Shareholders' Right to Distributions: A Misnomer

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1. Introduction

Investors, either an entrepreneur and/or a dormant investor prefer to invest their money in a company rather than any other business vehicle. The reason is that they can consider the risk diversification in their individual portfolio. The risk diversification ensures their expectation of return against their equity investment in a company. This return of expectation is named as the right to distribution of the shareholders. This right to distribution includes *inter alia* the right to dividend, and the right as a residual claimant at the time of winding up.

As a part of the distribution right, dividend is to be paid when the company has distributable profits for dividend. However, the shareholders cannot claim dividend as of right even if the company has distributable profit. This is because the payment of dividend remains on the discretionary power of the directors of the company whether to declare dividend or to declare a dividend reinvestment plan. Therefore, the dividend of the shareholder is on the state of the company as well as at the hands of the persons behind the management of the company.

Further, the shareholders have the right as residue claimant at the time of winding up if anything is left after discharging all the claims of creditors. It is very much usual that an individual invests his money with the expectation of return However, this right of the shareholders is also uncertain. They stay on risk of getting nothing if a company goes for liquidation when there is less chance of running profitably. Again, the chance of return is made subject to discretion of the directors as well as for the priority of the creditors.

To sell the share in the secondary market is another way remains for the ordinary shareholders to get the capital return against his investment. But again the price of shares of a particular company depends on the prospect of that company. This prospect is determined by the past declaration of dividend because no one wants to block his money in such company.

Therefore, it appears that the distribution right of the shareholders is in uncertainties. Since making equity investment in a company ensures neither the return of the shareholders against their investment nor their entitlement to the distributable profit of the company, the right to

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distribution stands as a misnomer. In jurisprudential interpretation, although the term 'right' denotes more certain and specific and enforceable by law, these traits of 'right' are missing in this 'right to distribution' and appears more close to mere possibility of return. Such mere possibility of distribution or mere expectation to distribution can be termed as a *Spes,* meaning hope or expectation to distribution not as a right to distribution.

Given this, this article aims at exploring the vulnerable state of the ordinary shareholders caused due to uncertainty in getting dividend, questioning the paradox of naming this uncertain entitlement as right, finding a balance between the jurisprudence of perception of right and the concept of the right to distribution under the field of corporate law, and the possible way-outs for the shareholders from such uncertainties. The answer to these questions would be helpful to develop a shareholder friendly dividend Policy Farther it would be supportive to enhance the corporate practice in respect of distribution of dividend. However this article is limited to the distribution right of the shareholders and the price correlation with the declaration of dividend and bonus share of the public limited companies only.

2. Distribution Rights in Corporate Law and Financial Practices

When a person makes equity investment by taking a share in a company he becomes entitled to distribution rights along together with other rights like voting rights, right to take part in the management if appointed as a directors, right to information, class rights when his shares fall in any special class of shares etc. The distribution right further includes dividend, bonus share, return of capital and right to claim as a residue claimant.

In Bangladesh, the Companies Act 1994 or other statute has not defined the term 'right to distribution'. However, it has been defined in the legislation of other countries as every description of distribution of a company's assets to its members (alternatively as its shareholders) in cash or in kind.[1]

This distribution of a company's assets is usually made by way of dividend payment. These are generally paid to members at the discretion of the directors that usually represents a share of the company's profits.

Another form of such distribution can be by way of issuing of bonus share. A company sometimes announces fully paid up shares in the name of the existing members at payment of the par value without any premium or administrative cost. However, these costs are covered by the share premium accounts or other accumulated undivided profit reserves. The bonus share is thus a bare mechanism for capitalizing profits. Moreover, the return of capital to the shareholders of the invested amount at the rate of face value of the share only not any premium paid by the Shareholder at the time of equity investment, and/or in the case of a partial reduction of

[1] *The Companies Act 2006* (UK) s 829

capital or part of the amount originally paid for the subscription of the share is also treated as a description of distribution.

Additionally, the shareholder has an entitlement to residue amount in the company's surplus assets at the time of winding up assuming there is a surplus after meeting the preferential payments as per law and agreement if any.

Despite all these forms of distribution to a shareholder, the right to distribution is more focused on the dividend and residue claim.

As a means of distribution, the term 'dividend' is used to mean the share of the profit that is distributed among the shareholders. String LJ defined dividend as prima facie a payment made to shareholders while the company is a going concern.[2] From the view point of the company, dividend means the part of profit that falls to the share of each individual member of a company. As a result, it is the portion of the corporate profits which has been set aside and "declared by the company as liable to be distributed among the shareholders"[3].

The dividend can be paid in cash or in kind. Dividend in kind can be by way of bonus share or cash dividend with an option of election between cash dividend and bonus share in lieu of cash.

The company's article of association may permit shareholders to elect to take additional fully paid ordinary shares in the company in whole or in part in lieu of cash dividend. A dividend in such form is known as scrip dividend.[4] This scrip dividend can be characterized as dividend reinvestment plan or bonus share. The characterization of bonus share is appropriate when the election of taking scrip dividend is made before the declaration of dividend.

Further, the characterization of dividend reinvestment plan is appropriate when the election by the shareholders is taken place after the declaration of dividend. Therefore, it can be said that dividend reinvestment plan comes with an option of election between cash and kind distribution whereas in case of bonus share, the option is more imposed than election.

In addition, if permitted by the articles of association a company has the power to convert its accumulated undivided profits into bonus shares. Directors may capitalize such profits and allot the ordinary shareholders in respect of the net amount capitalized fully paid up shares of the company. Two other sources for financing bonus shares are share premium accounts and capital redemption reserve fund. In the words of Supreme Court of India[5], a company issues bonus share when it intends

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2 *Re Crichton's Oil Co.* (1902) 2 Ch 86 [95].

3 Ghulam Hossain J, in *Bacha F Guzdar v CIT* (1955) 1 SCR 876 [882].

4 Eilis Ferran, *Principles of Corporate Finance Law* (Oxford University Press, 2008) 259.

5 *Standard Chartered Bank v Custodian* (2000) 6 SCC [427].

to capitalize its profits. Such capitalization is done by transferring its reserve amount equivalent to the face value of the bonus shares, issued, to its nominal capital. In other words, the profits, capable for distribution but not distributed, is retained by the company under the head of capital against the issue of bonus shares to its shareholders in lieu of dividend. Therefore, another difference between dividend reinvestment plan and bonus share can be made with the contention that in case of bonus share there is an increase of the capital resulting additional shares entered into the secondary markets but there will be no increase of number of shares in the market in case of adoption of dividend reinvestment plan.

Excepting these dividend options, sometimes the directors can recommend dividend reinvestment plan under their managerial powers. On such recommendation, the distributable profits are to be reinvested for any new or existing ventures of the company. In lieu of it, some additional benefits meaning additional shares are allotted to the existing shareholders without having to pay the normal dealing cost. The shareholders cannot usually deny or refuse such plan.

In a typical dividend reinvestment plan, no new share is issued; therefore the number of share in the market does not increase. So, it does not affect the demand-supply relation of shares of the company in market. Further, the dividend reinvestment plan does not cause any dilution of the existing share capital. It means that there appears no impact on the company's earnings-per-share or dividend per share ratios as there would be where there is extensive take up of scrip dividend alternatives.

Further, at the time of company's winding up, the shareholders have the right to participate at the residue of assets if anything left after discharging all debts and preferential payments as required to be paid under law. However, all type of shareholders are not entitled to the surplus assets. It is determined as par the rights attached to the share held by the shareholder. Since the company is entitled to issue different classes of shares, the rights and privileges attached to shares also vary.

Variations of Distribution Rights as per Different Classes of Shares

Like the right of a shareholder to receive the distribution as residue claimant, the payment of dividend is also governed according to the rights attached to the share held by the individual shareholder.

The most usual form of shares, issued by a company is ordinary share or common stock. It attaches the common rights to its holder. The rights related to common stock depend largely on the articles of association and by-laws of the company. In general, owners of common stock have voting rights in a company along with rights to receive distributions of money as dividends from the company. In a successful company, common stock ownership can be very lucrative. However, if a company is unsuccessful, common stock owners are usually the last in line to receive a distribution of the company's assets when the company's assets are liquidated.[6]

Again, a given country's statutes often vary with respect to the default rights of common stock owners. The company may also issue multiple classes of common stock, such as nonvoting common stock or common stock with special dividend rights.[7] For example in Bangladesh, as per section 71 of the Companies Act 1994, a company can issue various special classes of shares. These shares used to have various rights, privileges and priorities. Further, according to Article 3 of Schedule 1 of the Companies Act 1994, a company may by special resolution determine the following matters subject to its memorandum of association and without prejudice of any special rights previously conferred on the holders of existing shares:

(a) issue of preference shares, deferred shares or shares of having special rights

(b) restrictions that may be imposed with regard to dividend, voting, return of share capital or any other matter;

(c) Issue of any preference shares on the terms that it is liable to be redeemed or that it is so liable at the option of the company.

Moreover, different classes of shares hold different rights and priorities, such as the preference shares obtain further priority in payment of dividend, than the ordinary share and if anything left after distribution among ordinary shareholders, the deferred shareholders get the right to the residue dividend. Again, the preference shares may be of different types with varieties of distribution rights depending on the terms and conditions set at the time when shares have been issued.

For example, the following are the preference shares with the varieties of distribution rights:

(a) Preference shares carry a preferential right as to dividend in accordance with the terms of the issue and the articles, and hence preference shareholders are paid dividend before the dividend is paid to the equity shareholders of the company.

(b) Preference shares may be cumulative or non-cumulative. Dividend in arrears on cumulative preference shares can be paid in the subsequent years where there are profits sufficient for such payment. In case of non-cumulative preference shares, if no dividend is paid in a year, there is no right to receive it in future years.

(c) Preference share with participatory right used to have the right to participate with the ordinary shareholders at the residue payment

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6 <http://www.enotes.com/business-law-reference> last accessed 28 March 2012.

7 Ibid.

at the time of winding up provided that usually the preference shareholder is not entitled to residue payment at winding up.

Another form of share is deferred shares, also called as founders or management shares. These are usually of small nominal amount with a right to take the whole or a proportion of the profits after a fixed dividend have been paid on the ordinary shares. Their rights depend on the articles or the terms of issue. Deferred shares are rarely used now.[8]

Dividend Declaration

The dividend declaration in the private companies is unusual. Many such companies are small family concerns where all the shareholders also act as directors. Such companies usually distribute the profit to the directors by way of remuneration rather than by formal declaration of dividend[9]. On the other hand, public companies are bound to follow the formal procedure of law for declaration of dividend. Again, when the public company is a listed one it needs to follow the additional requirements. For example in Bangladesh, companies run under the Bangladesh Securities and Exchange Commission (BSEC) regulations. Therefore, the sources of laws regulating corporate finance in Bangladesh are of two types: the Companies Act 1994 and the BSEC regulations. Similarly, the laws governing the distribution among the shareholders are also regulated by laws from these two sources. In addition, every company's dividend policy is also governed by its own documents of construction like memorandum of association and articles of association.

Regulations Governing Dividend Declaration

Payment of dividend is broadly governed by two fundamental principles. The first one is that *dividend must never be paid out of capital.* It is further supplemented by the second one i.e. *dividend shall be paid out of profits only.* In support of first principles, it is said that payment of dividend out of capital is a breach of trust and the company may require the directors to replace the capital. Explaining the reasons for such principle, Jessel MR said that the creditor of a company has no debtor but that intangible thing i.e. the corporation which has no property except its assets of business. The creditor therefore extends credit to a company based on its capital on the faith of representation that the capital shall only be applied for the purpose of business and be kept by the corporation and not return to the shareholders by any means.[10]

However, the Madras High Court held a dissenting view on breach when it states that payments of dividend by way of borrowing is not a breach of principle of return of capital. In the words of Ram Chandra Ayyar CJ, Madras High Court, "profits of a year under the mercantile system of

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8 M Zahir, *Company and Securities Laws* (University and Press Limited, 2005) 33.

9 Ibid 158.

10 *Flitcroft Case* (1882) 21 Ch D [519].

accounting only mean the excess receipt for the year over expenses and outgoings during the same year. It will be open to the company to declare dividend on the basis of its accounts...where it is based on estimated profit which had not actually come in the form of cash to the company; it will be open to it to pay such dividend from out of other cash in their hand or perhaps even to borrow and pay them off. That will not amount to paying dividend out of capital."[11] Though the dissenting precedent is from Indian sub-continent, the views of Jessel MR is adopted in Bangladesh that no dividend can be declared for payment otherwise than profits of the year or any other distributable profits.[12]

In compliance with these principles, the company law allows dividends to be paid out of three sources namely, profits of the company for the year for which dividends are to be paid, undistributed profits of the previous financial years and a realized profit made on the sale of a fixed asset[13].

Another most important principle underlying corporate distributions to its shareholders is that the *distributions are* discretionary.[14] This means that the directors of a company have exclusive authority to declare distributions.[15] In absence of a declaration of dividends by the board of directors, shareholders have no direct proprietary interest in corporate earnings, there being no dividend in earnings until one is declared.[16] So, corporate directors have the ultimate say on when and how such distributions are to be made. The shareholders cannot claim dividends as of rights though the company has made profit in any particular financial year or there are distributable profits after balancing previous losses. In Bangladesh, the dividend shall be declared by the shareholders at the annual general meeting, but no dividend shall exceed the amount recommended by the directors.[17] However, the directors have exclusive power to declare interim dividend as and when they seems it justified by the profits of the company.[18]

Furthermore, the directors may before recommending any dividend set aside out of the profits of the company such sums as they think proper as reserve or reserves. This is left at the discretion of the directors and this may be applicable for meeting contingencies or for equalizing dividends or for any other purpose to which the profits of the company may be properly applied. Pending such application, the profits may at the like discretion

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[11] *Hariprasad v Amalgamated Commercial Traders* (1964) 1 Comp LJ 339, [349].

[12] *The Companies Act 1994* (Bangladesh) sch 1 Art 98.

[13] *Dimbula Valey (Ceylon) Tea Company v Laurei* (1961) a Ch. [353].

[14] *Zellerbach v. Allenberg,* (1893) 99 Cal. [57].

[15] *Gibbons v. Mahon,* (1890) 136 U.S. 549 [558].

[16] *Miller v. McColgan,* (1941) 17 Cal.2d 432 [436].

[17] *The Companies Act 1994* (Bangladesh) sch 1 Art 96.

[18] Ibid Art 97.

either be employed in the business of the company or be invested in such investments as the directors may from time to time think fit.[19]

Financial Practice regarding Dividend Declaration

Since the dividend can be declared only out of surplus earning there must be an exact method of determining whether there is surplus earning for that purpose.[20] However the Act of 1994 provides no such guidance. The reasoning of such grey area of the Act can be taken to be justified by the words of Lord McNaughton when he states that to formulate rules for the guidance of whether profit exists to pay dividend would constitute embarrassment of businessmen in the conduct of business affairs.[21]

In response of the views of Lord McNaughton, there are two tests underlying the two principles of payment of dividends under the conduction of business affairs. Firstly, *balance sheet test* and secondly *company's profit and loss account test.* The former follow-up its assets and liabilities at the end of the year and the later record the company's financial success (or lack of it) over a period of year.[22] The balance sheet test implies that a company must not make distribution if its net assets are (or would be after distribution) less than it's paid up share capital and distributable reserves.[23] In other words, the dividend out of profits rule also requires the company's net assets after the payment of the dividend to be equal to or exceed the legal capital.

Net Asset = Total Assets less Total Liabilities

On the other hand, the profit and loss account test implies that a company may make a distribution only out of profits available for the purpose. It defines 'profits available for the purpose' as the company's accumulated realized profits so far as not previously utilized for distribution or capitalization, less its accumulated, realized losses so far as not previously written off in a reduction or reorganization of capital duly made.[24]

Net Profits = Sale Revenues less Expenses

Profits Available for distribution = Net Profit of This Year less Any Previous Year's Loss not Written off Yet

Thus, the thrust of the profit and loss account test puts on two points. Firstly, *the company needs to assess its accumulated profits and losses over the years to determine whether there are profits to support dividend payment.* Secondly, *no nimble dividend is permitted* i.e. unless the previous year's losses are replaced out of the profits earned in the particular year,

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19 Ibid Art 100.

20 Shah J in *CIT v. Standard Vacuum Oil Co.* (1966) 1 Comp LJ [187].

21 *Dovey v Cory* (1901) ACC [477].

22 Jim Gower, *Principles of Company Law* (Sweet and Maxwell, 8th Ed. 2008) 289

23 Ibid 286.

24 Ibid 287.

no dividend can be paid. In consideration of profits and losses for the profit and loss account test, only the realized profits and losses are taken into consideration; the unrealized profits and losses are left out of account in calculation of distributable profits.[25]

The public limited companies listed with the Dhaka Stock Exchange Limited is required to follow some listing regulations before its dividend declaration. It can declare any dividend either interim or final, only after the close of a financial year. It is also required to make an announcement accompanied by a statement showing comparative figures of turnovers, gross operating profits, gross profits, and income from other sources and provision for taxation to the exchange before the declaration.[26]

Expectation versus Payment

From the shareholders' perspective, earning per share[27] and dividend per share ratio[28] are considered to measure the expected return of an individual shareholder against his shares. When the total return of an individual shareholder from the company is calculated, it is called dividend yield ratio. It measures the rate at which dividends provide a return to a shareholder. It is calculated as follows:

$$\text{Dividend Yield} = \frac{\text{Dividend per Share}}{\text{Market Price per Share}}$$

These concepts of dividend calculation and the return to the shareholders are necessary for various purposes, inter alia, to determine the fulfilment of expectation of the shareholders and also to verify the protection to the investments and risks associated with these investments, to find out the better risk management to the ordinary shareholders, to authenticate the efficient stock market, and to confirm the liquidity of the market.

Then again, from the company perspective, all dividends are declared and paid according to the amounts paid on the shares.[29] However, if and so long as nothing is paid upon any shares in the company, dividend is usually declared and paid according to the nominal value of the shares.[30]

Payment Procedure

Once a dividend is declared it becomes a statutory debt from the company to its shareholders. As pointed out by the Supreme Court of India[31], once

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25 Ibid.

26 The DSE Listing Regulations (Bangladesh) (Reg. no 36(A) sub reg. 8.

27 Earnings per Share is calculated by dividing up Net Income after preferred dividend by Average number of issued shares.

28 Dividend per share ratio is calculated by dividing up total amount of dividend declared by the average number of issued shares.

29 *The Companies Act 1994* (Bangladesh) sch 1 Art 99.

30 Ibid.

31 Ghulam Hossain J, above n 3.

the declaration of dividend is made and it becomes payable. It partakes of the nature of debt due from the company to its shareholders as payable within two months from the date of declaration.[32] Such time frame has two exceptions; firstly, when there is dispute as to right to receive the payment; or secondly, when the dividend has been lawfully adjusted by the company against the sum due to it from the shareholder. However, no interest accrues against the company for the late payment of dividend to the shareholders.[33]

In addition, the internal procedure which a company has to follow while declaring dividend is left to its respective articles of association. Usually the articles of association require both the recommendation of the directors and the approval by the shareholders. If the articles unusually say nothing about the mechanism for determining dividends, then no normal principles that decisions would rest with the shareholders alone.[34]

Residual Claim

There is no express legal provision governing the position and rights of the shareholders as residue claimant. It is governed by the corporate practices. As being the holder of common stock, the shareholders usually have a right to return of capital at the time of winding up. However, such right as residue claimant is subjected to the following conditions:

(a) The Company's solvency is not impaired. Its assets worth is so much that all legitimate preferential claims as per law and agreements if any have been paid.

(b) After all legitimate claims have been paid on their priority basis, if anything remains that shall be divided among the shareholder on pro rata basis.

Under the Companies Rules 2000, rules 171 to 177 deals with the residue payment to the shareholders. In the Companies Rules such payment is also termed as dividend which is declared by the official liquidator. The procedure of declaration is subject to the following procedures:

a) All the preferential payment is made;[35]

b) Notice of not less than 14 days is served to the creditors who have not proved their debt mentioning the intention of declaring dividend in favor of the shareholders.[36]

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32 *The Companies Act 1994* (Bangladesh) sch 1 Art 96.

33 Ibid Art 103.

34 Gower, above n 18, 285-6.

35 *The Companies Act 1994* (Bangladesh) s 325.

36 The Companies Rules 2000 (Bangladesh) rule 172, Form no 59 & 60.

c) The answers of the creditors lodged in response of the notice is verified in the manner as stated in rule 141 by the official liquidator and discharge their debt as deems fit to him.[37]

d) Minimum two months is elapsed after the service of notice.[38]

e) After minimum two months application for leave to declare dividend is made to the court by the official liquidator.[39] No dividend can declared without the sanction of judge.[40]

f) On obtaining the sanction from the court as to declaration of residue payment to the shareholders, a notice of not less than one month of the intention to declare and pay dividend is to be made to the persons who are supposed to be entitled to the residue claim. Such notice is made in the given forms.[41]

g) Dividend (the residue payment) is paid as per the rights attached to the shares.

3. Uncertainties and Conflict of Interest Control of the Creditors on Dividend Declaration

As discussed above, the creditors get preferential payment at the time of winding up. Furthermore, the creditors can influence the directorial decision of the company as to the declaration of dividend through their loan agreement with the company. Loan agreements between the sophisticated lenders i.e. banks and/or any non-bank financial institutions and the companies often contain covenants restricting the power of the later to declare dividends. On the other hand the trade creditors use other protective techniques such as retention of title or simply not becoming heavily exposed to a single debtor.[42] Another reason for caution is that the insolvency law is designed to address creditors' interest including the interests of creditors who cannot protect themselves contractually and save perhaps for some specific rules that might apply in the period when companies are in serious financial difficulties and potentially heading towards insolvency. It is, therefore, duplicative and perhaps damaging to worthwhile economic activity for the company law to take on that role as well.[43]

In order to protect their own interest in the loan agreements the creditors used to impose such covenant restricting distribution or that the distribution or dividend shall not exceed a specified percentage of the

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37 Ibid rule 173.

38 Ibid rule 172.

39 Ibid rule 172.

40 Ibid rule 171.

41 Ibid rule 174.

42 Gower, above n 18, 301.

43 Ferran, above n 5, 242.

company's net profit. However, it has been held that the shareholders' right of participation in the profits of the company exists independently of any declaration of dividend by the company.[44] One study found that dividend restrictions in debt contracts are as important factors for 42% of US managers and for 8% of European managers.[45]

Dividend Payment as a Weapon at the hands of the Directors

One fundamental rule discussed before is that distribution is discretionary. In exercise of this principle, the directors may prevent themselves from recommending any dividend showing the reason of non-availability of profit for distribution. In such case, declaration of dividend by the shareholders is unlawful; even the shareholders cannot declare dividend unless the directors make any recommendation for the same. However, remuneration of the executive directors or the directors in managerial power is justified to be paid in such circumstances when dividend distribution would not have been justified. It has been held in case laws that the directors approving the payment of remuneration to them were held to be not guilty of any breach of duty.[46] It shows that though the expectation of the ordinary shareholders is made subject to the recommendation of the directors, the regular income of the directors are not being interrupted. Even in adverse financial states of the company, the remuneration of the directors are allowed though the company may face the loss due to the improper management of business or impromptu decision of the directors.

In response to the discretionary power of the directors it can be said that the shareholders declare the dividend or bonus share or both at the annual general meeting. However, they cannot declare a dividend in excess of the amount recommended by the directors. Further, in contested takeover or other exceptional circumstances where tactical disputes over directors' dividend recommendation may arise between minority and majority shareholders, shareholders can be expected generally to be disinclined to opt for lesser amount. Thus, it means that shareholders decisions to approve final dividend can appear as a rubber stamp. However, it is true that the shareholders do at least have the opportunity to review the dividend recommendation and may require the directors to justify them if the shareholders feel necessary.[47]

Though the directors exercise discretion as to recommend the dividend or not, there are certain factors which prevent the ordinary shareholder to raise objection against the arbitrary exercise of discretion, such as -

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44 Ghulam Hossain J, above n 3.

45 F Bancel, UR Mittoo and N Bhattacharyya, 'Cross Country Determinants of Payout Policy: A Survey of European Firms' (2004) 33 *Financial Management* 107.

46 *Mac Pherson v European Strategic Bureau Ltd* (1999) 2 BCLC [203].

47 Ferran, above n 5, 238.

Firstly, the powerful market and commercial constraints on dividend policy limit the scope for abuse and hence for legal dispute;[48]

Secondly, the masking effect of a policy of paying dividends which are sufficient to satisfy the investors' demand even though the company's business and prospect would justify higher level means that it may be difficult to detect and prove wrongdoing;[49]

Thirdly, even if an action did reach the courts it is likely that in absence of evidence demonstrating a clear conflict of interests the court would be reluctant to second guess the directors' business judgment about dividend policy.[50]

To date, it was usual that, in the event of a conflict between the shareholders, the one who held the majority refuses to reach an agreement regarding the distribution of dividends in order to weaken the minority shareholder. The majority shareholder receiving some profit through the salary or through related-party transactions, prefer scrip dividend and/or dividend reinvestment plan which enable them to be in majority with more shares. Consequently, the minority shareholder is forced to sell and or to stop exercising his political and economic rights in order to recover at least part of the value of his investment.[51] Through this way the majority shareholders sometimes attempt to exclude the active minority shareholders who raise voice against the mala fide actions of shareholders in management in order to keep the control of corporate governance in hand. On the other hand, due to the consecutive non-distribution the shareholders do not get good price of their shares, and the majority shareholders get a chance of obtaining their shares under the pre-emptive rights. In such way the minority shareholders become bound to sell their shares to the existing majority shareholders at a lower price which ultimately results in losing their capital invested.

Expectation of Shareholders and Uncertain Position

The expectation of the investors making equity investment in any company primarily bears two objectives, either to earn quick return in the form of capital gain by way of selling the shares in secondary market or to have a regular income by way of dividend payment. Again, the regular income of the shareholders can be made by other means apart from cash dividend i.e. declaring bonus shares, rights shares etc. However, since dividend is paid in cash it is considered one of the best rewards a company can do to

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48 Daniel R Fischel, 'The Law and Economics of Dividend Policy' (1981) 67 *Virginia Law Review* 699 [715]

49 *Re a Company, ex p Glossop* (1988) 1 WLR 1068 [1076].

50 *Burland v Earle* (1902) AC 83 PC.

51 Alvaro Marco, 'Shareholders' Right to Dissociate in case of Non-distribution of Dividends in Spanish entities' <http://www.legalknowledgeportal.com/category/topic/corporate-law> last visited 10 February 2014.

its shareholders for enhancing their wealth. The shareholders also enjoy additional benefit since the dividend which they receive is tax free and need not pay any tax on dividend and the company would be liable to pay dividend distribution tax.

These objectives are separate in sense but their rise or fall are relied almost on the similar variables. Established canons of corporate finance are that shareholders in the widely owned companies which paid dividend in past, are conservative in their dividend expectations. Their expectation continues to receive regular dividend in respect of their shares that those dividend will be smoothed over time and that any increases will reflect underlying longer term prospects for the business.[52]

However, it is already mentioned that dividend payment is at the discretion of the directors; the shareholders hardly have any say on whether dividend will be declared or not. Therefore, the shareholders' expectation of getting regular income is at uncertain positions. At the same time the market practice shows that shares will have a higher value where the company retains the profits and the past accounts of the company giving dividend to the members at handsome amount. Such dividend payment makes a good impression about the financial status of the company which eventually attracts new investors. Every prospective equity investor calculates the existing dividend yield of the particular company before investing thereon. The reason for attraction may be that before investing in any new company the prudent investor used to study the previous records of the company. Therefore, the expectation of the shareholder to get capital gain out of selling the shares in secondary markets is also dependent on the previous declaration of dividends.

Underlying Agency Conflict

The shareholders provide the capital to the company and the managers conduct the business as agents of the shareholders. Here lies the principal-agent relationship between the shareholders and the managers or directors. Out of this agency relation, the agency conflict arises when the managers run the business with the fund of the shareholders but lack the incentives to maximize profits over the longer term and fail to provide any gain to the shareholders in return of their investments. The agency conflict also arises when the managers of a high earning company retain its earnings in order to engage in more activities like dividend reinvestment plan that actually benefits the managers more than the shareholders.

Such conflicts raise the agency cost meaning that because of the divergence between shareholders interest and managers' interest, investors will pay less for shares in companies where shareholding is widely dispersed. It follows that to improve the price which the investors

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[52] J Lintner, 'Distribution of Incomes of Corporations among Dividends, Retained Earnings and Taxes' (1956) 46(2) *American Economic Review* 97.

are willing to pay for its shares, the managers of a company should do all that they can do to reduce the agency cost.[53] Sometimes litigations are filed by the dis-satisfied shareholders against the company or the directors. The unattractive prospect of the commencement of such an action attracting media coverage is damaging to the company's commercial interest.[54] It also increases the agency cost. One probable way to mitigate such cost is to increase agreement between the shareholders and the managers. The degree of agreement (or disagreement) of the shareholders and the managers as regards the declaration of dividend or the reinvestment of the same is an economically determinant factor for resolving agency conflict.

The agency cost analysis suggests that companies should declare high dividend and where necessary raise finance from other sources. This will reduce agency costs because equity investors have the security of knowing that management will have had to expose their business records and their plans for the future to the scrutiny of the lenders or to the markets and may have had to submit restrictive covenants in order to secure the funds.[55] Mitigation of such agency cost is one of the fundamental objectives for any frameworks regulating dividend payment.

Uncertainties as Residue Claimant at the Time of Winding Up

The conditions, fulfilment of which the shareholders might receive something as residue claimant are themselves uncertain enough. First conditions underlies that the company should be solvent at the time of winding up. When a company is solvent and capable of running its ventures, why it would call its winding up?

Also the big priority list raises the suspicions about shareholders' receiving anything at winding up. The priority list may be as follows:

(a) The secured creditors of fixed charges

(b) The secured creditors of floating charges

(c) The unsecured creditors

(d) The holders of preference share

(e) The ordinary shareholders

However, before the payment of any debts, there is a provision for preferential payments under section 325 of the Companies Act 1994. In a winding up there shall be paid in priority to all other debts,

(a) All revenues, taxes, cesses and rates whether payable to the government or to a local authority due from the company

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53 Ferran, above n 5, 235.

54 Ibid 239.

55 M Jensen, 'Agency Cost of Free Cash Flow, Corporate Finance and Takeovers' (May 1986) 76 *American Economic Review* 323.

(b) All wages or salary of any Clark and other servant in respect of service rendered to the company within two months next before the date of winding up.

(c) All wages of any labour or workmen not exceeding five hundred for each whether payable for the time or piece work in respect of the services rendered to the company

(d) Compensation payable under the Workmen's Compensation Act 1923[56] in respect of the death or disablement of any officer or employee of the company

(e) All sums due to any employee from a provident fund, a pension fund a gratuity fund or any other fund for the welfare of the employees maintained by the company

(f) The expenses of any investigation held in pursuance of clause (c) of section 195 of the Companies Act 1994

This shows that there remains hardly any chance for the ordinary shareholders to obtain anything at the time of winding up as a residue claimant.

4. Implication of Those Uncertainties

Aspects of No Payment and of Superfluous Payment of Dividend Causing Vulnerable Position of the Shareholders

Distribution is not only a mode of return, it can perform an information function also. Paying healthy consistent dividends in environment shaped conservatism is a way of indicating to investors who are not directly involved in managing a company that its management has long term confidence in the business and its prospects.[57] If the managers choose to increase the level of dividend, it may be interpreted not just as an indication of company's past profitability but also as a sign of greater dividend capacity in the future. However, a dividend cut may be taken as an indicator of long term problems within the company rather than as a temporary blip in profitability or liquidity.[58]

Some academics have developed the idea of dividends as an information conveying mechanism to suggest that managers may use dividend policy to signal the strength of their company and to distinguish it from the competitors. The underlying reasoning is that weaker competitors will not be able to afford to take that step because of the longer term expectations

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56 *The Workmen's Compensation Act 1923* has been repealed by the *Labour Act 2006* (Bangladesh) and now the compensation is paid under the provision of *Labour Act 2006*.

57 WL Magginson, *Corporate Finance Theory* (Addison Wesley, 1997) ch 8.

58 JR Woolridge and C Ghose, 'Dividend Cuts: Do They Always Signal Bad News' (Winter 1986) *Midland Corporate Finance Journal* 20.

associated with paying off a generous dividend in one period.[59] In addition, discretionary power of the directors to recommend interim dividend without any other guard against their exercise of this discretionary power, acts as a weapon at their hand to regulate the secondary market of shares as well. For example, the announcement of dividend results in a strong factor regulating the price of share at the BSEC market. Again, when the directors find the share price downturn, they used to announce interim dividend even though the financial status of the company does not support. This interim dividend declaration is not subject to AGM or any other procedures. Such superfluous announcement of dividend sometimes facilitates the insider's trading affecting the interest of ordinary shareholders. It also hampers the efficiency of stock markets.

On the other hand, when no dividend is distributed for consecutive years, the price of the company's share (in case of a listed company) used to have a downturn. Such downturn might result in the non-confidence of the existing shareholder upon the present directors. It might increase the agency conflict. On such circumstances when the shareholders lose their confidence upon the directors they used to start a rebel against the directors. It is not uncommon to have unrest in the annual general meeting. Such unrest among the shareholders is known as short-termism. Failure to meet the shareholders expectation will have a negative effect on share price and may out the company into the frame as a potential takeover target.[60]

The loss of confidence of the shareholders upon the directors occurred especially when they (the directors) are waiving from declaring dividend with some mala fide motive or in spite of having enough profits in hand. In the word of Lord McNaughton, the vulnerable position of the shareholder is much more prominent. He stated: "People put their money into a trading company to give them an income and the sudden stoppage of all dividends would send down the value of their shares to zero and possibly involve its ruin'.[61]

On the other hand, declaration of over dividend attracts other big companies to acquire the company. Sometimes the directors recommend a healthy amount of dividend in spite of its loses in business to make the company target to others. At takeover bid, the price of the acquired company's shares and assets are valued as per their previous financial condition and declaration of healthy dividend is an indication of sound financial condition. Despite acquisition of the company, the investors with internal control sometimes save their investments by insider trading.

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59 S Bhattacharya, 'Imperfect Information and Dividend Policy and the Bird in the Hand Fallacy' (1979) *Bell Journal of Economics* 259.

60 Ferran, above n 5, 237.

61 *Dovey v Cory* (1901) ACC [477].

When the directors recommend dividend in spite of the fact that the company faced loses and has no profit for distribution, it breaches the principles of dividend that dividend cannot be paid out of capital or any other un-distributable reserves. Payment of such superfluous dividend constitutes unlawful distribution. Such unlawful dividend amounts to a misapplication of corporate property and where the transferee of the assets has the knowledge of the fact rendering the distribution ultra vires that party is under duty to restore those assets to the company because he is deemed to hold the assets as a constructive trustee. Under the common law of directors' duties, the directors who pay dividends improperly may in certain circumstances be liable to compensate the company for the loss thereby caused.[62] When the distribution is made to a member which the member knows or has reasonable grounds for believing is made in contravention of the statutory distribution rules, that person is liable to repay it or if the distribution is otherwise than case, its value. Thus, when the payment is though unlawful is neither void nor voidable but can nevertheless be recovered from any receiver of it who knew or thought to have known that it was unlawful.[63]

The philosophy behind holding the directors and receivers of unlawful distribution to restitute is that it causes agency problems between the creditors and the controllers of the company, because excessive payouts are liable to undermine a company's financial position to the detriment of its creditors.[64] In such case, the position of the creditors becomes vulnerable and the creditors whose interest is affected may file any suit against the directors who are responsible for such breach; and the shareholders who receive the dividend may be required to restitute the same. Nevertheless the vulnerable positions of shareholders are not remedied like the creditors.

The vulnerable position of the shareholders becomes more adverse when they lose their investment. In view of the status of secondary stock markets in Bangladesh for last few years, it is the prime concern that many individual shareholders lost their investment. Such loss of investment occurs when the dividend yield ratio falls shorter than their actual amount of investment (the price at which they have taken the shares). In such case neither their expectation is not being satisfied through dividend nor can they come out of the market by selling in the secondary market. Their invested money used to be stuck in the non-prospective company or company with mala fide directors waiving dividend though the financial position of the company supports distribution. Then the question arises whether the liability would be the same when the directors avoid the declaration of dividend though there is enough profit to

62 *Flitcroft Case* (1882) 21 Ch D [519].

63 Gower, above n 18, 296.

64 Ferran, above n 5, 241.

recommend. Such question has still remains in the grey area of laws governing dividend policy.

In such cases, the directors can be made liable for loss suffered by the ordinary shareholders for non-payment of dividend or loss of capital out of the fall of share price in the secondary market due to the non-payment of dividend. In support of such liability, contention can be raised that the directors have defaulted to make proper representation of financial position of the company. In *Bairstow vs. Queens Moat Houses PLC*[65] the principle was applied to hold the directors liable where the accounts filed to give true and fair view of the company's financial situation as a result of accounting irregularities of which directors were aware. Another ground for holding the directors liable for the same would be their failure to promote the success of the company for any ulterior motive or on the ground of an act of negligence.

Efficient Frontiers

Vulnerable states are more adverse to the shareholders than the creditors. Shareholders undertake the risks with the expectation of returns. It has already been shown that how much susceptible that the return is. Theoretically and practically the shareholders assume more risk with the expectation of more return, but the previous discussion has shown the different. Such states also go against the principles of efficient frontiers. The principle of efficient frontiers states that higher the risk, higher the return.

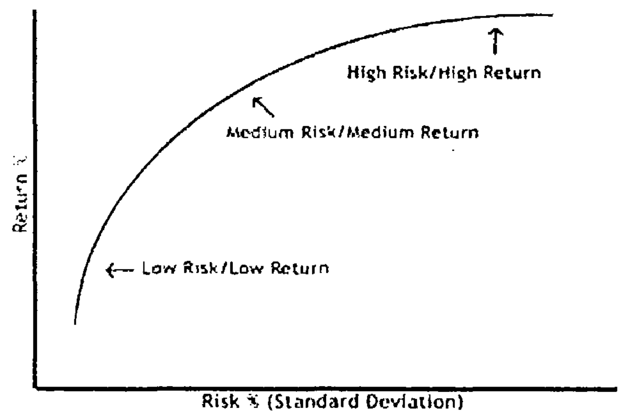

Figure: Efficient Frontier[66]

The shareholders undertake more risk than the creditors as the creditors are entitled to fixed rate of interest with the certainty of payment; even in

[65] (2001) 2 BCLC [531].

[66] <http://i.investopedia.com/efficient_frontier.png> last visited 09 February 2014.

case of default that acts as a debt upon the company. They also receive priority at the time of winding up. At the same time the ordinary shareholders undertake more risk than any other class of shareholder and similarly with the less chance of receiving any thing. Therefore, the right to distribution turns to be the incentive to them to undertake that risk.

Distribution Incentives as Right

Taking that incentive as a right can be a way to deal with such misnomer term of right of distribution; on the other way we should take it as a mere expectation distinct from the concept of right. Again when we want to use the term 'right' to describe the probable incentives to the shareholder, it can be a complete right in compliance with all requisites to be so or it is not a right at all. According to Buckland, a legal right is an interest or an expectation granted by law.[67] Under this definition, such incentive is a right. Similar view is also supported by the Supreme Court of India, "the shareholders' right of participation in the profits of the company exists independently of any declaration of dividend by the company.[68] Under these observations, incentive in the form of cash dividend, bonus share or scrip dividend is also a right though they are not enjoyable unless declared and not enforceable it not declared. When we term this as a right there must be some protection mechanism for such right like the creditor protection mechanism or mechanism adopted to ensure uninterrupted entrepreneurship providing immunities to the directors. There needs some enforcement mechanisms for such right since the shareholders cannot enforce the right against the directors unless declaration is made.

Questioning Its Authenticity as Right

Lack of enforcement mechanism has become the matter of consideration for another group of writers. Their concepts of right imply that according to *the Interest theory of Rights* advocated by Ihering, *a legal right is a legally protected interest.*[69] On the other hand in *Will Theory*, according to Justice Holmes a legal right is "nothing but a permission to exercise natural powers and upon certain conditions to obtain protection, restitution or compensation by the aid of public force."[70] These writers deny recognizing any interest as right unless there are some guarantees of their enjoyment as well as enforcement. In compliance with their observations, the distribution right cannot be termed as right as it is not legally protected; neither the shareholder can obtain it unless recommended nor can they enforce in court of law; nor can they have any restitution of dividend not declared by the directors though the financial status of the company supported like the creditors.

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67 W W Buckland, *'Some Reflections on Jurisprudence'* (Cambridge University Press, 1945).

68 Ghulam Hossain J, above n 3.

69 V D Mahajan, *Jurisprudence and Legal Theory'* (Eastern Book Company, 1996) 290.

70 Ibid 289.

Partially Recognized Right

Paton held a view little different from the above mentioned scholars. Although he defined legal right in terms of recognition and protection, according to him, there are three qualifications of this statement. One of them is partial recognition of legal right and also the cases where the court of justice does not have an adequate machinery to enforce their decisions.[71] In support of the view held by Paton the Indian Supreme Court observed that a declaration of distribution is necessary only for the enjoyment of profits. It does not impair the shareholders' right to distribution.[72] Under this observation, their entitlement to incentive is a partial right which lacks some fundamental requirements of being a legal right. These requirements include the right to enjoyment and right to enforcement. In concepts of legal right, enjoyment can be postponed like reversionary interest but not make a mere possibility. However, the settled principle on this regard is that such right of participation in the profit does not provide any proprietary right of the shareholder over that profit. As a result, where there is no proprietary right, the question of enforcement of the same never arises.

***Spes* to Distribution**

Like the expecting heir of a relative who will die in future, the shareholder is also a mere expectant of the distribution. Then how such expectation can be termed as a right? The expectation of a mere chance to accrue an interest or right in the property is termed as *spes successionis* in the legal world. Similarly the shareholders' expectation to receive dividend (which in corporate law has termed as distribution right) is quite alike to that mere expectation as shown above. Such mere expectation is better being termed as *spes* to distribution in the place of distribution rights where the Latin term *Spes* means hope or bare possibility. In the case of *Annada Mohan Roy vs. Gour Mohan Mallik*[73], the term spes successionis is shown as "the chance of an heir-apparent succeeding to an estate, the chance of a relation obtaining a legacy on the death of a kinsman or *any other mere possibility of a like nature,*" the shareholders' expectation to distribution of profit is of a mere possibility of like nature.

5. Probable Way Outs and the Consequences

Mere expectation, its consecutive failure of its fulfilment, lack of enforcement of that distribution right might mislead the shareholders from equity investment. Therefore, it is essential to find some alternative ways by which the frontiers of the shareholders' risk undertaking and return can again be brought into its efficient form. This can give some remedy to loss suffered by the shareholders due to the unlawful waiver from distribution by the directors; arbitrary exercise of discretion of the

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71 GW Paton, *'A text Book of Jurisprudence'* (Clarendon Pres, Oxford 1972) 325.

72 Ghulam Hossain J, above n 3.

73 65 Ind Cas [27].

directors. Moreover, such probable ways need to be in compliance with the fundamental principles of corporate laws.

Mandatory Dividend

There can be an option for mandatory dividend payment to the shareholders. Under such option, we can avoid the mala fide exercise of discretion of the directors as to the recommendation of dividend. The articles of association can contain the minimum mandatory dividend to be distributed each year by the company. This may be incorporated in law as is made in Greece (Article 45 of Codified Law 2190/1920), which according to Article 3 of Development Law 148/1967 is at least 35% of the Company's net profits, after all necessary withholdings to establish the statutory reserve.[74]

However such mandatory dividend would distort the basic difference between the equity finance and debt finance. This is because equity finance carries the right to participate in the share of profit and also to the surplus assets if left anything because of their assuming greater risk than the debt financiers. Such provision would also act as discouragement of the managers of the business to undertake large ventures. It would also act as a bar to the potential growth of the company.

Free Reserve

The company may form a reserve to meet the contingencies when it becomes unable to pay the dividend to its shareholders. In the Act 1994 there is such provision under Reg. 100, which states the discretion of the director to form reserves. The allowable uses of such reserve would be to meet contingencies, to equalize dividend, to reinvest or to any other purpose for which profit can be used. Here the risk of arbitrary application of discretion entrusted upon the directors remains. The directors may not form such reserve or may use the reserve for any such purpose as they think fit with mala fide intention.

On the other hand, in Indian Companies Act 1956 there is a provision of free reserve, which is mandatory with fixed rate of contribution of each year's profit. Here the most preferable option is that the reserve can be used only to pay dividend to the shareholders when there is no profit of that year at the hand of company. Section 205 (2A) of the Act prescribes that before any dividend is declared or paid, certain percentage of profits as may be prescribed by the Central Government, but not exceeding 10% will have to be transferred to the reserves of the Company. The term "Reserve" is also defined in the Rules made under the Act meaning "Free Reserves" i.e. reserve which are not created or set apart or intended for any special purpose. For example, Development Rebate Reserve, Capital Reserve or Special Reserve will not come under the category of free reserves for the purposes of this rule. If in a particular year, on account of inadequacy of profit, the company has to pay dividends out of the previous year's reserves.

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[74] <http://www.titan.gr/en/titan-group/corporate-governance/rights-of-shareholders> last accessed 20 August 2012.

Right to Withdrawal

The right to withdrawal is recognized in the Spanish Companies Law. It implies that shareholders, dissenting with decision of the directors as regard the declaration of dividend or announcement of any dividend reinvestment plan, may withdraw his share and the company will reimburse him the amount invested.

Article 93(a) of the Spanish Companies Law (LSC in Spanish) expressly recognizes the shareholders' entitlement to participate in company profit-sharing. The decision whether or not to engage in profit-sharing within a company tends to be one of the most common sources of disagreement in the company activity. Also the Law 25/2011 incorporates new article 348 *bis* to the LSC which recognizes that shareholders of unlisted public limited companies, limited liability companies and limited partnerships have the right to withdraw in the event of non-distribution of minimum dividends (a third of profits yielded in the period for which the financial statements have been approved). The right to withdraw corresponds to the shareholder that voted in favour of the distribution agreement. When enforcing the legitimate right to withdrawal, the company shall be bound to provide the shareholder with a refund of the fair value of the latter's company shares or stocks. Although the new provision does not set down the basis for calculation of distributable profits, we can conclude that said profits are those resulting from the company's regular activity, which is why extraordinary profit or loss shall not be included, nor shall be any surplus recognized in the statements or any restructuring operating reserves.

There are two exceptions to this right to withdrawal: firstly, it is not applicable to listed companies and secondly whenever the company operation could be endangered if profit-sharing were conducted the company may choose not to recognize the right to withdrawal to defend the fact of prioritizing the company's best interest.

Solvency Based Test

The possibility of introducing an alternative solvency based approach was first explored by the European Commission on the alternatives to the Second Directives. Through the solvency based approach the directors undertake the personal liability to make good the loss of investment occurred to the shareholders. It has been already shown that due to non-declaration of dividend or unlawful distribution, the shareholders might lose their investment, in such case the directors undertake to reimburse the shareholders out of their own pocket under the solvency based approach.

A solvency based system places considerable faith in the deterrent effect of sanctions that would apply to the directors who deliberately prevent the recommendation of dividend though supported by the financial states of the company; or negligently authorized distributions that are not supported by the company's financial position.[75]

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[75] Ferran, above n 5, 263.

Though similar provision is not adopted in Bangladesh, there is a chance of imposing personal liability on the directors. The same is provided under section 76 of the Companies Act 1994. Here it says that a limited company may by special resolution alter its memorandum so as to render unlimited liability of its directors or of any director. However, in such solvency based approach, whether the fundamental principle of company law i.e. limited liability is breached is a prime question. Again imposition of such personal liability discourages entrepreneurial activity. In response to this concern, personal liability of the directors to reimburse the loss of investment under the solvency based approach is made only for one year.

Personal Disqualification of the Existing Directors for his Election as Director for Next Term

If the directors were to manipulate the dividend payment to serve private interests rather than those of the members generally that would amount to a breach of their statutory duties to promote the company and to avoid the conflict of interest. For such default the directors may be subjected to civil or criminal liabilities. In India, there is a provision for personal disqualification of the directors for their being elected as director for next term though they might have the qualified amount of shares in the company. As per section 274 (1) (g) of the Companies Act 1956 of India, if a public company fails to pay dividend and such failure continues for one year or more, then any person who is a director of the company at the time when default is made, shall not be eligible to the appointed a director of any other public company for a period of 5 years.

Identification of Account

An obvious step to avoid the arbitrary decision of the directors as to recommendation of dividend would be the verification of account by independent authorities. Companies are required to produce account annually and to have them audited, thus providing a degree of verification and the declaration of the dividend is normally one of the decisions of the annual general meeting at which the accounts will be considered as well.[76] Therefore, the shareholders get a chance to know the present financial condition of the company and the independent authorities like auditors, chartered accountants, and credit rating companies would also bring a balance on the absolute power of the directors to recommend dividend.

Distribution in Kind

The distribution in kind applies where a company does not have profits available for distribution of sufficient amount to recover the distribution proposed. It may sell any of its assets with the accession of capital gain. In order to avoid the common law rules on distribution, especially in respect of distribution in kind, the asset would have to be transferred at market value.

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[76] Gower, above n 18, 292.

Extension of the Powers of Ordinary Shareholders in Respect of Dividend Declaration

The dividend policy of a company is mostly regulated by its own articles of association. It would be more open to the companies to vest more direct control in the shareholders via the articles of association. For example, the shareholders might be given the power to exceed the amount of dividend recommended by the directors. However, such excessive power vested upon the shareholder might bring an adverse result. This is because most of the shareholders are dormant un-expert investors and they are ill informed also. Replacement of managerial power over them in the place of directors would not be wise.

Right to Dissociate of the Shareholders

It has been adopted in the European corporate legislation[77] that the shareholders are going to have the right to dissociate in case of non-distribution of dividend in spite of having available profit for the same. The concerned legislation states that upon the completion of fifth year of incorporation of the company, if proposal for distribution of dividend is not passed in the AGM (by the directors or the majority shareholders), the shareholders (even minor in number) have the right to dissociate. This right accrues not only when no dividend is declared but also when the declared dividend is less than one third of the distributable profits of the previous financial year.[78] Exercising the right to dissociate, the shareholder sells his shares out to the company itself. In case of failure of the parties to determine the price of the shares, the same is determined by independent valuation such as by an independent auditor accountant.[79]

However, this regulation is made applicable for the non-listed companies only. It would not bring the same result for the listed companies. Therefore, the minority shareholders in the listed companies still remain under the risk of losing their investment in case of non-distribution of any dividend.

Introduction of Non-Director Executives to Declare Dividend

In order to protect the shareholders from being toys at the hand of the directors who are majority shareholders also, governance mechanism of appointing independent non-executive directors to the board would be another strategy. Non-executive directors may have more access than the shareholders in general meeting to information about the company's financial status and prospects and are much better placed to impose pressure on the executive directors and management to justify their dividend policy. The combined code of corporate governance applicable in the UK also recommends the balance of executive and non-executive directors.[80]

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77 European Directive 2007/36/EU.

78 *Capital Company Act* (Spa) 2006 (amended by Law 25/2011) Art 348.

79 Marco, above n 52.

80 Ferran, above n 5, 238.

6. Summary and Conclusion

The dividend policy and the principles governing the dividend payment are more prone to save the creditors' interest. In order to protect the creditor's interest the primary concern of the courts has been that the capital is maintained in the form of assets if not equal to the paid up capital at least sufficient to go round up the creditors. Once this is done a complete latitude is given to businessmen to pay dividend in good faith so as to keep up their company's reputation.

However, the shareholders purchase the shares with the expectation to get return either in the form of dividend or by way of capital gain. When the directors waive from recommending any dividend for consecutive few years, it causes an unsatisfactory situation among the shareholders. In spite of this, the value of that company's share at secondary market also falls. Therefore, the shareholders ultimately drop into an uncomfortable situation. They don't get any income nor can they get their invested capital back by disposing the shares at the capital market. The position becomes more vulnerable when the income out of shares held (by way of dividend or capital gain) is less than the principal amount invested.

In spite of such circumstance, the shareholders can sue neither the company nor the directors for compulsory distribution. The ground of such default is that the shareholders right to distribution is a mere expectation; their right to participate in the company's profit does not give them any proprietary right to enjoy the same unless declared. Such expectation under the heading of right is a mere misnomer. The term *Spes* (meaning bare possibility to entitle) is more appropriate to explain the nature of such grant to the shareholders in reply of their investment.

Many alternative ways can be suggested in order to provide for the fortification of shareholders' interest. It may be the incorporation of appropriate laws or rules but their enforcement and effectiveness completely depend on the underlying corporate practice, market performance and ultimately legal observation in case of interruption in such practices. One factor to be taken into account during those practices is that nothing of them causes imbalance in the interest and protection mechanisms to both the shareholders and the creditors; also in compliance with corporate law norms.