RIGHTS OF MINORITY SHAREHOLDERS

UNDER

COMPANIES ACT 2013

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Contents:

- *CONCEPT*
- *PROVISIONS UNDER COMPANIES ACT 2013 HIGHLIGHTING RIGHTS OF MINORITY SHAREHOLDERS*
- *ANALYSIS IN THE LIGHT OF FOSS V. HARBOTTLE*
    - **Ultra vires and illegal acts**
    - **Acts which entail a special resolution**
    - **Shareholder's personal right**
    - **Absence of action against the wrongdoer**
    - **Oppression**
- **CONCLUSION**

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CONCEPT

"Of all tyrannies a country can suffer the worst is the tyranny of majority"

Internal management or decision making is an intrinsic and essential aspect of the corporate set up. In the decades that followed, when individuals initiated as entrepreneurs, the working style was unalike as compared to the present. Taking unanimous decisions was the idiosyncrasy of the past but over the course of time with the proliferation of the businesses, resorting to the practice of collective decision making became a tough row to hoe. Obtaining the consent of every single member seemed to be an uphill task. To overcome this situation, obtaining the consent of majority came out as a viable alternative. The way in which the management of the company is effectuated is by means of voting which creates two categories of shareholders namely majority and minority. It is the disagreement in the opinions among the shareholders that leads to such a division. Some matters demand ordinary majority whereas some crucial matters demand special majority.

It is an established principle of the universe that the law of majority prevails and corporate world is no exception. This principle of the majority rule stands applicable to the administration and management of the affairs of the corporate entity. It is a common notion that the resolutions supported and passed by majority enjoy supreme authority and bind the minority shareholders. Thus, the power of majority plays a vital role and exercises dominance.

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When individuals voluntarily dedicate themselves to become members, there exists an implied consent on their behalf to concede to the will enjoyed by the majority and the tribunal also desists intrusion in the administration for the above reason. However, by going with the notion that power corrupts, there is a huge likelihood on part of the controlling shareholders that they are tyrannical towards the minority shareholders. They often engage in many unethical acts such as digression of funds or the majority decides that they want to initiate a new enterprise and many other activities with the intention to keep out the minority shareholders from receiving any benefit that they deserve to receive.

Only for the reason that the shareholders are in minority does not justify that they could be oppressed. They also possess certain rights that needs to be safeguarded and the majority cannot be permitted to misuse and abuse their powers while showcasing their strength to the detriment of the minority putting them in a disadvantageous position. There should be certain reasonable boundaries within which the majority power should be exercised and due care must be taken that the arbitrary utilization of power by them does not accord unfair treatment to the minority. Thus, the goal that the corporate world needs to focus is on attaining an equilibrium between the majority rule and safeguarding the rights of minority shareholders. Shareholders owe a special legal relationship to one another taking into account the interests of the company. To ease this herculean task, certain provisions are laid down in Companies act, 2013.

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PROVISIONS UNDER COMPANIES ACT 2013 HIGHLIGHTING RIGHTS OF MINORITY SHAREHOLDERS

The provisions beginning from section 241 to 247 is dedicated to the matter of oppression or mismanagement. Lack of a definition of any of these terms precipitates a vital question as to what constitutes oppression. The expression requires a liberal interpretation and in the backdrop of company law it could mean denying justness and fairness to the shareholders. The interpretation of this term by the Supreme Court is manifold. For instance, in *Shanti Jain*[i] it was laid down that the minimum parameter required to be fulfilled is discernible exit of the element of 'fairness' that forms the basis of trust for every shareholder.

Noteworthy improvements have been made as regards this subject because the only resort available against oppression was winding up order before the law of 2013 came into force. Also, there are no distinct provisions for oppression and mismanagement and it has been consolidated into a singular provision i.e. section 241 under which an opportunity is provided to the shareholder to make an application alleging either of them to the National Company Law tribunal under this same provision. A careful reading of section 241 provides making of an application where the complainant or complainants allege harm either to the entity or interest of the public.

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Contemporarily, the threshold laid down to determine minority shareholders is 10% or 100 members in the event of company consisting of share capital or 1/5th of the total members in the absence of share capital. However, a sigh of relief is provided under section 244 proviso which empowers the tribunal to waive this above-mentioned quantitative requirement as per its will which under the old law was granted to the Central Government. This shows that the tribunal can even entertain the application of a single shareholder which acts as a huge advantage to the minority shareholders. Empowering the tribunal can be perceived as a good change in the light of effectiveness and a speedy relief.

In addition to the above, the waiving off discretion which was subject to the establishment of 'just and equitable' circumstances under the 1956 Act has been relaxed under the current law according more flexibility to the tribunal and changing the game for minority shareholders. The powers of the tribunal under section 242 have been expanded as compared to the 1956 act. Even if the majority pass a resolution complying with all the relevant provisions of the Act failing to act ultra vires, section 241 can still be invoked.

A fresh provision by a vehicle of section 245 regarding class-action is provided which allows the minority shareholders to institute a class action against the company and auditors strengthening their position. Class action is nothing but a claim made by individuals collectively sharing common concerns against another bigger cluster of people.

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Section 235 and 236 of the contemporary law also concerns minority shareholders within which additional safeguards with respect to them are visible and minority squeeze-out is reflected. This can be better understood through a hypothetical illustration. Suppose there is Company 'A' and Company 'B'. If A proposes to takeover B and this offer has been accepted by the holders who carry 90 percent share value of B, then A needs to serve notice to any dissenting minority shareholder for the purpose of acquiring their shares. It would then open an option for such dissenting shareholder to put in an application to the Tribunal objecting this squeeze-out offer. The company at the receiving end in such cases must propose to buy the remaining shares at a value which is calculated on the basis of valuation done by a registered valuer. The minority have also been provided a right to initiate an offer to the majority shareholders for the purpose of buying their shares.

Section 151 statutorily mentions a listed company to have one director to be elected by small shareholders meaning a shareholder holding a share of nominal value of maximum twenty thousand rupees or another sum as may be notified. Here small shareholders are categorized in accordance of the value of their shareholding. They are dissimilar from minority shareholders who are categorized on the basis of having a "non-controlling stake" in the corporate entity. But where their little shareholding value leads to their non-controlling stake, they become minority shareholders and power has been conferred under this provision to them to choose a director.

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Schedule IV requires independent directors to abide by their responsibilities and one such duty that they must fulfill is to promote and encourage the confidence of minority shareholders. The Act also encourages proportional representation to be incorporated in the articles of association for the purpose of appointment of directors under section 163.

ANALYSIS IN THE LIGHT OF FOSS V. HARBOTTLE

The Majority rule is incomplete without the mention of a very popular case of *Harbottle*[ii] also well known as the *Foss v. Harbottle* Rule. In order to aid better understanding of the minority shareholders an explication of this case is a must. In the following case two shareholders of a company brought a suit action against the directors and solicitors of the company on the grounds of fraudulent transactions and allegations were thrown against them for illegally wasting the property held by the company and certain other unlawful activities. The shareholders pleaded that the defendants should be made to compensate the losses borned by the company.

The suit was with respect to maintainability and the fact that the action was initiated by the minority shareholders was rejected by the court. The wrongdoings claimed by the shareholders was an act which was capable of being approved by the majority shareholders so the suitable plaintiff in this case would be the company itself who operates through its majority shareholders. Thus going by this logic to file a suit or not is the discretion of the majority shareholders. The reasoning provided in this case has been reaffirmed in multiple cases.

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This case is a strong reflection of the prevalence of the supremacy or sovereignty of the majority. However, this rule does not stand correct in all the circumstances where the acts are not capable of being affirmed by the majority shareholders and thus each shareholder gains the right to sue. These are referred to as exceptions to the Harbottle rule which in reality are more popular than the case itself under which the minority shareholders can bring a lawsuit to safeguard their interests. These exceptions which entitles a minority shareholder to sue the company and its officers can be discussed below-

1. Ultra vires and illegal acts

The directors and promoters are encompassed by certain fiduciary duties that they cannot run from and the majority shareholders cannot sanction acts which are ultra vires. The acts which carry the nature of going against the constitution of the corporate entity are completely unacceptable and approval by majority to such acts is no excuse. The usage of power by the majority in order to defraud the minority is not immune. What activities come within the ambit of 'defraud' is not explicitly mentioned in the act so it requires interpretation in the background of various judicial pronouncements. The jurisprudence in this area is constantly developing and many activities in the past have been grouped as fraudulent activities by the courts of law which have now become precedents for the ongoing cases.

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2. Acts which entail a special resolution

The underlying principle here is that if something is supposed to be done in a particular way, then it has to be done by that way only and a person cannot in any situation deviate from it. Similarly, there are matters under the umbrella of internal management which entail the passing of ordinary resolution contrary to some matters which require the passing of special resolution. In the latter case if the majority proposes to take a decision by passing only an ordinary resolution, then a power is conferred on the shareholders to go to the courts of law. Likewise, this shall also be the case where a vital information is not mentioned or intentionally hidden or insufficiently fetched to the shareholders.

3. Shareholder's personal right

The majority rule applies only where corporate membership right is involved and not where individual membership right is involved. A shareholder can always raise his voice if his personal right has not been taken care of. Corporate membership rights may consist of right to obtain dividends etc whereas instances of personal membership rights include voting right, and right to file an application against oppression, and transfer shares that he holds and plenty of other rights.

4. Absence of action against the wrongdoer

A wrongdoer should never go unpunished. Going by this settled principle if the majority shareholders refuse to take action against such a doer of wrongful act, such injustice cannot be allowed to prevail.

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5. Oppression

Section 241 which has already been discussed above also acts as an exception to the general rule.

CONCLUSION

It is very apparent from the above analysis that the tussle between the majority rule and minority shareholders is a never ending one. The majority shareholders are often seen catering to their whims and fancies to the detriment of minority shareholders. However, such injustice cannot be permitted to prevail in a domain where a principle of not only natural justice but also fair play forms the essence of the legal world. Minority shareholders cannot be made victims at the hands of unscrupulous shareholders even if they form a majority.

It is definitely not a smooth task but to combat this situation visible efforts are evident in the Companies Act 2013.The battle between majority rule and minority shareholders is somewhat simplified under the current legal framework. The Act has made a key contribution in encouraging and safeguarding minority interests in a detailed manner to ensure that the rights of minority shareholders are not overshadowed by the fundamental rule of majority. Many of the shortcomings and lacunas that existed under the old 1956 framework are filled by the succeeding framework. Hence it may be concluded that the 2013 act is a welcome change.

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However, this does not end the problem as effective implementation of the provisions is not a easy job. The reality is that very often the shareholders are not aware of their rights in the first place so the question of exercising these rights become secondary. In circumstances where they are aware of their rights the burden of proof is on the complaining shareholder which again is a tough job. To overcome these issues awareness campaigns should take place and it is the duty of the shareholders to keep themselves updated with the current laws.

[i] Shanti Prasad Jain v. Kalinga Tubes Ltd, AIR 1965 SC 1535
[ii] Foss v. Harbottle, (1843) 67 ER 189

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