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GOLDEN SHARES IN PRIVATISATIONS: ALL THAT GLITTERS IS NOT GOLD

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Introduction

Discussions about privatisation usually provoke an emotive response from various vested interests and commentators in many parts of the world. Discussing privatisation in Nigeria is akin to stirring the proverbial hornet's nest. Professor Sam Aluko once said that economics is the science of choice (in response to ex-President Babangida’s assertion that there was no alternative to his structural adjustment programme ("SAP")).

Take, for example, the emotive response of Professor Tam David-West in **ThisDay**, December 28 1997:-

"As a scientist by profession, a philosopher by disposition and a Christian by religion, I am always uncomfortable when people, imperfect man-presumptuously or arrogantly prescribe Absolute Universal therapies for suicidal ailments".

"In short, I have no room for elixirs or panaceas or open sesames. On the contrary, I strongly hold that for every problem there is more than one possible solution; and what is elected at any particular point in time depends on objectively analysing and balancing a number of options at our disposal". Professor Tam David-West’s article entitled "A Layman’s Guide to Privatisation" then goes on to argue against Dr Pius Okigbo’s paper delivered at a brainstorming session which took place in the last quarter of 1997 as part of Vision 2010.

Although we agree with Chief Richard Akinjide (SAN) that economics is too serious a matter to be left in the hands of economists alone (*Newswatch*, February 21 1994, page 33), this article seeks to look primarily at the legal implications as well as the economic implications of the so-called "Golden Share" or "Special Share" in the context of privatisation. This matter is particularly relevant to Nigeria as the Federal Government of Nigeria has announced in the 1998 budget that Nigeria Telecommunications Limited (NITEL), National Electrics Power Authority (NEPA) and the Refineries as well as some other federal government utilities will be privatised as a prelude to further privatisations. Furthermore, a Nigerian Trust Fund is to be established into which the proceeds of the privatisation exercise will be lodged. The Abubakar-led federal government has reconfirmed the privatisation policy and, unlike the previous government, appears to want to implement the declared policy.

Privatisation is big business. 50 of the world's 100 largest economies are companies. The 500 biggest corporations control 25 per cent. of the world's economic output (*The Company Lawyer* 1998). These and other large businesses have considerable power, in the sense that their managers make choices that affect others significantly. The scope of this power is wide-ranging. As one commentator has observed: "By making ordinary business decisions, managers now have more power than most sovereign governments to determine where people will live; what work they will do, if any; what they will eat, drink, and wear; what sorts of knowledge they will encourage; and what kinds of society their children will inherit."

Privatisation

What do we mean by "privatisation"? The word derives from "private" which means not public. It is usually used to mean (and it is used here to mean) the general process of transforming a public company into a private company where the whole of the enterprise is to be sold. The sale may take the form of a trade sale to an institution or a group of institutions or a sale to the public (domestic and/or foreign).

The advantages of privatisation are numerous. They include the reduction of public borrowing through the proceeds of sale of privatisation, increased public profile of the company and share liquidity. Privatisation in the form of a public listing of shares provides greater access to equity finance and may provide the opportunity for cheaper debt finance. They free the enterprise from political control and interference, thereby enabling an organisation to raise finance without the limits imposed on the public sector. This is important for the enterprise as it needs to raise funds to develop its infrastructure and the business is on a commercial basis. The heavy hand of government which slows down corporation is removed and, if run properly, owners, employees and customers enjoy the success of the enterprise. Another advantage is that the management of the enterprise is able to take decisions in the long-term interest of the company and its shareholders as opposed to being swayed by the short-term political pressures of the government of the day.

Experience has proven that the advantages of privatisation far outweigh the disadvantages in most cases. However, it is worth listing the main disadvantages which include the cost of the whole process (fees to bankers, sub-underwriting fees, lawyers and accountants' fees, advertisement and PR

costs etc.), publicity requirements and discharge (Companies listed on the Nigerian Stock Exchange will be subject to the requirements of the Nigerian Stock Exchange and the Securities and Exchange Commission and exposed to institutional and shareholder pressure as well as the possibility of take-over (unless a golden share allows the government to prevent this).

The Legal Aspects

It is trite law that nothing should prevent the company from altering its constitutional documents (which in common law jurisdictions are the "memorandum of association" and the "articles of association"). In accordance with Section 48(1) of the Companies and Allied Matter Decree 1990, a company may, subject to the provisions of that Decree and to the conditions or other provisions contained in the memorandum, alter its articles of association by special resolution (233(2) "a resolution shall be a special resolution when it has been passed by not less than three quarters of the votes cast..."). In England and Wales, Section 9(1) of the Companies Act 1985 contains a similar provision in relation to companies registered in England and Wales. Apart from these restrictions, in respect of companies registered in Nigeria or England and Wales, there is no limitation on the capacity of the company to alter its articles and the company may not deprive itself of or fetter its ability to alter its articles by an arrangement contained in the articles in favour of either its members or a third party.

With regard to Nigerian companies, it is important to note that although the Companies and Allied Matters Decree 1990 prohibits the concept of weighted voting (see Bushell vs Faith (1969) 2 CH 438) in Section 116 of the Decree, Section 199 of the Decree allows a company to have shares with special rights ("...any share in a company may be issued with such preferred, deferred or other special rights or such restrictions...".)

A lot of material in this article is drawn from Britain's experience. In the field of privatisation from the late 70's Britain has been the trailblazer. The British undertook widespread privatisation before the IMF and the World Bank found it so fashionable before the rest of Europe (witness the privatisation of Deutsche Telekom in Germany, France Telecom in France and the privatisation announced in January 1997 of Telefonica de España, SA, the Spanish utility).

The privatisation of Telefonica de España is similar to the golden share technique used by the British to retain some influence over the privatised public utility. The difference is necessitated by the fact that the legal regime in Spain is that of civil law and not common law, therefore the Spanish Government have used administrative law technique as opposed to a corporate law technique. The 1995 Act on the Sale of state-owned Shares in Public Companies enacted through Royal Decree 8/1997 (the 1995 Act) provides that State-controlled companies which provide a service of public interest can be subject to regulation, in the event that the State's participation in such companies is reduced to shareholdings below a threshold figure of 15 per cent.

In many of the UK privatisations, and certainly in the initial wave of privatisations in the early 1980's, the British Government held substantial minority stakes in the state enterprises which were privatised. They therefore had de facto control over each of these companies as it is established company law that shareholders need consider only their own interests when voting (<u>N.W. Transport -v- Batty</u> (1887) 12 APP.CAS.589). However, as regards such shareholdings, the British Government said:-

"...the Government do not intend to control the company (*British Telecom*) or to use their rights as a shareholder to intervene in the company's commercial decisions...except in those circumstances [unacceptable takeover bids], the Government do not expect to vote their shareholdings in opposition to resolutions supported by a majority of the Board, although they retain the right to do so (Secretary of State for Energy, H C. Deb., vol. 16, col. 171, 1982)."

It is because shareholders need only consider their own interests when voting that some commentators have criticised (see Adekunle Oladele in *Punch* newspaper Tuesday, January 20 1998) the government's intention to have a 40 per cent. shareholding in public enterprises which would be privatised. The critics kick against the fact that the government will still remain the biggest single investor in the privatised companies. For example, Mr Lao Osayem, Managing Director and Chief Executive of a Thomas Wyatt Nigeria Plc, at a symposium organised by the Institute of Chartered Accountants of Nigeria (ICAN) on the 1998 Nigerian Federal Government project, justified his criticism of any such large stakeholding by the Federal Government of Nigeria by reminding the audience of the experience parastatals had when Government controlled these parastatal institutions by holding on to a stake

of 40 per cent. in them. According to him:-

"...there is always the temptation for government to politicise appointment to boards of companies where they have such control."

The question raised regarding the appointment of directors on to privatised companies is a valid one as the new shareholders would not wish to have any "dead weights" on their board of directors. In the British privatisations, there was no consistency. Cable & Wireless, British Telecom and Britoil had two government directors each whilst British Aerospace had only one. Amersham International and Enterprise Ore as well as Associated British Ports and British Gas and later privatisations did not have any. Generally, these directors could not vote on contracts between the company and the government. Whether or not it was appropriate for government directors to be appointed was not such a major issue in the case of the British privatisations, as these directors were non-executive and part-time and each one of them had a very strong background. They did not have any special duties enshrined in the articles of the companies and operated under the constitutions of the company and general company law, including the common law duty that a director owes its duty to the company.

Special Shares and Restrictions on Shareholders

Golden shares are a legal device to control privatised enterprises somewhat like a mother who wishes to control a child who has married. In the British privatisations, the golden shares were enshrined in the articles of association and they took effect in two ways. Firstly, the articles had provision for the divesting of shares by a specified class of persons (e.g. foreigners) who have an interest exceeding a specified level (typically 50 per cent. or more of the total votes attaching to the appropriate share capital of the company). The directors are compelled to serve a written notice on these people so that they are forced to expose their shares until the limit is not breached. If the notice is not complied with, the company is required to dispose of the shares at the best price which is reasonably obtainable.

The special provisions in the articles are protected so that they cannot be changed without the consent of the shareholder (i.e. the government).

The second device used in Britoil and Enterprise Oil operated by giving the holder of the special share special voting rights in certain circumstances. In these circumstances the special share, in respect of any resolution of the company in general meeting, will have enough votes to swamp any opposing shareholder or even just one more than the total number of votes passed on the resolution not registered in the name of the holder of the special share (i.e. the government).

In its purest form it is this second device that is the really "**golden**" share as the first device is merely a way of limiting shareholding although this is done by the careful drafting of certain provisions in the articles which will enable the Directors to effect the policy of limiting certain shareholdings. In respect of the Enterprise Oil special share, there are two triggers for the exercise of the powers contained in the special share. First, if any person either alone or with other persons attempts to "**take-over**" the company (in the sense of being interested in shares carrying more than 50 per cent. of the voting rights). Secondly, if any person either alone or with other persons is entitled to exercise, or control the exercise, of more than 50 per cent. of the votes a general meeting.

Conclusion

With regard to the future, our advice to the federal government of Nigeria as it seeks to privatise in particular utilities is to look at the British experience. The British were pioneers in this regard and they began by appointing government watchdogs to oversee the privatised water, gas and electricity monopolies. This was experimental and the federal government of Nigeria can learn from the mistakes the British made. These watchdogs were headed by high-profile civil servants and although they did a lot of good, in a green paper published in April 1998, the British Government announced plans to abolish the watchdogs because even though they are unelected officials they wielded a lot of power and sometimes in a way that would be viewed as capricious. The most favourable option in the green paper is to replace the regulators with panels of up to five people including "consumer champions".

If the federal government of Nigeria abandons the device of seeking control via golden shares and instead relies on a form of regulatory body to oversee privatised utilities (companies which are not utilities generally do not require regulation) then we would recommend that the federal government of Nigeria follows, or at least gives serious consideration to, the five "musts" suggested by Don Cruickshank, OFTEL's ("Office of Telecomunnications") well respected Director General (and supported by *The Economist* magazine):-

1. Transparency.

   No cosiness with the incumbent ex-monopoly. Regulatory proposals should be put under the full scrutiny of all the players in the market.

2. Inter-connection (This perhaps only applies to telephone networks).

   The cost that the incumbent monopoly charges to connect a call from a new entrant to the local network can amount to half the new entrant's costs. So monitoring inter-connection charges is vital.

3. Barriers to entry.

   With regard to telephone networks, the two biggest barriers are the way telephone numbers are allocated and the incumbent's exclusive access to their subscriber base. Customers want to keep their telephone number when changing carriers.

4. Retail pricing.

   Regulators need to apply price caps, but only to monopoly services. This is so that the ex-monopoly will not use its profits from services where it still has a monopoly to undercut competitors. Mr Cruickshank also advises watching the inter-connection charges and retail prices to prevent the incumbent excessively squeezing a new entrant's margins.

5. Competitive markets.

   Regulation is always second best to a competitive market. Regulators should aim to stimulate entry and competition by rewarding innovation and efficiency. The sooner regulators can withdraw from the detail of market management, the better.

In conclusion, it is understandable that *Time* magazines describe the 20th century as the century of capitalism (*Time*, April 13, 1998). Privatisation has been at the core of capitalism. Although capitalism requires safeguards, it is now the economic structure for most societies around the world. With economic freedom you tend to have political freedom. Therefore, although it is tempting for governments to seek to retain some control over privatised companies using devices of state control such as golden shares or special shares, save in the exceptional cases where national security overrides all other consideration, it is clear that not all that glitters is gold.

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