



## THE NON-VOTING PREFERENCE SHARES A DIFFERENT CLASS OF SHARES

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**Abstract** *The purpose of this paper is to provide an insight into the legal regime of non-voting preference shares; a different type of financial instrument than traditional securities such as common (ordinary) shares, or bonds.*

### Keywords

Joint-stock company, preference shares, common shares, bonds, movable values, capital structure

### 1. Overview of the issues

According to Law no.31/1990 on companies (as changed and amended) the joint stock companies may issue dual-class shares: common shares and non-voting preference shares, each class granting different rights to their owners.

Dual-class company operates a separation between ownership and control and, thus, face higher costs of equity capital and management. Thus, this kind of company may be able to significantly reduce their cost of capital through unification of dual-class shares into single-class voting shares, because of increases in firm value or shareholder-value.

On the other hand, the Law no.297/2004 regarding the capital market defines the shares as movable values without mentioning their class (first type of financial instruments in the order of the enumeration stipulated by Art.2, para.1, first point, letter a).

As it highlighted in the literature, the origin of preference shares, as financial instruments, has to be found in the common-law systems.(Țicleanu, 2000) In the Anglo-American legal practice, this class of shares represents a category of the securities with fixed income, from their owners' point of view.(Ștefanescu, Ene,Lupulescu, Vartolomei, 2003)

Thus, the non-voting preference shareholders have the right to receive dividends with fixed rate which is applied from the moment these shares are issued but only if the issue document or the public offer brochure stipulates this. (Fătu, 1998)

On the developed capital markets, there are different types of preference shares established by diverse clauses such as the accumulation clause, the participation clause, the conversion clause, the repurchase clause (Țicleanu, 2000).

The Romanian doctrine also showed the preference shares represent an intermediary stage between the common shares -based on the shareholders have the control over the company with their vote; and bonds – when the stock company has to give back their equivalent value on the due date. The company resorts to preference shares mainly for specialised needs such as acquisition and re-organisation.(Cristea, Ene, Voica, s.a. 2009)

### 2. Legal regime of non-voting preference shares

Until now, Romanian legislator has regulated only one category of non-voting preference shares, the ones with prior dividend. A preferred regime governed not only a prior dividend received before the common shareholders, but also the shares granted to their owners multiple voting rights (Fătu, 1998).

It is impossible that a joint stock company does not issue common shares, but it is easily imagine a joint stock company that does not issue preference shares or did not convert this type of shares already into common stocks. Thus, the preference shares are optional for the joint-stock company while the common shares are mandatory (Stoica and Ene, 2016).

Based on the provisions of Law no.31/1990, the non-voting preference shares grant to the owners two sets of rights: to collect prior dividends drawn over the sharing benefit of the financial exercise before the common shareholders, and the corporate rights, including the right to participate in general meetings except the right to vote. Thus, when it comes to preference shares, they are excepted from the rule established by Art.94, para.1 of the Law no.31/1990 – according to which the shares grant to their owners equal rights (Ene, 2010).

Being the registered shares, the administrators, the managers and the members of management and of supervision board, as well as the company's auditors cannot hold non-voting preference shares having prior dividends.

Art.95, para.2 provides the joint-stock company may issue non-voting preference shares in the amount of maximum a quarter of their social capital; each such share shall have the same nominal value as each common share. Therefore, although the owners of the preference shares paid the same amount of money for each of them as the common shareholders, they have no right to vote in the general meetings of shareholders. But, Art.96 of the Law no.31/1990 stipulates that the titleholders of each category of shares shall meet in special meetings, under the conditions set by the company's articles of association. Any titleholder of such shares may attend these special meetings.

### 3. The shortcomings of the non-voting preference shares

The main right recognized to the owners of preference shares is the priority in receiving dividends thus they will be paid for before any other drawing. Obviously, in the case that there are no sharing benefits of the joint-stock company, the preference shares do not have any interest.

Also, it is possible for the joint-stock company, although it has allotted benefits, to delay the payment of dividends; in this case the shareholders with preference shares would be at a disadvantage in relation to the common shareholders (Ene, 2016).

When the dividend payment is delayed, Art.95, para.4 becomes applicable, so the preference shares shall be vested with voting rights starting from the maturity of the obligation to pay the dividends that are to be allotted the following year or, if during the following year the general meeting decides that dividends will be not to be allotted starting from the publication date of the decision in question of the general meeting until the actual payment of the outstanding dividends.

Therefore, the shareholders have the option to give up the preferred regime of the shares, based on the provisions of Art.95 para.5 of Law no.31/1990. According to this article the preferences shares and the common shares can be converted from one category to another based on the decision of the extraordinary general meeting of the shareholders under the conditions of Art.115.

The main difficulty faced by the Romanian joint-stock companies that would like to issue preference shares is of accounting and not judicial nature.

Thus, "preferred is often categorized with corporate securities as a fixed income security, even though the legal status is not the same. As mentioned above,

preferred stock is more similar to securities than common stock, even though preferred stock appears in the ownership section of the firm's balance sheet" (Clarkson *et al.*, 1989).

The above quotation emphasized that the shares are included in the company's balance sheet, to the owners' section. The difference is one of the form and content of the text in comparison to the accounting system in Romania. As far as the form is concerned, the accounting balance sheet is different in the United Kingdom and United States where it is an expression of the single-entry accountancy (which reflects the goods of the firm), while Romania applies the French system, providing double-entry accountancy (which reflects the goods and the acquisition sources). (Țicleanu, 2000)

In this case, if a joint-stock company issued preference shares is a mark of financial prosperity and good faith of the company's management. Furthermore, the shareholder with preference shares grants confidence to the concerned company, which lead to the increasing celerity of the trade operations.

### 4. Conclusions

In essence, the preferred stock is a notion *sui generis* for our law with various valences and meanings.

Mainly, the preference shares grant to their holders rights that are different from the ones of the holders of common stockholders (Carpenaru, 2007).

Provisions regarding the non-voting preference shares of the Law no.31/1990 on companies present several benefits and can represent a premise for the next legislative developments, i.e. the diversification of the types of securities when our market needs it.

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