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Current Enforcement Mechanisms for Shareholder Protection in Pakistan: Need for Reforms in Shape of Derivative Action

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ABSTRACT

This article analyses the corporate structure of Pakistan with reference to shareholder protection mechanisms. Discussing the shortcomings of current enforcement mechanisms, this article would focus on need of reforms ensuring better protection of minority shareholders when a company wronged is under control of errant directors or majority shareholders. It's a common practice that directors having control over internal management of the company or the shareholders owning higher percentage of capital, i.e. higher voting rights tend to ignore interests of shareholders as well as company and abuse their powers for satisfying their personal interests. As a result of this abusive approach, both company and minority shareholders suffer at the hands of those in controlling positions. This approach also causes loss to country's economy. Though different remedies are in place for providing protection but inadequacy of these remedies worsens the situation. Therefore, an effective remedy in shape of derivative action to provide inclusive protection to shareholders is a must. That being said, provisions of derivative action in English company law would also be reviewed to see how world's most advanced jurisdiction dealt with issue of minority protection.

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1. Introduction

The company, as defined by Company law, is a distinct legal body, and it is closely intertwined with the term capital. The capital of a company is typically divided into shares, and individuals who possess those shares are referred to as shareholders. Majority shareholders, often the promoters or sponsor shareholders, tend to hold a greater number of shares and also serve on the board of directors. This arrangement allows them to actively manage the company and retain control over its operations. Large voting power allows these shareholders to exert control over the company as they can dominate the general meetings as well board of directors of the company, both essential for smooth operation of the company. Aside from majority shareholders, there are other shareholders who hold a smaller number of shares and are referred as minority shareholders. Because minority shareholders do not have enough power, collusion between majority and minority shareholders is unavoidable and such conflict impacts share value, causing it to fall, thereby enhancing the encroachment of minority shareholders' rights.

One contributing factor leading to such dissension is the desire of majority shareholders to retain company's advantages and earnings for themselves while stripping minority stockholders of their rights. ("Burland v Earle," 1902) Inadequacy of judicial system exacerbates the problem, as system loopholes allow majority owners to violate minority shareholders' rights by oppressing them. Minority shareholder protection is a recent development that is gaining momentum in today's corporate world (Cheffins, 2000). This study aims to explore the protection mechanisms under Pakistan's Company Act 2017 and the shortcomings of such remedies due to prevalent corporate practices in Pakistan. Further, this study aims to examine UK company law to see the protection mechanisms available to aggrieved shareholders there. Pakistan, being a former British colony and common law nation, might learn from the UK's experience to safeguard minority shareholders more effectively.

2. Concentrated Ownership Structure

The pattern of ownership and control has important implications for Pakistan's corporate governance regime because ownership arrangements have a significant impact on both governance challenges and the creation of corporate governance principles (Connelly, Hoskisson, Tihanyi, & Certo, 2010). Pakistan is country with high concentration of shareholder ownership, both in public and private sector, in the form of family and state-owned business groups. Companies are often controlled by shareholders having major shares directly or indirectly by different modes which includes interlocking, cross shareholding and pyramid structures (Burki, 2008).

In Pakistan, a vast number of public companies are operated by majority shareholders, who wield unreasonable authority over the companies. Major shareholders tend to pick their trustworthy individuals to serve on board of directors and non-executive directors. When filling directorial roles, they typically do not take into account aspects such as professional skills, business sector expertise & necessary degrees. Such officials then make crucial decisions without giving due regard to the interests of other shareholders (Faiza A. Chaudary, 2006). After corporate groupings dominated by family enterprises, State is Pakistan's 2nd largest corporate body. The government of Pakistan controls state owned enterprises. Among the top 40 companies listed on the Karachi Stock Exchange, 14 are under government ownership. Over past two years, the government has taken steps to commercialize several state-owned enterprises (SOEs) in response to the involvement of foreign financial institutions.

Usually, the State is unlikely to act against company and minority shareholder's interests. This is due to the State's genuine concerns about protecting the interests of corporations and non-controlling shareholder. However, it is important to note that the interest of State may not always align with the interests of other stakeholders or even with the company itself. State may, having overriding aims, abuse the resources of SOEs to achieve its own objectives (Singhai, 2002). Like family owned system, government also often shows disregard to appropriate expertise, business sector knowledge and essential credentials when appointing directors to SOE boards (Ali, 2019). As the managers and board members are often appointed by the government based on their political ties. Consequently, administration at SOEs protects the government's interests at the cost of minority shareholders.

There are three different modes through which directors or controlling shareholders in ownership concentration arrangements acquire control over a company. One of them is the use of the "block-holding tactic." Shareholders use the block holding technique to own blocks large enough to win control over company. The issuing of shares, together with greater voting rights, gives them the chance to exert control over the organization (Cheffins, 2008). The second technique of acquiring control is through pyramiding, which enables the controlling shareholders to exercise control over both the company, in which they have majority stake and its subsidiary, despite the fact that they have little shares in subsidiary company (La Porta, Lopez-de-Silanes, & Shleifer, 1999). Thirdly, shareholders may employ cross shareholding arrangements for exercising control. As a result of this structure, they are able to keep influence over several companies by owning shares in them.

3. Minority Shareholder Protection: Why Necessary

Two primary theories in company law include the concept of separate legal personality and the principle of majority rule. In English law, the majority rule was established in Foss v Harbottle, declaring that majority actions and choices would always be emphasised and favoured over minority options. The effectiveness of this rule in growing corporate profit earned it prominence; yet, one of the lessons learned from the current wave of economic meltdown is the need of protecting minority rights, which is critical for secure and trustworthy commercial existence. In Salomon v Salomon, a separate legal entity principle was recognised. According to Salomon, a corporation is a separate legal entity from its members and, as such, a legal person in the eyes of the law ("Foss v Harbottle,"). When a company is harmed, only it has the legal right to sue. Consequently, according to the law, it is evident that minority shareholders are not provided with the opportunity to individually rectify these injustices if they arise from the actions of the directors and are approved by the majority shareholders. When decisions are frequently made at the general meetings, it may be claimed that the company is in control of majority shareholders who dictate the directors. The biggest issue that arises is the detrimental impact on the company's operations, as it is unable to seek redress. As a result, the notion of minority shareholder protection arose in corporate law. Apart from establishing rights and remedies for minority shareholders, it is crucial to establish a robust corporate governance framework that incorporates mechanisms for effectively monitoring the organization. To ensure that a corporation is properly managed in accordance with its objectives, it is essential to establish an effective protection system such as a derivative claim. Based on economics, justice, and fairness principles, some arguments are given justifying the need of protecting minority shareholders.

The first argument contends that lack of minority protection has a detrimental influence on a company's average capital in terms of competition with other firms. The effectiveness of the legal framework implemented to safeguard shareholders has a substantial influence on a company's ability to secure the necessary funding for expansion, innovation, and competition. This is particularly crucial considering that foreign investors often hold minority stakes in companies (Salomon v Salomon & Co Ltd). By implementing litigation or other legal system changes that safeguard minority rights, a country enhances investor confidence in its corporate sector. This, in turn, encourages investors to allocate their investments towards countries that have robust protection mechanisms in place (Raja, 2012).

In the absence of adequate protection for minority shareholders, stock markets in these countries face challenges in flourishing, consequently making banks the predominant source of economic activity for businesses. On contrary, countries with active capital markets do a better job of safeguarding minority investors (Ararat & Ugur, 2003). Therefore, legal protection for minority owners is widely recognized as an efficient mode of attracting international investors & promoting capital market participation.

With major financial scandals occurring all over the world, the corporate governance system has grown in prominence. The 2008 financial crisis is relevant in this context because it resulted in the necessity for new legislation aimed at enhancing minority shareholder’s protection (Dahya, Dimitrov, & McConnell, 2008). Good corporate governance includes the company's openness and disclosure, a suitable board structure, independence, and, finally protection of the interests of shareholders alongside management and the board of directors (Kirkpatrick, 2009). The entire conversation underscores the significance of strengthening legal protection for the interests of minority shareholders. Interests (Bank, 2014)

Another key issue in corporate governance that is pertinent to mention to justify the need of protection mechanisms is of agency conflict. An agency problem occurs when one party's well-being is dependent on the actions/decisions of the other party (Briano-Turrent, (2016)). The challenge lies in convincing the agent to prioritize the best interests of the principal rather than their own, as it is commonly assumed that the agent has superior knowledge than the principal in a given scenario. Because the agent has more expertise, he might manipulate the position in a way that is unfavourable to the principal but enriching to him. As the principal cannot constantly keep an eye on the agent, the agent has a fiduciary obligation to the principal, which means he must do his tasks with competence, proper expertise and in the principal's best interests.

According to Eisenhardt, agency theory becomes significant in three situations: firstly, where a clash leads to opportunistic behaviour; secondly, where there is surrounding ambiguity; thirdly, in cases where surveillance is hard to carry out.

Such scenarios arise alongside management's opportunistic behaviour and shareholder protection. For example, independent directors are obliged to supervise executive directors; nevertheless, their strong relationships with directors and reliance on majority members of the board for re-election is an example that might result in dissension. Reducing agency difficulties has been a major focus of agency discourse (Kraakman & Armour, 2017).

Agency theorists propose the implementation of an effective mechanism to monitor managerial behaviours as a means to mitigate the conflict of interest issue. Legal origin theory advocates that to boost capital markets protection of minority shareholders is a must and legal frameworks should be in place to discipline the errant executives (Eisenhardt, 1989).

4. Current Enforcement Mechanisms of Protecting shareholder

There are some public enforcement methods in Pakistan, such as the deployment of police, inspectors, or public prosecutors, as well as private protection mechanisms. However, both procedures have their respective limitations and vulnerabilities, which are extensively analysed here, highlighting that they cannot serve as substitutes for derivative litigation. Introducing derivative litigation as a viable avenue for private sector enforcement, would provide a way out to yield compensation for companies harmed by directors, and safeguard the interests of shareholders (La Porta, Lopez-de-Silanes, Shleifer, & Vishny).

4.1. Contractual Remedy

In the absence of formal legal action, the contractarian theory of the corporation describes essential corporate governance arrangements as a sort of private ordering in which norms are concurrently produced (Richardson Green shields of Canada Ltd v Kalmacoff). Proponents of this approach argue that shareholders may be safeguarded through private contractual mechanisms, rather than through legal action. They suggest that managerial acts are subject to contractual duties, and that shareholders can protect their interests by using their contractual rights (Attenborough, 2017) Nevertheless, this hypothesis faces criticism due to the inherent imperfections of contracts and the limitations of corporate laws in addressing the gaps left by incomplete contracts. Additionally, the notion of limited liability, which shields shareholders from personal liability, and the concentration of ownership, which establishes a governance framework where agency costs become evident, pose further challenges. Furthermore, the transferability of shares, which can potentially enable larger shareholders to engage in fraudulent activities against minority owners, adds to the concerns surrounding this hypothesis (Michael, 2006).

The limitations of financial markets and internal governance systems prevent them from effectively compelling managers to act in the best interests of firms and shareholders (Clark, 1986). Consequently, the significance of establishing legal accountability for misconduct in managerial activities as a means to protect shareholders who bear the consequences of inadequate contracts is emphasized.

In the context of private firms, Keay and Zhang have discussed the imperfect contractual relationship. They believe that because parties cannot always predict future occurrences that may impact the contractual relationship, contracts cannot be properly & clearly visual to cover future events and all elements of management conduct (Jensen, 1993). A well-known issue with contract creation is that they cannot exist in an ideal form, as explained by Williamson, "the foresight is, at best, faulty." Due to the potential inability of small investors to anticipate the exploitation of incomplete contract clauses and the existence of loopholes that allow managers to engage in illicit activities, the incomplete nature of contracts can pose challenges (Keay & Zhang, 2008).

If a conflict of interest occurs after a shareholder's agreement, remedies may be possible; however, relying solely on shareholder contracts and delegating all responsibility to majority shareholders under the guise of preserving minority shareholders' interests should be avoided. Because then, if directors or controlling shareholders decide something against the interest of minority shareholders it becomes difficult to get remedy. The same position is maintained in this argument that law must interfere since normal contracts are incapable of covering all aspects of management behaviour. Resultantly, legal recourse through derivative action is required and should be used in conjunction with other minority protection measures such as voting rights, independent directors, and other mechanisms to provide shareholders with a robust enforcement mechanism in order to safeguard corporate assets as well as their own legitimate interests.

4.2. Shareholder Rights

Voting rights are one of private enforcement tools that are employed instead of litigation (Keay & Zhang, 2008). Directors are obligated to serve in the best interests of the firm and its respective shareholders; otherwise, shareholders have the ability to remove them from their positions by using their voting rights. Consequently, shareholder voting power can affect managerial conduct while lowering agency costs. However, this is not always the case since a variety of variables render shareholder voting ineffective. For example, even if the voting method has been made easier by electronic means, most shareholders are hesitant to vote. Due to the collective action problem, shareholder voting is likewise an unsatisfactory management disciplinary instrument. Furthermore, owing to time and expense constraints, shareholders exhibit apathy toward voting (Roe, 2005) This is characterised as 'rational indifference.'

According to studies, shareholder suggestions have had little effect on governance policies or corporate values (Cheffins, 1997). In order to sanction wayward directors and management, shareholder voting appears to be an insufficient method of private sector regulation, in Pakistan notably. Moreover, independent directors, are another private enforcement mechanism that is ostensibly responsible for monitoring executive and board performance. They are also required to guarantee that the interests of minority and majority shareholders are aligned, as well as to reduce conflicts of interest. However, the criticism levelled against NEDs, together with facts, demonstrates that the effectiveness of independent directors is hampered by a lack of true independence, increased costs, and insufficient business understanding (Karpoff, Malatesta, & Walkling, 1996).

An empirical investigation shows a negative association between NEDs and company performance. As a result, board composition has no substantial influence on the company's worth. Furthermore, the existence of NEDs influences management flexibility to make risk-based, profit-generating, and creative decisions. The data is inconclusive as to whether the NEDs are effective monitors and a sufficient managerial disciplinary mechanism. The 2008 financial crisis revealed the fact that the NEDs framework is merely one of the instruments for improving corporate governance and is not intended to replace other management disciplinary processes in this regard. Pakistan has encouraged enterprises to select independent directors under the Code of Corporate Governance, and as a result, many listed companies have embraced the NEDs structure. However, the independence of the NEDs to adequately check management is questionable. Since the concept of establishing a structure for NEDs is sound, however, securing the independence of such is impractical. To summarise, no managerial disciplinary measure produces the desired results in every case.

4.3. Statutory Remedies

Companies Act 2017 sets out remedies for the protection of minority shareholders including winding-up of company and remedy against oppression and mismanagement. The Companies Act of 2017 establishes a winding-up procedure to safeguard shareholders (Kraakman & Armour, 2017). Grounds for seeking this remedy, include when the court thinks it reasonable and equitable, the court may make an order for the company to be wound up, if there is irreconcilable stalemate (Company Act) and the prospects of the firm continuing its operation are very low. Another reason is when creditors and shareholders believe that the firm is unable to pay its debts ("Ali Woolen Mills Ltd v IDBP," 1989) and that if the case is delayed any longer, their security and further funds will be jeopardised.

However, most of the time, both parties are hesitant to seek this remedy since the repercussions are severe for both parties, and neither is prepared to shut down their business if the aggrieved party seeks justice. As a result, an unfair prejudice remedy is offered as an alternative to closing a firm.

In addition to the winding-up procedure, the Companies Act of 2017 provides an alternative remedy in cases of oppression and mismanagement (Re Yenidje Tobacco Co Ltd). The oppressive remedy focuses especially on minority shareholder protection, as majority shareholders always have the benefit of protecting their interests through voting rights. The Companies Act of 2017 requires courts to investigate all alternatives before closing down a business. In the case of "Integrated Technologies and Systems ltd v Interconnect Pakistan (pvt) limited, the court stated that where making a winding-up order is likely to prejudice the respondent shareholders or creditors, the applicant should be instructed to apply for oppressive remedy provided under section 290 of Company Ordinance 1984, which is a remedy particularly intended to protect minority shareholders as majority shareholders do not need it as they have enough voting power to protect their interests".

Due to the requirement of holding 10 voting shares in the corporation, this remedy is unavailable in some circumstances when minority shareholders have fewer than 10% voting shares. Confusion about the application of these cures eventually leads to problems obtaining both remedies. In the ABIL v EBM case, for example, the court concluded that an unfair prejudice remedy might be sought on the following grounds:

- Where executive conduct is damaging members' rights;
- When there are situations that give rise to the need for a winding-up order.("Re London and County Coal Co," 1867)

It is evident that seeking redress for oppression and mismanagement may involve grounds similar to those for corporate dissolution. Consequently, if one remedy fails, pursuing the alternative remedy could result in a dismissed petition for the other remedy as well. In addition to these two statutory remedies, aggrieved shareholders have the possibility of seeking recourse under ordinary civil law, although it is deemed inadequate for various reasons. First, rather than a particular corporate remedy, the remedy is merely in terms of damages(Company Act, 2017) Second, civil courts are known for delaying the issuance of judgments, which further delays the decision if the opposing party files an appeal. Furthermore, seeking interim and permanent injunctive relief compounds the issue (Company Act, 2017). These outmoded remedies necessitate substantial modifications to current laws in order to safeguard shareholders and attract investors from all around the world ("Integrated technologies and Systems ltd v Interconnect Pakistan (pvt) Limited," 2001).

5. Shareholder Protection in United Kingdom

Corporate governance system of UK is considered as an effective model that has not only improved the corporate environment in UK regarding shareholders but has also impacted many other jurisdictions in Asia & Europe. UK is also a common law country, therefore, Pakistan being a remnant of British colony can draw its lessons for better protection of minority shareholders.

In UK, the company's day-to-day operations are handled by its directors (according to legal requirements & company’s article of association). Nonetheless, certain actions may require shareholder approval, by a majority of 75% or simple majority, to be enacted. Minority shareholders' interests and rights may therefore be infringed by majority shareholders through decisions made during general meeting or by company’s Board of Directors. Meaning thereby, major stakeholders’ have the ability to pick management they want to work with and govern the company's business activities as they see fit ("ABIL v EBM ", 2003).

In the United Kingdom, the following measures are in place to safeguard minority shareholders’ interests. First, if a minority shareholder's personal rights are being abused, he might file a "direct action." Secondly, there is unfair prejudice petition which is intended to assist minority shareholders in dealing with difficulties that arise when their rights as shareholders are jeopardised. The court may order the petitioner shareholder's removal in exchange for the purchase of his shares at fair value (Khan, 2014). Any shareholder may file an unfair prejudice action for an order on the grounds that the company's affairs are being or have been conducted in a way that is detrimental to shareholder interests in general or certain of its shareholders in particular. The third method is the derivative action, which allows minority shareholders to file petition in a court for sanction to pursue a derivative action on behalf of a company when company suffers damage by management (Shah, Khan, & Farid, 2014).

The UK Government's goal in enacting a statutory derivative action under the UK Companies Act 2006 was to safeguard shareholders who desire to make legal claims while avoiding needless litigation. As per section 260 of Companies Act 2006, any member of the company may commence an action involving a cause of action vested in the company, when the member's goal is to seek remedy on behalf of and for the benefit of the company. The new legislative provision broadens the grounds for bringing derivative proceedings (Ali, 2019). As stated in section 260(3) of the Companies Act, the cause of action may be brought against the director, another person, or both of them. The circumstances of the action may have resulted from an actual or proposed conduct or omission by a former or real director or a shadow director of the firm, such as carelessness, negligence, breach of duty or trust (Kim, Kitsabunnarat-Chatjuthamard, & Nofsinger, 2007).

An applicant must show that he has a well-established case in order to pursue a derivative claim, and the proof must be acceptable to the court. As a result, if the court holds that the application and evidence presented by the applicant are insufficient to establish a prima facie case to enable the derivative litigation to proceed, the application must be denied.(2006). Despite the new derivative action's strategy being characterized by greater flexibility and fewer restrictions, it still poses certain challenges for minority shareholders regarding their access to relief. While it may be deemed acceptable for company law to grant courts discretion in deciding whether to allow a derivative claim to protect the company's operations, this very discretion can also lead to unexpected and uncertain outcomes, thereby creating a sense of unpredictability within the rule. Moreover, it is critical for minority shareholders and practitioners to understand the distinctions between unjust prejudice remedy & derivative action. At initial glance, there seems to be little discernible difference between these two remedies. However, as highlighted by Hannigan, there is an overlap between them, and if the legal system fails to address the disparities, the ongoing similarity between the two remedies will remain problematic (UK Companies Act, 2006). Since in first case, the shareholders are directly affected by the actions of directors or majority shareholders while in later the company is directly affected by the actions of persons in control & the minority shareholders are being affected indirectly.

In summary, while there are alternative methods to protect minority shareholders, the new derivative action, despite its inherent flaws, stands as a powerful tool for safeguarding minority rights, especially in cases of corporate misconduct. The above discussion serves as a foundation for providing some reform recommendations for enhanced corporate governance through efficient derivative actions. The entire debate demonstrates that minority shareholders in Pakistan are put in a vulnerable position where their rights can easily be infringed by directors or dominant management. As a result, various modifications are proposed in light of the UK Companies Act 2006, which might aid in the protection of minority shareholders' interests.

Firstly, the rules of common law are difficult and vague (Joffe, QC, Drake, Richardson, & Lightman, 2011). Because these circumstances are damaging to shareholders' interests, the creation of statutory derivative action is appropriate. To bring a derivative action to court, shareholders must obtain permission from the court in a two-stage process outlined by the UK Companies Act 2006 (Part II). In the first stage, the court assesses whether there is a prima facie case and considers factors such as the best interests of the company and whether the act or omission has been ratified or authorized. If permission is granted, the shareholder can proceed in the same way as the court action would have done if the company had decided to raise the proceedings itself (Companies Act, 2006).

Secondly, Locus standi should be extended, similar to the UK Companies Act 2006, which provides that "each individual shareholder, regardless of voting power, has *locus standi* to begin suit against directors or majority shareholders who do wrong." Shareholders who acquire shares by operation of law may also bring a derivative lawsuit. The phrase "by the operation of law" refers to transfer of a party's right or obligation as a result of operation of legal principles without the party's purpose. No minimum share is required to start a derivative claim, according to the Act. In other words, any shareholder, having even one share in his name, may bring a derivative lawsuit (" Abouraya v Sigmund," 2014).

Thirdly, the causes of action for derivative claims should be broadened. The current corporate legislation exclusively holds directors liable. It is not possible to take legal action against a corporation for acts that are dependent on the directors' decisions. To illustrate, current legislation does not regulate majority shareholders, therefore absolving them of their fiduciary duties. The same is true for NEDs, as common law only permits for actions to be brought against people in charge of the corporation. This threshold permits NEDs to make mistakes. However, the UK has broadened its cause of action, enabling shareholders to sue both incorrect non-executive directors and majority shareholders (Hannigan, 2009).

Fourthly, judicial supervision of derivative actions is viable option instead of Board supervision because the later often becomes ineffective due to lack of independence and good faith. Pakistani courts might use the same strategy as UK courts since courts are independent of insider influence and can easily establish prima facie case before proceeding with full hearing of the case. To make derivative action a better choice for safeguarding shareholders' and companies' interests, courts should examine criteria such as "promotion of derivative claim, prohibition of baseless actions, and preference for supreme interests of companies in conducting derivative proceedings evaluation."

Lastly, to incentivize shareholder participation in derivative actions, it is advisable to allocate a fair percentage of the resulting benefits to shareholders. This approach is observed in New Zealand, where courts have the discretion to order a specific portion of derivative action proceeds to be distributed to shareholders, considering the unique circumstances of each case instead of allocating the entire amount to shareholders (Reisberg, 2005).

6. Practical Implications

Derivative Action is often seen as an effective means of providing relief to aggrieved shareholders, regardless of their shareholding. However, this remedy is not without its drawbacks, as demonstrated in the case of Anwar Baig, Chairman Conservancy Management Committee (CMC) & others versus the Government of Pakistan through its Secretary Ministry of Climate Change & others.(2023) In this case, the court discussed the scope of Section 286 of the Companies Act 2017 and deliberated on the rationale behind imposing a threshold test for shareholders to bring their action before the court. Previously, Section 290 of the Companies Ordinance offered a remedy to minority shareholders holding at least twenty percent of the issued share capital, allowing them to petition for the prevention of oppression and mismanagement in a company. With the enactment of the Companies Act, Section 286 retained the rights of minority shareholders but reduced the threshold test to ten percent of the issued capital. The intention behind this change was to strike a balance, ensuring that not every individual member's grievance is brought before the court, while still providing a recourse for significant minorities affected by oppression or mismanagement.

The rationale for establishing a threshold to determine the locus standi of minority shareholders in petitioning the court for relief lies in the existence of an internal mechanism within the Companies Act and the constituent documents of the company. This mechanism involves the distribution of powers between management and shareholders, providing an avenue for resolving grievances internally. However, if a substantial minority, holding at least ten percent of the total shareholding, believes that their interests are being undermined by the board's actions, Section 286 of the Companies Act allows them to seek redress before a court.

While the requirement to obtain court permission for derivative action, whether under the Companies Act or common law jurisdiction, serves as a necessary procedural filter to protect against spurious claims, the judicial conditions in Pakistan may present challenges in pursuing such actions. Nevertheless, the threshold test and permission requirement aim to strike a balance between protecting shareholders' rights and preventing the court from being inundated with baseless claims.

7. Conclusion

This article began by addressing contemporary corporate practices in Pakistan, demonstrating how minority shareholders are placed in a vulnerable position at mercy of controlling directors and majority shareholders. There was also discussion of limited enforcement methods and inadequate remedies. It was alleged that majority shareholders do not typically respect minority shareholders' rights and prioritise their own while exerting control over the company's activities. Minority shareholders should not be subject to unrestricted exploitation by majority owners within the company. When minority shareholders have an issue with the company, they should file a lawsuit and seek a solution. Given the nature of the ownership structure and the inefficiency of the judiciary in Pakistan, derivative actions have the potential to be significant. Because the ownership model in Pakistan is highly potent, with families, organisations, and states dominating, such families, groups, and states nominate individuals of their trust to the board, and therefore dominate the board. They also hold enough voting shares to control even publicly traded firms. As a result, minority shareholders have less voting power to settle disputes. Derivative litigation can be useful in decreasing agency expenses and deterring managerial/directorial misbehaviour. As a result, a successful derivative lawsuit lays culpability on irresponsible directors, resulting in reputational harm and other financial losses. By implementing derivative action, it acts as a deterrent not only for preventing future misconduct by company management on whose behalf shareholders have acted but also as deterrence for potential wrongdoing by directors of other companies.

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