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☞ INTRODUCTION

As the world focus shifts on the Indian market, there has been a flurry of activity to improve corporate governance in the last few years to provide comfort for foreign investors. Both the regulators as well as Indian companies are taking a greater interest in improving transparency in several aspects of management ranging from meeting practices, both at the board and shareholder levels, day-to-day operating activity as well as shareholder rights.

Five acts govern corporate activity in the country: the fundamental legislation, Companies Act, 1956 **("Act")** enshrines a three-tier administrative system on the national, state and regional level. This Act regulates the pre-incorporation, incorporation, day-to-day operations and duties of companies. It also deals with the rights and obligations of directors and shareholders. The Department of Company Affairs **("DCA")** administers this while the Company Law Board **("CLB")**, a quasi-judicial body, enforces it.

The other applicable laws are Securities and Exchange Board of India **("SEBI")** Act, 1992 applicable to listed companies; the Securities Contracts (Regulation) Act, 1956; the Depositories Act, 1996[1]; and the Sick Industrial Companies (Special Provisions) Act, 1985. The scope of this newsletter is specific and so the latter four legislations are not within its ambit. Rather, this newsletter aims to highlight the rights of minority shareholders and the various thresholds under the Act that need to be borne in mind during acquisitions or while structuring entry strategies into the explosive Indian market.

➢ The Problem

Corporate law is based on the premise that all shareholders are equal within each class. Indian companies can issue two types of shares[2]: preference and ordinary. Preference shares give the holder the preferential right to dividend and repayment of capital in case of liquidation of the company. An ordinary equity shareholder runs the risk of variable dividends while it confers on its holder a right to vote on all resolutions that require shareholders approval under the Act. Preference shares carry limited voting rights.

The major obstacle to minority shareholder rights is consolidated ownership as large controlling shareholders present a problem. Family-owned companies are still quite prevalent in India, with family members and close acquaintances controlling not only large parts of the shares, but much of the board as well. Consequently, despite the protection offered in law, the family owned/controlled shareholders have an ability to oust the minority. This happened frequently a few years ago when listed companies started to de-list securities and then attempted to reduce their capital. Once the number of shareholders falls below 50, a public company can convert to a private limited company. In functional terms, this means fewer checks and balances for private companies, more freedom to run the business and less stringent reporting norms to comply with.

[1] The paper based ownership and transfer of securities has been a major drawback of the Indian securities markets since it often resulted in delay in settlement and transfer of securities and also led to "bad delivery", theft, forgery etc. This 1996 Act was, therefore, enacted to pave the way for smooth and free transfer of securities.

[2] Section 85 of the Act.

➢ Shareholders Thresholds

Matters of importance in corporate functioning and governance require shareholder approval. Under section 189 of the Act, there are two classes of resolutions: ordinary and special. An ordinary resolution is passed by simple majority of more than 50 percent of the shareholders present and voting whereas special resolutions require 75 percent of those present and voting. The basic objective of special resolutions is to secure that every important change is made after due deliberation, and with the sanction, active or passive, express or tacit, of the greater body of the shareholders of the company.

Therefore, in other words, there are certain thresholds that a foreign investor needs to consider while structuring investments in India because they either result in certain minority rights or the ability to block certain actions. It is these specific shareholder thresholds that are critical in analyzing the sectoral caps that the regulators have imposed in accordance with the prevailing foreign investment policy, for foreign investment in different industries. The following are generally applicable in the context of both public and private companies:

1. Ten percent: the approval of at least 10% of the shareholders is required for the requisition of an extraordinary general meeting or for an application to the CLB for relief, if there is oppression or mismanagement by the majority shareholders.

2. Fifty-one percent: the approval of at least 50% of the shareholders is required for an ordinary resolution including for:

- Alteration of the share capital
- Declaration of dividend
- Election, removal and remuneration of directors
- Approval of annual accounts
- Appointment of external auditors
- Appointment other officers
- Routine matters relating to the conduct of a company

3. Seventy-five percent: the approval of at least 75% of the shareholders is required for a special resolution including for:

- Capital increases
- Alteration in the Memorandum and Articles of the company
- Changing the registered office address of the company from one state to another
- Change in the name of the company
- Buy-back of shares
- Proposed mergers
- Liquidation

Therefore, a minority shareholder with more than 25% voting rights would have the ability to block special resolutions.

➢ Treatment of minority shareholders and their rights

As is apparent, minority shareholders are guaranteed certain rights under Indian law. Minority shareholders with qualified minority may initiate action against decisions of the majority in a court of law. A qualified minority consists of at least one hundred shareholders or one-tenth of the total number of shareholders, whichever is less, or any shareholder(s) holding one-tenth of the issued share capital of the company fully paid up.[3]

Some methods by which the minority shareholders participate in the company and enforce their rights are described below:

Participation and voting in company meetings: Indian shareholders with the qualified minority may call a shareholders meeting[4] with a prior notice period of 21 days. Once the shareholder request is supported by reason and signature it is incumbent upon the board to announce and hold such a meeting within 45 days of the requisition[5]. The prior notice must contain the agenda with supporting documents including, drafts of resolutions to be discussed in the meeting, and a proxy form. Shareholders are entitled to appoint another person as his/her proxy, irrespective of whether the proxy is a shareholder or not. The proxy has to be in writing, signed by the appointing shareholder, and registered with the company at least

[3] Section 399 of the Act.
[4] This could be either an annual general meeting which takes place annually or an extraordinary general meeting of the shareholders.
[5] Section 169(4) of the Act.

48 hours before the meeting. A proxy has the right to attend and vote, but not speak at the meeting.

Voting is by show of hands[6]. If any shareholder disputes the outcome and has the ability to establish that he/she represents ten percent of the voting rights or INR 50,000 (US$1,100 approximately) of the paid-up capital[7], such shareholder has the right to demand a poll. In this case, it is incumbent upon the chairman of the meeting to arrange for a poll and the show of hands is effectively overturned by the proxy votes.

Oppression and mismanagement: Sections 397 to 409 of the Act deal with '*Prevention of Oppression and Mismanagement*'. Parties can seek recourse to legal remedies. Minority shareholders can sue the controlling shareholders for oppression and mismanagement[8]. They can apply to CLB for redress against oppression by management, provided that for a company with a share capital, the plaintiffs comprise at least 100 shareholders accounting for ten percent of voting rights. If CLB establishes that oppression of the minority by the majority has taken place, it can, under Section 402 of the Act, intervene in the regulation of the affairs of the company as it deems fit and may bar such decisions from being implemented or may grant monetary compensation to the minority shareholders. Possible remedies, for example, can be:

- the CLB can instruct management to buy out the dissenting shareholders at a fair price;
- terminate or amend agreements executed by the company;
- set aside any transactions; or
- remove or appoint directors.

The aggrieved shareholder can appeal CLB's decision and move the High Court and, thereafter, the Supreme Court.

Rights of minority shareholders in listed companies: This would be a subject matter of a separate article. For the current purpose, suffice to say that any equity investor in a listed company can apply directly to SEBI for redress against violation of shareholders rights. They are encouraged to approach the company or the registrar first and when no action is taken despite two reminders over a period of one month, they can approach SEBI who has the power to give rulings. Under its "omnibus powers", SEBI can take action[9] against anybody involved in the capital markets, if that person or entity does not act in the best interest of investors or markets including conducting investigations and imposing fines. However, SEBI does not have judicial powers of a court and the Ministry of Finance can overturn its rulings.

☞ CONCLUSION

It becomes critical when either negotiating affirmative shareholders rights in a shareholders agreement or in investing in industries with sectoral caps, to evaluate the implications of shareholder threshold limits. In most joint-ventures special provisions are inserted in the Articles of Association to provide protection to minorities. These provisions, enshrined in a Shareholders Agreement, often give the minority shareholders the right to have a certain number of directors appointed to the Board and provide veto rights to shareholders and directors in key areas where the minority protection provisions and the matters requiring a special resolution under the Act are inadequate.

The allocation of the decision-making power is of most concern to the foreign investor, especially if his interest in the company is 50%. Even if the foreign investor has an interest of 51%, the Indian partner will probably wish to have a say in the decision making for the balance 49%. A shareholder having more than 25% of the share capital has the power to block special resolutions, while a shareholder holding 10% shares can successfully obtain injunctive relief where family-controlled majority endeavors to throw them out. Though it is debatable if the matters which require special resolutions are sufficient to allow the minority to have the requisite say in certain operational matters, such

[6] Section 177 of the Act.
[7] Section 179 of the Act.
[8] These remedies are available at the level of CLB, the high court of the state where the company is registered, and the Indian Supreme Court.

[9] SEBI's actions are frequently for the benefit of shareholders and delays in making timely announcement of results or share transfers have been punished by suspension of trading.

as finance, sales policy, quality control etc., yet, the ability of the minority to enforce their rights cannot be excluded and should be an area of paramount concern to which adequate attention be given when (a) structuring joint ventures where the foreign investor has control; (b) planning entry strategies with possible partners; (c) making global acquisitions which have the effect of inheriting Indian companies; or (d) de-listing.

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