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“A study on the Rights of the Minority Shareholders and the challenges faced by them in relation to the Companies Act, 2013.”

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Abstract: Minority shareholders are the firm's equity holders who do not enjoy voting powers within the firm on account of having less than 50% ownership of the firm's equity capital. The Companies Act, 1956 contained few provisions for the protection of minority shareholders against the majority shareholders. It was the legislator's first step in recognizing the rights of minority shareholders in India but in the Companies Act 1956, the minority shareholders were not considered an integral part of the Company due to the suppression of minority interests. However, the Companies Act of 2013 has taken several necessary steps to safeguard shareholders' interest in the minority rights in the Company. This paper will be assessing the rights which are available for the minority shareholders under the Companies Act, 2013. The researcher will also throw light on the challenges that are faced by the minority shareholders while exercising their rights available under the Companies Act, 2013 and will give suggestions on how the challenges can be tackled in a better way for the best future of the minority shareholders in the Company.

Introduction

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Though the expression 'Minority Shareholder' has not been defined under any law, however, when reference is made to Section 395 and Section 399 of the Companies Act, 1956, we can understand that minority shareholders have been set forth as 10% of shares or minimum hundred shareholders, in case of companies having share capital and in companies without share capital one-fifth of the total number of its members.

In simple words, minority shareholders are the firm's equity holders who do not enjoy voting powers within the firm on account of having less than 50% ownership of the firm's equity capital.

A company is an institution run by the democratic process, and most of its operation is carried out by the resolution passed by the majority shareholders. Hence, it becomes essential to

maintain a balance between effective control of the company and the interest of the minority shareholders to upkeep the concept of shareholders democracy in the company.¹ It has rightly been stated by Palmer that a proper balance of rights of both majority and minority shareholders is imperative for the smooth operation of the company.²

The decision-making process is a fundamental part of the functioning of the corporate bodies; the said procedure is exasperated in case of a conflict of belief between the minority and majority shareholders when the majority shareholders take such decisions that are not for the benefit of the company but their personal interests prejudicing the rights of minority shareholders.³The Majority Rule found its firm roots in the landmark common law judgment *Foss v. Harbottle*⁴, where the court held that the "There will be no intervention by the Courts regarding the internal working of a company at the request of a shareholder and there will be no interference with the company's management which is done by the directors as far as they are operating within the powers which are conferred on them under the Company's Articles of Association. Nothing concerning an internal dispute between shareholders is to be made the subject of an action by a shareholder."⁵ The same principle was applied in several Indian judgments like *Rajahmundry Electric Supply Corporation v. A. Nageswara Rao*⁶ and *Bagri Cereals v. Hanuman Prasad Bagri*⁷, reaffirming the principle that if a simple majority can ratify a wrong, the court will not intervene. In a corporate world, all democratic decisions and management of a company are made with the majority rule, which is deemed fair and justified. The majority rule of decision making, quite often than not, overlooks the views of minority shareholders. A minority shareholder is a person who does not hold much power in the management of the company, and the interests are disregarded. A majority shareholder is one who owns 50% or more of the shares in a company.

¹"Minority Interests" available at <http://www.mca.gov.in/Ministry/chapter6.html>

²N. A Bastin, "Minority Protection in Company Law" (1968) JBL 320

³Rebecca Furtado, "*Protection Of Minority Shareholders Under The Companies Act*", 2013, Ipleaders, (August 12, 2016) <https://blog.ipleaders.in/protection-minority-shareholders-companies-act-2013/>

⁴ *Foss v. Harbottle* 67 ER 189 (1843)

⁵ *Mac Dougall v. Gardiner*, 1 Ch. D 13 (1875)

⁶ *Rajahmundry Electric Supply Corporation v. A. Nageswara Rao* 1955 SCR (2)1066 (India)

⁷ *Hanuman Prasad Bagri* 2001 105 CompCas 465 Cal (India)

But some companies are controlled by shareholders who own only 40 percent, 30 percent, or 20 percent or less of the shares and who exert full control over the company because the remaining shares are being scattered. The definition of majority shareholders will be the shareholders who exercise control over the board of directors and the functioning of the company. Despite the provisions placed under the Companies Act 1956 to protect the interest of the minority shareholders, the minority shareholders were not able to exercise their rights properly due to a lack of time and resources to fight big corporate giants.

The Companies Act, 2013 fixes the crack above towards protecting the interest of the minority shareholders. Various rights are provided by the Companies Act, 2013 to such shareholders for protecting their interest in their companies and addressing abuse issues done by the majority shareholders or persons who have the control of the company. The Act also consists of provisions concerning various benefits for the minority shareholders who were not listed in the Companies Act, 1956.

Rights of a Minority Shareholders

Following are some of the rights which are available for the minority shareholders under the Companies Act, 2013:



1. Right to appoint one director by Small Shareholder

According to Section 151 of the Companies Act, 2013, the small shareholders, also known as minority shareholders, are provided with the right to nominate an individual as a small director on the Board of Directors in their Company, which is listed. When a shareholder holds shares in a company, the face value of which is not more than 20,000 rupees is known as a small shareholder. For such a proposal, at least 10% of the Company's total number of small shareholders, or 1,000 of such small shareholders, should approach jointly and set forth a notice to the Company, including their signatures.⁸ If appointed, the individual will be classified as an independent director and serve for three years. Once the director's term is over, neither can he be

⁸ Rule 7 of the Companies(Appointment of and Qualification of Directors) Rules, 2014

reappointed for a further period nor can he be associated with the Company for three years after the term is over.

2. Right to apply to NCLT in case of Oppression and Mismanagement

Minority shareholders have been vested with the right to approach the NCLT to report any acts that have led to oppression and mismanagement done by the promoters, management, or board of the Company.⁹

Here, the term 'oppression' would mean unjustly exercising power or authority.

Some of the examples of oppression can be:

- No calling of general meeting,
- Preventing the members from enjoying their right to the dividend of the Company.

'Mismanagement' comes into existence when the affairs of the Company are regulated in a discriminatory way where the interests of the public or minority shareholders of the Company are threatened.

Some of the examples regarding mismanagement taking place in a company are as follows:

- When personal profit is made through the business of the Company.
- When the Directors continue to receive their salaries even when the Company is not in a good position and is suffering losses in a continuous manner.
- When the management control is misused.
- Violation of any of the laws of the Company.

⁹Section 241 of Companies Act, No 18 of 2013

If it is observed by the NCLT that the Company's affairs are being regulated in a biased way or which is oppressive concerning the Company's interests; and winding up the Company would be unjust for the member(s); it may pass an order which includes the following¹⁰:

- Regulation regarding the conduct of the Company's affairs in the future,
- The interests or shares of any member of the Company to be bought by other members,
- Restriction on the allotment or transfer of the shares of the Company,
- Removal of the managing directors, manager, or any of the Company's directors, etc.

3. Right for Reconstruction and Amalgamation of Companies:

The interests of minority shareholders are mostly suppressed in amalgamations, mergers, and reconstruction(s). For addressing these, protection is offered through two sections, i.e., section 235 and section 236 of the Companies Act, 2013, to the minority shareholders. They are as follows:

- Section 236 (1) and (2): On becoming the holder of 90% or more of issued equity share capital, the minority shareholder shall be offered by the acquirer to purchase at the determined value, the equity shares;
- Section 236 (3): An offer can be made by the minority shareholders to the majority shareholders to purchase their shares; and
- Section 236 (5): For the purpose of making payments to the minority shareholders, it will be acted by the transferor company as a transfer agent.

4. Right for filing a Class Action Suit

An opportunity for filing a class action suit is provided by the Companies Act, 2013, for the minority shareholders. A class-action is nothing but a lawsuit in which a group of people who have a common interest approaches the National Company Law Tribunal against the Company, its management, or Board. Both the shareholders, as well as creditors of the Company, can file the suit. This provision is different from the right provided under Section 241, as under section

¹⁰ Section 242 of Companies Act, No 18 of 2013

241, only the shareholders can come forward to the NCLT to complain against the oppression and mismanagement.¹¹

The relief which both the creditor and the shareholders may enjoy in class-action suits are:

- Prohibiting the Company from doing something which is not within the Company's power,
- Prohibiting the Company from breaching any of the provisions enumerated in the Articles of Association or the Memorandum of Association.
- Prohibiting the Company from doing something contrary to the provisions of any law,
- Prohibiting the Company from taking action contrary to any resolution passed by its shareholders, etc.

5. Consideration of a Valuation Mechanism which is fair:

For protecting the interests of the minority shareholders, it is imperative for the Company to adopt a valuation mechanism to evaluate the Company's share value. It is the audit committee who is responsible for appointing an independent valuer. The committee shall take necessary steps to ensure the shareholders' rights for approaching the National Company Law Tribunal whenever the process seems unfair. This type of system for evaluating the shares can also be applied even if the companies are not listed, and the base of Shareholders is 1000 or even more.



6. Voting through electronic means

It has been made obligatory for the listed companies to offer the electronic voting system to the shareholders to vote on shareholders' meetings.¹² This has led to the active participation of the

¹¹AbhishekDutta, "Are the Rights of the Minority Shareholders Protected?", Lawyered, (June 16, 2020), <https://www.lawyered.in/legal-disrupt/articles/are-rights-minority-shareholders-protected-abhishek-dutta/>

¹²AnubhavPandey, "Rights of minority shareholders under Companies Act, 2013", Ipleaders, (October 25, 2017), <https://blog.ipleaders.in/rights-minority-shareholders-companies-act-2013/>

minority shareholders in the company's matters even if they are not residing outside. Their voting rights could be exercised without being in the meeting itself in person.

7. Piggy Backing :

As per this provision, if the majority shareholders sell their part of shares, then the right of minority shareholders must be incorporated in the deal. Moreover, it is required by the "Piggy Backing," consideration of the business's purchase by the party for selling 100 percent of the outstanding shares.

Challenges faced by Minority Shareholders while protecting their rights.

While the objective of the provisions mentioned above is to protect the minority shareholder's interest, the efficient execution of these is still in question. Since the Company's management rests in the majority shareholders' grip, the minority stakeholders may not acquire enough proof, including accounts, information, or records for substantiating their claims regarding the wrongdoing.¹³ Though remedies are provided by the Companies Act (2013) yet it remains to be approved. Moreover, usually, the remedies based on litigation have mostly proven to be expensive and lengthy. The shareholder involved in filing the claim has to bear the expenses and gets only a commensurable indirect benefit on the claim's success.

When a minority share is acquired by private equity and venture capital investors, specific contractual rights are obtained from the promoters. The contractual rights are generally stated in the shareholders' agreement, most of the right to proportional board representation, veto rights on some issues, and information and inspection rights. Though these rights are essential to safeguard the minority investors' interests, the Company's management rests in the promoters' grip. In contrast, minority investors have limited opportunities for questioning the poor decision of the administration.

¹³AbhishekDutta, "Are the Rights of the Minority Shareholders Protected?", Lawyered, (June 16, 2020), <https://www.lawyered.in/legal-disrupt/articles/are-rights-minority-shareholders-protected-abhishek-dutta/>

The Board representation right is also effectively contradicted by the promoter's right for the majority directors' appointment. The veto rights can use the minority investors as a reactive right to block specific actions, without essentially consulting any corroborative right of handling the management. Moreover, the inspection rights and the information that the minority investors are granted under the Shareholders Agreement usually are confined to periodic filings, statutory records, books of accounts. It might not give access to the fundamental documentation to the investor, which may be essential for uncovering fraudulent conduct.

Exit rights are provided additionally by the Shareholders Agreement for minority investors. In a practical scenario, the Shareholder Agreement is not strictly followed, and exit rights available to minority investors mostly end up remaining on paper. An exit depends on the Company's willingness and monetary capability. Therefore, the sole remedy for the promoter's non-compliance with its obligations below the Shareholder Agreement is a boundless dispute resolution process. If the minority investors and the promoters are not on good terms, the investors may face difficulty getting an exit because of the promoter. If the performance of the Company is not up to the mark, it can become challenging to search for third-party purchasers.

In various cases, it is seen by the minority investor the deterioration of the worth of the Company as a silent observer. Shareholder democracy cannot only be considered with the majority rule. Further, there cannot be a complete disregard for the investments made by the minority shareholders. Judicial precedents indicate that the majority's absolute rule, as enunciated in *Foss v. Harbottle*, could not be enforced regularly in India. The breach of fiduciary duty by those shareholders who have control of the Company will enable the minority shareholders to obtain relief against those who have control. While the existing regulatory framework not in any way clearly states the fiduciary duties of those shareholders who have the control, judicial precedents have noted that the controlling shareholders should not be involved in making secret profits arising out of the Company, full disclosures should be made of all relevant facts, they must make use of their position in a fair way and rationally in the interest of the Company, and must not be involved in fraud and undue influence. SEBI, in a consultative paper that reviewed Corporate Governance Norms in India (2012) had recognized the fiduciary duty of the controlling shareholder to the minority shareholder and proposed that those shareholders who have the control of the company in a listed companies must be involved into a relationship agreements with the listed Company, and also the minority shareholders, and this will specify the responsibilities and duties of those who have the control. Various jurisdictions with sophisticated capital markets have long recognized the fiduciary duty of controlling shareholders to the minority shareholders.

The minority shareholders' rights can be protected only when the controlling shareholders realize that they have legal obligations to all shareholders and should engage with the minority

shareholders during the decision-making process.¹⁴ Controlling shareholders should also provide an adequate opportunity for minority shareholders to redress their grievances. The preservation of the company values is the board's righteous endeavor and not just catering to the controlling stakeholders' interests.

Conclusion

After critically assessing the provisions of the Companies Act, 2013, it can be ascertained that the legislation's core intention is to safeguard the interests of the minority shareholders. There is no doubt that significant efforts are made by the Companies Act, 2013, for protecting minority shareholders' interests. The company law of 1956 also contained provisions for the protection of minority shareholders against the majority shareholders. It was the legislator's first step in recognizing the rights of minority shareholders in India. In the Companies Act 1956, the minority shareholders were not considered an integral part of the Company due to the suppression of minority interests. However, the Companies Act of 2013 has taken several necessary steps to safeguard shareholders' interest in the minority rights in the Company, regardless of the oppression and mismanagement of the Company, which affects the rights of minority shareholders. It can also be said that the primary purpose of the legislation is to protect the interests of minority shareholders. Still, it requires a proper implementation of these provisions for protecting considering their rights. It can also be said that the minority shareholders back in the Companies Act, 1956 were not considered a significant part of the Company due to majority rules and regulations which were suppressing them in the Company.

However, Companies Act 2013 has taken various crucial steps to safeguard the interest of the minority rights of the Company's shareholders irrespective of the existence of oppression and mismanagement of the Company which affects the rights of the minority shareholders. Therefore, this dual approach towards the enforcement of the minority rights guarantees proper administration of the corporate activities successfully only when appropriately implemented by giving importance and rights to the minority shareholders in the Company's management.

¹⁴PuneetRathsharma and Kunal Mehta, "Challenges In Protecting The Rights Of Minority Shareholders", BW BUSINESSWORLD, (January 02, 2018), <http://www.businessworld.in/article/Challenges-In-Protecting-The-Rights-Of-Minority-Shareholders/02-01-2018-136149/>

However, awareness of the said Act is limited to specific areas. To avail the option of judicial redressal, it is essential to familiarise both majority and minority shareholders with provisions of the Companies Act, 2013.

In the Insolvency and Bankruptcy Code (IBC), there are not less than hundreds of companies that are listed. The current shareholders would get a deal which is raw due to the new promoter or a successful bidder who brings in equity which is fresh with majority power and this will lead to the existing shareholders becoming minority shareholders in these companies.

Hence, the minority rights guaranteeing appropriate organization of the corporate exercises will be actualized in an appropriate manner only when the rights of the minority stakeholders are upheld.

