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Disenfranchisement of Majority Shareholders and Approach of Courts: Way Forward

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This research paper delves into the complex dynamics of disenfranchisement faced by majority shareholders and its significant implications for corporate structures. Typically, majority shareholders wield substantial influence and control within a corporation due to their considerable ownership stakes. However, this paper sheds light on scenarios where majority shareholders might experience oppression from minority counterparts, challenging traditional notions of power distribution within companies. The study examines the legal, regulatory, and constitutional aspects of these situations. It underscores the importance of adopting a nuanced approach to address potential conflicts and imbalances in corporate governance. By focusing on transparency and accountability, the research advocates for a balanced regulatory framework that aligns with constitutional values. The research emphasizes the necessity for ongoing evaluation and adaptation of corporate governance practices to reflect evolving business landscapes and shareholder dynamics. By doing so, companies can uphold their constitutional responsibilities while fostering an equitable corporate culture. Finally, this paper highlights the critical need for a comprehensive approach to corporate governance that considers the interests of all shareholders.

Keywords: *corporate governance, oppression and mismanagement, shareholder rights, corporate law.*

INTRODUCTION

The Indian Companies Act[1] outrightly rejects the idea and rightly so, in the Indian context traditionally, majority shareholders are often Socio-Political powerhouses. It makes little sense to award them protection from Oppression. Yet, it is possible albeit extremely unlikely and maybe even unfathomably rare that they are oppressed, and as India moves towards a more egalitarian Society recognizing and remedying such situations becomes pivotal in reconciling the rights of all the Stakeholders.

The question surrounding Oppression stems primarily from the ability to vote. While there are several other conditions under which the Power dynamics shift in favour of the minority, they are not as likely. In discussing these situations, we would predominantly consider the approaches of other countries and maybe venture into a cautionary tale. We would analyze them on the threshold of their constitutionality in India.

Chapter XVI of the Companies Act, 2013[2] which has Sections 241-246,[3] which carries with it crucial statutory provisions aimed at curbing oppression and mismanagement within a company. Notably, the Act refrains from providing precise definitions for 'oppression' and 'mismanagement'. Instead, oppression is characterized by a discernible deviation from the principles of equitable conduct and a breach of the just expectations that shareholders have when entrusting their funds to the company.

On the other hand, mismanagement denotes the conduct of the company's affairs in a manner detrimental to the public interest or contrary to the prescribed norms.[4] The bedrock of principles that govern acts of oppression was laid down more than fifty years ago in *S.P. Jain v Kalinga Tubes Ltd.*[5] and further expounded in the case of *Needle Industries India Ltd. v Needle Industries Newey (India) Holdings Ltd.*[6], These provisions are integral in safeguarding the interests of

[1] Companies Act 2013
[2] *Ibid*
[3] *Ibid*
[4] *Elder v Elder & Watson. Ltd* [1952] Scottish Cases 49
[5] *S.P. Jain v Kalinga Tubes* Ltd (1965) 2 SCR 720
[6] *Needle Industries India Ltd. v Needle Industries Newey (India) Holdings Ltd* (1981) 3 SCC 333

shareholders and upholding corporate governance standards, contributing to the overall stability and transparency of the corporate sector.

While the remedies under the provisions of the Companies Act, 2013[7] are generally available to 'minority shareholders' the provisions under it are 'shareholder neutral, there is no mention of 'majority' or 'minority' in these provisions, hence these remedies can and should be available to 'any member' of the company. Yet on the other hand, it seems to have been assumed that only minority shareholders should possess the relevant *locus standi* to bring an action although there exists no real legislative bar.

COMPARISON WITH INTERNATIONAL LEGISLATION

While in India there is a certain legislative rationale that supports an action brought forth against the minority shareholders in the broader international context the same has not necessarily been the case for other jurisdictions.

Malaysian Companies Act Sec. 346[8] which deals with oppression and mismanagement is neutral to Majority and Minority as seen in the case of *Kumagai Gumi*[9]. In Singapore, Section 216 of the Singaporean Companies Act[10] uses neutral terms in the legislation to support action by both the majority and the Aminority, as confirmed in the case of N*g Kek Wee v Sim City Trading Ltd*[11].

In referring to the UK equivalent of the Sec. 216 remedies,[12] one commentator has noted that it 'is now firmly established as the remedy from which the minority shareholder derives his principal form of statutory protection, against a background in which majority rule is regarded

[7] Companies Act 2013
[8] Companies Act 2016, s 346
[9] *Kumagai Gumi Co Ltd v Zenecon-Kumagai Sdn Bhd* [1994] 2 MLJ 789
[10] Companies Act 1967, s 216
[11] N*g Kek Wee v Sim City Trading Ltd* [2014] 4 SLR 723
[12] Companies Act 2006, s 994

as fundamental'.[13] Leading academic and practitioner texts, both in the UK and internationally,[14] tend to classify the Sec. 216 remedy as a form of minority shareholder protection.

The authors of the *Anatomy of Corporate Law: A Comparative and Functional Approach*,[15] a well-known text on the conceptual structure of corporate governance, locate the Sec.216 remedies under the wider umbrella of legal constraints used to address the agency problem but qualify their contentions by stating that any using traditional remedies available under Sec. 216 must be justified by reference to the existence of an unrecognized reverse agency problem between minority shareholders (as agents) and majority shareholders (as principals); as well as by reference to the underlying purpose of the Sec.216 remedy and its place in the overall architecture of shareholder protection in corporate law.

Mandating that, a clear principle must be articulated and fleshed out for situations where majority shareholders are permitted recourse to the Sec.216 remedy, the authors do not specify the condition attracting the Section or even conceding to the necessity of the same. This is necessary also because, to date, there has been little academic comment on this issue (apart from several brief, slightly- dated, and jurisdiction-specific discussions)[16], and none that brings together the various common law principles on this issue.

ISSUES OF SELF REMEDY

One may infer that this is due to the majority shareholder being expected to exercise his or her voting powers to self-remedy the oppression. But such self-remedy should not come at the cost of protection by law.[17] There are situations where the majority shareholder truly has been

[13] Zhong Xing, 'Reverse Oppression And The Residual Nature Of The Shareholder's Commercial Unfairness Remedy' (2015) 27 Singapore Academy Law Journal <https://journalsonline.academypublishing.org.sg/Journals/Singapore-Academy-of-Law-Journal/e-Archive/ctl/eFirstSALPDFJournalView/mid/495/ArticleId/439/Citation/JournalsOnlinePDF> accessed 17 July 2024

[14] A J Boyle, *Minority Shareholders' Remedies* (Cambridge University Press 2002)

[15] Reinier H Kraakman, *The Anatomy of Corporate Law: A Comparative and Functional* Approach (Oxford University Press 2004)

[16] Xing (n 13)

[17] *Ibid*

oppressed by a minority shareholder, reversing the traditional majority-minority dynamic and such situations should not stand at the mercy of conventional narratives.

In an attempt to dispel the traditional narratives regarding the power dynamic between the majority and Minority, we will try to analyze certain uncommon situations where there is a scope for disenfranchising the majority shareholder.

RIGHT TO VOTE: CORPORATE ENFRANCHISEMENT

One of the methods by which disenfranchisement of Majority Shareholders Occurs is by denying them the right to vote. The fundamental question that comes up before us to consider in the case of the *right to vote* of a shareholder is the characterization of the right that the shareholder has. In the Indian Context, *Share* as defined under Section 2 (84) of the Companies Act *means a share in the share capital of a company and includes stock.*[18] In essence, it signifies a fractional ownership of the money that is invested in the company.

In the Sale of Goods Act, the definition of Goods[19] includes *Share*s and the definition of *Property*[20] includes *Goods,* so while a cursory glance at these provisions would justify the assumption that Shares are the property of an individual, thereby warranting constitutional protection, a closer look would reveal that Property is defined as the *property in goods*[21], and hence the goods or shares are themselves are not the property but the title to them is.

Additionally, when we buy, sell, and trade Shares, what we are in essence buying, selling, and trading is the monetary value of the Share capital of the Company, as per the definition, and not the fractional ownership of the Company. This is an important idea because in trying to attempt to understand the nature of voting rights of the Company we must be mindful of where the rights are derived from. The *Right to Vote* is not derived from the Constitutional right to Property that Individuals have under Article 300A[22].

[18] Companies Act 2013, s 2(84)
[19] Sale of Goods Act 1930, s 2(7)
[20] Sale of Goods Act 1930, s 2(11)
[21] *Ibid*
[22] Constitution of India 1950, art 300A

Hence, the Indian Legislation is inept in structuring to understand the rights of a Shareholder. To remedy the situation the courts in India have stepped in and created a Broader Construction of the rights of property to include the right to vote.[23]

SEBI'S TRYST WITH VOTING RIGHTS

In *Bishambhar Dayal Chandra Mohan v State of U.P,*[24] the Supreme Court of India held that the word 'law' in the context of Article 300-A must mean an Act of Parliament or a State legislature, a rule, or a statutory order, having the force of law, that is positive, or State made law.[25]

The discussion of whether the Securities Exchange Board of India (SEBI) is an *Authority Established by Law/Enabling Authority* becomes important because the LODR Regulations notified under Sections 11(2), 11A, and 30 of the SEBI Act[26], read with Section 31 of the SCRA,[27] Unlike Section 47 of the Companies Act[28] is neither *an Act of Parliament …. Nor State Made Law'* nor *delegated Legislation* by *enabling authority*.

Yet, it curtails the voting power of Majority Shareholders, a Constitutional right which according to Article 300A can only be subrogated by law or an Act of Parliament through an *Authority Established by* or *Enabling Authority*. Therefore, the Measure of SEBI alienating the Majority Shareholder by the way of its Regulations would be unconstitutional, such infractions by the way of Regulations and Orders would not be the first for SEBI.[29]

Jurisdiction of Securities Exchange: A thorough read of Sections 11(2), 11A, and 30 of the SEBI Act, and Section 31 of the SCRA would suggest that SEBI does not have the power to determine the Voting rights of a Shareholder. Unlike the Companies Act,[30] which talks about the voting rights of a shareholder[31], the SEBI Act does not mention anything about voting rights

[23] *Mohini Mohan Chakravartty v Mohanlal Thalia* (1964) 03 CAL CK 0009
[24] *Bishambhar Dayal Chandra Mohan v State of U.P* (1982) 1 SCC 39
[25] *Jilubhai Nanbhai Khachar v State of Gujarat* (1995) Supp 1 SCC 596
[26] Securities Exchange Board of India Act 1999
[27] Securities Contract (Regulation) Act 1956, s 31
[28] Companies Act 2013, s 47
[29] *Alka Synthetics Ltd. v SEBI* (1997) SCC Online Guj 258
[30] Companies Act 2013
[31] Companies Act 2013, s 47

whatsoever, and neither does the SCRA Act[32]. Furthermore, the outline of Section 24[33] precludes the transfer of power to decide on Voting rights from under the Companies Act to SEBI. Hence, there arises no question on whether SEBI has powers on this Matter.

Majority of Minority: The concept of the 'majority of minority' as outlined in Regulation 23(4) [34] of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reflects a significant shift towards enhancing corporate governance and ensuring equitable treatment of shareholders. This provision mandates that for any material Related Party Transaction (RPT), related parties are disqualified from voting to approve the resolution, regardless of their involvement in the transaction. Consequently, the approval must come from a majority of the minority shareholders.

This regulation is pivotal as it effectively curtails the influence of majority shareholders in decisions where potential conflicts of interest might arise. By disenfranchising them in these scenarios, the regulation aims to protect the interests of minority shareholders, who might otherwise be sidelined in decision-making processes. This approach promotes a fairer, more transparent corporate environment by ensuring that the voices of minority stakeholders are not just heard but are decisive in critical transactions.

From a legal perspective, this regulation raises intriguing questions about the balance of power within corporate entities. While it serves as a safeguard against the exploitation of minority shareholders, it also challenges traditional corporate governance models, where majority rule is a fundamental principle, since related party transactions may not be just limited to the promoters themselves but to other shareholders. Hence it is one of those conditions where the minority holds greater strongholds for decision making than a majority does.

Voting in the Scheme of Arrangement: In the case of Schemes of arrangement undertaken by listed entities, where the scheme provides for allotment of shares to the promoter/ promoter

[32] Securities Contract Regulation Act 1956, s24
[33] Companies Act 2013
[34] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, s 23(4)

group, involves the listed entity and a promoter/ promoter group entity, and so on SEBI has mandated a majority of Minority Style approval system[35].

Implementing the majority of minority approval systems can introduce complexity to decision-making processes. While the intention is to protect minority shareholders, this system might be seen as limiting the autonomy of promoters or promoter groups.

The latest addition to this approval format includes a consultation paper that proposed the introduction of a 'majority of minority' approval for

(a) agreements impacting management or control of a listed entity, irrespective of whether the listed entity is a party; and

(b) business transfer agreements (BTAs) undertaken outside the scheme route [36]

In the case of different voting rights: The oppression of majority shareholders through the use of differential voting rights shares refers to the situation in which minority shareholders gain a disproportionate amount of control over a company's decision-making processes, despite owning a smaller portion of the total equity. This occurs when a company issues shares with varying degrees of voting power, allowing certain shareholders to wield more influence than their actual ownership percentage would suggest. This strategy can result in the majority shareholders being marginalized and their decision-making power significantly diminished, leading to a scenario where they are effectively oppressed by the minority.

The aforementioned scenario finds its roots in the English legal precedent of *Re, H R Harmer Ltd.*[37] In this case, the defendant and his spouse, despite their status as minority shareholders, possessed a combined voting influence that surpassed that of the majority shareholders. This

[35] 'Master Circular on Scheme of Arrangement' (*Sebi.gov*, 23 November 2021) <https://www.sebi.gov.in/legal/master-circulars/nov-2021/master-circular-on-scheme-of-arrangement_54132.html> accessed 17 July 2024

[36] 'Consultation Paper On Strengthening Corporate Governance At Listed Entities By Empowering Shareholders – Amendments To The Sebi (Lodr) Regulations, 2015' (*Sebi.gov*, 21 February 2023) <https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-strengthening-corporate-governance-at-listed-entities-by-empowering-shareholders-amendments-to-the-sebi-lodr-regulations-2015_68261.html> accessed 17 July 2024

[37] *Re, H R Harmer Ltd* [1958] EWCA Civ J1117-3

was made possible through their shareholding of higher voting power shares, which conferred upon them the entirety of the voting power. The court determined that the majority shareholders, predominantly possessing lower voting power shares were devoid of voting rights, had suffered from oppression and were not precluded from seeking redress for the oppressive conduct.

SHAREHOLDERS' AGREEMENT CONFERS MANAGERIAL POWERS

Apart from voting rights, another avenue through which power can be abused is representation on the board and conditions inherent present in an agreement, delegating or agreeing to delegated powers to another individual, the powers of the Majority shareholder under an agreement. In such cases, the progenitor of the power would be left bereft of it.

This was observed in the landmark Malaysian Case *Kumagai Gumi*[38], where a minority shareholder filed an oppression petition. During its proceedings, the Court discovered that the majority shareholders had delegated power and management to the petitioner through an agreement. This delegation was based on the promise to invest much-needed capital in the company, which afterwards failed. In an ironic twist, the High Court noted that a thorough evaluation of the case showed that the minority shareholder had not only failed to prove oppression but had also become the true oppressor.

Interestingly, the Malaysian judge, Justice Anuar in the case, referred to the Indian case of *Ramashankar Prasad & Ors v Sindri Iron Foundry (P) Ltd & Ors.*[39], which expounded on the applicability of Provisions relating to oppression and Mismanagement to Minority shareholder standing in contrast to Section 210 of the UK Companies Act 1948[40]. The UK's Section 210 falls under the heading in which the title specifically contains 'Minorities'. However, such a heading is absent in the Indian provision (and equally in the Malaysian provision).

This is one of the fascinating situations where legislation from the UK stands archaic in comparison to the Indian legislation on the same matter and where Indian Jurisprudence on the

[38] *Needle Industries India Ltd. v Needle Industries Newey (India) Holdings Ltd* (1981) 3 SCC 333
[39] *Ramashankar Prasad & Ors v Sindri Iron Foundry (P) Ltd & Ors* (1966) 70 CWN 520
[40] Companies Act 1948, s 210

inclusive approach to who can be an oppressor in a corporate Set-up would stand to inspire judicial thinking across the Globe. In India, this situation would not be possible because, under the Companies Act, a right that causes irreparable injury to the shareholder cannot be stripped away by way of the articles of association.[41]

CONSTITUTIONAL ARRANGEMENT & POWERLESSNESS

Other Situations that warrant our attention, are where the constitution of the company renders the Majority Powerless. This is Interesting as unlike an agreement which is often voluntarily entered into by both parties, the constitution of a company can be an archaic document of a bygone era without any control being exercised unilaterally by any party.

This was seen in New Zealand in the case of *Sturgess v Dunphy*,[42] where the majority shareholders, despite owning more than 75% of the company, had no control over its affairs because the constitution did not allow them to pass ordinary or special resolutions. The company's governance has been unusually vested in its board of directors, and the appellant could veto Board decisions under the company's constitution. Those arrangements allowed shareholder and Board deadlock. With a management services contract that nominated the appellant as the CEO that the Board could not terminate, the majority shareholders were powerless to discipline any unauthorized conduct or actions by the appellant, a director, and a minority shareholder. In this case, the New Zealand Court of Appeal found that the appellant could oppress the majority shareholders.

In a similar situation, in the Australian Supreme Court of New South Wales in the case of *Richardson & Wrench Holdings Pty Ltd.*[43] Mr. Kie Chie Wong, one of three directors of Richardson & Wrench, was appointed as a representative for a company called ME Shelf. This appointment gave him the power to attend meetings and make decisions on behalf of the company. However, the appointment did not specifically mention his authority to pass resolutions without holding meetings. This rendered the Majority 71% of shareholders completely powerless.

[41] *Needle Industries India Ltd. v Needle Industries Newey (India) Holdings Ltd* (1981) 3 SCC 333
[42] *Sturgess v Dunphy* [2014] NZCA 266
[43] *Richardson & Wrench Holdings Pty Ltd.* [2013] NSWSC 1990

These cases as a cautionary tale beg an important question that is, whether in the Indian Context a condition which stipulates that a Legal right or power conferred under legislation can be stripped away by the Memorandum or Association or articles of association. A clear argument can be made stating that in the Indian context, such conditions in the articles of association would not be permitted.[44] [45]

MAJORITY SHAREHOLDERS WITHOUT THE POWER TO SELF-REMEDY

Companies and corporate functionaries are often complex machinery with Several Layers and webs that extend far and wide. Often these webs and chains overlap to form complex chains of cause-and-effect relationships. Hence it is possible albeit unlikely that minority shareholders would seek retribution from majority shareholders by oppressing the erstwhile majority in companies where the erstwhile Minority is the majority.

In the case of *Parkinson v Eurofinance Group Ltd*,[46] where the minority shareholders devised a plan to exclude the majority shareholder from company management using fabricated complaints. The majority shareholder was escorted off the premises and faced attempts to dilute his controlling power in another company. As a result, traditional remedies were inadequate due to his exclusion from the board, making the pursuit of a remedy essential to address the oppression.

To contextualize the Indian case of *Needle Industries (India) v Needle Industries Newey (India)*[47], a landmark case on this subject, the Supreme Court decided that, the foreign majority shareholders, who alleged oppression by the Indian minority shareholders the victims of a failed attempt at the oppression of the Majority. It was also held that the court had the power to do substantial justice in the matter and therefore on the facts and circumstances of the case, the Supreme Court rejected the plea of oppression, directed the minority Indian shareholders to purchase shares held by the majority foreign shareholders to remedy the Injustice.

[44] *British Murac syndicate Ltd. v Alperton rubber Co Ltd* [1915] 2 Ch 186
[45] *K.G. Khosla and Anr v Rahul C. Kirloskar and Ors* (1995) 35 DRJ 124
[46] *Parkinson v Eurofinance Group Ltd* [2001] BCLC 720
[47] *Needle Industries (India) v Needle Industries Newey (India) Holding Ltd.* (1981) 3 SCC 333

THE MAJORITY PREMIUM: DULY PAID

In the case of Majority Shareholders, it is argued, have an Inherent Moral & Legal Right to have power over the affairs of the Company.[48] This is because there is a premium associated with being the Majority shareholder. An individual becomes the majority shareholder only if he or she is the founder of the company or has paid the premium associated with the Merger/ Acquisition of the Majority of the shares of the Company. Hence it would be counterintuitive to penalize the individual for having achieved the status.

While the Courts in India have recognized the power of the majority in corporate democracy and given effect to the same in *Life Insurance Corporation of India v Escorts*[49], it is the narrative that majority shareholders cannot be oppressed and that need to be more sensitive to the challenges that they face. However, broadly speaking it is the narrative that majority shareholders are impervious to oppression warrants a complete overhaul. Legal frameworks, such as the majority of minority rule, challenge traditional power structures by limiting the voting rights of majority stakeholders in specific contexts, particularly to prevent conflicts of interest.

It is argued that there should be a balanced approach that considers the responsibilities and vulnerabilities of majority shareholders. While they wield significant influence, they also bear considerable risks and responsibilities. Thus, protecting their rights while preventing potential abuses of power is crucial.

The evolving nature of corporate governance necessitates a nuanced understanding of these dynamics. By fostering an environment where both majority and minority shareholders are safeguarded, companies can achieve a harmonious balance that promotes transparency, accountability, and sustainable growth. This approach not only aligns with global best practices but also instills confidence in the corporate landscape, encouraging investment and innovation.

[48] *Foss v Harbottle* [1843] 2 Hare 461
[49] *Life Insurance Corporation of India v Escorts* (1986) 1 SCC 264

CHANGING NARRATIVES AND BROADER HORIZONS

In discussing the various situations under which the Majority can be oppressed by the minority, across various jurisdictions, it is not the intention of the author to mandate for regime that is supportive of the Majority. The Fundamental Principle of Corporate Democracy relies on the decision-making power of the Majority.[50] Hence, it makes little sense to mandate greater protection to be accorded to the Majority. But while in most circumstances the Majority has little to no need for protection it is in certain niche situations that the Majority can be unduly overwhelmed. The author contends that such circumstances should be remedied and Legislation should be clarified to mitigate circumstances that allow for unfair decision-making processes.

In trying to achieve a more inclusive legal structure, we have to be mindful of the circumstances and power dynamics that are in play rather than go for a mechanical approach to disenfranchisement. In this regard, the Indian Courts have considered situation[51] and awarded remedies in situations where the Majority has been alienated by the Minority.[52] The approach of the court can also be exemplified in cases where the courts have denied Minority Squeeze out when they were unfairly imposed upon the minority.[53] Since It is the duty of the court and the Legislature to protect the company, even if has to be protected from itself, it would be wise to recognize the mindset that discounts the oppression be it of the Majority or minority, and create quantifiable metrics, as feasible, to streamline the process of identifying such situations.

CONCLUSION

Discussing the issue of power dynamics and inclusivity in corporate structures, particularly in the context of majority and minority shareholders, the authors call for a more inclusive approach to corporate governance in the Indian legal system. While the courts have awarded remedies in situations where the majority has been alienated by the minority, the article underscores the

[50] *Yashovardhan Saboo v Groz-Beckert Saboo Ltd.* (1995) 83 COMP CAS 371
[51] *Ramshankar Prosad v Sindri Iron Foundry (P) Ltd.* (1965) SCC OnLine Cal 193
[52] *Needle Industries (India) v Needle Industries Newey (India) Holding Ltd.* (1981) 3 SCC 333
[53] *Chander Mohan Jain v CRM Digital Synergies P. Ltd.* (2008) 142 COMP CAS 658

importance of the Indian legislation framework, comparing it with existing frameworks across the globe.

Overall, the article highlights the importance of inclusivity and power dynamics in corporate structures and the need for legal systems to recognize and address these issues. The Indian legal system is presented as an example of a more inclusive approach to corporate governance and suggests that this approach could inspire judicial thinking across the globe. It also highlights the need for caution in complex corporate structures, and the potential for minority shareholders to seek retribution from the majority.