RWANDA – WHERE MINORITY SHAREHOLDERS HAVE A MAJOR RIGHT

On 31 May 2017, Rwanda gazetted the highly anticipated Law No 27/2017 Governing Companies (the **Companies Act**), overhauling the regime regulating companies in Rwanda. Tucked within the act at section 4 of Chapter 9 is a relatively short set of provisions, rather innocuously entitled "Buyout", which hold major implications for investors considering Rwanda as an investment destination where the proposed transaction involves a minority partner.

Key issues

- Rwanda has introduced a new Companies Act which gives minority shareholder, in certain circumstances, the right to require a buyout of his shares
- Due to uncertainties within the relevant provisions, the unintended consequence is that companies may be at the mercy of minority shareholders
- Investors need to reflect on how to contractually structure their investments and otherwise manage their relationships with minority shareholders prior to a buyout right being triggered

BACKGROUND TO CHANGE

The Government of Rwanda has stated that its vision is to develop a strong, vibrant economy which supports a per capita equivalent to that enjoyed by a middle income country, with a relatively equitable distribution pattern. Fundamental to furthering economic development to meet these goals, and the Vision 2020 goals more broadly, is an improved business atmosphere with increased reliability, transparency and ease of business conduct. The Companies Act, in modernising the legal regime applying to companies, is designed to accomplish an improved business framework – but has Rwanda inadvertently made itself less competitive and less attractive to investors?

GENUINE LOCAL PARTICIPATION

There has been a significant move towards greater local participation across Africa. Historically, directorships for in-country individuals were considered sufficient. However over the years we have witnessed increased mandatory minimum ownership requirements in Africa across multiple sectors including mining, land ownership, telecoms, banking, aviation and many others. There is no question that the landscape has shifted towards local ownership, either due to legal requirements or commercial necessity. Many African countries have therefore justifiably turned their attention towards ensuring that local ownership brings tangible, genuine benefits to Africans (and is not simply a paper event).

ARTICLES 225 AND 226

Article 225 of the Companies Act attempts to partly address this issue by granting rights to minority shareholders where they are in discord with investors over major issues. It states that a minority shareholder in a company (a **Minority Shareholder**) can, in certain circumstances, compel that company (the **Company**) in which it holds shares (**Shares**) to acquire its Shares (the **Buyout**). The trigger for the Buyout is where the Minority Shareholder votes against certain resolutions of the Company yet the resolution is carried. Examples of the types of decisions caught include certain changes to the constitution of the Company, a variation of rights attaching to shares or the approval of a major transaction. Pursuant to Article 226, the Minority Shareholder initiates the Buyout procedure by notice to the Company following which a director of the Company must:

(a) arrange for some other person to buy the Shares;

(b) arrange for the Company to buy the Shares;

(c) apply to court for relief (granted in exceptional circumstances); or

(d) reverse the contentious decision.

The pricing for the Shares is proposed by the directors of the Company (the **Proposed Price**) as agreed by the Minority Shareholder, failing which the matter is referred to an arbitrator to determine a fair and reasonable price (the **Final Price**) for the Shares. In the interim, the Company must pay the Proposed Price to the Minority Shareholder.

THE CHALLENGE

At first glance the buyout provisions in Section 4 sound sensible – if the Minority Shareholder feels disregarded or is otherwise not happy with the direction of the Company he or she should be afforded a well regulated exit which provides appropriate value. Arguably, the inclusion of this type of provision simply ensures that the Minority Shareholder's voice is heard in respect of critical issues, particularly bearing in mind a regular complaint of shareholders in Africa is that insufficient consideration is given to advice provided by local participants – to the detriment of the company.

However, the reality (presumably unintended by the legislator) is that Section 4 may put investors at the mercy of their local shareholders by enabling a "my way or the highway" dynamic to develop within the company. Since the provisions are vague, the mechanism could be manipulated to a local shareholder's advantage, and international investors with local minority shareholders are likely concerned by the new legislation for this reason.

UNCERTAINTY LEADS TO DISPUTE AND DISPUTE IS NEVER A GOOD OUTCOME

There are a number of uncertainties resulting from the provisions in Section 4 which could lead to disputes between companies and their shareholders.

Firstly, the descriptions around what constitutes a trigger are inadequately described. An example is the lack of definition of "a major transaction". Whether one views a transaction as "major" or not is subjective and also involves cultural considerations. The criteria could be financial, legal, commercial, political or reputational, or any combination of the foregoing. This lack of definition creates a risk that any issue, no matter how inconsequential it may seem to the investor, may be raised as a trigger by the Minority Shareholder.

Secondly, in respect of the regulations around pricing, certain critical elements are not set out in Section 4 which leads to uncertainty, including:

(a) the mechanism for selection of the arbitrator (which obviously bears on the confidence that the parties have in arbitration as a means of fairly determining the price payable for the Shares);

(b) the assumptions for pricing (which should include valuing the Shares on an arm's length sale basis between a willing buyer and seller, disregarding or having regard to the Shares representing a minority interest, whether the Company should be considered a going concern, etc.); and

(c) the timing of the rendering of a decision.

Thirdly, if pricing is referred to arbitration, the Company is required to pay a sum equal to the Proposed Price. However, the Company does not acquire the Shares in return for making this cash payment, and there is no security to support the future performance by the Minority Shareholder of his obligation to transfer the Shares when the arbitral decision is rendered, nor to return any excess funds in the event the Final Price is less than the Proposed Price. The Minority Shareholder then holds both the Shares and the cash payment. The old saying "possession is 9/10th of the law" comes to mind, with the practicalities of asset retrieval being challenging at the best of times.

As a further general point, as in other places, litigation in Africa tends to be long running, and if the arbitrator produces a figure which the Company challenges, it is not inconceivable for the Company to be caught for years in a situation where it has paid for an asset it has not received, and is locked in with a recalcitrant Minority Shareholder.

SOLID ADVICE AND STRUCTURING IS THE SOLUTION

Investors need to reflect on how to contractually structure their investments so as to ensure that they are able to avoid disagreements of this type with Minority Shareholders, find a mutually agreeable solution, or otherwise manage their relationship, with Minority Shareholders prior to a Buyout being triggered. This is the key to avoiding disputes and protecting against uncertainty and Company value diminution.

This change to the Companies Act may adversely affect Rwanda's ability to attract foreign investment, as the potential for a Minority Shareholder to have significant rights in an ill-defined and subjective regime introduces unpredictability for investors. This was certainly not the intended consequence, and one hopes that Rwanda will take note of some of the short-comings of this change in order to avoid it potentially reducing the country's global competitiveness for investment, impacting on its ability to meet its own stated goals under Vision 2020. Until then, with the right legal protections in place, investors should be able to take a holistic view as to the investment environment offered by Rwanda as against its regional competitors, and Rwanda will hopefully remain a relatively forward-thinking regime towards international investors.

CONTACTS

Krista Bates
Senior Consultant

T +61 8 9262 5550
E krista.bates
@cliffordchance.com

Sam Luttrell
Partner

T +61 892625 564
E sam.luttrell
@cliffordchance.com

Terence Foo
Partner

T +86 106535 2299
E terence.foo
@cliffordchance.com

Vicky Ma
Consultant

T +852 2825 8995
E vicky.ma
@cliffordchance.com

Ross Howard
Partner

T +81 3 6632 6617
E ross.howard
@cliffordchance.com

Hans Menski
Counsel

T +81 3 6632 6669
E hans.menski
@cliffordchance.com

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