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Shareholders' Rights & Shareholder Activism 2023

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India: Law & Practice

C R Dua, Sanjeev Kaul, Abhinav Rastogi and Akansha Chaudhary
Dua Associates

INDIA

Law and Practice

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Dua Associates

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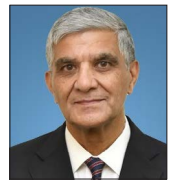

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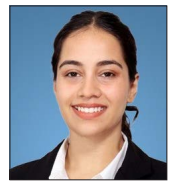

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1. Types of Company, Share Classes and Shareholdings

1.1 Types of Company

The Companies Act, 2013 (the "Act") is the primary legislation in India relating to companies. The Act provides for two main types of companies that can be formed in India:

- a private company, whose articles of association ("Articles") restrict the right to transfer its shares, limit the number of its members and prohibit invitation to the public to subscribe for any securities of the company; and
- a public company.

The Act also provides for a one-person company, which refers to a private company consisting of only one person as a member.

These companies may be limited by shares or by guarantee, or may be unlimited companies.

Furthermore, a subsidiary of a company, not being a private company, is also deemed to be a public company under the Act, even where such subsidiary continues to be a private company in its Articles.

1.2 Types of Company Used by Foreign Investors

Generally, foreign investors use a private company limited by shares for their investments and ventures, as the Act exempts a private company from several provisions, thereby placing it in an advantageous or privileged position compared to a public company. The compliances applicable to a private company under the Act are less than those applicable to a public company. A private company provides more flexibility in terms of management and the conduct of its affairs.

Foreign investors cannot set up a one-person company as only a natural person who is an Indian citizen, whether resident in India or otherwise, is eligible to be a member of such company. Furthermore, from a foreign investment perspective, a company limited by guarantee or an unlimited company is also irrelevant, so the provisions pertaining to such types of companies will not be discussed in this article.

1.3 Types or Classes of Shares and General Shareholders' Rights

A company limited by shares can issue two kinds of shares: equity shares and preference shares. Equity share capital can be issued either with voting rights or with differential rights with respect to dividends, voting or otherwise. Preference share capital refers to the share capital of the company and carries or would carry preferential rights or accords priority with regards to the payment of dividends, repayment in case of a winding-up or repayment of capital.

A private company may issue the above or any other kind of share capital, on terms that it thinks fit. However, private companies tend to restrict their share capital to the two aforementioned types of share capital.

An equity shareholder has the basic right to:

- attend and vote on resolutions at a general meeting;
- receive copies of the annual report, notice of a general meeting and declared dividends; and
- inspect documents such as the register of members and the minutes of general meetings.

The basic rights attached to the shares are set out in the Act itself and/or the terms of the issue.

A company's Articles may provide for additional rights for a specific shareholder/shareholders' group, provided such additional rights do not conflict with the provisions of the Act.

1.4 Variation of Shareholders' Rights

Where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied through the following measures, provided that the provision with respect to such variation is contained in the company's memorandum of association ("Memorandum") or Articles:

- with the consent in writing of the holders of not less than 75% of the issued shares of that class; or
- by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class.

In the absence of the respective provision, such variations can take place if they are not prohibited by the terms of the issue of shares of that class.

Furthermore, if variation by one class of shares affects the rights of any other class of shareholder, the consent of 75% of such other class of shareholders shall also be obtained.

1.5 Minimum Share Capital Requirements

There is currently no minimum paid-up share capital requirement under the Act for the types of companies mentioned in **1.1 Types of Company**, regardless of whether the company is incorporated by persons who are resident in India or outside India.

1.6 Minimum Number of Shareholders

The minimum number of shareholders for the types of companies mentioned in **1.1 Types of Company** are as follows:

- for a private company – two;
- for a public company – seven; and
- for a one-person company – one.

Under the Act, there is no requirement for any such shareholder to be a resident in India. However, foreign direct investment (FDI) in India is limited/restricted in certain sectors/business activities; where 100% FDI is not permitted in a sector, the balance of the shareholding is to be held by a shareholder(s) who is a person resident in India.

1.7 Shareholders' Agreements/Joint Venture Agreements

Where there are two or more sets/groups of shareholders in a company, it is common to have a shareholders' agreement (SHA) or joint venture agreement (JVA), the relevant provisions of which are also reflected in the charter documents of the company (Memorandum and Articles).

1.8 Typical Provisions in Shareholders' Agreements/Joint Venture Agreements

The typical provisions included in a SHA/JVA pertain or relate to:

- the ownership percentage;
- management of the company;
- the constitution and composition of its board and representation by each party thereon; and
- the conduct and proceedings of the board and shareholders' meetings, including quorum, reserved matters, future funding, provisions on the transfer of shares, exit options,

assignment, non-compete and non-solicitation and other usual provisions, such as arbitration, governing law, information rights, confidentiality, termination, etc.

The enforceability of SHAs/JVAs has been a subject matter of various litigation, and there have been conflicting judgments of the High Courts of different states on the matter. Pursuant to the court judgments and certain changes in the law, it can be deduced that SHAs/JVAs are enforceable as contracts between the contracting shareholders/parties. However, for the contracting shareholders to enforce the relevant provisions of the SHA/JVA against the joint venture company or other shareholders, the provisions of the agreement shall be incorporated in the Articles. Articles constitute a contract between each member and the company, and between the members inter se. Furthermore, the provisions of the Act have effect notwithstanding anything to the contrary contained in any such agreement, and any provision contained in such an agreement shall, to the extent to which it is repugnant to the provisions of the Act, become or be void, as the case may be.

In respect of public companies (whose shares are freely transferrable), even the Act now recognises that any contract or arrangement between two or more persons in respect of the transfer of securities shall be enforceable as a contract.

Generally, a SHA/JVA is a private document between the parties thereto; however, upon their reflection in the Articles, such provisions become public, as a company's Articles is a public document open to inspection or download from the government website concerned, upon payment of a nominal fee.

2. Shareholders' Meetings and Resolutions

2.1 Types of Meeting, Notice and Calling a Meeting

A number of matters prescribed under the Act are required to be transacted only at a general meeting of the shareholders. All general meetings except the annual general meeting (AGM) are referred to as an extraordinary general meeting (EGM).

AGM

Every company is required to hold an AGM each year. An AGM is called by giving not less than 21 clear days' notice, either in writing or through electronic means. An AGM may also be convened at shorter notice with the consent (in writing or electronically) of not less than 95% of the members entitled to vote thereat.

Apart from any other matters that are reserved for the competence of the AGM either under the Act or under the Articles (called as special business), an AGM is required to transact ordinary business matters such as the consideration of financial statements and reports of the directors and auditors, declarations of any dividends, the appointment of directors in place of those retiring, and the appointment and remuneration of the auditors.

EGM

All matters other than the ordinary business matters to be transacted at an AGM can be passed at the EGM, such as an alteration of the Articles, an increase in the authorised share capital, a reduction of share capital, approval of a merger or amalgamation, or changing the name of the company. Therefore, the board may call for an EGM when there is a need to transact such matters. An EGM may also be requisitioned by

members – for more information on this, please see **2.3 Procedure and Criteria for Calling a General Meeting**.

2.2 Notice of Shareholders' Meetings

An EGM may be called by giving not less than 21 clear days' notice, either in writing or through electronic means.

An EGM may be convened at shorter notice with the consent of members representing not less than 95% of such part of the paid-up share capital as gives a right to vote at the meeting.

2.3 Procedure and Criteria for Calling a General Meeting

Shareholders cannot call and hold an AGM by themselves; it is the board that calls the AGM every year, to be held within the prescribed period.

An EGM may be called by the board whenever it deems fit. An EGM may also be convened by the board at the request (in writing) of such number of shareholders who hold not less than 10% of the paid-up share capital that carries the right of voting. The request shall be sent at least 21 days prior to the proposed date of the EGM. The notice shall state the matters to be discussed at the meeting and should be signed by those making the request. The board is then required to convene the EGM within the prescribed period, failing which the shareholders making the request may themselves call and hold the EGM within the prescribed period.

2.4 Information and Documents Relating to the Meeting

All shareholders of a company are entitled to receive notice of general meetings, and have the following basic information and inspection rights:

- to receive the audited annual financial statements along with the auditor's report and the directors' report thereon;
- to receive the notice of the general meeting along with an explanatory statement setting out the material facts concerning each item of special business to be transacted at the general meeting;
- to inspect the minutes book of the general meetings;
- to inspect the statutory registers maintained by the company under the Act, such as the register of members, the register of contracts or arrangements in which directors are interested; and
- to inspect the annual returns submitted by the company.

2.5 Format of Meeting

The Act does not contain a provision permitting shareholders' meetings to be held virtually or remotely. However, the COVID-19-related restrictions on the movement of persons in 2020 led to the government permitting companies to hold such meetings through videoconferencing or other audio-visual means for a prescribed period; this period has been extended by the government from time to time, and is currently valid until 30 September 2023. Certain classes of companies are also required to provide e-voting and postal ballot facilities to shareholders.

2.6 Quorum, Voting Requirements and Proposal of Resolutions

The quorum requirements for the general meetings are as follows.

- For a public company, if on the date of the meeting the total members of the company are:
  (a) not more than 1,000 – five members personally present;

(b) between 1,000 and 5,000 – 15 members personally present; and
(c) more than 5,000 – 30 members personally present.

- For a private company – two members personally present.

However, the Articles can provide for a higher quorum.

2.7 Types of Resolutions and Thresholds

There are primarily two types of resolutions, which are passed by the shareholders under the Act by casting their votes either in a show of hands, electronically or in a poll: an "ordinary resolution" and a "special resolution".

An ordinary resolution is a resolution for which a notice has been duly given and which is required to be passed by a simple majority (votes in favour exceed the votes against the resolution).

A resolution is classed as a special resolution when the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or when other intimation has been given to the members and the votes cast in favour of the resolution are not less than three times the number of votes, if any, cast against the resolution by members (resolution is carried with 75% of the votes in favour).

Only the votes of members who are "entitled and voting" are counted.

The Act also prescribes a special majority for a very few matters – eg, a compromise or arrangement with creditors and members requires the approval of the majority of members representing 75% in value of the share capital voting in person or by proxy or by postal ballot.

2.8 Shareholder Approval

Certain matters are reserved under the Act for the approval of shareholders by way of ordinary resolution or special resolution. Briefly, ordinary resolutions are used for routine matters requiring a simple majority vote (more than 50% vote), while special resolutions are used for significant matters requiring a higher majority vote (75% vote).

Matters requiring ordinary resolution include:

- appointing a new director in place of those retiring or following the removal of existing directors;
- considering the audited financial statements and the reports of the directors and auditors;
- declaring a dividend;
- appointing auditors and fixing their remuneration;
- removing a director;
- entering into certain related party transactions; and
- altering the Memorandum to increase, consolidate, sub-divide, convert or cancel share capital.

Matters requiring special resolution include:

- altering the objects clause in the Memorandum of a company or changing the place of its registered office from one state to another;
- changing the name of a company;
- altering the Articles;
- varying the rights of special classes of shares;
- reducing the share capital;
- making loans and investments or providing guarantee or security in excess of the prescribed limits (not applicable to a private company);
- removing the auditors; and
- winding up the company voluntarily.

2.9 Voting Requirements

Voting Rights

Every member of a company limited by shares who holds equity share capital therein shall have a right to vote on every resolution placed before the company, and their voting right on a poll shall be in proportion to their share in the paid-up equity share capital of the company. If a company has issued equity shares with differential rights as to voting and dividends, voting rights would then be computed accordingly. In the case of voting by a show of hands, each shareholder is entitled to one vote.

Voting by Proxy/Authorised Representative

Proxy: a member of a company is entitled to appoint another person (who need not be a member of the company) as a proxy, who shall attend and vote at general meetings on behalf of such member. The proxy is not permitted to speak during the meeting and can only vote on a poll.

Authorised representative: a corporate member of a company may – by a resolution of its board of directors or other governing body – authorise any person it deems fit to act as its representative at any general meeting of the company. Such authorised representative is treated as a member personally present.

Manner of Voting

The Act provides for the following manners of voting by shareholders.

- Show of hands: the voting in any general meeting on a resolution shall be through a show of hands unless a poll is demanded or the voting is carried out electronically. A proxy cannot vote by show of hands.
- Poll: before or on the declaration of the result of the voting on any resolution on a show of hands, the chair of the general meeting may, on their own motion, order a poll to be taken; they shall order a poll to be taken if demand on that behalf is made by the members present in person or by proxy (where allowed) having not less than 10% of the voting power or holding shares on which an aggregate sum of not less than INR500,000 has been paid-up.
- Electronic means: every company that has listed its equity shares on a recognised stock exchange and every company having not less than 1,000 members shall provide its members with a facility to vote on resolutions proposed to be considered at a general meeting by electronic means.
- Postal ballot: any item of business other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any general meeting may also be transacted through postal ballot (ie, the casting of a vote by a shareholder by postal or electronic means). For a company with more than 200 members, certain prescribed matters are required to be transacted only by means of postal ballot.

For voting by poll, electronic means or postal ballot, a scrutiniser is appointed to scrutinise the voting and ensure the voting process is carried out in and fair and transparent manner.

2.10 Shareholders' Rights Relating to the Business of a Meeting

A shareholder cannot bring up a specific issue to be considered or resolved upon and put it to vote at the general meeting if said issue was not included in the agenda/notice convening the general meeting. However, shareholders holding the prescribed number of shares can request the company to call an EGM and set out the matters for the consideration at the EGM so requested

(see **2.3 Procedure and Criteria for Calling a General Meeting**).

2.11 Challenging a Resolution

Oppression and Mismanagement

As a general rule, a shareholder cannot challenge a resolution validly passed at a general meeting, but a resolution may be challenged by the shareholder through approaching the National Company Law Tribunal ("Tribunal"), only under certain circumstances. Over a passage of time and through various decisions, the courts/Tribunal have described the circumstances in which such powers may be invoked by a shareholder. Briefly, not each and every non-observance of company law, failure to comply with required procedures or even a unilateral/one-off illegality would give rise to such circumstances.

The Tribunal may intervene where the complainant shareholder can demonstrate the following:

- the affairs of the company have been or are being conducted in a manner that is prejudicial to public interest or the interest of the company, or in a way that is oppressive to said shareholder or any other member(s) of the company; or
- a material change has been brought about in the management or control of the company and it is likely that the affairs of the company will be conducted in a manner prejudicial to its interest or that of its members or any class of members.

The Act states that no fewer than 100 shareholders can approach the Tribunal with such a complaint, or not less than 10% of the total number of its members (whichever is less), or any member(s) holding not less than 10% of the issued share capital of the company; however, the Tribunal may waive such requirement to enable the members to file such complaint. In any case, there is no such threshold if a shareholder decides to approach a civil court, which usually does not entertain such matters.

Class Action Suit

Under the Act, a certain prescribed number of members may approach the Tribunal if they are of the opinion that the management and conduct of the affairs of the company are taking place in a manner that is prejudicial to the interest of the company or its members, and seek an appropriate order from the Tribunal such as to declare a resolution altering the Memorandum or Articles of the company void if such resolution was passed by the suppression of material facts or was obtained by misstatement to the members or the company and its directors were restrained from acting on such resolution.

2.12 Institutional Shareholder Groups

As a flourishing economy, India has attracted large investments from international investors and financial institutions. Institutional investors and large shareholder groups keep a close watch on their portfolio companies, including their progress, performance and public disclosures made from time to time.

Institutional investors and other shareholder groups actively use the rights attached to their shareholdings, such as voting during general meetings. The involvement of investors and shareholder groups in discussing matters to be transacted by the company in a meeting also influences the public shareholders. Institutional investors engage in dialogue with company management and boards of directors with inputs on strengthening the corporate governance practices and protection of investor rights and interests.

2.13 Holding Through a Nominee

A registered holder of shares (ostensible owner) who does not hold the beneficial interest in such shares is required to make a declaration in the prescribed manner to the company intimating the name and particulars of the beneficial owner. The beneficial owner is required to make a similar declaration in respect of the registered member. The company makes a note of such declarations in its records.

The Act only recognises the registered owner of the shares, who is the only person legally entitled to enjoy the rights associated with such shares.

Rights shares, bonus shares and dividends are offered to the registered member. However, the registered member may direct the company to pay the dividend on their shares in favour of the beneficial owner, and may renounce the rights shares offered to them in favour of the beneficial owner.

Typically, the beneficial owner enters into a contract with the registered owner, or another instrument is executed for the creation of a beneficial interest, which records the arrangement between the parties with respect to the shares held by the nominee/registered member and, inter alia, provides that the notice of the general meetings received by the registered member shall be handed over by the registered member to the beneficial owner and that the registered member shall vote on such issues as per the directions and instructions of the beneficial owner. The Act or the company is not concerned with any such arrangement between the parties.

2.14 Written Resolutions

As a general principle, all resolutions requiring shareholders' approval are passed only at a general meeting. However, certain matters are reserved under the Act to be passed (as ordinary or special resolution) only by postal ballot if a company has more than 200 shareholders. There are very few matters expressly provided under the Act that can also be passed with the written consent of the members, such as variations of the rights of any class of shares (see **4. Cancellation and Buyback of Shares**).

3. Share Issues, Share Transfers and Disclosure of Shareholders' Interests

3.1 Share Issues

The Act provides for pre-emptive rights with regards to fresh issues of shares to a company's shareholders. In cases where the company intends to raise monies by way of issuing further shares, such shares are first offered to the existing shareholders of the company in proportion to their paid-up share capital (referred to as a "rights issue"), unless the shareholders have decided by way of a special resolution to issue shares to any persons, regardless of whether or not they include any existing shareholders.

In the case of a rights issue, a shareholder may accept or decline an offer for subscribing the shares on a rights basis, or may subscribe for a lower number of shares than offered, or may renounce the shares offered to them in favour of another person, unless the Articles state otherwise.

3.2 Share Transfers

A private company is required to restrict the right to transfer its shares in its Articles.

The shares of a public company are freely transferable. However, the Act recognises that any contract or arrangement between two or more

persons in respect of the transfer of securities shall be enforceable as a contract.

A company shall not register a transfer of shares (where such shares are held in physical form) unless a proper instrument of transfer in the prescribed format, duly stamped and executed by or on behalf of the transferor and the transferee, is delivered to the company within 60 days from the date of execution, along with a certificate of the securities or a letter of allotment of the securities.

Any transfer of shares from a person resident in India to a person resident outside India or vice versa is also subject to Indian foreign exchange laws, including the pricing guidelines and reporting requirements. A transfer of shares from a person resident in India to a person resident outside India is also subject to sectoral caps on foreign investment, if applicable.

3.3 Security Over Shares

Shareholders can grant security interests over their shares by way of pledge, charge or hypothecation, unless the Articles restrict such ability. Since a private company is required to restrict the transfer of its shares by way of its Articles, such companies usually permit the creation of a security interest on the shares by the shareholders for the limited purpose of securing loans by the company.

3.4 Disclosure of Interests

Unlisted Companies

As mentioned in **2.13 Holding Through a Nominee**, the registered owner and beneficial owner of shares are required to make certain declarations with the company. Every individual who is a "significant beneficial owner" of a company is also required to file a declaration in this regard with the company. Upon receipt of such declaration, the company shall file a requisite return with the Registrar of Companies. If a company knows or has reason to believe that a person (who is not a member of the company) is a "significant beneficial owner" of such company, or that such person has knowledge of the identity of a significant beneficial owner, it shall give notice in the prescribed manner to such person.

Listed Companies

As per the Securities and Exchange Board of India (SEBI) takeover regulations, the following applies in the case of a listed public company:

- any acquirer, together with persons acting in concert with them, who acquires shares or voting rights in a target company, which taken together aggregates to 5% or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company to the SEBI and the target company in the prescribed manner; and
- any person, together with persons acting in concert with them, who holds shares or voting rights entitling them to 5% or more of the shares or voting rights in a target company shall disclose the number of shares or voting rights held and any change in shareholding or voting rights, even if such change results in their shareholding falling below 5%, if there has been a change in such holdings from the last disclosure made and if such change exceeds 2% of the total shareholding or voting rights in the target company, to SEBI and the target company in the prescribed manner.

Furthermore, as per the SEBI insider trading regulations, disclosures are required to be made to the company by every promoter, member of the promoter group and director of the company

regarding the shares held, acquired or disposed of by them.

4. Cancellation and Buybacks of Shares

4.1 Cancellation

A company may cancel its shares after issue by way of a reduction of share capital by passing a special resolution and through confirmation by the Tribunal, either with or without extinguishing the liability on any of its shares, in any manner. In particular, it may:

- cancel paid-up share capital that is lost or unrepresented by available assets; or
- pay off any paid-up share that exceeds the wants of the company.

4.2 Buybacks

A company may buy back its shares, provided that such activity is authorised by its Articles and a special resolution has been passed at a general meeting for the buyback. The board can authorise a buyback of 10% or less of the total paid-up equity share capital and free reserves of the company by passing a resolution at its meeting. A company cannot buy back if it has defaulted in the repayment of deposits, interest payment, redemption of debentures, preference shares, payment of dividend or repayment of any loan.

Key conditions for buyback include the following:

- the buyback should be 25% or less of the aggregate paid-up capital and free reserves of the company, and the buyback of equity shares cannot exceed 25% of the total paid-up share capital of the company in any financial year;
- the ratio of aggregate secured and unsecured debt after the buyback to the paid-up capital and its free reserves should not be more than 2:1;
- a declaration of solvency is to be made by the directors and filed with the relevant Registrar of Companies in the prescribed manner before making the buyback; and
- a company may purchase its own shares out of its free reserves, the securities premium account or the proceeds of the issue of any shares or other specified securities, but the buyback shall not be made out of the proceeds of an earlier issue of the same kind of shares or the same kind of other securities.

Buybacks by a company whose shares are listed on a recognised stock exchange are also governed by the provisions of the relevant SEBI regulations in this regard.

5. Dividends

5.1 Payments of Dividends

A company may pay dividends to its shareholders. Interim dividends may be declared by the board of a company, whereas final dividends can be recommended by the board but declared by the shareholders of the company at the AGM. Interim dividends for a financial year can be declared during that financial year or at any time during the period between the closure of the financial year and the holding of the AGM.

A company can only declare or pay dividends for any financial year out of its profits for that year, arrived at after providing for depreciation as per the Act, or out of the profits of any previous financial year or years arrived at after providing

for depreciation in accordance with the provisions of the Act and remaining undistributed, or out of both. Where a company proposes to declare dividends out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, owing to an inadequacy or absence of profits in any financial year, such declaration of dividends shall not be made, except in accordance with the prescribed rules.

A company cannot declare or pay dividends from its reserves other than free reserves. Furthermore, no company can declare dividends unless carried over previous losses and depreciation not provided in the previous year or years are set off against the profit of the company for the current year.

6. Shareholders' Rights as Regards Directors and Auditors

6.1 Rights to Appoint and Remove Directors

Appointment of Directors

Except as provided in the Act, every director shall be appointed by the company in a general meeting by the shareholders. The board can appoint additional directors or alternate directors (if the Articles so permit), or fill a casual vacancy.

In the case of a public company, unless the Articles provide for the retirement of all the directors, not less than two thirds of the total number of directors shall be persons whose period of office is liable to determination by retirement by rotation and eligible to be reappointed at the AGM. Independent directors are not included for the computation of the total number of directors. At the AGM, one third of such directors as for the time being are liable to retire by rotation shall retire from office. At the AGM at which a director so retires, the company may fill the vacancy by appointing the retiring director or some other person.

A person who is not a retiring director can be appointed as a director at any general meeting, if they or some member intending to propose them as a director have provided to the company a written notice signifying their candidature as a director or, as the case may be, the intention of such member to propose them as a candidate for that office, along with the deposit of the prescribed amount, which is refundable in prescribed situations.

Removal of Directors

Shareholders have inherent powers under the Act to remove a director by passing an ordinary resolution at the general meeting, pursuant to receiving from a shareholder a "special notice" of a resolution to remove a director. The Act provides for an elaborate process to be complied with in relation to the removal of a director.

Briefly, a notice of intention to move such resolution is to be given to the company by such number of members holding not less than 1% of the total voting power or holding shares on which such aggregate sum as prescribed has been paid-up. Such notice is to be sent by the members to the company within the prescribed timeframe before the relevant general meeting. Upon receipt of such notice, the company is required to give its members notice of the resolution at least seven days before the meeting or, if not practicable, to publish the notice in newspapers. The affected director is entitled to make a representation in writing and can ask the company to circulate said representation to all members of the company, which the company is obliged to do if there is adequate time. If there is

not, the director's representation has to be read out at the meeting itself, and such director is entitled to attend the general meeting.

For the removal of an independent director who has been reappointed for a second term, a special resolution shall be passed after giving the director a reasonable opportunity to be heard.

6.2 Challenging a Decision Taken by Directors

The board is vested with management powers over the company, and the shareholders are only entitled to exercise power over those matters that are specifically reserved under the Act or the company's Articles for their approval. Therefore, shareholders generally cannot interfere in the board's decision-making process or usurp any authority available to them, and it is difficult for them to challenge a board decision that has been passed in compliance with the Act and is not ultra vires of the Memorandum and Articles of the company.

The courts/Tribunal in India are usually reluctant to interfere with the management decisions taken in the best judgement of the directors, unless it can be proved that the directors acted mala fide in a manner that is prejudicial to the interest of the company, in which case they may approach the Tribunal alleging mismanagement. See **2.11 Challenging a Resolution**, which to a greater extent applies here as well.

6.3 Rights to Appoint and Remove Auditors

Appointment of Auditors

The first auditor of a company is appointed by the board within 30 days from the date or incorporation of the company. If the board fails to do so, the members of the company shall appoint an auditor within 90 days at the general meeting, and such auditor shall hold office until the conclusion of the first AGM. At the first AGM, the shareholders shall appoint the auditor to hold office until the conclusion of the sixth AGM.

Any casual vacancy in the office of an auditor shall be filled by the board of directors within 30 days, but if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the board, and the auditor so appointed shall hold the office until the conclusion of the next AGM.

Removal of Auditors

A company may remove an auditor from office before the expiry of its term through the shareholders passing a special resolution at a general meeting, only after obtaining the prior approval of the Central Government. The company shall hold the general meeting within 60 days of receiving approval from the Central Government to pass the special resolution. The auditor concerned shall be given a reasonable opportunity to be heard.

7. Corporate Governance Arrangements

7.1 Duty to Report

The board of a company is required to formulate a report ("Directors' Report" or "Board's Report"), which is attached to the audited annual financial statements for the consideration of the shareholders. Various matters pertaining to the affairs of the company are required to be included in said report, including on various aspects of corporate governance such as the number of board meetings held, related party transactions, the risk management policy and an evaluation

of the performance of the board and individual directors (applicable in the case of listed companies and certain classes of public companies).

A listed company is also required to provide a corporate governance report to be attached to the Directors' Report, containing a brief statement on:

- the company's philosophy on the code of governance;
- the composition and category of directors;
- the attendance of each director;
- the number of shares held by non-executive directors;
- a chart or a matrix setting out the skills, expertise and competence of each director;
- the various committees of the board, including their terms of reference, meetings held and the attendance of each committee member;
- the remuneration of directors; and
- other general shareholder information.

A listed company is also required to submit a quarterly compliance report on corporate governance in the format specified by SEBI to the recognised stock exchange(s) within 21 days from the end of each quarter. Such report also includes details of all material transactions with related parties.

8. Controlling Company

8.1 Duties of a Controlling Company

The Act does not contain an explicit provision on the duties of a controlling (holding) company towards the other shareholders of the company it controls. The general rule is that the controlling shareholder should not cause the conduct of the business and affairs of the company to be undertaken in a manner that is prejudicial to the interests of the controlled company or any of its other shareholders. A shareholder may approach the Tribunal if the controlling company (majority shareholder(s)) acts in a manner that is oppressive to the minority shareholders (see **2.11 Challenging a Resolution**).

9. Insolvency

9.1 Rights of Shareholders If the Company Is Insolvent

Under the Insolvency and Bankruptcy Code, 2016, the corporate debtor by itself (by passing a special resolution of its members) may initiate its corporate insolvency resolution process if it has committed a default in paying a debt that has become due and payable but not paid, by making an application to the adjudicating authority providing books of accounts and such other documents as specified and the name of the person proposed to be appointed as interim resolution professional. If the resolution process fails, the adjudicating authority may then pass a winding-up order.

Under the Act, shareholders of a company may also approach the Tribunal for the winding-up of the company, by passing a special resolution. Upon liquidation (by whatever mode, whether by creditors, corporate debtor or the company itself under the supervision of the Tribunal), the liquidator realises and distributes the assets in the order of priority, resulting in a waterfall method as provided under law. The claims of the equity shareholders over the proceeds from the sale of assets rank last after the insolvency resolution process costs, workers' dues, debts owed to secured creditors, the wages of other employees, government taxes and dues, amounts payable to preference shareholders, etc.

10. Shareholders' Remedies

10.1 Remedies Against the Company

Shareholders may approach the Tribunal if they believe that the affairs of the company are being conducted in a manner that is prejudicial to public interest or the interest of the company, or that is oppressive to the shareholder concerned or any other shareholder(s) of the company, provided the complaining shareholders meet the criteria for making such an application, as mentioned in **2.11 Challenging a Resolution**. They may also bring a class action suit against the company.

10.2 Remedies Against the Directors

Shareholders can bring legal action against a director(s) for:

- any act done in a manner that is prejudicial to the interest of the company;
- fraud on the company;
- any act that goes against the law or the charter documents;
- negligence or breach of their duties as directors;
- any act done in a mala fide manner; or
- the diversion of company funds.

Shareholders can also bring an action against any officer or employee of the company for wrongfully obtaining the possession of any property or wrongly withholding or applying such property for purposes other than those expressed or directed in the Articles and authorised by the Act. Shareholders can also remove a director by passing an ordinary resolution and following the process as provided under the Act (see **6.1 Rights to Appoint and Remove Directors**).

10.3 Derivative Actions

The Act does not provide an explicit provision with regards to bringing a derivative action. However, courts have paved the way for bringing such an action, and some courts have allowed such suits on the grounds of oppression and mismanagement. Such suit is only maintainable if the shareholders have come with "clean hands".

Certain elements of a derivative action can be found in "class action" suits, which are alternate remedies available to minority shareholders (see **2.11 Challenging a Resolution**). The major difference is that a class action is to sue on behalf of the entire class, whereas in a derivative action the directors and officers are sued on behalf of the corporate entity.

11. Shareholder Activism

11.1 Legal and Regulatory Provisions

Shareholder activism has arrived in India and is growing. Various legal and regulatory provisions or tools are available to activist shareholders under the Act and SEBI regulations, to encourage/promote their activism, such as:

- information and inspection rights available to the shareholders;
- the ability of shareholders to appoint and remove directors;
- the facility of e-voting to vote from remote places without physically attending the meeting;
- the right to approve the remuneration of directors in public companies;
- shareholder approval required for the appointment and removal of the director, the payment of dividends, etc;
- shareholders have a right to request a shareholders' meeting by requiring the board to call an EGM on the agenda of their choice and concern;

- shareholders have several legal remedies against the prejudicial and oppressive conduct of the company or its directors/officers; and
- listed and certain other classes of companies are required to constitute a stakeholder relationship committee to provide a mechanism for redressing shareholder grievances.

11.2 Aims of Shareholder Activism

Activist shareholders have become more involved and vocal. They undertake a pivotal and proactive role, and use their rights to influence change in the internal and external matters of the company. Activist shareholders usually focus on:

- ensuring good corporate governance, creating transparency with regards to the management of the company or changes in the internal structure of the company due to poor management by the board of directors;
- promoting change in policies governing environment and social governance (ESG);
- ensuring the protection of shareholders' interests and rights;
- financial issues, such as cost cutting, increasing shareholder value, capital inefficiency and under-performance; and
- addressing the problem where the management does not adequately respond to shareholders' concerns.

11.3 Shareholder Activist Strategies

Activist shareholders commonly employ various strategies to pursue their agenda of protecting shareholders' interests, influencing or strengthening corporate governance policies and bringing transparency to the affairs of the company. To purse such agenda, activist shareholders employ the following strategies:

- consistent interaction with the board to ensure transparency, giving strategic advice and actively participating through a stakeholders' relationship committee;
- requesting the board to convene a general meeting to discuss a particular agenda;
- making public announcements of their opinion on a particular matter proposed to be transacted at a meeting or after such matter has been passed;
- using legal remedies such as approaching the Tribunal on the grounds of company affairs being conducted in a manner that is prejudicial to the company and its shareholders, or initiating a class action suit; and
- filing a complaint with SEBI on the grounds of a breach of governance norms as prescribed for listed companies.

Activist shareholders do not need to acquire a large shareholding in the target company, even with a small stake, they may pursue their agenda by seeking other shareholders' support.

11.4 Recent Trends

In India, shareholder activism is a recent phenomenon and is not specific to any industry or sector. Of late, institutional investors have targeted or taken interest in promoter-driven companies and recently listed companies, addressing issues such as succession, governance issues, enhanced remuneration proposals for promoter directors, related party transactions, the induction of independent directors and the alteration of Articles proposing to give more management control and powers to the promoters. Recent examples of companies targeted by such activists include Zee TV, Dish TV, FSN E-Commerce Ventures Ltd. (Nykaa), Sun TV, Zomato, Eicher and Burger King.

11.5 Most Active Shareholder Groups

In India, institutional investors including mutual funds, insurance companies and foreign institutional investors are more active than individual shareholders.

11.6 Proportion of Activist Demands Met

Activist shareholders have been seen to play a very vital role and achieve decent success. Pursuant to such activism, resolutions for certain matters involving promoters have been rejected, such as enhanced remuneration proposals for promoter directors, the alteration of Articles proposing to give more management control and powers to the promoters, and related party transactions. In a few cases, institutional investors/large shareholders did not shy away from initiating legal proceedings against the company/promoter directors when their demands/proposals were not accepted or their issues were not resolved by the existing board. There have also been instances where the promoters have managed to pass the resolutions despite the activist shareholders, opposition, because of their large shareholding in the company concerned.

11.7 Company Prevention and Response to Activist Shareholders

Strategies Employed to Respond to Activist Shareholders

A company may consider following a three-fold strategy in responding to activist shareholders – before, at and after the general meeting. Before any general meeting, the company may proactively approach such shareholders to understand their concern and to provide them with the assurance that their concerns will be considered by the management and necessary measures will be taken to the extent possible. A company may also consider and analyse the solution proposed by the activist shareholder and formulate a suitable strategy for the resolution of the issue. At the general meeting, the company may elaborate and explain the adoption of such strategy to the activist shareholders, convincing them why such strategy is mutually beneficial for the company and its members. After the conclusion of the meeting, companies ensure the implementation of the strategy and undertake a timely review of its impact.

Minimising the Risk of Shareholder Activism

Shareholder activism arises in companies that have weak governance with regards to the management of the company and the treatment of the rights of its shareholders. To minimise the risk of shareholder activism, a company or its board may take the following practical steps:

- ensure that the company complies with the legal and regulatory requirements;
- formulate a corporate strategy and policies that are beneficial to the growth of the company and its members;
- create transparency by having periodic conversations and dialogues with the institutional and other major public shareholders with regards to the matters of concern to them;
- ensure timely and sufficient disclosure of those matters requiring disclosure under the applicable listing and disclosure laws; and
- evaluate the performance of the company, its strategies and policies, and the conduct of its management.

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