

Module-II



STEP - 1

RESOLUTION OF CORPORATE DISPUTES NON COMPLIANCES AND REMEDIES

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HIGHLIGHTS

- As amended in Line with Jan'2022 New Module Issued by ICSI
- Covers all the Previous Year Exam Papers
- Model Answers of the Previous Year Exams
- Highlighted Important Concepts for Mind Mapping

SHAREHOLDER'S DEMOCRACY

• MEANING

- Democracy means the rule of people, by people and for people. In that context the shareholders democracy means the rule of shareholders, by shareholders', and for shareholders' in the corporate enterprise, to which the shareholders belong. Precisely it is the ability of the shareholders to directly or indirectly manage the affairs of the company by electing Board of Directors who are responsible for managing the day-to-day affairs of the company. Under the Companies Act, 2013, the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The Directors exercise their powers through meetings of Board of directors and shareholders exercise their powers through Annual General Meetings/Extraordinary General Meetings. Although constitutionally, all the acts relating to the company can be performed in General Meetings, most of the powers in regard thereto are delegated to the Board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.
- It is a widely acclaimed fact that in any corporate enterprise, the shareholders are the owners. But in fact , they are seldom able to exercise any ownership rights except to sometimes cast votes at General Meetings. The members therefore, are only passive investors rather than active participants in the governance of the corporate process. Still the directors, as per law, are answerable to the shareholders at least for two reasons, one the shareholders are directly concerned with the economic viability of the investee company so to feel sure about the safety of their investment and secondly being the recognised owners of the company to enforce their rights to control the company as and when the company enters into contractual relationship with third persons thereby incurring greater obligation.
- Thus, the shareholder' democracy can play an important role in stimulating the Board of directors, raising company performance and ensuring that the community at large takes a greater interest in industrial progress. Recognising the supreme authority of the shareholders', the Companies Act has given authority to them to appoint directors at the Annual General Meetings to direct, control, conduct and manage the business and affairs of the company.

- **COMPANIES ACT 2013 AND RIGHTS OF SHAREHOLDERS**

Right of Shareholder under Companies Act, 2013 include:

- 1. Rights of shareholders under Companies Act, 2013*
- 2. Right to receive information.*
- 3. Right to give approval*
- 4. Right to appoint and remove directors.*
- 5. Right to appoint an auditor.*
- 6. Right to requisition a meeting.*
- 7. Right to vote including electronic voting. This is available only in listed companies or companies with more than 1,000 shareholders.*
- 8. Grievance redressal mechanisms. Listed companies or companies with more than 1,000 shareholders debenture holders, deposit holders and any other security holders at any time during a financial year must have a Stakeholders Relationship Committee. Listed companies should also be registered on SCORES platform (operated by the Securities and Exchange Board of India). Both of these provide mechanisms to resolve shareholder grievances.*
- 9. Provisions relating to Oppression and mismanagement. Minimum of 100 members or 10% of the total number of the members (whichever is less), or members holding at least 10% of the issued share capital of the company can approach the National Company Law Tribunal to initiate oppression or mismanagement*
- 10. Provisions relating to Class action suits.*
- 11. Application to the Serious Fraud Investigation Office.*

Under Section 179 of the Companies Act, 2013, a general power has been conferred on the Board of directors. "The Board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do."

Proviso to this section restricts the power of the Board of directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act, 2013 or Memorandum of Association or the Articles of Association of a company. Thus, the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.

Some powers of shareholders are as following:

1. *Alteration of Memorandum of Association and Articles of Association.*
2. *Further issue of share capital.*
3. *To transfer some portions of uncalled capital to reserve capital to be called up only in the event of winding up of the company.*
4. *To reduce the share capital of the company.*
5. *To shift the registered office of the company outside the state in which the registered office is situated at present.*
6. *To decide a place other than the registered office of the company where the statutory books, required to be maintained may be kept.*
7. *Payment of interest on paid-up amount of share capital for defraying the expenses on Construction when plant cannot be commissioned for a longer period of time.*
8. *To appoint auditors.*
9. *To approach Central Government for investigation into the affairs of the company.*
10. *To allow Related Party Transaction.*
11. *To allow a director, partner or his relative to hold office or place of profit.*
12. *Payment of commission of more than 1% of the net profits of the company to a managing or a whole-time director or a manager.*
13. *To make loans, to extend guarantee or provide security to other companies or make investment beyond the limit specified.*
14. *To borrow money and to charge out the assets of the company to secure the borrowed money.*
15. *To appoint directors.*
16. *To increase or reduce the number of directors within the limits laid down in Articles of Association.*
17. *To cancel, redeem debentures etc.*
18. *To make contribution to funds not related to the business of the company.*

The courts have further determined two broad duties to be performed by a director:

- 1. Duties of utmost care and skill in managing the affairs of the company or else be liable for damages.*
- 2. Fiduciary duties to act bona fide in the interest of the company, not to exercise powers for collateral benefit and not to earn profit from the position as a director.*

PRACTICAL SCENARIO

- Despite the powerful weapons handed over to the shareholders by the Companies Act, the shareholders have not been able to use them. Most of the provisions remain dead and have not been used by the shareholders as potential weapons to correct any wrongful act on the part of the directors or to give them any directions. Consequently, the Board of directors of a large number of companies are elected only by a few shareholders who attend the Annual General Meetings and those who can muster sufficient number of proxies and can demonstrate their voting power. Government Companies is an exception. In Government Companies all the directors are appointed on the advice of the Government by the President of India or the Governor of concerned State. Hence, theoretically it can perhaps be said that the shareholders democracy is absolute in such companies.*
- In other companies, however, the shareholders democracy is dependent upon the voting power of shareholders and also to a great extent on the availability of members attending their General Meetings either by themselves or through their proxy. This again depends on the proximity of Registered Office of the company to the place of residence of the shareholders.*
- Most of the shareholders do not have enough time to spare from their busy schedules to concern themselves with the affairs of the company in which they have invested. Besides, they are not always educated enough and experienced enough to be conversant with the working of the joint stock companies.*

Although the concept of shareholders' democracy has been enshrined in the Companies Act, yet, because of the aforementioned deficiencies and flaws in the general body of shareholders as a whole, it is not reflected in the constitution of the Boards of directors of many companies in India. For achieving the shareholders' democracy, the shareholders have to unite and organise themselves on national, state and district levels and get their associations registered under the

Societies Registration Act or any other applicable statute so that their voice is heard and they can assert themselves and safeguard the interests of their members. Constitution of such associations should be suitably amended so as to insist upon all the non-Government companies to allot a minimum number of shares to such associations of shareholders so that these associations can attend the Annual General Meetings of all the companies and make sure that the directors elected to company Boards reflect a fair representation

CASE STUDY:

In 2018, Minority shareholders of Apollo Tyres Limited have steered Chairman and Managing Director to cap their remuneration to 7.5 per cent of profit before tax with effect from Financial Year 2018-19. This cap, the firm suggests, can be further reduced over a period of time. The earlier limit was 10 percent of the net profit. This move came after when the reappointment of Managing Directors was rejected by Minority Shareholders due to the increase in remuneration inspite of Losses in the company. The Board of Directors decided to cap the remuneration of Chairman and Managing Director both to 7.5% of the Net Profit. Further, the remuneration of the both doubled during FY 2014 to FY 2018. The E&Y report also suggested few changes in promoter compensation, performance-based remuneration and annual increments to the company's Nominations & Remuneration Committee (NRC), and these proposals have been approved by the Board of the Company

- **SHAREHOLDER'S ACTIVISM:**

Due to recent changes in Corporate Laws including the Company Act, 2013, shareholder's activism has been strengthened. These changes empower the minority shareholder's to present their viewpoints to the Board of Directors and more actively protect their interest.

The following factors have played an important role in fostering shareholder activism in India:

1. **ELECTRONIC VOTING:**

The Companies Act, 2013 has acknowledged the need to bring the advantage of technology to voting system of companies in order to enable the shareholders to be active in the decision making of the company. Through e-voting, a shareholder can vote on the resolutions of a meeting without even being present at the general meeting, from a remote location.

The process of e-voting has given due recognition to the corporate democracy, as it has widened the participation of maximum shareholders in the voting process and has provided an opportunity to the shareholders residing in far-flung areas to participate in the decision-making process of the company. Thus, Boards now have to ensure higher accountability and ensure transparency for the effectiveness of their overall governance process.

Section 108 of Companies Act 2013 read with Rule 20 of the Companies (Management and Administration) Rules, 2014 empowers Central Government to prescribe the class or classes of companies and the manner in which a member may exercise his right to vote by the electronic means.

2. SEBI REGULATIONS:

Regulation 44 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, provides that the listed entity shall provide the facility of remote e-voting to its shareholders, in respect of all shareholders, resolutions and shall submit to the stock exchange, within 48 of conclusion of its General Meeting the details regarding the voting results in the prescribed format. The e-Voting platform aims to improve transparency and Corporate Governance standards and also helps in reducing the administrative cost associated with Postal Ballot while facilitating declaration of results immediately after the close of the voting.

3. APPROVAL OF RELATED PARTY TRANSACTION BY SHAREHOLDERS:

As per section 188 of the Companies Act, 2013 the consent of the Board of Directors given by a resolution at a meeting of the Board is mandatory for a company to enter into any contract or arrangement with a related party. rule 15 of the Companies (Meetings of Board and its Power) Rules, 2014 provides rules for related party transaction. A company shall enter into any contract or arrangement with a related party subject to the following conditions:

- **Rule 15 (1)**

The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-

1. the name of the related party and nature of relationship;
2. the nature, duration of the contract and particulars of the contract or arrangement;
3. the material terms of the contract or arrangement including the value, if any;

4. any advance paid or received for the contract or arrangement, if any;
5. the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
6. whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
7. any other information relevant or important for the Board to take a decision on the proposed transaction.

- **Rule 15 (2)**

If any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

- **Rule 15 (3)**

a company shall not enter into a transaction or transactions, without the prior approval of company by a resolution where the transaction or transactions to be entered into,-

1. as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mention below-
 - i. sale, purchase or supply of any goods or material, directly or through appointment of agent, amounting to ten percent or more] of the turnover of the company, as mentioned in clause (a) and clause (e) respectively of section 188(1).
 - ii. selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, amounting to ten percent or more of net worth of the company , as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188.
 - iii. leasing of property any kind amounting to ten percent or more of the turnover of the company, as mentioned in clause (c) of sub-section (1) of section 188.
 - iv. availing or rendering of any services, directly or through appointment of agent, amounting to ten percent or more of the turnover of the company as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188.

2. is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and a half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188.
3. is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one percent. of the net worth as mentioned in clause (g) of sub-section (1) of section 188.

In case of wholly owned subsidiary, the resolution is passed by the holding company shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

The explanatory statement is required to be annexed to the notice of a general meeting convened pursuant to section 101. It should contain the following particulars:

- (a) name of the related party
- (b) name of the director or key managerial personnel who is related, if any
- (c) nature of relationship
- (d) nature, material terms, monetary value and particulars of the contract or arrangements
- (e) any other information relevant or important for the members to take a decision on the proposed resolution.

PRACTICAL INCIDENTS OF SHAREHOLDERS' DEMOCRACY

- The rejection of an increase in remuneration of certain key executives of Tata Motors by its shareholders in July 2014.
- In June 2017, shareholders of Raymond Ltd rejected the sale of JK House at an allegedly below market price to the promoters of Raymond Ltd.
- In September 2017, certain shareholders of Religare Enterprises Ltd ("Religare") filed a petition before the NCLT to prohibit Religare from making an investment of around INR 500 crore in its subsidiary.

I. MAJORITY POWERS AND MINORITY RIGHTS

• INTRODUCTION:

- Majority shareholders are those who own more than 50% shares of the Company. A company being an artificial person with no physical existence, functions through the wishes of the majority. It is a cardinal rule of company law that prima facie all the resolutions are passed according to the will of majority. The resolution of a majority of shareholders, passed at a duly convened general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company. Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs.
- The basic principle relating to the administration of the affairs of a company is that "the will of the majority prevails or majority is supreme". Usually the general rule is that the decision of majority shareholders in a company binds the minority. Therefore, it is only majority of members who can control the board of directors. The majority is in the position where they are connected to every part of the company. They maintain their rights without considering the interests of minority which creates sullen effects. They misuse their power to exploit the rights of minority. In such a case a proper balance of the rights of majority and minority shareholders is essential for the smooth functioning of the company.
- Companies Act, 2013 has laid down certain provisions which restrict the unbridled supreme majority and confer rights on minority to apply to the National Law Company Tribunal or Central Government in case of Oppression or Mismanagement. According to Section 47 of the Companies Act, 2013, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. A special resolution, for instance, requires a majority of three-fourths of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough [Edwards v. Halliwell]

- There are two very important limitations to the powers of majority-
- 1. Firstly, the powers of the majority of members is subject to the provisions of the Company's memorandum and articles of association. A company cannot legally authorise or ratify any act which outside the ambit of the memorandum of the company.
- 2. Secondly, the resolution of a majority must not be inconsistent with the provisions of the Act or any other statute or constitute a fraud on minority depriving it of its legitimate rights.

- **PRINCIPLE OF NON-INTERFERENCE**

- The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members, the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company. The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles are the protective shield for the majority of shareholders who compose the board of directors for carrying out their object at the cost of minority of shareholders. This is called as the principle of non-interference
- Principle of non-interference has been laid down in the famous case of *Foss v. Harbottle*. Foss and Turton, two minority shareholders filed a complaint against the directors and alleged that the property of the company had been misapplied and wasted and hence, an adequate compensation should be paid to the company. Judge dismissed the claim of shareholders on the grounds of "proper plaintiff rule" and "majority rule". It was held that company functions on the concept of separate legal entity. It can sue and be sued on its own name. Hence, when

the company is wronged by its directors only company has the right to sue, Foss and Turton are not a proper party to the suit. Secondly, according to the concept of Majority rule, if acts can be ratified by the majority members through a resolution in general meeting, then court will not interfere in the same.

Similar cases:

- In **Pavlides v. Jensen** a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, "It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company's mine at an undervalue, proceedings should not be taken against the directors".
- In **Rajahmundry Electric Supply Co. v. Nageshwara Rao**, the Supreme Court observed that: "The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it."

- **JUSTIFICATIONS FOR THE PRINCIPLE**

The justification for the rule laid down in Foss v. Harbottle is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder. Moreover, a company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a

suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff.

The main advantages that flow from the Rule in *Foss v. Harbottle* are as following:

1. **Recognition of the separate legal personality of company:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress because the company is a legal entity separate from its members.
2. **Need to preserve right of majority to decide:** The principle in *Foss v. Harbottle* preserves the concept of majority rule which provides right to majority to decide how the affairs of the company shall be conducted.
3. **Multiplicity of futile suits avoided:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.
4. **Suit filed by minority is of no use if majority does not wish it:** If the irregularity complained of is one which can be subsequently ratified by the majority it is of no use to have litigation about it except with the consent of the majority in a general meeting.

Application of Foss v. Harbottle Rule in Indian context – The Delhi High Court in *ICICI v. Parasrampuriah Synthetic Ltd.* has held that an automatic application of Foss v. Harbottle Rule to the Indian corporate realities would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding atleast 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of Foss v. Harbottle Rule would be unjust and unfair.

- **EXCEPTIONS TO THE RULE OF NON-INTERFERENCE**

The cases in which rule of majority will not apply are called as exceptional cases and these cases protect the rights of minority.

Cases in which principle laid down in *Foss v. Harbottle* does not apply are as following:

1. **ULTRA VIRES ACT:** when the shareholders perform any act which is beyond the scope of MOA or AOA i.e. ultra vires then rule in *Foss v. Harbottle* will not apply and minority can make an application to the tribunal. Shareholder has the right to obtain restraining orders or orders of injunction from the court.

In *Bharat Insurance Ltd. v. Kanhya Lal*, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was: "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments". The Court observed: "In all matters of internal management, the company itself is the best judge of its affairs and the Court should not interfere. But application of assets of a company is not a matter of internal management. As directors are acting ultra vires in the application of the funds of the company, a single member can maintain a suit".

2. **FRAUD ON MINORITY:** when an action of shareholders amounts to fraud on minority, shareholder can individually make an application to the tribunal. Though there is no clear definition of the expression "fraud on the minority", but the court decides a particular case according to the surrounding facts.

The general test which is applied to decide whether a case falls in the category of fraud on the minority or not is whether a resolution passed by the majority is "bona fide for benefit of the company as a whole"

3. **RESOLUTIONS REQUIRING SPECIAL MAJORITY PASSED BY SIMPLE MAJORITY:** if a resolution requires a special majority and resolution is passed by simple majority, then shareholder can individually make an application to the tribunal.

Example- when a special resolution was required to be passed at the general meeting and resolution is passed without serving proper notice to the shareholders then shareholder can make an application to the Tribunal.

4. **BREACH OF DUTY:** The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In *Daniels v. Daniels*, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000.

It was held that the exception to the rule in *Foss v. Harbottle* enabling a minority of shareholders to bring an action against a company for fraud where no other remedy was available should include cases where, although there was no fraud alleged, there was a breach of duty by directors and majority shareholders. Hence, the minority shareholders had a cause of action.

5. **WRONGDOERS IN CONTROL:** If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court because if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue.

In *Glass v. Atkin* a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed: "While the general principle was for the company itself to bring an action, where

it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action.”

6. **PERSONAL ACTIONS:** Individual membership rights cannot be invaded by the majority of shareholders. An individual member is entitled to all the rights and privileges appertaining to his status as a member. In case there is an individual wrong, the individual can file a suit which is maintainable.
7. **PREVENTION OF OPPRESSION AND MISMANAGEMENT:** when majority shareholders are guilty of oppression and mismanagement then members of the company can make an application to the Tribunal and principle of non-interference will not be applied.

Q1. A minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. Is the action maintainable?

Q2. Majority shareholders of the company bonafide passed a resolution to sell all the assets of the company, in order to pay the dues of Creditors. However, the assets are sold at an undervalued price. Is majority guilty of Fraud?

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [Panipat Woollen & General Mills Co.Ltd. v. R.L. Kaushik,]

SUMMARISED VERSION (CHART FORM)



CS Muskan Gupta

Muskan is a graduate from ILS Law College, Pune. She Qualified as a Company Secretary at the age of 21 with AIR 15 in Foundation Programme. She has completed her masters in Psychology and pursuing masters in law from Bhartiya Vidyapeeth, Pune.

She has worked with esteemed lawyers and firms and has always shown great interest in subjects like Crpc, CPC, Constitution of India and Corporate Laws. She contributes to the legal fraternity by running a project called "VAKAALAT" which is a venture to brighten up the future of students pursuing law.

She has authored and published research papers in the field of Intellectual Property Rights, Cyber Law, Corporate Laws, etc. She has an inherent passion for teaching and firmly believes-

"Keep working hard, until you are insanely proud of yourself"