A NEED FOR STRICTER ACCOUNTABILITY OF PROMOTERS IN THE CORPORATE GOVERNANCE REGIME IN INDIA: IN THE CONTEXT OF MAJORITY SHAREHOLDING OF PROMOTERS

Shruti Nandwana[*]

Abstract

A promoter is a person who is instrumental in the incorporation of the company. In India, such a promoter owns the majority of the shares of the company either by himself or along with his family members or associates. In most cases promoters make their way up to the management of the company by being part of the board of directors. Both the holding of majority shares as well as being part of the management gives them immense power to affect decisions that are made in the company thereby licensing them to abuse the power for personal interest. Hence, there is a need for a stricter accountability of promoters under the corporate governance regime in India.

The corporate structure in India has a concentrated shareholding pattern and companies are essentially family-run businesses with related members of the concerned family owing majority stakes in the company. Drawing inspiration from the UK and the US, the Companies Act, 2013 and securities law in India deal with the powers and duties of promoters with complete disregard to the peculiar position of promoters in India which have been analyzed in the paper with an examination of the Tata-Mistry dispute relevant in the current context.

The present work is an attempt to analyze the existing law on the liabilities and obligations imposed on these controlling shareholders who in India are majorly promoters with the help of empirical study of top 20 public limited companies as per market capitalization. Further an attempt has been to look into the lacunas which exist in the above-mentioned laws such as the securities law and the Companies Act, 2013 and to suggest measures to curb abuse of power by them.

[*] Assistant Professor of law, Dharmashastra National Law University Jabalpur, M.P.

I. Introduction

A PROMOTER is a person who is instrumental in the incorporation of the company. In India, despite there being no statutory requirement for the promoter to hold majority shares, promoters own majority of the shares of the company either themselves or along with their family members or associates. In most cases promoters make their way up to the management of the company by being part of the board of directors. Thus, both the holding of majority shares as well as being a part of the management gives them immense power to affect decisions that are made in the company. Majority shareholding helps them to affect decisions taken in the general meeting by virtue of their voting powers and being on the board of directors gives them the power to influence internal functioning of the company. Thus, the position of a promoter is prone to abuses in cases where promoters keep their interests above the interests of other stakeholders of the company. Thus, there is a need for a stricter corporate governance regime in India.

While the corporate governance regime in India seeks guidance from various corporate governance regimes throughout the world, there are still loopholes which exist due to the peculiar shareholding structure of Indian companies. Corporate structures throughout the world have varied forms. While the UK and US corporate structures have predominantly scattered and dispersed shareholding, with no single entity holding majority shares, the situation in India is quite different. In India, the corporate structure primarily has concentrated shareholding which are essentially family-run businesses owning majority stakes in the company. Thus, the Anglo-Saxon model of governance which forms the basis of corporate governance in India has some limitations in its applicability.

The present work is an attempt to analyze the existing law on the liabilities and obligations imposed on these controlling shareholders who in India are majorly promoters. Further an attempt has been to look into the lacunas which exist in the law today and to suggest measures to curb abuse of power by them.

II. Promoters: Who are they?

A promoter is a person who undertakes to form a company with reference to a given project and to set it going and to this end takes necessary steps to accomplish the purpose.[1] He is the one who originates the scheme for the formation of the company, has the Memorandum and Articles of the company prepared, executed and registered. There may however, be persons who take a much lesser dominating role in the floating of the company like any company or individual who negotiates preliminary contracts, place shares or arrange for persons to become a director and are still treated as promoters of the company. Further, there may be a group of persons who act purely in a ministerial capacity such as accountants and solicitors they are not treated as promoters because they undertake to provide merely their professional services. Thus, who constitutes a promoter in a particular case is a question of fact.

Promoter(s) are usually persons, who, in the formation of the company, secure themselves the management of the company or persons who convert their private business into a public or private company and secure for themselves a more or less sinecure position and/or controlling interest in the company's management.

The term promoter had not been defined in the Companies Act, 1956.[2] The definition of a promoter in Indian law is given under the Companies Act, 2013 and the Securities (Issue of Capital and Disclosure Requirement) Regulations, 2009 ("ICDR Regulations"). Under the Companies Act, 2013, [3]

> "*a promoter means a person:*
> *(a)who has been named as such in a prospectus or is identified by the company in the annual return; or*

[1] As per Cockburn J. in *Twycross* v. *Grant* (1877) 2 CPD 469.

[2] The definition given under s. 62(6) was restricted and meant for the purposes of civil liability for misstatements in the prospectus only.

[3] Companies Act, 2013, s. 2(69),

(b) who has control over the affairs of the company, directly or indirectly; or

(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act."

The ICDR Regulations define a promoter as, [4]

(a) the persons who are in control of the issuer;

(b) the persons who are instrumental in the formulation of a plan or programme pursuant to which securities are offered to public;

(c) the persons named in the offer document as promoters……

It must be noted that both the definitions in the Companies Act, 2013 as well as the ICDR regulations lay stress on the person who has "control" over the affairs of the company or those who are in "control" of the issuer. Thus, the interpretation of the word "control" becomes important here to understand the complete meaning of the word promoter.

Control has been defined under section 2(27) of the Companies Act 2013 and Regulation 2(e) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Code"), which states that "*control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner."* The definition of control makes it clear that promoters are persons or entities who have the right to run the management of the company either themselves or through directors appointed by them.

III. Liabilities and obligations of Promoters imposed under existing Legal Regime

Law recognizes the fact that a promoter is instrumental in the incorporation of a company and has hence imposed certain liabilities and obligations on him. These liabilities and obligations start from the pre-incorporation stage and exist throughout the life of the promoter in the form of disclosures required to be made by him. Following are the few liabilities and obligations

[4] ICDR Regulations, 2009, s. 2(za).

placed upon promoters under the Companies Act, 2013 and the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Code").

IV. Pre-incorporation liabilities and obligations

Since the promoter is the one responsible for the incorporation of the company, there are a number of contracts which are entered into by him for the purpose of setting up the company so as to make it functional. These contracts entered into by the promoter are termed as pre-incorporation contracts. However, until incorporated, the company cannot enter into contract or do any other act. Nor, once incorporated, can it be made liable for or entitled under contracts purporting to be made on its behalf prior to incorporation. Hence, the pre-incorporation contracts will either have to be left to mere "gentlemen's promise" or the promoters will have to undertake personal liability.[5] The legal position of pre-incorporation contracts can be divided into two phases.

i. Position before the passing of Specific Relief Act, 1963, and
ii. Position post 1963 *i.e.,* after passing of the Specific Relief Act, 1963.

Since a pre-incorporation contract did not bind a company, there arose problems with respect to their enforcement. Further, ratification of a pre-incorporation contract was not possible because of the non-existence of the ostensible principal at the time when the contract was made. In the case of *Kelner* v. *Baxter*[6] it was held that a contract entered into by the promoter and signed by him on behalf of the company will make the promoter personally liable for the contract. In the case of *Re English and Colonial Produce Company* case,[7] In order to prepare the necessary documents and obtain registrations for incorporating a company, a solicitor was engaged. He paid the registration fee and incurred certain expenses incidental to registration. However, the promoters defaulted in making the payments. It was decided by the court that the company was not bound or liable to pay for the expenses and services offered by the solicitor since the contract was a pre-incorporation contract.

[5] *Ibid.*
[6](1866) 15 LT 213.
[7] *Re English And Colonial Produce Company Case* (1906) 2Ch. 435 CA.

Further, a company cannot sue on a pre-incorporation contract. This can be seen through the case of *Natal Land and Colonisation Company* v. *Pauline Colliery Syndicate*[8] where it was held that a company cannot by adoption or ratification obtain the benefit of a contract purporting to have been made on its behalf before the company came into existence.

Since the pre-incorporation contracts were void and could not be ratified by the company, the promoters found it difficult to carry out work related to the incorporation of the company. People were hesitant to enter into contracts and supply goods or services due to the unenforceability of pre-incorporation contracts which made it difficult for them to recover money in case there was a default or fraud by promoters. The passing of the Specific Relief Act, 1963 was a much-needed step towards ensuring that pre-incorporation contracts are honoured and that the parties are held liable under contract for the obligations undertaken by them.

Sections 15(h) and 19(e) of the Specific Relief Act, 1963 provide that a relief can be obtained for a pre-incorporation contract if the contract is entered into by the promoter of a company for incorporating such a company, the terms of incorporation warrant such a contract, the company has accepted the contract post its incorporation and such acceptance is communicated to the other party to the contract. Section 15(h) made it clear that the contract of promoters is enforceable by the company, when it had accepted the contract and communicated the acceptance to the other party to the contract. Thus the position of law enunciated in the *Natal Land* case[9] is not applicable in India. The liability under Section 19(e) was established in England during the 19th Century by decisions given in the Courts of Equity, partly on the basis of an explicit obligation that has either been placed on the company by Memorandum or Articles of Association or undertaken by it after its incorporation. This is on grounds independent of the contract and are more similar to estoppel, whereby, if any person has assisted or abstained from preventing the promoters of the company on certain terms, in obtaining the requisite registrations, the company, when incorporated cannot use its powers in violation of those terms to prejudice that person.[10]

V. Liabilities and Obligations related to issue of Prospectus

---

8 (1904) AC 120.

9 *Ibid.*

10 Pollock and Mulla, *Indian Contract and Specific Relief Acts,* (LexisNexis 14th edn. 2012).

Promoters being the ones who bring the company into existence, have the responsibility of bringing out the prospectus in cases of listing of companies. It is the promoter who is considered by law to be instrumental in bringing the company into existence and further it is on the basis of the trust people have on the promoter that they invest their hard-earned money in the company. And thus, law holds a promoter liable in case there is a false statement made in the prospectus of the company. Section 26 of the Companies Act, 2013 fixes liabilities on the promoters in case of misstatements made in the prospectus. A promoter has to disclose the litigation going on against him during the last five years immediately preceding the year of issue of prospectus and sources of promoter's contribution. Further, the Companies (Prospectus and Allotment of Securities) Rules, 2014 also give details about the disclosures which are required to be made with respect to the promoters.[11] The Companies Act , 2013 under section 35 expressly makes the promoter(s) of a company liable to pay compensation to every person who sustains a loss or damage in the event of any misstatements in the prospectus.

Besides the Companies Act, the ICDR Regulations must also be complied with by the promoter while issuing a prospectus. Under regulation 32(1) of the ICDR Regulations, in case of an Initial Public Offer (IPO), the promoters of an issuer are required to contribute not less than 20% of the post issue capital and in case of a further public offer, either to the extent of 20% of the proposed issue size or 20% of the post-issue capital. As per regulation 36 of the ICDR Regulations, minimum contribution of the promoters shall be locked-in for a minimum period of three years. Any holding in excess of minimum contribution shall be locked-in for a period of one year. Along with the above obligations ICDR requires certain other disclosures to be made about the promoter and promoter group. This has been provided to make sure that the promoters are sincere and serious with respect to the company and contribute a significant portion of capital to their business.

If an offer on a private placement basis is made in contravention of section 42 of the Companies Act, 2013 then the promoters and directors shall be liable to pay penalty. The courts and tribunals have come down heavily on the promoters along with the company where there have been cases of misstatements in the prospectus or contravention of the disclosure obligations relating to the issue of prospectus or the utilization of proceeds of the money collected from IPO proceeds.

[11] See also, Companies (Prospectus and Allotment of Securities) Rules, 2014, r. 3.

In the matter of *RDB Rasayan Limited,*[12] SEBI had held the promoter, who was also the chairman of the company, along with the directors of the company liable for violation of provisions of ICDR Regulations for misstatements in the prospectus and improper utilization of the IPO proceeds. SEBI imposed monetary penalty, jointly and severally, on the promoter along with the directors of the company. In the matter of *PG Electroplast Limited,*[13] the company and the promoter directors were held liable for non-disclosures in the prospectus and thus for violation of ICDR Regulations and SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations 2003. They were barred from raising capital from the securities market and prohibited from dealing in the securities market. In the case of *Sahara India Real Estate Corporation Limited* v. *SEBI*,[14] Sahara in its Red Herring Prospectus filed with the Registrar of Companies made statements that it was offering Optionally Fully Convertible Debentures (OFCD) by way of private placement. However, it had issued OFCD to more than 49 people. The company was found guilty for violation of provisions of private placement and also for misstatements in prospectus. The Supreme Court upheld the SEBI and Securities Appellate Tribunal orders holding the promoter and directors liable.

The courts may, in appropriate cases, where fraud is alleged on the promoters, lift the corporate veil to ascertain who is the person responsible for decision making in the company. The Supreme Court in the case of *Life Insurance Corporation of India* v. *Escorts Ltd.,*[15] stated,

> *the corporate veil may be lifted where a statute itself contemplates lifting the veil, or fraud or improper conduct is intended to be prevented ... It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that necessarily depend on the relevant statutory or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of the public interest, the effect on parties who may be affected, etc.*

VI. Opportunity to be given to Dissenting Shareholders

[12] *RDB Rasayan Limited,* Adjudication order no. IVD-ID9/RDB/AO/DRK-AKS/EAD3-565-569 /109-113/2014.

[13] In the matter of *PG Electroplast and its Promoter Directors,* SEBI, Whole Time Member Order: WTM/SR/IVD/ID-V/08/03/2014.

[14] *,Ci*vil Appeal No. 9833 of 2011.

[15] *Life Insurance Corporation of India* v. *Escorts Ltd*. 1984 SCR (3) 643.

Public invests money on the basis of the objects disclosed in the prospectus. Objects of the company lay down the bounds within which it operates and thus helps the public to assess whether they would want to invest in the field where the company purports to work. In case there is a change in the objects of the company, there must be an opportunity provided to shareholders who do not approve of such a change to take their funds and exit the company. The Companies Act, 2013 has placed an obligation on the promoters to provide an exit opportunity to the dissenting shareholders in the following events:

i. Section 13 - in case of an unutilized amount of money raised from the public, the company intends to change its objects for which it raised.
ii. Section 27 - in case the company intends to vary the terms of the contract referred to in the prospectus or objects for which the prospectus was issued.

Section 13 and 27 state that the exit opportunity is to be given in accordance with the regulations to be specified by SEBI. For the said purposes, SEBI has approved a framework to provide an exit opportunity to dissenting shareholders, which has been included under Chapter VI-A of the ICDR Regulations.[16]

The salient features of the framework under the ICDR Regulations is as follows:

i. It shall be applicable on a prospective basis i.e. for issues which opened after the commencement of the related provisions in the Companies Act, 2013, i.e. April 01, 2014.
ii. It would be applicable if the proposal is dissented by at least 10% of the shareholders and the amount to be utilized for the objects for which the prospectus was issued is less than 75% of the amount raised.
iii. Investors holding shares as on the date of the board meeting in which the proposal to change the objects is approved shall be eligible to avail of the exit opportunity.
iv. The exit price shall be based on the pricing parameters applicable in case of exit offer given to the existing shareholders in terms of the Takeover Code.
v. Companies with no identifiable promoters or shareholders having control would be exempted from this requirement.
vi. Acquisition under the framework is exempted from certain obligations under Takeover Code and SEBI (Prohibition of Insider Trading) Regulations, 2015

[16] Please refer to Ch. VI– A Conditions And Manner Of Providing Exit Opportunity To Dissenting Shareholders (Reg. 69A – 69G).

VII. Liabilities and Obligations imposed under Takeover Code

The Takeover Code is applicable in cases of acquisition of companies so as to ensure that the interest of shareholders is protected. There are a set of obligations in the form of disclosure to be made which are imposed on promoters under the Takeover Code so as to ensure that a true picture of the shareholding of the company with the promoters as well as any encumbrances on the shares held by them are promptly disclosed to the shareholders and stock exchange with a view to maintain transparency in the functioning of the company. Regulation 30(2) lays down an obligation on the promoter of every target company to disclose its aggregate shareholding and voting rights in the company, as of March 31 of each year. Regulation 31(1) requires the promoter to disclose details with respect to the creation/invocation/release of encumbrances on shares held by him in the company. Such disclosures are to be made to the company and to the stock exchanges on which the shares are listed. Obligations applicable to any acquirer and persons acting in concert with such acquirer under the Takeover Code, shall also be applicable to a promoter.

SEBI Appellate Tribunal in *Gopalakrishnan Raman* v. *SEBI,*[17] held that if the promoters of a listed company are individual promoters, then the obligation is on the individual promoters and in case there is a 'promoter group', then the promoter group is required to make yearly disclosure. Further, in case of failure, the promoter group is jointly and severally liable.

In the matter of *Hindustan Unilever Limited,*[18] the promoter had filed disclosures under regulation 30(2) after a delay of a certain period. SEBI held that when a mandatory time period is stipulated for doing a particular activity, completion of the same after that period would constitute default in compliance and not delay. Penalties were imposed on each promoter for the delay in disclosures.

In *PB Jain Investment* v. *SEBI,*[19] increase in shareholding/voting rights of the promoter and promoter group was more than the permissible creeping limit of 5% in a financial year. The promoters were under obligation to make an open offer in accordance with Regulation 3(2) of

[17] *Gopalakrishnan Raman* v. *SEBI,* Appeal No. 281 of 2014.
[18] *Hindustan Unilever Limited*, Adjudication Order No. ASK/AO/21-27/2014.
[19] Appeal No. 169 of 2013.

the Takeover Code which they failed to make. SAT ordered promoters and promoter groups to make a combined public announcement to acquire shares of the target company and also pay an interest to the shareholders for the default in making an open offer. In *Alacrity Securities Limited* v. *SEBI*[20] The appellant was a promoter who pledged the shares he held to a bank for raising finance and failed to make a disclosure as per Regulation 31(1) of the Takeover Code. SAT imposed a penalty on the appellant for failure to disclose the encumbrances on shares.

VIII. Duties attributed to Promoters

The early Companies Acts contained no provisions regarding the liabilities of promoters, and even today legislation is largely silent on the subject and merely imposes liabilities for untrue statements in listing particulars or prospectus to which they are parties. The courts, however, are conscious of the possibilities of abuse inherent in the promoter's position and have thus elaborated equitable fiduciary duties which are imposed on promoters similar to those which have been imposed on agents. The court in the case of *Erlanger* v. *New Sombrero Phosphate Co.*[21] held that the promoters of a company undoubtedly stood in a fiduciary duty.
Despite the prominent position of a promoter, he is not the trustee of the company he promotes, and so there are no absolute prohibitions on his making a profit out of a promotion in which he participates.[22] The two fiduciary duties imposed on a promoter are: (i) not to make any secret profits out of the promotion of the company without the company's consent; and (ii) to disclose to the company any interest which he has in a transaction entered into by it. [23]

In earlier times the usual way by which promoters made secret profits was by acquiring business or property themselves and then selling it to the company at inflated price. In the case of *Re Cape Breton Co,*[24] it was held that such a difference in the actual and inflated price shall be considered to be profits, only if the promoter had commenced to promote the company when he bought the business or property, such that he had a duty to the not to make profits while selling the same to it. Further, the case of *Re Coal Economising Gas Co.*[25] makes it clear that what a promoter is prohibited to do is to make secret profits, there is no prohibition on him to

[20] *Alacrity Securities Limited* v. *SEBI*, Appeal No. 112 of 2013 .
[21] *Erlanger* v. *New Sombrero Phosphate Co.* (1878) 3 APP. CAS. 1218 HL.
[22] *Omnium Electric Palaces Ltd.* v. *Baines* (1914) I Ch 332.
[23] Robert R. Pennington, *Company Law*, (Oxford University Press, 8th edn., 2001)
[24] *Re Cape Breton Co* (1885) 29 Ch.D 795.
[25] *Re Coal Economising Gas Co* (1875) 1 Ch. D 182.

make profits while promoting a company. He may, with the consent of the company, make profits while promoting it. The case of *Gluckstein* v. *Barnes*[26] held that disclosures of secret profits made by promoters in capacity of directors of the purchasing company were not sufficient. In addition to the duty of not making secret profits, a promoter is bound to disclose to the company any interest he has in a transaction entered into by it or proposed to be entered into by it. Disclosure must be made in the same way as though the promoter were seeking the company's consent to his retaining a profit for which he is accountable.[27]

The role that the promoter plays when they acquire a property can be in two forms. One is when the promoter acquires a property after the commencement of promotion of the company, he is presumed to have done so in the capacity of a trustee and must transfer the property at the cost at which it was acquired. This is a duty of the promoter, which is breached if the promoter acquires the property for his own benefit and fails to disclose the profits and it further amounts to an expropriation of the company's property. For the promoter to retain the gains of such a transaction would require the unanimous consent of all the shareholders of the company after it is formed since a resolution of general meeting cannot authorize an expropriation of the company's property.[28] The other role of the promoter is that of a vendor where the promoter buys the property for himself for the purpose of resale to the company. In such a situation, the duty of the promoter is to disclose the profits and nothing more. The difference in the two roles lies in the intention of the promoter at the time of purchase of such property. If he intends to buy the property for himself for reselling it to the company, then the role he plays is that of vendor while if he initially buys for the company, then the role he plays is that of a trustee which he cannot change later on and act as a vendor.[29]

IX. The tale of Two Titans - Tata- Mistry Case: Corporate Governance Issues

The removal of Cyrus Mistry as the chairman of Tata Sons has raised a series of questions with respect to the dominance of promoter holding in the appointment and removal of directors.

---

[26] *Gluckstein* v. *Barnes* (1900) AC 240.
[27] *Re Lady Forest (Murchison) Gold Mine Ltd* (1901) 1 CH 582.
[28] *Cook v. Deeks* (1916) 1 A.C.554, PC.
[29] L. C. B. Gower, and P. L. Davies *Gower & Davies' Principles of modern company law* (Sweet & Maxwell; 9th edn., 2012)

Tata Sons is an unlisted entity and the holding company of Tata group. Tata Trusts dominate the shareholding of Tata Sons, holding 66% of the company. On October 24, 2016 Cyrus Mistry was removed from the chairmanship of Tata Sons with immediate effect, thereby removing him as the chairman of the Tata Group of Companies. Meanwhile Ratan Tata, who is a part of the promoter group and dominant shareholders of Tata Sons, was appointed as the interim chairman of Tata Sons. The reasons stated for Cyrus Mistry's removal was that there has been a substantial weakening in the performance of the Tata Group of Companies since he had taken over as the chairman.[30]

After the removal of Cyrus Mistry from the chairmanship of Tata Sons, independent directors of various entities of Tata Group like Indian Hotels Company's Nusli Wadia, independent directors of Tata Chemicals and Tata Steel also came forward disapproving the removal of Cyrus Mistry as the Chairman of Tata Sons. However, Nusli Wadia was removed from the board on the grounds of acting in concert with Cyrus Mistry which led to the detriment of the company.

This led to a series of letter-war which raised a number of questions on the independence of the board and reflected how the management was dominated by the promoter/promoter Group in major decision making. It is important here to note that a number of amendments were made in the Articles of Associations of Tata Sons after Cyrus Mistry had taken the post of chairman of the company. Tata Trusts, consisting of a cluster of trusts such as the Sir Ratan Tata Trust and the Sir Dorabji Tata Trust, have a share of two-thirds in Tata Sons. They hold special rights with respect to the appointment and removal of chairman of Tata Sons by virtue of the Articles of Association of the Company [31]

Article 104B states that till Tata Trusts holds at least 40% of the shareholding in Tata Sons, it can nominate one-third of its directors. Further, the quorum for the board meeting of Tata Sons "*shall include a majority of the directors who are appointed pursuant to Article 104B*." The Articles of Association of Tata Sons further provides that selection committee will comprise

[30] Devina Sengupta, *Cyrus Mistry* v. *Ratan Tata, a valuable lesson for B-school students,* Economic Times *available at,* https://economictimes.indiatimes.com/news/company/corporate-trends/cyrus-mistry-vs-ratan-tata-a-valuable-lesson-for-b-schools/articleshow/55213511.cms.(last visited on Feb.19, 2020).

[31] Aveek Datta, *Tata* v. *Mistry: The inside story,* Forbes India, *available at* http://www.forbesindia.com/article/battle-at-bombay-house/tata-vs-mistry-the-inside-story/44721/1 (last seen on Feb. 19, 2019).

of three persons "*nominated jointly by the Sir Dorabji Tata Trust and the Sir Ratan Tata Trust who may or may not be directors of the company, one person nominated by and among the board of directors and an independent outsider selected by the board*." Most striking amendment was the power of affirmative voting which was given to the directors who were nominated by Tata Trust who had to approve through a majority of affirmative voting the appointment and the removal of chairman of Tata Son. An affirmative vote item is one where the company cannot take an action in the absence of the concerned directors.[32]

It is amply clear from the amendments made in the Articles of Associations that Tata Trust being the promoter/promoter group wanted to retain maximum power with them with respect to the management of the holding company of the Tata Group. Further, the ease with which the independent director *i.e.,* Nusli Wadia was removed raises serious concerns on the independence of the Independent directors. However, the most important concern that is raised is on the efficacy of the corporate governance in companies which have dominant promoter shareholding.

There is an ongoing legal tussle between Cyrus Mistry and Tata Sons with allegations of oppression and mismanagement from the side of Cyrus Mistry on Tata Sons. On the other hand Tata Sons has voted in its annual general meeting to convert into a private company and has also received a nod from the Registrar of Companies for the same. Converting into a private company from a public company means that Tata Sons will have lesser transparency with respect to its functioning and decision making will be faster as the number of compliances required are less.

X. Analysis of Promoter Shareholding in Companies[33]

Serial No.	Company Name	Promoter and Promoter Group Shareholding (As on June 30, 2018)	If the promoter is on the Board of Directors
1.	Tata Consultancy Services	72.05%	No

[32]Samasti Legal, *Case Report on Tata V Mistry Case*. *Available at* https://samistilegal.in/wp-content/uploads/2017/05/Report-on-TATA-MISTRY-case-1.pdf. (last seen on Feb. 19, 2019).
[33] Companies are selected on the basis of market capitalization. The table includes only the top twenty non-government companies based on market capitalization. The data has been taken from www.nseindia.com and is based on data as on (Mar. 30, 2019).

2.	Reliance Industries	47.29%	Yes
3.	HDFC Bank Limited[34]	26.25%	No
4.	Housing Development Finance Corporation	0.00%	No
5.	Hindustan Unilever	67.18%	No
6.	ITC Ltd.	0.00%	No
7.	Infosys Ltd.	13.15%	Yes
8.	Maruti Suzuki India Ltd	56.21%	No
9.	Kotak Mahindra Bank Ltd	29.98%	Yes
10.	ICICI Bank Ltd	0.00%	No
11.	Larsen and Toubro Ltd	0.00%	No
12.	Bajaj Finance Ltd	55.14%	Yes
13.	Axis Bank Ltd	16.16%	No
14.	Bharti Airtel Ltd	62.71%	Yes
15.	Asian Paints Ltd	52.79%	Yes
16.	HCL Technologies Ltd	60.00%	Yes
17.	Sun Pharmaceutical Industries Ltd	54.38%	Yes
18.	Wipro Limited	74.05%	Yes
19.	IndusInd Bank Ltd	14.39%	Yes
20.	Mahindra & Mahindra Ltd	19.87%	Yes

The above table depicts the shareholding pattern of promoter/promoter groups in the top 20 companies based on market capitalization (government companies not included). It is evident

[34] "*The Memorandum and Articles of Association of the Bank provides the following rights to HDFC Limited, promoter of the Bank:*
The Board shall appoint non-retiring Directors from amongst the Directors nominated by HDFC Limited with the approval of shareholders, so long as HDFC Limited and its subsidiaries, singly or jointly hold not less than 20% of the paid-up share capital of the Bank.
HDFC Limited shall nominate either a part-time Chairman and the Managing Director or a full time Chairman, with the approval of the Board and the shareholders so long as HDFC Limited and its subsidiaries, singly or jointly hold not less than 20% of the paid-up share capital of the Bank.
Under the terms of Bank's organisational documents, HDFC Limited has a right to nominate two directors who are not required to retire by rotation, so long as HDFC Limited, its subsidiaries or any other company promoted by HDFC Limited either singly or in the aggregate holds not less than 20% of paid up equity share capital of the Bank. At present, the two directors so nominated by HDFC Limited are the Chairman and the Managing Director of the Bank." Available at https://www.hdfcbank.com/aboutus/cg/Promoters_Rights.htm. (last visited on Feb.19, 2019).

from the above table that out of the 20 companies analyzed, in nine companies the promoter/promoter group holding exceeds 50% of the total shareholding. Only four out of the 20 companies have 0% promoter/promoter group shareholding. Except for these four companies, the shareholding by the promoter/promoter groups in no other company is less than 12% which forms a major part of shareholding. The table clearly depicts the concentration of shareholding in the hands of promoter/promoter groups in Indian companies. Decisions in the general meetings are taken either by an ordinary majority or by a majority of two-thirds of the members present and voting. In India, because of the passive shareholding, major decisions are ultimately taken in the general meetings by the promoter/promoter groups because of the chunk of shares held by them which helps them to form a majority in most cases.

XI. Inadequacies in the Law and its Implications

Loopholes in the corporate governance regime with regard to promoters leads to the abuse of powers by promoters which are manifested primarily in the forms enumerated below.

Impact on independent directors

The provision requiring appointment of Independent Directors was not present in the Companies' Act, 1956 but was mandated by the listing agreement which was required to be complied with by listed companies. The mandatory provision for appointment of independent directors for listed public companies was introduced through the Companies Act, 2013.[35] This provision was introduced with the aim of maintaining the balance between various stakeholders. Since the directors were inclined to further their specific interests, there was a requirement of independent directors to ensure objectivity in the functioning of the company.[36] They were required to act as conscience-keeper for the company.

The manner of appointment of independent directors is governed by the provisions of the Companies' Act, 2013 and Companies (Appointment and Qualification of Director) Rules, 2014. The Act provides that the company may select an independent director from a data bank

[35]Companies Act, s. 149(4) 2013- "*Every listed public company shall have at least one-third of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.*"
[36] Ministry of Corporate Affairs, Government of India, J.J. Irani Committee Report On Company Law" 2005.

of eligible and willing persons[37] whereby the responsibility of exercising due diligence lies with the company which makes the appointment. It further requires that the appointment of the independent director has to gain approval of the members of the general meeting. The notice that is sent for the convening of this meeting has to be accompanied by an explanatory statement which must provide for the justification of such appointment.[38]

The Companies (Appointment and Qualifications of Directors) Rules have been amended recently in 2019 to include qualifications for the appointment of independent directors. It is now mandatory for an Independent director who is already appointed to get her/his name registered with the "Indian Institute of Corporate Affairs, Manesar" within three months from the amendment of the Rules.[39] Further, it is mandatory for a person who intends to get appointed as an independent director to get his name included in the data bank.[40] The said enrolment of the name can be made either for a period of one or five years or for the lifetime of the person.[41] Such a person who gets his/her name registered should also pass an "online proficiency self-assessment test " which is conducted by the Indian Institute of Corporate Affairs, Manesar within one year from the date of getting his name included in the data bank.[42] It is mandatory to get not less than sixty percent in order to get the person's name included in the data bank, failing which his/her name would be removed from the data bank.[43]Certain persons have been exempted from giving the proficiency test such as directors and key managerial persons in certain companies.[44] There is no limit on the number of times a person can appear for the test.[45]

The procedure prescribed for appointment of independent directors is similar to the appointment of other directors. At the general meeting, by way of a separate resolution the appointment of each director is voted on by the shareholders individually. In order to approve the appointment of a director, the majority of shareholders present and voting must have voted in favour of such appointment.

[37] Companies Act, 2013,s. 150(1).
[38] Companies Act, 2013, s. 150(2).
[39] Rule 6(1) of Companies (Appointment and Qualifications of Directors) Fifth Amendment Rules, 2019
[40] *Ibid.*
[41] *Ibid.*
[42]Companies (Appointment and Qualifications of Directors) Fifth Amendment Rules, 2019, R. 6(4).
[43] *Ibid.*
[44] *Ibid.*
[45] *Ibid.*

However since the promoters by reason of their majority shareholding are able to muster the requisite majority votes, they are able to exert control over the appointment of independent directors. This occurs mostly in companies which are dominated by an individual family in which the friends and relatives of the same family own substantial shares in the company.

Ajay Tyagi, the chairman of SEBI has aptly described the position in the following words: [46]

> *There are too many lacunae with respect to the concept of independent directors with many having no commitment to any cause. Some independent directors are appointed at the mercy of promoters—(with) no prescribed qualifications or procedures, favouritism, (many are from) closed clubs (such as) only those people being in all boards, no commitment to any cause.*"

This leads to a failure of the purpose of appointment of Independent Directors and ends their independence in the literal sense of the term. Further the Independent Directors have been reduced to a ceremonial post in a number of companies dominated by promoters so that they are refused the information necessary for them to make decisions within the ambit of their role. The role of safeguarding the interests of the minority shareholder which the independent directors are required to perform has therefore largely been unsuccessful.

The law did not provide any specific conditions for nomination and appointment of these directors except the requirement of a nomination and remuneration committee which has been made mandatory by the 2013 Act.[47] Nomination of candidates for being appointed as independent directors by the Nomination Committee provides for a mechanism to increase transparency and reduce the influence of promoters and managers. However, the system still fails to address the issue at hand because the safeguard is restricted only to the procedure for nomination. Once nominated, the approval of the candidate as independent director has to be done at the general meeting where the controlling shareholders, which are the promoters generally, are able to decide on their appointment. The nomination committee thereby is forced

---

[46] Tyagi, Aja, *Independent Directors are not independent: SEBI chief,* Economic times, *available at* https://economictimes.indiatimes.com/markets/stocks/news/independent-directors-are-not-independent-sebi-chief/articleshow/58428702.cms (last visited on Mar.10, 2020).

[47] Companies Act, 2013, s. 178.

to perform their function under the influence of the promoters since they have the capacity to oppose the elections of all candidates which do not serve their purpose. Rejection of appointment of all candidates nominated by the committee is an embarrassment for the committee.[48]

This risk is further aggravated by a trend that has been observed whereby the persons related to the promoters are appointed as independent directors. Another trend is the situation of board interlocks. When a person who is associated with one organization occupies a position on the board of directors of some other organization, then such a situation is referred to as an interlocking directorate or board interlock.[49] These trends ensure that the independent directors act as mere puppets in the hands of the promoters.

XII. Removal of Directors

The Companies Act, 2013 provides for a uniform mechanism for removal of any director, whether independent or not. It empowers the shareholders to remove a director, except directors appointed by tribunal[50] or those appointed by proportional representation, by an ordinary resolution in a general meeting. In addition to the board of directors, shareholders can also send a special notice of the resolution to remove a director to the Board of Directors of the company.[51] The only condition that is imposed with regards to such removal is that it should be done after providing the said director with a reasonable opportunity of being heard and that his representation should be communicated to the shareholders.[52]

At the general meeting, the resolution for removal of director can be approved by a simple majority of shareholders who are present and voting. Further, shareholders[53] can also requisite

[48]Umakanth Varottil, 6(2) "Evolution and Effectiveness of Independent Directors in Indian Corporate Governance" *Hastings Business Law Journal* 281 (2010).
[49] Mark S Mizruchi, "What Do Interlocks Do? An Analysis, Critique, and Assessment of Research on Interlocking Directorate" *22 Annual Review of Sociology, 271*-98 (1996).
[50] Companies Act, 2013, s. 242
[51] Companies Act, 2013, s.115.
This special notice, however, can be sent only by such number of members who hold not less than 1% of the total voting power or hold shares on which such aggregate sum not exceeding Rupees 5,00,000, as may be prescribed, has been paid-up.
[52] Companies Act, 2013, s.169.
[53] Companies Act, 2013, s.100 reads, 'Requisition can be made by:
(a) in the case of a company having a share capital, such number of members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

the convening of an extraordinary general meeting for the purpose of removal of a director and if the board fails to convene such a meeting within a prescribed time period, then the requisitioning shareholders may themselves convene such a meeting and be reimbursed for the costs of the same. The shareholders can exercise this power for a number of reasons including inefficiency of a director to perform the functions in the interest of the company and thereby the shareholders.

In light of the above provision, the promoters, who have a majority shareholding, can easily remove a director. Even in companies where the promoters do not have a majority shareholding as required by the above provisions they may still influence the decision of removal of directors because of the dispersed shareholding among members who may not attend the General Meetings at all where the decision is taken by members "present and voting." While it may prima facie appear to be an exercise of shareholder democracy, in reality it is violative of board independence mechanism since the directors are then required to act under the influence of the promoters who hold the capacity to remove them if the former does not act in the interest of the promoters. Directors act under the surety that their terms will not be renewed if the promoters cease to be pleased with their efforts which is in complete violation of shareholder democracy and board independence.[54] The appointment by promoters also significantly affects the way the independent directors perceive their duties. As noted in a study, all the directors in promoter-dominated companies considered strategic advising as their primary function as opposed to the role of monitoring management and of controlling the shareholders.[55]

XIII. Abuse as majority Shareholders in Decision Making Process

Corporate governance system has been structured to give effect to the protection afforded to the shareholder class.[56] This protection has been sought to be given by providing shareholders to be involved in major corporate decisions of a company. The idea behind this concept is to

---

(b) in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote, call an extraordinary general meeting of the company within the period specified in subsection (4).'

[54] Umakanth Varottil,, India's Corporate Governance Voluntary Guidelines 2009: Rhetoric or Reality? 22(2) *National Law School of India Review* 1(2010).

[55] Vikramaditya Khanna, and Shaun J. Mathew The Role of Independent Directors in Controlled Firms in India: Preliminary Interview Evidence, National *Law School of India Review* 35-66 (2010).

[56]Reinier Kraakman, *The Anatomy of Corporate law: A Comparative and Functional Approach* (Oxford University Press, 2 edn. 2009)

provide adequate means to all shareholders to have a say in the crucial decisions of the company which have an impact on their interests. The major decisions that shareholders of a company are involved in include the right to vote on matters of ordinary and special business[57] on which the shareholders are required to give their approval by ordinary or special resolution.[58] The difference lies in the impact of the business on the shareholders. Fundamental corporate decisions, therefore, require an effective supermajority vote to be approved while minority interests are given a weaker form of decision rights. This strategy aims at protecting minority shareholders by giving them a 'blocking right' which will enable them to restrict the exercise of power by a 'bare majority.'[59]

However, the presence of a promoter in the form of a controlling shareholder defeats this measure of corporate democracy whereby the voting rights granted to them by virtue of their shareholding enables them to control the outcome of the voting. The effect of this controlled shareholding is evident not only in conducting the "ordinary business" of the company but also "special business" where the shareholding by the promoters and their relatives and friends is so high that they become the sole decision-making entity in the company in complete disregard of the views of the minority shareholders.

XIV. Remuneration of Promoters

Recovery of remuneration for services cannot be claimed by a promoter as a matter of right except in a situation where there is an express contract to this effect. In the absence of such a contract, the promoter cannot claim even for recovery of the preliminary expenses incurred by him and, therefore, has no guarantee of repayment. As said by Lord Hatherly,[60] "the services of a promoter are very peculiar; great skill, energy and ingenuity may be employed in constructing a plan and in bringing it out to the best advantages." Therefore, it is reasonable

[57]Companies Act, 2013, s.102 reads, Ordinary business at an Annual General Meeting pertains to the consideration of financial statements and the reports of the Board of Directors and auditors, the declaration of dividend, the appointment of directors in place of those retiring; and the appointment of, and the fixing of the remuneration of, the auditors. All other businesses are deemed to be special. All business transacted at any other meeting is special business.

[58] Whether a business requires the approval by ordinary or special resolution is determined by the Companies Act, 2013.

[59] *Supra* note 56.

[60] *In Touche* v. *Metropolitan Ry Warehousing Co (*1871) L.R. 6 Ch. App. 671 at 676.

for a promoter to expect reward for the work put in by him subject to the condition of full disclosure to the company of such rewards.

It is usually a practice to include a provision for remuneration of promoters in the articles of the company.[61] Moreover, in India, the practice is for the promoters to occupy positions in the board as directors. A practice that has been observed is that the remuneration paid to the executive promoter director of a company is disproportionate to that paid to other executive directors. The fixing of managerial remunerations is a critical company decision which the promoters can easily exert control on.[62] Hence this situation is bound to arise.[63]

An upper limit on the compensation that can be paid to directors of a company has been provided for by the Companies Act in the form of maximum managerial remuneration.[64] However the upper limit is inclusive of the remuneration payable to all directors, whether promoter or not. Therefore, the promoter-directors can easily appropriate the larger part of this share as their remuneration while leaving the non-promoter directors with substantially less remuneration. The SEBI (Kotak) Committee on Corporate Governance, 2017 (Kotak Committee Report) in its report, mentioned that such discrepancy was needed to be addressed by subjecting the decision on compensation of directors to shareholders' scrutiny. It recommended that "shareholders' approval be required by special resolution if the total remuneration paid:

> i) to a single executive promoter director exceeds Rs. 5 crore or 2.5% of the net profit, whichever is higher; or
> ii) to all executive promoter-directors exceeds 5% of the net profits."

Although the Securities Exchange Board of India (SEBI) did not accept the recommendation, the report goes on to show the abuse of power by promoters in division of remuneration amongst directors.

XV. Related party transactions

[61] *Supra* note, 13

[62] Companies Act, 2013 s. 196 reads, The appointment of a managing director or whole-time director or manager and the terms and conditions of such appointment and remuneration payable thereon must be first approved by the Board of directors at a meeting and then by an ordinary resolution passed at a general meeting of the company.'

[63] Sarkar, Jayati, and Subrata Sarkar, *Corporate Governance in India* (Sage Publication, New Delhi, 2012).

[64] Companies Act, 2013, s. 197.

The high concentration of ownership with the promoters and the grouping together of a large number of companies under the common control of a promoter or promoter group are the two prominent reasons which have led to the rise of abuse of related party transactions in India. The promoter is required to share the profit of the firm with the minority shareholders if the company makes a profit. But such related party transactions allow the promoter to divert resources to himself or to another firm in which he might have a higher share of ownership so that he can enjoy a higher share of the firm's profits. Such diversion of resources which leads to shifting of value from one firm to another within the promoter group is called tunneling which can be done in a number of ways including granting loans to each other at high or low rates, manipulation of transfer prices, or selling assets at higher or lower prices than market prices.[65]

The Companies Act, 2013 has provided for a mechanism of regulating related party[66] transactions in order to ensure that the funds of the company are not siphoned off which is bound to have a detrimental effect on the interests of the company and/or its shareholders, more specifically the minority shareholders. Also, the company in such cases loses an opportunity of dealing with a party which provides better terms of transaction and hence is more favourable than the related party.

Such transactions are regulated by requiring the consent of the board of directors given a resolution at a meeting of the board before entering into a contract or arrangement with a related party.[67] Further prior approval of the company by a special resolution is required where the paid-up share capital of the company or the value of the transaction is beyond the limit prescribed by the law.[68] The SEBI (LODR) Regulations, 2015 also govern related party transactions and additionally require prior approval of the audit committee before entering into such transactions.[69]

[65] Galani, Ami, and Nathan Rehn, Related Party Transactions: Empowering Boards and Minority Shareholders to Prevent Abuses (22)2 *National Law School of India Review* 29-57 (2010).
[66] Companies Act, 2013, s. 2(76).
[67] Companies Act, 2013, S. 188.
[68] Companies (Meetings of Board and its Powers) Rules, 2014, r. 15.
[69] The SEBI (LODR) Regulations, 2015, reg. 23

However as seen before, the control of the promoters over the majority shareholding makes this exercise futile since the promoters are able to obtain consent for tunneling through related party transactions by procuring the desired share of votes.

XVI. Conclusion and the way forward

From the above discussion, it is evidently clear that promoters in most Indian entities hold majority shares as India companies are characterized as largely family-driven and dominated by such promoters who also form a part of the board and thus influence and alter practically all decisions of the company. The Companies Act, 2013 has made great strides in enhancing the corporate governance regime in India. The Companies Act, 2013 has introduced the definition of a promoter and has recognized a promoter as one who has control over the affairs of the company or as the one on whose advice the management is accustomed to work. This clearly shows that the legislature recognizes the control which a promoter exerts over the affairs of the company. The law as it exists today, is adequate in certain respects, placing liabilities on promoters for pre-incorporation contracts, recognizing promoters as being instrumental in the formation of the company and thus placing liabilities on them for misstatements made by them in the prospectus which is a document relied on by investors while deciding to put their hard-earned money into the company. Companies Act, 2013 also recognizes that people decide to invest in a company on the basis of the objects and puts an obligation on the promoter to give exit opportunity to dissenting shareholders in case there is a change in the objects of the company or when the unutilized money raised by the company is used for purposes other that those which are stated as objects of the company. Further, effective corporate governance requires transparency in the functioning of the company and thus, Companies Act, 2013 mandates promoters to make a number of disclosures while issuing a prospectus to tap public funds. Further law recognizes the fact that shareholders ought to know about changes in the promoter's shareholdings and any encumbrances made by him on the shares he owns in the company, and thus, the Takeover Code mandates the promoters to disclose to stock exchanges about changes in promoters stake in the company.

Though the present law places certain liabilities on promoters to ensure effective governance of the company, in India the promoters being dominant shareholders and also members of the board raise issues with respect to independence of decision making by the board. It is often seen that these promoters holding majority shares of the company not only have the "power" to control the affairs of the company, but also have the "right" to do so.

The Kotak Committee Report has highlighted a number of issues dealing with abuse by Promoters and has provided recommendations thereon, however, not all recommendations have been accepted by SEBI. The recommendations which have been accepted by the Board include barring of board interlocks and revising of the eligibility criteria of independent directors in a company. The person to be an independent director must not form part of the promoter group of the listed company.

With respect to the related party transactions, the report has enhanced the scope of the term “related parties" to include all promoters or promoter groups having a shareholding of more than 20% in a listed company. It further requires half-yearly consolidated disclosures of all related party transactions and also transactions with promoters or promoter groups having more than 10% shareholding. Further, since negative votes on related party transactions by promoters will not lead to a conflict of interest, therefore promoters have been allowed by this recommendation to cast negative votes on matters relating to related party transactions.

Apart from the above, there are a few recommendations which have not been accepted by the Board which would have had a positive impact on the corporate governance regime with regard to abuse of power by promoters. Some of them are enhancing the knowledge base of the board of directors for informed decision-making by induction and training, especially of independent directors and filling of casual vacancies with approval of shareholders with regard to the office of independent directors.

A few steps which can be taken to regulate the powers exercised by promoters by virtue of their majority shareholding includes increasing the number of independent directors on the Board of Directors. There can be regulations made to ensure that promoter-directors do not take part in the appointment of independent directors to ensure their independence. In entities having dominant promoter shareholding, regulatory bodies like SEBI can appoint a nominee director to ensure that corporate governance is taken care of while day-to-day decisions are made.

Where related party transactions are carried out on a continuous basis, then a validity period for approval of such recurring related party transactions can also be done.

In line with the prohibition on voting by related parties on related party transactions, the decisions on managerial remuneration should be taken in a meeting where the interested parties abstain from voting on the issue beyond a certain limit. Lastly, legal recognition of fiduciary duty can be done by introducing specific fiduciary responsibilities of promoters and by mandating a relationship agreement between the company and the promoter specifying the duties and responsibilities of the promoter.