

IMPORTANT LESSONS FOR PRIVATE EQUITY AND VENTURE CAPITAL INVESTORS IN INDIA

By: Amrit Mehta, Partner, and Rahul Datta, Associate, Majmudar & Partners, India

Typically, private equity and venture capital investors seek various contractual rights to protect their investments and secure their returns. In relation to private investments in public enterprises or PIPE deals, it becomes important for minority shareholders (including financial investors) to understand their statutory rights as listed below and ascertain whether their rights are well and truly enforceable.

Rights of minority shareholders in India

The Companies Act, 2013 (the “Act”) provides several key rights to minority shareholders of companies in India, which include:

- **Protection against prejudicial actions:** Under sections 241 and 244 of the Act, the shareholders of a company can approach the National Company Law Tribunal (the “NCLT”) if, *inter alia*, the affairs of the company are being conducted in a manner prejudicial to public interest or the interests of the company, or its affairs are oppressive against any member of the company. Further, the shareholders of a company can also approach the NCLT by way of a class action suit under Section 245 of the Act if they are of the view that the management affairs of a company are being conducted in a manner prejudicial to the interests of the company or its members, and claim damages or compensation.
- **Requisition rights:** Under Section 100 of the Act, shareholders holding at least 10% of the share capital of the company having voting rights can requisition a shareholders’ meeting by issuing a requisition notice to the board of directors of a company (the “Board”). If the Board fails to convene a meeting upon receiving a requisition, the shareholders can convene a meeting themselves.
- **Variation of shareholder rights:** Under Section 48 of the Act, shareholders holding 10% of the issued shares of a class can approach the NCLT for cancellation of any variation to the rights associated with their shares if they did not consent to such variation.

Shareholders of public listed companies have certain additional rights under the Act and under the regulations issued by the Securities and Exchange Board of India (the “SEBI”), which include:

- **Board representation:** Under Section 151 of the Act, a prescribed number of small shareholders of a listed company can elect a director on the Board of the listed company. For this purpose, the Act defines small shareholders as a shareholder holding shares having a maximum face value of INR20,000 (Indian Rupees Twenty Thousand).

- General shareholder rights: Regulation 4(2)(a) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the “**LODR Regulations**”) obligates listed entities to protect certain rights of its shareholders, including: (i) the right to participate in, and to be sufficiently informed of, decisions concerning corporate changes; (ii) the right to effectively participate and vote in shareholder meetings; and (iii) the right of minority shareholders to be protected from abusive actions by or on behalf of controlling shareholders. Further, Regulation 4(2)(c) provides for the equitable treatment of all shareholders, including minority and foreign shareholders.
- Control over corporate strategy: Several key corporate actions require a special resolution under the Act read with the LODR Regulations, including, any alteration in the articles of a company, any issuance of shares on a preferential basis, any transfer of an undertaking by a public company, and any borrowing availed in excess of the prescribed limits. Similarly, under Regulation 24 of the LODR Regulations, any proposal for disposal of a material subsidiary or any transfer of a significant portion of the subsidiary’s assets requires approval by way of a special resolution (i.e., approval by at least three-fourth majority). These requirements read with Regulation 19(2)(B) of the Securities Contract Regulations Rules, 1957, which prescribes a minimum public shareholding percentage of 25%, provide an opportunity for significant minority shareholders to veto any undesirable corporate actions.
- Independent directors: The Act read with the LODR Regulations provides for the appointment and responsibilities of independent directors. Schedule IV of the Act, which prescribes the code of conduct for independent directors, specifically requires such directors to safeguard the interests of minority shareholders.

The Invesco-Zee dispute – a troubling trend

In October 2021, a single judge of the Bombay High Court granted an injunction against a requisition issued by Invesco Developing Markets Fund (“**Invesco**”), which held 17.88% of ZEE Entertainment Enterprises Limited (“**Zee**”), to convene a meeting of Zee’s shareholders. Invesco had sought to requisition the meeting of Zee’s shareholders to consider the following proposals:

- removal of three (3) non-independent directors of Zee, including, its managing director and chief operating officer, Punit Goenka; and
- appointment of six (6) independent directors.

As per press reports, Invesco claimed that it had sought the changes in Zee’s Board to protect the minority shareholders of the company and strengthen the corporate governance standards at a Board level.

Despite receiving the requisition, Zee's Board did not act on the requisition notice and did not convene a shareholders' meeting. Given this, Invesco filed a petition before the NCLT, Mumbai seeking directions to, *inter alia*, have the meeting conducted. In its preliminary order, the NCLT directed Zee to consider the requisition made by Invesco.

After considering the requisition notice, Zee's Board concluded that Invesco's requisition was invalid and/or illegal, as, in their view, the resolutions sought to be proposed by Invesco in the meeting were in contravention of applicable laws. Simultaneously, Zee filed a writ petition before the Bombay High Court seeking, *inter alia*, a perpetual injunction restraining Invesco from pursuing its requisition notice on the grounds that it was invalid due to its unlawful object.

In the initial order, a single judge of the Bombay High Court granted the injunction restraining Invesco from taking any action in furtherance of the requisition notice. The single judge held that Section 100 of the Act, which requires a valid requisition notice, only permits shareholders to issue requisition notices which have a lawful object, and the resolutions proposed by Invesco were held to be *ultra vires* applicable laws.

On March 22, 2022, a division bench of the Bombay High Court allowed Invesco's appeal against the injunction granted by the single judge and observed as follows:

- The requirement of a valid requisition under Section 100 of the Act only requires that the requisition satisfies the numerical and procedural requirements set out under the Act. The term, "*valid*", has no reference to the object of the requisition.
- The Board is not empowered to assess the merits of the resolutions proposed in a requisition notice and determine if they are in compliance with applicable law.
- Shareholders who are eligible to requisition a meeting under the Act are only bound to lay out the facts that are material to the proposed resolution and are not required to provide any reasons for proposing the resolution. Further, any reasons that are provided by the shareholders are not subject to judicial review.

During the pendency of the dispute, Zee announced a proposal to merge with Sony Pictures Networks Private Limited. Given this, Invesco did not pursue its right to requisition a shareholders' meeting, despite the order issued by the Bombay High Court, and in fact, has sold certain portions of its shareholding in Zee.

It appears that systemic delays and forum shopping by the counterparty can become problematic issues for minority shareholders seeking to enforce their statutory rights in a speedy and effective manner.

Other jurisprudence

- In 2021, the Supreme Court had analyzed the rights of minority shareholders claiming oppression and mismanagement under the Act in the high-profile dispute between Tata Sons Limited and Cyrus Investments Limited. While the Supreme Court held that the mere dismissal of a director did not amount to oppression and mismanagement, it went on to also hold that such an incident could, in the context of multiple oppressive practices, evidence the oppression of minority shareholders.
- In late 2020, Vedanta Limited's delisting attempt failed spectacularly when the minority shareholders deemed the offered price to be too low, and Vedanta Limited failed to attract the minimum number of offered shares to delist from the public market.
- In 2021, Eicher Motors Limited's shareholders rejected the re-appointment of its managing director as the director sought a substantial salary hike in a pandemic hit year. While the managing director was later re-appointed, it was only once he had agreed to a salary cap to appease the shareholders.

Conclusion

While several rights are accorded to minority shareholders under Indian company law, the exercise of these rights is often litigated. Therefore, shareholders should seek nuanced legal advice to ensure they are able to effectively exercise their rights.

In allowing Invesco's appeal, the division bench of the Bombay High Court safeguarded a key shareholder right and provided a major boost to all investors. We have highlighted some key takeaways below:

- Requisitioning a shareholder meeting is one of the key rights enshrined under the Act as a requisitioned meeting allows aggrieved shareholders to highlight their concerns. As evident from Invesco's use of the right, the right can also be a tool to publicly raise grievances against the affairs of the company or the functioning of the board.
- The division bench's ruling has reiterated the requirements for a valid requisition, and by invalidating the Board's discretionary dismissal of the requisition notice, it has laid down a marker for protection of minority shareholders.
- While the single judge's ruling was likely to have made shareholders apprehensive about enforcing their rights on account of having to litigate against the company and its board, the division bench ruling is likely to raise shareholder confidence.