

AN APPRAISAL OF THE REGULATORY FRAMEWORK FOR PREFERENCE SHARES ADMINISTRATION: A SOJOURN FROM NIGERIA TO BRAZIL

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Abstract

In corporate law financial system, the issuance of preference shares is common, and the holders of such shares have accrued special rights. Preference shareholding is based on the same concept all over the world but form, substance, and procedure it takes depend on the law of the country being considered. This article considers the concept of preference shares in Nigeria and Brazil putting into consideration the corporate laws guiding such practice. It observes that though there are differences in the provisions of the laws of these two jurisdictions, however, there are areas of convergence and divergence between the two jurisdictions and in the broader context of global working of corporate system, the concept of preference shares is the same all over the world. It brings out areas of convergence and divergence between the two jurisdictions and in the broader context of the global working of corporate system. The company's ownership is known through shareholding. There are various classes of company shareholding; these classes give the holders different benefits apart from the universal purpose of receiving dividends. This article discusses preference shares as a foundation for shareholding through legal and regulatory frameworks governing companies and an examination of the concept in Nigerian and Brazilian corporate law.

Keywords: Regulatory, Framework, Preference, Shares, Administration

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1. Introduction

Preference shares administration is an important aspect of corporate practice which is governed by the law. According to Tripathi, A. N., and Maheshwari (2003, P.74), corporate ownership and its administration requires adequate process through an efficient law and regulation.

2. The Concept of Shares

Shares can be described as units of ownership in a company. It refers to the size of investment of a person in a company. Adewumi T.A & Jolaosho T.O (2022, p.31) describe shareholders as owners of the company with several rights among which voting right is one.

Kee, H. Y., & Luh, L. L (1999, p.554) in describing the concept of shares, opine that the ownership in the corporation is divided into pieces known as shares and the number of pieces held by members represents the percentage of their ownership. The description given here is quite instructive because shareholding is evidence of company membership and shares issued par value.

C. C. Langdell (1898, p.536) emphasises the importance of the document known as “share certificate” he mentions that no other document can confer ownership of shares on any member. I quite agree with Langdell that shares are not physical assets but can only be felt by the share certificate of the corporation, which is the only evidence of shareholding. In other words, a share is an abstract that can neither be seen nor touched except through document which confers ownership and accompanying rights.

In analysing implication of shareholding, Grantham, R (1998, p.554) opines that the shareholders as owners are to be in total control of the company, the management and the benefits thereof. However, C. Thomas Attix, Jr (1951, p.999) opines that the notion of shareholders as owners of the company had lost its efficacy today when he states that turning to outsiders for financial assistance for the purpose of the growth of corporate entities has widened the gap between ownership and control.

The earlier view represents that of the 1950s. Today, the shareholders are in control through the directors representing shareholders’ interest. Modern company law had taken a step forward to ensure the appointment of technocrats to the Board in the form of independent directors to curb the excesses of the executive management.

The Nigerian Companies and Allied Matters Act (CAMA) 2020 (Act No. 3 2020) provides that “share” means “the interests in a company’s share capital of a member who is entitled to share in the capital or income of such company; and except where a distinction between stock and shares is expressed or implied, includes stock” (Section 868 CAMA 2020). Benefits and obligations attached are provided for under section 138 CAMA 2020 that subject to the provision of the law, the rights and liabilities attached to the company’s shares or any class shall: “(a) be dependent on the terms of issue or the company’s articles; and (b) notwithstanding anything to the contrary in the terms of the articles, include the right to attend any general meeting of the company and vote at such a meeting”. So, it is basic that shares entitle the owners access to company meetings.

CAMA 2020 forbids non-voting and weighted shares in section 140. The exception to this is stated under section 140(3) which provides that “Nothing in this section shall affect any

right attached to a preference share under section 168”. This provision shall be discussed in the later part of this article.

Under CAMA 2020, a company where authorised by its article of association can create categories of shares which cannot be treated equally if they are not of equal status (Section 143 CAMA 2020). The law further provided that “Without prejudice to any special rights previously conferred on the holders of existing shares or class of shares, any share in a company may be issued with such preferred, deferred or other special rights or such restrictions, whether with regard to dividend, return of capital or otherwise, as the company may determine by ordinary resolution” (Section 144 CAMA 2020).

The Brazilian Corporation Law did not specifically define what shares are but Article 1 states that “The capital of a corporation or joint stock company shall be divided into shares, and the liability of the partners or shareholders shall be limited to the issue price of the shares subscribed to or acquired.” Article 11 further provides for the establishment of shares thus:

Article 11. The bylaws shall establish the number of shares into which the capital shall be divided and shall establish whether or not the shares shall have a par value.

Paragraph 1. The bylaws may create one or more classes of preferred shares with par value for a corporation whose shares have no par value. Paragraph 2. The par value shall be the same for all shares of a corporation.

Paragraph 3. The par value of the shares of a publicly held corporation shall not be less than the minimum value established by the Comissão de Valores Mobiliários.

Article 15 describes types of shares to be common, preferred, or fruition "depending on the nature of the rights or advantages which it confers upon the shareholder" (Article 15 of the Brazilian Corporation Law). Paragraph 1 of Article 15 provides that “Common shares of a closely held corporation and preferred shares of closely and publicly held corporations may be of one or more classes”. Article 15(2) further provides that the number of preferred shares without voting rights, or subject to the restriction on voting rights, may not exceed fifty percent (50%) of all issued shares.

On the issue of common shares, Article 16 provides that:

There may be different classes of common shares of a closely held corporation, depending on:

I - their convertibility into preferred shares;

II - a requirement that the shareholder be a Brazilian citizen; or

III - the right to vote separately to fill certain positions in administrative bodies.

Unless expressly provided for, an amendment to that part of the bylaws which regulates the different classes of shares shall require the approval of the shareholders of all shares thereby affected.

From the above, in Brazil, the common shares of a closely held corporation may be issued in different classes.

3. The Concept of Preference Shares

The concept of preference shares at common law is not of much difference to today's concept except with the provisions of the law which restrict the benefits to prevent abuse of privileges attached to such shareholding.

I agree with Tat (1992, p.128) that the right of preference shareholders is a matter of contract between the company and the preference shareholders. It is however important to mention that the law of each country provides guides on the relationship between a company and its preference shareholders.

To Pickering (1963, p.499), preference shareholding has some unsatisfactory characteristics; this is not entirely true, although its nature may change from time to time, it is still the same preference shares. Modern company law has made its features consistent. This we will see as we discuss the statutory provisions of the countries in issue. Perhaps the best description of preference shares can be seen in the work of Laws (2018, p.6) where he describes the concept as a right to fixed, higher and cumulative dividends.

In all of the above, one thing is most common about preference shares; the right of preference shareholders to prioritise dividend payment above ordinary shareholders.

4. Preference Shares under CAMA 2020

In Nigeria CAMA 2020 provides for the administration of preference shares and this section is discussed under subheadings for better understanding.

4.1 *Issue with rights attached*

CAMA 2020 provides that shares may be issued with special rights or restrictions concerning dividends, and return of capital that the company may determine by ordinary resolution (Section 144 CAMA 2020). The company mentioned in this provision are members of the general meeting, that is, the shareholders of the company.

However, the law forbids a company limited by shares from issuing preference shares that cannot be redeemed; the law however allows a company subject to its articles of association to issue preference shares that are redeemable upon such conditions as prescribed in such articles or terms of issue (Section 147 CAMA 2020).

4.2 *Right of a preference share to more than one vote*

Despite the provision of section 140 CAMA 2020, section 168(1) CAMA 2020 allows the company's article to provide that preference shares issued shall carry the rights to attend general meetings and on a poll at the meetings, to more than one vote per share in the following circumstances, upon resolution:

(a) "during such period as the preferential dividend or any part of it remains in arrears and unpaid, such period starting from a date, not more than 12 months or such lesser period as the articles may provide, after the due date of the dividend".

- (b) “which varies the rights attached to such shares”
- (c) "to remove an auditor of the company or to appoint another person in place of the such auditor" or
- (d) “for the winding-up of the company or during the winding-up of the company”.

Section 168(2) CAMA 2020 further provides an instance where a preference share can be entitled to more than one vote as an exception to section 140 CAMA 2020. It follows that where the required percentage of votes expected from the preference shareholders is not met, a special resolution can be made to make each preference share entitled to additional votes to one vote per share. It follows that the additional votes per share can be as many as possible. It is however doubtful if this is the intention of the law.

On the issue of when a dividend is due, following from section 168(2), section 168(3) CAMA 2020 provides that dividend becomes due on the date in the articles and where such is not provided for, it will be a day after the expiration of the year in issue.

Above is about the dividend accrued to the preference shareholders. It is however unclear how a preference shareholder can claim a dividend that is due but not declared putting into consideration the provision of section 428 CAMA 2020 which prohibits a company from declaring dividend where declaring such will throw the company into debt.

4.3 Construction of class rights

Section 169 CAMA 2020 provides for the rules of construction in the company's articles concerning the rights attached to shares. The rules are:

- (a) “unless the contrary intention appears, no dividend is payable on any shares unless the company resolves to declare such dividend”.
- (b) "unless the contrary intention appears, a fixed preferential dividend payable on any class of shares is cumulative, and no dividend shall be payable on any share ranking after them until all the arrears of the fixed dividend have been paid".
- (c) “unless the contrary intention appears, in a winding-up arrears of any cumulative preferential dividend, whether earned or declared or not, are payable up to the date of actual payment in the winding-up”.
- (d) “if any class of shares is expressed to have a right to a preferential dividend, then, unless the contrary intention appears, such class has no further right to participate in dividends”.
- (e) “if any class of shares is expressed to have preferential rights to payment out of the assets of the company in the event of winding-up, then, unless the contrary intention appears, such class has no further right to participate in the distribution of assets in the winding-up”.
- (f) “in determining the rights of the various classes to share in the distribution of the company’s property on a winding-up, no regard shall be given, unless the contrary intention appears, to whether or not such property represents accumulated profits or surplus which would have been available for dividend while the company remained a going concern” and
- (g) “subject to this section, all shares rank equally in all respects unless the contrary intention appears in the company’s articles”.

The rules above show clearly the rights of preference shareholders which include;

- (i) Fixed dividend
- (ii) The dividend is cumulative and it has priority of dividend payment over ordinary shares
- (iii) In winding up, arrears of any cumulative dividend must be paid.
- (iv) Preferential shares with claimed preferential dividends cannot have further right in the remaining dividend.
- (v) Where there are preferential rights to payment out of the company's assets at winding up, there will be no further right to participate in the distribution of the company's assets.

From the above rules, the law still gives the company the choice to vary these rules by the word “unless the contrary intention appears” in its provision.

5. Preference Shares in Brazil

The Brazilian Corporation Act (Federal Law No 6,404/1976) is the law governing the administration of companies in Brazil. The provisions on preference shares are discussed below.

5.1 Advantages of Preference Shares

The Corporation Act in Article 17 provides for the benefits of preferred shares as follows:

- i. “priority in the distribution of fixed or minimum dividends”;
- ii. “priority in the reimbursement of capital, with or without premium”; or
- iii. “the accumulation of the preferences and advantages provided for in items i and ii”.

The advantages are well spelt out in the above provisions.

Article 17(1) provides for the conditions under which preferred shares can be accepted for trading in the securities market (despite the priority right to reimbursement of capital with or without premium). It provides that such preferred shares should have at least one of the following:

(i) “the right to have an interest in the dividend to be distributed, corresponding to at least twenty-five percent (25%) of the net income for the year, calculated as outlined in Section 202, according to the following criteria”:

a) “a priority in the receipt of dividends mentioned in this item, corresponding to at least three percent (3%) of the share’s net worth”; and

b) “the right to have interest in the profit distributed in conditions equal to the common shares, after a dividend equal to the minimum priority as outlined in item a is assured; or

(ii) “the right to receive a dividend, for each preferred share, at least ten percent (10%) higher than the dividend assigned to each common share”; or

(iii) “the right to be included in the public offering for alienation of control, in the conditions outlined in Section 254-A, in addition to the right to receive dividends at least equal to the common shares dividend.

Article 17(2) provides that “In addition to those outlined in this Section, the bylaws must precisely indicate preferences or advantages assigned to the shareholders without voting rights, or with restricted voting rights”. This means that the bylaws can add more advantages to the preference shares apart from those mentioned in the law. It also means that the preference shares have no voting rights or have restricted voting rights.

Article 17(3) provides that “Dividends, even when fixed or cumulative, shall not be distributed to the detriment of the share capital unless the corporation is liquidated and this advantage has been expressly afforded” (Former paragraph 1 turned into paragraph 3 by Law n. 10.303, of October 31, 2001). This provision is clear, the dividend which is fixed or cumulative cannot be paid in a way that will affect the share capital except the company is being liquidated and that right has been expressly provided for. It means that no matter the situation, where the company is a going concern, a dividend cannot be paid out of the company's share capital.

Article 17(4) provides that except it is provided in the bylaws, the priority dividend is not cumulative, and fixed dividend share has no right to share from the remaining profits, and “the share with minimum dividend has an interest in the profits distributed in conditions equal to the common shares after a dividend equal to the minimum is paid to such shares” (Former paragraph 2 turned into paragraph 4 by Law n. 10.303, of October 31, 2001).

The law further provides “that the bylaws may not exclude or restrict the right of preferred shares to participate in capital increases resulting from the capitalization of reserves or profits except with respect to shares with fixed dividends” (Article 17(5) of the Brazil Corporation Act). This means that the bylaws of the company have the discretion not to exclude preferred shares in the participation of capital increase except the preference shares with fixed dividends.

Also, Article 17(6) allows the bylaws to “confer upon the preferred shares with priority in the distribution of cumulative dividends the right to, in such years where earned profits were insufficient, receive such dividend to the account of the capital reserves provided for in § 1 of Section 182” (Former paragraph 5 turned into paragraph 6 by Law n. 10.303, of October 31, 2001). This means where the earned profits cannot satisfy the cumulative dividend of the preferred shares with such priority, the dividend will be paid from the capital reserves.

The law makes provision in corporations' object of privatization, for the creation of a special class of preferred shares owned exclusively by the privatizing entity. It provides further that the “bylaws may confer specific powers upon such shares, including the power to veto resolutions of the general meeting in certain matters” (Article 17(7) Brazil Corporation Act). The above provisions have shown the characteristics of preference shares in the Brazil Corporation Act.

Article 18 gives the corporation the power to make bylaws that gives the right to one or more classes of preferred shares to elect one or more members of the administrative bodies by separate ballot. It further provides that “the bylaws may require that specific statutory amendments be approved at a special shareholders' meeting by the shareholders of one or more classes of preferred shares”.

5.2 Disclosing Details of Preference Shares in Bylaws

Article 19 provides in clear terms that “the bylaws of a corporation having preferred shares shall state the advantages attributed to each class of such shares and the restrictions to which they shall be subject, and may provide for redemption, amortization or conversion of shares from one class into another and into common shares, and of the latter into preferred shares, and shall establish the respective conditions for each of the foregoing”. In essence, the law allows the conversion of shares from one class to another and from common share to preferred share or vice-versa.

6. A Comparative Study of preference shares in Nigeria and Brazil

The administration of preference shares in Nigeria and Brazil had been discussed above. It is important to carry out a comparative study of these laws for mutual lessons from these countries.

6.1 Voting Rights

Nigeria

As previously discussed, in Nigeria, section 168(1) CAMA 2020 allows the company’s article to provide that preference shares issued have the right to attend general meetings and on a poll at the meetings, to more than one vote per share upon resolution in the following circumstances:

- (a) "during such period as the preferential dividend or any part of it remains in arrears and unpaid, such period starting from a date, not more than 12 months or such lesser period as the articles may provide, after the due date of the dividend".
- (b) “which varies the rights attached to such shares”
- (c) “to remove an auditor of the company or to appoint another person in place of such auditor” or
- (d) “for the winding-up of the company or during the winding-up of the company”.

Also, section 168(2) CAMA 2020 provides further on an instance where a preferred share can have votes additional to one vote per share.

Brazil

However, Brazil’s preference share is without voting right or with restricted voting rights (Article 17(7) Brazil Corporation Act). There is no provision in the Brazil Corporation Act clothing preference shares with rights to vote except in Article 18 of the Brazil Corporation Act which gives the corporation the power to make bylaws that gives the right to one or more classes of preferred shares to elect one or members of the administrative bodies by separate ballot and nothing more.

Article 17(2) provides that “In addition to those set forth in this Section, the bylaws must precisely indicate preferences or advantages assigned to the shareholders without voting rights, or with restricted voting rights”.

6.2 *Dividend Rights*

Nigeria

Section 144 CAMA 2020 provides “that shares may be issued with special rights or restrictions with regard to dividend, return of capital which the company may determine by ordinary resolution”. Section 169 CAMA 2020 provides for the dividend rights of preference shares and it can be summarised as follows:

- (a) Fixed dividend
- (b) A dividend is cumulative and it has the priority of dividend payment over ordinary shares
- (c) In winding up, arrears of any cumulative dividend must be paid.
- (d) Preferential shares with claimed preferential dividends cannot have further right in the remaining dividend.
- (e) Where there are preferential rights to payment out of the company's assets at winding up, there will be no further right to participate in the distribution of the company's assets.

The above is the dividend rights of the preference shares.

Brazil

On the dividend right, there is priority dividend right, fixed dividend right, and minimum dividend rights. These dividend rights vary as provided for under Article 17(4) of the Brazilian Corporation Act. Article 17(4) as previously stated provides that except it is provided in the bylaws, the priority dividend is not cumulative, and fixed dividend share has no right to share from the remaining profits, and "the share with minimum dividend has an interest in the profits distributed in conditions equal to the common shares after a dividend equal to the minimum is paid to such shares" (Former paragraph 2 turned into paragraph 4 by Law n. 10.303, of October 31, 2001).

The Corporation Act vividly analysed the dividend rights available to the three classes of preference shares which can be summarised as follows:

- the priority dividend is not cumulative.
- fixed dividend share has no right to share from the remaining profits.
- the share with a minimum dividend has an interest in the profits distributed in conditions equal to the common shares after a dividend equal to the minimum is paid to such shares.

The preference share with priority to the cumulative dividend will be paid from the capital reserve where the earned profit is insufficient (Article 17(6) of the Brazil Corporation Act).

7. **Lessons Learnt**

The lessons learnt from these jurisdictions are as follows:

In Nigeria, the preference shares as provided for under CAMA 2020 have rights to vote and under special circumstances, can have more than one vote. In Brazil, the preference shares have no voting rights or restricted voting rights.

The classification of preference shares under the Brazil Corporation Act is very clear. The preference shares are of three classes: preference shares with a priority dividend, preference shares fixed dividend, and preference shares with a minimum dividend. There is no such classification under CAMA 2020 except the general description of the rights of the preference shares.

8. Conclusion

There has been an attempt for a comparative study of the legal framework for preference shares administration in Nigeria and Brazil. This article has been able to show that preference shares are all the same from country to country, that is, the right to a fixed dividend that ranks higher than that of the “ordinary shares” as it is called in Nigeria and “common shares” as it is called in Brazil.

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