> Shareholders shall be allowed a period of not less than fifteen days from the date of publication of the offer made to them for exercising this priority.
> A company may contain its articles of association a provision that give a shareholder the right to surrender from his priority in advance and also may put any restrictions on this right.

It is clear this article guarantees the pre-emption right provided in Article 131 and added that every shareholder has a priority right of subscribing for a number of the new shares commensurate with the number of shares already held by him. Also, the later article provided a time limit. Therefore, any shareholder interested must exercise his priority rights within fifteen days from the date of publication of the offer made to the shareholders.[43]

The problem in the above article, is in the last part of it. The Kuwaiti legislator gives JSCs the right to impose any restrictions on the right of pre-emption. As a result, the board of directors, who usually control the company and its GMs, can limit or prohibit this right. Directors can do this by passing a resolution which deprives shareholders from this right.[44] In other words, the KCL confers indirectly on the

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[43] The question that may arises here is, does a shareholder who wishes to transfer his shares to a person who is not already a shareholder have an obligation to offer these shares to other shareholders first? The answer according to the KCL is no, because the pre-emption right according to the two articles mentioned above about the shareholders right of pre-emption to have the option to buy any newly created shares before any outsider is given the opportunity to buy those new shares.

[44] Tamma, *supra* note 9, p. 458.

directors to issue new shares to outsiders or their friends without regard to right of pre-emption or with qualification of this right. Furthermore, this defective article does not demand the directors, as fiduciaries, when they place restrictions on the pre-emption right to exercise this power bona fide in what they consider to be the best interests of the company and not for any collateral purpose. The KCL has granted shareholders in the JSCs the right of subscription in the new shares. However, granting this right is not adequate, as the same article that granted this right has granted the board the authority to impose constrains on its practice especially if the board is dominating the GM of the company, which is considered as a point of criticism of Kuwaiti law. Therefore, the legislator shall always be accurate when mentioning the rights of shareholders, as it shall not add legal paragraphs or articles that are contradicting this right. The Kuwaiti legislator shall consider the UK CA 1985, as it is more accurate and detailed regarding treating this right.

In the UK, in order to ensure that the existing shareholders are not prejudice by the issue of newly created shares, s. 89 requires that the new shares must first be offered to existing shareholders. They can acquire a proportion of the new shares that corresponds to the proportion of shares they already hold in the company. For example, if a shareholder owns 10 per cent of the company's shares, he must be offered 10 per cent of any newly created shares. The terms of the offer to existing shareholders must also be the same as or more favourable than the terms offered to outsiders.[45] The existing shareholders have 21 days in which to accept or refuse the offer.[46] However, a JSC in the UK may vary or exclude s. 89 of the UK CA from all

[45] S. 89 (1) of the UK CA.

[46] *Ibid.*, S. 90 (6).

its allotments, if its directors have a general authority to issue shares under s. 80, by a provision to that effect in its articles or by passing a special resolution.[47]

What are the consequences of failure to communicate the offer to the existing shareholders? In fact, none of the KCL articles deal with this problem. This means that shareholders, according to the KCL, can do nothing when they are deprived from practising the right of pre-emption. In the UK, for example, if the directors fail to make the pre-emption offer to existing shareholders, the existing shareholders may demand compensation for any loss, cost or expenses they may have incurred as a result of being deprived of the opportunity to acquire the newly created shares. However, any harmed shareholder must make his claim for compensation within two years of the allotment or his claim will be time-barred.[48]

4.3 Shareholder's Right to Dividends

One of the main reasons why a shareholder joins a JSC is to receive dividends. It is one of the rights which is mentioned in all companies' Articles of Association, that the profits be distributed at the end of each financial year. Also, commercial companies are formed to earn profits for the shareholders out of which dividends can be paid.[49] However, in spite of the significance of this right to the shareholders and their expectations to be paid the maximum dividend, companies use their profits to meet their financial requirements and consolidate their financial positions. Moreover,

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[47] *Ibid.*, S. 95.

[48] S. 92 of the UK CA 1985. In the UK, the procedure of issuing new shares must be strictly adhered to. In *Re thundercrest Ltd*, [1994] BCC 857, in this case the allotment of 5000 shares to two shareholders was cancelled by order of the Court as the letter of provisional allotment did no allow at least 21 days for acceptance, and the letter had not been property served on the other shareholders of the company.

shareholder's entitlement to dividends at the end of each financial year is thus affected by the fact that companies retain a portion of their earnings directly or indirectly and shareholders cannot therefore insist on being paid these earnings in full at the end of each financial year.[50]

4.3.1 The Nature of Dividends' Right

A dividend is the share received by a shareholder of the company's profits legally available for dividend and divided among the shareholders. As previously mentioned, a shareholder's eligibility to receive dividends is his basic right and it is one of the main reasons that make a shareholder join a JSC. Other rights, such as the right to know what is going on in his company, the right of discussion with the board of directors, and his right to vote are established to enable him to be entitled to be offered dividends. Consequently, the KCL, when determining the shareholders' rights in a JSC in Article 131(1) mentions this right as the first right every shareholder must enjoy. This article provides that

> A member (of a share company) shall in particular enjoy the following right: (1) to receive (a rateable share of) the profits and benefits it shall be decided to distribute to the shareholders.

And to insure this right the KCL provides in Article 133(2) that

> The shareholders' GM may not: (2) reduce the percentage of net profits specified in the articles of the company to be distributable to the shareholders.

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[49] Mayson, Stephen, French D. and Ryan, C., *Company Law*, 15th edn, London: Blackstone Publishing. (1998-99), p. 302.

[50] Radwan, *supra* note 27, p. 478; To make matters worse, it is taken for granted nowadays that any company's GM may, at its discretion, decide not to distribute the profit for any year in full and retain a portion thereof to create reserves, and this situation continues for many successive years.

Accordingly, the dividend is certainly one of the basic rights of the shareholders in the JSCs and it cannot be reduced or stopped when the company made profit in the last financial year. The profit realised may only be dividends when it becomes a net profit and following the approval of the company's balance sheet for the relevant financial year. Hence the date of entitlement of dividends, if any, is fixed. The company's Articles of Association often fix the date of dividend payment, otherwise it is fixed by the GM, which is the company's highest authority.[51]

It may be asked, what is the definition of net profits according to the KCL? The KCL has mentioned the net profits in a number of articles but unfortunately none of them provide a clear definition of it.[52] This definition is very important; in order to know what is can be accounted as part of the net profit and what is not. Also, by means of this description shareholders can calculate approximately how much dividend they will get this year.[53]

4.3.2 When is a Shareholder Entitled to Dividends?

Some argue that a shareholder becomes entitled to dividend the moment he is aware of the net profit earned in the previous year. This entitlement is established even before the GM approves the company's balance sheet and financial statements for the relevant year, as the role of the GM is secondary in this respect. In other words, a shareholder's entitlement to dividends arises the moment the profit is established.

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[51] Tamma, *supra* note 9, p. 456.

[52] See articles 166, 167 and 168 of the KCL.

[53] The Egyptian Company law no. 159/1981 provides clear definition of net profits when it provides in Article 40(1) that "the net profits are those realised from operations exercised by the company after deduction of all expenses needed for their realisation, and after accounting for all consumptions and allocations, which the accountancy rules impose and putting them aside before proceeding on any distribution in whatever way"; see Alkali, *supra* note 41, p. 427.

However, that argument is disputed by the fact that the balance sheet presented to the GM is only suggested rather than final and the GM may, at its discretion, approve the same and make amendments thereto. The GM may also decide to retain the profit made in the previous year and transfer the same to reserves to provide for the company's financial commitments.

Other commercial law jurists say that a shareholder claims his share of the profit the moment the balance sheet is approved and a dividend is fixed by the GMs, in accordance with the general rules which distinguish between the establishment of a right and the time it is due.[54] In other words, prior to the GM's resolution, the entire shareholders are collective creditors of the company with the amount of profit that the company must pay if it has made real profit. The GM's resolution to distribute profit establishes a shareholder's right thereto as it determines the dividend and makes it payable and allows the shareholder to seize it, thus becoming a creditor of the company claiming actual distribution of the profit.[55]

Each shareholder shall be entitled to a dividend immediately upon the passing of the GM's resolution to distribute such a dividend. Unfortunately, the KCL allows the company's board to fix a date for payment of the dividends at its discretion. As a result of this shortcoming, the board of directors in Kuwaiti JSCs can delay the distribution of dividends for some time to execute the decision of GM. This attitude should be taken by the Kuwaiti legislator in order to prevent any attempt by directors to delay the distribution of dividends to the shareholders. A good example to follow in this issue is in Egyptian Company Laws. Such provides that each shareholder shall be

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[54] Mustafa, Kamal, *Commercial Companies: General Provisions in Companies*, Cairo: Dar Al-jama Al-jadeeda Publishing, (1997), p. 316. See also Radwan, Fayez N., *Commercial Companies*, Almansoora: Maktabat Aljla'a Aljadeeda, (1994), p. 583.

entitled to a dividend immediately upon the passing of the GM's resolution to distribute such a dividend.[56] The board of directors shall implement the GM's resolution to distribute dividends within one month.[57]

In the UK, dividends are paid in the manner laid down in the Articles of Association. Table A, Article 102, provides that the company may declare a final dividend by ordinary resolution at the annual GM and this dividend should not exceed the amount recommended by the board of directors.[58] Then shareholders pass an ordinary resolution to approve the level of dividend or reduce it.[59] The announcement of a dividend by the company creates a debt due to its shareholders. If the dividend is stated to be payable at some future date, a shareholder will not be able to enforce the payment until the actual date for payment arrives. Dividends can only be paid in cash, unless there are words allowing payment by the issue of shares or debentures.[60] From

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[55] *Ibid.*, p. 317.

[56]Article 44 (1) of Egyptian Company Law no 159/1981 provides that "both the shareholder and workers will deserve, each his part in the profit, immediately upon issue of the decision of the general assembly for distribution."

[57]*Ibid.*, Article 44 (2) provides that "the administrative board should proceed to the execution of the decision of the general assembly for distribution of profits to shareholders and workers, within one month at most from the date of issue of the decision."

[58] S. 234 (1) of the UK CA 1985 requires the directors of a company to state in their report, which they must prepare for each financial year and present it to the GM, their recommendations on dividend.

[59] Article 102 of Table A 1985 provides that "... the company may by ordinary resolution declare dividends in accordance with respective rights of the members, but no dividend shall exceed the amount recommended by the directors"; see also *Scott v Scott* [1943] 1 All ER 582.

[60] Table A, art 5 authorises the payment of dividends in kind; in *Potel v Inland Revenue Commissioners* [1971] 2 All ER 504 Brightman J. summarised the entitlement of shareholders to dividends in the following terms; (a) If a final dividend is declared, a date when such dividend shall be paid can also be specified; (b) If a final dividend is declared by a company without any stipulation as to the date of payment, the declaration of the dividend creates an immediate debt; (c) If a final dividend is declared and is expressed to be payable at a future date a shareholder has no right to enforce payment until the date for payment arrives.; (d) In the case of an interim dividend which the board has resolved to pay, it is open to the board at any time before payment to review the decision and resolve not to pay the dividend. The resolution to pay an interim dividend does not create an immediate debt; (e) If directors resolve to pay an interim dividend they can, at or after the time of such resolution, decide that the dividend should be paid at some stipulated future date. If a time for

the time that a dividend is payable to shareholders, it is a debt owed by the company to the shareholders.[61] Therefore, a dividend is a debt due to the shareholders only as soon as it has been declared. In a case of liquidation it is a deferred debt, and shareholders will only obtain their outstanding dividends once preferential and ordinary creditors have been paid.[62]

A company may issue different classes of shares and grant different rights with different classes of shares, either by the Memorandum or articles or by other ways.[63] Therefore, in the case of dividends, if a company has different classes of shares such as ordinary and preference shares, the shareholders of the class that has priority (preference shares) are entitled to a preferential dividend before any dividend is paid to the shareholders who hold ordinary shares. If there are two or more classes of preference shares, the shareholders of the class that has priority (senior preference shares) are similarly entitled to their preferential dividend before any dividend is paid in respect of the junior class for the same financial year.

According to the KCL, there is one kind of share. Therefore, all shareholders have equal rights either with respect to distribution of profits, division of the company's assets after liquidation, or voting rights (see 3.3.1).[64]

The dividends' beneficiary must be one person, assumed to be the shareholder or his agent or proxy. If the share is jointly owned, the holders must elect one from

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payment is so prescribed, a shareholder has no enforceable right to demand payment prior to the stipulated date.

[61] Mayson, *supra* note 49, p. 302; see also Alkali, *supra* note 41, p. 427.

[62] S. 74 (2) (f) of the Insolvency Act 1986; see also *Re Compania de Electricidad de la Provincia de Buenos Aires* [1980] 1 Ch 146.

[63] Pennington, Robert. *Company Law*. 6th edn, London: Butterworth Publishing, (1990), p. 205.

[64] The KCL provides in Article 130 that: "The promoters who have subscribed to the company's Memorandum and Articles of Association, as well as subscribers who have subscribed for its shares,

among their number to receive the dividends. Another point to note is, shares that have not been paid up upon subscription receive a rate of dividends proportionate to the normal value of the shares paid. This provision is not covered by the KCL but is required by equity. This is a shortcoming in the KCL which leads to the possibility of manipulation on the part on the board (see chapter 3).

4.3.3 Determination of Distributable Profits

The first aim of any commercial company is to make a financial profit and distribute most of it to its shareholders. However, this aim is not continually achieved as the company's economic enterprise may face difficulties and suffer losses in bad years. On the other hand, it may realise profits in good years. Accordingly, profits mean the amount of money a company adds to its financial assets or accounts. The company laws always seek to ensure that a dividend paid to the shareholders by the company is not, in whole or in part, a return of capital they have contributed to make profits to be distributed among them.

The issue of specifying the profits that shall be distributed to shareholders is extremely significant. Before specifying the profit that shall be distributed, this process requires exploration of information regarding the company's financial position in which shows accurately the profits achieved by the company in the previous fiscal year, as well as the percentage transferred to the company's reserve. This issue is related to shareholders right to know the company's status and to read all the reports regarding this issue this will be examined further in the next chapter.

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shall be deemed to be members of the company and shall have equal rights and be subject to the same obligations, with due observance of the provisions of the law."

The annual GM is the body authorised to announce dividends. However, it has no absolute authority in this regard. It is limited and governed by the provisions of company law concerning maintaining the capital intact and observing the draft balance sheet presented by the board as well as the company's interests.[65] The GM, as the highest authority in the company, may make some amendments to the draft balance sheet, however, it may not decide to distribute unreal or false dividends. It is also obligated to deduct a certain amount and transfer the same to statutory reserves.

The GM cannot distribute dividends before it determines distributable profits. If such profits do exist distribution can only be made after deduction of the losses. That the capital may have incurred, and of the amounts transferred to the legal reserve. The GM must also add profits carried forward from the previous financial year to the year ending before carrying out the suggested distribution.

In accordance with the KCL there are two restrictions that must be respected before any distribution of dividends. First, the KCL provides that a percentage of the total profits must be debited, and this amount must be specified by Articles of Association of the company or by the board of directors. This amount should be set aside every year for depreciation and for offsetting devaluation of the company's assets. Such deductions shall be applied to the purchase or repair of the necessary material, machinery and installations and this money may not be distributed to the shareholders.[66]

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[65] Tamma, *supra* note 9, p. 480.

[66] Article 166 of the KCL provides that "A percentage of the gross profits, to be specified in the articles of the company of fixed by its board of directors, shall be set aside each year for writing off the assets of the company or making provision for the depreciation in their value. This money shall be used for purchasing or repairing the machines and constructions needed; it may not be distributed to the shareholders."

Furthermore, it is taken for granted that the company's capital must remain intact and may not be reduced or distributed to the shareholders as it represents the minimum amount for securing the rights of the company's creditors.[67] Accordingly, distributable profits must be limited to the extent that they do not affect the capital. But if the company suffers losses and these are deducted from the capital, no profits may be distributed in the next financial year unless the capital is replenished. It is a general rule that whenever there are previous losses, there are no distributable profits.[68]

Second, the GM may only distribute dividends after deduction of the percentage specified by law to create a legal reserve. This reserve is recognised to ensure the ability to settle debts. It also has a precautionary function in that it prevents the distribution of exaggerated dividends with no consideration of the consequences. There are two kinds of reserves mentioned in the KCL. It provides that 10 per cent of the net profit of a JSC shall be retained as a provision for the legal (compulsory) reserve as Article 167.1 of the KCL provides that

> Unless the articles of the company provide for a greater percentage, ten per cent of the gross profit shall be set aside each year to the compulsory reserves.

Therefore, according to the above article, a company's Articles of Association may provide for a higher percentage than ten per cent, and if the Articles of Association do not have anything determining the compulsory reserves, these reserves must be ten per cent of the whole profits made in the last financial year. However, it must be reasonable, taking into consideration the company's and shareholders' interests. The profits as a whole may not be transferred to the reserve, thus denying

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[67] Ferran, Eilis, *Company Law and Corporate Finance*, 1st end., Oxford: Oxford University Press, (1999), p. 410.

shareholders the essential right to receive annual dividends if the company's earnings are such that cover the compulsory reserve and provide available dividends.[69]

The GM of a JSC may only distribute the compulsory reserve to the shareholders in one case, namely to ensure a dividend of up to 5 per cent in the years during which the company's profits do not allow that rate. Therefore, assuming that a company does not have distributable profits, as determined according to the legal provisions, it is automatically obligated to distribute up to 5 per cent as dividends to the shareholders, and these dividends should be taken from the compulsory reserves as provided in Article 167(2) of the KCL.[70]

The GM may suspend deduction from the net profits for the compulsory reserve if such a reserve exceeds half its capital. It may also use the excess in the manner and for the purposes it considers desirable and beneficial to itself and to its shareholders.[71]

Another type of a reserve mentioned in the KCL is the voluntary reserve. This is governed by Article 168 of the KCL under which the GM may, at the recommendation of the board of directors, decide each year to retain a portion of the net profits to the account of a voluntary reserve. This reserve will be used for purposes decided by the GM. To be valid, the GM's resolution must be reasonable and in the interests of the company and its shareholders. If it is designed to be adversary to the minority

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[68] See Hassni, Almasry, *Investment Companies*, Cairo: Dar Al-Nahdah Publishing, (1981), p. 238.

[69] The purpose of retaining a higher rate as a reserve must not be only to damage the interests of the minority shareholders.

[70] The compulsory reserve may not be distributed to the shareholders, but it may be used to permit distribution to the shareholders as dividends up to 5 per cent in years in which the profits of the company do not admit of distributing this percentage.

[71] Article 167(3) of the KCL.

shareholders it will be subject to challenge and they may file a legal action demanding invalidation thereof.[72]

The determination of distributable profits in the UK CA is more explicit than in the KCL. The basic rule in the UK is that a company must not make a distribution except out of profits available for the purpose.[73] The statutory rules restricting distributions apply to every description of distribution of a company's assets to its shareholders, whether in cash or otherwise, (except distributions by a number of ways mentioned in s. 263(2) of the UK CA 1995).[74] The profits available for distribution in the UK are defined as the company's accumulated realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.[75]

Moreover, there are two restrictions imposed on a JSC making a distribution provides in s. 264(1) that states

> A company may only make a distribution at any time (a) if at that time, the amount of its net assets is not less than the aggregate of its called-up share capital and undistributable reserves, and (b) if, and to the extent that, the distributions does not reduce the amount of those assets to less than that aggregate.

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[72] *Ibid.*, Article 168 provides that the GM, on proposal submitted by the board of directors, may each year pass a resolution to set aside a proportion of the net profits to a voluntary reserve.
[73] S. 263(1) of the UK CA 1985.
[74] *Ibid.*, S. 263(2) provides that "in this part, Distribution means every description of distribution of a company's assets to its members, whether in cash or otherwise, except distribution by way of (a) an issue of shares as fully or partly paid bonus shares, (b) the redemption or purchase of any of the company's own shares out of capital (including the proceeds of any fresh issue of shares) or out of unrealised profits in accordance with Chapter VII of Part V, (c) the reduction of shares capital by extinguishing or reducing the liability of any of the members on any of the company's shares in respect of share capital not paid up, or by paying off paid up share capital, and (d) a distribution of assets to members of the company on its winding up.
[75] *Ibid.*, S. 263(3).

This means in practice that before any distribution is made, first, the net assets must be greater than the total of the called-up share capital and the undistributable reserves. Second, the proposed distribution must not make the net assets amount to less than the total of the called-up share capital and the undistributable reserves.

It is common for JSCs' Articles of Association in the UK to provide that the boards of directors may transfer part of their profits to reserves before recommending a dividend despite the fact that the present UK CA does not have any provision demanding directors to create reserves.[76]

Therefore, in the UK, dividends are payable only out of profits, and to pay a dividend out of capital would be to return capital to shareholders in breach of the above principle. Capital can be reduced only according to strict requirements set out in the CA. Consequently, the UK CA sets out detailed provisions to ensure that only profits available for distribution as dividend are so utilised.

4.3.4 The Effect of Reserves of the Company on the Dividends' Right

Reserves are taken from the net profits of the companies. They refer to those amounts retained from the company's net profit in any financial year as a provision against losses or foreseen or unforeseen expenses in the future and other purposes. A reserve may not be created unless the company realises profits.[77]

The distribution of dividends is not conditional on the company's making profit during the financial year. It may have free reserves which may be distributed in the

[76] The companies Act 1948 Table A, art 117, contained such a power.

[77] Mustafa, *supra* note 51, p. 310.

form of dividends in the years in which no profits are realised.[78] This could lead to a question about which reserves are disposable. The GM cannot distribute all reserve funds to the shareholders as some reserves are complementary to the capital. Its function is only to insure against the risks that the company may face in the future and to ensure the established rights of the company's creditors. These kinds of reserves are not distributable.[79]

It is worth noting that the GM's right to dispose of the reserve must be based on legal or agreement grounds. Law provides that the GM may distribute the reserves it is allowed under law or the Articles of Association to dispose of in part or as a whole. The reserves may only be used for their intended purposes, unless the GM decides otherwise.[80]

As provided above, if the company realises no profits in any year and an amount of money is deducted from the reserves to distribute to the shareholders as dividends, the source of these funds must be disclosed in order not to give a false impression of the company's financial position or cheat the shareholders and others by implying that it made real profit in the previous financial year while profits were taken from the reserves.[81] Failure to disclose the source of such profits entails that the GM's resolution to distribute the same becomes null and void. Also, the company's board of directors should be held legally responsible, as such an act leads the company's customers and shareholders to misunderstand the real financial position of the

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[78] Younes, Ali, *Commercial Companies*, Egypt: Dar-Al-feker Al-Araby Publisher, (1991), p. 185.

[79] Mahmoud, Alsharkawi, *Commercial Companies in Egyptian Law*, Cairo: Dar Alnahdah Publishing (1986), p. 238.

[80] Alkalyoubi, supra note 19, p. 525.

[81] Hassni, AL-Jondi, *The Criminal Law of Business Transactions*, Cairo: [no publishing] (1989), p. 247.

company. The KCL should compel the board of directors to disclose that the company did not make any profits in the last financial year and that the reserves might be used to pay dividends.

To sum up, the obligation to disclose the deductions from the reserves is an essential guarantee of shareholder's rights and supports the principle of balance sheet accuracy and credibility, that helps reflect the real financial position of the company. Additionally, it threatens to reveal the consequences of the board's wrong policies and mismanagement of the company's funds, and therefore, makes the directors act more carefully and responsibly, urging them to realise profits rather than being negligent. Disclosure also consolidates a shareholder's authority and control over the company's activities. In spite of the importance of this issue, the KCL fails to provide for such guarantees, the result of which is that shareholders are more passive at the GM. It also undermines their financial rights as well as creditor's guarantees of the reserves.

The question that may be asked is: Is there a conflict between the company's interest and shareholder's interest in using the annual profits? On the one hand, the company's interest always requires retaining some of the dividends, transferring to the reserves, and using them in new investments to enhance the economic capability of the enterprise. Shareholders, on the other hand, desire to share the maximum rate of dividends. The two interests must be aligned and balanced in order not to make one prosperous at the expense of the other. But, if some of the profits go to the company and its reserves, do shareholders benefit from the profits that are retained by the company rather than paid out as a cash dividend? Arguably there are no conflict of interests between the shareholders and their companies, and also the body of shareholders benefit indirectly from the profits that are retained by the company for a number of reasons. First, self-financing has an advantage in that it puts a portion of the dividend at the company's disposal to use in new investments, projects or facilities without seeking assistance from others (e.g. bank loans) who may take too close an interest in the company's affairs and play the role of shadow directors.[82] Self-financing then plays a key role in formulating companies financial policies and is highly regarded by boards.[83] It is worth noting that company laws usually encourage the creation of reserves such as compulsory and voluntary reserves in order to ensure companies' independence and security in the face of conditions in the business environment and their ability to meet its financial needs dealing with unpredictable circumstances in the next financial year. This, of course, is extremely important for the shareholders and creditors of the company. However, the excessive application of self-financing has a negative impact on shareholder's financial rights and could lead to depriving them of the dividends that would be wholly devoted to the company's growth and expansion. This is unacceptable. This is also the case when a company pays out only a proportion of the profits as a cash dividend, while retaining the remainder. As a result, shareholders receive part of their returns in the form of dividends and part as a capital gain, and it is true that some shareholders prefer capital gains to dividend income.[84] This is because the price of their shares will appreciate by the amount of the retained profits divided by the number of shares outstanding.[85] Furthermore, a company adopts a self-financing policy when it needs additional funds, and that helps it remain

[82] The bank may act as shadow director of a company when the company is managed in accordance with the bank's recommendations. See Bhattacharyya, G., Shadow Directors and Wrongful Trading revisited, 16 *Co Law* (1995) p. 313.

83 Some jurists dismiss the policy of self-financing on the grounds that the main purpose of forming the company is to share profits as stated in Article 1832 of the French Civil Law.

[84] Ferran, *supra* note 67, p. 408; see Xuereb, Peter G., *The right of shareholders*, Oxford: Blackwell Scientific Publications Ltd, (1989), p. 48.

[85] Xuereb, *supra* note 84, p. 48.

independent and enhance its economic capability without suffering any burdens. But if it receives loans or facilities from banks, it must repay the principal amount and interest, as well as foreign exchange differentials in certain cases. Sometimes it is forced to substitute debts to shares and is thus placed at the mercy of the lender. Similarly, a company may follow a capital increase policy by issuing new shares, which can results in a number of significant and even serious consequences. The capital increase through issuing new shares can reduce the prospects of making higher profit in the future due to increasing the number of shareholders. It also undermines the old shareholder's authority and control in favour of the new shareholders and threatens the board's stability.

4.3.5 The Criminal Distribution of Fictitious Profits

The purpose of a company is usually to make financial gains to distribute to its shareholders, and the gains depend on the success of the company's performance.[86] The real distributable profits in the form of dividends are the result of commercial or industrial transactions and the remainder of the profit for the financial year after deducting all necessary commitments, depreciation and reserves. Profit which differs from that sense is considered untrue or false and so too are the dividends, which are contrary to law and the Articles of Association and represents a criminal act. This is considered a criminal act because such dividends are in fact deducted from the capital and thus reduce it,[87] which damages the rights of the company's creditors as the capital

[86] Alsharkawi, *supra* note 79, p. 239.

[87] Tamma, *supra* note 9, p. 480.

is general security for repayment.[88] Also, fictitious dividends will hardly effect the creditors of the company. At the same time, because shareholders and other interested groups in the company are not directly involved in the company business affairs, the fictitious dividends give them a false impression of the company's financial position. It deceives shareholders and attracts the public into subscribing for the company's shares. It may drive many banks and financial institutions to advance loans and open credit accounts. However, the deception is soon uncovered and the company appears unable to meet its commitments.[89] Hence, the rights of others become at stake and shareholders' lose rights. Eventually the company may go bankrupt and collapse.[90] Finally, dividend and earning announcements effect the share prices on the stock exchange, and if the dividends that are announced were fictitious and the company did not make this profit last year, as a result, the investors in the market would make inappropriate decision.[91]

Due to the detrimental effects of this action on the company and its shareholders, many company laws encounter such activity by clear and direct provisions which treat this action as a criminal offence. For example, the Egyptian Company Law in Article 162/4 provides that

> Without prejudice to severer penalties enacted by other laws, any one of the following personalities will be liable to a penalty of imprisonment during a period not less than two years, and to a fine not less than L.E. 2000 and not more than L.E. 10000 which the infractor should personally support, or by one of these two penalties:

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[88] Kanam, AL-Kanam M., The Protection of Public Saving in JSCs, Cairo: Dar AL-Nahdah Publishing, (1988), p. 72.

[89] *Ibid.*, p. 72

[90] Farrar, *supra* note 8, p. 410.

[91] Almousawi, Hishmah, Price Reaction Surrounding Dividend Announcement: An Empirical Evaluation of the Kuwait stock Exchange, 66 *Journal of the Gulf and Arabian Island Studies* (1992) p. 178.

> (5) Any member of a board of administration who distributes profits or interests contrarily to the provisions of this law or the statutes of the company, and any controller who sanctions such as distribution.[92]

The Egyptian Company Law in this article is trying to prevent the board of directors from distributing profits to shareholders in a way that contravenes the company law or Articles of Association, and compel them to distribute dividends when the company made profit from its business transactions in the last financial year. Otherwise, the distribution of fictitious dividends will affect the stability of the company and the rights of shareholders and creditors. In addition to the Egyptian Company Law, many Arabian countries such as the UAE company law in Article 322/4, Bahrain company law in Article 391/5, Saudi company law in Article 229/5[93] and Omani company law provide a comprehensive description of this crime in Article 170/4; this article provides that

> Upon being found guilty, the following persons shall be punished by imprisonment from three days to three years or a fine of ten to five hundred Rials omani, or both:
> Every person who knowingly participates in the distribution of fictitious profits of a commercial company on the basis of a fraudulent balance sheet, or without having a balance sheet, or on the basis of a fraudulent inventory or profit and loss statement.

Unfortunately, the KCL does not address this issue. This is a legislative shortcoming which needs to be rectified to eliminate its adverse effects on the company

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[92]Also Article 43 of Egyptian company law provides that "No distribution of profit allowed if it culminates in disabling the company from confronting its cash liabilities in due time.
Creditors of the company may demand from the competent court the invalidation of any decision issued in contravention to the provisions of the preceding clause. The member of the Administrative Board who approved the distribution will be jointly responsible in front of the creditors, within limit of the amount of the profits the distribution of which has been prevented.
Recourse may also be had on the shareholders who know that the distribution was effected in contravention of this article within limit of the profits they obtained."

[93]Article 229/5 of Saudi company law provides that "without prejudice to the requirements of the provisions of the Islamic Shari'ah, the following offenders shall be liable to imprisonment for a period of not less than three months and not more than one year, and/or to a fine of not less than five

and its shareholders and creditors. Therefore, an article should be added to the KCL and this suggested article should regulate that a penalty is imposed in the event of fictitious dividends. This penalty should be designed to strike a balance between the illegal act and the punishment.[94] The penalties under the current KCL are too lenient and do not match the gross mistakes which make the company and its shareholders suffer. Also, the Kuwaiti legislator should follow the approach adopted by the Egyptian legislator who specified the persons who may be prosecuted for involvement in this crime, namely board members and auditors who are in office at the time of fictitious dividends distribution.[95]

With regard to the crime of distributing fictitious profits there are a number of elements to say that this crime has been committed. First, this crime may have occurred in the absence of stocktaking or by using default stocktaking. As stated in chapter five, the board must carry out a stocktaking and prepare a balance sheet together with a profit and loss account, as well as a report about the company's activities during the year and its financial position at the end of the year. To substantiate the occurrence of the crime of fictitious profits, no stocktaking or a false one was carried out showing the company's assets in excess of its liabilities and that it has earned distributable profits. Second, the crime is not established unless dividends are declared and put at the disposal of the shareholders even if they have not actually received them. The crime is committed when the GM, under the recommendation of a director, issues a resolution declaring the dividends to be distributed to the

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thousand not more than twenty thousand Saudi Riyals: (5) Any manager or director who receives or distributes among the members or third parties fictitious (unearned) profits."

[94] Kanam, *supra* note 88, p. 90.

[95]See Article 162.5 Egyptian Company Law no. 159/1981.

shareholders.[96] A third element is the existence of fictitious profits. These refer to the dividends distributed to the shareholders despite the fact that the company has not made such profits or if they exceed the real profits earned. As the company has not gained profits from certain activities or operations, dividends are only deducted from the capital. These are deemed to be false dividends and a violation of the principle of maintaining the capital intact to secure the rights of creditors. The final element is bad faith or intent on the part of a board of directors. This element is the immaterial (moral) element of this crime. Bad faith refers to knowledge that the dividends are false regardless of the board's motive to commit such a crime.[97]

After committing this crime the question is; Can a company recover the dividends distributed to shareholders once they are discovered to be false? Once again, the Kuwaiti legislator fell short of addressing this matter, a position that should be criticised, as such distribution is deemed illegal gain. Some jurists, however, argue that shareholders are obligated to return these dividends to the company whether or not they are aware that they are false. This attitude corresponds with the Kuwaiti Civil Law which provides that any person who receives a payment in trust which is not due to him shall return the same as it is illicit profit earning.[98]

Others maintain that shareholders with bad faith should be singled out and required to return the dividends.[99] Their argument is based on the assumption that a

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[96] Kanam, *supra* note 88, p. 94; Abdel hameed, AL-Shwarbi, Financial and commercial Crimes, Alxsindra: Dar AL-Matboat AL-Jameah Publishing, (1986), p. 332.

[97] Younes, *supra* note 78, p. 527. See also Kanam, *Supra* not 85, p. 100.

[98] Younes, *supra* note 78, p. 131.

[99] This is the attitude of Egyptian company law in article 43(3) of it and Lebanon company law in article 108 of it; for more information see Sami, Fawzi, *The Commercial Companies "Public and Private Provisions"*, Jordan: Maktabt Dar Al-Thgafah Publisher, (1999), p. 523; Mustafa, *supra* note 54, p. 318.

shareholder can only exercise control on the management of a company by reading the balance sheet, profit and loss statement and board report. If these documents are falsified or if they contain misrepresentations, a shareholder may be unable to detect that. It is then fair and just that he retains the dividend, even if it were false, so long as he does so in good faith.[100] This is harmonised with the attitude of the UK CA that provides any shareholder who receives a distribution which he knows, or has reasonable grounds to believe, has been paid in breach of ss. 263 to 281 of the Company Act, must return that amount to the company[101] and he will be liable to account to the company as a constructive trustee.[102] However, a shareholder who receives an improper dividend, even if he does not know or has no grounds to believe that dividend is improper, may, under the UK CA, be liable if there is a clause in the Articles of Association of the company indicating this, or if he has at some stage signed a contract indicating that he would repay any improper dividend irrespective of the underlying circumstances.[103]

4.4 Shareholder's application of assets on a Winding-up

It is generally acknowledged that a shareholder may not claim the value of his shares during the life of the company. If he wants to leave the company, he must assign his shares to other persons who thus become new shareholders. However, upon

[100] Younes, *supra* not 78, p. 131.

[101] Section 277(1) of the UK CA 1985 provides that "where a distribution, or part of one, made by a company to one of its members is made in contravention of this part and, at the time of the distribution, he knows or has reasonable grounds for believing that it is so made, he is liable to repay it (or that part of I, as the case may be) to the company or (in the case of a distribution made otherwise than in cash) to pay the company a sum equal to the value of the distribution (or part) at that time."

[102] See *Precision Dippings Ltd v Precision Dippings Marketing Ltd* [1985] 3 WLR 812.

[103] S. 277(2) of UK CA 1985.

the termination of the company, after dissolution and liquidation of the company and statement of its debts, a shareholder may redeem the nominal value of his shares from the balance remaining, if any. If there is a surplus after the liquidation, shareholders may apportion the same as provided under law and the Articles of Association.

The KCL has provided the circumstances which lead to the lapse of a company. A JSC is liquidated when the company has achieved the objective for which it was established; with the expiry of a fixed period for which the company was established; at the declaration of the company's bankruptcy; with the dissolution of the company according to the law; and when a judicial judgement is issued to wind up the company.[104] Moreover, if the company has lost three-quarters of its capital, the board of directors must convene an EGM to discuss either the liquidation of the company or the reducing of its capital. If the board of directors fails to convene this meeting, or a quorum is not presented at the meeting, or the shareholders in the meeting refused to liquidate the company, the government department concerned and every shareholder may introduce legal proceedings to force liquidation.[105]

4.4.1 Settlement of Debts

If the company is solvent, the liquidator, before settling the company's debts, first pays the cost, charges and expenses properly incurred in the winding up, and this includes the remuneration of a liquidator. After that, he should settle the matured debts and reserve for the non-matured debts and disputed debts should be set aside.[106]

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[104] Article 170 of the KCL.

[105] *Ibid.*, article 171.

[106] *Ibid.*, Article 40(1) of the KCL provides that "the property of the company (which remains) after settlement of the rights of the creditors and deduction of the sums required to meet debts which have not fallen due and debts which are in disputes shall be divided among all its shareholders."

4.4.2 Return to the Shareholders the Value of their Shares in the Capital

The general rule is that a shareholder has claim to the company's common funds as soon as the closing accounts are approved, liquidation concluded and debts settled. In the KCL provisions to the effect that the liquidator shall return to the shareholders the value of their shares in the company's capital are met. As provided above, such refund occurs only when all company's liabilities are settled. The company's assets are distributed in the manner set forth in the Memorandum or Articles of Association, in the absence of which Article 40.2 of the KCL applies.[107] It provides that each shareholder shall be entitled to a share equivalent to his share in the capital, and the balance remaining, if any, shall be divided among the shareholders pro rata to the share of each in the profits. If the company's net balance fails to cover such shares, this means that the company has incurred losses and the loss is shared by all shareholders at the agreed rate.

A shareholder's claim to a company's assets varies in extent depending on the Articles of Association and whether these articles allow greater and smaller equities (or preference equities) than ordinary shares in terms of the remaining profits and/or capital. The KCL has settled this matter. In accordance with Article 176 that provides:

> On completion of the liquidation activities, the liquidators shall prepare the final balance setting down the share of each shareholder of the company assets.

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[107] *Ibid.*, Article 40/2 provides that "each member shall be entitle to a portion equivalent to his share of the capital as stated in the memorandum of association, and the surplus, if any, shall be divided among the members in proportion to their shares of the profits. On the other hand, should the net (pro-ceeds) of the company's property be insufficient to meet the members' shares, the loss shall be

Therefore, the company's liquidators are those responsible for determining the share of each shareholder in the assets. Distribution of the company's assets in Kuwait is easy since the company law allows the issuing of one kind of share, namely ordinary shares, and, accordingly, there is no preference for shares to others.

If the net assets of the company are insufficient to cover the full value of the shareholders' shares in the company's capital, then the deficit shall be apportioned among the shareholders in the proportion provided for the division of losses.[108]

If any rights or claims are discovered following the company's liquidation, any shareholder may file a legal action against the debtor claiming such rights in the name of the company and all shareholders. Shareholders have such a right when the liquidation process has been completed and the liquidator no longer represents the company or shareholders and hence is not authorised to claim settlement of the debts in the name of the company. Shareholders alone are the aggrieved party, as they have been paid an equity less than that in the liquidated company.

4.4.3 Distribution of the Remaining Assets

Once the company's liabilities are settled and the value of contributions to the capital has been refunded to the shareholders, the remaining assets, if any, shall be distributed among the shareholders. The KCL does not provide much detail about this distribution except that stipulated in the Articles of Association: Otherwise, the

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apportioned among the members in accordance with the ratio agreed (to be applied) in apportioning the loss."

[108] *Ibid.*,

remaining assets shall be distributed among the shareholders in proportion to their interest in the company's capital.[109]

4.5 Conclusion

Persons buy shares and become shareholders of JSCs in order to obtain a number of rights. The first rights one may think of are the financial rights. These rights are considered as an encouragement for shareholders to participate in the company, and to be more keen on knowing most of the company's affairs, which enable them to be aware of the company's financial position. However, as asserted at the beginning of this chapter, making profits for the body of shareholders is not the only aim of the company. Any JSC is, in fact, a web of contracts. Thus, it has a number of interested groups, and every group has its own interests. But, because the study is about the rights of shareholders it concentrates on their rights alone. Also, as provided in the Chapter Two, this study disagree with the supporters of the contractual theory who treat the shareholders as owners of the company, and the company must be managed in their interest alone because any company nowadays is a separate legal person. As provided previously a company is not purely a private contract between private people. In addition, as well as a board of directors and shareholders, there are other interested groups in any JSC. Sometimes it is not an institution created by the State alone without any major participation from private parties. It is a kind of combination between both theories (see chapter 2).

However, shareholders have in the company a particular special position in their company because; they are the owners of the company shares, they first bear the risk of

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[109] *Ibid.*,

venture failure and they are paid at the end, after all other interested groups in the company. In other words, they are residual risk-bearers. Therefore, they enjoy a number of powers and rights that other interested groups do not have. These include, amongst others, financial rights and attending and voting in the GMs.

This chapter started with the right of shareholders to transfer their shares at any time or in any way. It was emphasised that this is one of the basic rights that shareholders cannot be deprived of. If for some reason, the company law imposes some restrictions on the rights of shareholders to dispose of their shares, these restrictions must be designed in the interest of the company and its shareholders. The legislator must not over-impose his restrictions to the extent of depriving shareholders of this right. Unfortunately, the KCL has gone too far in imposing restrictions on this right. Investors show interest in these JSCs for the privilege that shareholders enjoy and which enable them to discard their shares expeditiously and whenever they need to do so.

Also reviewed was the right of existing shareholders to subscribe in new shares offered during the company's existence. These new shares should be offered first to the shareholders of the company and not to the public to preserve the existing balance of power in the companies. The KCL, Article 131/6 has given this right candidly to shareholders. But, unfortunately, the KCL in another article has given the boards of directors of the companies the privilege to impose restrictions on this right.[110] It must be clear in the company law and in the contract of the company that shareholders must not be deprived of this right unless they voluntarily relinquish it.

Regarding the annual profit, the KCL is criticised for not having a clear definition

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[110] *Ibid.*, Article 111.

of the word annual dividends despite its importance. With respect to determining dividends due dates, it is provided that the annual dividends become the right of the shareholder as soon as it is declared in the resolution issued by the GM of the company. However, the KCL is found to be at fault when giving the board the authority to determine the date for the distribution of the annual dividends. This means that distribution of profit can be delayed for sometime. Profits should be distributed as soon as they are advertised and boards should have no authority on this matter.

The discussion in this chapter also involved the issue of reserves, the means of creating reserves and the importance of preserving reserves as a means of maintaining the company's independence; especially avoiding banks with the need to finance projects. It criticised the KCL for allowing JSCs to pay annual dividends to shareholders from these reserves without obligating companies to inform their shareholders directly of the sources of their profits.

This chapter highlighted the fact that there is no clear mention by the KCL of the crime of distributing false dividends. This is a fault that needs rectifying. The lack of a clear article in the KCL that incriminates the alleged dividends has made many boards distribute profits from the capital without them knowing that they are alleged profits.

Finally, a company as a legal entity owns its own assets, but at the time of dissolving the ownership these assets are transferred to the shareholders and they become the owners of the assets. These assets are not to be distributed among shareholders unless or until all debts are settled. Each shareholder receives a percentage of the assets related to the shares he is holding as compared to the companies' capital.

When a shareholder invests his savings in a JSC, he knows or should well know his financial rights, as these rights are the motivation and main reason why he invested in this kind of company. However, does every shareholder know the other rights that are granted to him in his capacity as a shareholder? These rights when exercised should help him effectively to maintain his rights in the company, especially his financial rights. Among these rights is the shareholder's right to know what goes on in the company through reading any information they deem important. This is the focus of the next chapter.

Chapter Five

The Right of Disclosure of Information

5. Introduction

Shareholders of JSCs, as many commercial law jurists argue, are the interested parties, since they are the owners of the company's shares and as such are affected by the developments that take place during its lifetime. The acts of companies always, therefore, provide that the highest authority should be in the hands of the shareholders' GM.[1] The GM expresses the will of the corporate body and is thus authorised to pass resolutions related to the company's activities and its future and to appoint and remove the board of directors; it also has many other powers (see 2.4 and chapter 7). However, all these powers would be useless without a good system of disclosure.

Disclosure of information means the right of the shareholders and other interested groups in the company to receive or have access to the information related to different aspects of the company's business. This enables the shareholders etc., to evaluate the board of directors' performance[2] and to exercise effective control over their activities[3] by attending the GM, sharing in discussions, and voting on resolutions equipped with knowledge of the matters under consideration.[4] In addition, a shareholder cannot take advantage of his financial rights unless he has sufficient

[1] Shearman, Ian, *Shackleton on the Law and Practice of Meetings*, London: Sweet & Maxwell publishing, (1997), p. 115.
[2] Meier-Schatz, Christian J., Objectives of Financial Disclosure Regulation, 8 *Journal of Comparative Business and Capital Market Law* (1986) p. 231.
[3] See *Caparo Industries plc v. Dickman* (1990) 1 All ER 568.

information about the financial position of his company. For example, if a shareholder wants to exercise his right of disposal of his shares, he needs information to choose the right time of disposal to get more profit. Likewise, shareholders need to inspect and understand the company's reports and attend the GM to make sure that his savings in safe hands.

Therefore, disclosure should help shareholders to make more intelligent voting decisions.[5] An advantage of disclosure is provided by Meier-Schatz

> The studies also indicate that more effective disclosure rules would have made the execution of the fraudulent schemes very difficult, if not impossible. In addition, practical experience seems to suggest that some fraudulent conduct simply does not get off the ground because of the existence of a mandatory disclosure process. Both empirical results and experience support the thesis that the financial disclosure regulation of new securities issues can reduce although not prevent fraudulent practices detrimental to small investors.[6]

In this chapter the right of JSCs shareholders to have access to information concerning the company's affairs will be discussed. In other words, to have the right to know what is going on in their company, and to what extent companies are required under the KCL to provide such disclosure of information.[7] This is an issue of paramount importance to the shareholders and the company alike. There are many questions that this chapter will try to answer, such as; do the shareholders, according to the KCL, have the right to know the company's affairs? Does the board of directors

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[4] Mustafa, Ahmed, Protection of Minority Shareholders in JSCs, 6 *Journal of Legal Studies* (1991) p. 229.

[5] Meier-Schatz, *supra* note 2, p. 227.

[6] *Ibid.*, p. 221.

[7] Not only shareholders but many groups will use the information that must be disclosed by JSCs– bankers, debenture holders and possible debenture holders, employees, customers, suppliers and potential suppliers, etc. Benjamin, James and Stanga, Keith, Differences in Disclosure Needs of Major Users of Financial Statements, 7 Accounting *and Business Res* (1977) p. 187.

have a responsibility to deliver the information about the company's business? What documents and reports are put at the shareholder's disposal and for how long?

The right that is the subject of this chapter, is one of the most important rights considered in the study, as it is directly related to the other rights for shareholders. Through this right, attending GMs can be useful, and the votes of shareholders can also be used effectively for the interests of the company and its shareholders (see 7.3.1). By disclosure of information, shareholders can learn whether the company is suffering from problems because of the board or a third party, which gives shareholders the right to demand the adoption of judicial procedures from the board in order to protect the company's interests (see 8.1.2). Should this not happen, shareholders can take the initiative to defend the company's interests through filing a suit for the company. This chapter therefore studies a specially significant subject, as without it, many of these rights are of little use. Thus, all the information and data revealed from the company's reports shall be correct and compatible to reality, and this is what shall be assured or denied by the auditors of the company's accounts (see chapter 6). In return, this ensures the role played by the auditors of the company's accounts to in relation the company's interests, which indicates that auditors in all companies shall enjoy wide authorities. They should also be independent and far from any effect imposed by the board, and this is considered as an important right for shareholders (see 6.1).

This chapter will first discuss how far the company's board of directors is obligated to disclose the information to the shareholders and to what extent it fulfils such an obligation without request from the shareholder. It will then specify the possible sources of disclosure obligations under the KCL. Finally, the shareholder's right to use the services of an expert to help in understanding the financial position of the company if he does not possess sufficient technical knowledge will be dealt with.

5.1 The Board of Directors' Obligation of Disclosure to Shareholders

Chapter Two of this study tried to establish the nature of the relationship between directors and shareholders. Having discussed the nature of this relation it is possible, at least in theory to discover the obligations that every organ owes the other in a JSC. Chapter two provided that there are two main theories. The nature of the relationship between shareholders (the owners of the company, as many scholars argue) and the board of directors according to contractual theory is based on the agency's nature.[8] Thus, it is a relation between principals and agents. Agents are required to execute certain services on behalf of their principals; their duty should lie in the best interest of their principals.[9] As a normal result of this relation, the shareholders as principles always have the right to know what is going on in their company; and the directors as agents always have a duty to inform the shareholders about the company's business affairs.[10] However, there is the possibility that the agents controlling the company may direct the company in their own interests rather than in the interests of the principals. In this situation, and to protect the interests of the shareholders, there should be a clear disclosure of obligations on the people who

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[8] Jensen, Micheal and Meckling, William, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 *J. of Fin. Econ* (1976) p. 308.

[9] *Ibid.*

[10] Al-Shemmari, Tammah, *The Board of Directors of Joint Stock Company: Comparative Study Between Law of Kuwait and the Laws of USA*, 1st edn, Kuwait: Institution of Kuwait Publishing,

control the company.[11] On the other hand, the nature of the relationship according to the institutional theory is different. The shareholders and directors are organs among other organs. Their relationship is controlled by the law of the State. Therefore, the law determines the rights and authorities of all organs, as well as determining what should be disclosed to the shareholders by the directors. Arguably the obligations of disclosure come from both, the contract of the company (Memorandum and Articles of Association) and the Company Law.

Furthermore, in JSCs, as explained previously in the chapter 2, there is a clear distinction of powers either between shareholders through the GM and the board of directors who control the company or between power and ownership. Therefore, there are two main organs in any JSC; first, the board of directors and, second, the body of shareholders through the GM. Each organ has specific duties and rights. Company acts, in every business, give each organ powers to carry out its duties. The KCL provides that the powers of management are vested in the directors; they alone can exercise these powers.[12] In Article 146, the KCL give the board of directors extensive powers to managing their company in order to achieve the company's objectives.[13] Here it is noticed that the legislation specified the duties of the board of directors and the power they need to carry out these duties. On the other hand, the body of shareholders through the GM hold important powers in their company. The most

(1987), pp. 102-3; see also, Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn, Cairo: Dar Al-Kitab Al-Hadeeth Publishing (1978), p. 451.

[11] The relationship between the shareholders and the board of directors is a relation between principles and agents. See chapter two of this research.

[12] Article 138 of the KCL provides that "The company shall be managed by a board of directors whose composition and terms of office shall be stated in the Articles of Association…".

[13] *Ibid.*, Article 146 provides that "the board of directors may exercise all such managerial functions as are consistent with its objects, and this power of the board shall be subject to no limitation except

significant powers retained by the board at a GM, according to the KCL, are: that they have the right to elect the board of directors and auditors;[14] they can remove directors;[15]and they can fix their remuneration if this is not fixed in the Articles of Association.[16] Many rights make the directors accountable to the shareholders (see 2.5.2).

One of the aims of Companies Laws is to create a kind of balance between the main organs in every company. However, this balance does not exist until the shareholders have full knowledge of their company. Moreover, the shareholder's right to know the company's conditions and situation is closely related to his right to vote at the GM. Therefore, it cannot be imagined that shareholders could be asked to vote on matters of which they know nothing. Shareholders cannot make a good choice in the election of board of directors if they know nothing about the candidates. Also, it is not acceptable to ask shareholders to vote on the proposal of a resolution without giving them full information about its objectives. In addition, shareholders cannot be commanded to accept their part of the annual dividends until all information on the company's accounts is disclosed to them (see 4.3).[17]

To enable shareholders to exercise their right of control and supervision over the company's activities, they should be given some rights related to managing the

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such as may be provided for by law, the articles of the company, or the resolution of its general assembly...".

[14] *Ibid.*, Article 157(4).

[15] *Ibid.*, Article 152 provides "the GM may dismiss the chairman or any member of the board upon a proposal being made by the absolute majority of the board or upon application signed by a number of shareholders who hold not less than one-quarter of the capital subscribed for".

[16] *Ibid.*, Article 157(4).

[17]E.F. Fama and M.C. Jensen, Separation of Ownership and Control, 26 *J. Law & Econ.* (1983) P. 301.

company, such as access to information and the right to attend and vote at the GM.[18] To this end, many countries give shareholders of a JSC the right to control and monitor the activities of their board of directors and access to information about the financial situation of their company.

Under the KCL, the board of directors has an obligation to put some documents and reports at the shareholder's disposal[19] to prove that accounting records have been kept properly, and to show what has happened to the shareholders' wealth. However, the KCL omitted to give the shareholders some rights relating to disclosure of information, which is important in order for them to practice their role in their company, this will be discussed later in this chapter. This does not mean that the KCL does not give shareholders access to information; it gives them some rights and fails to give others, and is unclear in some instances.

Therefore, the KCL should be amended or articles should be added to enable shareholders to have more access to the company's books and records and give them enough time to identify the company's position.[20] Also, a look at the disclosure system in the UK would be useful to the legislators in Kuwait. In the UK CA 1985, the shareholders of companies and other interested groups are provided with great

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[18]Bartlett, Susan and Chandler Roy, The Corporate Report and the Private Shareholders: Lee and Tweedie Twenty Years On, 29 *British Accounting Rev* (1997) p. 247.

[19] See Articles 131, 134, 154 and 179 of the KCL.

[20] Such as French Company Law promulgated on 24 July 1966, where it is provided that shareholders have the right to know and specify the documents which the shareholders may have access to and the manner in which they exercise such a right in good time prior to the GM, see Article 162 of the French Company Law. The Egyptian legislator did the same in Article 66 of the Company Law No. 159 of 1981. Moreover, Article 66 of Egyptian Company Law provides that "the executive regulation indicates what should be brought to the knowledge of shareholders, before the meeting of the general assembly, of data concerning the allocations and salaries of the chairman and members of the board of administration and all advantages or other allowances the obtained and the operations in which any of them is interested, in discord with the interest of the company, and any other data relating to subventions or expenses of propaganda."

opportunities to obtain a great deal of information about the companies' affairs.[21] The disclosure of obligations according to the UK CA obligate JSCs to provide their shareholders with complete financial information that will enable them to take decisions with full knowledge of the facts.[22]

The directors' obligation is to run the company. Therefore, they are invested with full power to perform this task.[23] At the same time, they have an obligation to prove that they are running the company in the interest of the owners of the company or for the corporate body. To prove this, they must disclose all information related to the company's affairs as proof. In the UK, therefore, every shareholder entitled to receive notice of GM of a company must be sent a copy of the directors' report.[24] Every shareholder also has the right to demand copies of accounts and reports at any time during the year and without any charge.[25] If a shareholder's demand is not met within seven days, the board of directors and every officer in the company is guilty of an offence as provides in Section 239:

> (1) Any member of a company…is entitled to be furnished, on demand and without charge, with a copy of the company's last annual account and directors' report and a copy of the auditors' report on those accounts.
> (3) If a demand under this section is not complied with within seven days, the company and every officer of it who is in default is guilty of an

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[21] Until one of the company law scholars argues whether we need all this huge disclosure here in the UK, see Seally, Lennard, The Disclosure Philosophy and Company Law Reform, 2 *Co Law* (1981) p. 53.

[22] See Villiers, Charlotte, Disclosure and Corporate Governance, in UKNCCL(ed.), *UK Law for the Millenium*, London: UKNCCL Publishing, (1998), p 151; see also as examples see Sections 10, 19, 226, 227, 231, 232, 234, 235, 238, 709 and 711 the UK CA 1985.

[23] Table A Article 70 of the UK CA 1985.

[24] *Ibid.*, S. 238.

[25] *Ibid.*, S.239 provides "any member of a company and any holder of a company's debentures is entitled to be furnished, on demand and without charge, with a copy of the company's last annual accounts and directors' report and a copy of the auditors' report on those accounts."

> offence and liable to a fine and, for continued contravention, to a daily default fine.

This can be seen clearly in the Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury) 1992 where para.16 provides:

> Boards of directors are accountable to their shareholders and both have to play their part in making that accountability effective. Boards of directors need to do so through the quality of the information which they provide to shareholders, and shareholders through their willingness to exercise their responsibility as owners.

At the end of this section, it could be agreed that there are two main bodies in every JSC and the disclosure of information is seen as the only way for communication between these two bodies.[26] Therefore, the directors should carry out their duties in the interest of the company and disclose everything necessary about the company's business. On the other hand, shareholders receiving this information and documents should understand them and then exercise their right to monitor the directors' actions.

Consequently, shareholders should have the right at any time to inspect the annual accounts and directors' reports presented to GMs. They are entitled to be given relevant information in advance of any GM, which will enable them to take decisions with full knowledge of the facts. Moreover, this disclosure may prevent any activities by the board of directors that are seem to be in conflict with the interest of the shareholders or the company.[27] However, to what extent should such disclosure be offered to shareholders?

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[26] Bartlett, *supra* note 18, p. 246.

[27] Villiers, *supra* note 22, p. 150.

5.2 Sources of Disclosure Obligations to the Shareholders

Disclosure obligations may be imposed in Kuwait by two different sources. The first and main source is the KCL No 15/1961, from which come most of the disclosure obligations. The second source provides the laws and bylaws that organise the KSEM. These laws are imposed on any JSC wishing to be listed in the KSEM.[28] Another source of disclosure of information that exists is the information disclosed voluntarily by companies. However, it could be said that this is not one which should be relied upon in making any investment decision. Usually the purpose of information disclosed in this way is to promote the image of the company or that of the board of directors.[29]

It is worth mentioning that the company law is the main source, which obliges the companies to reveal the information required in their reports. This law is applied on all companies whether it is registered in the stock market or not. Thus it is more comprehensive, and require special attention to the articles of this law, so that it becomes more detailed and specific, which shall be revealed. In the same time, this does not deny the special importance of the bourse laws or the KSEM Laws, which require revealing some of the information such as issuing quarterly or half annually reports on the companies registered in the market. These laws may be another source for information of which shareholders and investors may benefit from in the market. Then, the role of these laws whether company law or likewise is an integral role, as each one is completing what is lacking in the other, which is generally aiming at accomplishing shareholders and investors interests.

In comparison to other countries Kuwait has very few disclosure sources-though should be more. In the UK, for example, besides the disclosure obligations imposed by

[28] Decree published on 14th of August 1983 and law No. 2 of 1999.

the UK CA 1985 there are many sources of disclosure obligations. For instance listed companies on the London Stock Exchange Market (hereafter LSEM) have to submit to various extra disclosure obligations contained in the Listing Rules of the LSEM.[30] Furthermore, a number of reports issued by Cadbury[31], Greenbury[32] and Hampel[33] committees have disclosure obligations. Other obligations may be imposed by the Institute of Chartered Accountants, the Take-over Panel and the Accounting Standards Board.[34]

5.3 What should be disclosed to Shareholders?

This section determines the documents and information that shareholders by statutory means are entitled to have access to before GMs at any time during the year, according to the KCL. This section will justify the importance of these documents or information to shareholders in exercising their role in the company and raises negative aspects of depriving shareholders from seeing or getting hold of these documents and information.

5.3.1 Shareholder's Register (Register of Members)

Every JSC must hold a register of its shareholders. This register should contain information about the shareholders of the company, such as their names and addresses,

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29 Villiers, *supra* note 22, p. 157.

30 *Ibid.*, pp. 155-6; Pendlebury, Maurice and Groves, Roger, *Company Accounts*, 3rd edn, London: Routledge Publishing, (1994), pp. 6-9.

31 Cadbury Committee, Report on the Financial Aspects of Corporate Governance (Gee: London, July 1992).

32 Greenbury Committee, Report on Directors' Remuneration (Gee: London, July 1995).

33 Hampel Committee, Final Report on Corporate Governance (Gee: London, July 1998).

how many shares held by each, the date which each person became a shareholder, and the date which each person ceased to be a shareholder as provides in Article 134 of KCL. All shareholders must have access to the register at the company's head office and any other person may have such access upon the payment of a reasonable fee.[35]

Due to the importance of the shareholders' register, the UK CA 1985 mentions it in many sections of the Company Act so as to have an effective register in the JSCs. In the UK every company with more than 50 shareholders must keep a register of its shareholders, and the register must be open to inspection during business hours free of charge, to shareholders.[36] The register of the company states the name, address, date of registration, date of cessation of being a shareholder, and where the company has a share capital, the extent of the shareholding and the amount paid up on each share.[37]

Anyone can inspect the index of shareholders at any time provided the register is not closed.[38] If a person wishes to obtain a copy of the register with addresses he can do so, but the company has 10 days from the day from the day of the request.[39] Also in the UK, if the register is inaccurate in any respect, it is possible to apply to the court to rectify the inaccuracy under S.359 (1). The court has wide powers to assert the right of an applicant to have his name entered in the register or have names deleted from the

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[34]Pendlebury, *supra* note 30, pp. 6-9.

[35] Article 134 of the KCL provides that "A (share) company shall keep a register of (its) shareholders in which it shall record the names, addresses and date registration of its members, the number of shares owned by each of them and the sum paid up on every share, and the date and manner of disassociation of disassociated members. This register shall be kept at the registered office of the company and shall be open to inspection by the members free of charge. It shall also be open to the inspection of any other person against a reasonable charge; and anyone concerned may apply for its correction if the name of a person is entered in or struck off it without justification."

[36] See S. 352, 354 and 356 of the UK CA 1985.

[37] *Ibid.*, S.352.

[38] *Ibid.*, S.356(1).

[39] *Ibid.*, S. 356(3).

register.[40] The court is also given powers, where inspection is refused or copies of the register are not supplied, to order an immediate inspection or direct copies required to be given to the person requesting them.[41]

The right to know shareholders' names and other information, such as shares held by each shareholder prior to a GM, has many benefits as it gives shareholders the opportunity to communicate with one another, identify their attitudes and co-ordinate matters which will be discussed at the GM. Such communication and co-ordination helps shareholders challenge the domination of the board members over the GMs (see 7.3.2).[42] The question that should be asked under the KCL is, if the inspection required by a shareholder or an investor is refused or if a copy of the names of shareholders or any other information required is not sent, what can shareholders do to enforce the registry to do its duty? What are the penalties that may be imposed on the company and every officer in default? Unfortunately, there are no answers to these questions in the KCL. Therefore, to have an effective registry the legislators in Kuwait should take the UK CA an as example to follow.

5.3.2 The GM Notice and Agenda

A GM cannot be held unless proper notice of it has been given to every shareholder entitled. A notice must contain important information such as the date, time, and location of the meeting. It must also contain an agenda of the meeting

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[40] *Ibid.*, S. 359(2).

[41] *Ibid.*, S. 356(5) and (6) of the UK CA 1985 provides that "if an inspection required under this section is refused, or if a copy so required is not sent within the proper period, the company and every officer of it who is in default is liable in respect of each offence to a fine. (6) in the case of such refusal or default, the court may by order compel an immediate inspection of the register and index, or direct that the copies required be sent to the persons requiring them."

[42] Younes, Ali, *Commercial Companies*, Egypt: Dar-Al-Feker Al-Araby Publishing (1991), p. 286.

stating clearly the nature of the business to be transacted and the draft resolutions proposed by the board of directors or shareholders. From the documents and information about the matters to be considered and discussed at the GM, the shareholder may be able to take appropriate decisions.

The agenda is usually sent out in good time with the notice announcing the meeting so as to enable shareholders to look into the agenda, study it, and form an opinion and appropriate decision on the matters to be discussed.[43]

In fact, the KCL is not perfectly clear as far as informing shareholders prior to the GM is concerned:[44] Article 154/1 of the KCL provides that:

> Notices of meeting shall be sent by registered mail to all the shareholders and shall contain a clear summary of the agenda at least one week before the date of the meeting.

Thus, the agenda of the GM must be sent to all shareholders and must contain a clear outline of the agenda. On the wording of this article – what is the meaning of "outline or clear summary" of the agenda that should be sent to all shareholders? Is an outline of the agenda sufficient? That means the summarised notice or the agenda under the KCL does not contain the draft of proposal resolutions. Arguably the agenda of the meeting should contain the proposed draft resolutions that the board of directors wants to approve following discussion thereof, in order that the shareholders may attend the meeting fully acquainted with what is to be discussed. Therefore, just an outline is not enough, and the KCL provides full details of what should be in the notice as in the UK CA 1985.

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[43] Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn, Cairo: Dar Al-Fker Al-Arabi Publiher, (1978), p. 462.

[44] Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 3rd edn, Kuwait: Author Publishing (1999), p. 460.

The UK CA provides that no less than 21 days' notice must be given for an annual GM or for a meeting to pass a special resolution. At least 14 days' notice is required for any other meeting.[45] The notice of the meeting in the UK should have much information, giving shareholders a sufficient indication of the matters to be discussed.[46] If the true nature of the meeting is not disclosed, such as transactions to be passed, the meeting will be invalid.[47] The notice should disclose any benefit the the directors will obtain as a result of the passing of any resolution.[48] The directors should give shareholders an explanation or additional information to understand the implication of any proposed transaction.[49]

5.3.3 The Company's Balance Sheet and Profit and Loss Account

The balance sheet is a sign of the financial situation of affairs of the company at the last financial year. It shows the net assets of the company and how they are financed.[50] The profit and loss account, on the other hand, summarises the outcome of the company's activities during the last financial year.[51] Because of the importance of

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[45] S. 269 of the UK CA 1985.

[46] See Table A, Article 38 of the UK CA.

[47] See *Baillie v. Oriental Telephone and Electric Co Ltd* [1915] 1 Ch 503. In this case the directors had from 1907 to 1914 received fees from a subsidiary company. At a later date they were advised that payment of the fees should have been approved by the shareholders. They called a meeting to approve their remuneration and to alter the articles to allow directors to receive payment for serving on the boards of subsidiary companies. The notice merely stated that directors' fees would be a small percentage of the subsidiary's profits, and did not state that the subsidiary had made very large profits, or that the total amount of directors' fees was in the region of 45 000 pounds. It was held that the resolution approving the payment of these was invalid, as proper disclosure had not been made to the shareholders.

[48] S. 426 of the UK CA.

[49] *Ibid*, S.376 (1) (b); The notice according to the UK CA should sometimes have certain resolutions to be set out in full see S. 378.

[50] Pendlebury, *supra* note 30, p. 52.

[51] *Ibid.*, p. 21.

the balance sheet and the profit and loss account, each shareholder should have the right to have a copy of the company's balance sheet and accounts to identify the company's financial position.

According to the KCL, each shareholder shall have the right to obtain a copy of the book containing a balance sheet and a profit and loss account for the previous financial year. Article 131/4 of the KCL provides that:

> A member (of a share company) shall in particular enjoy the following rights; (4) to obtain a printed booklet containing the balance sheet for the ending accounting period, the profit and loss account.

Article 25 of implementing regulations of Law No. 15 of 1960 pertaining to KCL provides:

> A copy of the balance sheet, the final accounts and the auditors' report shall be sent to the control department at least two weeks prior to the GM; the balance sheet shall be prepared in accordance with the specimen forma attached hereto.

Therefore, accounts of the company should be prepared in accordance with the model provided of the pro forma attached to the implementing regulations of the KCL.[52] However, the provisions mentioned above suffer from some shortcomings. First, KCL does not specify the period within which the shareholder shall have access to the balance sheet, say 15 days prior to the GM, as is the case in many countries which is a serious lack.[53] Article 154 of the KCL, that mentions the procedures of sending the agenda of the GM, has nothing about sending the balance sheet and the profit and loss account. Second, the KCL does not have any article that compels the directors to give any information about the post-balance sheet and its effect on the

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[52]See Appendix C that attached to implementing regulations of Law No. 15 of 1960 pertaining to KCL.

[53] See, for example, Article 89 of the Saudi Company Law where it gives the right to have a copy of the balance sheet of the company 15 days before the date of a GM.

financial position of the company. Third, there is nothing in the KCL about disclosure of information of the bonus shares distributed to a number of shareholders and the procedures that follow the distribution of this kind of share. Therefore, the Kuwait legislator should compel the Kuwaiti JSCs to keep accounting records, which are sufficient to show and explain the company's transactions. Finally, the KCL requires the board of directors to put the balance sheet for the previous financial year at the disposal of the shareholders. This could be viewed as in sufficient because in order for the shareholders to follow the soundness of the company's financial position, he needs to identify the company's balance sheet and profit and loss accounts for a number of previous years.[54] In France, each shareholder has the right to receive a brief statement of the financial situation about the company at the end of its last financial year together with the financial statements of that company for each of its last five financial years.[55]

In the UK, a copy of the company's annual accounts along with a copy of the directors' report for the financial year and the auditors' report on the accounts, must be sent to every shareholder at least 21 days before the date of the meeting.[56] The company must always supply a copy of the full accounts and related documents to any shareholder wishing to receive them.[57]

The balance sheet and the profit and loss account must give 'a true and fair view' of the company's financial position. They must also comply with detailed requirements

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[54] In Egypt shareholders of JSCs have the right to see the balance sheets and the reports of auditors for three years, for more information see, Sameha, Al Kalyoubi, *Commercial Companies*. Egypt: Dar Alnadah Publishing, (1993), p. 511.

[55] Le Gall, Jean-Pierre & Morel, Paul, *French Company Law*, 2[ed] edn, London: Longman Publishing, (1992), p. 161.

[56] S. 238 of the UK CA 1985.

[57] *Ibid.*, S. 251.

of Schedule 4.[58] The advantage of such a schedule is that the companies have to prepare their balance sheet and profit and loss account in accordance with specified formats and the contents of the balance sheet and profit and loss account is already determined by law. In particular, the accounting records must contain as provided in S. 221 of the UK CA;

(1) Entries from day to day of all money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(2) A record of all the company's assets and liabilities;

In the case of a company dealing in goods; (a) Statements of stock held by the company at the end of each financial year; (b) Statements of stocktaking; (c) Statements of all goods purchased and sold and buyers and sellers of these goods.

5.3.4 Statutory Disclosure Obligation Regarding the Board of Directors

The business of the company is executed by the board of directors who are obliged to act in the interests of the company. Directors have complete power to carry out their duties. To ensure that directors are working in the interests of the company and not in their personal interests, there should be a disclosure obligation imposed on them to produce information about themselves in order to inform the shareholders about the people controlling their company. Directors should also have to present a report on the company's business affairs. Finally, shareholders have the right to know how much the directors receive every financial year from the company, such as remuneration, benefits or bonus.

[58] See S. 226(3) of the UK CA.

5.3.4.1 Shareholders' Right to Know Who Manage and Control the Company

Article 16/2 of the implementing regulations of the KCL provides that the company shall prepare a detailed list, certified by the board of director, giving the names and capacities of the company manager, the chairman and directors of the said board. The original draft of this list shall be sent to the control department of companies, and any changes to the list during the year should also be reported to the MCI. Article 93 of the KCL requires the board to publish, within two months of the approval of the GM, the company's balance sheet and financial statements of the previous year, and a list of the board members' and auditors' names.[59]

Information about the current directors, the shadow director, managers and secretary is very important for shareholders in identifying who controls their company and what their qualifications and experience are it can help them determine whether directors meet the conditions for board membership and elect the directors they deem appropriate. Articles 140/1 of KCL that provide:

> No person even though representing a legal entity, may be a director of more than three joint stock companies which have their head offices in Kuwait, neither may he be a delegated director or board chairman for more than a joint company which has its office in Kuwait.

The KCL gives shareholders the right to know whom the current directors and managers of their company are. However, information about the directors and managers should include more than names, as these are easy to find. In other words, biographies of directors' and managers are required, so that the shareholders know the history, qualifications and experience, including previous directorship of each director. In the absence of such information it is likely that an inappropriate director is elected; this is neither in the interest of the company nor the shareholders.[60]

Therefore, an article should be added to KCL which should impose a duty on directors, managers, secretaries and candidates who want to become directors, to disclose any information that may help the shareholders learn about who is controlling the company or wants to be appointed as a director.[61]

The situation, according to the UK CA 1985, is totally different. Every company in the UK must maintain a register of directors and secretaries; it must be open to inspection to shareholders without a fee and to the public on payment of a prescribed fee. Here the shareholders and the public can obtain different kinds information about directors or shadow directors and secretaries of the company.[62] The register must state names and any former names, their date of birth,[63] usual residential address, nationality,

[59] Article 93 of the KCL provides that "the directors shall, within two months from the date on which the GM approves the accounts, publish in the Official Gazette the balance sheet of the expired financial year and a list stating the names of the directors and the auditors".

[60] Unfortunately, the KCL do not have any article that concentrate on the qualifications that every directors or manager must has. This shortcoming must be fixed to protect the interests of shareholders and other interested groups in every company by prohibiting unsuitable directors from being concerned in management of JSCs see Hicks, Andrew, Director Disqualification: can it Deliver? *J.B.L* (2001) p. 433.

[61] In Egypt, Article 87 of the Egyptian Company Law no. 159/1981 provides "every company should dress annually a detailed list approved by its board chairman and the delegated member, with the name of its president and members of the board and their qualities and nationalities"; also Article 221/1 of implementing regulations of Egyptian Company Law no. 159/1981.

[62] See S. 288 of UK CA 1985.

[63] This is because directors of the JSCs in the UK need approval from the shareholders if they are to remain in office over the age of 70; see S. 293 of the UK CA 1985.

business occupation, obligation relevant to former directorship relating to the previous five years,[64] and a copy of each director's contract of service.[65]

5.3.4.2 Board of Directors' Report

The directors' report is extremely important to the shareholders as it contains information on the company's business, management and financial position. All company laws, therefore, provide that every JSC should present these two reports. For example, Article 131 of the KCL provides that:

> A shareholder (of a share company) shall in particular enjoy the following rights: (4) to obtain a printed booklet containing...the report of directors.

According to this article, each shareholder shall obtain a copy of the directors' report. However, this article has a defect with regard to specifying an important point, namely the minimum period before the GM within which the shareholder must receive this report. According to the KCL, each shareholder should be sent a copy, but the question is how long before the GM should the report be sent? This is a very important point since most shareholders are ordinary who may not find it easy to understand the figures and statistics in the report. Therefore, they need to have the report some time before the GM. The KCL should thus have a specified minimum period, say 15 days. In the UK, every shareholder has the right to receive a copy of a company's annual accounts, together with copies of the directors' report and auditors' report, at least 21 days before the date of the meeting.[66]

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[64] *Ibid.*, S. 289.

[65] *Ibid.*, S. 318.

[66] *Ibid.*, S. 238.

Regarding the contents of the report, it shall include information such as net proceeds and payments and a detailed description of the method in which the board proposes that the dividends of the year be distributed. Article 157/1 of the KCL provides that:

> (1) The reading of the directors' report on the activities of the company and its financial situation during the year; the report shall give sufficient explanations of items of income and expenditure and a detailed proposal of the method and date of distributing the net profits of the year;

According to this article, the directors' report must contain details of the company's activities and its financial situation during the last financial year. The report should also provide the date and level of the dividends recommended by the board of directors.

The information that should be disclosed by the directors' report, according to the KCL is not sufficient. The directors' report should be imposed to contain more information than that mentioned in Article 157. The directors of the JSCs should not be left entirely free to choose exactly what information is to be disclosed to the shareholders and the public. Despite the importance of this report, the KCL, unfortunately, has only this small provision explaining what should be mentioned in it. The directors' report is one of the most important reports issued by JSCs. Therefore, a company law and Articles of Association must always give it the attention it deserves. In addition, the directors' remuneration should always be linked to the performance, and this link will encourage them to enhance their performance in the company.[67] Thus, the KCL should contain a mandatory schedule of the report that the directors must comply with when they write their report, as is the situation in the UK CA.

[67] This is one of the main criticizes to the directors remuneration policy in the UK, see Directors' Remuneration: A consultative Document, DTI July 1999, para 5.7.

Shareholders also have the right to be aware of the deals concluded between the company and the members of the board of directors. This attitude is adopted by the KCL when it provides in Article 151 that:

> The chairman and member of the board of directors may not have any direct or indirect interest in contracts and deals with the company or on its behalf without the authorisation of the GM.

From this, it is very clear that the board of directors may not have any interest directly or indirectly in the agreements or deals concluded with the company or on its behalf without permission from the shareholders in the GM.[68] The purpose of this provision is to protect the company and shareholders from any abuse that may result from the board of directors pursuing personal gains. Hence, these deals should be under the control of the shareholders in the GM.[69] However, arguably this rule should be applied to shadow directors and higher employees of the company, and the deals concluded between the company and any director, shadow director or employee, should be mentioned in the directors' report upon permission from the GM. Furthermore, the directors' report should contain information about employment, such as the number of employees in the company and their total remuneration, qualifications and any other relevant information.

In the UK, the directors' report must include a great deal of information that the KCL does not compel directors to mention. For instance, the report should have details about the board of directors[70] and their interest in the shares and debentures of

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[68] Also Article 19 of pro forma of articles of association of a JSC (similar to Table A in the UK AC) provides that "a director may not…have a direct or indirect interest in contracts or transactions which are concluded with or for the company, nor shall he have an interest which conflicts with the interest of the company, save when the same is specifically authorised by the GM".

[69] Tamma, *supra* note 44, p. 425; Mustafa, Kamal, *Commercial Companies: General Provisions in Companies*, Dar Al- jama Al-jadeeda Publishing, (1997), p 271.

[70] See S. 234(2) of the UK CA 1985.

the company.[71] The report should also have clear information about the business activities and development of the last financial year,[72] the likely future business development, and the level of the dividends recommended to shareholders.[73] Moreover, the report should have information on the employees of the company.[74] The UK legislator can then draw a clear picture of the directors' report and specify in a direct way what should be in the report.

Besides this, the UK CA imposes a duty on any director with a direct or indirect interest in contracts or a proposed contract to disclose such an interest. This duty is also imposed also on the shadow director as applied on directors, thus he too has to disclose all the interests he has in the company.[75]

5.3.4.3 Shareholders' Knowledge of Directors' Remuneration and Benefits

As a company is an artificial person, it cannot carry out any of its tasks and must act through a number of natural persons. The amount of directors' remuneration is usually fixed in the directors' service contracts or in the Articles of Association. Shareholders have the right to be aware of the directors' remuneration and fringe benefits so as to be able to detect any malpractice in this respect and ensure that directors are only paid the amount to which they are entitled under company law or the Articles of Association. Also, the disclosure of directors' remuneration is of

[71] *Ibid.*, Sch 7, 2A.

[72] *Ibid.*, S. 234(1)(a).

[73] *Ibid.*, S. 234(1)(b).

[74] For more information see the UK CA1985, Sch 4, para 56, Sch 7, para 3-5, para 7(a)(b)(c), para 8(9) and para 12.

[75] *Ibid.*, S. 317.

fundamental importance to strengthening accountability and encouraging enhanced performance.

Unfortunately, the KCL as always, does not give this issue enough attention: thus, the door is opened for the directors in many JSCs to take advantage of this lack and get remuneration they do not deserve. Article 150 of the KCL provides:

> The Articles of Association shall specify the manner of determining the remuneration of the chairman and members of the board of directors. The total of those remuneration's may not exceed 10 per cent of the net profit after all deductions of depreciation and the amount (set aside to) reserves, and distributing to the shareholders as dividends (the equivalent of) 5% of the capital or such other percentage as may be provided for in the articles whichever is greater.

Also Article 157/4 of the KCL provides:

> The following matters shall be included in the agenda of the AGM:
> (4) The election and determination of the fees of the directors and auditors payable to them during the coming year, if it is not fixed in the articles of association of the company.[76]

The board's chairman and directors' remuneration shall be determined by the company's Articles of Association, and if it not determined by these, the remuneration of directors should be presented to the GM to be determined. However, in all cases, such remuneration shall not exceed a maximum of ten per cent of the net distributable profit of the company after deducting depreciation, the reserves and distribution of dividends to the shareholders of not less than five per cent of the company's share capital.[77]

According to the KCL, it is clear that the remuneration of directors should not exceed ten per cent of the net distributable profits of the company and each

[76] Article 27 Implementing Regulations of KCL No. 15 of 1960 provides "Notwithstanding the provision of the law of commercial companies, the ordinary GM shall determine the remuneration of the directors; the board of directors shall determine remuneration of the delegated directors and the salary of the managing director."

shareholder has the right to know the amount the directors receive as remuneration. Nevertheless, the Kuwaiti legislator overlooked the other amounts that directors may receive during the financial year which the shareholders have no idea, such as expenses, attendance fees, travel fees, benefits in kind, consultancy fees, and shares in the net distributable profits of the company. The total of these amounts may exceed the directors' remuneration. The KCL does not impose any duty on the board of directors to present a detailed statement of remuneration and benefits received.

As this is an important issue, the Kuwaiti legislator should impose a disclosure obligation on the directors to provide a statement or schedules at the end of each financial year. This schedule should disclose to the shareholders all the benefits the director have gained during the last financial year. It is hoped that the Kuwaiti legislator will adopt the attitude of the Saudi Companies Law on this issue, which provides in Article 74/3:

> The board of directors' report to the regular GM must include a comprehensive statement of all the amounts received by directors during the financial year in the way of emoluments, share in the profit, attendance fees, expenses, and other benefits, as well as of all the amounts received by the directors in their capacity as officers or executives of the company, or in consideration of technical, administrative, or advisory services.

This kind of report would certainly help shareholders in the GM detect any wrongdoing or misuse of the company's funds, as it is inconceivable that directors would exaggerate their remuneration when they are obligated by law to present such a statement to the shareholders. [78]

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[77] Alshammiri, *supra* note 10, p. 196.

[78] Article 151 of the Yemeni Company Law compels the board of directors of any JSC to present an annual statement to the shareholders 15 days prior to the GM.

Directors' remuneration in the UK may be determined by a company's Articles of Association. In this event the court will not make its own determination of remuneration.[79] Table A, Article 82, provides:

> The directors shall be entitled to such remuneration as the company may by ordinary resolution determine and, unless the resolution provides otherwise, the remuneration shall be deemed to accrue from day to day.

This means that the directors' remuneration may be determined at the GM by ordinary resolution. However, it must be mentioned that the UK CA 1985 does not require the accounts of the company to disclose the remuneration of a director by name, it only requires that a company reveal in the annual accounts the total amount of the directors' remuneration, fees and other benefits.[80]

The Greenbury Committee declared a Code of Best Practice concerning the directors' remuneration.[81] This Code is annexed to the Listing Rules of the LSEM. However, its listing companies have to declare whether or not they have submitted to Section A of the Code.[82] In addition, they have to issue a report of the remuneration committee and this report has to provide the amount of each different specified component in the remuneration package of every director.[83] In the UK CA there are also a number of provisions on disclosure of directors' interests in shares and debentures. A director must disclose to the company any interest, or changes in

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[79] See *Guinness plc v. Saunders* [1990] 2 AC 663; *Re Richmond Gate Property Co. Ltd* [1965] 1 WLR 336.

[80] See S. 232(1) and Sch. 6, part I; Ramsay, Ian M, Directors and Officers' Remuneration: The Role of the Law, *JBL* (1993) p. 355; Hampel Committee Report, para 2.12, provides that "the company's annual report should contain a statement of remuneration policy and details of the remuneration of each director."

[81] Greenbury Committee, *Report on Directors' Remuneration* (Gee: London, July 1995).

[82] See Listing Rules 12.43 (w); section A is concerns the establishment and operation of committees of remuneration.

interest, he or his spouse or dependent children have in shares and debentures of the company.[84] The particulars must be supplied to the company and shareholders within 5 days of the event which gave rise to the disclosure obligation or the director's knowledge of it. The company must maintain a register of directors' interests and, in the case of a JSC, the notification must be passed to the Stock Exchange before the end of the day following the date which the company receives the information. The Exchange may publish the information it receives. Criminal sanctions are imposed for non-compliance.[85]

In addition to statutory legislation, the Listing Rules of the London Stock Exchange apply to securities transactions by directors of the companies, listed on the Stock Exchange. In chapter 16 of the Listing Rules, companies are required to notify the Exchange of information they receive pursuant to part X of CA 1985.[86] Thus, every shareholder of one of the listed companies can easily, at the end of the financial year of his company, know how much benefit every director has received from the company.[87]

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[83] *Ibid.*, 12.43 (x).

[84] Not just directors are obligated to disclose their interest in shares of the company. Part VI of the CA 1985 sets out the law on the disclosure of interests in shares. The law applies to all JSCs. Section 198 and related provision require persons with interests in shares to disclose these to the company, within two days, when they reach or fall below specified disclosure thresholds. For most types of interests the starting threshold is 3% of the company's shares and disclosure must be made at each percentage point thereafter. Section 212 and related provisions empower companies to issue notices requiring those believed to have an interest in their shares to provide certain information. See Proposals for Reform of part VI of the Companies Act 1985, Consultative Document, DTI, April 1995.

[85] Sections 324 – 329 and Schedule 13 of the UK CA.

[86] See Disclosure of Directors' Shareholders: Proposal for an Order Under the Deregulation and contracting out Act 1994, DTI, Consultative Document, August 1996.

[87] The current disclosure requirement in the UK have been subject to criticism. As provided in one of consultative documents published by the DTI 1999 "the main criticism are, 1- requiring disclosure in excessive detail, with the result that the essential features are often obscured; 2- failing to provide information which clearly shows the link between pay and performance, even in respect of long term

5.3.4.4 Documents and Information that must be delivered to the MCI

In every country there is a governmental department, usually at the MCI, and this department has the right to exercise control over JSCs to ensure that the provisions of the law and Articles of Association have been respected, as provided in Article 178/1:

> The government department concerned may exercise control over a joint stock company to insure that the provision of the law and the Articles of Association have been observed.

Therefore, to enable this department to carry out its duties and have effective control over the JSCs' affairs, there should be full disclosure from these companies to this department. It might be asked what is information and documents that should be delivered and kept in the government department concerned of MCI according to the KCL.

In fact the information and documents that must be delivered to the government department concerned is a general things, such as Memorandum and Articles of Association,[88] a list showing the names of the chairman, other directors and the managers of the company,[89] a copy of the balance sheet, the final accounts, and the

incentive schemes." See Directors' Remuneration, Consultative Document, DTI: July 1999, pp. 21-22, also Villiers, Charlotte, Disclosure Obligations in Company Law: Bringing Communication Theory into the Fold, *Journal of Corporate Law Studies* (2002) p. 181.

[88] See Article 71 of the KCL.

[89] *Ibid.*, Articles 145 and 153; Implementing Regulations of KCL No. 15 of 1960 provides in Article 15 that "the control department for companies (in the Ministry of Commercial and Industry) shall keep an alphabetical register wherein shall be entered the names of the chairman and directors of the board of directors and delegated directors of joint stock companies showing against each name the names of companies in which they hold such positions".

auditors' report.[90] Also, every JSC in Kuwait has, at the department concerned in the Ministry of Commerce, the names, addresses and qualifications of the auditors.[91]

Shareholders are allowed access to the company's records and documents at this department. In other words, anybody (shareholder or non-shareholder) may have right of access to the information and documents relating to any JSC, and may obtain a copy of the originals of such information and documents.[92]As provided in Article 179 of the KCL:

> Any interested person may have access to all information available at, and documents kept with, the government department concerned which pertain to the company; he may also obtain a true copy of the originals thereof against payment of a fee, to be filed by the government department concerned.

The information that is located in this department is basic information and shareholders do not need to go to the department concerned at the MCI to obtain it either because of the low value of these documents and information or because they may be obtained elsewhere. Therefore, this situation must be changed and more important information on the Kuwaiti JSCs must be sent to this department so that it becomes one of the main sources of information to the shareholders and public. The UK Companies Act is a very good example to follow. According to the UK CA 1985, much information must be sent to the registrar and kept at Companies House for

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[90]Article 25 of Implementing Regulations of the KCL no. 15 of 1960.

[91]*Ibid.*, Article 24.

[92] Also Article 31 of Implementing Regulations of the KCL provides "(1) any interested person may have access to the information and document relating to any joint stock company which are in the custody of the control department for companies against payment of a fee of 10 rupees for each quarter-of-an-hour or fraction thereof. (2) any interested person may obtain a true copy of the originals of such information and documents against payment of a fee of 10 rupees per page or part thereof".

inspection by the public.[93] This includes the address of the company's registered office, its Memorandum and Articles of Association,[94]its issued share capital, names of directors and secretary of the company a copy of the company's annual accounts and reports, and much more information.[95] A company must notify the registrar within 14 days of any change in its directors or its secretary,[96]

5.4 Obligation of Disclosure Imposed by Kuwaiti Stock Exchange Market

In addition to the duties of disclosure laid down in the KCL, the regulations that organise the KSEM impose more disclosure obligations on public companies.[97] The regulations of the KSEM give shareholders and investors, in general, a good opportunity to get more information on the business affairs of the public companies listed on the market.[98]

Every JSC seeking a listing on the stock market must produce comprehensive and accurate disclosure of its business affairs. Therefore, every JSC registered in the KSEM has to submit all the information and statements that the management of the market may demand and this should be accurate and match the real situation of these

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[93]Gower's *Principles of Modern Company Law*, Paul L. Davies (ed), 6th edn, London: Sweet & Maxwell Publishing, (1997), p. 506.

[94]See S. 10(1) of the UK CA 1985.

[95]*Ibid.*, S. 10(2).

[96] *Ibid.*, S. 288(2)

[97] See the decree organising the KSEM published on 14th of August 1983 that organising the KSEM and the law no. 2/1999.

[98] The companies listed in the KSEM are divided into eight sectors: the banks sector, the investment sector, the insurance sector, the real estate sector, the industrial sector, the services sector, the food sector, the non-Kuwaiti companies sector.

companies.[99] Also, all the records and registries of shareholders should be under the observation of the management of the market which has the right to properly make sure, that the information is right and accurate.[100] Every JSC has to disclose all the information and resolutions that may affect the prices of their stocks to the management of the market.[101] Furthermore, Law No 2 of 1999 adds a new obligation of disclosure, though this time on every shareholder in one of the companies listed on the Kuwaiti market. Every shareholder who has a number of shares equal to five per cent or more of the company capital has to, by official methods, inform the board of directors of the company. The company then has to transfer this information to the management of the market.[102] This information should be kept in a registry in the market and any person concerned may inspect the information and documents kept in this registry[103] after making an application to the management explaining the reasons for his request.[104] At this stage, the management of the market has the right to accept or reject this request without giving any reason for so doing. Law no. 2/1999 has one main defect; this law gives the management of the market the right to agree or refuse to disclose any information it has. Therefore, this law will not achieve its full aims until the information that has been disclosed to the market by public companies, publishes directly to the shareholders and investors in the exchange market.[105]

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[99] See Article 14 internal bylaw of the KSEM.

[100] *Ibid.*, Article 15.

[101] *Ibid.*, Article 17.

[102] Article 1 of the law no. 2/1999 and Article 2 of resolution no. 5/1999 of KSEM Committee.

[103]Article 3 of the law no. 2/1999

[104] Article 6 of resolution no. 5/1999 of KSEM Committee.

[105] Many investors complained because there is no transparency in the market and they are saying that some of the members of the committee of the market are not working neutrality. They are asking the

After pointing out to the information sources for shareholders, mentioned the rights admitted by the Kuwaiti legislator, and criticised the KCL regarding many deficiencies, in which is it characterised by inadequacy and weakness, we shall pose the following significant question: in case of the complete and full exposure of all the required information, how can shareholders benefit from this exposure and expression? We shall first point out that each shareholder has a limited number of shares that grant him a number of votes, and that it is impossible that any shareholder has a remarkable individual role in the company's GM. Therefore, this role can be effective after being acquainted with the company's status, as there must be co-operation between shareholders. This co-operation shall lead to the co-ordination among shareholders in the GM, which in turn shall lead to granting them supreme authority in the assembly. All the aforementioned facts shall result in opposing correct surveillance on the works of the board. Hence, the statement of the names and addresses of shareholders, as well as the shares they possess, is an important matter for helping shareholders to communicate. It also assists in eliminating the reason that may be behind the carelessness of many shareholders regarding attending the meeting of the GM. This subject shall be examined when we study shareholders rights in the GM are discussed (see 7.3.2).

5.5 Shareholder's Right to Use the Service of an Expert

One of the possible reasons put forward to explain the lack of usefulness of the annual reports of the company is that reports are too difficult to understand. Therefore, a shareholder's right to use the services of an expert is important in the

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ministry of commerce to fix the situation. For more information see Economic Editor, Deviation some of market committee's members, *Al-rai Al-aam newspaper*, 8 April 2000.

event that he or she does not fully understand the annual reports, certain items in the company's balance sheet or board resolutions, or draft resolutions at the GM. Many studies note that private shareholders face difficulties in reading and understanding parts of annual reports.[106] This may be due to the fact that the information presented to the shareholders is inadequate or needs technical expertise, which most shareholders lack. The shareholder, therefore, finds himself needing to resort to a person with the necessary technical expertise.[107]

The KCL does not provide that shareholders have the right to resort to an expert on looking into the company's documents. This is a legislative defect, which must be addressed in order to give the shareholders the greatest amount of protection. As experience has shown the weakness of control of the GM and the domination of the board of directors over the company's affairs – in addition to the measures they take at the GM to ensure that no decision is taken to remove them from office or file a lawsuit against them. Also, the majority prevail at the GM and the interests of the minority are neglected. Moreover, auditors are likely to be influenced by the board members and hide their mistakes.

The Kuwaiti legislator should give shareholders the provision to approach experts, when they exercise their right of access to the company's books and records. The expert must be a lawyer or an accountant, which is logical, as information is often

[106] Chandler, *supra* note 18, p 248; see Anderson, Ray H., and Epstein Marc J., *the Usefulness of Corporate Annual Reports to shareholders in Australia, New Zealand, and United States: An Interenational Comparison*, London: JAI Press INC, (1996), p. 17.

[107] Abou Zied, Radwan, *Shareholding Companies in Public Sector*, Egypt: Dar Al-fker Al-Arabi publishing, (1983), p 271; Mahmoud, Al sharkawi, *Commercial Companies in Egyptian Law*, Egypt: Dar AL-Nahdah AL-Aribia publishing (1986), p. 231.

of a legal or accounting nature.[108] It is worth noting that in all events an expert may only have the same degree of access to the company's books and records as the shareholder himself.

5.6 Conclusion

Clearly, shareholders have a number of responsibilities in their company that can not be carried out by others such as creditors, employees or even directors of the company. They have these responsibilities because of their position in JSCs. In chapter two it was established that the body of shareholders are not the owners of the company as provided in the contractual theory because a company as a separate legal person owns its assets. In addition, shareholders are not simply one of a number of organs within the company as provided in institutional theory. This is because a company is not a private contract or an institution created by the State. It is somewhere between these two theories (see chapter 2).

However, the body of shareholders is an appropriate body to carry out a number of rights and responsibilities because of their special position in the company. They are the main providers of the company's capital. They the owners of the company shares and, furthermore, they first bear the risk of venture failure because they are paid after all other interested groups in the company. In other words, they are residual risk-bearers with more potentially to lose. Due to their position in the company, the powers within any JSC distribute between two main organs. The body of shareholders is one of them. Shareholders appoint and dismiss directors and auditors. They monitor the performance of the board of directors through reports of the company and

[108] See for example the Implementing Regulations of the Egyptian Company Law no. 159/1981

by attending and voting in GMs. Hence, any of these obligations can not be carried out without a good system of disclosure and a clear transparency.

Shareholders cannot carry out their rights without disclosure of information. In fact, shareholders may assist in increasing the company's turnover when they have information about their company's business. Finally, disclosure is an effective method of reducing the attempts of directors to run the company in their own personal interests.

Unfortunately, the system of disclosure in the KCL is insufficient in ensuring that shareholders receive the true picture of the company's situation. Shareholders will not play their vital role if they are not granted a clear right to be informed of all company's documents and reports. Therefore, this matter should be reviewed and clarification should be transparent in the KCL.

Consequently, there is no doubt that the disclosure of information is an essential right of shareholders and other interested groups. Therefore, the KCL must specify the content of these reports to ensure that all the information needed by the shareholders or investors is included. However, what is the credibility and quality of this disclosure, especially if the information is prepared by the board of directors of the company? How do shareholders know the disclosed information is full and accurate information? This is the duty of the auditors of the company and it is the focus of the next chapter.

Article 301/1 that provided expressly the shareholder's right to use the service of an expert.

Chapter Six

The Auditors and Their Duties toward Shareholders

6. Introduction

The separation of ownership and control may create conflict of interests between directors who control the company and the body of shareholders who own the company (see 2.4 and 2.5). Shareholders, through the GM, have the right to control and supervise the activities of the board to make sure that the directors are working in the interest of the company and not in their personal interests. In practice, few individual shareholders attend GMs (see 7.2.3). There are many circumstances that may prevent shareholders from carrying out their rights in their company, such as the large number of shareholders and their indifference to the affairs of the company. In addition, many lack the necessary expertise and so their control over the GM is insufficient.

Therefore, Company Acts always seek to provide the shareholders with instruments to help them monitor the performance of the directors. These include obliging companies to keep proper accounting records, preparing a profit and loss account and balance sheet and requiring directors to hold a GM annually to discuss these accounts before shareholders. Copies of all of these documents and accounts must be sent to the relevant governmental department in the MCI.

However, as these accounts are prepared by directors and managers in the company, they are essentially reporting on their own performance. Thus, they may be tempted to disclose incorrect or incomplete information in their reports to reflect favourably on the management of the company's affairs. Here, there is a clear conflict of interest between the directors who fix the financial reports, concerning their performance in the last financial year, and shareholders and investors who use these reports to ensure that directors are working to maximise their welfare. Every party has its own interest; directors want to design the report in such away that reflects the high value of performance, whilst shareholders want the reports to represent the real financial situation of the company.

Therefore, shareholders and other users of the company's reports expect auditors to enter into company business affairs to exercise observation over the board and management of the company and to take an active part in improving the quality and extent of financial disclosure. The auditor is expected to be concerned with the possibilities of both fraud and illegal behaviour by management. Shareholders also want this report to be accurate in order to help them to decide whether to leave their holding of shares as it is, increase it, sell out, or, in some circumstances, use their voting right in such a way as to protect the shareholders' interests. In summary, the users of financial reports want the auditors to provide reasonable assurance that directors have fulfilled their responsibilities and be truthful in the company's reports.

It can be seen that there is a potential conflict of interest between the organisers and users of the reports. At the same time, shareholders cannot individually undertake to monitor the activities of directors to ensure the accuracy of the financial reports. In other words, shareholders do not know if directors will behave with the resources of the company in their personal interest or in the interest of the company. Therefore, it is prudent to appoint an independent auditor to report on the activities of the directors.

There must be a person or persons working on behalf of the shareholders to audit the company's accounts and ensure the quality of the information contained in these accounts and statements.[1] These persons should be professional and have the right of access to the accounts and records of the company. They should submit a report to the shareholders at the GM stating whether in their opinion the financial statements presented by the directors give a true and fair view of the company's performance and situation.[2] In other words, the duties of the auditor are to examine the company's financial accounts, which have been prepared by the board of directors. This report of auditors may be used as evidence to support the accuracy of information contained in the financial reports.[3] However, it could also be seen as a certificate that guarantees the correctness of the company's reports or an instrument that adds to the credibility of the company's accounts.[4]

An important question that may be asked here is, do as the existence of the auditors sufficiently protect the shareholders? Without doubt, auditors do protect the interests of shareholders and other interested groups in any company. Their report is one of the most important documents that every shareholder and investor should start with in order to understand the real financial and non-financial position of the company. They confirm the quality of the information that is disclosed by directors in the reports of the company. Furthermore, the existence of an auditor is useful for creating a balance of power between the two main organs in any JSC (see 2.5) because the auditors monitor the reports of directors in the interest of the body of shareholders.

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[1] Dunn, John, *Auditing Theory and Practice*, Great Britain: Prentice Hall Publishing, (1991), p. 6; see also Sherer, Michael and Stuart Turley, Current Issues in Auditing, 3rd edn, London: Paul Chapman Publishing, (1997), p. 6.

[2] Paula, F. Clive and Attwood, Frank A., *Auditing Principles and Practice*, London: Pitman Publishing, (1976), p. 6.

[3] Shere, Michael and Kent, David, Auditing and Accountability, London: Pitman Publishing, (1983), pp. 8-9.

As will be seen later in this study (see Chapter 7), shareholders, through the GM, have the power they need to establish whether the directors are working in the interest of the company. Unfortunately, most of the shareholders in the JSCs are not active in their companies. They are not using the power they have in and out of the GM to monitor the work of the directors. This absence makes the role of auditors even more important to maintain the balance of powers within the company. But that does not mean the auditors of the company drive the shareholders to distance themselves from their company as the role of auditors is totally different to the role of the shareholders in the company.

However, if the auditors are not independent from the control of directors, and the legislator does not provide the powers they need to perform their duties in the company law they will not carry out their duties sufficiently to protect the shareholders. In effect, their report will be worthless.

Auditors, according to the KCL, are agents of shareholders. Therefore, auditors should always keep the interest of the body of shareholders at the forefront of their mind.[5] In fact, auditors are playing a role that should be played by shareholders. However, due to lack of experience, qualifications, time, and the huge number of shareholders, there should an auditor to perform this role on behalf of shareholders. This person is a practised accountant who inspects the company accounts in order to give his or her opinion as to the reliability of those accounts.

This chapter will cast some light on the role of auditors in the JSCs under the KCL, and their relationship with the body of shareholders. It begins with the

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[4] G. W. Beck, The Role of the Auditor in the Modern Society: an empirical, Accounting and Business Research, (1973), p. 118; see also Lee, T.A., the Nature of Auditing and its Objectives, 81 *Accountancy* (1970) pp. 292-6.

importance of the auditors' role in the JSCs in relation to the body of shareholders, followed by a discussion on the appointment and removal of auditors, the procedures that must be followed to appoint or remove the auditors. In addition, the chapter focus on the duties of the auditors toward the company and the body of shareholders, and the powers they have to execute their duties, the auditors' report and the authority of auditors.

6.1 For Whom are the Auditors Preparing their Report?

There is no doubt that the auditing professional sees the shareholders as the main interest group.[6] Auditors, as professional people, represent the body of shareholders in examining the books and accounts of the company and submit a report at the end of their task to add more credibility to financial accounts of the company. This is clear in the KCL when Article 165 considers auditors as agents of shareholders. In almost all Companies Laws looked at so far, the body of shareholders (in theory at least) have the right to appoint auditors, fix their remuneration and remove them from office. Consequently, there is a contractual relationship between the principals (the body of shareholders) who has the authority to appoint the auditors and auditors (agents). An auditor has a contractual responsibility toward the shareholders.[7] The main statutory duty imposed on auditors is to report to the shareholders independently on the information provided by directors. However, shareholders are not the only user of this report. The auditor report is important to anyone who has or who wants to have interest in the company.

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[5] Article 165 of the KCL no. 15/1960.

[6] Beck, *supra* note 4, pp. 117-22,

Because of the importance of the role of auditors in the interest of shareholders and to have this kind of clear and clean auditing, shareholders must play the main role in many cases such as, the appointment and removal of auditors, qualifications, independence, freedom of access to the company books and accounts at any time, to determine the contents of their report and their relationship with shareholders. These issue will be discussed in the rest of this chapter.

6.2 Appointment of Auditors

As stated above, many things can influence the independence of the auditors. One is the issue of their appointment. The first auditors are appointed at the general constituent meeting[8] at the end of the subscription process for the public. This appointment is made by an absolute majority resolution of the shares represented.[9] Subsequent appointments are made by annual GMs according to Article 161 of KCL that provides:

> The company shall have one or more legal accountants who shall be appointed and his/their fees determined by the GM to audit the accounts of the company; he/they shall audit the accounts of the company during the financial year for which appointed. Exemption from the above provision, any JSC registered in the KSEM shall have at least two legal accountants from different accounting offices.[10]

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[7] Hopkins, Leon, The Auditor Report, London: Butterworths Publishing, (1984), p. 97.

[8] The first meeting after the end of the process of incorporation of the company contribution.

[9] Article 90 of the KCL provide that "The general constituent assembly shall elect the first board of directors and the first auditors, and proclaim that the incorporation of the company has become final." The general constituent assembly's resolutions shall pass by an absolute majority of the shares represented, in accordance with the provisions of Article 156.

[10] In Kuwait, the auditor's relationship with the company is governed by the provisions of Commercial Companies Law and Decree Law 5 of 1981 concerning the auditing profession.

Every JSC must appoint one or more auditor to audit the accounts of JSCs. However, JSCs registered in the KSEM must have at least two auditors and each must be from different accounting companies.

Shareholders at the GM have the power to appoint the auditors and fix their fees for the financial year in question. However, the questions that may be raised in practice are: Who recommends the candidates to work as auditors? Who in practice, determines the remuneration of auditors? Unfortunately, the auditor's appointment and fees are determined upon the recommendations of the board of directors. In other words, directors, as a result of the weakness of the body of shareholders in the GM (see 7.4) indirectly appoint the auditors and fix their remuneration. This makes the auditors' (the agents of the shareholders) relationship with the board closer than that with the shareholders at the GM.[11] In this situation, we cannot expect an auditor to be independent if his or her appointment and fees are under control of directors.[12] This serious shortcoming may affect the auditor's action as an agent of the shareholders[13] to monitor the account presented by the board of directors. It is inconceivable that the auditor will perform his duties efficiently, because continuing his job may be seen as dependent on the board's satisfaction. Therefore, the Egyptian legislator, to make sure that the board of directors is not involved in the process of appointing auditors provides in Article 103/3 of the Company Law no. 159/1981 that:

> It is not allowed to vest the board of directors with the nomination of the auditor or fixing his remuneration without deciding a maxim.

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[11] Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 3rd edn, Kuwait: Author Publishing, (1999), p. 473.

[12] Sherer, *supra* note 1, p. 19.

[13] See Article 165 of the KCL.

If the board of directors have the main role in appointing the auditors, they can easily mislead the shareholders by publishing information about its accounts, which are incorrect or incomplete, and they will be in a position to prevent the auditor from disclosing the real situation to the shareholders and the public.[14] In this situation, the aim of the process of auditing will be not achieved. It can also be said that, in such circumstances, auditors cannot be independent as they may not be able to resist the influence of the directors.

It is proposed that this defect would be corrected by the following, the board of directors should not be vested with the appointment of the auditor and the fixing of their remuneration. Directors must not be involved with the appointment of the auditor because of the conflict of interest that exists between directors (who are in charge of controlling the resources of the company and reporting to the shareholders about the business affairs of the company) and the auditors (who are in charge of evaluating the activities of the directors). Auditors should not see the board of directors as their employers.[15] Second, as Dr Tamma provided, a committee should be formed from among the shareholders to select the auditor and fix his fees and put forward a recommendation to this effect to the GM. This may ensure the auditor's independence from the board of directors.[16]

There is another important defect that should be taken care of to protect the interest of shareholders that is, the auditors of the JSCs according to the KCL should

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[14] O'Sullivan, Noel, Auditors' Liability: Its Role in the Corporate Governance Debate, 23 *Accounting and Business Res* (1993) pp. 415-6.

[15] Anderson, Ray H., and Epstein, Marc J., *The usefulness of corporate Annual Reports to shareholders in Australia, New Zealand and the United States: An International Comparison*, London: JAI Press INC Publishing, (1996), p. 19.

[16] Tamma, *supra* note 11, p. 437; Sameha, Al Kalyoubi, *Commercial Companies*. Egypt: Dar Alnadah Publishing, (1993), p 489.

be re-appointed or replaced every financial year. This means that, if the auditor of a company wants to work again for a new financial year, they have to seek the satisfaction of directors who, in practice, control the appointment of auditors. Auditors can get the approval of directors by issuing a report that agrees with the accounts of the company disclosed by the directors. This situation gives the board of directors the opportunity to challenge the auditors' independence by threatening to replace them at the end of their term if they try to disclose information contrary the information disclosed already in the company's account. To maintain the independence of auditors, it is suggested that auditors should be appointed for a period of more than one financial year, say two or three years, in order to stop the directors from intimidating auditors at the end of every financial year. French Company Law provides that auditors should be appointed for a term of six fiscal years. Their term shall expire after the ordinary general shareholders' meeting that acts on the financial statements for the sixth fiscal year.[17] In this way directors cannot put pressure on auditors every year to acquiesce on accounting matters or risk losing their jobs.[18]

6.3 Removal and Resignation of Auditors

The removal of auditors from their office is also a sensitive issue that may have an impact on their independence. Auditors will have real independence only if they can be protected from unjust removal from office. Therefore, removal of an auditor from his office before the termination of the fited term is an important matter that must be regulated carefully by law.

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[17] See Article 224 (1) of French Company Law.

[18] See Farmer, T.A., Rittenberg, L.E., and Trompeter, G., M., Investigation of the Impact of Economic and Organisational Factors on Auditor Independence, *Auditing*, (1987) pp. 1-14.

It is must be clear in the company who has the power to remove auditors and what procedures must be followed to remove them. Therefore, every company law should contain a number of articles, which aim to guarantee that directors cannot weaken the auditors' independence by threatening to remove them from the office of auditing. The removal should be based on a reasonable justification provided to shareholders at the GM. Otherwise, auditors may lose their independence this gives the directors the opportunity to intimidate them with removal if they try to disclose the truth about the company's business affairs to the shareholders. It is possible that an auditor, who expresses doubts about the information and figures that the directors have published, is more likely to be replaced or removed.[19]

Unfortunately, the KCL does not have any articles regulating the removal of auditors from their office before the termination of his or her term.[20] Because of the lack of legal provision that controlling this issue in the KCL. As a general rule in civil law, the body that has the authority to appoint the agents has the authority to dismiss them. Therefore, an auditor could be removed by shareholders at the GM. According to the KCL, only the EGM may remove the auditor. They cannot be removed by the ordinary GM because at the ordinary GM, the term of the auditor is already finished. If the shareholders in the GM do not want him to work as the auditor again, they will not name him as an auditor of the company for the next financial year.[21]

The Kuwaiti legislator would be wise to follow the approach adopted by the UK CA. In the UK, there are a number of provisions which determine that the board of

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[19] Simon, Elliot B., Can the Auditor be Truly Independent? *Accountancy* (1980) p. 106: see also C. W, Chow, Chee W., The Demand for External Auditing: Size, Debt and Ownership Influences, 57 *Accounting Rev* (1982) p. 272.

[20] Shaheen, Abraham O., The Independence Aspects of External Auditor in JSC, 74 *Journal of the Gulf and Arabian Island Studies* (1986) p. 69.

directors cannot weaken the auditor's independence by threatening to replace him or her from office. Thus, the removal of the auditor is left in the hands of the shareholders by ordinary resolution.[22] Due to the importance of the matter in the UK, a special notice must be given of such a resolution.[23] The company must also send a copy of the notice to the auditor whom they want removed.[24] Furthermore, the auditor has the right to make a written representation, which must be sent to every shareholder of the company. If the written representation is received by the shareholders too late, the auditor may read his representation at the GM.[25]

Another essential matter is that, after the removal or resignation of auditors, does the KCL impose any obligation on the ex-auditor to communicate with the new auditors or shareholders? Or are obligated to deposit a statement to the shareholders setting out any relevant circumstances they believe should be disclosed? This communication is important for the new auditor and shareholders. With this communication, the ex-auditor discloses to the new auditor and shareholders in an official way the circumstances that he or she believes important to be passed to the new auditor. In fact, in the KCL there is not even one article that deals with the matter of removing an auditor. Therefore, the ex-auditor does not have any obligation to pass information to the new auditor or to shareholders.

In the UK, the auditor who ceases for any reason to hold the office of auditor, must deposit at the company's registered office a statement of any related

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[21] *Ibid.*

[22] S. 391(1) of the UK CA 1985 provides that "A company may by ordinary resolution at any time remove an auditor from office, notwithstanding anything in any agreement between it and him".

[23] *Ibid.*, S. 391A (1).

[24] *Ibid.*, S. 391A (2).

[25] *Ibid.*, S. 391A (3), (4) and (5).

circumstances which the ex-auditor believes should be passed to the attention of shareholders and creditors. Therefore, Section 394(1) of the UK CA provides that:

> Where an auditor ceases for any reason to hold office, he shall deposit at the company's registered office a statement of any circumstances connected with his ceasing to hold office which he considers should be brought to the attention of the members or creditors of the company or, if he considers that there are no such circumstances, a statement that there are none.

Also, if an auditor resigns, he must provide the company with a statement of any circumstances, connected with his ceasing to hold office, of which he thinks shareholders must be aware. Even if there are no such circumstances he must still deposit a statement at the company's registered office stating there are no such circumstances. If the auditor believes there are circumstances that should be brought to the attention of the shareholders or creditors, he should prepare a statement to that effect and, can, if necessary, demand a meeting to be called by the directors, at which he can clarify to the shareholders his reasons for resigning.[26] Also, under the UK CA The auditor, can insist that the company circulate his statement to the shareholders.[27] Moreover, he may still speak at the next GM[28] on any matter which concerns him in his position as a former auditor of the company.[29]

The KCL also fails to address another important issue – what happens when an auditor becomes ineligible to carry out the audit because of lack of independence? What is the obligation imposed on the auditor in this situation? In the UK for instance, an auditor has to vacate his office as soon as he becomes ineligible for lack of

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[26] *Ibid.*, S. 392 (2).

[27] *Ibid.*, S.392A (3).

[28] *Ibid.*, S.390.

[29] *Ibid.*, S. 392A (8).

independence;[30] otherwise, he or she will be punished.[31] Therefore, for the benefit of shareholders and other interested groups in a JSC, there should be, in the company law, a clear obligation that demands auditors to vacate their office when they lose their independence. Also, if the auditor is found to be ineligible to carry out the audit, despite having done it already, the Secretary of State can insist on a second independent audit.[32]

6.4 Eligibility and Qualifications of Auditors

Article 161, mentioned above, provides that the auditor shall be a legal accountant. That capacity applies to the accountants licensed by the MCI to practice auditing and whose names are listed in the relevant register.[33]

The ministry license is only granted upon meeting a number of conditions, such as:

(1) An auditor must be a natural person (i.e. a human being), a license may not be granted to companies or anybody corporate;

(2) He must hold a Bachelor of accountancy from Kuwait University or any other accredited university and must be a member of a recognised accounting association;

(3) He must have experience after graduation ranging from at least seven years for auditors of banks, insurance and financial companies and up to five years for auditors of other institutions;

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[30] *Ibid.,* See S. 28.

[31] *Ibid.,* S. 28(5).

[32] *Ibid.,* S. 29(1) CA 1989.

[33] Article 1 of Law 5 of 1981 concerning practice of auditing.

(4)He must be a Kuwaiti national, legally competent and not less than 25 years of age;

(5)He should have good reputation and standing, not have been detained in a crime involving integrity and not subject to a disciplinary action for violation of the ethics of the profession unless he has been rehabilitated and after the lapse of three years following the final disciplinary action;

(6)He should pass the examination qualifying him to practice auditing;

(7)He must swear an oath that he shall perform his duties with honesty and integrity, observe the principles of the profession, not to hide the truth from the parties concerned, and not disclose any information about his clients or any other confidential information.[34]

It is not necessary under the KCL, for auditors to be eligible for appointment as a company or for an auditor to be a member of a recognised supervisory body. That is a legislation shortcoming that needs to be rectified. The supervisory bodies are applying rules that must be obeyed to continue membership, and they have extensive ethical and other guidelines that every member is expected to follow, otherwise he or she may be barred from membership.

Under the UK CA 1989, for example, Sections 24-54 are extensive regulations that have been set down for the qualification of auditors.[35] A person is eligible for appointment as a company auditor only if he or she is a member of a recognised

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[34] *Ibid.*, Article 2.

[35] The Companies Act 1989 implemented the Eighth EC Company Law Directive (Directive 84/253/EEC.) on the qualifications and training of auditors. The stated proposes of the Act provides in S.24 (1) "the main purposes of this Part are to secure that only persons who are properly supervised and appropriately qualified are appointed company auditors, and that audits by persons so appointed are carried out properly and with integrity and with a proper degree of independence."

supervisory body, and he is eligible for appointment under the rules of that body.[36]

Section 25(1) of CA 1989 provides that:

> A person is eligible for appointment as a company auditor only if he -
> (1) Is a member of a recognised supervisory body, and
> (2) Is eligible for the appointment under the rules of the body.[37]

In the UK, if someone acts as an auditor, or tries to obtain the position of auditor when, in reality, he is not appropriately qualified nor on the appropriate register of auditors required to be kept under the CA 1989 s. 35 he commits a criminal offence.[38]

Furthermore, the Kuwaiti legislator, to ensure the independence of auditors, provides that a person is barred from holding the office of auditor of a company in some occasions as provided at Article 162 of the KCL:

> An auditor may not, when auditor of the company, at the same time participate in the incorporation, be a director of, or carry out on a permanent basis any technical, administrative or consultative duties in the company.

It is not permissible to combine the duty of auditor and participate in the foundation of the company and membership of its board of directors, or work permanently in any technical, administrative or consultant duties in the company, even in the capacity of a consultant or advisor. Also, a person(s) is barred from working as an auditor of a company where he is already an employee or if he is a blood relative within four generations of either a founder, director and manager of a company or he.[39]

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[36] The Supervisory bodies in the UK are the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Institute of Chartered Accountants in Ireland, and the Chartered Association of Certified Accountants.

[37] See sections 31and 32 of the CA 1989.

[38] S. 41(2) UK CA 1989.

[39] See also Articles 18, 19 and 20 of Law 5 of 1981 concerning practice of auditing.

6.5 Duties of the Auditor and the Contents of their Report

The auditor's principle duty is to form a report on the company's annual accounts for the company's shareholders. In this report he must determine, whether or not the statements prepared by the board of directors give a true and fair view of the real financial situation of the company. However, many users of audit reports do not entirely understand the extent and purpose of the auditors' duties.[40] They also assume that the auditor's duty is to guarantee the correctness of the financial accounts of the company, make sure that no frauds had been prepared by directors and officials of the company, and ensure that the board of directors had performed all of their duties.[41] This is what users of the report expect from the auditor's report. Therefore, any misunderstanding of the auditors' role in the company may cause an 'expectation gap' between shareholders and other users of auditors, and their understanding of what to receive from the auditors.[42]

As stated by Mrs. Purificacion Grajal Martin in a paper presented about the role of the statutory auditor in one of the European Commission conferences:

> First of all, the user of financial statements should be advised that the auditor of the accounts is not responsible for detecting each and every possible case of fraud that may arise in the company he is examining. In other words, the criteria of materiality and rationality must also be taken into account here as well. Given this, we can classify fraud under two headings: one, fraud which may be described as "tangible fraud" which has an effect on the financial statements and which the auditor needs to ensure is properly treated in the financial information. Two, "intangible fraud" which should be notified to the competent authority by the auditor and which, where appropriate, the directors are responsible for disclosing in the financial statements. The auditor's

[40] T. A. Lee, the Nature of Auditing and its Objectives, 81 Accountancy (1970) pp. 292-6.

[41] Beck, *supra* note 4, pp 117-22.

[42] Sherer, *supra* not 1, p. 9.

> report should only mention the existence of cases of tangible fraud which significantly affect the financial statements being audited.[43]

Section 235 of the UK CA 1985 and Article 164 of the KCL as well, do not mention auditors having a duty to detect fraud. Both laws provide that the auditor's responsibility is to give an opinion, not a guarantee. Nor is he to detect all frauds, errors or irregularities that may exist in the company accounts.[44] Although, the auditors do not have an obligation to detect fraud, they do have to exercise reasonable skill and care. If an auditor fails to detect a fraud that influences the truth and fairness of the financial reports, he could probably be held liable for negligence.[45] The duty of auditors was considered by Lopes LJ who stated in the *Kingston Cotton Mill Co* case:[46]

> It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care, and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog, but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representation, provided he takes reasonable care. If there is anything calculated to excite suspicion he should probe it to

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43 European Commission, Act of the Conference on the Role, the Position and the liability of the Statutory Auditor within the European Union, 5 and 6 December 1996, p. 72.

44 Pound, G. D., and Courtis, John K., the Auditor's Liability: A Myth? 10 *Accounting and Business Res* (1980) p. 300; Dunn, *supra* note 1, p. 40; Lord Denning, in *Fomento (sterling Area) v. Selsdon Fountain Pen Co.* [1958] 1 All ER 11, p. 245, observed that: "An auditor is not to be confused to the mechanics of checking vouchers and making arithmetical computation. He is not to be written off as a professional adder-upper and subtractor. His vital task is to take care to see that errors are not made, be they errors of computation, or errors of commission or downright untruths. To perform this task properly, he must come to it with an inquiring mind – not suspicious of dishonesty, I agree – but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none."

45 Sherer, *supra* note 1, p. 15; See also *Re London and General Bank* (No 2) [1895] 2 Ch 673 at 682-3.

46 [1896] 2 Ch 279 at pp. 288-9.

> the bottom; but in the absence of anything of that kind he is only bound to be reasonably cautious and careful.
> ...(an auditor) does not guarantee the discovery of all fraud.[47]

Thus, the duty of the auditors is to perform the statutory requirements of the company act. They must act honestly, and with reasonable care and skill. It is clear that auditors, when they carry out their duties, must pay due attention to the possibility of frauds and of errors but within reasonable bounds.

The statutory duty on the auditor under the KCL is to report to the shareholders of the company on the company's accounts. The auditor must attend the GM and has to read his report to the GM. This report should consist of all the data prescribed by the law in Article 164 which provides that:

> The auditor shall be present at the GM to give his opinion on that which relates to his assignment and particularly on the company's balance sheet; he shall read out his report on the GM; his report shall cover the following particulars:
> (1)Whether the auditor has obtained the information which he considered necessary for the satisfactory performance of his duties;
> (2) Whether the balance sheet and the profit and loss account are in agreement with the real state of affairs and whether they contain all that is required by law and the articles of the company to incorporate in and give an honest and clear view of the true financial standing of the company; (3) Whether proper books of account have been kept by the company; (4)Whether the stock taking has been duly conducted; (5) Whether the information contained in the report of the board of directors is in agreement with the books of the company; (6) According to the information available to him, whether or not any violations to the provisions of the Articles of Association or the law have been committed during the financial year such as will effect the company's activities or financial situation and whether or not the violations (if any) still persist.

The auditor has to present a report to the GM. In this report he has to answer all the questions provided in Article 164. First, he has to determine whether or not he has

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[47] In *Caparo Industries PLC v. Dickman* [1990] 1 All ER 568 "it was held that the purpose of an audit is to fulfil the statutory requirement of Company Act with a view to circulating the accounts to shareholders and laying the accounts before the GM. A duty of care is owed to the shareholders as a

obtained the information needed to carry out his duties. Then, he has to determine whether the information disclosed by the board of directors in the directors' report, the balance sheet and profit and loss account is correct and accurate, and whether or not an inventory has been prepared in accordance with the established procedure. Finally, the auditor has to state any violations of the Articles of Association or Company Law that occurred during the fiscal year which may have had an adverse effect on the business of the company or its financial standing (and if so whether they are continuing).

According to the KCL, it is not possible to determine whether an auditor is under any obligation to clearly disclose information that the board of directors failed to disclose to the shareholders. Examples include some aspects of the remuneration of directors, expenditures, or certain transactions between the company and its directors or officers. Under the UK CA, auditors are under an obligation to disclose in their report any information about directors' earnings, pensions, compensation or loans, which might not be shown in the accounts prepared by the management.[48] Therefore, it is proposed that auditors should mention in their report any information that directors intentionally or unintentionally fail to disclose.

The auditors' report in the UK is more comprehensive than the auditors' report under the KCL. The UK CA requires auditors to disclose to the shareholders any details which directors fail to disclose. The auditors' report must state whether, in their opinion, the accounts of the company have been suitably prepared in accordance

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body, not to individual shareholders or to members of the public who rely on the accounts in deciding whether to purchase a company's shares"

[48] S. 237(4) and Sch 6 of the UK CA 1985.

with the UK CA 1985 and give a true and fair view.[49] They also must consider whether or not the information mentioned in the directors' report agrees with the annual accounts and, if they believe it does not agree, they must state that fact in their report.[50] Furthermore, auditors may carry out any investigations that enable them to form an opinion on whether proper accounting records have been kept and whether the accounts of the financial year agree with those accounting records. They have to state in their report any doubts they have on these matters.[51]

6.6 Authority of Auditors

Auditors play an essential role in any JSC on behalf of shareholders. Thus, they should always have wide powers that may help them to carry out their duties. The Kuwaiti legislator gives some powers to the auditors that may help them to carry out their duties. Therefore, Article 163 of KCL provides:

> (1) The auditor is entitled at all time to have access to all the books, registers and documents of the company and to call for any particulars which he deems necessary; he may also verify the assets and liabilities of the company. (2) If he is unable to exercise the foregoing powers, the auditor shall prepare a written report setting down such facts which shall be submitted to the directors and referred to the GM.

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[49] *Ibid.*, S. 235(2) of the UK CA 1985 provides "the auditors' report shall state whether in the auditors' opinion the annual accounts have been properly prepared in accordance with this Act, and in particular whether a true and fair view is given – (a) in the case of an individual balance sheet, of the state of affairs of the company as at the end of the financial year, (b) in the case of an individual profit and loss account, of the profit or loss of the company for the financial year, (c) in the case of group accounts, of the state of affairs as at the end of the financial year, and the profit or loss for the financial year, of the undertaking including in the consolidation as a whole, so far as concerns members of the company."

[50] *Ibid.*, S. 235(3) the auditors shall consider whether the information given in the directors' report for the financial year for which the annual accounts are prepared is consistent with those accounts; and if they are of opinion that it is not they shall state that fact in their report.

[51] *Ibid.*, S. 237(2).

To have an accurate and comprehensive report, auditors should have the right and power to request and receive all relevant information that they believe is necessary to carry out their duties. Therefore, at all times, auditors usually have the authority to examine all the books, registers, and documents of the company and request information and explanations which he believes fundamental to the completion of his duties. The board of directors has to facilitate the auditor's mission.[52] In case the auditors are unable to exercise their stated duties, this should be asserted in a written report which they have to submit to the board of directors, and the GM.

The auditors' duty is to make a judgement on whether the accounts of the company are fair and true, and they make this judgement upon the information disclosed by directors. So, if they do not have the authority at all times to have access to the books and documents of the company, request any information they believe is important and can carry out any investigation, their judgement will be incorrect because of lack of information. Therefore, it would be argued that auditors, as agents of shareholders, should have more powers and unrestricted access to all of the company's books of accounts, records and other documents. The board of directors of any JSC should always, under legal obligation, send a copy of all documents relating to the company's affairs to the auditors' office. They should be invited to attend the meeting of the board of directors in order to be aware of the general policy of the company that is usually drawn up by the board of directors.[53] Auditors should also

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[52] Tamma, *supra* note 11, p 476; Mustafa, Kamal, Commercial Companies: General Provisions in Companies, Dar Al- jama Al-jadeeda Publishing, (1997), p 284.

[53] See Article 270/1 of implementing regulations of Egyptian Company Law no. 159/1981; Sameha, *supra* note 16, p. 495.

have the right to request a GM if they think that it is necessary, and if the board of directors failed to call it.[54]

Under the KCL, an auditor does not have the right to convene the GM when he believes it is necessary to be held. A good example to follow is in the company law of Saudi Arabia Article 131. According to this article, if the board of directors fail to provide the auditor with the required assistance, the auditor may then invoke the authority vested in his office to convene a GM of the shareholders of the company in order to investigate his allegations.[55] However, despite its importance, the auditors under the KCL do not have the right to attend the meeting of the board of directors.

6.7 Shareholder's Right to Discuss the Auditor's Report

If the existence of an independent auditor is one of the shareholders' rights in the JSCs and they are agents of shareholders, shareholders should have the right to discuss and ask the auditors about their report in order to understand it. The Kuwaiti legislator has given shareholders the right to discuss the auditor's report and require an explanation of the information contained therein, as provided by Article 165 of the KCL:

> As agent of the shareholders, the auditor shall be accountable for the truth of the information contained in his report, and any shareholder may, during the meeting of the general assembly, call him to account and demand explanation of the contents of his report.

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[54] In France, if the board of directors fail to call a GM at the request of the auditors, they may call the meeting themselves and set on its agenda; see Le Gall, J., *French Company Law*, 2[ed] edn., London: Longman publishing, (1992), p. 155.

[55] Article 131(2) of the Saudi Company Law provides that "the chairman of the board of directors must enable the auditor to perform his duty as specified in the preceding paragraph. If the auditor encounters any difficulty in this respect, he shall state that fact in a report to be submitted to the board of directors. If the board fails to facilitate his task, the auditor must call a regular GM to look into the matter."

The auditor then, as agent of shareholders, is required to answer shareholder's queries and explain any ambiguous data. He is responsible for communicating the information gained about the company to the shareholders accurately and honestly. The shareholder has the interest and the right to discuss the auditor's report and he, therefore, must not be denied such rights.[56]

Auditors are personally responsible for their failure to perform the obligations imposed on them. They are also jointly and severally liable for the breaches of duty when the consequential loss suffered by the company would not have happened if their duties had been carried properly. According to the KCL, auditors are considered as agents of all shareholders as provided by Article 165 and, as such, assume contractual responsibility to the company and its shareholders. If the auditor commits a criminal act, such as infidelity, fraud or forgery or hides any violation of the provisions of law of the company's Memorandum or Articles of Association which might have an adverse effect on the company's financial position or business, he shall be punished under the provisions of the Kuwaiti Criminal Law No. 16/1960.[57] Auditors are also subject to further penalties if they are in breach of the provisions of Law 5 of 1981 or the principles or ethics of the profession, or if they commit gross negligence or a dishonest act. In the event of the occurrence of any of these acts of default, he shall be punished by notice (warning), suspended for up to three years or have his name struck off the auditors' list. In the latter event, he is allowed to resume practice after the lapse of five years.[58]

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[56] Sameha, *supra* note 16, p. 495.

[57] See Articles. 231-236, 240 and 257 of Kuwaiti Criminal Law No. 16/1960.

6.8 The Extent of the Auditors Responsibility

As for the question concerning the responsibility of companies auditors, if they are responsible for all what is mentioned in their reports before the company and its shareholders only, or if they shall bear the responsibility also towards all those who utilize these reports (even if he is from outside this company) especially if utilizing the information mentioned in the reports leads to harming who relied on the information mentioned therein, as it may be inaccurate or incorrect.

First, Auditors shall legally abide towards the company --as this is very clear in all companies laws. Any prejudice to this obligation shall lead to giving the company as well as its shareholders the entitlement to sue the auditors and claim compensation therefrom, in case of any shortcoming from their side regarding performing their duties stated according to companies' law. Therefore, the statutory provisions do establish a relationship between auditors and the company (and shareholders and debenture-holders). However, the statutory provisions do not establish such a relationship with everybody who has a right to be supplied with copies of the auditors' report.[59]

Second, auditors have a contractual obligation. Auditors in all companies are appointed in order to conduct auditing tasks for the company, by virtue of a contract made between the company represented in the GM and those auditors. If these auditors fail to perform their duties according to the contract, the other party –the company- shall be entitled to sue them and claim compensation for the damages resulting from the prejudice to the clauses of contract.

If there is a legal and contractual obligation on the part of auditors towards the

[58] Articles 23 and 26 of Law No. 5/1981 concerning practice of auditing.

[59] *Gower's Principles of Modern Company Law*. Davies, Paul L (ed.), 6th edn, London: Sweet & Maxwell Publishing, (1997), p. 552.

company, while they do not have any legal or contractual obligation towards third party, if any person outside the company utilises the auditors' reports in order to conduct any work, and this led to harming the utilises, auditors have no responsibility towards the same. This matter is very clear in the Kuwaiti law, which states that auditors are company's agents for shareholders to ensure or deny the credibility of board's reports, and present reports regarding this matter to the GM formed of shareholders. So is the case in the UK, there are a lot of cases which mentioned the cause of auditors' responsibility, as they have emphasised on the necessity of not allowing the opportunity for anybody to use auditors' reports for the purpose of demanding compensation and make up damages resulting therefrom. For example, in *Caparo Industries plc v Dickman.*[60] In this case Caparo was an existing shareholder of fidelity plc. Fidelity's 1984 accounts showed profits significantly lower than expected and led to a significant fall in been circulated to shareholders, Caparo purchased more shares and eventually mounted a successful take-over bid for fidelity. Caparo then concluded that its new acquisition was in fact worthless and that the accounts which had been certified by the auditor had been grossly inaccurate. Caparo sought redress against the auditors, alleging negligence and arguing that the auditors owed it a duty of care in both its capacities- that of existing shareholder and as potential bidder for Fidelity. The Court of Appeal held by a majority that there was a distinction between the position of the existing shareholder who purchased additional shares in reliance on negligently prepared accounts, to whom the auditors owed a duty, and that of non-shareholder potential investors, to whom they did not. The house of lords rejected this distinction and held that the auditors did not owe a duty of care to persons who relied

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[60] [1989] 1 QB 653

on the accounts in deciding to purchase shares, irrespective of whether they were existing shareholders or not. Mere foreseeability of the fact that a third party such as Caparo might rely on the accounts to launch a take-over bid for fidelity was not enough to make the auditors liable for negligence.[61]

In the end it must be clear that an auditor will not be liable if, given a duty of care, he is not in breach of it. Auditors are not likely to be in breach of duty if he follows auditing standards and guidelines, statements of Standard Accounting Practice and Financial Reporting Standards devised and issued by the profession. If he does that , he will at least have the advantage of the judgment of McNair J in *Bolam v Frien Hospital Management Committee*.[62] He said in connection with doctors: 'A doctor is not guilty of negligence if he has acted in accordance with a practice accepted as proper by a responsible body of medical men skilled in that particular art....merely because there is a body of opinion who would take a contrary view'. This statement is of course equally applicable to other professions including that of accountant and auditors.

6.9 Conclusion

The powers within every JSC are distributed between two main organs; the shareholders and the board of directors. As provided the chapter five, the role of shareholders in their company can not be carried out without a good system of disclosure. However, directors and managers of the company prepare the disclosed information in the company's reports. Therefore, the disclosure of information alone is not enough because the directors write the reports about their performance. Hence,

[61] Gower's, *supra* note 59, p. 552.

[62] [1957] 2 All 118

there should be another body with the responsibility to assure the quality of the disclosed information.

The existence of auditors is shown to be useful to the body of shareholders. They are agents of shareholders as provided in the KCL, their report is a source of significant information that every shareholder and investor should start with in order to understand the real financial and non-financial position of the company. The existence of auditors is useful to create a balance of power between the two main organs in any JSCs.

Auditors should always know they are agents of shareholders. Therefore, they should give priority to the interests of the body of shareholders first. However, the role of auditors cannot be complete without the existence of several factors. First, the essential factor for auditors to carry out their role is that they should always be independent from the board of directors. Second, auditors should possess the proper academic credentials and specialities necessary to enable them to carry out their duties. Third, auditors should be given all the powers they need to carry out their duties.

The rights that come after these rights that are discussed in the above chapters, are shareholders' rights in the company's GM, as this is the place where shareholders practice many of the rights and make decisions based on the aforementioned rights. The next chapter, focuses on shareholders rights in the GM. However, shareholders cannot take advantage of their rights in the GM until they know their position in the company, financial rights, the company's status through practicing his right in knowing and reading the company's reports, and is sure of the correctness of these information through the auditors in the company.

Chapter Seven

The Rights of Shareholders in GMs

7. Introduction

As discussed in Chapter Two, there are two main organs in any JSC and the division of powers between these two organs depends entirely on the Company Act and the Constitution or the contract of the company (the Memorandum and the Articles of Association). Where some powers are vested in the board, the body of shareholders in the GM cannot interfere in the business of the board unless the board is working contrary to the provision of the Company Act or the Constitution of the company (see 2.5).[1]

Consequently, in general, every JSC acts through two bodies. The first is the board of directors and the second is the GM of shareholders. Each organ has exclusive powers, in theory at least, and legislature and legal scholars of company law always try to balance the power between them. This balance of powers can be found in any modern Company Law and a clear example of this balance can be found in the Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury) in its definition of Corporate Governance in para. 2.5:

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[1] See *John Shaw & Son Ltd v. Shaw* [1935] All E. R. 456 at 464, Greer L.J. provided in this case that "A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in the GM. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove they can remove the directors now by ordinary resolution according to CA 1985, s. 303. They cannot themselves usurp the powers which by articles are vested in the directors any more than

> Corporate Governance is the system by which companies are run. At the centre of the system is the board of directors whose actions are subject to law, regulations and the shareholders in a GM. The shareholders in turn are responsible for appointing the directors and the auditors and it is to them that the board reports on its stewardship at the AGM.[2]

It is clear from the foregoing that each organ in a JSC has an obligation and power to fulfil its duty. The relationship between the board of directors and GM is contractual, based on company laws and the constitutions of the companies. One might ask about the purposes of GMs of the JSCs. GMs have a monitoring role and they are responsible for ensuring that the board of directors and managers are carrying out their duties in the right way i.e. in the interest of the companies and in accordance with the Articles of Associations and company law.

A GM is a place in which the board should account for their control of the company. It is the place where a number of resolutions are passed that justify the actions of directors in the last financial year. At the GM, the directors are obliged to pass on to the shareholders information about important events concerning on the company at present and in the future.[3] Therefore, in accordance with power division in the company, the GM is the high authority therein, as its power surpasses the board's authority.

However, in order to obtain the desired profits from their company shareholders must fulfil their role as owners of the company's shares and take advantage of the

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the directors can usurp the powers vested by the articles in the general body of shareholders"; see also *Scott v. Scott* [1943] 1 All E. R. 582.

[2] In the same report see also paragraph. 6.1 which provides "the formal relationship between the shareholders and the board of directors is that the shareholders elect the directors, the directors report on their stewardship to the shareholders and the shareholders appoint the auditors to provide the external check on the directors' financial statement. Thus the shareholders as owners of the company elect the directors to run the business on their behalf and hold them accountable for its progress".

[3] See Butcher, Donald B., Reform of the GM, in Saleem Sheikh and Willliam Rees (eds.), Corporate Governance and Corporate Control, Great Britain: Cavendish Publishing Limited, (1995) pp. 221-

rights in company law or the articles of association conferred on them to protect their interests. They should know what is going on in their company, struggle to obtain all of the information about the company affairs, take a deep look at all the reports of the company, attend all GMs of their company and discuss with the directors all the issues that they think are not clear. Finally, they should cast their vote in a wise way according to the information they have to establish their interest.

A JSC must hold a GM once every calendar year to approve the annual accounts and the directors' report. A GM is very important because company law requires that a number of decisions in the running of a company be taken by shareholders at the GM.[4] Moreover, the will of the shareholders of a company is normally expressed at the GM when they may vote for or against any resolution that is proposed. If the appropriate majority is obtained for a resolution, the will of the majority of the shareholders usually prevails and binds every shareholder. In this way the majority of shareholders are entitled to exercise the company's powers and control its operations. They are able to make some changes to the company, such as dismissing or replacing the board of directors or auditors, capital structure may be changed, and a company may alter its Articles of Association or the company's objects. GMs also provide the opportunity for a shareholder to ask questions and demand justifications about the directors' performance and future strategies.

This chapter considers the rights of shareholders at the GM whether at an ordinary or extraordinary meeting. As a result of owning a share, shareholders enjoy a

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[4] A number of powers are returned by the statute to the shareholders at the GM. For example, the most significant powers retained by them at a GM according to the KCL are: they have the right to elect the board of directors and auditors; the power to remove directors; the power to fix their remuneration if it is not fixed in the Article of Association; the power to issue shares; shareholders approval is required of any purchase of the company's own shares. See Articles 152,157(4).

numbers of rights at the GM. These include the shareholder's right to be invited to attend the GM. The right of attending the meeting is one of the most important rights every shareholder must practice. A shareholder that cannot attend the meeting in person should have the right to send a proxy to represent him. By the right of attending, shareholders can practice other rights, such as shareholders' right to discuss and vote in the GM. However, before determining and discussing the rights of shareholders in GMs, it is necessary to introduce such matters as the concept of GMs, kinds of GMs, invalidation of GMs and its resolution and the needs of GMs.

7.1 Kinds of General Meetings

The GM is composed of all shareholders of a company, whatever their number or the number of shares held by them, and regardless of the type of share. The GM convenes regularly and as the need arises. Kuwaiti legislators have laid down regulations which govern the holding of these meetings, including the parties who have the right to call the meeting, formalities of the notice calling the meeting, agenda, quorum etc. A GM may be an ordinary or extraordinary. There may also be special meetings of shareholders of a particular class when a company has different kinds of shares. The distinction between ordinary and an extraordinary lie within the affairs each may deal with, and different quorums and majorities are required to pass resolutions at them.

The GM derives its powers from law and the company's Articles of Association. It has the authority to pass any resolution subject to the substantive and procedural rule by law and under the company's Articles of Association. The majority should also exercise their power in good faith and in the best interests of the company and shareholders alike.

The powers of the GM are determined in light of its functions of control and supervision of the company's management and election of board members as well as the appointment of auditors.[5]

The powers are relatively straightforward. However, they are confined to control over the board of directors and do not question appropriateness of board resolutions. In other words, the GM may not interfere directly in the powers of the board or put forward recommendations or directions. Furthermore, these powers are bound by legal provisions and by the company's Articles of Association. The GM is not authorised to consider amending the articles or increasing or reducing the capital, as these powers are among the exclusive powers of the EGM. The powers of the GM must also be guided by the interests of the company and shareholders without being beneficial to one particular group at the expense of another, and its resolutions must be clear of any arbitrariness and/or fraud otherwise they will be invalidated.

It is worth mentioning that under Article 133 of the KCL there are a number of restrictions on the GM that must be complied with to protect the shareholders of the company. This article provides that:

> The shareholders' GM may not: (1) increase a shareholder's financial liability or the nominal value of the share; (2) reduce the percentage of net profits specified in the articles of the company to be distributable to the shareholders; (3) impose fresh conditions in addition to those set out in the articles (of the company) in connection with the shareholder's qualification for voting at and attending the GM; (4) restrict the shareholder's right to bring an action for damages, in accordance with law, against all or some of the members of the board of directors in respect of such damage as he may sustain. These provisions may,

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[5] The powers of the GM are set fourth expressly in Article 157 and 158 of the KCL.

however, be overridden by the shareholders' agreement in writing or unanimous vote.

Therefore, a GM, whether ordinary or extraordinary, may not increase a shareholder's financial obligations or the nominal value of the shares held by them because each shareholder in this kind of company shall always be responsible for the company's losses to the extent of his own shares. Furthermore, GMs cannot reduce the dividends distributed to the shareholders as specified by the company's Articles of Association; cannot impose new terms and conditions regarding eligibility to attend and vote at the GM other than those set forth in the articles; or restrict a shareholder's right to file lawsuits against all or some board members claiming compensation for any damage he has suffered. None of the above rights may be prejudiced unless agreed in writing by all shareholders or by unanimous voting, which is not feasible, particularly in JSCs that comprise a large number of shareholders.

The KCL does not require the directors to give notice of a resolution which the requisitionists intend to move at the next GM. The Kuwaiti legislator will find a good example to follow in the UK CA 1985. In the UK, shareholders who hold 5 per cent of the total voting rights or not less than 100 shareholders holding shares on which there has been paid an average sum per shareholder of not less than £100, may compel a company to give notice of a resolution to be moved at a meeting to shareholders.[6] They may also require the company, on giving one week's notice, to circulate to shareholders a statement not exceeding 1,000 words with respect to any resolution or business to be dealt with at any GM.[7] It can be said that when such provisions exist in any company law, they will enable shareholders who are opposed to a course of action

[6] S 376 of the UK CA 1985.

[7] *Ibid.*

or plan to be submitted at the meeting, to pass round their objections to the other shareholders before the meeting. Thus, to protect the shareholders' right, they should have the right to require the directors to give them notice of any resolution the directors intend to move at the next GM. Also in the UK, no shareholder can be bound by an alteration to the articles made after he became a shareholder to the extent that the alteration demand him to take or subscribe for more shares than the number held by him at the date on which the alteration is made, or in any way increase his liability as of that date to contribute to the company's share capital or otherwise to pay money to the company.[8] Therefore, in the UK the financial obligations of the shareholders cannot be increased without their individual consent. S.16 of the UK CA 1985 is clearly intended to protect shareholders from having their financial obligations to the company compulsorily increased.

7.1.1 Annual General Meeting

Each year the company should hold an AGM. Article 154 of the KCL provides that:

> (1) The shareholders' general assembly shall hold a meeting at least once in each year, at the time and place specified in the articles of the company. The board of directors, however, may call a meeting of the assembly whenever it thinks fit, and shall do so whenever requested by a number of shareholders holding not less than one-tenth of the capital.

[8] *Ibid.*, S. 16 provides "(1) a member of a company is not bound by any alteration made in the memorandum or articles after the date on which he became a member, if and so far as the alteration (a) requires him to take or subscribe for more shares than the number held by him at the date on which the alteration is made; or (b) in any way increase his liability as at that date to contribute to the company's share capital or otherwise to pay money to the company.
(2) subsection (1) operate notwithstanding anything in the memorandum or articles; but it does not apply in a case where the member agrees in writing, either before or after alteration is made, to be bound by the alteration."

It is clear from the foregoing that the AGM shall be held at least once each year at the time and place designated by the company's Articles of Association. It is a duty of the directors to convene GMs and they do so at their discretion when they see fit, except when the law expressly imposes a duty on them to call a meeting. The board of directors shall call the meeting, often following the end of the company's financial year.[9] The AGM may also be called whenever the board deems necessary. The board also has to call the meeting if requested to do so by holders of at least ten per cent of the company's capital. Shareholders can exercise this right if the board fails to call the meeting. The proper government authority of Ministry of Commerce may also call a GM to consider any illegal acts committed by the board and which may damage the interests of the company and the shareholders or the national economy.[10]

The notice of the GM must be sent by registered mail to all shareholders. Moreover, the notice must be published in two daily Arabic newspapers twice and the second publication must be one week after the first. The notice must contain a clear outline of the items on the meeting agenda. The agenda is important because it draws attention to the matters under consideration so that the shareholder is well prepared for the meeting. It also prepares directors to look beforehand into the matters raised for voting at the meeting (see 5.3.2).[11]

The body authorised to draw up the agenda is the board of directors. However, a meeting, as stated above, can be held at the request of the shareholders who should

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[9] The financial year usually start in January and end in December. Article 45 of Appendix B Pro Forma Memorandum of Association of a Joint Stock Company of the KCL No. 15/1960.

[10] See Article 178 of the KCL.

[11] *Ibid.*, Article 154 (2) of the KCL "(2) The notice of the meeting shall contain a clear summary of the agenda of the meeting and must be sent in two ways. First, the notice of the meeting shall be sent to all the shareholders by registered mail at least one week before the date of the meeting. Second, the notice shall be published in two daily Arabic newspapers two times and the second publication must

have the right to draw up the agenda of the meeting. Unfortunately, the above article does not give a clear picture of this right. It is suggested, therefore, that the agenda of any meeting should always be worked out by the bodies calling the GM. Thus, if the meeting held is at the request of the shareholders, auditors or the Ministry of Commerce they each shall have the right to decide what should be on the agenda.

The KCL specifies the items on the agenda of the AGM at Article 157.[12] According to this article, the AGM must discuss the following matters: First, it should hear the report of the board of directors on the business of the company and its financial standing during the year. Second, it should hear the report of the auditors on the balance sheet of the company and the accounts submitted by the board of directors. It should then consider and sanction the accounts and declare a dividend. Following this, they should elect the members of the board of directors, the auditors and fix their remuneration for the coming year, if it is not fixed in the Articles of Association. Furthermore, the meeting may discuss proposals for increasing the capital, issuing new shares, borrowing, mortgaging and providing guarantees and deciding sums and any other proposal the board of directors may enter on the agenda. A proposal may also be submitted during the meeting of the GM by a number of shareholders holding not less than one-tenth of the total number of shares.

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be one week after the first."

[12] *Ibid.*, Article 157 provides "the following matters shall be included in the agenda of the annual GM: (a) the reading of the directors' report on the activities of the company and its financial situation during the year; the report shall give sufficient explanations of items of income and expenditure and a detailed proposal of the method and date of distributing the net profits of the year; (b) the reading of the auditors' report on the balance sheet and the account submitted by the directors; (c) the examination and approval of the accounts and determination of the distributable profits; (d) the election and determination of the fees of the directors and auditors payable to them during the coming year, save when the same is stated in the Articles of Association; (e) the deliberation on and passing of resolutions on proposals made for the increase of the capital, the issue of debentures, borrowing, pledging and the issue of securities; (f) the deliberation on and passing of a resolution in respect of any other proposal placed on the agenda by the directors; such proposal may be made during the GM by a number of the shareholders who hold not less than one-tenth of the number of shares."

Only the matters listed on the agenda may be considered. However, the GM may consider a matter proposed by the board or holders of at least ten per cent of the company's capital. This is likely to deny shareholders who do not constitute the minimum number required, the opportunity to discuss any matter that may be extremely important.

The shareholder who wants to attend the GM must enter his name on a special register at the company's registered office at least 24 hours prior to the meeting. The entry shall show the shareholder's name the number of shares owned or represented. He will be given a card or a slip authorising him to attend and showing the number of votes he is entitled as principle or proxy.[13]

In accordance with the KCL, for a GM to be valid, holders of more than half the capital must be present. If the meeting lacks such a quorum it must be adjourned to another day and the second such meeting shall be valid regardless of the number of members present. In other words, the second meeting shall be valid even if attended by only one member.[14] This provision seems the best available solution to the problem of non-attendance at the GMs (see 7.3.1). However, it also reveals a drawback in the relationship between the board and the shareholders. The quorum is formed on the basis of the number of shares making up the company's capital and, as previously mentioned, attendance may be in person or by proxy.

The GM is presided over by the chairman of the board of directors or his deputy or any person authorised by the board.[15] As already stated each shareholder has a

[13] See Article 34 of Appendix B Pro Forma Memorandum of Association of a Joint Stock Company of the KCL No. 15/1960.

[14] *Ibid.*, Article 155.

[15] Article 155 of the KCL provides 'the meeting of the GM assembly shall be presided by the chairman or deputy chairman of the board of directors or by the person appointed by the board of directors to be

number of votes equivalent to the number of shares he holds, whatever that number may be (see 7.2.5).

In accordance with the provisions of Article 156, GM resolutions are passed by absolute majority. If the number of shares represented at the meeting is 100,000, for example, for a resolution to be passed it must be approved by shareholders representing more than 50,000 shares.

7.1.2 Extraordinary General Meeting

Any GM of a company other than the AGM is called an EGM. The law usually gives power to the directors to call an EGM at any time they think fit. Shareholders holding not less than 25 per cent of the company's shares can at any time compel the directors to call, or requisition, an extraordinary meeting, and the directors must arrange the meeting within one month from the date of receiving the request.[16] Twenty-five per cent could be considered high. Therefore, it is proposed that this should be less. Most other jurisdictions give shareholders, if they hold not less that 10 per cent, the right to insist on holding an EGM.[17] For example, in the UK shareholders holding not less than 10 per cent of the paid up capital carrying voting rights may at any time compel the directors to call an EGM.[18]

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chairman of that meeting...'

[16] As provided in Article 159 of the KCL: An extraordinary meeting of the company may be called (by the board of directors, either) at the instance of the board or on application in writing made to the board by shareholders holding not less than one fourth of the shares of the company.
In the latter case the board shall call the meeting within one month from the date of receiving the application.

[17] According to Article 70(1) of Company Law of Egypt no. 159/1981 the board of directors must call such a meeting if required by shareholders holding at least 10 per cent of the issued capital.

[18] See s. 368 of the UK CA 1985. For more information see Pennington, Robert R., *Company Law*, 7th ed., London: Butterworths Publishing, (1995), p. 827.

Also, in Kuwait, the board must convene such a meeting if the company has suffered losses which amount to three-quarters of its capital.[19] This means that losing less than three-quarters of the company's capital (for example, one-half) is not enough to call an EGM under the KCL. It can be said that losing half of the shareholders' capital is enough to compel the board to call the meeting, as in accordance with the UK AC 1985. In the UK, a JSC must convene an EGM if there is a serious loss of capital. That is, if the net assets are half or less of the company's called up share capital. The directors must call a meeting to consider what measures should be taken to deal with the situation.[20]

The EGM is another side to the shareholder's right to share in managing the company. Extremely important decisions are taken involving amendments to the company's memorandum or Articles of Association, capital increase or reduction, liquidation or the merger of the company. In view of the serious nature of the resolutions passed by this meeting, it is subject to regulations different from those governing the AGM in terms of conditions of convening and the manner of voting.

In accordance with Article 160 of the KCL it provides that:

> The quorum of an extraordinary meeting of the general assembly shall be shareholders representing three-fourths of the shares of the company. If this quorum is not present, notice shall be given of a second meeting. The quorum of the second meeting shall be shareholders representing more than half the shares. Resolutions (of the general extraordinary meeting) shall pass by a majority of more than half the shares of the company.

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[19] Article 171(1) of the KCL provides "if the company loses three-quarters of its capital, the directors shall convene an EGM to decide whether the situation necessitate the premature winding-up of the company, the reduction of the capital or the adoption of any other proper measure".

[20] S. 142 of the UK CA 1985. Also Article 69 of Company Law of Egypt no. 159/1981provides that the
directors of a JSC should call the EGM if the losses of the company reach half the issued capital.

In this context, an EGM will be valid if attended by shareholders representing at least three-quarters of the company's shares. If the meeting lacks such a quorum, it must be adjourned to another day and the second such meeting shall be valid if attended by shareholders representing more than half the shares. Resolutions are passed by a majority; over half the total number of the company's shares, not half of represented shares. Such a large majority required by the KCL to render the EGM valid is commensurate with the seriousness of the matters that it is authorised to consider.

It is worth pointing out that the serious error the Kuwaiti legislators have committed in Article 160 is inappropriate and illogical. The EGMs' resolutions passed by a majority exceeding half the company's shares can only be applicable to the first meeting at which three quarters of the shares are represented. As previously mentioned, if the meeting lacks such a quorum, a second meeting is called which shall be valid if half the shares are represented. This necessarily entails that for the meeting to be valid, the second meeting's resolutions must be passed unanimously or almost unanimously, as resolutions under Article 160 are passed by majority agreement exceeding half the company's shares. This is illogical and in some instances impossible. How can the entire quorum of the second meeting be a condition for the validity of the meeting? Therefore, it is recommended that the said Article be amended and set a different majority at the second meeting.

Article 158 of the KCL sets the powers of the EGM:

> No resolution on (any of) the following matters may be passed except by the general assembly in extraordinary meetings. (1) Altering the memorandum of association of the company or its articles; (2) selling or otherwise disposing of the entire under-taking of the company; (3) dissolving the company or amalgamating it with another company or body (of person); (4) reducing the capital of the company.

It is clear in this article that Kuwaiti legislators decided that these issues might be the reason to call an EGM. Therefore, under the KCL, the EGM may be called for four reasons. First, only the EGM is entitled to alter of the Memorandum or Articles of Association of the company. Second, if there is a desire to or otherwise disposing of the entire undertaking of the company, only the EGM is entitled to do this. In addition, dissolving the company or amalgamating it with another company must be done through the EGM. Finally, any proposal to reduce the capital of the company must be presented in the EGM.

7.2 Invalidation of the GMs and their Resolutions

As the above discussion shows, every JSC must hold ordinary or extraordinary sessions and pass appropriate resolutions on matters under consideration. However, this must be done in compliance with the substantive and procedural regulations by law or under the company's Articles of Association in order to render the meeting and resolutions valid.[21] The KCL does not specify where the GM or its resolutions are invalid. However, any meeting held without notice thereof to the shareholders or in contravention of the procedures and provisions of law is invalid. The resolution affecting shareholder's basic rights set forth in Articles 131 and 133 is also invalid, and so is the resolution passed by means of fraud or misrepresentation to the GM.

Any shareholder who objected to a resolution or a result of fraud or misrepresentation has approved a resolution, or absent may apply to a court of law demanding invalidation of the meeting and any resolution passed by it. This is because

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[21]Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn., Cairo: Dar Al-fker Al-Arabi Publishing, (1978), p. 486-9; Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 1st edn., Kuwait: Author Publishing, (1999), p. 99.

the GM was held in contravention of law and the company's Articles of Association. However, a shareholder may demand invalidating the resolution only if the meeting itself was valid (see chapter 8).[22]

As for the minority shareholder's right to object to the resolutions of the EGM, Article 136 of the KCL establishes that right if the objections constitute at least 15 per cent of the company's capital and provided they have voted against the resolutions in question at the meeting and proved that these prejudice of their rights.[23] The objections must be submitted to the court within 30 days of issue of the meeting resolution, and the court may uphold, modify, overrule or defer implementation of the resolution pending an appropriate settlement of the dispute by buying the objectors' shares or in any other appropriate manner (see 8.2).[24]

7.3 A Shareholder's Right at the GMs

It must be stated first that the rights of shareholders in the GMs, such as the right of attendance, discussion and voting are not useful if the shareholder does not practice his other rights. He should be acquainted with his financial rights, and knew the company's status and reports. If not he should make sure about the correctness of what is discovered through communication with the company's auditors. The

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[22] Article 133 of the KCL.

[23] *Ibid.*, Article 136 provides 'within thirty days from the date on which a resolution is passed in accordance with the preceding article, (any) number of the shareholders who did not consent to that resolution, holding shares to a total value of not less than 15% of the subscribed capital, may, if the resolution is to their detriment, make opposition to it before the court.
The court may confirm, qualify or cancel the resolution, or (order) postponement of its carrying out until a suitable arrangement for purchasing the shares of the dissenting member – provided that no expense whatsoever towards such purchase shall be charged to the company – or any other suitable settlement is made.'

[24] *Ibid.*,

shareholder who is not aware of his rights or the company's status, will not be useful when attending the meetings. On the contrary he can be harmful to it.

Every shareholder of a JSC enjoys a number of rights at GMs, and these fundamental rights have been given to shareholders to perform duties, as the owners of the main interested group in the JSCs, towards their companies. Hence, following sections will concentrate and determine these rights.

7.3.1 Shareholder's Right to Attend the GM

The shareholder's right to attend the GM is associated with his capacity as a shareholder of a JSC and must not be denied.[25] Therefore, as a general rule every shareholder may attend regardless of the number of the shares he owns.[26] However, this differs from other laws that specify a minimum number of shares as a condition for attending the GM.[27] Accordingly, a number of countries deny some shareholders the right to attend because they do not hold the required minimum number of shares.[28]

The shareholder enjoys the right to attend even if a part of the value of his shares is due to the company. in other words, even if he has not paid up his shares.[29] That is because his capacity as a shareholder of the company is not conditional on payment of the unpaid amount of the shares he subscribed for and if the shareholder is a body

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[25] Akthem, Al-Koli, *Commercial Law of Lebanon*, Beirut: Dar Alnahda Publishing, (1980), p. 257.

[26] This right is established in Kuwait by Article 154 of the KCL and in the UK by Article 38 of Table A and S. 370(2) that provides 'notice of the meeting of a company shall be served on every member of it in the manner in which notices are required to be served by Table A.'

[27] Younes, Ali, *Commercial Companies*, Egypt: Dar-Al-feker Al-Araby Publisher, (1991), p. 358.

[28] See for example the Saudi law Article 83 that provides "the articles of association of the company shall specify the (classes of) shareholders entitled to attend GMs. Nevertheless, every shareholder who holds twenty shares shall have the right to attend, even if the articles of association of the company provides otherwise."

[29] Younes, *supra* note 27, p. 356.

corporate, it delegates a natural person to represent it. If the shares are jointly held by a group of persons they must choose from among their number to exercise the rights derived from such a holding, including the right to attend the GM.[30]

It is known that a shareholder may mortgage the shares he holds but in this case, who has the right to attend; the creditor or the debtor (shareholder)? Article 108 of the KCL provides that:

> The property of a (share) company may not be attached for the satisfaction of debts owing from one of (its) shareholders but the shares of that shareholder and the dividends thereon may, and in such a case an entry of the attachment, based on a notice from the authority concerned and not to be removed without a notice from that authority, shall be endorsed against the registration of the shares in the shares register of the company.

It is clear in this article that the matter of attendance at the GM, according to the KCL, is an established right associated with the owner of the mortgaged shares. Accordingly, the creditor may not exercise the right of the debtor (shareholder) to attend and vote at the GM.[31]

Through attending GMs, shareholders can exercise the powers they have been given by the law and the Articles of Associations. Unfortunately, most of the shareholders are uninterested in participating in GMs. This situation might drive one to ask; why are they uninterested in participating in their companies? There are in fact, a number of justifications for the absence of shareholders from GMs.

7.3.2 The Reasons for Shareholders' Absenteeism from GMs

It is established that shareholders often intend to practice their rights by

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[30] See Article 99 of the KCL; Mahmoud, Al Sharkawi, *Commercial Companies in Egyptian Law*, Cairo: Dar Al-nahdah Publishing, (1986), p. 119.

attending GMs. During these meetings shareholders presumably enter into discussions about the various topics on the agendas and personally vote for the draft resolutions proposed by the board of directors. Nevertheless, despite the importance of the attendance of shareholders as owners or the main interested group in a JSC, they are often unable or unwilling to attend.

In order to identify reasons for shareholders' absenteeism from GMs, it is essential to look at the motivations that urged them to invest their funds, whether permanently or temporarily. When a permanent investor buys long-term shares he is looking for an annual income with a share of the dividends distributed by the company to its shareholders. He also expects an increase in his invested capital, matching the rise in the value of shares. On the other hand, when the temporary or short-term investor buys shares in a company he expects to benefit from the rise in their value due to price fluctuations. His profit margins are achieved by re-selling such shares.[32]

Based on the above, it is noted that there are two categories of shareholders: permanent and temporary. The psychological conditions of both categories are very different. Temporary shareholders are in fact speculators and they will sell their shares as soon as the market value of their shares goes up, therefore, they have their own reasons to be absent from the GMs. What are the reasons that prevent permanent shareholders from attending the GMs of their companies?

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[31] Abdalah, Foaid, *Management of JSC*, Beirut: Dar Am Al-Ktab Publishing (1996), pp. 158-9; Younes, *supra* note 27, p. 363.

[32] Abou Zeid, *supra* note 21, p. 404.

7.3.2.1 The Large Number of Shareholders

The large number of shareholders who share the stakes of the company's capital constitutes the first material reason for absence. In such a situation, it is difficult to gather the shareholders in one place for a GM. For example, in very large companies there may be tens of thousands of shareholders. Also, when so many are entitled to attend and vote, none of the shareholders expects his vote to decide the matter, and none of them think his voice can be heard among this huge number of shareholders. As a result, most shareholders do not have the appropriate motivation to study the company's affairs and vote intelligently.[33]

7.3.2.2 Geographic Spread of Shareholders

The geographic spread of shareholders over such vast areas hampers their participation in the GMs. These often take place in the capital where the majority of companies' headquarters are located.[34] It is, therefore, more difficult for those who reside in remoter areas to attend the meetings. Those who live closer have much easier access (bus ticket or taxi fare).[35]

7.3.2.3 Shareholders are too Busy

In order for shareholders to attend the meetings, they need more than invitation

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[33] See Easterbrook, Frank H. and Fischel, Daniel R., The Proper Role of a Target's Management in Responding to a Tender Offer, 94 *Harv. L. Rev* (1981) p. 1170-1.

[34] The DTI Report in the Annual General Meeting and Shareholder communications (Consultative Document) (October 1999) para 19 provides that "for JSC, at least those whose shares are listed on a stock exchange, the GM fails for quite different reasons to provide the reality of democratic accountability and control. There are many thousands – sometimes hundreds of thousands or even millions – of individual shareholders of such companies; they live in all part of the UK, and many live abroad. It is quite impracticable for more than a small minority of them to attend a GM on a working weekday at a single location in the UK".

cards or newspaper advertisements. It is too difficult, if not impossible, for those shareholders who have regular jobs to have the time to attend such meetings, especially when they have shares in several different companies.

It is also established that in order for shareholders to be able to lead discussions during the GMs, they need to access sufficient, in-depth information on the company. In fact, this can be accomplished only if the company provides them with the relevant documentation and reports. Again, shareholders need to call at the company's premises to collect copies of these materials prior to the GMs. This could be costly and time-consuming. Accordingly, shareholders are unable to attend GMs on a regular basis. Only those who have no other job (normally seniors, retired persons, or unemployed people) are able to do so.

7.3.2.4 Limited Liability of Shareholders

All shareholders know that their responsibility for the debts of their company is limited to the extent of the nominal value of their shares.[36] Therefore, when a shareholder pays the whole value of his subscribed shares, he will not be liable for the company's debts. This limited liability is one of the reasons preventing shareholders from attending GMs (see 3.2.4).[37] Limited liability decreases the need for shareholders to monitor the directors of their companies because the financial consequences of the

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[35] Abdalah, *supra* note 31, p. 269.

[36] See Article 63 of the KCL; John, Hicks, Limited Liability the pros and Cons, in Orhnial, Tony (ed), *Limited Liability and The Corporation*, London: Croom Helm Publishing, (1982), p. 30, see also David Goddard, Corporate Personality-Limited Recourse and its Limits, in Ross Grantham and Charles Rickett (eds.), Corporate Personality in the 20th Century, Oxford: Hart Publishing, (1998), p. 23.

[37] According to Article 133/1(a) of the KCL the GM of a company cannot issue a resolution that may increase the shareholders' liability.

companies' failure are limited.[38]

7.3.2.5 Simultaneous Meetings by Most of the Companies

One of reasons that may cause absenteeism is that the majority of companies hold their GMs at the same time of year. Shareholders can be invited to attend GMs on the same date, and, sometimes, at the same hour. In such an event, a shareholder has to select the meeting that deserves more care. In Kuwait, AGMs of all JSCs are usually held in December or January, because the financial year of any JSC starts on the first day of January and ends on 31st of December.[39]

7.3.2.6 Shareholders' Psychology

There is a close causative relationship between the shareholder's interest in the company and the amount of his stake. For instance, if a shareholder maintains a 20 per cent or more stake of a company's share capital, it is natural to see him think about the company with the mentality of a major stakeholder. He will be highly interested in following up the company's activities as he realises that his business fortune depends on its proper management. Therefore, he will naturally attend the company's GMs on a regular basis.[40] On the other hand, a minor shareholder whose participation in the company's capital represents a small part of his funds will have less interest in the

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[38] Ian M Ramsay, Models of Corporate Regulation: the Mandatory/Enabling Debate, in Ross Grantham and Charles Rickett (eds.), *Corporate Personality in the 20th Century*, Oxford: Hart Publishing, (1998), p. 251.

[39] As provided in Article 45 of Appendix B Pro Forma Memorandum of Association of a Joint Stock Company of the KCL No. 15/1960 'the financial year of the company shall start on the first day of January and expire on the 31st day of December of every year, exception being made of the company's first financial year, which shall commence from the date of the declaration of the legal incorporation of the company and expire on the 31st day of December of the following year'.

[40] J.H. Farrar & B.M. Hannigan, *Farrar's Company Law.* 4th edn., London: Butterworths Publishing,

management's work and he will attend the GMs less regularly.[41] Hence, most of the individual shareholders who are absent from GMs do not come because they believe the number of votes they have is not enough to have a significant role in the matters of the meeting.

7.3.2.7 The Shareholders' Failure to Follow-up the GMs

As the shareholders feel ineffective, they fail to attend GMs on a regular basis. Most companies invite their shareholders to attend the GMs during morning hours. If reports and documentation are read, there will not be sufficient time to discuss the details. In this context, notes made by the chairman and members of the board for answering the questions are briefly provided. Taking confidentiality as a pretext, they often refrain from giving any other notes than those exhibited in the reports. This causes participation by shareholders in the discussions to be of no use. Moreover, board members and auditors are not obliged to answer all questions during the GM's discussions. In many cases, the directors prevent shareholders from practising their rights in obtaining sufficient information about the company on confidentiality grounds.

Nevertheless, confidentiality must not be left to the mood of the board members and should not constitute an illusive risk. If confidentiality necessitates respecting the company's interests it must not give a permanent pretext for the board to conceal information.

(1998), p. 305.

[41] Abdalah, *supra* note 31, p. 275.

7.3.2.8 Most of the Shareholders Lack Technical Experience

The shareholders' failure to participate in the GMs may be interpreted more comprehensively. Most individual shareholders lack financial and managerial experience.[42] As ordinary shareholders, they are unable to comprehend the complicated financial reports issued by the directors.[43] Henceforth, their votes have a weak effect on the resolutions adopted by the GMs (see 5.5).

7.3.3 The Right of Attending the GM by Proxy

A proxy is a person appointed by a shareholder of a company to represent the shareholder's voting interests at a GM. If a shareholder is unable to attend the GM in person for some reason, they have the right to authorise others to attend on their behalf. The purpose behind this is to give shareholders the opportunity to share in managing and controlling the company's business by proxy. The KCL article 155 provides that; "A shareholder may appoint another person to attend the meeting as his proxy." This means any shareholder who is entitled to attend and vote at a GM of the company is entitled to appoint another person, whether a shareholder or not, as his proxy.

Despite the importance and sensitivity of the issue, the KCL only has this provision in regard to proxy. This leads to the view that the legal rules relating proxy at the KCL are not sufficiently detailed, as for example in the UK CA 1985. In the UK, a shareholder has the right to attend the GM by proxy as provided in the

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[42] Lee T. A., and Tweedie D. P., *Shareholder Use and Understanding of Financial Information*, London: Garland Publishing, (1990), p. 27; see also Al-Sharkawi, *supra* note 30, p. 231.

[43] Bartlett, Susan and Chandler Roy, The Corporate Report and the Private Shareholders: Lee and Tweedie Twenty Years on, *British Accounting Rev* 29 (1997) p. 248; see also, Abou Zied, Radwan, *Shareholding Companies in Public Sector*, Egypt: Dar Al-fker Al-Arabi publisher, (1983), p. 271.

sufficiently detailed S. 272. According to this section, any shareholder entitled to attend and vote at a company meeting may appoint another person, whether a shareholder or not, to attend and vote as his proxy.[44] Every notice calling a meeting must state this right of a shareholder to appoint a proxy.[45] The Articles of Association cannot require the instrument appointment of a proxy to be deposited with the company more than 48 hours before the meeting or adjourned meeting.[46] A proxy is appointed by an instrument in writing, in accordance with the Articles of Association of a company.[47] A proxy has no right to speak at the meeting except to require or join in requiring a poll, and he can only vote on a poll.[48] To prevent directors from selecting only shareholders who would grant them proxies of support, S. 372(6) provides that an invitation to appoint a proxy must be sent to all shareholders. In the UK, there are two kinds of proxies in use; ordinary proxy – appointing a person to vote as he thinks fit at the meeting; and a special proxy – directing the proxy before the meeting to vote for or against a particular resolution.[49]

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[44] See S. 272(1) of UK CA 1985.

[45] *Ibid.*, S. 272(3).

[46] *Ibid.*, S. 272(5).

[47] Article 60 Table A, Companies (Tables A to F) Regulations UK 1985.

[48] See S. 372(2); Table A in the UK does not permit proxies to vote on a show of hands: see Article 59. In a private company, in the UK, proxies have the same rights as the shareholder who appoints them to speak and vote as provides in S. 372(1) of the UK CA 1985. Also it is worth mentioning that one of the recommendation provided by the DTI Report on the *Annual General Meeting and Shareholder communications* (Consultative Document) (October 1999) para 50 states that the statutory right to speak be extended to proxies attending GMs of JSC.

[49] *Ibid.*, Article 61; the Listing Roles in the UK require that a proxy form must enable the shareholder (the appointer) to specify how the proxy is to vote on each issue other than procedural issues. See Para 13.28(b) of the Listing Roles.

Article 155 of the KCL does not lay down regulations governing attendance by proxy.[50] Hence, a shareholder who holds a small number of shares may act as a proxy of a large number of shareholders and, in turn, direct their votes in his own personal interest and thus ignore the interests of the company and those of the other shareholders. Failure of the law to impose regulations on that process may encourage major shareholders to obtain the largest possible number of proxies legally or illegally (something which helps them dominate the GM). This is the case in some companies in Kuwait where major shareholders are used to buying the votes of small shareholders by buying the notices to the GM to give the act a legal shape, thus describing it as an agreement for attendance by proxy. Therefore, the Kuwaiti legislator should impose some limitations on those shareholders that want to attend the GM by proxy, such as Company Law of the Republican of Yemen. The Yemeni Company Law eliminated this defect by imposing a limitation to the proxy related to the number of votes – any one proxy may not exceed 5 per cent of the company's capital.[51]

Moreover, according to the general wording of Article 155 of KCL, any member of the board of directors of the company can attend the meeting as a proxy of a shareholder. GMs are the right place for shareholders to practice their power and an opportunity to monitor the board of directors. Therefore, a director should not be allowed to attend as a proxy for a shareholder.[52] In this context, the result is acknowledgement that the acts of the board in the previous year were legitimate and

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[50] There are two conditions for proxy in Egypt, first, the proxy must be confirmed in writing. Second, the proxy must be another shareholder; see Article 208 of implementing regulations of Egyptian Company Law no. 159/1981.

[51] See Article 158/3 of Yemeni Company Law.

[52] Sami, Fawzi, *The Commercial Companies "Public and Private Provisions,* Jordan: Maktabt Dar Al-Thgafah Publishing, (1999), p 490; Younes, *supra* note 27, p. 358; Sameha Al Kalyoubi, *Commercial Companies*. Egypt: Dar Alnadah Publishing, (1993), p. 359.

valid without any question. The Egyptian Company Law averted this error by providing that a shareholder may not authorise a director to act on his behalf at a GM.[53] Thus, the KCL should expressly prohibit the directors from acting as a proxy of a shareholder at the GM

In summary, it is suggested that new rules relating to the representation of shareholders at GMs by proxies should be added and made more stringent in order to prevent abuses that frequently occur in practice. It should no longer be possible to appoint a proxy for an indefinite number of GMs. Therefore, each appointment of a proxy is valid only for the specific meeting for which the appointment is made. Also, a proxy should not represent more than a limited number of shares, for example, they should not exceed say 5 per cent of the company's capital. Otherwise, one shareholder may be represented as a proxy for the majority of shareholders, thus enabling him to control the GM. Likewise, directors of the company should not be allowed to attend the GM as a proxy of a shareholder.[54]

7.3.4 Shareholder's Right to Discuss at the GM

Chapter five concentrated on the right of shareholders to obtain all the information they need to know about the development and present condition of the company's affairs in order to be able to exercise their rights to discuss and vote properly (see 5.3). It stated that at many times the reports sent to shareholders are not clear enough. Therefore, shareholders need to have the right to discuss and ask question and directors should have to answer to clarify any vagueness. Accordingly,

[53] See Article 59.2 of The Egyptian Company Law provides "no shareholder other than members of the administrative board is allowed to charge any member of the administrative board to replace him in the attendance of GM."

issues scheduled in the agenda of a GM should be open to discussion to all company's shareholders, and the shareholders should have the right to direct questions regarding the agenda of the meeting, both to the directors and auditors. Directors and auditors will be required to provide satisfactory answers to the questions put to them by their shareholders. However, questions must be answered in such a way so as not to jeopardise the company's interest. If a shareholder feels that an unsatisfactory answer has been given to one or more of his questions, he should have the right to appeal against it at the meeting.[55] This is one of the basic rights which every shareholder must enjoy during the GM. Accordingly, any provision in the Articles of Association of the company that attempts to limit or deprive the shareholders of this right, shall be considered null and void.[56]

The KCL is not clear on this important issue. There is no article in the KCL about this basic right. The Kuwaiti legislator should follow the Saudi Company Law when eliminating this defect. It provides, in Article 94, that issues scheduled in the agenda of a GM should be open to discussion to all shareholders. Also, shareholders should have the right to direct questions regarding the agenda, both to the company's directors, and its auditors. Due to the importance of this right, the Saudi legislator stated in the same article that, any provisions in the Articles of Association of the company that attempt to deprive a shareholder of this right will be considered null and

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[54] Abou Zied, *supra* note 21, p. 224.

[55] Younes, *supra* note 27, p. 370.

[56] Sameha, *supra* note 52, p. 378.

void.[57] Egyptian Company Law also clearly mentions this right when it provides in Article 72/1:

> Every shareholders who attends the meeting of the general assembly has the right of discussing the questions included in the agenda of the meeting, and calling the members of the administrative board, and the auditors of accounts to answer on questions relating to them. He may also present any question before the meeting of the general assembly, at the time fixed by the regulation. Any provision depriving the shareholder from exercise of this right will be invalid.

In the UK also, it is customary, before putting a resolution to shareholders for approval, that directors invite shareholders to ask if they have questions and the chairman should answer their questions. This right came from common law. It is not a demand of the Company Act.[58] Therefore, to have a good corporate governance and balance of powers between directors and shareholders, new articles should be added to the KCL under which shareholders are expressly and directly given the right to discuss and address any questions to the GM.

Another thing that may facilitate the process of discussion and questions at a GM is that if one of the shareholders has his questions ready a few days prior to the meeting he should send them to the board of directors so they can answer them in the meeting.[59] Moreover, it is necessary to require board directors and auditors to answer all shareholders' questions and provide satisfactory answers, otherwise, shareholders

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[57] Article 94 of Saudi Company Law provides that "every stockholder shall have the right to discuss the matters listed in the agenda of a meeting, and to address questions to the directors and auditor in respect thereof. Any provision in the company's bylaws depriving a stockholder of this right shall be considered null and void. The directors or the auditor shall answer stockholders' questions to such an extent as would not jeopardise the company's interests. If a stockholder feels that the answer to a question put by him is unsatisfactory, he may appeal to the meeting, whose decision shall be final in this respect."

[58] Smerdon, Richard, *A Practical Guide To Corporate Governance*, London: Sweet & Maxwell Publishing, (1998), p. 155.

[59] For example, five days under the Yemeni Company Law to allow the board or auditor to produce replies see Article 163/2 of Yemeni Company Law.

should have the right to appeal against the board of directors or the auditors at the GM.

However, if a huge number of shareholders attend a GM this may restrict the right of each shareholder to get a chance to ask questions. Accordingly, some jurisdictions should be included such as in the company law of France whereby any shareholder may submit an unlimited number of written questions to the board of directors prior to the GM. Such questions must relate to the agenda, and the directors are required to answer these questions verbally at the meeting.[60]

7.3.5 Shareholder's Right to Vote at the GM

When the shareholders and directors finish their discussion on one of the matters that is presented to the meeting, they reach the stage of taking a decision by voting. The voting of shareholders in the GM is a right and a tool for shareholders, and considered as a proof of the special position shareholders exclusively enjoy (see 2.4). The shareholders' votes are a tool and an effective weapon as decisions cannot be made without these voices. Usage of this tool cannot be useful for the company or shareholders, unless the shareholders are fully aware of their other rights and practice these rights in order to stay close to the company and be aware of what goes on therein.

Therefore, voting is a basic right of a shareholder, which may not be denied under the company's Article of Association, or even by a resolution of an AGM or EGM. The voting rights, as practised by shareholders during GMs, are closely related to the company's existence. It is the basic motivator of its business. As the quorum is

[60]Article 162 of French Company Law no. 66-357 of July 24, 1966.

competed, upon providing the shareholders with sufficient information on the matters presented to the GM, and upon deliberation of each topic of the agenda, such matters are subjected to voting in order to adopt the relevant resolutions. Therefore, votes are used in important corporate decisions such as electing directors or auditors, authorising the accounts of the company, major asset sales, mergers, and authorisation of new shares issues. That means that the effectiveness of corporate governance depends on the efficiency of the voting process.

In general, every individual at a meeting has one vote and this is exercised by a show of hands. Each voter can be counted only once no matter how many shares he has. However, a company may allow shareholders to have a number of votes equal to the number of shares held – this is called vote on a poll.[61] The Kuwaiti legislator has dedicated this right of the shareholder as provided in Article 156 of the KCL:

> Every shareholder shall have a number of votes equal to the number of shares he holds and resolutions shall be passed by the absolute majority of the shares represented.

It is stipulated that each shareholder shall hold a number of votes equal to the number of shares owned by him. Therefore, the KCL recognises one method of voting (voting on a poll) when it provided, in the above article, that every shareholder has a number of votes equal to the number of shares he holds.

With regard to multiple voting shares in many countries, JSC shares, which are equal in nominal value, qualify their owner to enjoy equal rights. However, some countries, which have different kinds of shares such as ordinary shares and preference shares, give their holder a priority in receiving dividends during the life of the company

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[61] Article 54, Table A, Companies (Tables A to F) Regulations UK 1985.

and/or priority in distributing the company's assets in the event of liquidation (4.5).[62] Holders of preference shares may also be given extra votes at a GM, and these are called "multiple voting shares".[63] Whatever the reasons for issuing preference multiple voting shares, they are in fact misused and breach the rule of equality of shareholders. This is because they are granted to certain shareholders with the aim of dominating the company's business by accumulating a majority in the hands of a few shareholders. With this in mind, many countries prohibit issuing multiple voting shares.[64]

According to the KCL, JSCs may issue one kind of share. That share is an ordinary share and each shareholder has a number of votes equal to the number of his shares (see 3.3.1). In this context, JSCs in Kuwait cannot issue multiple voting shares.[65] In the UK, the law does not ban multiple voting rights. Therefore, it is entirely legal for companies to issue a class of share with multiple voting right.[66] In *Bushell v. Faith*[67] the articles of the company provide that in the event of a resolution being proposed at a GM for the removal of a director, each share held by that director should carry three votes. It was held that such voting rights were valid. On other hand, JSCs in the UK may have shareholders that have no rights to vote at GMs. However, non-voting shares are strongly disapproved of by the Stock Exchange of London.

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[62] Sameha, *supra* note 52, p. 249

[63] Sharkawi, *supra* note 30, p. 171.

[64] *Ibid.*

[65] See Article 156 of the KCL.

[66] See *Rights and Issues Investment Trust Ltd v. Stylo Shoes Ltd* [1965] Ch 250.

[67] [1970] 1 All ER 53.

7.3.5.1 By Whom is the Vote Exercisable?

Creditors and employees do not have a right to vote in GMs. The general rule is that every person whose name appears on the register of shareholders of the company is a member of the company and may vote accordingly (see .3.3).[68] The KCL is clear on this issue when it provided in Article 156 "every shareholder" meaning only shareholders who have the right to vote. Therefore, a company's Articles of Association cannot give a non-shareholder a right to vote at the GM other than as a proxy or representative of a corporate body. The UK CA 1985 clearly contemplate that only shareholders and their proxies or representative are entitled to vote.[69]

The questions that may be asked here are: it is possible for a share to be owned by a person who suffers from a mental disorder? And shares be charged as security for loans? Shares may also be owned jointly by two or more persons, or artificial persons may own them. Furthermore, a shareholder may be bankrupt. The question here is who is entitled to attend and vote at the GM in such circumstances? If the holder of the shares is incapable of managing his affairs by reason of mental disorder, he may attend and vote by his curator or other person authorised on his behalf appointed by a competent court. If the shareholder is a body corporate, it delegates a natural person to attend and vote at the GM. If the shares are jointly held by a group of persons they must choose from among their number to exercise the rights derived from such a holding, including the right to attend and vote at the GM. Finally, as far as the company is concerned, it is the registered owner alone who is entitled to attend and

[68] See Articles 130 and 134 of the KCL and S. 352 and 361 of the UK CA 1985.

[69] In the UK CA 1985 the definition of extraordinary and special resolutions refers only to the votes of shareholders; see S. 378.

vote at the company meeting,[70] even if shares are charged by a shareholder in favour of his creditor. Alternatively shares may be held in trust, that is, the legal ownership may be vested in one person who is obliged to hold the shares for the benefit of another.[71]

7.3.5.2 Why do Shareholders Alone Have Voting Rights?

In Kuwait as in many countries, shareholders alone have voting rights at GMs. One might ask why shareholders alone have this right? To answer this it may be useful to start with the importance of voting at GM. It is first necessary to understand that the right to vote is the right to make all decisions at the GM. All kinds of resolutions of the GM are issued by the votes of shareholders. Shareholders, for instance, may elect directors and give them the discretionary powers they need over the management of the company and/or they may dismiss them. The board of directors has to get agreement from the voters at the GM to increase or decrease the capital of the company, to change the company's objections, to distribute annual dividends, to appoint auditors. Therefore, votes are the instrument that must be used to make the resolutions of the GM, and this instrument should be under the control of the owners of the company or the main interested group in a JSC. In both cases, the group that has the power of voting at the GM is the shareholders (see 2.4).

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[70]Article 108 of the KCL provides "The property of a (share) company may not be attached for the satisfaction of debts owing from one of (its) shares but the shares of that shareholder and the dividends thereon may, and in such a case an entry of the attachment, based on a notice from the authority concerned and not be removed without a notice from that authority, shall be endorsed against the registration of the shares in the shares register of the company.
The execution creditor and the mortgage shall be bound by all the resolution of the general assembly equally with the shareholder whose shares are charged or mortgaged but neither of them shall be entitled to the rights of membership of the company."

[71] Younes, *supra* note 27, p. 363; see also Taha, Mustafa, *Commercial Law*, Buiret: AL-Dar Al-Jamaah publishing, (1982), p. 368.

To answer the question provided above, a number of different explanations can be put forward. First, shareholders, as many scholars believe, are owners of the company and the voting right is seen as a result or aspect of this ownership.[72] Therefore, the right to vote is the method which shareholders exercise to monitor and have control over the board of directors who are managing their money. Second, there are those who reject treating shareholders as owners of a company and treat them as one of the interested groups in any JSC (see 2.4). They say that shareholders should enjoy the voting right at the GMs because they are the residual claimants to the company's income.[73] Therefore, shareholders as the residual claimants, have the appropriate motivation to make discretionary decisions.[74] Thus, shareholders also, by this explanation, have a motivation to monitor the board of directors and company law gives them the power to do so by vesting in them the power to vote on many matters at GMs.

They enjoy this right because they are the providers of the company's capital and the residual risk-bearers. Therefore, they should enjoy a special position in their company, as discussed in Chapter two.[75] Voting rights exist because someone must have residual power to act where the aims of the company are not complete. The right is usually attached to the shareholders as the residual claimants to a company's income. They receive most of the marginal gains and suffer most of the marginal costs. Hence,

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[72] Ferran, Eilis, *Company Law and Corporate Finance*, 1st end., Oxford: Oxford University Press, (1999), p. 245; see the Cadbury Committee Report states at para 6.1.

[73] Easterbrook, F. & Fischel, D., *The Economic Structure of Corporate Law*, London: Harvard University Press, (1991), pp. 67-72.

[74] *Ibid*, p. 68; Ferran, *supra* note 72, p. 246.

[75] E.F. Fama and M.C. Jensen, Separation of Ownership and Control, 26 *J Law & Econ* (1983) p. 301.

it is felt that they are the appropriate group to exercise voting rights.[76] This has already been discussed in Chapter Two.

7.3.5.3 Voting Agreement

Shareholders may enter into agreements that determine the manner in which they exercise their votes. The question arises whether a shareholder is allowed under the KCL to enter into an agreement with his co-shareholder(s) for exercising the right to vote in a specific way or to abstain from voting. This kind of agreement forms a bloc between a number of shareholders enabling them to carry more weight at GMs. The KCL, as in many cases, is silent on this matter. It is therefore, left to the courts to decide in each particular case whether an agreement should be upheld.[77] However, as said earlier in this chapter, that the right to vote is a right of property and, therefore, voting agreements are a valid exercise of property rights and are enforceable in the courts, if they do not breach the law and the Articles of Association of the company.[78] Voting agreements are probably invalid if they; first, provide for a financial benefit to a shareholder for voting as directed; second, purport to oblige shareholders to cast their vote in a certain way as directors or always follow the directions of the company; third, purport to fetter the company's power to alter its articles.[79]

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[76] Easterbrook, F. & Fischel, D., Voting in Corporate Law, *J.L & Econ,* (1983) p. 403.

[77] Sameha, *supra* note 52, p. 362; see also Maeijer, J., *A Modern European Company Law System: Commentary on the 1976 Dutch Legislation*, Rotterdam: Sijthoff & Noordhoff International Publishing, (1978), p. 107.

[78] See *Greenwell v. Porter* [1902] 1 Ch 530.

[79] Farrar, *supra* note 40, p. 137.

7.3.5.4 The Voting right and Conflict of Interest

A director of a company is in a fiduciary position and, therefore, he is subject to a number of restrictions to prevent a conflict of interest (see 2.5.1). However, the position of a shareholder in a JSC is different. Shareholders of a company are not in a fiduciary position. Therefore, in general, they can vote at the GM in any way they think fit to achieve their interests. In the UK, there are many cases that agree with this right. In *Carruth v. Imperial Chemical Industries Ltd* Lord Maugham said: "The shareholder's vote is a right of property, and prima facie may be exercised by a shareholder as he thinks fit in his own interest."[80]

Many cases in the UK are placing a shareholder's rights in a company as property rights on the basis of a shareholder's status which itself arises from membership of the company (see 2.5.2). Therefore, ownership of a share gives the shareholder a number of rights of property; one of these rights is the right to vote at the GM. This right can be practised in any way the shareholder thinks fit,[81] even if he has a personal interest in the resolution.[82] This principle was regarded as firmly incorporated by the Privy Council in *Burland v Earle*[83] where Lord Daver held that it was a principle of law that

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80 [1937] AC 707; In *Pender v Lushington* (1897) 6 ChD 70. Jessel MR held: Pender is a member of the company, and whether he votes with the majority or with the minority he is entitled to have his vote recorded, an individual right in respect of which he has a right to sue. That has nothing to do with the question like that raised in *Foss v Harbottle* (1843) 2 Hare 461 and that line of cases; also in *Northern Counties Securities Ltd v Fackson and Steeple Ltd* [1974] 1 WLR 1133 at 1144 Walton J. said "when a shareholder is voting for or against a particular resolution he is voting as a person owing no fiduciary duty to the company and who is exercising his own right of property to vote as he thinks fit. The fact that the result of the voting at the meeting will bind the company cannot affect the position that, in voting, he is voting simply in exercise of his own property right."

81 Jaffey, Peter, Contractual Obligations of the Company in GM, 16 *Legal Studies* (1996) p. 31.

82 Younes, *supra* note 27, p. 364; see also Jamal-adeen, Ali, *Commercial Company*, Cairo: Dar Al-Nahdah Publishing, (1961), p. 375.

83 [1902] AC 83.

> Unless otherwise provided by the regulations of the company, a shareholder is not debarred from voting or using his voting power to carry a resolution by the circumstance of his having a particular interest in the subject matter of the vote.

The Privy Council cited with approval *North-west Transportation Co Ltd v Beatty*[84] where Sir Richard Baggallay had held that

> Unless some provision to the contrary.....,and every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject-matter opposed to, or different from, the general or particular interests of the company....

However, the freedom of shareholders to use their votes at the GM are subjected to some restrictions. First, when shareholders cast their votes at the GM they must always act bona fide for the benefit of the company, otherwise the resolution of the shareholders would be invalid.[85]

The KCL provides in article 132/3 that 'A member shall, in particular, be subject to the following obligations: (3) to abstain from any act intended to prejudice the company.' It is clear from the above article that a shareholder is demanded with good intentions toward the company. In other words, when a shareholder's act prejudices the company, he, in fact, does not act bona fide. Thus, the power of voting that the shareholders enjoy in GMs must be exercised, not only in the manner required by law, but also bona fide for the benefit of the company as a whole and to protect the interests of other shareholders.[86] Secondly, a shareholder may not vote in certain cases

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[84] [1887] 12 App Cas 589.

[85] *Clemens v Clemens Bros Ltd* [1976] 2 All ER 268; also see *Estmanco (Kilner House) Ltd v. Greater London Council* [1982] 1 All ER 194. In this later case Sir Rebert Megarry VC said "no right of a shareholder to vote in his own selfish interests or to ignore the interests of the company entitle him with impunity to injure his voteless fellow shareholders by depriving the company of a cause of action and by stultifying the purpose for which the company was formed."

[86] Abid-Alfdal, Ahmad, Protection of minority of shareholders, 2 *Journal of Legal and Economic*

specified by law. For example, a shareholder should not have the right to vote on a resolution ratifying a contract entered into by the company in which he has a personal interest.[87]

A question may be raised about the shareholder's eligibility to vote at the GM on matters in which he has a direct interest. In other words, the question is, whether the shareholder may vote in his own immediate personal interest or whether the right to vote is really a power to be exercised solely in the higher interests of the body of the shareholders as a whole? A shareholder may not vote in certain cases specified by law, whereby he has a personal interest in the adoption of a certain resolution, for example, a deal between one of the shareholders and the company. In this case we have to say that shareholders are not a fiduciary for the company. As a result, shareholders, in general, have the right to use their rights to vote at the GM in any way they believe is appropriate for them to protect the interest of the company and the rest of shareholders. This issue must be controlled by statute.

Unfortunately, KCL does not organise this issue except in one case, namely by allowing the shareholder with a contribution in kind to vote on the resolution concerning the valuation of his contribution at the constituent meeting.[88] In other cases, a shareholder is allowed to vote even if he has an interest in the resolution subject to voting except when the Articles of Association of a company provides that a

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Research (1987) p. 151.

[87] For example Article 103 of French Company Law no. 66-537 of July 24, 1966 provides "(4) the interested party may not take part in the vote and his shares are not counted in calculating the quorum and the majority."

[88] See Article 105 of the KCL that provides "A (share) company may (issue) shares otherwise than in cash: for money's worth or for choices in action; and the founders (of the company) shall apply to the President of the High Court for appointing an expert to check whether such consideration has been rightly valued. But the evaluation shall not be final until it is sanctioned by a majority in number of the shareholders holding two-thirds of the cash shares (remaining) after excluding the cash shares owned by the contributors – who shall have no right to a vote in the sanctioning of the evaluation – of

shareholders may not participate in voting if the shareholder has a personal interest in the resolution. As provided in Article 33(2) of Pro Forma Memorandum of Association of a Joint Stock Company, Appendix A:

> A member may not participate in the voting on his own behalf or that of his principal, if the matters in respect of which the voting is required, relate to a personal benefit to him or to a dispute between him and the company.

However, despite the innocence of the wording of this article it has to be said that Appendix A is not mandatory in JSCs. It is just a proposal of Articles of Association issued by the MCI, therefore, JSCs have a choice whether to follow it or not.[89] In order to avoid an abuse of the right to vote by major shareholders the KCL should have expressly prevented a shareholder from voting if he has an interest to acquire personal gains from the matter under consideration. Taking into account that under the KCL there is no limit to the number of votes a shareholder may have either in person or by proxy. Therefore, the above article of the KCL must be a mandatory article to which all shareholders must comply. And, as previously mentioned, shareholders alone have the voting power because they are the driving force behind making the right decisions for the future of their company. Therefore, they should not use this power against the interest of the company to achieve a personal interest.

Directors are, in fact, shareholders in the company they manage. Therefore, the above principle should be applied to them as well. They should be prevented from casting their votes as shareholders at GMs to achieve their personal interests, and from using their voting power to ratify their own breaches of duty.[90]

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that consideration."

[89] It is alike to Table A in the UK.

[90] See Sealy, L. S., the Directors as Trustee, *C.L.J* (1967) p. 83; see also, *Hogg v. Cramphorn Ltd* [1967] Ch 254; *Bamford v. Bamford* [1968] 2 All ER 655.

In the UK, if the director controls the voting at the GM because he holds a majority of the shares carrying voting rights,[91] a resolution allowing him to retain the profit, which is passed as a result of votes cast or controlled by him, is void. He can still be held accountable to the company.[92] A director, according to the KCL, may vote as he wishes in the GM and no restrictions apply to his right to vote as in the UK, where the directors are given the opportunity to ratify their own breaches of duty and pass any resolution they want.

7.4 Do General Meetings Matter to the Shareholders?

One might ask, do GMs matters to the body of shareholders if;

(1) Shareholders are not interested in attending and voting at GMs, the minority who do attend the meeting go along with the directors.

(2) Shareholders are not, in general, interested in using the powers granted to them by the company's Articles of Association and the company law to hold the directors of their company to account.

(3) An individual shareholder cannot do anything because he typically has only a tiny part of the shares in any JSC, and is, therefore, not in a to exercise effective monitoring of the performance of the directors.

(4) Institutional shareholders, who are estimated to own between 65 per cent and 75 per cent of shares of quoted companies in the UK,[93] are not interested

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[91] *Cook v. Deeks* [1916] 1 AC 554.

[92] *Pavlides v. Jensen* [1956] Ch 565, [1956] 2 All ER 518.

[93] Final Report of the Committee on Corporate Governance (January 1998) (Hampel Committee Report) para 5.1 note 60 per cent is held by UK institutional, around 20 per cent by foreign owners and the remaining 20 per cent or so by private investors. The DTI also estimates that around 80 per cent lies in institutional investors: the Annual General Meeting and Shareholder communications (Consultative Document) (October 1999) para 20; see also Potter Julian, the Role of the Institutional

in playing their role as the most powerful group in the GMs (as a number of studies prove).[94]

As a result of this situation (the weakness of GMs), the boards of directors in many JSCs are effectively playing two roles; that of the GM and their original role.[95] Therefore, the AGMs of many companies have become places where boards of directors make their work of the last year legal; at the sametime, the role of shareholders in the company becomes just a way of putting money into the company.

If having an effective GM is an impossible goal or difficult to achieve, one might ask why GMs need to be held every year?[96] If most shareholders believe that directors of JSCs have complete control over the voting process and do what they want why do JSCs not stop holding these seemingly impractical and valueless meetings that cost the companies too much money? Why is company law everywhere still enforcing JSCs to hold GMs? Finally, why not think of something better than holding GMs as provides in one of the DTI report that[97]

> There are two ways or responding to the ineffectiveness of the AGM in fulfilling its role in the governance of JSCs. The first is to extend to plcs a right to dispense with the AGM; the second is to improve the

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Shareholders' Committee, in Saleem Sheikh and William Rees (eds.), Corporate Governance and Corporate Control, London: Cavendish Publishing Limited, (1995), p. 383.

[94] Mallin, Christine A., Investors' Voting Rights, in Kevin Keasey and Mike Wright (eds.), *Corporate Governance Responsibilities, Risks and Remuneration*, England: John Wiley & Sons Ltd Publishing, (1997), p. 146. In this article Mallin provides that "the result of a survey on voting sent to top 250 companies in the UK provide evidence of a low level of voting with, on average, only 35% of shares being voted. In 90% of the companies, the voting level is at 52% or less. These result have implications for UK institutional investors, who own between 65% and 75% of UK equity, and have been the object of criticism for not exercising their votes more." These institutions have access to management in way any time that individual shareholders do not have, and they can if they wish bring significant pressure on board of directors. For more information see Mallin, Chris, Voting: The Role of Institutional investors in Corporate Governance, London: the Institute of Chartered Accountants in England and Wales Publishing, (1995), p. 1.

[95] Butcher, *supra* note 3, p. 230.

[96] Smerdon, *supra* note 58, p. 156; also see Butcher, *supra* note 3, p. 229.

[97] See the DTI Report in *the Annual General Meeting and Shareholder communications* (Consultative Document) (October 1999) para 23.

legislative provisions relating to the AGM to enable it better to fulfil its role.

Arguably demanding the abandonment of GMs will not solve the problem of the effectiveness of GMs. It will create new problems and make the process of monitoring the affairs of the company quite complex.[98] This in turn should mean more losses and damages for the shareholders and other interested groups. Therefore, the second way is preferable; to have effective meetings because a JSC without a GM would be like a democratic country without a parliament (impossible to imagine). The GM is one of the main two organs of a JSC and it has its own duties and responsibilities (see 2.4). Therefore, how can we re-achieve balance among the most important organs in the company, which are the board and general meeting?

Any solution for the brining about balance again between the main two organs in any company shall be through creating means for obliging the GM to perform their tasks again. Shareholders are the main players GMs. Thus, any attempt for re-achieving balance shall be often made through the body of shareholders first. That is the reason behind giving shareholders their full entitlements in the company, as obstacles which hinder them from practising their supervisory role shall also be removed as already mentioned in this study. If the shareholders are unhappy with the performance of the directors, the effective way to express their unhappiness and present their ideas to the board of directors and other shareholders is through the GM. Therefore, GMs in general have always had a fundamental role to play in JSCs. If GMs do not perform their role effectively that does not mean the solution is to abandon them.

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[98] *Ibid*, para 25.

To have more effective meetings it is necessary to think about how to remove the obstacles that preclude shareholders from attending GMs and from having an effective role in the meeting (see 7.3.2). Therefore, if the main reasons are the large numbers, the geographic spread of shareholders or that they are too busy to attend the GM, company law should be amended to allow voting on resolutions by post, telephone or even electronic ballot. These methods may improve voting levels.

One of the suggestions presented by the DTI Report on the *AGM and Shareholder Communications* (Consultative Document) (October 1999) para 30 provided that

> It would be possible to go one stage further and envisage an interactive virtual meeting held in no location; directors' presentations would be posted on an electronic company bulletin board accessible to shareholders' interventions and the directors' responses would also be posted on the bulletin board. Such meeting would probably have to remain open for several days. Such a procedure could potentially offer even wider shareholder access... it is suggested that this option should be open to plcs with unanimous shareholder agreement, as an alternative to dispensing with the AGM altogether...[99]

However, to make sure that those who cast vote by these methods are real shareholders, there should be some procedure and/or conditions in place before giving a shareholder the right to vote in this way. In these circumstances, all the proposals for resolutions must be sent to shareholders in good time before the meeting. This is because, as already mentioned, shareholders are usually lay people who do not have enough experience to understand the accounts of the company easily. They should, therefore, be given greater time to review the annual accounts and reports of the company (see 6.7). A real obligation must also be imposed on the board of directors of every JSC to give enough time to make disclosures of the annual accounts (see 5.3).

Furthermore, to enhance the function of GMs in the JSCs, company law should impose more obligations on directors to improve the distributions of invitations to shareholders to attend the meetings, to give the shareholders the right to submit resolutions on the expense of the company,[100] and create a good atmosphere for auditors to work independently and provide real information that presents to the shareholders the true picture of their company (see 6.6).[101] Also, the body of shareholders should have the main role regarding the auditors, such as the appointment of auditors and the determination of their remuneration, the determination of the audit extent, and the provision of any other services to the company by the auditing firm.

Additionally, as provided above, a shareholder usually only has only a tiny part of the shares of the company that push him to thinking he is not in a position to exercise an effective role at GMs.[102] Therefore, there should be an approach to have some kind of communication between shareholders to encourage them to attend the meetings and make them realise that when they work together they will have the majority. This will enable them to monitor the performance of the board of directors and have a significant voting group, which could pose as a real threat to the board of directors.[103]

Moreover, institutional shareholders should be prevented from ignoring a monitoring role. In other words, they should be encouraged to carry out their

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[99] *Ibid.*, para 34..

[100] Butcher, *supra* note 3, p. 234.

[101] *Ibid.*, p. 237.

[102] Short, Helen and Keasey, Kevin, Institutional shareholders and Corporate Governance, in Kevin, Keasey and Mike Wright (eds.), *Corporate Governance: Responsibilities, Risks and Remunerations*, London: John Wiley & Sons Publishing, (1996), p. 29.

[103] Whittington, G., Corporate Governance and the Regulation of Financial Reporting, 23 *Accounting and Business Re* (1993) p. 313.

responsibilities as shareholders to their companies.[104] As provided above, institutional shareholders in the UK for example, control more than 65 per cent of shares of quoted companies. This amount of ownership gives them the potential to have an effective role at GMs. As the Cadbury Committee Report states at Para. 6.9:

> Institutional shareholders...are largely holding their shares on behalf of individuals, as members of pension funds, holders of insurance policies and the like. As a result, there is an important degree of common interest between individual and institutional shareholders. In particular both have the same stake in the standards of financial reporting and of governance in the companies in which they have invested

Studies have shown that when institutional shareholders play a more active role in corporate governance affairs the more returns the shareholders get from their company. Therefore, if an individual shareholder, who only has a tiny part of the company's shares is not in the position that allows him to exercise an effective role in the GM, the bodies that control huge numbers of shares should take their responsibility. Thus, there should be a compulsory rule in every company law or articles of association compelling these institutions to participate and vote in the GM and stop them from using their powers selfishly.[105]

GMs shall not be held, unless with the attendance of the majority of shareholders whom are not members in the board. Among the problems resulting from the Kuwaiti law is that upon invitation for the meeting, when the required majority does not attend in the first meeting, another meeting shall be held, If the meeting lacks such a quorum

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[104] Short, *supra* not 102, p. 28; in this articles the authors provided that "there are several reasons why institutions may adopt such a stance. First, if they intervene publicly, they are effectively drawing to the public attention the difficulties the company is facing. This is likely to be perceived as bad news by the market, resulting in a fall in share price and a reduction in the value of their investment. Second, if they become involved in the management of such problem companies, they become privy to inside information and unable to trade in those shares, potentially compounding their losses. Finally, effective monitoring is costly in terms of time and money, especially for institutional investors which hold divers portfolios."

[105]See Sheridan, Thomas and Kendall, Nigel, *Corporate Governance: An Action Plan for Profitability*

it must be adjourned to another day and the second such meeting shall be valid regardless of the number of members present. This issue is very critical, as if we assume that the majority in the second meeting are from board members (most often from shareholders), the normal result would be that the GM looses the capacity or role it set for. Thus, for the purpose of re-achieving equilibrium, a reasonable majority shall be demanded in the invitation for the second meeting, as it shall be correct –whatever the number of attendees is.

Auditors shall also be entitled to perform a significant role in the GM for shareholders interests, as they represent the company, when they monitor board reports. They shall have a role in clarifying to shareholders and GMs what is going on in the company, such as operations which may not be identical to what is mentioned in the company's reports. Shareholders shall also be entitled to ask auditors for clarifications about any matters that is considered vague for them.

Finally, for the sake of re-achieving equilibrium, the minority of shareholders shall be granted their entitlements, as they are entitled to participate in decisions affecting them and the company. They are also entitled to investigate in the company's affairs by the ministry of Commerce in order to protect the company and its shareholders. If this minority sensed that the GM is managed by a method that does not achieve the company's high interests. It must be indicated that the existence of such entitlements may be a reason in suppressing who may wishes to illegally manipulate the general meeting's affairs. There must be a supervisory role for the MCI in order to make sure that the GM is managed correctly according to the constitution of the company and the company law.

and Business Success, London: Pitman Publishing, (1992), p. 23.

7.5 Conclusion

It could be said that the GM is the highest authority in the company. It plans the policies of the company, monitors and audits the company's directors and appoints the directors. Shareholders are the main players in the GM, and they have a number of rights in this meeting that enable them to carry out their role.

The position of shareholders entitles them to a number of powers and responsibilities in and out of the GMs. They acquire this position, not because they own the company, but because they are the main providers of the company's capital. They are also the owners of the company shares and, furthermore, they are residual risk-bearers. Consequently, they are the most appropriate organ to monitor the fulfilment of the directors of the company.

However, the rights which shareholders enjoy in the GM cannot be fully applied without first attending the meeting. Therefore, the right of attending is substantial and connected with other rights, such as voting. Shareholders should have a strong belief that their attendance is beneficial for them to protect their interests and to protect their company as whole. Therefore, the obstacles that prevent them from attending should be removed, thus encouraging them to attend. The field should not be left for the board of directors to do whatever they please in the company without any real supervision.

Furthermore, the role of institutional shareholders in Kuwait is absent. They have a considerable weight that cannot be neglected in these kinds of companies. Institutional shareholders should be obligated by law to perform certain duties in the GM, such as communicate with other shareholders. Thus, it is believed that the KCL should handle this type of shareholder and impose them to play the role of shareholders.

Resolutions of the GM can only be made by votes and shareholders alone have this right. They, under any kind of circumstances, should not be deprived from practising this right. To make the votes of shareholders more effective and influential in decision-making, shareholders should have the right to arrange voting agreements.

Finally, it should be pointed out that so far this study has discussed in detail shareholders rights, such as the financial rights and other significant rights. These rights and authorities are important to maintain their interests in the company. If they are practiced in the right way, they may be called "preventive rights", as they can be considered as an adequate protector of the company's and shareholders' interests. The question that shall be posed in the next and final chapter is: If a mistake is made by the board of directors or third party, and this mistake or shortcoming harms the company and shareholders, what shall be required whether from the board or the GM to compensate for these harms? If the shortcoming is from the board's side, shall shareholder(s) perform the required role to compensate the harms caused to the company? What is the role of the law in order to protect the rights of shareholders minorities who do not possess the required majority to make their voice heard by the board and the GM?

Chapter Eight

Shareholders' Remedies

8. Introduction

The shareholders in the GM are supreme in the company. Shareholders are the ones who contributed to the company's capital. Therefore, they should have the major say in what is done with the capital that they invested in the company. However, the picture is not always as excellent as this for many reasons; including the fact that directors may be majority shareholders. They are, thus, in a position both to handle awkward questions from shareholders and are in a position to approve their own actions because they have the advantage of weighted voting.

The question that is addressed in this chapter is; if the minority shareholders have been treated badly by the board of directors who may be the majority shareholders, or if the directors who control the majority of shareholders are managing the company to achieve their personal interests, what remedy can the minority shareholders seek under the KCL?

As a general principle, each person sustaining damage as a result of a decision or erroneous act may proceed with a liability action. In the case of JSCs, the damage arising from the acts of the board of directors may harm the company and some or all of the shareholders, as well as third parties. However, a JSC, as a legal person, may file an action against the wrongdoers to recover the damages, and if it fails to defend its rights, a shareholder or number of shareholders of the company have the right to resort to the courts and file an action in his, or in the company's name, to force the board of directors to maintain the assets of the company or to obtain a fair indemnity against the damages sustained by him as a result of the error committed by the board.

In this final chapter, there is a focus on the means available for shareholders or the minority of shareholders, to repair or remedy the harm done to the company and shareholders (or some of them), because of the negligence of the board or because of the action of a third party. Hence, the objective of this chapter is to discuss what is required to be done about the damage and by whom. What are the rights and authorities for shareholders or the minority of shareholders to face these harms, in or outside the GM, according to the KCL? Is there a shortcoming in the law regarding this matter?

This chapter will be divided into two parts. The first part will be about the actions that may be brought by the company and shareholders. There are different types of action to defend the company and shareholders' rights. These may be proceeded by the company itself or the shareholders against the board of directors or a third party. Examples include the company's action, the derivative action and personal action and these will each be discussed in turn. The second part of this chapter will concentrate on the statutory remedies that exist for shareholders who do not want to proceed with a legal action to defend the company or their personal rights.

8.1 Liability Actions

This section will consider the liability actions that may be brought by the company itself or its shareholders to defend the interests of the company or their personal interests.

A question that may be asked before discussing the kinds of actions that may be brought by the company or shareholders and the statutory protection of shareholders under the company law, is: What is the distinction between the company's rights of action and shareholders' rights of action? The differences between the company's right of action and an individual shareholder's right of action lie in the purpose of the action and in the nature of the damages sought. An action belongs to the company either when the company or all of its shareholders have an interest in the action, and if its purpose is to maintain, reconstitute or augment company capital. On the other hand, an action will be a personal action if the company and the majority of shareholders do not have an interest in it, and if also the purpose of the action is to recover damages relates to the personal right of the shareholder in the company. Thus, he sues to protect his personal rights.

However, as will be discussed later in this chapter, there are a number of obstacles in the path of a shareholder who wants to proceed with an action against the wrongdoing directors or officers, whether, as provided above, on his own behalf or on behalf of the company.[1]

8.1.1 Action of the Company

The company, as a legal person, like any other person is entitled to initiate an action against any person committing an actionable wrong causing damage to it, even if the wrongdoers are its directors, founders or officers.[2] The action of the company is the action owned by the company as an artificial person.

The objective of this action is to indemnify the company against material damage

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[1] Sealy, Problems of standing, Pleading and proof in Corporate Litigation, in Pettet, B. G. (ed.), Company in Change: Current Legal Problems, London: Sevens Publishing, (1987), p. 2.

[2] Abou Zeid, Radwan, *Commercial Companies in Kuwait Comparative Law*, 1st edn, Cairo: Dar Al-fker Al-Arabi Publishing ,(1978), p456; Mahmoud, Al sharkawi , *Commercial Companies in Egyptian Law*, Cairo: Dar AL-Nahdah Publishing (1986), p.226

sustained by it, i.e. the artificial person itself. The aim is to protect the shareholders represented by the company and eliminate the damage sustained by them. In this action, damages are general and sustained by the company and all of its shareholders[3]and it is insufficient to believe that the damage has extended only to the company's shareholders.[4]

The damages that may be sustained by the company can take several forms these include a decrease of its capital due to gross negligence of the board, misuse of powers, or the conclusion of loss-making transactions, thus harming the financial adequacy of the company and the shareholders at that time.[5] The damage extends to each shareholder, whose shares lose part of their value, in addition to the losses incurred by the company.

Pursuant to the KCL all commercial partnerships and companies (except joint ventures),[6] constitute legal personalities with the result that when the contracting parties enter into legal agreements on behalf of the company, they are not considered as separate persons exercising rights and bearing obligations, but as part of one entity. Also, KCL leaves no doubt about when legal personality takes effect when it provides in Article 74 that:

> The decree of incorporation of a JSC shall be published in the official Gazette, and the company shall become a legal person as from the date of issue thereof.

However, such a legal personality (the company) and its directors cannot be pleaded against by a third party unless all the registration formalities have been

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[3] Younes, Ali, *Commercial Companies*, Egypt: Dar-Al-feker Al-Araby Publishing, (1991), p.429.

[4] *Ibid*, p. 429.

[5] Abou Zied, Radwan, *Shareholding Companies in Public Sector*, Eygpt: Dar Al-fker Al-Arabi publishing, (1983), p. 219.

satisfied otherwise any action that may be brought by the company will be rejected.[7]

As the JSC is an artificial person, it cannot by itself proceed with an action. Therefore, who can represent the company and start the company action? Who in this action is the proper plaintiff in this action to redress an alleged wrong to the company by anyone, whether directors, shareholders or outsiders? Who has the direct right to proceed on this action? It is established that this action is initiated by the company's representative i.e. the chairman of the board of directors, being its representative before third parties, including the judiciary. This conforms with the provision of Article 147 of KCL that provides:

> The chairman of directors of the company shall (also) be its president. He shall represent the company in dealings with third parties and his signature in such dealings shall be deemed that of the board of directors. He shall carry the resolutions of the board into effect and the company with its recommendations.

Hence, the board of directors and, specifically, the chairman is the party with jurisdiction to initiate such an action in order to protect the company's rights.[8] Therefore, if an actionable wrong has been done to the company, then the company, as an independent person, has the right to file an action through its representative. One of the authorities granted to the boards due to distribution of authorities in JSCs, is the representation of the company before the courts in order to defend the company's

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[6] See Article 2 of the KCL.

[7] Article 10 of the KCL provides that " The directors of the company shall comply with the formalities for its registration prescribed by the provisions of the Commercial Register Law, and, as against a third party, the company may not contend that it exists but from the date on which those formalities are completed. Failure to complete them shall cause any action brought by the company to be rejected.
One the other hand, a third party may maintain that the company exists though the formalities for its registration have not been completed."

[8] The Egyptian Company law no. 159/1981 in article 85/3 is clearer than KCL when provides " the chairman of the board represent the company before the judicature..."

rights in case it was exposed to any harms. If the board of directors fails to perform their duties, the authority shall be transferred to shareholders in the GM.

In the UK, the company as an artificial person may initiate an action against anybody committing a wrong to it, even against its directors if they violate their duties towards the company, exceed their limits of their authority, or violate the provisions of the law or the company's Articles of Association. Therefore, the company itself is the proper plaintiff to initiate the action of the company. This is mentioned in one of the most famous cases in this subject on the UK: *Foss v Harbottle*. In this case Foss and Turton were minority shareholders in a company in which Harbottle and others were directors and shareholders. The directors sold a plot of land to the company at an inflated price.[9] Foss claimed that the directors had defrauded the company. The directors replied that they were entitled to decide what price the company should pay for its acquisitions. Foss and other minority shareholders sued the directors. It was held that it was not for Foss and his fellow minority shareholders to raise an action against the directors for fraud or for making the company lose money on a costly bargain. The court also held that the proper plaintiff was the company itself, as it was the company as a whole that was being defrauded or mismanaged, and because the plaintiff (Foss and Turton) were not the company. If the company had suffered, it was for the company to start an action.

From the statement of Lord Davey in *Burland v Earle*[10] it is also noticed that there are three principles:

[9] At the time of the case the present rules on fiduciary duties of directors were undeveloped and there was little judicial control over companies.
[10] [1902] AC 83.

1. If a wrong is done to the company as a person separate from its shareholders then the only body which may sue for redress is the company itself;
2. The court will not interfere in the internal administration of the companies performing within their powers;
3. A shareholder cannot sue to rectify a mere informality or irregularity if the act when done regularly would be within the powers of the company and if the intention of the majority of shareholders is clear.[11]

Moreover, it is usual that the articles of associations of JSCs grant the board of directors the right to initiate action on behalf of the company.[12]

It could be noticed that the above cases and discussion took no account of the fact that, sometimes, directors are the perpetrators of wrongdoing or fraud. In other words, the position described above is acceptable if the defendant or the wrongdoer is somebody outside of the board of directors. If the defendants include all or the majority of the board of directors, it is surely unreasonable that the board could sue itself on behalf of the company.[13] So, a question may be asked: What if the board adopts a resolution not to proceed with the action?

KCL provides that the company itself, the shareholders and third parties may

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[11] In *Edwards v Halliwell* [1950] 2 All ER 1064, CA, Jenkins LJ referred to the rule in *Foss v Harbottle* as applying only where a wrong had been done to the company as a separate person and said that it had two elements: "First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the member, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quaestio*."

[12] See Table A, art 70 of the UK CA 1985; and article 21(1) of the Kuwaiti pro forma of article of association of a JSC Appendix B that provides "The chairman of the board of directors shall represent the company before the judiciary and shall implement the directors' resolution."

[13] Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, 3[ed] edn, Kuwait: Author Publishing, (1999), p. 443.

hold the board of directors to account even after a vote of the GM to absolve the board of responsibility if the board committed one of the types of conduct mentioned in Article 148 of the KCL. Article 148 provides:

> The chairman and members of the board of directors shall be accountable to the company, the shareholders, and third parties, for any fraudulent act, abuse of powers, violation of law or the articles of the company, or error of management and a vote of the general assembly to absolve the board of responsibility shall not prevent an action for liability from being brought.

Therefore, the company as an artificial person, may initiate the action against its board of directors if they commit fraud, misuse their authority, violate the law, the provisions of the company's articles of association, or commit a gross error in management. It is understood from this article that KCL gives the company, as an independent person, the right to sue whoever damages its interests. As a company does not have a physical existence, it must act through other people. When the company wants to sue, it practises this right through its representative i.e. the board of directors.

Does the company, by its GM under the KCL, have the right to proceed with the action on behalf of the company and against the board of directors if the board has refused to proceed with the action? According to the above article, the board of directors is accountable to the company. That means the company through its GM, has the right to proceed with an action of the company against the board of directors. Therefore, the GM can proceed with the action of the company against that board. The GM, in this case, may dismiss the board of directors and elect another board to proceed with the action. If the wrongdoers only include some of the directors, then the action against them is conducted in the name of the company by the other directors. [14]

However, the majority in the GM may ratify an act by as long as the purpose of this ratifying resolution is passed bona fide in the interest of the company. In *MacDougall v Gardiner* the Mellish LJ provides that:[15]

> In my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority get its wishes. Is it not better that the rule should be adhered to that if it is a thing which the majority are the master of, the majority in substance shall be entitled to have their will followed?

The exercise of power of the majority to ratify the actions of the board depends on whether it was exercised bona fide in the interest of the company as a whole.[16] If the wrongdoing directors held the majority of the votes in the GM, then the directors' action cannot be ratified.[17] Therefore, the court will allow minority shareholders to bring an action on the basis that the majority had acted with the purpose of benefiting

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[14] See Article 160/5 of the Egyptian Company Law; Like in the Saudi Arabian Company Law article 77 that provides "the company may institute an action in liability against its directors for wrongful acts that cause prejudice to the body of shareholders. The resolution to institute this action shall be made by the regular GM, which shall appoint a person (or persons) to pursue the case on behalf of the company…"; see also Awad, Ali, *Commercial Companies*, Cairo: Dar Al-nahda Al-arabia Publishing, (1961), p. 203-4.

[15] (1875) 1 ChD 13 at 25.

[16] In *Parke v Daily News Ltd* [1962] Ch 927 a company sold a major part of its business and proposed to distribute part of the proceeds of the sale to its employees as compensation for loss of employment. A minority shareholders successfully objected on the basis that the employees had no legal right to such compensation. The court held that the directors' proposal was not inspired by the best interest of the company, therefore, that the voluntary payments were *ultra vires* the company and the majority in GM could not ratify the proposal.

[17] See *Cook v Deeks* [1916] 1 AC 554.

themselves or the directors at the minority's expense.[18] Nevertheless, there are a number of exceptions that permit a shareholder or minority shareholders to start an action on behalf of their company and these will be discussed in the next section.

It should be noted that the liability of the board of directors is a joint one if all members collectively create liability.[19] However, if the act of creating a liability is committed by only one director, the company shall have no other option but to have recourse against that member of the board. If he indemnifies the company, then it shall not be entitled to have recourse against the remaining directors, as provided in Article 149 of KCL that:

> (1) The liability referred to in the preceding article may be personal, i.e. attach to an individual member or collective, i.e. attach to the whole board as a body. In the latter case all the members shall be jointly and severally liable for the damages, unless some of them had objected to the resolution which resulted in the liability and the objection had been entered in the minutes (of the meeting).
>
> (2) The period of limitation on the action for liability (referred to in the preceding article), shall be five years from the date of the meeting of the general assembly at which the board of directors rendered an account of its management.

According to this article, the directors' liability shall be assumed by all directors if the wrongful act arises, for example, from a resolution adopted by a unanimous vote. But with respect to resolutions adopted by a majority vote, dissenting directors shall not be liable if they have expressly recorded their objection in the minutes of the meeting. Absence from the meeting at which such resolution is adopted, shall not constitute cause for relief from liability, unless it is approved that the absentee was not

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[18] See for example *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350.

[19] See article 199 of the KCL and article 169 of the Egyptian Company Law; see also *Carriage Co-operative Supply Association* (1884) 27 Ch D 322.

aware of the resolution. The limitation period for the action that may be brought against the board of directors is five years, starting from the date of the GM where the board of directors rendered the accounts of its management.

8.1.2 Derivative Action

A derivative action is commenced by a shareholder or the minority of shareholders in the name of the company to redress a wrong done to the company. This type of action has no support from the board of directors or the majority of shareholders. Therefore, a derivative action is not duly authorised by the proper organs of the company. The derivative action as described in *Smith v Croft*[20] is:

> ... a form of pleading originally introduced on the ground of necessity alone in order to prevent a wrong going without redress.

The derivative action is an exceptional procedural instrument for enabling the court to do justice to shareholders of a company controlled by the wrongdoing directors or shareholders.[21] It could be said that a shareholder or the minority of shareholders who want to bring this action are seeking to escape from the principle of majority rule.[22]

Some people may raise a question about the legal basis of this action. It is within the framework of protecting the public savings of the shareholders who invest their savings in the shares of JSCs. The legislators have surrounded this type of company with a special protection by noting the company's action if it sustains damage. The

[20] [1988] Ch 114, 185; see *Shareholders Remedies: A Consultative Document*, DTI November 1998, URN 98/994.

[21] As Lawton L.J. provided in *Nurcombe v Nurcombe* [1985] 1 W.L.R. 370 at 376.

[22] Hollington, Robin, *Minority Shareholders' Rights*, London: Sweet & Maxwell Publishing, (1994), p. 11.

GMs would have the right to decide whether to initiate such an in its sole capacity as the artificial person (company). If it deputises the board to take over the company's affairs, the GM solely has the right to question on the damages sustained by the company as a result of their violation of the company law or the company's articles of association, or if they commit errors or misuse the funds of the company.

A company, as an artificial person, may initiate an action against any body. As provided above, a company is the proper plaintiff to bring an action to recover damages. Thus, a third party cannot be allowed to bring an action in relation to wrongs done to another and, if a third party (such as a shareholder) is allowed to, this could lead to multiple actions against a single defendant in relation to a single wrong.[23] Nevertheless, due to the fact that the company is an artificial person acting through its board, the board shall be the party representing the company in bringing the action. This is acceptable if the defendants are of the directors of the company or even some of the board's members. But, if the defendants include the majority or all of the members of the board of directors, then it is illogical that the board will sue itself. As previously mentioned, it is left to the GM of the company to dismiss the present board and appoint a new one to initiate the action.

However, this not always easy,[24]especially if such a board has control over the GM or if the majority shareholders are the directors of the company.[25] Therefore, a GM may be unable to perform its function, i.e. protecting the company's funds. As in

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[23] This principle mentioned in many cases for example in *Prudential Assurance Co Ltd v Newman Industries Ltd* (No2) [1982] Ch 204, 210 provided that "... the elementary principle that A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C."

[24] Tamma, *supra* note 13, p.444.

[25] Stamp, Mark, Minority Shareholders; Another Nail in the Coffin, 9 *Co Law* (1988) p. 135.

the case of *Cook v Deeks,*[26] the board of directors (who hold the majority votes in the GM) sought to ratify their action that breached their fiduciary duty toward the company. Lord Buckmaster LC opined:

> Even supposing it be not *ultra vires* of the company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress the minority.

Consequently, the action of the company could be restricted or stopped by the board of directors or by the majority in the GM who are actually controlled by the board. As a result, a company would be unable to proceed with the company action to protect the company capital and shareholders interests. This situation compelled many legislative bodies to admit the right of a shareholder to initiate the company's action if the GM fails to do so.[27]

If the shareholders have the right to start the action on behalf of the company, who is responsible for the costs of the derivative action? The cost of the action is one of the greatest obstacles to the shareholder action. In *Wallersteiner v. Moir* (No2) [1975] 1 All ER 849, the Court of Appeal held that in a minority shareholder's action, the court could order that the company indemnify the plaintiff (a shareholder) against the costs of the action. This is rational because a shareholder as plaintiff has sued on behalf of the company, and the benefit of the action, if successful, will accrue to the company and only indirectly to the shareholders who proceed the action.[28]

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[26] [1916] 1 AC 554 at 564.

[27] For example, see article 245 and 246 of France Company Law 1966 that give shareholders the right to start derivative action; see Sugarman, David, Reconceptualising Company Law-Reflections on the Law Commission's Consultation Paper on Shareholder Remedies, in Rider, Barry A K., (ed)., *The Corporate Dimension*, Bristol: Jordans Publishing, (1998), p. 210.

8.1.2.1 What is the stance of KCL towards the derivative action?

Do shareholders under the KCL have the right to bring this action on behalf of the company? Some countries, such as Egypt, give this right to the shareholders of a JSC[29], in addition, Saudi Company Law provides in article 78:

> Every shareholder shall have the right to institute the action in liability against directors on behalf of the company if the wrongful act committed by them is of a nature to cause him personal prejudice. However, the shareholder may institute such action only of the company's right to institute it is still valid and after notifying the company of his intention to do so...[30]

Unfortunately, this is another issue that the KCL is not clear about. The Kuwaiti legislator has not taken a stance on whether to allow or reject the right of derivative action. But, from the provision of Article 148 of the KCL that provides that the chairman and members of the board of directors are accountable to the shareholders, it could be concluded that the shareholder might initiate derivative action, as declared by Dr. Alshammiri.[31]

However, in light of the wording of article 148, it cannot be asserted that the Kuwaiti legislator specifically permits derivative action in the article. The article is also ambiguous regarding the rights of shareholders' to bring an action because of its expansive scope. If it is accepted that Article 148 refers to the right of a shareholder to bring an action against the board of directors, one might ask what kind of action personal action or derivative action? This is difficult to establish from the wording of the article. Therefore, it is unclear whether a shareholder or a minority of shareholders

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[28] Tamma, *supra* note 13, p.444.

[29] See Egyptian Company Law no 159/1981 article 102/3, Syrian Company Law article 196/2, Lebanon Company Law article 168, Jordanian Company Law article 188.

[30] See Aziz, Al-akali, *Commercial Companies: Jordan Law*, Aman: Maktabat Dar Althkafah Publishing, (1995), p. 377-8.

have the absolute right to sue the board of directors on behalf of the company by bringing a derivative action.

The Kuwaiti legislator should have realised that the board of any company has many ways and means of preventing the GM from taking the decision to initiate action against it. Therefore, any shareholder should clearly and explicitly be allowed to initiate a derivative action if the GM of the company fails to assume its responsibilities.

The right of derivative action should at least be indicated in article 131.5 of the KCL, which determines the rights of shareholders in a JSC.[32] It provides that each shareholder of a JSC must have the power to apply to the court for the annulment of any resolution issued by the GM or the board in violation of the law, public order, or the memorandum or articles of association of the company.[33] This article omits the shareholder's right to initiate an action on behalf of the company if the GM fails to initiate it.

If the shareholders under KCL do not have a clear right of derivative action against the board of directors, do they have the right of this action against the founders of the company who were in control of the company before the election of the first board of directors? In fact, nothing in KCL no. 15/1960 gives such a right to shareholders against the founders of their company. As a result of this lack in KCL, many offences have been committed by the founders of JSCs against these companies and the investors in these companies such as shareholders. For example, the Committee that was established by the Kuwaiti Cabinet after the Kuwaiti Stock Market

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[31] Tamma, *supra* note 13, p. 445; see also Radwan, *supra* note 2, p. 459.

[32] *Ibid.*

[33] Article 131/5 of the KCL provides that " A member shall in particular enjoy the following rights; (5) to apply to the court for adjudging null any resolution of the GM or the board of directors which infringes law or the public policy or is *ultra vires* the article of the company or its memorandum of

crash in 1982 found that the founders of some companies carried out the companies' activities and disposal of capital of their companies before the completion of the official establishment of these companies. Despite the fact that founders are not allowed, under the KCL, to dispose of their shares in the first three years after the completion of the establishment of the company, some also sold their (see 4.1.3.2). Therefore, the founders of any company must be responsible for all illegal or *ultra vires* actions and, if they have the power to prevent the action of the company against them, every shareholder should have the right to bring a derivative action against the founders to protect the company assets.

If the company is being wound up, the liquidator, as a general rule, has the statutory power to litigate in the name of the company as provided in Article 175 of KCL:

> The liquidators shall be provided with an account of the management of the company from the date on which the GM approved the last balance sheet up to the commencement of the liquidation; and they shall submit to the court (any matter dealt with by this account) which in their opinion should be submitted to the court.

Thus, if the company has gone into liquidation, there is no need for a derivative action to be brought by a shareholder because the liquidator will have taken control of the company's business affairs. If there is reasonable cause for the company to bring action against wrongdoers (such as directors), the liquidator can do this in the name of the company.

The question here is, if the liquidator is unwilling to bring an action in the company's name, does any shareholder under KCL have the right to bring an action? Unfortunately, this right has only been given to the GM, who can contest the accounts

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association.

of the liquidators and go to the court. Therefore, if the GM is controlled by the board of directors, as in many JSCs, an ordinary shareholder will be deprived to use his rights to go to court to protect the assets of the company.[34] In the UK, for example, if the liquidator is unwilling or refuses to bring an action in the name of the company, any shareholder of the company may apply to the court to order the liquidator to do so. Alternatively, shareholders may get an order allowing them to bring an action in the name of the company.[35]

The shareholder's right to bring a derivative action has several advantages; first, it forces the founders and the board of directors of any company to protect the rights and funds of the company, and to work purely in the interests of the company, especially when they know that they could be sued any time. It would minimise the control of the majority in the GM, especially when the GM is controlled by the board of directors. If so, the GM of shareholders will be able to take deterrent decisions against the action of the company. Therefore, the KCL needs to be modified with a clear article giving the shareholders this right on behalf of the company, if the board and the GM fail to bring an action. Third, it is important to mention in this context that, when the board is controlling the GM, the shareholders must seek a mechanism or means to rectify such errors as well as protect the rights of the company and, consequently, their rights.

In the UK, a company is a separate legal person and, therefore, the proper

[34] Article 177 of the KCL provides that "The auditors shall make a report on the accounts tendered by the liquidators. This report shall be submitted to the GM in an ordinary meeting to be approved by the GM together with the liquidators' release.
If the GM contests the accounts, the dispute shall be referred to the court.

[35] The power of the court to order the liquidator to sue is granted by the Insolvent Act 1986, ss. 112 (1), 167 (3) and 168 (5) the latter section provides that " If any person is aggrieved by an action or decision of the liquidator, that person may apply to the court; and the court may confirm, reverse or modify the act or decision complained of, and make such order in the case as it thinks just." ; see also

plaintiff to defend its rights. However, this rule is subject to a number of exceptions in which an individual shareholder or minority shareholders may bring a derivative action. This action is brought instead of an action in the name of the company.

As an exception to the rule in *Foss v. Harbottle,* a derivative action may be brought by a shareholder or by minority shareholders in the UK for the following reasons. First, where the wrong is a fraud by the majority of the shareholders (who are often also commonly the directors) on the minority and where the wrongdoers are in control of the company's GM. The minority shareholders, in this case, are not only defending their interests in the company, but also first the right and interests of the company. For example, say the wrongdoers control the majority of votes in the GM and will not permit an action to be brought in the name of the company. If the wronged minority shareholders are not able bring an action, in such a case, their objections would never reach the court.[36] In *Daniels v Daniels*[37] the minority shareholders were allowed to bring an action where the directors had approved the sale of company land to one of them at a price alleged to be well below its market value. The directors refused to bring an action, stating that fraud had not been alleged. Templeman J provides:

> If minority shareholders can sue if there is fraud, I see no reason why they cannot sue where the action of the majority and

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Fargro Ltd v Godfroy [1986] 1 WLR 1134, 1136.

[36] In *Cook v Deeks* [1916] 1 AC 554 a shareholder brought an action to compel the directors to account to the company for the profits made out of the construction contract which they took in their own names. See also as example of fraud *Hogg v Cramphorn* [1967] Ch 254, in this case the directors have authority to allot shares, and use that authority to allot shares to new members, who when voting with the directors in their capacity as shareholders, are able to outvote the previous majority and turn it into a minority; see J.H. Farrar and others, *Farrar's Company Law*, London: Butterworths Publishing, 4th edn (1998), p. 436.

[37] [1978] Ch. 406.

> directors, though without fraud, confers some benefit on those directors and majority shareholders themselves.[38]

Second, where the act is illegal or *ultra vires*, an individual shareholder may obtain an injunction to restrain the company proceeding with the illegal or *ultra vires* act. An illegal transaction or act cannot be ratified, and a shareholder can compel the company not to undertake it. If the illegal transaction is already being carried out, the shareholder can stop any further process of the illegal transaction. Section 35(2) gives statutory effect to the right of a minority shareholder to bring proceedings to restrain the doing of an *ultra vires* act.[39]

The third reason for a derivative action is when a company has acted on a resolution which has not been properly passed. This may happen when there is a matter that could not be validly sanctioned by a simple majority but only by a special majority, and where this special resolution has not been obtained. Thus, in *Bailli v Oriental Co. Ltd*[40], a shareholder was able to bring a derivative action when the company tried to pass a special resolution without giving adequate notice. Also, a company would be restrained from acting on an ordinary resolution when the company's articles of association required that the matter in question be authorised by a special resolution.

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[38] See Sealy, L S., *Cases and Materials in Company Law*, 5th edn, London: Butterworths Publishing, (1992), p. 480.

[39] S. 35 (2) of the UK CA 1985 provides that "A member of a company may bring proceedings to restrain the doing of an act which but for subsection (1) would be beyond the company's capacity; but no such proceedings shall lie in respect of an act to be done in fulfillment of a legal obligation arising from a previous act of the company."; see *Parke v the Daily News Ltd & Ors* [1962] 2 All ER 929.

[40][1915] 1 Ch. 503.

Fourth, where the personal rights of shareholders, such as, the right to vote or the right to attend meetings has been violated.[41] Here, a shareholder may sue in his own name to restrict an act which is an infringement of his individual rights.[42]

8.1.2.2 The Limit of Derivative Action

As mentioned at the beginning that shareholders' right to start a derivative action in the name of the company is an exceptional right, which cannot be practiced unless within the narrowest limits. As granting this right without remarkable constrains shall affect the company's reputation. Therefore, conditions must be set on practicing this right, and this practice shall be made in the narrowest limits as mentioned.

However, it may be said that, the intervention of the shareholder in filing the action on behalf of the company may limit the board's authority, and confound the expectations of such a board. Furthermore, it would motivate the management not to neglect the maintenance of the company's rights. It would also encourage the minority of shareholders to monitor the company's management actions, while limiting the

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[41] *Pender v Lushington* (1877) 6 Ch D 70; see also *Wood v Odessa Waterworks Co.* (1889) 42 Ch D 636.

[42] The law Commission published a report on shareholder remedies which made a number of recommendations for legislative and procedural change. See Law Commission Consultation Paper No 142, Shareholder Remedies: A Consultation Paper (London: the Stationery Office, 1996). The DTI support the majority of the recommendations and summarised these recommendations in one of its consultative papers. The report provided regarding the derivative action: there should be a new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue the action. Also, about the availability of the new derivative action it provide; the new procedure should only be available members if the cause of action arises as a result of an actual or threatened act or omission involving (a) negligence, default, breach of duty or breach of trust by a director or shadow director of the company, or (b) a director putting himself in a position where his personal interests conflict with his duties to the company. The claimant of the action should give a notice at least 28 days before the commencement of proceedings, and this notice should determine the grounds of the proposed action. Moreover, a shareholder is able to start the action if; (1) the applicant of the action in a good faith want to protect the interest of the company and the court has the power to refuse the action if the action not in the interests of the company; (2) the claim is capable of being pursued as a derivative action; (3) the company has failed to prosecute the claim diligently; for more information see *Shareholders Remedies: A Consultative Document*, DTI November 1998, URN 98/994.

control of the majority over the company's destiny.[43] Therefore, the existence of the rights of derivative action is vital for the body of shareholders. However, some people might think that giving the shareholders this right could cause some difficulties. Granting the shareholder this right may be a reason for concern and instability to the company's management. The possibility of multiple actions may lead to the rendering of contradictory judgments. It may also damage the reputation of the company. This would cause some people to demand that the right to bring such an action be confined to the GM of the company.

However, such criticism may be refuted by noting that the lack of this right of shareholders may cause alot of damage to the company and, consequently, the shareholders, especially if the board of directors fully control the GM of the company. There may be concern that shareholders could misuse this right and thus cause damage to the company's image. The legislator may impose a number of conditions on this right in order to guarantee that nobody can misuse this right.

1. The person that wants to bring the action must be a proper person to bring this action to the court. Therefore, he must be a shareholder in the company.[44]

2. A particular person might not be a proper person if his conduct is tainted in some way under the rules of justice. For example, a shareholder will not be allowed to bring the action if he participated in the wrong doing or if motivated by completely personal interests which are not to the benefit of

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[43] Alumani, Asyed M., *Protection of Minority Shareholders in Holding Companies*, (1986), p. 134.

[44] According to the Canada Business Corporation Act, there are a number of Conditions that must be existed and the court must be satisfied that these conditions exist as provides in Ss. 238 and 239 (1) reasonable notice has been given to the board of directors (2) the complainant is acting in good faith; and (3) it appears to be in the interests of the company that the action be brought or defended.

the company.[45]

3. The law should always provide that this right is an exceptional right and a shareholder cannot take advantage of it until the board of directors and the GM have refused or failed to bring the action on behalf of the company.
4. Any shareholder who intends to start this action on behalf of the company must be doing so, for the benefit of the company and not for some other purpose.[46]
5. A shareholder should only be allowed to bring the action for the benefit of the company only if another satisfactory remedy is not available.[47]
6. The shareholder who wants to bring the derivative action must first inform the GM about his intention to bring an action in the name of the company. This condition may compel the board or the GM to remedy wrongs done to the company, or to bring the action on behalf of the company instead of letting a shareholder bring a derivative action that may affect the company's reputation.
7. Company law may specify exceptional cases where a shareholder may bring such an action, as in the UK.
8. The court should always have the power to dismiss any derivative action brought by a shareholder which, in the opinion of the court, has no realistic prospect of success at full trial.

9.Finally,among the means which contribute to not resorting to filing an action

[45] See *Barrett v Duckett* (CA 1994) [1995] 1 BCLC 243.

[46] French law stipulates, under articles 245 and 246, that a shareholder who wishes to practice the company's action in his name should produce evidence that such action is being practised for the company's interest rather than his personal interest, and that it aims at indemnifying the company for the damages sustained by it.

in the name of the company by one of the shareholders is the particularly significant resolutions of GMs, which affect shareholders' rights (especially the minority) shall not be issued unless by a special majority, as the ordinary majority is not sufficient, which may be available easily for board members. Hence, they can decide what they may wish easily. Therefore, the following matters should be carried out by special resolution and article and memorandum of association cannot provide to the opposite.

(a) Alteration of the objects of the company;

(b) Alteration of the article of association;

(c) Changing of the company's name;

(d) Reducing or increasing the company capital;

(e) Restricting the liability of the board of directors;

(f) Any resolution about wounding up the company;

(g) Any resolution about merging or reconstructing the company.

8.1.3 The Personal Action

Obviously if a shareholder can point to the violation of some of his personal rights then he need not to be concerned with the rule of *Foss v Harbottle* at all[48] this is because the wrong is done to him and not to the company, and this wrong damages his personal right in the company. In other words, if the board, some of its members, or an employee commit an act that causes direct damage to one or more shareholders, any party sustaining damage may sue the board of directors.

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[47] See *Barrett v Duckett* [1995] 1 BCLC 243 at 250.

[48] Wedderburn, K.W., The Rule in Foss v. Harbottle, *C.L.J* (1957) p.194; Wedderburn, K.W., Shareholders, Rights and the Rule in Foss v. Horbottle, *C.L.J* (1958) p. 93; see also Sealy, *Cases and*

A shareholder would initiate the personal action in his name, claiming indemnity for the damage incurred personally by him. Such a right is already established under the provision of article 148.2 of KCL. The action is based on the grounds of omissive responsibility.[49] Therefore, shareholders have the right to bring this action when their rights have been breached and where they have suffered direct damage. Because of the importance of this right, KCL provides in Article 133(4) that:

> The shareholders' GM may not;
> (4) Restrict the shareholder's to bring an action for damages, in accordance with law, against all or some of the members of the board of directors in respect of such damage as he may sustain.

Also the KCL in Article 131 provides that:

> A shareholder shall in particular enjoy the following rights:
> (5) to apply to the court for adjudging null any resolution of the GM or the board of directors which infringes law or the public policy or is *ultra vires* the articles of the company or its memorandum of association.

A shareholder has the right to bring a personal action in three situations. First, a wrong must have been committed by one or all directors or founders against a shareholder. Second, this wrong must have caused damage or deprived a shareholder of his personal rights. Third, the damage sustained by a shareholder was a direct result of the defective actions of the directors, or founders of the company.[50]

A shareholder's right to initiate such an action does not lapse even if he sells his shares after initiating the action, as long as the damage incurred by him happened prior to selling out his shares.[51]

As this is an individual or personal action, it is deemed to constitute a pure right

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Materials in Company Law, 6th edn, London: Butterworths, (1996), p. 517.

[49] Radwan, Fayiz, *Commercial co mpanies*, Amansora: Maktabt Aljala'a Publishing, (1994), p. 550.

[50] Sameha Al Kalyoubi, *Commercial Companies*. Egypt: Dar Alnadah Publishing, (1993), p. 476.

of the individual shareholder. Thus, he may not be deprived of his right to initiate it, whether by a provision in the company's articles of association or under a resolution by the GM. Moreover, initiating the action may not be conditional on the GM's permission. In addition, the approving of the company's balance sheet during the GM should not affect the personal rights that stem from the law or the company's articles of association, or those derived from his position as a member of the company. This is because he claims indemnity for the damage incurred personally, rather than representing the company in this action.

8.2 Statutory Protection Shareholders

When the subject of the company's theory was examined in the second chapter, it was explained that, according to all theories, a company issues its decisions by the approval of the majority in its GM. Thus, the opinion of the majority consists in fact of many shares which entitle its owner to many voices. Those who possess the biggest number of votes enjoy the loudest voice in the company. This problem does not emerge if the majority dominating the company acts in a way that most benefits the company and shareholders.

The question that is posed here is: What are the rights and means in which the majority can resort to in the GM or outside it, to cease any exploitation from the majority to achieve personal interests, especially if the board is dominating this majority? If the minority of shareholders are granted some of the rights they may have a significant role in protecting the company and its shareholders. Some of the authorities that shall be granted to this minority are; requesting to hold the EGM to

[51] Tamma, *supra* note 13, p. 450.

discuss specific subjects, the right of the majority to resort to court to cancel any decision that changes the company's objectives, or impose new commitments on shareholders, asking the concerned bodies in the MCI to conduct an investigation in the company's transactions and the right of the minority to liquidate the company, as well as other rights.

The first part of this chapter was concerned with the right of a shareholder to bring an action on behalf of his company or in his personal name. The second part deals with statutory remedies that are available to the shareholders if they do not want to bring a legal action. The KCL contains a limited number of articles concentrating on the statutory protection of shareholders' rights. An attempt will be made to identify these articles to decide whether they are enough to provide the statutory protection demanded by the body of shareholders. Article 136 of KCL provides that:

> Within thirty days from the date on which a resolution is passed in accordance with the preceding article[52], (any) number of the shareholders who did not consent to that resolution, holding shares to a total value of not less than 15% of the subscribed capital, may, if the resolution is to their detriment, make opposition to it before the court. The court may confirm, qualify or cancel the resolution, or (order) postponement of its carrying out until a suitable arrangement for purchasing the shares of the dissentient member – provided that no expense whatsoever towards such purchase shall be charged to the company – or any other suitable settlement is made.

As for the minority shareholder's right to object to the resolutions of the EGM, Article 136 of KCL establishes that right if the objections constitute at least 15 per cent of the company's capital provided, they have voted against the resolutions in question at the meeting and prove that the same prejudice their rights. The objections must be

[52] The preceding article is 135 that provides " the memorandum of association of a JSC and its articles of association may be altered by a resolution of its EGM, as provided in the article 158. Also, as provided in the said article, the EGM may decide to sell or otherwise dispose of the whole undertaking of the company or to amalgamate with any other company or body."

submitted to the court within 30 days of issue of the meeting resolution, and the court may uphold, modify, overrule or defer implementation of the resolution pending an appropriate settlement of the dispute by buying the objectors' shares or in any other appropriate manner.[53] Likewise, minority shareholders who control not less than one tenth[54] of the capital of the company may request the GM to meet and discuss any proposals or decisions made by them.[55]

Shareholders who hold not less than one-quarter of the company shares may demand that the directors convene an extraordinary meeting. This meeting must be held within one month of the date of receipt of the application (see 7.1.2).[56]

Minority shareholders may inform the relevant government authority in the MCI about the violations of company law or the company contract by the board of directors or managers of the company. This authority may ask the auditor of the company to inspect the company's accounts and all its transactions if it discovers that the board of

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[53] Almelhem, Ahmed, Privatisation and Protection of Investors in Kuwait: Reality and Ambition, 13 *A..L.Q* (1998) p.184.

[54] Article 154 (2) of the KCL provides that "the board of directors, however, may call a meeting of the assembly whenever it thinks fit, and shall do so whenever requested by a number of shareholders holding not less than one-tenth of the capital."

[55] Article 157 (6) of the KCL provides that "The agenda of the annual meeting of the general assembly shall include the following items: (6) discussing any other proposal the board of directors may enter on the agenda to be decided (by the GM). A proposal may also be submitted during the meeting of the GM by a number of shareholders holding not less than one-tenth of the total number of shares.".

[56] Article 159 of the KCL provides that "(1) The EGM shall be convened pursuant to convocation by the directors or pursuant to a written application addressed to the board by a number of shareholders who hold not less than one-quarter of the company's shares. (2) In the latter case, the directors shall convene the EGM to transact business within one month of the date of receipt of the application."
One of many example that prove that even the rights that have been given to minority shareholders by KCL are not applied in many cases easily. In one of the Kuwaiti close shareholding companies (Alsahel For Development and Investment) one of its shareholders who hold more the quarter of its capital demanded the board of directors to call a GM according to the article 159 of the KCL. The board here must within one month make a call the shareholders to attend a GM. However, the board of this company refused to make such a call until the Ministry of Commerce interfered after few months and compelled the company to hold its GM. This incident and many other incidents give us a bad impression about the application of the articles that provide the rights of minority shareholders;

directors or employees of the company breached the law or the constitution of the company. As provided in Article 178 of KCL:

> (1) The Government department concerned may exercise control over a joint stock company to insure that the provisions of the law and the Articles of association have been observed; the said department may at any time require the auditor of the company to examine its accounts and all its business.
> (2) If it is established that a violation of the provisions hereof has been committed or some of the company directors or promoters have acted in a manner prejudicial to the interests of the company, or if all or some of the shareholders or the violation is such as may have an adverse effect on the national economy, the government department concerned shall submit a report to that effect to the GM, and may convene the GM to discuss its report, and report the said violation to the competent authorities.

Therefore, according to this Article, the government department concerned in the MCI has the power to investigate the affairs of the company if these affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of the company or the interests of the shareholders.

Besides this, it is unacceptable for the GM to impose new conditions or reduce the shareholders' rights beyond those imposed or given to them in the company law or the constitution of the company (see 7.1).[57] All shareholders of JSCs may also, at any time, go to the concerned government authority in the MCI and review the documents of their company, and they can obtain an original copy of the document (see 5.3.5).[58]

These are the rights of minority shareholders under KCL, and may be used to protect their interests in the company and prevent or nullify an *ultra vires* act of a promoter, the directors or a majority in the GM.

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for more information see Alwatan Dealy Newspaper, Kuwait, Issue no. 8193/2639, on December 1998.

[57] Article 133 of the KCL.

[58] *Ibid.*, Article 179.

The role of the GM regarding the minority of shareholders issue is criticized for its weakness, as the KCL has not given this issue adequate concern and care, bearing in mind that the majority that always dominates the company and manages it for its own interest is often representing – at the same time- the board members, as they are these members are main shareholders in the company. The KCL is also criticized for other matters and needs to be amended to take into consideration that the minority shall have a role in the GM, in order to protect their interests and the companies', if its managed for personal purposes. This requires addition of many rights that are not available in the present law in Kuwait.

With regard to the statutory protection of shareholders under the KCL, a number of issues can be raised. First, do minority shareholders have the right to present a petition to the court to wind up the company? Does a shareholder have the right to present a petition for relief to the court which could order the company to be wound up on the grounds that the business affairs of the company are being, or have been, conducted in a manner which is unfairly prejudicial to the interests of the company, the shareholders, or part of them? In fact, courts, according to the KCL, do not have the legal authority to accept such a petition because shareholders of JSCs do not have the right to go to the court to wind up the company, except where a company loses three-quarters of its capital.[59] In this event and in this event alone, if the directors fail to convene an EGM to wind up the company, any shareholder may petition to the court for a decree to wind up the company (see 7.1.2). The right to present a petition to the court on the grounds of an unfairly prejudicial act is an essential right every shareholder must enjoy, and the courts should be given the power to enable them to

[59] *Ibid.*, Article 171.

play their appropriate role. The court alone has the power to accept or refuse the petition. Moreover, to demand the protection of the court, there should be no minimum number of shareholders needed to petition to the court.

Also, as provided above, the MCI, by its concerned department, has the power to hold an investigation into a company's business affairs. It could be said that the system of investigation that is provided in the KCL is defective and shareholders will get nothing from it for a number of reasons. First, the Ministry in this investigation depends on the auditors of the company to carry out the investigation and provide an end report to the Ministry. This is unjust for shareholders because these auditors may themselves need to be investigated. They may be controlled by the board of directors as in many companies, as in the report the Kuwaiti Cabinet provided after the Stock Market crash.[60] If a company has good auditors there may be no need for an investigation by the Ministry because all of the facts about the company's affairs will be in the reports of such auditors. Therefore, the Ministry, which must have their independent professional investigators carrying out the investigation to obtain the end report, has the facts. Second, how will the Ministry behave when the concerned authority, depending on the report of the auditors, discovers that the board of directors, founders or managers of the company breached the law or the constitution of the company and it is proved that they have been guilty of fraud towards the company and its shareholders. What measures will be taken by the Ministry? What are the punishments that may be imposed on the wrongdoers and what are the remedies given to the victims? Unfortunately, as described above, Article 178(2) of the KCL provides that the Government Department concerned in the MCI should demand a GM to be

[60] See the the report of the committee that established by the Kuwaiti Cabinet on 13/03/1983 by Cabinet resolution no. 10 meeting 11/1983 to inspect the affairs of number of companies.

called to discuss the report. Therefore, the company itself will determine what shall be done regarding the report. Thus, if the GM is already controlled by the directors or the majority shareholders, nothing will happen regarding the breaches of law and the constitution of the company, and the wrongdoers will be safe from any punishment. The KCL in Article 178 is, in fact, giving a gift to the directors because, at the end of the investigation, according to this article, the MCI must transfer the report of the investigation to the GM, and if the board controls the GM, they would issue a resolution to ratify their wrongful actions. The law should not give this gift to the wrongdoers.

The question that must be asked here is: What is the advantage of the system of the investigation in the KCL? The system of investigation under the KCL should be reformed. Minority shareholders should have a clear right to demand that the Ministry appoint an independent investigator to examine the company's affairs. The Ministry should have its own investigators and there should be no need to ask the auditors to conduct the investigation into the company's affairs. The powers of the investigators must be enough to enable them to carry out their duties. Therefore, they must have the right to demand that the officers of the company produce every book and document they have. They should have the right to interview personally any or every person in the company. The Ministry should have, under the KCL, the right to present a petition for relief to the court which could order the company to be wound up on the basis of results from the investigation.

If there is a fear that shareholders may misuse this right and the reputation of the company is at stake, the Ministry should be entitled to impose a number of conditions before accepting the demand of shareholders to hold an investigation. First, the minority shareholders must comprise one-tenth of the shareholders. Second, the shareholders must support their application for investigation of the affairs of the company with evidence to prove that they have good cause for the demand and to no illegal purpose.

In the UK the statutory protection of minority shareholders is quite comprehensive in comparison with the shareholders situation in the KCL. In the UK the minority may always petition the court to wind up the company on the grounds that the conduct of the majority is unjust.[61] However, sometimes it is not in the minority's interest for the company to be wound up. Therefore, they have the right to petition the court for an injunction under Section 459 of the CA for relief against the company. This section provides that:

> A member of a company may apply to the court by petition for an order under this part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

Any shareholder may petition the court on the ground that; (1) the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members; (2) any actual or proposed act or omission of the company is or would be so prejudicial.[62]

In order to present a petition under the UK CA, a person must have the *locus standi* prescribed in S. 459(2) of the Act. S. 459(1), as noted above, provides that a member of a company may petition, then S. 459(2) provides:

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[61] S.122(g) of the Insolvency Act 1986 provides that "A company may be wound up by the court if-(g) The court is of the opinion that it is just and equitable that the company should wound up."

[62] Roberts, Pauline and Poole, Jill, Shareholder Remedies-Efficient Litigation and the Unfair Prejudice Remedy, *J.B.L* (1999) p. 40; *Re Bird Precision Bellows Ltd* [1986] Ch 658 and *Re Cumana Ltd* [1986] BCLC 430.

> The provisions of this part apply to a person who is not a member of the company but to whom shares in the company have been transferred or transmitted by operation of law, as those provisions apply to a member of the company; and references to a member or members are to be construed accordingly.[63]

Therefore, a person is qualified to present a petition when he is a subscriber to the memorandum or entered as a member in the company's register of members. However, S. 459(2) expands the *locus standi.* As a result, where a person to whom shares have been legally transferred by a proper method of transfer, but the company or the directors have refused to enter his name in the register of the company, he has *locus standi* to present a petition.

If the court is satisfied that the petition is well founded, it may issue such order as it thinks appropriate.[64] The court may also make an order;

1. Regulating the conduct of the company's affairs in the future;
2. Requiring the company to do, or to refrain from doing, any act;
3. Authorising civil proceedings to be brought in the company's name or on behalf of the company by such persons and on such terms as the court may direct;
4. Providing for the purchase of any shares and, if appropriate, any consequent reduction in the company's capital.[65]

Point no. 3 is quite interesting because it gives a shareholder or minority shareholders the right to start an action against the wrongdoers on behalf of the company, (even where the conduct in question is not one of the exceptions to *Foss v Harbottle*) although, if he wants to bring such an action he needs the authorisation of

[63] A member of a company is defined in S. 22 of the UK CA to be a subscriber to the memorandum of association, and every other person become a member when he or she agrees to become a member of the company and whose name is entered in its register of members; see Prentice, D., Protection of minority shareholders, 25 *Current Legal Problems* (1972) p. 130.

[64] S. 461(1) of the UK CA 1985.

the court.[66]

Also, in the UK, the Secretary of State is authorised under CA 1985 to investigate the affairs of the companies for various reasons as provided in S. 432(2) of the UK CA.[67] This section provides that the Secretary of the State for Trade and Industry is authorised to appoint an investigator in the following instances;

1. When the Secretary of State is convinced that the company's affairs are being handled in such a manner so as to defraud its creditors or other persons;
2. When there is concern that the company was established for an illegal purpose or that its acts are oppressive or harmful; or
3. When the managers of the company or its initiators have been found guilty of fraudulent management of the company's affairs;
4. When the company members have not been given the information which they are entitled to receive in relation to the company's affairs.

The inspectors who are in charge of the investigation of the company's affairs have wide powers. They have the right to interview directors and employees and anyone else connected with the company. All these people are required to provide all information and documents they have.[68] The inspectors can require that interviewees be put on oath,[69] and, if interviewees refuse to comply with the inspectors' orders, this may result in the matter being reported to the court. The court may then listen to any

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[65] *Ibid.*, S. 461(2).

[66] Ryan, Christopher, Company Directors: Liabilities, Rights and Duties, 3[ed] edn, Bicester: CCH Editions Limited Publishing, (1990), p. 273; Mayson, Stephen W and *Mayson French & Ryan on Company Law*, 15[th] edn, London: Blackstone Publishing, (1998-99), p. 564.

[67] Instone, Ralph, Inspectors, Investigation and Their Aftermath, *J.B.L* (1978) p. 121.

[68] S. 434 (1) and (2) of the UK CA 1985.

evidence and has the power to punish an obstructive interviewee for contempt of court. Furthermore, the UK CA allows the investigators to search the company's premises to find and seize documents and evidence that pertain to the investigation.[70] The investigators are authorised to examine the company under investigation as well as affairs of its associated companies.[71]

When the Secretary of the State has received a report from the inspectors confirming the existence of illegal conduct, he can use this report as evidence in any petition to the courts to have the company wound up under the IA 1986 S. 124A.[72] He may also bring civil proceedings as well as criminal proceedings against directors and/or officers of the company, depending on the report of the investigator and if he considers that it is in the public interest to do so. These proceedings are brought in the name of the company.[73]

The report can be used to obtain a remedy for the company' shareholders in respect of the unfairly prejudicial conduct.[74] Therefore, shareholders are given some protection and assurance that the company's affaires will be properly controlled because of the possibility of a comprehensive investigation by the Secretary of State, and the fact that real actions may be taken against the wrongdoers to recover damages.

There are other sections protecting minorities within companies in the UK. The holders of not less than ten per cent of the paid up capital carrying a right to vote in the

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[69] *Ibid.*, S. 434 (3).

[70] *Ibid.*, S. 447.

[71] Such as holding, fellow subsidiary, or subsidiary companies see S. 433.

[72] About the function of investigators Buckley L.J. in *Re Pergamon press Ltd* [1970] 3 All E.R. 535 said that "is an inquisitorial function. His duty is to investigate the affairs of the company and to report on them to the Board of Trade. It is not a judicial function."

[73] S. 438 of the UK CA 1985.

GM may at any time force the directors, by a signed requisition, to call an extraordinary GM.[75] The directors then have just 21 days to convene the extraordinary GM.[76]

The right of a class of shareholders can only be altered if the shareholders of the class itself agree to it.[77] However, the holders of not less than 15 per cent of any shares influenced by a variation of class rights may apply to the court to have the variation cancelled.[78] If they wish to do this, they must, first, not have voted in favour of the variation, and second, they must apply to the court within 21 days of the passing of the class resolution or the granting of consent.

If some of the shareholders of a company themselves wish to move a resolution at an annual meeting, or circulate to shareholders a statement relating to any proposed resolution or business to be dealt with at any GM, they can do so. The holders of not less than 5 per cent of the company's paid up capital, or 100 shareholders who have paid an average of £100 on their shares, may compel a company to give notice of a resolution to be moved at a meeting and circulate statements to shareholders.[79]

Also, shareholders may object to any alteration of the objectives of their company. Thus, the UK CA provides that 15 per cent of the shareholders, or holding 15 per cent of any class of shares, may apply to the court within 21 days of the passing of a special resolution altering the objects of the company. The objectors must not

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[74] *Ibid.*, S. 460.

[75] *Ibid.*, S. 368.

[76] *Ibid.*, S. 368(4).

[77] *Ibid.*, S. 125.

[78] *Ibid.*, S. 127

[79] *Ibid.*, S. 376

include anyone who previously voted in the favour of the alteration.[80]

The holders of at least 10 per cent of the issued shares of the company, or 200 shareholders whatever their shareholding, may apply to the Secretary of State to appoint inspectors to investigate the company's affairs[81] the company's ownership.[82]

The minority shareholders may require a liquidator to acquire their shares on a reconstruction of the company.[83] In a take-over bid, the dissenting shareholders may compel the company to acquire their shares if the company has not chosen to do so.[84] The holders of not less than 5 per cent of the issued share capital or 5 per cent of the members (if no share capital) or fifty shareholders can apply to the court to cancel a resolution for re-registering a JSC as a private company.[85]

Minority shareholders have the right to demand a poll.[86]

8.3 Penalty of the Wrongdoers as a Remedy

It could be said that the law cannot be followed and respected without a number of penalties that may be imposed upon persons who abuse the law. Such penalties can be considered as a remedy for shareholders by forcing the directors, founders, managers and others to respect the rights of shareholders and other interest groups in the company. These penalties may also prevent, or at least reduce, the offences against companies and other interested parties in the company. Amongst all the articles of the

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[80] *Ibid.*, S. 5.

[81] *Ibid.*, S. 431.

[82] *Ibid.*, S. 442.

[83] S. 11 of the IA.

[84] S. 429 of the UK CA 1985.

[85] *Ibid.*, S. 54.

KCL, there is only one which imposes limited penalties upon any person who violates specific articles. This Article is 184 (bis) of KCL which provides that:

> Any person who violates the provision of article 85, 106, 109, the last paragraph of article 77 and the last paragraph of article 104, shall be punished with a fine not less that 10 dinars nor more than 200 dinars; the court may decree the impounding of the shares which were the subject of the violation; any interested person may claim damage, (if appropriate) from the defaulter.[87]

KCL provides in this article that any person breaching one of the articles mentioned (Articles 85, 106, 109 and last paragraphs of 77and104) will be penalized. The penalty will be a fine of not less than 10 Kuwaiti dinars[88] and not more than 200 dinar and the court may impound the shares of the wrongdoer. The question that must be asked here is: what about the other articles of company law, is it acceptable that they are breached? It could be said that, the penalty under the current law is too lenient and does not match the gross mistakes which the company and its shareholders suffer. In the UK, for example, the Companies Act 1985 contains approximately 202 separate criminal offences punishable by fine, imprisonment or both. Examples include;

1. Directors exercising company's power of allotment without the authority required by S. 80 (1) are liable to a fine.
2. Each of the directors knowingly or willfully authorising or permitting non-compliance with S. 142 (requirement to convene a company meeting to consider serious loss of capital) is liable to a fine.
3. A director who makes a statutory declaration under S. 155 with particulars of

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[86] *Ibid.*, S. 373.

[87] Article 77 and 85 of the KCL concentrate on subscriptions in JSC, 106 and 109 impose restrictions on the process of transferring the shares of JSCs and finally article 104 about the shareholders' responsibility to pay the calls.

financial assistance to be given for acquisition of shares without reasonable grounds for the opinion expressed in it is liable to imprisonment and/or a fine.[89]

4. Every director who knowingly or recklessly is a party to approving defective accounts is guilty of an offence and liable to a fine.[90]

5. The company and any person (include directors) who fails to send annual accounts, the directors' report and the auditors' report to those entitled to them is guilty of an offence and liable to a fine.[91]

6. The company and every officer who fails to supply a copy of accounts and reports to shareholders on his demand is guilty of an offence and liable to a fine.[92]

7. Any director or shadow director who fails to declare an interest in a proposed contract with the company is liable to a fine.[93]

8. The company and every officer (include directors) who fails to make directors' service contracts open to inspection, or fails to notify the registrar within 14 days where they are kept, or refuses to allow the inspection required under S. 318(7) is liable to a fine.[94]

9. Directors who fail to notify an interest in company shares; or who make false statements in purported notification are guilty of an offence and liable to

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[88] One Kuwaiti Dinar equals £2.

[89] See S. 156 (7) of the UK CA.

[90] *Ibid.*, S. 233 (5).

[91] *Ibid.*, S. 238 (5).

[92] *Ibid.*, S. 239 (3).

[93] *Ibid.*, S. 317 (7).

imprisonment or a fine, or both.[95]

10. Every director or secretary who fails to file an annual return and who cannot show that he took all reasonable steps to avoid commission of the offence is liable to a fine.[96]

11. Every director who failed to take all reasonable steps to convene meeting requested by a resigning auditor is guilty of an offense and liable to a fine.[97]

12. Any person who fails to give the Secretary of State information or gives false information about his interests in shares is liable to imprisonment or a fine, or both.[98]

The purpose of these criminal offences punishable by fine, imprisonment or both is not just to punish the wrongdoers, but also to deter other from committing such crimes or wrongs that may affect the company and its shareholders interests. These aims cannot be achieved under the current KCL because this law, in terms of the punishments that may be imposed on the persons who breach the laws and constitutions of companies is too weak. Therefore, a number of suggestions were introduced in a new chapter ten,[99] which regulates the penalties imposed in the event of a breach of the provisions of commercial company law, thereby canceling Article 184 (bis) concerning penalties. The suggested amendments are designed to strike a balance

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94 *Ibid.*, S. 318 (8).

95 *Ibid.*, S. 324 (7).

96 *Ibid.*, S. 363.

97 *Ibid.*, S. 392A (5).

98 *Ibid.*, S. 444 (3); related laws such as the Company Securities (Insider Dealing) Act 1985, the Business Name Act 1986, the Company Directors Disqualification Act 1986 and the financial services Act 1986 also impose criminal penalties.

99 Produced by the Kuwait National Assembly and government of Kuwait to put forward number of suggestions for amending the Company Law which are now under consideration by the assembly's financial and legislative Committee.

between the contravention and the punishments as the penalties under the current law are too lenient and do not match the gross mistakes which the company and its shareholders suffer, and the new provisions, therefore, attempt to eliminate such a mismatch.

In this proposed new article, the offender committing one of the actions determined in the article will be liable to a penalty of imprisonment for a period not less than three years, and to a fine not less than 5,000 Kuwaiti dinars and not more than 20,000 dinars, or by one of these two penalties. This proposed article incriminates;

1. Any one who mentions intentionally in publication the issue of shares, false data, or contradiction to the company law.
2. Whoever intentionally makes a false report and creates a false picture about the real financial situation of the company such as directors, auditors, managers and liquidators.
3. Whoever overstates the value of any contribution in kind.
4. Whoever distributes profits or interests contrary to the provisions of the company law or the constitution of the company and the financial situation of the company.
5. Whoever manages the company (e.s directors and liquidators) to achieve his personal interests directly or indirectly.
6. Every director, manager, auditor, officer of the company who discloses a secret, known by reason of his work.
7. Whoever is employed to inspect the affairs of the company and intentionally advertises false data that affect the result of investigation.
8. Whoever distributes false information or misleading information about the financial situation of a company registered in the Kuwait Stock Market.

9. Whoever publishes hidden information about companies registered on the stock market to gain personal profit.[100]

Eventually, one might ask, do the minority shareholders' have enough protection under the KCL from unfair prejudicial acts? Minority shareholders do not have minimum rights to help them protect their interests in the company against the board of directors or the majority of shareholders.

8.4 Conclusion

This chapter focused on the channels or instruments available for a shareholder or minority shareholders to remedy the harm done to the company, shareholders or both caused by an act or negligence of the board of directors or a third party. Usually, those who cause harm to the company and its shareholders control the company and the GM and can therefore, prevent any action by the company to remedy the harm. In this situation, every shareholder should have a number of means that enable him to remedy the harm done. Thus, if the minority shareholders feel that the actions of directors or majority shareholders cause damage to the interests of the company, they should be able to raise an action to protect their interests by protecting the interest of their company. In addition, because the way to the court may be long and expensive, they should have other means such as asking the MCI or DTI to investigate the company's affairs or present a petition to the court to wind up the company.

It is clear that the KCL has failed to provide protection for shareholders regarding this significant matter. According to the KCL, shareholders have no right to

[100] See proposed article no. 246 of the proposal which is now under consideration by the assembly's Financial and Legislative Committee in the Kuwait National Assembly. This proposal suggests adding a new article to the KCL

sue in the name of the company. Minority shareholders do not have protection against the behaviour of the majority of shareholders and they have no right to litigation. They can neither request liquidation of the company, nor ask the MCI to investigate the affairs of the company by an independent investigator.

Therefore, the KCL fails to address many of the issues relating to shareholders' rights, and especially the topic of shareholders' remedies. Therefore, there is a real need for passing a new Company Law that mentions all of the shareholders' rights. If there is concern that shareholders may misuse these rights and thus cause damage to the company's image, the legislator may impose a number of conditions on this right to guarantee that nobody can misuse. First, to practice these rights he must be a shareholder in the company. Second, a shareholder will not be allowed to bring an action (or a demand) to investigate the affairs of the company if he participated in the wrong or if motivated by completely personal motives which are not to the benefit of the company. Third, the Company Law should always provide that these rights are exceptional rights. Therefore, a shareholder cannot take advantage of it, until the board of directors and the GM have refused or failed to bring the action on behalf of the company. Fourth, practicing these rights by shareholders should always be for the benefit of the company and not for some other purpose. In addition, the court or the MCI (DTI in the UK) will not allow the derivative action or investigation to be brought if there is another satisfactory remedy. Moreover, the shareholder who wants to bring the derivative action, present a petition or demand an investigation must first inform the GM about his intention. This condition may compel the board or the GM to remedy wrongs done to the company to protect the company's reputation. Finally, the court and the MCI may always have the power to dismiss or refuse any derivative action or demand of investigation brought by a shareholder which, in the opinion of the court or MCI, has no realistic prospect of success at full trial.

Conclusion

This study addressed the issue of Shareholders' rights in the JSCs in accordance with the KCL No. 15 of 1960. In Kuwait, there has not been a single study conducted on this topic despite its importance. This was the main reason behind the selection of this topic as the body of this study.

Shareholders are the owners of the company's shares and as such, they provide the capital of the company. Shareholders bear losses whenever a company's project fails, each according to his shares in the total capital of the company. They are also the last to be financially compensated when companies are liquidated. Therefore, they are one of the main two organs in any JSC and, because of their position, they possess numerous authorities enabling them to participate in administrating and monitoring those running the Company.

In general, in this study, an attempt was made to define the rights that those shareholders should enjoy with consistent reference to articles contained in the KCL. Company laws in other countries were touched on, particularly the UK Companies Act 1985, with the aim of finding solutions to existing problems in the KCL and to fill the apparent discrepancies in the issues pertaining to shareholders rights as contained in the KCL, compared to those other laws.

In this conclusion the most important points that appeared in this study will be discussed. Recommendations will also be made in relation to the shareholders' rights in JSCs as related to the KCL.

The theory of the company was discussed in Chapter Two. This was important in order to understand the position of the shareholder in this type of company. Contractual theory, states that the shareholder company is nothing but a contractual agreement between several persons and that those persons are the actual owners of the company. This contract, like any other private contract, is in no way related to the State other than in an organisational sense. According to Institutional Theory, the company is an establishment initiated by a state decree in which the role of the shareholders is limited to producing the capital of the company.

It is not easy to come to a conclusion on the matter of contractual and institutional theories, and determine whether a company is a contract or an institution. Nevertheless, it is quite true that the establishing and running of JSCs is no longer considered as a purely private affair freely organised by private parties. Thus, the legislatures almost everywhere in the world impose several significant restrictions upon the process of incorporating and running companies. Companies in general, and especially JSCs, have a very strong influence on the economy of every country. They also affect the lives of ordinary people who use their products and services; they affect the environment, and many other things, which force the countries by their Company Acts to interfere in commercial life in order to protect their economy and also to protect public savings. Consequently, the legislature of Kuwait in Company Law No. 15/1960 has given the MCI in Kuwait a major role in the process of incorporation.

The notion of contract does not totally disappear. But, at the same time, a JSC is not purely a private contract. It is a fact that a company is created by a number of contracts between a number of persons. However, these contracts are not like other private contracts between private parties. Thus, the rules of private law are not totally abandoned to adopt public law. Because, the operation of subscription still appears directly or indirectly as a contract. For example, see Article 78 of KCL, S. 14(1) of the UK Companies Act 1985, and Art. 1832 of French Civil Law.

In discussing company's ownership it was explained that when the company is established legally and formal legal decree of its establishment is issued, it becomes a legal entity. This legal entity (the company) owns all of the Company's assets. Therefore, during the existence of the Company, Shareholders do not own the Company's assets. However, they do own the Company's shares which give them numerous rights. The ownership of the assets of the Company does not get transferred to the Shareholders except when the Company is dissolved and all debts are settled. Only then will the Company's assets become the property of the Shareholders, pro rata the number of Company's Shares that he is holding.

It was clarified in Chapter Two that many groups have an interest in these types of companies such as members of the board, creditors, bondholders, company employees, company customers and shareholders. The rights of every interested group should be protected since the JSCs are not just making profits for the shareholders alone. However, this study is about the rights of shareholders and, therefore, it concentrated on their rights. It stressed the distinguished position shareholders enjoy in these companies, as compared to other beneficiaries. For this reason, company's regulations grant them (as opposed to the board) several rights and authorities.

It was also made clear in this chapter that JSCs are not managed is the interests of shareholders alone. There are many groups in every JSC, and every group has interest that must be protected. However, because the study is about the shareholders rights it concentrates on their rights.

The distribution of power and authority in shareholder companies between the board and the shareholders was discussed in this chapter. Each possesses a number of different authorities which create, even theoretically, some sort of balance of power between the two sides. It was stressed that this balance of power will fulfil the goals of the company.

Chapter Three concentrated upon the definition and description of shares and the shareholder. A person becomes a shareholder in a JSC when he owns a share, and because of this ownership he enjoys a number of rights and powers within the company. The KCL was criticised for not including any definition of shares, despite the importance of such a definition. The KCL was also found to be lacking in the issue of the preference shares. The KCL only recognises one type of share; the ordinary shares. Companies in Kuwait do not issue anything but ordinary shares, a fault that needs to be reprimanded. A company should be granted the rights to issue preference shares if it desires to do so and give preference shareholders special privileges that ordinary shareholders do not enjoy. The issuance of this type of share does not jeopardize the principle of equity among shareholders of the same type of shares. In other words, equity should prevail among owners of ordinary shares. The same should be true for shareholders of the preference shares.

The rest of the study concentrated on the rights of the shareholder in a direct way. It should be clear that making profits for the body of shareholders is not the only aim of the JSCs. Any company is in fact a web of contracts. Therefore, there are a number of interested groups, and every group has rights and interests to be achaeived. Shareholders, as one of these interested groups, also have interests and rights in the company. Their first right is the financial right. This right is one of the main reasons that drive them to participate in these kinds of companies. Also, this right is or should be considered as an encouragement for shareholders to pay more attention in the company's affairs.

Chapter Four began with the right of shareholders to dispose of their shares in any disposition way (selling, gift, present or giving up). It was emphasised that this is one of the basic rights that shareholders cannot be deprived of. It is also one of the main reasons why people invest in these types of companies.

It was mentioned in this study that the company laws for a number of reasons, impose some restrictions on the rights of shareholders to dispose of their shares. These restrictions must be designed in the interest of the company and its shareholders and the legislator must not super impose his restrictions to the extent of depriving shareholders of this right. It could be said that the KCL has gone too far in imposing restrictions on this right.

Also reviewed was the right of existing Shareholders to subscribe in new Shares that are being offered during the company's existence. It was made clear that these new shares should be offered first to existing Shareholders and not to the public in order to preserve the existing balance of power within the companies. Article 131/6 of the KCL has given this right candidly to Shareholders. However, as indicated earlier, the KCL Article 111 has given companies the privilege to impose restrictions on this right. This means that the board, especially if it monopolises the Company's GM (as is the case in many companies) will have the authority to impose any restrictions. It can therefore, deprive the company's shareholders from priority in subscribing to new Shares offered. This is one of the problems in the Kuwaiti law that should be evaded. Shareholders should not be deprived of this right unless they voluntarily relinquish it.

One of the most important financial rights that encourage investors to engage in the JSCs is the right of Shareholders to an annual profit. In Chapter Four, "Profit" was defined and the KCL was criticised for not having a clear definition of the word despite its importance. Also tackled was the issue of determining profit's due dates and when the shareholder can claim his profit. Profits become the right of the shareholder as soon as it is declared in the resolution issued by the GM of the company. However, the KCL is found to be at fault when giving the board the authority to determine the date for the distribution of the annual profits. This means that distribution of profit can be delayed for some time. Profits should be distributed as soon as they are advertised and Boards should have no authority on this matter.

The issue of reserves was handled in this chapter. It discussed types reserves, means of creating reserves and the importance of preserving reserves as means to maintain the company's independence (especially avoiding the need of a banks to finance a project). Despite the importance of reserves, this should have no reflection on the rights of shareholders to receive their profits. Shareholders should be informed in any fiscal year if the annual profit is being derived from the company's reserves. The KCL was criticised for allowing Companies to pay annual profit to Shareholders these from reserves without obligating companies to inform their Shareholders directly of the sources of their profits. The Shareholders should become aware of the financial situation of the Company.

This Chapter also focused on the issue of distributing unreal or alleged profits. This is the case when the Board decides to distribute annual profit without having any real profits made by the company during the past fiscal year. These amounts are drawn from the Capital of the company. It was clearified that the Kuwaiti Company's law does not mention this crime. This is a fault that needs rectifying. The lack of an article that incriminates the alleged profits has forced many Boards to distribute profits from the capital without them actually knowing that they are alleged profits. There is a crucial need to impose new provisions to be added to the company law, incriminating this act and demanding that those who accepted alleged profits return them.

The final issue addressed in Chapter Four was the issue of shareholders' rights to the Company assets at the time of dissolving the company. The Company being a legal entity owns its own assets, when the company is dissolved, the ownership of these assets is transferred to the shareholders. These assets are not to be distributed among shareholders until all debts are settled. Each Shareholder receives a percentage of the assets related to the Shares he is holding.

Chapter Five was about the rights of shareholders to know what goes on in the company. Having studied and reviewed the KCL, it is clear that there is an apparent lack in this area. Despite the fact that the KCL mentions the shareholders' right to information in several articles, this is still insufficient to ensure that the Shareholders will receive the true picture of the company's situation. Therefore, this matter should be remedied. It is not possible to expect Shareholders to play their role as supervisors to the board of directors' administrative work if they do not have enough information on the company's position.

In order to ensure that shareholders are playing a vital role, they should be granted a candid right to be informed of all the company's documents and reports, not just for one fiscal year but for three fiscal years. This is necessary to enable shareholders to make comparisons on the Company's performance over these years. They will then be able to find out for themselves whether the company is actually developing or deteriorating.

This chapter also looked at all types of annual reports. Each report was examined separately and it was suggested that the Kuwaiti legislature be more inclusive and simplified. These reports should be presented in a simpler way so that they can be comprehended and understood by a regular shareholder with no experience in this field also, in order for these reports to be beneficial, the KCL along with the Board of Directors should distribute these reports at least two months before the session of the GM. This will allow Shareholders ample time to study these reports and to understand its contents of figures, graphics and plans.

Moreover, if the bulk of the shareholders do not have enough experience to understand these reports, why not allow shareholders, especially big ones, to be accompanied by experts at meetings. Experts could help them understand these reports and assist them in making the right decision when the company's position clearly understood.

This chapter pointed out the information that should be available in the agenda of the meeting of the Shareholders. The agenda for the GM should include all the projects for resolutions to be discussed in the meeting. Shareholders should be made aware of these proposed resolutions and should have enough time to study them and prepare questions to the board of directors. It is felt that the KCL should mention these points clearly to obligate the Board of Directors to reveal all the decisions they intend to take in their GMs.

There is plenty of information relating to members of the board and company management that needs to be made available. The place for this information is the private report of shareholders on company members of the board. To make sure they are in compliance with the law, the directors should reveal to Shareholders any awards and/or bonuses that they might have received as members of the board.

All personal interests of the board of directors should be disclosed. For example, contracts which tie the company to any one or number of its members has to be disclosed; thus ensuring that these contracts were not made on accounts of the company or for achieving any personal gains, for the members of the board of directors. The Kuwaiti legislature should be commended for preventing board members from acquiring any direct or indirect gains except upon receiving the approval of the GM for the company. Unfortunately, this prevention does not include relatives of board members. Any board member wishing to engage in a contract with the company for personal gain can do so in the name of one of his relatives. This is one of the loopholes in the company law that can cause damage to the company's interest and that of the shareholders. In order to remedy this, this prevention of receiving any contract or interest from the company needs to be extended to include at least first and second relatives of the board members.

The reality about companies in Kuwait and previous incidents prove the necessity of a new law obligating Board members to reveal all they gain in terms of rewards, privileges and contracts that may have been attained at the cost of the company and the company's shareholders.

There is also a need for the MCI to play a supervisory role to reveal these wrongdoings and to keep shareholders informed. This would be in addition to its authentic role of providing information on all companies in the commercial area and opening its offices for Shareholders and Investors who are in search of facts about some companies.

Chapter Six was devoted to a discussion about the role of auditors towards company shareholders. The chapter pointed out the importance of the role played by these individuals in commercial companies, especially JSCs and with regard to the interest of Shareholders of these companies. As mentioned in the KCL, The auditors are, in fact agents of the shareholders. Since they play an important role in this kind of company in the interests of the body of shareholders, their existence can be seen as one of the shareholders' rights.

It is known that, at the end of every fiscal year, many reports are presented indicating the financial condition of the company and its commercial activities during the last fiscal year. These reports are prepared under the supervision of the Board of Directors and are not published until endorsed by the Board. In reality, these reports do not have real value. This is due to the fact that these reports are prepared by the board on the activities conducted by the board and this lessens its credibility. It cannot be foreseen that the board will prepare reports indicating discrepancies in management or point out to personal gains attained on the accounts of the company and the shareholders. Therefore, it is necessary to have an independent figure to present reports on the company and the company's stand. The role of this report is to actually assert or refute the information addressed in the company's reports. In other words, the reports prepared by the Board of Directors do not enjoy credibility unless they are endorsed by the company's auditors.

This important role of auditors cannot be carried out without the existence of several points. First, the auditor should be utterly independent from the board of directors. This means that they should be free from any influence or authority from the board of directors that may affect the integrity of their reports. Second, the individual who wishes to be appointed as an auditor should possess the proper academic credentials and experience. These might include, possessing the suitable accounting degrees, practical experience in the field and membership of the proper syndicate or society for this profession, which usually obligates its members to work within a recognized professional code of conduct. Third, the auditor should be given all the authorities and power within the company to enable him to fulfill his role of monitoring the company's situation and affairs. He should be given the right to review all records, documents, deals and contracts for the company. The auditor should be granted the right to call upon the GM at any time if he sees a need for it to protect the company and the shareholders. This is a matter that was not mentioned in the KCL despite the fact that these are the only individuals, besides the board members, who are aware of the actual situation of the company. Finally, auditors are proxies (as provided in the KCL) of the shareholders this means that the shareholders have the right to question these proxies regarding their work and for any information they may gather from the company. The proxy should not under any condition refrain from answering any inquiries from the shareholders.. They should not stall in their answers for the questions directed to them by the shareholders.

Chapter Seven emphasized the right of shareholders whether ordinary or extraordinary during the GMs of companies. It was made clear that these meeting are nothing but a higher authority in the company that supposedly plans the policies of the company, monitors and audits the company's directors and appoints them to the board of directors and renews or terminate their appointment as they see fit.

The KCL was criticised for stating that in order for any shareholder to be able to include items of discussion on the meeting agenda, he needs to be holding at least 10 percent of the company's capital. This percentage is available only to a small number of shareholders and they are usually board members. Therefore, it would be much better if the Kuwaiti legislature would change that percentage to 5 percent of the total capital of the company. This would include larger numbers of shareholders to participate in the GM.

The right of shareholders to attend the meetings of the GMs was then discussed. It was clarified that the rights which shareholders enjoy within these GMs cannot be fully applied without their attendance at these meetings. Therefore, any shareholder, regardless of the number of shares he is holding should have the right to attend the meetings. The shareholder has the right to attend even if the value of his shares has not been fully paid up.

In Chapter Seven, there was stress on the importance of practising the right to attend meetings by shareholders, not only to practice their rights but also to monitor the work of the board of directors and to participate in the planning of the public policies of the companies. Attending these meetings is the golden opportunity for shareholders to face the members of the boards of directors and question them. However, the vast majority of shareholders are not enthusiastic to attend these meetings, and this leaves the field open for the board of directors to do whatever they please in the company without any real supervision from the shareholders. The reasons that prevent shareholders from attending these meetings should be studied. If the reason that prevents shareholders from attending these meetings rests in the excessive numbers, the board should prepare an appropriate setting large enough to accommodate each shareholder and facilitate their attendance. If the reason for not attending is the location of the meeting place, i,e., the distance from home causing additional transportation costs, then other means of participation should be included such as participation by registered mailing or by internet. However, measures should be put in place to ensure the proper organisation of this type of participation and to avoid any misuse.

Some shareholders may have a strong belief that their attendance would not be useful and are, therefore, not motivated to attend these meetings. It could be because they only own a negligible number of shares in comparison with the big shareholders. This, in fact, is the main reason that makes shareholders lose interest in attending these meetings. To overcome this matter means must be established to encourage small shareholders who, if united, will form an accountable force, able to communicate among themselves. Therefore, companies should provide shareholders with information on other shareholders whenever this information is requested. Communication should be facilitated by publishing names and addresses of shareholders, and the number of shares each holds.

The institutional shareholders have huge numbers of shares in JSCs, which enables them to play an important role in the administration and supervision of the board of directors of such shareholding companies. They, therefore, have an important role and carry weight that cannot be ignored in these companies. The questions pose that themselves in this study are: What is the role of the institutional shareholders in Kuwait? What is the nature of the relationship with other types of normal shareholders? Is there any communication between the two types of shareholders ? Unfortunately, the KCL does not mention institutional shareholder in any of its articles. Therefore, it does not place any special obligations towards the company and shareholders.

The KCL gave each shareholder the right to attend the GM of the company through his proxy. This is an important matter as not every shareholder can attend all the GMs for all the companies in which he is a shareholder. However, a weak point in the KCL is that a board member can attend the GM as a proxy for an unlimited number of shareholders, even for all the shareholders. The primary role of these meetings is to monitor and audit the members of the board and it is not logical for board members to represent or attend as proxies for the shareholders in these meetings. How would the board member question himself if he is the proxy for all the shareholders? Therefore, it is thought that board members should be prevented from acting as proxies for one or several of the shareholders.

An important right that shareholders enjoy in the GM is the right to question and to discuss matters with the members of the board. According to this right board directors are obliged to answer any inquiries in an obvious and understandable way; along with supporting evidence. The importance of this right stems from the ambiguity of the reports issued by the company. The meeting of the GM is the opportunity for shareholders to address the directors and auditors may be present to clarify the ambiguity of these reports for shareholders. The Kuwaiti legislature in the KCL did not mention this right clearly in any of its articles. It is suggested that this right should have an article by itself and that this right should not be restricted, even if the meetings of the GM go into prolonged sessions. For the process of asking questions, shareholders may be allowed to prepare their questions on the company's stand prior to the meeting of the general assembly and these inquiries could be sent to the company. The company's directors should arrange these questions, omit similar and then show them to the board members and auditors in an organised way during the GM's session.

Another right that needs special attention, is the right of shareholders to vote in the GM. Decisions can only be made by voting and this right is acquired as soon as they hold a share of the company. Under no circumstances, should they be deprived from practicing this right. One of the issues ignored in the KCL is the right of shareholders to arrange voting agreements among themselves pertaining to their method of voting in the GM. These agreements are very important and make the votes of the shareholders more effective and influential in decision making for the company and in the interest of the shareholder. These agreements push shareholders to cooperate among themselves to defend their rights. With the absence of this cooperation, the role of shareholders in these companies disintegrates. As mentioned earlier in this study that each shareholder alone cannot possess an active role in the GM, especially in the large JSCs, unless he cooperates with the other shareholders. Therefore, these agreements cannot be ignored by the Kuwaiti legislature and should instead be organised to achieve the interest of the companies and the shareholders. This organization should be handled legally and additional articles should be included in the Company law.

This study also looked at the rights of the shareholders to vote if they have a personal interest in the voting matter. It has already been established that the voting right is an authentic right that can not be withheld from the shareholder. However, if the shareholder attains a respected number of votes in the GM of the company and the same shareholder has personal interest in the issue of the vote he will no doubt give precedence to his personal interest over the interest of the remaining shareholders in the company. Therefore, in an attempt to protect the remaining shareholders, organisational methods should be applied to regulate this issue. The KCL does not include any article to this effect which gave an opportunity to those who own the majority of votes in the GM of the company to issue decisions in their direct personal interest. A legal article that regulates this important matter is recommended.

Chapter Eight focused on the shareholders' remedies according to the KCL. After studying the shareholders' remedies in the KCL and comparing them with other laws such as the UK CA, the KCL was found to be obviously lacking. According to the Kuwaiti law the shareholders have no right to sue in the name of the company even if the company, through the board of directors failed to take the necessary action and sue in defence of its interest. The KCL should candidly give any shareholder or a group of shareholders the right to litigate in the name of the company and in defence of its interest; if the company through members of the board have failed to do so..

The KCL fails to provide the minority of shareholders with protection against the behavior of the majority of shareholders, even the directors who usually control the proceedings of the GMs. According to the KCL, the minority of shareholders do not enjoy their rights. If the minority of shareholders are deprived of their rights, as a minority they have no right to litigation to request the liquidation of the company. Nor can they request the Ministry of Commerce to investigate fairly through independent investigators who have the rights and the authorities to conduct any procedure to secure the truth and give justice to the minority of shareholders.

Therefore, if they find out that their rights have been violated, it is the right of the minority of shareholders to litigate and request the liquidation of the company. Ultimately, the matter should rest in the hand of the legal system and if strong justifications exist for these demands of liquidation the matter should be decided by the court alone. The minority of the shareholders should always have the right to request the MCI to conduct an investigation. The MCI should consider their request and it should always have independent investigators separated from the auditors of the company. These investigators should have all the authorities to reach the truth. If the MCI determines that there are some discrepancies or mistakes in the company it should have the right to litigate and request liquidation of the company.

Moreover, the role of the courts in Kuwait in the case of protecting the shareholders is absent. A shareholder should always have the right to go to the court to defend the interests of his company and also his personal interest in it. The court should have the power to restrict or forbid the carrying out of any proposed act, make an order requiring the company not to make any specified, alteration to the memorandum or articles of association, require the purchase of the shares of the dissenting shareholders by other shareholders or by the company and it should also have the power to wind up the company if it just to do so.

On studying the subject of shareholders rights according to KCL it can be concluded that the shareholders in JSCs of Kuwait do not enjoy all of their rights. These rights can enable them to carry out their supervisory roles on the activities of the Boards of directors which, in turn, helps them protect their interests in the companies in which they have shares. Despite many adjustments to the KCL since 1960, this law is still underdeveloped and inadequate. It has failed to address many of the issues relating to shareholders equities. There is a need for the passing of a new Company Law, contemporary and suited to the new world order in which we are living today.

It is hoped that the following point would be considered in the passing of a new law;

1. Shareholders should be granted all the rights that are not included in the present KCL no. 15/1960. These rights should be given in accordance with the real role and position of shareholders. One may ask what these shareholders' rights should be? There are a number of rights that must exist in any company law and these rights are; the right to remain in the company as a shareholder who presented a part of the company's capital, the right to dispose of his share at any time and by any means of disposition, the right to reject the increase of his commitments in the company, the right to acquire profits, the right to participate in the company's management, the

right to hold a responsibility according to the capital paid by him, the right to receive the deed proving his rights in the company, the right to have access to information that enable him to read specific documents, data and reports sent to him, or be put under his disposition at certain appointments and occasions, the right to attend and vote in the GMs, the right to demand abrogation or dissolution of the company, if there is a legal reason for that. Shareholders are also entitled to file suits before the judge in the name of the company to defend its interests or in his own name, to defend his own interests in the company.

2. It is not enough that shareholders simply receive their rights. Proper methods should be implemented to encourage these shareholders to practice these equities. A law should be passed to encourage the cooperation between shareholders to enhance the influence of practicing these rights in the company.

3. There is a direct, basic and inseparable relation between the board of directors and shareholders. Directors, by the powers they have within the company, can impede the continuity of the rights granted to shareholders. Any new Law should consider the matter of directors and, therefore, the issue of directors' powers and responsibilities should receive constant attention;

(i) Restrictions should be imposed on the vast authorities given to the board of directors of the JSCs and they should be obliged to reveal all their private interests in the companies in their annual reports;

(ii) Any new law should impose on the board of directors that all reports be more detailed and simplified so that they can be understood by the regular shareholders. This opportunity should be given to any shareholder at any time to attain the information required to assist him in playing a more vital role.

(iii) Moreover, it is the right of shareholders to have their companies administered by qualified members. Any new law should request that shareholders wishing to elect themselves as members of the board of the company must have the specific qualifications that would help him to carry out his role in handling the company. This is a matter not mentioned in the KCL.

(iv) Any new law should include what is known as Shadow Director. This is not mentioned presently in the KCL. Duties and obligations should be imposed on the individual playing the role of "Shadow Director" to protect the interest of the company and the Shareholders.

(v) Punishments, whether fines or imprisonment, should be imposed on board members and company auditors when they violate the company law or Articles of Association of the company in which they work. The present law only includes modest penalties. The presence of punishments will assist in preventing the directors, managers and auditors from exceeding their limits and harming the interest of the shareholders.

4. The relationship between auditors and shareholders also cannot be ignored. Therefore, company auditors should be independent and given all the authorities and the privileges that they need to fulfill their supervisory role on the activities of the company and its administration.

5. Any new Law must test all powers and authority, as addressed in this study, upon the MCI, with a particular emphasis on the department supervising the shareholding companies. Hence, the companies may be directly protected. Such a department should be entitled to intervene at any time it deems appropriate.

Moreover, each shareholder should be entitled to resort to this department for information or to request intervention to protect the company's interest. He should be able to request independent auditors to audit the Company's accounts. Also, the department should also be entitled to protect the accounts and request dissolution or liquidation of the Company, if necessary, to protect the shareholders' interests.

6. Among the important recommendations of this study, is conducting a study through which it can assist in being acknowledged of the distribution of shares in Kuwait, meaning determining where the shareholding company's shares are concentrated. Is it in the hand of the company's board members, the ordinary or institutional shareholders. As this study shall require time, as well as complete team.

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