“The Protection of Minority Shareholders Rights: Remedies to unfair prejudice and premises for bringing proceedings”

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UNDER SUPERVISION OF:

Ms. TRISHLA SINGH
Assistant Professor
SoLS, BBDU

SUBMITTED BY:

VIJAY SINGH RAJPUROHIT
Roll No.: 1190990029
SoLS, BBDU

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NAME:

VIJAY SINGH RAJPUROHIT

UNIVERSITY ROLL No.- *1190990029*

LL.M. (2019-20)

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LEGAL AND REGULATORY FRAMEWORK FOR PROTECTION OF MINORITY SHAREHOLDERS IN INDIA

INTRODUCTION

Corporate governance is a phrase that arises frequently whenever the proper conduct of business is questioned or discussed. However, the relevance of this term extends beyond the question of how a corporation should be managed or controlled. Corporate governance systems are of great significance to governments for the creation of national wealth and for the realisation of social objectives. Increased dispersion of shareholding means more members of the public invest their money in these corporate entities and therefore a strong and sound governance system is a *sine qua non* to inspire investor confidence.

Though the importance of corporate governance is rarely disputed these days, a precise determination of the scope of this term still eludes us. ―In its narrow sense, corporate governance is concerned with matters such as the composition and functioning of the boards, their accountability to shareholders and shareholder‗s participation in the decision-making process of companies. In a broader perspective, corporate governance embraces the entire network of those who depend on, or contribute to, the organisation and in that context, it addresses the fundamental questions about what companies should do, who controls them, how this control is exercised and how the risks and benefits from its activities are apportioned‖[1].

In the United Kingdom, the evolution of corporate governance was driven by the principle that managers are agents of the shareholders thus requiring that managers act in the shareholder‗s interest. Shareholder‗s interest was in turn taken to mean maximisation of the return on their equity. This _shareholder primacy model‗ has influenced the systems of governance in other parts of the world. However, the spectacular corporate failures of Enron and WorldCom led to the consideration of an alternative _stakeholder‗ approach to the management of companies. The emergence of the stakeholder approach also coincided with the emergence of a supplementary idea of corporate social responsibility – an idea that was based on the premise that the responsibility of a company should extend beyond the traditional objective of maximisation of shareholder wealth.

The shareholder versus stakeholder debate was addressed by the Companies Act, 2006 in UK wherein on one hand shareholder primacy was reaffirmed but with a caveat that the shareholder must be an ‗enlightened' shareholder who understands the necessity of an inclusive approach towards all stakeholders and the adoption of long term view of economic performance of the company[2]. Thus the Companies Act reaffirms the traditional view that managers are agents of the shareholders and thus ought to act in their interest even as it characterises the shareholder as an enlightened shareholder.

[1] Peter Neil Tylor, **Enlightened Shareholder Value and the Companies Act, 2006**, PhD Thesis submitted to Birkbeck College, University of London, May 2010, at p.13. Also see, Margaret M Blair, ***Ownership and Control – Rethinking Corporate Governance for the Twenty First Century***, Brookings Institution Press, Washington, 1995, at p. 7.

Derivative Action

The derivative action is a route by which shareholders, usually the minority shareholders, are able to enforce the company's rights where directors have breached their duties (since in these circumstances it is unlikely that the directors, who usually act on behalf of the company, will want to take action)[3]. The purpose of such an action is to protect the minority shareholders against abuses by the corporation, its directors, officers and controlling shareholders and to ensure corporate accountability. Derivative actions evolved as an exception to the general rule of law, also known as the rule in *Foss vs Harbottle*[4], that it is the company alone that can sue to enforce rights of action vested in it. The rule was the result of refusal of Courts, and rightly so, to interfere in the management of the company at the instance of a minority of its members who are dissatisfied with the conduct of the company's affairs by its board of directors. The rule received unequivocal support from the

2 This approach of the UK Companies Act 2006 can be discerned from s. 172 (1) wherein a director of a company is required to promote the success of the company —for the benefit of its members as a whole‖ and in doing so shall (also) have regard to the long-term consequences of any decision made, and to the interests of stakeholders such as employees, suppliers, customers, the community, and even the environment.

Supreme Court of India when it observed in *Rajahmundry Electric Supply Co. vs Nageshwara Rao*[5] that —It is no doubt the law that courts will not, in general, 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 as they are acting within the power conferred on them under the Articles of Association‖[6] However, it is equally true that this rule can lead to manifest injustices in some circumstances. Problems may arise when a majority of the directors are themselves engaged in conduct detrimental to the company and as such the board refuses to bring a suit in the name of the company. As a consequence, a number of exceptions to the rule in *Foss vs Harbottle* were developed to allow a member to sue in order to protect his or her ownership interest in the company.

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[3] Arad Reisberg, **Derivative Actions and Corporate Governance**, Oxford University Press, 2007, at p 1.

[4] (1843) 2 Hare 461; 67 E.R 189

Statement of the Problem

Centralized management had long been accepted as a practical necessity and advantage especially in the running of a big public company and company law embraces this concept[7]. However, centralized management implies a separation of ownership and management control and this is particularly the case where ownership of the company is widely dispersed amongst hundreds and thousands of different shareholders while the company�(s management is in the hands of a group of professional managers, who may not even own any of its shares. This situation gives rise to what economists call _agency problems‘ that is, the problem of management acting purely in their own interests instead of the interests of shareholders and the company. In other words, the decision managers (the management) who initiate and implement important decisions are not the major shareholders (the owners) and therefore do not bear a major share of the wealth effects of their decisions. Without effective control procedures, such decision managers are more likely to take actions that deviate from the interests of the shareholders[8]. Corporate governance codes and much of company law are preoccupied with dealing with these agency problems.

Agency problems can be categorized to be of two types. The first as earlier stated, relates to the conflict between the company‘s managers and its‘ owners. This _manager – shareholder‘ agency problem exists largely in countries like the United States of America and the United Kingdom which display dispersed share ownership structure. Because of this widely dispersed shareholding structure and the consequent separation of ownership and control, the efforts to deal with agency problems primarily focuses on the reduction of agency costs arising from self-serving managerial conduct by monitoring the activities of the managers and enhancing their accountability towards shareholders[9].

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[5] AIR 1956 SC 213

[6] *Ibid*., at para 14

[7] Eugene F. Fama and Michael C. Jensen, *Separation of Ownership and Control*, **Journal of Law and Economics**, Vol 26, No 2, June 1983, pp. 301 – 325, at p 304. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=94034. Last visited on October 31, 2016.

Companies in India are characterized by cohesive groups of _insiders' who have a closer and long-term relationship with the company as the shareholders. In other words, Indian companies display ownership concentration in the hands of few persons. Diffused ownership can be found only in a handful of Indian listed companies[10]. The insiders typically have a controlling interest in the company and thereby possess the ability to exercise significant control on the company's affairs. They are virtually able to appoint and replace the entire board and through this, influence the management strategy and operational affairs of the company. In companies like these, the managerial agency problem becomes fundamentally a problem for minority shareholders alone because the controlling shareholder/management's interests may conflict with those of minority shareholders. This therefore, is the second type of agency problem. Companies dominated by controlling shareholders/management are sometimes considered to be free of managerial agency problems of the first kind because as substantial shareholders with control of management they are better able to deal directly with managerial disloyalty or incompetence through hiring and firing and close monitoring of the management process, which would also benefit minorities. While this is true in some cases, there are too many situations where decisions are taken exclusively in the interests of the controlling shareholder and in disregard of minority interests. Furthermore, minority shareholders may be faced with a controlling shareholder/management which is incompetent or negligent.

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[9] Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, 6 **Hastings Bus.L.J**. 281, at p 285.

[10] *Ibid.* at p. 287.

These were the reasons why the Delhi High Court in *ICICI vs Parasrampuria Synthetic Ltd.*[11], was cautious in mechanically applying the rule in *Foss vs Harbottle*. The Court reasoned thus:

―A mechanical and automatic application of Foss vs Harbottle rule to the Indian situations, Indian conditions and Indian corporate realities would be improper and misleading. The principle, in the countries of its origin, owes its genesis to the established factual foundation of shareholder power and majority shareholder power centering around private individual enterprise and involving a large number of small shareholder, is vastly different from the ground realities in our country. Here the modern Indian corporate entity is not the multiple contribution of small individual investors but a predominantly and indeed overwhelmingly state supported funding structure at all stage by receiving substantial funding up to 80% or more from financial institutions which are entirely State controlled or represent substantial State interest and, thus, their shareholding may be small but it is these financial institutions which provide entire funds for the continuous existence and corporate activities. If we apply mechanically the Foss vs Harbottle Rule, it would amount to giving weightage to that majority of the shareholding having notionally holding more percentage of shares and the financial institutions which may own a small percentage of shares though contributed 80% or more in terms of the finances to such companies. 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 vs Harbottle would be unjust and impracticable.‖

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[11] (1998) 92 Comp. Cas. 238 (Del) at para 38.

In addition to the common law remedy of derivative actions afforded to the minority investors by exceptions to the rule of *Foss vs Harbottle*, the Companies Act, 1956 contains special provisions for prevention of oppression and mismanagement. The aim of such provisions contained in sections 397 to 409 of the Companies Act, 1956 is to safeguard the interest of investors, including minority shareholders in companies and also to protect the public interests.

Thus, Company Law jurisprudence in India offers two parallel regimes of protection for the minority investors. However, the relation between the two alternate modes has not been understood properly in India. On many occasions[12], courts appear to have either confused or have attempted to read one mode within the other whereas both these modes of protection should have been read independently. This also explains why the law relating to derivative actions has not grown any significantly in India when compared to the volume of case law under sections 397 to 409 of the Companies Act 1956. One of the principal reasons for this is the lack of a clearly defined derivative action[13].

Perhaps this could be the reason and also partly influenced by the developments in the United Kingdom, that the J.J. Irani Expert Committee on Company Law in its Report recommended that while the existence of derivative and class actions have been recognized by the courts in India, these should nevertheless be statutorily recognized[14]. Interestingly, while class actions have been recognized in the Companies Act, 2013[15], derivative actions have, however, been omitted.

It has been observed[16] that a number of factors conspire to make the position difficult for minority shareholders in India including, the persistence of close control even among listed companies and the

‗well-documented delays that bedevil the court system'. In all of these circumstances, whereas a derivative action exists at common law in India there would be definite advantages to this being set out clearly on a statutory basis – just as was done in the United Kingdom[17].

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[12] The most significant instance being *BSN (UK) Ltd & Ors vs Janardan Mohandas Rajan Pillai & Ors*, (1996) 86 Comp. Cas. 371 (Bom).

[13] John Paterson, ―Corporate Governance in India in the Context of the Companies Bill 2009: Part 1: Evolution‖, **International Company and Commercial Law Review** 2010, 21 (2), 41 – 53 at p 51.

Aims and Objectives

The research seeks to achieve the following aims and objectives:

- To emphasise the need for the protection of minority rights in the company law regime;
- To highlight the importance of derivative action as a mechanism for protection of minority investors;
- To explain the origin and evolution of derivative action;
- To analyse the impact of the statutory derivative action in the UK;
- To highlight how this mechanism has not been used in an optimal manner in India;
- To show why a statutory derivative action is necessary to strengthen the rights of minority investors in India.

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[14] Report of the Expert Committee on Company Law headed by Dr. Jamshed J. Irani, submitted to the Ministry of Company Affairs, Government of India on 31st May 2005, Chapter VI, Para 10.2.

[15] S. 245 of the Companies Act, 2013.

[16] See John Paterson, *Corporate Governance in India in the Context of the Companies Bill 2009: Part 3: Proposals*, **International Company and Commercial Law Review** 2010, 21 (4), 131 – 143, at p 138.

[17] *Ibid.*

Hypothesis

In order to realise the abovementioned aims and objectives, the following hypothesis shall be tested at the conclusion of the research:

- *—Derivative action is essential for the protection of minority rights in company law jurisprudence and due to the lack of clearly defined derivative action principles, statutory recognition of the same is necessary in India.‖*

Research Methodology

The research is intended to be a doctrinal research adopting a historical and analytical approach to the study of derivative action. The research will also be comparative in nature with the principal comparison being the position in India and the United Kingdom. Where relevant, comparisons to the position in the United States will also be made. The primary sources that will be relied on in the research will be *inter alia* statutory materials like the Companies Act, 1956 and the UK Companies Act, 2006, the Companies Act, 2013, Reports of various Committees like the Kumaramangalam Birla Report[18], the J.J. Irani Report[19] etc. and judicial decisions pronounced by the various courts in India, UK and elsewhere. Secondary sources relied upon will include research papers, articles, working papers etc. published in various journals and also other online resources.

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[18] Report of the Committee on Corporate Governance under the Chairmanship of Shri Kumaramangalam Birla constituted by SEBI in 1999.

Research Questions

The following research questions are raised, the answer to which, it is expected, will help in the testing of the hypothesis:

- Is there a need to protect minority investors in a company?
- Does derivative action have a separate advantage that other remedies available to the minority investors do not provide?
- Has derivative action been effectively utilised in India?
- Is there a need to statutorily recognise a derivative action?

Chapterization

The research will be carried out by dividing the research work into seven chapters.

Chapter 1

The first chapter will be ‗*Introduction*' that will introduce the subject of research, importance of the theme, and state the hypothesis, of the research. It will also lay out the research methodology, which the researcher intends to follow in the course of this research.

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[20] John Armour, Henry Hansmann and Reinier Kraakman, *Agency Problems, Legal Strategies and Enforcement*, **Discussion Paper No. 644**, Harvard Law School, July 2009, at p. 2. Available at http://www.law.harvard.edu/programs/olin_center/papers/644_Kraakman.php
. Last visited on October 31, 2016.

[21] *Ibid.*

Chapter 2

The second chapter is entitled ‗*Agency Costs – Problems and Perspectives*'. An agency problem in its most general sense arises when the welfare of one party – the ‗principal' depends upon actions taken by another party, termed the ‗agent'[20]. It is termed as a problem because of the central question as to how to ensure that the agent would act in the principal's interest rather than in the agent's own interest. The problem lies in the fact that because the agent has better information than the principal about the relevant facts of a transaction, the principal is normally not in a position to ensure that the agent's performance was indeed in the best interest of the principal. Consequently, the agent is tempted to act ‗opportunistically, skimping on the quality of his performance or even diverting to himself some of what was promised to the principal[21].

The theory of the agency problem seeks to address the question as to how the shareholders (the principal) of a company can assure themselves, that once they invest their funds, the management (the agents) will act in a manner that protects the former's interest. Without effective control procedures, managers are more likely to take actions that deviate from the interests of the shareholders[22]. This deviance could be either on account of either disloyalty or dishonesty or could simply be attributed to the negligence or incompetence of the managers.

The consequences of the agent's shirking of his responsibilities or deviance from his duty to act in the interest of the company are known as agency costs. Agency costs refer to the decline in the firm's value due to the agent's conduct, which are in divergence with the owner's interests[23]. The chapter then details the various modes of countering the agency problem and thus reducing agency costs.

Chapter 3

Chapter 3 is entitled ‗*Minority Interests: Forms of Actions Available for the Protection of the Minority Investor*'. The shareholders of the company express their wishes at the general meetings by voting for or against the resolutions proposed, and the will of the shareholders is expressed by a simple majority of votes or such other majority as may be prescribed by the bargain between the shareholders. Once a resolution is passed by the appropriate majority, it binds all the members including Can the majority shareholders use this power, for example, to appropriate the rights of the remaining shareholders? That certainly cannot be the case. Thus while in general the company shall be run in accordance with the will of the majority of the members, they cannot be permitted to use the powers so conferred to commit a fraud on the minority. Thus, the laws of most jurisdictions provide for various remedies to the minority shareholders for the protection of their rights.

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[22] *Ibid.*

[23] Pallab Kumar Biswas and Md. Hamid Ullah Bhuiyan, *Agency Problem and the Role of Corporate Governance Revisited*, **The Bangladesh Accountant**, Vol 52, No. 25, July- September 2006 pp. 109 – 117. Also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1287185, October 2008. Last visited on October 31, 2016.; see also Antoniadis, Lazarides, Sarrianidas & Goupa (2008) – Antoniadis I., Lazarides T., Sarrianidas N. and Goupa H., *The Impact of Agency Problem in Form Value and the Greek Stock Exchange Market Financial Crisis*, International Conference on Applied Economics

those who voted against it[24]. This is popularly known as the majority rule. While this principle is one of the basic postulates of company law jurisprudence, is this power of the majority to pass resolutions absolute and without limits?

(ICOAE) 2008. Electronic version available at http://kastoria.teikoz.gr/icoae2/wordpress/wp-content/uploads/articles/2011/10/004-2008.pdf.Last visited on October 31, 2016.

This chapter will look into the various remedies available to the minority shareholders for the protection of their rights. Since Indian company law jurisprudence is built on the foundations of the English company law, a proper assessment of the rights of the minority shareholder can only be made in comparison with the remedies available in English law. Thus, the chapter caries a detailed examination of the remedies available in the English legal system followed by an analysis of the remedies available in the Indian legal system. The remedies under English law discussed in the chapter include the Unfair Prejudice Remedy, Winding up on Just and Equitable Grounds and the Representative action and Group Litigation Order. In the Indian legal system, the remedies of Winding up on Just and equitable Grounds,

Remedy against Oppression and Mismanagement and regulatory measures by SEBI have been discussed.

In addition to the above remedies there are other remedies namely derivative actions and class actions. Class action is a new remedy introduced in the Companies Act 2013. However, since class action is another form of shareholder litigation like derivative action and since derivative action is the focus of this research, these forms of actions have been left out from the scope of this chapter and shall be dealt with separately in the succeeding chapters.

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[24] *Attorney General vs Davy*, 26 E.R. 531.

Chapter 4

This chapter ‗*Derivative Action: Historical Evolution*', attempts to trace the historical evolution of derivative action in the United Kingdom. The starting point of this study is based on the rule in *Foss vs Harbottle*. It then discusses the exception to the rules laid down in *Foss vs Harbottle* and the manner in which the courts have applied these rules in various instances.

Chapter 5

Chapter 5 is entitled ‗*Derivative Action under the Companies Act, 2006 in the United Kingdom*'. This chapter discusses the problems and deficiencies of the common law rules pertaining to derivative action and the approach of the lawmakers towards reform in this area. The new statutory derivative action is explained and a critical analysis of the same is carried out.

It discussions in this chapter shows that the attempt to reform the law on derivative action was a brave one as it was clear from the beginning that it would be a very difficult task to codify an extremely complex area of the law. It is equally true that the final product as contained in Part 11 of the UK Companies Act, 2006, do not entirely remove the problems faced under the common law regime. Questions like ratifiability and wrongdoer control which plagued the common law derivative action are likely to be revisited. This, it is opined, will create _uncertainty for some period as to the scope and extent of the derivative claim provisions and the burden of that will largely fall on the company'[25]. However it must also be noted, that the statutory derivative mechanism broadens the situations in which an action may be brought. In particular, such a claim may be brought in respect of negligence, default, breach of duty or trust by a director. Whether these provisions will in practice result in any significant change in the scope of a derivative action will have to be seen only in course of time. It is submitted that the attitude of courts in this regard will also play a very crucial role. This is particularly true because of the wide discretion that is vested in the courts by the provisions of Part 11 of the UK Companies Act, 2006. While an aggressive approach of the courts might fuel many U.S. – style litigation, the typical lackadaisical or over-cautious approach which has been the characteristic feature of the English courts in this respect might mean that the new reforms might not end up being too different from the common law derivative action.

[25] Reisberg (2007), *Supra* fn. 3 at p. 164.

Chapter 6

Chapter 6 is entitled ‗*Shareholder Litigation: Varied Dimensions and the Indian Scenario*'. This chapter focuses on the various forms of remedy available to the minority shareholder through litigation against the actions of a delinquent manager (excluding the remedies discussed earlier in Chapter 3). The chapter begins by explaining the dilemma of shareholder litigation. As Gower and Davies observes[26], ―the decision whether to initiate litigation in respect of an alleged breach of director's duty will not always be an easy one and a negative decision is not necessarily a sign that the company is being too lax towards its directors‖. At the same time, one cannot lose sight of the fact that most often the decision as to whether a company must litigate or not, is made by the board and this creates a conflict of interest. So when should the shareholder be allowed to litigate the matter is the dilemma.

The chapter then discusses the various forms of shareholder litigation possible under the Indian company law regime namely, the representative suits, class actions and finally the derivative actions. The chapter analyses the interpretation of derivative actions by the courts and analyses the reasons for the rarity of derivative actions in India.

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[26] Paul L. Davies (ed.), **Gower & Davies' Principles of Modern Company Law**, 7th ed., Thomson Sweet & Maxwell, 2003, at p. 443.

Chapter 7

Chapter 7 entitled ‗*Concluding Analysis: The Call for a Statutory Derivative Action in India*' contains the analysis, inferences/conclusions, in the light of discussions made in the previous chapters. The study finds that the courts in India have not been able to truly demarcate derivative action from the statutory remedy of Oppression and Mismanagement. The class action provided in the Companies Act, 2013 also does not substitute for a derivative action. Thus, it is the requirement of time that derivative action be statutorily defined so as to enable the minority shareholder with a separate remedy for the protection of his rights. This chapter tests the hypothesis stated in the introductory chapter and finds it to be true. The chapter concludes the research by providing a draft derivative action provision for statutory incorporation in the Companies Act, 2013 and provides justification for the same.

In the recent times, corporate governance has gained significant attention and focus across the globe. Sound corporate governance norms are of utmost importance for developed as well as developing nations to achieve their economic goals. One of the most essential requirements of a sound corporate governance system is that the rights of shareholders should be effectively protected and they should be allowed to participate and influence the corporate strategic decision- making.

Shareholders invest their money in a company and in return the company issue shares to them. The ownership of shares entitles the shareholders to certain rights. Though they do not control the company directly but still they are considered to be the real owners of the company. Thus, it becomes imperative to protect the rights of the shareholders as they are the real contributor of the capital of a company. Protection also becomes important because company is a business structure that covers different classes of people and has more than one owner. Efficient protection of shareholders rights can be achieved only if there is a law that provides for such protection. Thus, there is legal as well as actual aspect of shareholders protection. The legal aspect i.e. protection of shareholders as given under the law determines the position of shareholders in the law and the various accompanying rules and regulations. Shareholders play a very crucial in a company and hence their protection is important. It is always seen that in almost all the areas majority usually dominates the minority and so is in the case of the shareholders. The interests of minority shareholders are tend to be overshadowed by the over- powered majority shareholders or promoters of the company. Though there are certain rights granted to minority shareholders under the legal regime still they become a subject of dominance by the majority shareholders and the company.

Henceforth, the protection of minority shareholders becomes all the more important. Protection of minority shareholders can have some major effect on the valuation of the firm.While numerous factors play into whether a country has a dynamic financial market, there's one in particular that stands out. *Countries that offer a legal framework to protect minority shareholders tend to have more robust markets because investors are more willing to take risks.*[1]

In India, the shares of a Company are held predominantly by the promoter or their near and dear ones or sometimes also by their foreign business counterparts either in the form of investment or through institutional investments.[2] Nevertheless, this does not mean that company should turn a blind eye to the interests of the minority shareholders of the company.

Before dealing with the rights of minority shareholders in detail let us first look into the meaning of shareholders and minority shareholders.

Who is a Shareholder?

Companies Act, 2013, though does not define the meaning of the word shareholder expressly but section 2(55)(iii) states that 'member' in relation to a company means- *every person holding shares of the company and whose name is entered as a beneficial owner in the records of the depository*.

Thus, we can derive the meaning of the term shareholder from the above section to mean a person who holds the shares of the company and by virtue of this he is considered to be a member of the company.

Majority Shareholders:

Generally, the term majority shareholder is used to define a shareholder who owns most of a company's shares. Usually it is more than 50% of the shares of a company. They have a considerable degree of power as compared to other shareholders and tend to largely influence the decision-making process of the company.

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[1]*See* Mauro Guillén, *Why we need to protect minority shareholders*, (dated 16th Oct.2015), *available at*: https://www.weforum.org/agenda/2015/10/why-we-need-to-protect-minority-shareholders/ (last accessed on 12th April., 2018

[2] *See India has third highest number of family-owned businesses*, THE HINDU, (dated 26th Oct., 2017), *available at* https://www.thehindubusinessline.com/economy/india-has-third-highest-number-of-familyowned-

businesses/article9925495.ece (last accessed on 12th MaApril, 2018)

Minority shareholder:

Companies act, 2013, also does not define who is a minority shareholder but in common parlance, it is usually used to refer to a shareholder who is in possession of less than 50 percent of the total voting rights of a company and neither directly nor indirectly controls the management of the company.

According to the **Black's Law Dictionary** Minority Shareholder means a " Equity holder with less than 50% ownership of the firm's equity capital and having no vote in the control of the firm'.

In the explanation provided under section 151[3] of the Companies Act, 2013 the meaning of the term '**Small Shareholders'** has been given to mean means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed. But such meaning is confined to this particular section only.

Also, another question that now arises is that whether small shareholders and minority shareholders are the same or not and whether these terms can be used interchangeably or not? One of the answers that can be given for the above question is that small shareholders are different from the minority shareholders as small shareholders are determined as per their individual shareholding which according to the section should be less than rupees 20,000. On the other hand minority shareholding is determined collectively and viewed as having non-controlling stake in the company. Nevertheless, small shareholders may be considered as minority shareholders owing to the small amount of shares that they hold resulting in non-controlling stake in the company.

Though there is no statutory provision that defines who is a majority or a minority shareholder

but the degree of control that may be exercised by them over the company can be used as determinant to distinguish between the two groups.

[3] Appointment of director elected by small shareholders.-A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

2. RIGHTS OF MINORITY SHAREHOLDERS UNDER THE COMPANIES ACT, 2013-

Right to appoint Small Shareholders' Directors-

The small shareholders[4] or minority shareholders as often construed, of a listed company have a right to appoint a shareholder of their choice on the board and such shareholder may be called as a 'Small Shareholders' Director' under section 151 of the Act.

The concerned company may on an application by not less than one thousand small shareholders or one tenth of the total number of such shareholders appoint a small shareholders director. The listed company also has the power to suo moto appoint such director. The director so appointed under this section is considered to be an independent director subject to his fulfilling the criteria under section 149(6) of the Companies Act, 2013. Such director is not eligible for reappointment once his term finishes.[5]

The provisions of this section were first brought into action by the minority shareholders of Alembic Limited. Unifi Capital one of the minority shareholders, holding 3% of the shares in Alembic, moved an application to appoint its vice-president as the small shareholders; director. But the same was rejected by the Board and it was also not considered in the Annual General meeting of the company.[6]

Although, this provision is important for the protection of small shareholders, it should be ensured that it is not misused by the large institutional investors who may act on whims of the promoters. Without appropriate checks and balance, the small shareholders may end up acting as pawns in larger corporate battles amongst groups of influential shareholders such as a large institutional investor and the promoters. This will end up compromising the interest of passive retail shareholders rather than protecting them, which was the reason for the small shareholder director in the first place.[7]

Legal experts say there is no provision under law that gives an automatic right to any shareholder to appoint a director on the board, based on certain threshold shareholdings. However, Section 151 of the Companies Act allows a listed company to have one director elected by small shareholders. Such a director is appointed by an ordinary resolution at a general meeting, for a single term of three years.[8]

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[4] The explanation to section 151 of the Companies Act, 2013 gives the meaning of small shareholders as "For the purposes of this section ―small shareholders‖ means a shareholder holding shares of nominal value of not

more than twenty thousand rupees or such other sum as may be prescribed”.

Right to apply to NCLT for Oppression and Mismanagement-

Usually, a company operates through its Board of Directors, who are expected to work in a manner that would maximize shareholders' value and in the best interest of its shareholders. The general scenario in any company is that the shareholders of the same class have equal voting rights. And thus, it has become a cardinal rule that apparently the majority shareholders have greater powers as compared to that of the minority ones and are in a better position to control the affairs of the company. Those decisions of the majority that are well within the scope of law and are also not ultra vires of the articles of the company would have a binding effect on the minority shareholders also.

But there are chances that it may so happen that the decisions of the majority may not always be in the best interest of the minority. There might be cases where majority takes a decision that would advance their interests at the expense of the minority. In such cases the minority shareholders can approach the National Company Law Tribunal (hereinafter referred to the NCLT) under the provisions of the Companies Act, 2013. Chapter XIV of the Act lays down the remedies that minority shareholders can resort to in cases of oppression and mismanagement. Section 241, 242 and 244 that relates to oppression and mismanagement were made effective from 1st of June, 2016.[9]

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[7] *See* Umakanth Varottil, *Activism through Directors Elected by Small Shareholders*, INDIACORPLAW, (dated 25th July, 2017), *available at* https://indiacorplaw.in/2017/07/activism-through-directors-elected-by.html (last visited on 18th April., 2018)

[8] *See* Sudipto Dey, *When can a small shareholder appoint a director on the board*, BUSINESS STANDARD, (dated 25th July, 2017) *available at* http://www.business-standard.com/article/companies/when-can-a-small-shareholder-appoint-a-director-on-the-board-117072400789_1.html (last visited on 18th April., 2018)

[9] *See* Ministry Of Corporate Affairs, *Notification S.O. 1935(E),* (dated 1st June, 2016) *available at*

http://www.mca.gov.in/Ministry/pdf/Notification_02062016_I.pdf (last visited on 26th Mar., 2018)

Section 241[10] of the Companies Act lays down the cases wherein any member of a company may make an application for relief to NCLT in cases of oppression and mismanagement. A member can base his claims on any of the grounds as provided under the said section.

The meaning of 'any member of a company' has also been discussed in various case laws. One such case is *S.V.T. Spg. Mills (P.) Ltd. v. M. Palanisami*[11], where the court held that the term 'member' under section 2(27) of the 1956 act (corresponding to section 2(55) of the 2013 act) has to be construed on a larger connotation, which means persons other than bearers of share warrants are to be treated as members.The applicability of section 397 and 398 (corresponding to sections 241, 242 and 244 of the 2013 act) is an equitable jurisdiction which is intended to protect the minority members of the company from any oppression and mismanagement at the hands of majority of members.

The Madras High Court, in *Amalgamations Limited (Now Amalgamations (P) Ltd) & Others v. Shankar Sundaram & others*[12], cleared the position as to the question that *whether a member of a holding company can file a petition in the affairs of a subsidiary company?* The Madras High Court upheld the decision of the Company Law Board and said that it had rightly arrived at a conclusion that it will be improper and illegal to join subsidiaries in the company application on facts and circumstance of the case. It was stated that when a person is not a member of a company, his alleging oppression and invoking the provisions of section 397 (Companies Act, 1956) against that company does not arise. Therefore, a shareholder of a holding company cannot complaint of oppression by a subsidiary in which he is not a member as there is no legal relation between him and the subsidiary company.

Central government is also empowered to make an application to the NCLT.[13]

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[10] section 241- Application to Tribunal for relief in cases of oppression, etc.— (1) Any member of a company who complains that—

(a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or

(b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter.

Maintainability of the suit filed under section 241-

Section 244 enlists the members who are eligible to make an application under section 241. As per the provisions of the section, in the case of a company having a share capital, at least one hundred members of the company or one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares and in the case of a company not having a share capital, at least one-fifth of the total number of its members.

But the eligibility criteria as given under this section may be done away with if it allowed by the tribunal on an event of an application made to it on this behalf. This is allowed under the proviso of the said section.

A very recent example of maintainability of suit under section 241 and waiver of the criteria given under section 244 is the ruling of the National Company Law Appellate Tribunal in the famous case of *Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd*[14]. The appeal arose out of the order of NCLT that rejected the petition filed by the *Mistry group* alleging oppression and mismanagement by the TATA sons on the basis that it held only 2.17% of the total share capital of TATA sons as against the minimum the requirement of 10% given under section 244 of the Companies Act.[15]

The appellate tribunal divided the issue into two parts. Firstly, whether the petition filed by the Mistry group is maintainable under section 241, 242 and 244 of the act. If not then, secondly, whether the petitioner has made an application for waiver under the proviso of section 244?

The NCLAT held that though the petitioner fails to fulfill the threshold limit as given under section 244 but it allowed the maintainability of the petition by waiving off the limit. The appellate tribunal while giving its ruling laid down certain parameters that would be considered while deciding an application waiver under this section. It further clarified that these parameters are not exhaustive but other factors may also be considered.[16]

In *Shanti Prasad Jain V. Kalinga Tubes Ltd*[17], the court held that continuing up to the date of the petition showing that the affairs of the company were conducted in a manner oppressive to some part of the members. The conduct must be burdensome, harsh and wrongful and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless the lack of confidence springs from oppression a minority by a majority. It must involve at least an element of lack of probity or fair dealing to member in

the matter of his proprietary rights as a shareholder.

Right to file a Class Action Suit-

It is another type of protection given to minority shareholders. A class action suit usually means a legal suit wherein a group of persons sharing a common interest can go to NCLT if they are of the view that the affairs of the company are conducted in manner that is prejudicial to the interests of the company or members or depositors.

The concept of class action suits in India finds its genesis in the J.J. Irani Committee Report.[18] The report suggested that *in case of fraud on the minority by wrongdoers, who are in control and prevent the company itself bringing an action in its own name, derivative actions in respect of such wrong non-ratifiable decisions have been allowed by courts. Such derivative actions are brought out by shareholder(s) on behalf of the company, and not in their personal capacity(ies), in respect of wrong done to the company. Similarly the principle of Class/Representative Action by one shareholder on behalf of one or more of the shareholders of the same kind have been allowed by courts on the grounds of persons having same locus standi. Though these principles have been upheld by courts on many occasions, these are yet to be reflected in Law.* The committee highlighted the importance of this principle and its need to be placed in law.

The aim for insertion of this concept under the new Companies Act, 2013 was basically to protect the small shareholders, ensuring greater accountability of auditors and protection against the chances of corporate frauds and scams. "*The rationale offered by the Ministry of Corporate Affairs for insertion of this provision was to see that "the shareholder feels like a king" in matters such as managerial remuneration."*[19]

The satyam scam highlighted the urgent need for introduction of such class action mechanism in India. Though the promoters and members of the board and the key managerial personnel were prosecuted under the SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations 2003 and the SEBI (Prohibition of Insider Trading) Regulations 1992, there was an absence of provisions relating to the compensation of shareholders loss.[20] In a strive to recover the loss of shareholding value, a lot of investors knocked the doors of National Consumer Disputes Redressal Commission along with Supreme Court but failed to get the same as their claim was rejected for the lack of an existing law that authorizes recovery of shareholding value in such cases. The National Consumer Disputes Redressal Commission said that "*we do not have the infrastructure to deal with such kind of petition".*[21] The Supreme Court also on appeal turned down the matter.[22]

The absence of a provision on class action suit led to the suffering of Indian shareholders and

investors as they failed to recover their loss of shareholder value, but on the other hand the investors in America were able to recover the loss through a settlement of $125 million and $25.5 million from Satyam and PwC respectively. The inconsistency of treatment between the security holders in India and in America drew the attention of Ministry of Corporate affairs regarding class action suits, which ultimately found its place under section 245 of the new Companies Act.

Section 245 empowers members and depositors to proceed against the company, the directors, auditors, or any advisor or expert if they are engaged in any wrongful, unlawful and fraudulent act or omission or conduct relating to the company.

Eligibility Criteria: section 245(3) lays down the minimum requirement for the purpose of filing a class action suit.

Type of Company	**Minimum Requirement**	**Depositors**
Company with Share Capital	At least 100 members or the prescribed 10%[23] of the total members whichever is less or member(s) holding 10% share capital at least. However, it is important to note here that such members should have paid all the calls due on their shares.	Minimum 100 or at least 10% of the total depositors, whichever is less or a depositor to which company owes 10% of the total deposits.

Company without Share Capital	1/5th of the total number of members	

Admissibility of Class action Suit:-

The Tribunal along with the factors stated in section 245(4) of the Act shall also take into account rule 85 of the National Company Law Tribunal Rules, 2016 which sets out the criteria for admitting a class action. The following factors shall be considered for the same:

a) That whether the member or the depositor who is making the application is doing it with bona fide intention or not;
b) Any evidence that shows the involvement of any other person except the directors or officers of the company in relation to the matters stated in section 245(1)(a)-(g);
c) That the cause of action is such that it can also be pursued by the member or the depositor in his individual capacity instead of taking the route under this section;
d) Any views of the members or the depositors that show that they neither have any direct nor any indirect personal interest in the concerned matter;
e) That the cause of action is such which has not taken place yet but is likely to happen and the chances are such that it may be authorized or ratified by the company before its occurrence;
f) That whether there are so many members in the concerned class that approaching them individually would be very difficult and hence class action preferable;
g) That there are questions either of fact or law that are common to that particular class;
h) That the claims made or the defenses put forward by the parties are such that they are typical to that particular class;
i) That whether it would be fair and adequate in the interest of the class to allow the representative on behalf of that class.

Benefit to Minority shareholders:-

Generally, the minority shareholders do not have sufficient rights individually and are often suppressed. Section 245 allows them to come together and file a legal suit and empowers them to claim damages from the company, its directors, auditors, experts and advisors. Such benefit may not be available to a shareholder if he goes to the tribunal in his individual capacity as compared to a class action suit.[24]

Class Action vs. Oppression and Mismanagement-

There have been questions as to the incorporation of class action suits under section 245 when already under section 241 (oppression and mismanagement) a suit can be filed by the members of a company if they are of the opinion that the business of the company is conducted in such a manner that is detrimental to the interest of the company. But there are certain differences that make its (section 245) important. One such is that section 245 also covers within its ambit depositors who are not included under section 241 i.e. depositors are also allowed to make an application under section 245. No doubt the remedies that are available under section 241 that includes order for purchase of shares by any member, restricting transfer or allotment, termination or modification of an agreement, removal or appointment of director etc is much more wider than that compared to under section 245 still section 245 is much more liberal with regard to award of damages and compensation.

Any order made under Section 245 is in nature of rem and is binding even on those members or depositors who are not party to the application as opposed to an order of oppression and mismanagement which is only binding on the parties to the application. While a Class Action can be invoked in case of any act prejudicial to the interest of the members, the depositors or the company; in case of oppression and management, public interest is also taken into account.[25]

Section 241 to section 245 gives the much required protection to the minority shareholders. It is a useful weapon in the hands of shareholders which can be used by them to make the negligent officers answerable for their acts. The enforcement of such sections shall open the eyes of the corporate bodies and its officers and shall make them more cautious while discharging their duties and making key policy decisions. [26]

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[24] *See* Arjya Majumdar, *Class Action Suits – Genesis, Analysis And Comparison*, (dated 12th Dec., 2016), *available* at https://ssrn.com/abstract=2883976 (last visited on 25th April, 2018)

[25] *See* Varun Munjal, *India: Class Action Suits: Notified Yet Ambiguous*, (dated 30th Nov., 2016), *available at* http://www.mondaq.com/india/x/548850/Class+Actions/httpwwwmondaqcomcontentprarticleaspprid20550prod

uctid (last visited on 25th April., 2018)

Merger and Acquisitions and Minority Squeeze Out:

The decisions related to merger and amalgamation are generally taken by the management along with the majority of shareholders which means small shareholders do not have much say in the matter. If a shareholder is unhappy with the transaction at his best what he can do is that he may vote against the resolution. But the problem arises because they do not have much votes in their hands. If the majority shareholders agree to sell the company at a low price to a relative entity (usually seen in companies which are family run) or where there is reverse merger i.e. merger of a healthy company with a relatively unhealthy one then it may affect the interests of the minority shareholders. Also, the determination of fair price is also not easy because sometimes it may so happen that initially the price that seems to be unfair at the time of merger may prove to be a really fair one once the results of the merger comes out (acquisition of JLR by TATA Motors).[27]

The concept of squeeze out has emerged greatly in the past few years and thus it becomes important to regulate it. It used as tool to exploit the minorities and since most of the companies are controlled by families the regulation it becomes even more important.[28]

Squeeze out is a process of acquisition of the shares of the minority shareholders in exchange of compensation. It is an example of the immense power that the majority shareholders can use to flush out the minority shareholders. It is the demonstration of the significant control by the majority shareholders on the company. Squeeze out may prove to be beneficial for the company but may be harmful for the interests of the minority shareholders. Though it is done through a legitimate process yet it is a threat to the minorities in the company.[29] Squeeze out may be effected through four ways under the Companies Act., 2013[30].

Section 236 of the Companies act makes provision for squeeze out which puts forward the criteria wherein the majority can buy the minority shareholding. If an aquirer or such person acting in concert with him by reason of any merger, exchange of shares or conversion of securities, becomes owner of at least 90% of the equity share capital (issued) of the company then such person has the right to inform the minority shareholders i.e. the remaining 10% shareholders about his intention to buy their shareholdings. The price offered for such purchase shall be determined through valuation by a registered valuer. Sub-section (3) of section 236 also empowers the minority shareholders to offer their shareholdings for purchase to the majority shareholders.

The legal position of squeeze out in India has been interpreted by the courts in many cases. In *Sandvik Asia Limited v. Bharat Kumar Padamsi*[31], the question that was put before the court for its consideration was that whether the decision to drive out the minority shareholders in exchange of a price can be said to be unfair and inequitable. The court while giving its decision said that "*once it is established that non-promoter shareholders are being paid fair value of their shares, at no point of time it is even suggested by them that the amount that is being paid is any way less and that even overwhelming majority of the non-promoter shareholders having voted in favour of the resolution shows that the Court will not be justified in withholding its sanction to the resolution*."

Certain guidelines were laid down by the Bombay High Court in the case of *Cadbury India Limited*[32] and it also defined the meaning of the word prejudice. The court said that in transactions involving minority buy-outs it is the duty of the court[33] to make sure that "*the scheme is not against the public interest, is fair and just and not unreasonable, does not unfairly discriminate against or prejudice a class of shareholders and draws a balance between the commercial wisdom of the shareholders expressed at properly convened meetings. The term "prejudice" in relation to valuation of a scheme would mean something more than just receiving less than what a shareholder desires, being a concerted attempt to force a class of shareholders to divest themselves of their holdings at a rate far below what is reasonable, fair and just*"

In another case of *In re Elpro International Limited*,[34] the squeeze out of minority shareholders through the route of reduction of share capital was challenged by the Bombay Stock Exchange on the basis that the silence of the minority shareholders was treated as their acceptance to the proposal. Though the court did not invalidate the proposal and approved the same but it stated that the stock exchanges have the freedom to take action under the listing agreements in case they are of the view that securities law has been violated. The stock exchange did not accept the squeeze out and as result of which the company had to take withdrew its proposal of squeezing out the minority shareholders[35]. This case is a classic example of how stock exchanges have come forward to protect the interests of the minority shareholders as and when needed.

The concern that still arises is that the role of SEBI is limited only to the regulation of the listed companies.[36] The squeeze outs that are done in unlisted companies fall outside the scope of SEBI. And in order to keep SEBI out of the transaction companies usually first go for delisting and then bring out a proposal for squeezing out and thus the regulatory supervision is least which the make the minority shareholders of such companies even more vulnerable.

Related party transactions-

In the recent years there have been growing concerns over the abuse of related party transactions in Asian countries and more particularly in India[37]. The problem stems from the structure of ownership that the Indian companies have. There is wide concentration of ownership which gives the controlling power in the hands of a single family or individual or it may also happen that the same promoter group is controlling a number of companies. Though related party transactions are not prohibited and may also prove to be value enhancing for the company but the there are chances that it may be used as a tool by the controlling shareholders to misappropriate the corporate value. Many times related party transactions are associated with unfavorable consequences for the minority shareholders. Such transactions have acted as a catalyst in certain corporate frauds.[38]

Section 188 of the Companies Act, 2013 does not prohibit related party transactions but attempts to regulate it. As per the 1st proviso any that has a minimum paid up share capital of rupees 10 crore or more or wherein the company seeks to enter into a transaction certain transactions then such company can only do so by passing a resolution to that effect.[39] Further, the 2nd proviso prohibits any member who is a related party from casting its vote on the said resolution. Which often leads to the empowering of minority shareholders in allowing a related party transaction and this assumes greater importance in India where most of the companies are family run i.e. majority shareholders are related parties. Regulation 23(4) of the SEBI (Listing Obligations And Disclosure Requirements) Regulations, 2015 also lays down such prohibition.

However, it has been clarified by the Ministry of Corporate affairs that 'related party' in the above context refers only to such related party as may be a related party in the context of the contract or arrangement for which the said resolution is being passed.[40]

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[38] *See* A. *Galani & N. Rehn, Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses*, N.L.S.I.R., (2010), pp. 134, 137, *available at* http://www.nlsblr.com/uploads/3/7/6/7/37673841/03.pdf (last accessed on 29th April 2018)

[39] Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014

[40] *See* Government Of India Ministry Of Corporate Affairs, General Circular No., 3O/2O14, (dated 17th July, 2014), *available at* http://ebook.mca.gov.in/notificationdetail.aspx?acturl=6CoJDC4uKVUR7C9Fl4rZdatyDbeJTqg3uaDT7Vp4Q49CMLrjLkTdQ3Pyokn1IG4M1v2eQsahUIhbgQpxm44GdQtcvtvroFBL

[41] *See* Jyotindra Dubey , *Battling the giants: How minority shareholders are making the right noises*, THE

HINDUSTAN TIMES, (dated 4th Mar., 2016),

Examples wherein the minority shareholders have blocked a related party transaction[41]:

- The case of PTL enterprise where the proposal related to the sale of its holding in hospitals. It was opposed by the shareholders on the grounds of low valuation. Also, KSIDC one of the minority shareholders in PTL was successful in restraining the proposal from being approved. As a result of which the company had to drop its plan.
- In another case in 2014, the management of Siemens India proposed to sell its metal technology business to its parent company Siemens AG. The proposed valuation was relatively low as compared to that of its earlier transfer to Siemens India. By reason of it being a related party transaction the same had to be presented before the shareholders for its approval and it was subsequently, rejected. Consequently, the management had to raise the valuation and it was again put before the shareholders who ultimately accepted it.

Though such changes in the new companies Act and its allied rules have been embraced by many in the legal fraternity but at the same time they have shown their concern over the harassment of promoters by the shareholders in genuine cases.[42]

3. COMPARATIVE STUDY ON MINORITY SHAREHOLDERS RIGHT UNDER COMPANIES ACT, 1956 AND COMPANIES ACT, 2013

Combined Provisions for relief related to oppression and mismanagement:

The following are some of the key changes that have taken place in the provisions related to oppression and mismanagement-

Protection of Minority shareholders form Oppression and Mismanagement	Provisions under Companies Act, 2013	Provisions under Companies Act, 1956
Relevant provisions	The new companies act contains a combined provision for relief against oppression and mismanagement. Section 241 deals with both the concept.	The old act had two separate sections i.e. section 397 and section 398 separately contained the concept of oppression and mismanagement respectively.
Authorized body	NCLT is the authorized body and the application has to be made to the tribunal.	Under the earlier act, Company Law Board was the concerned authority to receive applications.
Waiver of eligibility criteria	The tribunal has the power to waive the eligibility requirement in certain cases as discussed earlier in this chapter.	Central government had the power to waive off the eligibility criteria.

Apart from the above changes there has also been an increase in the powers of the tribunal i.e. the tribunal has wider powers as compares to that of the Company Law Board. These include restriction on transfer or allotment of shares of the company, removal of the managing director or any other director of the company. The intent of the lawmakers is to improve the mechanism that though existed but needed certain amendments which have now been incorporated under

the provisions of the new act.[43]

Class Action Suits:

The concept of class action suit which was missing under the old act has now been introduced under the new act. After the satyam scam there was a glaring need of such concept in India.[44] the bitter experiences of the past has shown that the inability to file a class action suit led to numerous individual suits which creates additional burden on the judiciary which ultimately leads to an wanted backlog of cases. The potential effect of introducing such a concept seems to be promising as it will lead to lower costs of litigation as compared to that involved in the individual law suits, increased benefits to the minority shareholders, decreased cases which mean fewer burdens on the judiciary. But the role of NCLT has been increased in the sense that there is no definite definition of "good faith" and it has to be determined on a case to case basis. There is greater amount of responsibility on the tribunal to pursue the case with respect to the threshold requirements, the bona fide of the petition and of the applicants so that it is not abused.[45]

The introduction of class action suit has been a great achievement of the Ministry of Corporate affairs. It has been highly embraced by the shareholders, depositors and the members. In addition to the increased protection of the minority shareholders it also ensures that the companies are now more cautious while discharging its various functions. Additionally, it also casts a duty on the shareholders and the members of the company that this mechanism is not used as a tool in furtherance of the self-interest or personal gain of the minority shareholders and shall avoid frivolous suits.

Apart from the above measures the 2013 act also makes provision for the institution of Independent director. Schedule IV of the Act, lays down the 'Code of Independent Directors' which states that the that independent directors shall inter alia work towards promoting the confidence of minority shareholders.

Companies Act, 2013 has sought to invariably provide for protection of minority shareholders rights and can be regarded as a game changer in the tussle between the majority and minority shareholders. Various provisions have been introduced in Companies Act, 2013 to essentially bridge the gap towards protection and welfare of the minority shareholders under Companies Act, 1956.[46]

Further, in the year 2017, India's rank in the area of 'minority investors protection' improved to four, on the back of several policy changes undertaken by market regulator SEBI to increase investor protection and market integrity.[47]

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[45] *See* Lalit Kumar, *India: Get Ready For Class – Action*, (dated 28th Sep., 2016) *available at*

http://www.mondaq.com/india/x/530880/Shareholders/GET+READY+FOR+CLASS+ACTION

4. WHAT INDIA CAN ADOPT FROM OTHER JURISDICTIONS?

Though in india, there is no provision that specifically talks about the fiduciary responsibilities of the controlling shareholders but there are jurisdictions where such concept has been recognized and incorporated into law. The Securities and Exchange Board of India, in a consultative paper on review of Corporate Governance Norms in India (2012), had also recognised the fiduciary duty owed by the controlling shareholder to the minority shareholder, and proposed that the controlling shareholder of listed companies should enter into relationship agreements with the listed company, and the minority shareholders, which will specify the duties and responsibilities of controlling shareholders.[48]

In U.K., the listing rule extends greater protection to the minority shareholders of a premium listed company. These rules apply to premium listed companies with controlling shareholders. As per the rules a controlling shareholder is any person who exercises or controls on their own or together with any persons with whom they are acting in concert, 30% or more of the votes of the company". under the rules such companies are required to enter into a Controlling shareholder agreement, and there are certain undertaking in the agreement that includes that if any transaction takes place between the company and the controlling shareholders then it must be based on the arm's length pricing, the controlling shareholder will not take any action that would prevent the issuer from complying with its obligations under the Listing Rules and the controlling shareholder will not propose or procure the proposal of a shareholder's resolution that is intended or appears to be intended to circumvent the proper application of the Listing Rules. In case of cancellation of such listing agreement a majority of 75% is required which further protects the minority.

As already seen there is prevalence of such controlling shareholders in many Indian Companies. Such a provision can also be made on the same lines in India for listed entities in India. This will ensure that these controlling shareholders do not exercise any undue influence over the company and its actions

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[46] *See* Akshat Sulalit, *Companies Act, 2013: Rise of the Minority Shareholder,* I.L.J., *available at:* http://www.indialawjournal.org/archives/volume6/issue-2/article5.html (last visited on 1st May, 2018)

[47] *See* Pavan Burugula, *Ease of doing business: India scores on minority investor protection*, BUSINESS STANDARD, (dated 1st Nov., 2017), *available at* http://www.business-standard.com/article/economy-policy/ease-of-doing-business-india-scores-on-minority-investor-protection-117110100042_1.html (last visited on 1st May, 2018)

Shareholders' rights and empowerment in India & U.S.

The status quo of corporate governance and shareholders rights

The corporate governance arrangements of a company come from two sources: the corporate charter and the laws of the company's state of incorporation.[2] Both the sources and thus corporate governance structure can be changed with critical company decisions, for example, a merger decision. Shareholders being the ultimate owners of a public traded company, it is only right to entitle them with sufficient power which helps them to ensure that their interests are well served during the company's day to day functioning as well as while taking critical company decisions. Even though corporate laws of different jurisdictions provide shareholders various sort of rights, they are not serving the purpose in practice. Let us take a look at some of the corporate law principles and practices in common law countries - India, U.S. and U.K.

A brief look through shareholder rights in India:

In India, tremendous power resides with the majority shareholder & promoters. Unlike in the United States & U.K., majority shareholder and promoters in India, rather than the Board of Directors, have the most direct influence on management of a company that can lead to suppression of minority shareholders' rights and can make an easy way to corruption.[3] Shareholder protection has steeply increased in the last decade with the introduction of Clause 49 of the Listing Agreement. The important rights of shareholders in India are briefly specified in the following paragraphs.

All shareholders in India have the right to participate and vote in company meetings and shareholder ballots. All matters of importance regarding a company's functioning require shareholder approval. Shareholders have a right to vote by proxy and are entitled to appoint another person as his/her proxy, irrespective of whether the proxy is a shareholder or not.[4] A proxy has the right to attend and vote, but cannot speak at the meeting. Shareholders can approach Company Law Board (CLB), the courts or SEBI for redress when their legal rights are violated. The minority shareholders can apply to CLB for redress against oppression and mismanagement, subject to the minimum requirement of not less than one hundred members or 1/10th of the total number of members whichever is less, or any member/s holding not less than 1/10th of the issued share capital.[5] The Companies Act requires all shares and all share transfers to be registered and the registers must be available for public scrutiny.

[2] Lucian Arye Bebchuk "The Case for Empowering Shareholders" (2003)
[3] Joshua Skolnick "India's Satyam scandal raises corporate governance concerns in Asia", February 17, 2009
[4] Reserve Bank of India "CORPORATE GOVERNANCE IN INDIA: CURRENT STATUS & RECOMMENDATIONS", April

The Companies Act, 1956 (as amended by the Companies (Amendment) Act, 1999), India, mandates companies to have an annual general meeting of their shareholders. The notice of the AGM has to be posted to all shareholders 21 days prior to the meeting, containing the company's reports and accounts, the agenda, all resolutions that are to be discussed in the meeting and a proxy form. Shareholders accounting for at least 1/10th of the paid-up share capital have the right to call an extraordinary general meeting. If the request is supported by reason and signatures, it is incumbent upon the board to announce such a meeting and hold it within 45 days.

Ordinary resolutions such as election and removal of directors, appointment of external auditors, remuneration of directors, payment of dividend, approval of annual accounts and the routine matters relating to the conduct of a company are passed with the approval of more than 50 per cent of the shareholders present and voting. Special resolutions such as buy-back of shares, proposed merger or de-merger, changing the name of the company, altering the memorandum and articles of association or the registered address of the company from one state to another, voluntary winding up of the company and similar decisions require special resolutions with the approval of 75 per cent of those present and voting.

With respect to disclosure and transparency, shareholders have a right to receive copies of balance sheet and auditors' report. The balance sheet and profit and loss account should give true and fair view of the state of affairs of the company. Under the provisions of the Listing Agreement, all listed companies are required to make detailed disclosures.[6] The companies are bound by law to make timely disclosure of material and price sensitive information including events having an effect on the performance of the company to the regulators as well as to every stock exchange where they are listed.

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[5] The World Bank Group, "Corporate Governance Assessment And ROSC Module"

[6] Reserve Bank of India "CORPORATE GOVERNANCE IN INDIA: CURRENT STATUS & RECOMMENDATIONS", April

There are special legislative measures included in Indian company law to serve minority shareholders interest. Minority shareholders with qualified minority may initiate action against decisions of the majority in a court of law. According to section 399 of the Companies Act, 1956, a qualified minority consists of at least one hundred shareholders or one tenth of the total number of shareholders, whichever is less, or any shareholder(s) holding one-tenth of the issued share capital of the company fully paid-up. Moreover, minority shareholders who hold more than 25% of the shares will have the ability to obstruct special resolutions, seek intervention of the Company Law Tribunal (CLT) and, therefore, impede the functioning of the company at some level. The Indian company law protects minority shareholders' interest by providing an adequate platform at CLT to raise grievances in case of oppression or mismanagement by the majority shareholders of a company. It is important for corporations to ensure that board membership reflects the interest of minority shareholders. In this regard, the Independent Directors (IDs) have an important role to play in ensuring minority shareholders' interests are protected.[7] The IDs also need to be easily accessible for minority shareholders to convey or raise their concerns. Minority shareholders can also nominate candidates for the ID position.

As we see above, shareholders in India are equipped with necessary rights by law. Still the rights are not really executed, in other words, shareholder activism is minimal in India so far. The major task for the Indian corporate sector is that to discipline the dominant shareholder & promoters and protecting the minority shareholders. I explain these issues in detail in the chapter 3.

A brief look through shareholder rights in U.S.:

Shareholders in U.S. face many obstacles on their way in order effectively execute their current rights. In the following sections, we will see the main rights that are assigned to shareholders under current corporate governance rules. Lucian Arye Bebchuk, School of Law, Harvard University has given deep thoughts about shareholder empowerment in U.S. and his recent publications have been an important source for this section.

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[7] Reserve Bank of India "CORPORATE GOVERNANCE IN INDIA: CURRENT STATUS & RECOMMENDATIONS", April

A central and well-settled principle of U.S. corporate law is that all major corporate decisions require a decision, or at least initiation, by the board.[8] Unlike other common law countries like U.K.[9] or India, shareholders may not initiate any such decisions, and they can change the course of the corporation only by replacing the board with a new board that will do so.[10] Thus U.S. companies are far from being an inherent corollary of the modern, large corporation.[11]

The basic and long standing principle of U.S. corporate law is that the power to manage the corporation is conferred on the board of directors.[12] Bebchuk also reminds us that the board's power is not only limited to the daily operation of the corporation, but board also has significant power over important corporate transactions. In addition to the rules that produce dispersed ownership, another set of rules, that are denying shareholders the power to intervene, make U.S. shareholders further weak. Bebchuk from Harvard Law Review Forum claims that even with the existing patterns of ownership, introducing shareholder power to intervene would considerably change the balance of power between management and shareholders and thereby have profound and largely beneficial impact on corporate governance. In general, shareholders have the power to reject a termination resolution put forward by the Board, as it commonly require an approval with vote by a majority of the outstanding shares. So, the power that shareholders have is only a veto power and they still lack the power to initiate a termination transaction.

With reference to Delaware General Corporation Law, the first step in a merger or consolidation transaction must be the approval of a merger agreement by the board. After such approval, the merger agreement is brought to a vote of the stockholders at an annual or special meeting and must receive approval by a majority of the outstanding stock.[13] Similar rules are applied for liquidation decisions as well as decisions to sell all corporate assets under Delaware law. In fact, the Delaware code specifically authorizes the board to abandon a merger or a proposed sale of assets that received prior approval from the shareholders.[14] Bebchuk learns that's under Delaware law and the law of other U.S. states, the power to declare dividends is granted exclusively to the board, and no shareholder approval is required.

Shareholders have the power to veto fundamental changes rather than the power to direct that they be made.[15] As we have seen the fundamental rules governing company winding up transactions, the rules controlling company charter amendments are very similar. Majority of outstanding stockholders votes are required to take effect any corporate amendment decision, but again only company board can initiate such proposals and bring them to vote.

Stockholders are incapable of making such a proposal and bring it to vote[16] without management interest. Bebchuk, in his research paper in December 2004, depicts that "As for the state of incorporation, no state statute explicitly sets forth a procedure for reincorporating in other states. Reincorporation is generally accomplished by merging the corporation into a shell corporation incorporated in the desired new state of incorporation. Since state statutes allow for merger with a corporation incorporated in another state, it is possible to create a company that is identical in every respect but is simply incorporated elsewhere. As reincorporating takes procedurally the form of a merger, the rules governing merger decisions apply." Thus, Bebchuk acknowledges that under Delaware law, reincorporation requires a shareholder vote of approval, but again only the board can initiate such a vote.

It is worth noting that, under current corporate governance rules in the U.S., shareholders have the concurrent authority with the board to amend the company's by-laws.[17] The by-laws, however, are subordinate to the charter and cannot alter any of the arrangements set in the charter.[18] Bebchuk leaves an interesting thought that while shareholders have power to intervene in second-order rules, they are denied the power to intervene in high-level rules.

Under most state laws the default standard for uncontested director elections is a plurality vote, which means that a director is elected in an uncontested situation even if a majority of the shares are withheld from the nominee.[19] Since 2006 some companies have volunteered to adopt majority voting standards, but in many cases they have only done so when pressured by shareowners forced to spend tremendous amounts of time and money on company-by-company campaigns to advance majority voting.[20] Another reality is that shareholders very often unable to vote to replace directors immediately. This would be possible only in those companies in which shareholders have the power to call a special meeting or act by written consent and in which the board is not staggered.[21] When shareholders do not have such power or are not allowed to act by written consent as in most U.S. companies, they will have to wait at least until the forthcoming annual general meeting and, in case of staggered boards, at least until the next two annual meetings, which could be two years down the road. One can imagine that how disastrous a company can get to with two years of mismanagement. Lucian Arye Bebchuk finds that indeed most U.S. companies have charters that would force shareholders to wait a significant period of time before they can vote management out.

In practice, under the traditional U.S. regulatory framework, the ability of shareholders to propose nominees to the board is severely constrained. There are several reasons why sitting directors can easily coagulate enough consensuses to obtain the election of either themselves or their favorite candidates over candidates advanced by shareholders.[22] Directors send out proxies using corporate resources and information. Shareholders cannot easily piggyback on the proxy solicitation conducted by the corporation because, pursuant to federal law, directors can exclude shareholders' proposals concerning the election of directors from the corporate proxies. Adding nominees to the slot of candidates advanced by the board of directors is considered a matter regarding directors' election, and therefore shareholders can be denied access to corporate proxies in this regard. On the other hand, shareholders could independently solicit their own proxies, but this is unlikely to happen because proxy solicitation can be extremely expensive (also in terms of potential liability for misstatements in the proxy documents). In addition, the corporation is not mandated to reimburse proxy expenses, even in case of complete or partial victory of the dissenting shareholders. On top of that, shareholders might face other procedural obstacles in their proxy fight, such as obtaining an updated lodger of shareholders of record in a timely manner.

Thus we can see that shareholders of U.S. companies either do not have enough power to effectively involve in corporate transactions or unable to exercise their rights efficiently. I shall discuss in detail about these concerns in the chapter 4.

A brief look through shareholder rights in U.K.:

law provides shareholders with better power than U.S. law[23] and Indian law, in particular, provides them with power to intervene in company operation. The default arrangement, which is provided by model provisions of the article of association supplied by the Companies Act, prescribes that the business of the company shall be managed by the directors.[24] This management, by the board, however, is subject to "any directions given by special resolution" of the shareholders. According to the Companies Act, shareholders always have the residual right to adopt through a special resolution any change in the articles of association and any corporate decision. A special resolution requires a majority of 75%, but this is a majority of 75% of the votes cast at the meeting rather than that all the voted that shareholders are entitled to cast.[25]

Shareholders have a common law right to propose resolutions at an annual shareholder meeting. Shareholders wishing to exercise this right are only required to give notice to shareholders of such proposals and to bear the cost of notice. Furthermore, the directors are required to call a general meeting once the company has received requests to do so from shareholders representing at least 5% paid up voting share capital. The threshold has been reduced from 10%.

Shareholders have got right to request the company to include an item in the business of the annual general meeting. As is the case for resolutions requested by shareholders, the company pays the expense of circulation of the agenda item if the request is received before the end of the financial year preceding the meeting. If the request is received after the end of the financial year, the expenses are borne by the shareholder.

Thus, we see that shareholders in U.K. are better protected and furthermore the UK Stewardship Code issued by the Financial Reporting Council (FRC), UK aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities.[26]

An analysis on shareholder rights in common law & civil law countries:

The analysis begins by considering shareholder rights under company laws. Because shareholders exercise their power by voting for directors, evaluations of shareholder rights focus on voting rights. These include voting rights attached to shares, rights that protect the

voting mechanism against interference by insiders, and remedial rights. Investors may be better protected when dividend rights are tightly linked to voting rights, that is, when companies are subject to one-share-one-vote rules. The idea is that when votes are tied to dividends, insiders cannot appropriate cash flows by maintaining voting control despite controlling only a small proportion of the company's shares.[27]

Five other rights essentially describe how easy it is for shareholders to exercise their voting rights. These rights measure how strongly the legal system favors shareholders relative to managers in the voting process. The below interesting findings are based on the publication by the World bank Group.

- To vote in shareholders meetings in some countries, shareholders must show up in person or send an authorized representative. In other countries, by contrast, they can vote by mail, which makes it easier for them to cast their votes. In Japan, for example, about 80 percent of companies hold their annual meetings the same week, and voting by mail is not allowed.
- In some countries, the law requires that shareholders deposit their shares with the company or a financial intermediary several days before a shareholders' meeting. This practice prevents shareholders from selling their shares for several days around the time of the meeting and keeps shareholders who do not bother to go through this exercise from voting.
- Some countries allow cumulative voting for directors, which in principle gives minority shareholders more power to put their representatives on boards of directors.
- In some countries, the law provides minority shareholders with legal recourse against perceived oppression by directors. The mechanisms may include the right to sue directors (as in American derivative suits) or to force the company to purchase the shares of shareholders who object to such fundamental changes as mergers or asset sales.
- Company law also establishes the percentage of share capital needed to call an extraordinary shareholders meeting—the higher the percentage, the harder it is for minority shareholders to organize a meeting.

Two major facts emerge from the analysis of shareholder rights in the countries in the sample.[28] First, countries with a common law system afford comparatively the best legal protection to shareholders. They most frequently allow shareholders to vote by mail, they

never block the sale of shares for shareholders meetings, they have the highest incidence of laws protecting oppressed minorities, and they generally require a relatively small percentage of shares to call an extraordinary shareholders meeting. Second, countries with French civil law origin afford the worst legal protection to shareholders. They have the lowest incidence of allowing voting by mail, a high incidence of blocking share sales for shareholders meetings, and a low incidence of laws protecting oppressed minorities, and require the highest percentage of share capital to call an extraordinary shareholders meeting.

In Australia and South Africa, two common law countries, a minority shareholder can vote by mail, can trade his/her shares during a shareholders meeting, is protected from certain expropriations by directors, and needs only 5 percent of share capital to call an extraordinary meeting. By contrast, in Italy and Belgium, whose legal systems are based on French civil law, a minority shareholder cannot vote by mail, cannot trade his shares during shareholders meeting, is not protected from expropriation by directors, and needs 20 percent of share capital to call an extraordinary meeting.

1. Corporate governance and shareholders activism in India: An inside look

Corporate governance in a developing country setting takes on additional importance. Good corporate governance is vital because of its role in attracting foreign investment. The extent of foreign investment, in turn, shapes the prospects for economic growth for many developing countries. This chapter discusses about corporate governance reformations in India before and after the "Satyam scandal". The chapter also focuses on shareholder activism as well as major roadblocks to shareholder activists.

Corporate governance movements in India:

The historical development of Indian corporate laws has been marked by many interesting contrasts. At independence, India inherited one of the world's poorest economies but one which had a factory sector accounting for a tenth of the national product. The 1956 Companies Act built the functioning of joint-stock companies and protection of investors' rights. While the Companies Act has always provided an excellent framework, and clear instructions for maintaining and updating share registers, in reality minority shareholders had often suffered from irregularities in share transfers and registrations. Because of a vast majority of Indian corporate companies are controlled by promoters and families who while owning a significant proportion of share capital, rule them as if they are they are their personnel freedom; a kind of self regulation. Sometimes non-voting preferential shares had been used by promoters to channel funds and expropriate minority shareholders. There were cases in which the rights of minority shareholders had been compromised by management's private deals in the relatively infrequent event of corporate takeovers.

Company Boards had often been largely ineffective in their monitoring role, and their independence had been perceived as highly questionable.[29]

In Indian context, the need for good corporate governance has been highlighted because of the series of scams that had become an annual feature ever since the government liberalized the economy in 1991. The series of important scams which includes Harshad Mehta scam, Ketan Parikh scam, the UTI scam, Vanishing companies scam, Bhansali scam and so on shook investor confidence. The real history of Indian corporate governance started in the year 1992 following efforts made in many countries of the world to put in place a system suggested by the Cadbury Committee, United Kingdom[30]. Thus important developments have

shown in the field of corporate governance and investor protection in India through the establishment of Securities and Exchange Board of India (SEBI) in 1992. Also, the existence of voluntary code framed by the Confederation of Indian Industry (CII) in 1997 had a great impact on Indian corporate governance. In the next three years, almost 30 large listed companies accounting for over 25 percent of India's market capitalization voluntarily adopted the CII code. By 1999 the SEBI set up a committee headed by Kumar Mangalam Birla to mandate international standards of corporate governance for listed companies. Three years later the Naresh Chandra committee gave governance more thought. From 2001 over 140 listed companies accounting for almost 80 per cent of market capitalization started following the mandatory international standards and from 2003 each and every listed companies joined the SEBI code. The SEBI implemented the recommendations of the Birla Committee through the enactment of Clause 49 of the Listing Agreements. In 2004, the Narayana Murthy[31] committee affected changes to clause 49 of the listing agreement. Clause 49 may well be viewed as a milestone in the evolution of corporate governance practices in India. It is similar in spirit and in scope to the Sarbanes- Oxley[32] measures in the United States. The key mandatory features of Clause 49 regulations deal with the following:[33] (i) composition of the board of directors; (ii) the composition and functioning of the audit committee; (iii) governance and disclosures regarding subsidiary companies; (iv) disclosures by the company; (vi) CEO/CFO certification of financial results;

(vi) reporting on corporate governance as part of the annual report; and (vii) certification of compliance of a company with the provisions of Clause 49. The composition and proper functioning of the board of directors emerges as the key area of focus for Clause 49. It stipulates that the board of a company must have an optimum combination of executive and non-executive directors with not less than fifty percent of the board comprising the non-executive directors. The number of independent directors would dependent on the nature of the chairman of the board. In case a company has a non-executive chairman, at least one-third of board should comprise of independent directors and in case a company has an executive chairman, at least half of board should be independent. The areas where Clause 49 stipulates specific corporate disclosures are: (i) related party transactions; (ii) accounting treatment; (iii) risk management procedures; (iv) proceeds from various kinds of share issues; (v) remuneration of directors; (vi) a Management Discussion and Analysis section in the annual report discussing general business conditions and outlook; and (vii) background and committee memberships of new directors as well as presentations to analysts. In addition, a board committee with a non-executive chair is required to address shareholder or investor

grievances. Finally, it is mandated that the process of share transfer (that had been a long-standing problem in India be expedited by delegating authority to an officer or committee or to the registrar and share transfer agents.[34]

Although Clause 49 mandates many of these improvements, Indian companies were voluntarily improving corporate governance, through the emergence of globalization which served as the impetus for adoption of corporate governance best practices**.** The motivation behind this is that every Indian company is in, a) need to access foreign capital either through listing on a foreign stock exchange such as the LSE, NYSE or NASDAQ or by attracting private equity, foreign institutional investors or joint venture partnerships, b) need to become a reputable company to export globally, and c) desire to become multinational companies.[35]

Ownership and financial Structure of Indian corporate enterprises

Indian corporate sector is characterized by the co-existence of state owned, private and multinational enterprises. The shares of these enterprises are held by institutional as well as small investors. But this is not the case in public sector enterprises where the government is the promoter and owner of such enterprises. The findings indicate the presence of highly concentrated ownership structure in the Indian corporate firms. Family-run business groups clearly play a crucial role in the Indian corporate sector. About 60% of these companies (comprising about 65% of the total market capitalization of the Exchange), are part of these business groups. The actual ownership within these companies is far from being completely transparent with widespread pyramiding, crossholding, and the use of non-public trusts and private companies for owning shares in group companies. About 11% of companies comprising about 22% of the market capitalization are companies wholly or significantly owned by the Central (Federal) or State Governments; about 20% of companies comprising about 8% of the market capitalization are non-Group companies controlled by Indian promoters; and about 9% of companies comprising about 5% of the market capitalization are non-Group companies controlled by foreign promoters. Even in 2002, the average shareholding of promoters in Indian companies was as high as 48.1% and for the 500 largest Indian companies, based on data from Prowess which is a database of the financial performance of Indian companies , promoters own about 53% of the shareholding. Evidence from BSE-200 Index companies shows relatively few companies in India are widely held with no significant single-promoter control.[36] Thus it clearly confirms the belief that the Indian companies are dominated by families and promoter's stakes though the situation is slightly changing.

Also the financial structure of the company, that is, proportion between debt and equity, has implications for the quality of governance. Recent research has shown contrary to the Modigliani-Miller hypothesis that the financial structure of the firm has no relationship to the value of a firm, that the financial structure does matter, it is no secret that the lenders exercise significant influence on the way a company is managed and controlled. Banks can perform the important function of screening and monitoring companies as the banks are better informed than other investors. Further, banks can diminish short-term biases in managerial decision-making by favoring investments that would generate higher benefits in the long run. Banks play a more favorable role than other investors in reducing the costs of financial distress.[37]

Reformation in Indian Corporate Governance:

If we consider why the corporate governance has become a popular subject of debate in developing countries, we could realize that it is the impact of globalization. Corporate governance represents the value framework, the ethical frame work and the moral frame work under which business decisions are taken. The investors want to be sure that not only their capital handles effectively, but also the business decisions are to be taken in a manner which is not illegal or involving moral hazard.

India's corporate reform efforts were initiated by corporate industry groups, many of which were instrumental in advocating for and drafting corporate governance guidelines. The first phase of India's corporate governance reforms were aimed at —making boards and audit committees more independent, powerful and focused monitors of management as well as aiding shareholders, including institutional and foreign investors, in monitoring management. effort of Securities and Exchange Board of India (SEBI). SEBI constituted two committees to revise the Clause 49 listing agreements and to review the progress of the corporate sector and to determine the role of present companies. Moreover SEBI encouraged the credit rating agencies -CRISIL[38] and ICRA[39] - to evolve a suitable corporate governance index as a measure of wealth creation by the corporates. Some of the companies have been rated against the index. The revised listing agreement provided for the following major aspects of corporate governance.[40]

- Changes have been made to the definition of 'independent directors'; strengthening the responsibilities of audit committee; improving the quality of financial disclosures and finally; the board as a whole has been tasked with the adoption of a formal code of conduct for statements issued by the CEO. Accordingly companies are now required to constitute various committees like a 'nomination committee', 'compensation committee', 'governance committee' and other committees to adhere to corporate governance.
- The Indian law requires the nomination committee of the board to be composed entirely of independent directors, who will be responsible for the evaluation and nomination of board members. In India, the responsibilities of 'audit committee' include scrutiny of the company's annual audited financial statements, appointment of external auditors, interacting with internal auditors and issues relating to internal controls existing in the company.
- The committee also recommended to improve the role of the chairman of the board.

The role of Chairman is to ensure that the board meetings are conducted in a manner which secures the effective participation of all directors, executive and non- executive alike, and encourages all to make an effective contribution, maintain a balance of power in the board, make certain that all directors receive adequate information, well in time and that the executive directors look beyond their executive duties and accept full share of the responsibilities of governance.

- The board should set up are remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment. All remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc. has to be disclosed to shareholders.
- With regard to the shareholder rights, half-yearly declaration of financial performance including summary of the significant events in last six-months, should be sent to each household of shareholders. The Committee believes that the formation of such a committee will help focus the attention of the company on shareholders' grievances and sensitise the management to redressal of their grievances. To expedite the process of share transfers the board of the company should delegate the power of share transfer to an officer, or a committee or to the registrar and share transfer agents. The delegated authority should attend to share transfer formalities at least once in a fortnight.
- The institutional shareholders has to take active interest in the composition of the Board of Directors, be vigilant, maintain regular and systematic contact at senior level for exchange of views on management, strategy, performance and the quality of management, ensure that voting intentions are translated into practice and evaluate the corporate governance performance of the company.

Corporate Governance reformation after Satyam scam:

Satyam Computers services limited was a consulting and an Information Technology (IT) services company founded by Mr. Ramalingam Raju in 1988. It was India's fourth largest company in India's IT industry, offering a variety of IT services to many types of businesses. Its networks spanned from 46 countries, across 6 continents and employing over 20,000 IT professionals. On 7th January 2009, Satyam scandal was publicly announced & Mr. Ramalingam confessed and notified SEBI of having falsified the account.[41] India's corporate community experienced a significant shock with the damaging revelations about the board failure and colossal fraud in the financials of Satyam. It is to be considered that, the period

after Satyam Scandal is the second phase of reform in Indian Corporate Governance.

In September 2008 the World Council for Corporate Governance honored the now-beleaguered Indian outsourcer Satyam with a “Golden Peacock Award” for global excellence in corporate governance. With its honoree now engulfed in scandal, the Council rushed to distance itself from the troubled company by rescinding the award, issuing a press release through the India-based Institute of Directors stating “the award was obtained as a result of non-disclosure of material facts.” In the historic confession letter of former chairman of Satyam, B. Ramalinga Raju, admitted a fraud of Rs 78 billion (USD 1.6 billion) that has caused the regulators and the investors everywhere to re-examine the corporate governance standards. Raju confessed that Satyam’s balance sheet of 30 September 2008 contained:

- Inflated figures for cash and bank balances of Rs 5,040 crores (US$ 1.04 billion) [as against Rs 5,361 crores (US$ 1.1 billion) reflected in the books].
- An accrued interest of Rs. 376 crores (US$ 77.46 million) which was non-existent.
- An understated liability of Rs. 1,230 crores (US$ 253.38 million) on account of funds which were arranged by himself.
- An overstated debtors’ position of Rs. 490 crores (US$ 100.94 million) [as against Rs. 2,651 crores (US$ 546.11 million) in the books].[42]

The scandal all came to light with a successful effort on the part of investor’s to prevent an attempt by the company promoters to use the firm’s cash reserves to buy two companies owned by them i.e. Maytas Properties and Maytas Infra. As a result, this aborted an attempt of expansion on Satyam’s part, which in turn led to a collapse in price of company’s stock following with a shocking confession by Raju. The truth was its’ promoters had decided to inflate the revenue and profit figures of Satyam thereby manipulating their balance sheet consisting non-existent assets, cash reserves and liabilities.[43]

Thus the Satyam scandal served as a catalyst for the Indian government to rethink the corporate governance, disclosure, accountability and enforcement mechanisms in place and also has reiterated the importance of checks on related party transactions. As described below, Indian regulators and industry groups have advocated for a number of corporate governance reforms to address some of the concerns raised by the Satyam scandal. Shortly after news about the scandal broke out, the CII (Confederation of Indian Industry) began examining the corporate governance issues arising out of the Satyam scandal. Other industry

groups also formed corporate governance and ethics committees to study the impact and lessons of the scandal. In late 2009, a CII task force put forth corporate governance reform recommendations. In its report, the CII emphasized the unique nature of the Satyam scandal, noting that ―Satyam is a one-off incident. In addition to the CII, the National Association of Software and Services Companies (NASSCOM, self-described as
―the premier trade body and the chamber of commerce of the IT-BPO industries in India) also formed a Corporate Governance and Ethics Committee, chaired by N. R. Narayana Murthy, one of the founders of Infosys Limited and a leading figure in Indian corporate governance reforms. The Committee issued its recommendations in mid-2010, focusing on stakeholders in the company. The report emphasizes recommendations related to the audit committee and a whistleblower policy. The report also addresses improving shareholder rights. The Institute of Company Secretaries of India (ICSI) has also put forth a series of corporate governance recommendations. [44]

Satyam prompted quick action by both SEBI and the MCA (Ministry Company Affairs). In September 2009 the SEBI Committee on Disclosure and Accounting Standards issued a discussion paper that considered proposals for: [45]

- Appointment of the chief financial officer (CFO) by the audit committee after assessing the qualifications, experience and background of the candidate;
- Rotation of audit partners every five years;
- Voluntary adoption of International Financial Reporting Standards (IFRS);
- Interim disclosure of balance sheets (audited figures of major heads) on a half-yearly basis;
- Streamlining of timelines for submission of various financial statements by listed entities as required under the Listing Agreement.

In early 2010, SEBI amended the Listing Agreement to add provisions related to the appointment of the CFO by the audit committee and other matters related to financial disclosures. However, other proposals such as rotation of audit partners were not included in the amendment of the Listing Agreement. Inspired by industry recommendations,

including the influential CII recommendations, in late 2009, the MCA released a set of voluntary guidelines for corporate governance. The Voluntary Guidelines address a myriad of corporate governance matters including independence of the boards of directors; responsibilities of the board, the audit committee, auditors, secretarial audits; and mechanisms to encourage and protect whistle blowing. Important provisions include:

- Issuance of a formal appointment letter to directors
- Separation of the office of chairman and the CEO
- Limiting the number of companies in which an individual can become a director simultaneously
- Tenure and remuneration of directors
- Training of directors
- Performance evaluation of directors
- Additional provisions for statutory auditors
- Institution of a nomination committee for selection of directors

With the clear evidence from Satyam scandal, it cannot be denied that the Satyam episode was a stark failure of the code of Corporate Governance in India. Just as the United States needed the Enron Scandal to clean up its act, perhaps India needed the Satyam fiasco to introduce sweeping changes in its own corporate governance including financial reporting system and to strengthen shareholder activism.

Evolution of Institutional Investors

India's financial market began its transformation path in the early 1990s. The Securities and Exchange Board of India (SEBI) was established in 1992 with a mandate to protect investors and usher improvements into the microstructure of capital markets. Competition in the financial market increased with establishment of the National Stock Exchange (NSE) in 1994 leading to a significant rise in the volume of transactions and to the emergence of new important instrument in financial intermediation. In Indian capital market Institutional investment comprises government sponsored mutual funds, insurance companies, banks and development financial institutions (DFIs) that are long-term creditors, and foreign institutional investors (FII). Indian investors have been able to invest trough mutual funds since 1964. Between 1987 and 1992 public sector banks and insurance companies set up mutual funds. Since 1993, private mutual funds have been allowed which brought competition to the mutual fund industry. The notification of the SEBI in Mutual Fund Regulation of 1993 brought about a restructuring of the mutual fund history. The regulation prescribed disclosure and advertisement norms for mutual fund and it permitted the entry of private sector mutual funds. Again the 1993 regulations have been revised on the basis of the recommendations of the Mutual Funds 2000 report prepared by SEBI. The mutual funds are now required to obtain the consent of investors for any change in the fundamental attributes of a scheme on the basis of which unit holder have invested.

India opened its stock markets to foreign investors in 1992, has since 1993 received a considerable amount of portfolio investment from foreigners in the form of Foreign Institutional Investment (FII) in equities. SEBI's definition of FII presently includes foreign pension Fund, mutual fund, charitable/endowment/university funds etc. as well as asset management companies and other money managers operating on their behalf. The sources of these FII flows are varied. The FIIs registered with SEBI come from as many as 28 countries including money management companies operating in India on behalf of foreign investors. U.S. based institutions accounted for slightly over 41%, those from the U.K constitute about 20% with other Western European countries hosting another 17% of the FIIs. A significant part of these portfolio flows to India comes in the form of FII's investments, mostly in equities. Ever since the opening of the Indian equity markets to foreigners, FII investments have steadily grown from about USD 520 million in 1993 to over USD 54.4 billion till the end of Feb 2008.[46] Thus we could realize that institutional Investment including FII has a great impact in the corporate enterprises.

Shareholder activism in Indian corporate governance:

The current corporate governance assessment for India has found that over the last few years, a series of legal and regulatory reforms have transformed the Indian Corporate Governance frame work and improved the level of responsibility of insider's fairness in the treatment of minority shareholders, board practices and transparency. The Companies Act 1956 is the basic and fundamental statutory work for the regulation of investor protection. The SEBI set up a statutory authority in 1992, and has taken the number of initiative in the area of investor protection. The Birla committee, to promote and raise standard of corporate governance, in its report observed that the "strong corporate governance and the vibrant capital market is the important instrument for investor protection".

However, despite the various provision in the Companies Act 1956 and the regulations issued by the SEBI regarding the protection of shareholder rights, there was various case filed by investors complaining of malpractices. This is because shareholder rights remain in paper and are not really executed. The main reason for this, shareholders are not involved in the meeting of the company and do not execute their voting rights. It is also noted that minority shareholder are often deprived of their rights because of most companies are run by families and promoters and they take active participation in the company matters as a controlling shareholders. Sometimes non-voting preferential shares had been used by promoters to channel funds and expropriate minority shareholders.

Institutional investor participation in India is hardly prevalent. They do not exercise their voting rights meaningfully. They usually evaluate the associated cost with exercising their voting rights and find the cost as being too high as compared to the advantage which they would accrue. So in most Indian companies institutional investors including Foreign Institutional Investor (FII) to play a monitoring role are either missing or are only marginally visible.

We could categorize the main reasons for the lack of shareholder activism as follows:[47]

- **Lack of active long term investors:** Most investors in India are focused on short term gains; long term investors such as pension funds and hedge funds takes 5-7 years call on companies
- **Large number of tightly controlled companies**: Promoters typically retain control of companies by owning a significant ownership stake in companies. Shares not owned or controlled by the promoter and his family and friends are widely dispersed, making it difficult for minority shareholders to voice their concerns.
- **Lack of institutional share ownership**: Although FII's increasingly own a large number of shares in Indian companies, in general, no single minority shareholder owns enough shares to significantly influence change. Although there are some government companies like LIC and UTI have significant stakes in Indian companies, they are not activist shareholders. Therefore even though there are laws that empower shareholders controlling 10 percent of equity, the dispersed nature of ownership of shares makes it difficult for minority shareholders to benefit from the low threshold levels that allow for taking a more active role in the management of the company.
- **Limited investment scope for pension/insurance companies**: Pension and insurance companies are owned by the government and constitute a large part of the Public Sector Unit (PSU) sector. The Indian government has only recently begun allowing private sector companies to engage in these activities. Moreover, the government strictly regulates the instruments in which pension funds can invest that limits the scope of investment for these potential institutional investors.
- **Weak Court System**: Courts are the ultimate justice delivery providers for minority shareholders in India. Although the laws are generally comparable to those in the United Kingdom, the court system is seen as inadequate to handle the volume of cases being brought to trial**.** This results in delays in the delivery of justice. Verdicts are sometimes given 10 to 20 years after the incidents occur. This is one of the main reasons that shareholder activism has not taken hold in India, as minority investors are not willing to wait decades for redress. To prevent such thing, Indian authority has to take an action to the amended Companies Act 2006 requiring the establishment of special courts to handle securities and finance related crimes.
- Also, India suffers from a **problem of too many regulations**. Investors are having little faith in the system as high cost is involved, manipulative ways are adopted by the promoters sometimes, which makes it tough for activist shareholders to survive;

- **Lack of minority Shareholder protection:** Although the legal structure for corporate governance in India provides for strong minority shareholder protection compared with other emerging markets, in practice minority share holder cannot always excercise their rights. The Companies Act together with SEBI's listing agreement account for most of the key minority shareholder protection that are found in the IIF code. Usually the threshold for the minority shareholder can participate by calling special meeting and exercising their right is 10 percentage. Though this threshold suggested by FII Code is below than 10 per cent, in practice this threshold cannot be reached due to founder promoters' control in many companies and highly dispersed share distribution of minority shareholders.
- **Corruption**: Corruption in the lower levels of Indian bureaucracy makes the overall business environment less than attractive to investors, particularly foreign investors. It is common in India that, large shareholder, mainly the family promoters, has a great influence on Indian Government authority and they will take this advantage to establish their priorities.

But it is very important to have a look to some of the recent activities in the Indian Corporate Governance which shows that the shareholder activism has improved considerably. The need for widening the scope of shareholder democracy and rights, investor protection and information disclosure has been rightly emphasized through the enactment of New Companies Bill 2009. [48]

Some of the recent news shows that, Indian corporations can no longer expect shareholders to remain calm if their rights are trampled upon. Not just big institutional investors, but even minority shareholders are now turning increasingly assertive to influence corporate decision-making. Recent developments in the financial markets and in business practices suggest a growing trend in shareholder activism, wherein investors attempt to influence management and corporate practices by raising uncomfortable questions to the top management of the company. For example, the lead Indian companies like Infosys Limited, Coal India Ltd, Akzo Nobel India[49] and Vedanta Resources plc have run up against shareholders who are not afraid to raise their voices, even if they happen to be minority shareholders. Also, when Satyam Computer Services had decided to acquire Maytas-Infra and Maytas-Infrastructures properties for $1.6 billion, institutional investors, though they belong to the minority shareholder category, protested against the deal and succeeded in reversing the proposal.

The Children's Investment Fund Management (Foreign Institutional Investor, UK) has threatened to sue the company, its independent directors and the government of India unless they agree to make decisions with the interests of minority shareholders in mind, as the central government pushed the company to sign a deal with power producers, inflicting a serious threat to its financial stability. Chief among its demands is that Coal India be allowed to sell fuel at market prices, not government-set rates, which are about 70 percent to 80 percent lower than prices the company has been able to get in limited auctions. The fund also wants the company, which has 549 billion rupees (about $10.5 billion) in cash, to substantially increase its dividend. Coal India being a public sector undertaking, this incident shows shareholder activism has been on the rise even in the public sector as well. As another case, a large chunk of minority shareholders of Akzo Nobel India (formerly known as Imperial Chemical Industries (India) Ltd.) have raised their voice either by voting against or abstained from voting as a protest to the amalgamation of three unlisted entities - Akzo Nobel Car Refinishes India Pvt Ltd, Akzo Nobel Coatings India Pvt Ltd, and Akzo Nobel Chemicals (India) Ltd. Even though Akzo Nobel managed to receive shareholder approval for the merger proposal in February 2012, 23.15 percentage of the 28.99 million valid votes polled at a court-convened shareholder meeting, were against the merger proposal. [50]

Also now the current issues making headlines in investor protection that, as a number of foreign firms are threatening to take the government of India to arbitration for its failure to protect their rights under Bilateral Investment Promotion and Protection Agreements (BIPPAs) and Comprehensive Economic Partnership Agreements (CEPAs). According to information posted by the finance ministry, India has signed 82 BIPPAs, of which 72 are in operation. Besides, India has signed agreements with its partners to protect foreign investment in their respective jurisdictions that are part of CEPAs. The provisions allow foreign investors to initiate dispute-settlement proceedings directly against the host state.

In conclusion, the shareholder activism will need to be seen more in India, from foreign investors as well as from domestic investors in the coming days if shareholders interests are not valued and good corporate governance are not practiced.

[50] K. S Badri Narayanan, shareholder activism, 2012

CONCLUSION

Enhancing the role of shareholders in corporate governance by facilitating them with required rights and enabling them to execute their rights efficiently and effectively contribute to good corporate governance. Being the ultimate owner of publicly traded companies, their interests should be served with priority along with company objectives and principles. Also, we have seen that shareholder empowerment is a necessary mean to hold the company owners' interests over the management interests.

We have categorized public held companies into three as (i) corporations with empowered shareholders where shareholders with much power to intervene and make their own proposals and decisions (ii) corporations with empowering shareholders where shareholders lack power to effectively put forward their own resolutions or their rights are not well exercised and thus needs empowerment (iii) corporations with little shareholder activism. We took more consideration into categories 2 and 3 and did a study about shareholder rights and activism in the U.S. and Indian companies.

In India, despite the fact that shareholders are granted with more rights by law as compared to U.S., there is little shareholders activism. We have seen with real corporate incidents that the situation is improving of late. The major task for the Indian corporate sector is that to discipline the dominant shareholder & promoters and protecting the minority shareholders. Since the last decade, shareholders' protection has steeply increased in India mainly because of the strengthening of corporate governance norms with the introduction of Clause 49 of the Listing Agreement by Securities and Exchange Board of India (SEBI). Major corporate governance reforms by SEBI, before and after the Satyam corporate scandal would help the shareholders to increase their values. Still, there need to be more rules and regulations in order to empower minority shareholders.

We realized that various long existing statutory provisions and judicial decisions have the effect of blocking meaningful exercise of legitimate shareholder rights. Stockholders' power in U.S. companies is much restricted under the traditional U.S. regulatory framework and they often lack the power to put forward their resolutions. Still with a significant existence of staggered boards, U.S. shareholders need to be provided with a way to replace the entire board of their company if a situation demands so. Long standing plurality voting system need to be replaced with majority voting in major corporate matters. Studies about company failures in U.S. reinforces that shareholder empowerment is a necessary mean to improve corporate governance. The current state of shareholder rights is the result of an unfortunate blend of competing regulations that undermine more fundamental aspects of corporate law and therefore would benefit from reform.

Enron taught investors that they could not trust the numbers contained in financial reports. Investors lost confidence & faith in company governance and no single solution can easily restore it. The average shareholding period in companies has fallen drastically over the last years. Provided with required rights and responsibilities, shareholders can really monitor and direct the management when mandated by a situation towards the growth of their company & values, which would in turn encourage the shareholders to invest for long term. Empowering long-term shareholders will lead to healthy business practices that are beneficial to all stakeholders, including employees, customers, and even the wider economy.

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