Appointment of small share holder director

Section 151 of the Companies Act, 2013-Small shareholders' rights to appoint Nominee on the Board-Whether their rights have been scuttled by Alembic Pharma

Section 151 of the Companies Act, 2013 (hereinafter referred to as 'The Act' which bestows on the small shareholders the right to appoint their representatives on the Boards of companies of which they are members has become the topic of discussion across the professional fraternity in the wake of the recent decision of the Board of Alembic, the Country's oldest pharmaceutical company to reject the request of a section of the small shareholders to have their representative on its Board.

In this discussion we shall endeavour to dissect the law on the subject, bringing out its nuances, the subtle differences that exist between Section 151 in the Act and its corresponding provision Section 252 in the 1956 Act before putting forward our views on whether the Alembic Board's decision is legally sustainable or not .Before getting into brass tacks, it would be appropriate to

summarize the facts as gleaned from Newspaper Reports on the issue so that the controversy could be viewed in its right perspective.

The Alembic Story in brief

For the first time since the introduction of the Act, small shareholders of the requisite number had invoked their rights under Section 151 pushing for a Board seat in Alembic(hereinafter ' the company') by serving on the company a notice to move for a resolution to appoint a director on their behalf at the AGM of the Company which was held on July 27, 2017. Through the requisition, they were seeking better investor returns by way of re-organization of the Board..The shareholders had congregated under the banner of an activist asset manager Unify Capital which has a 3% stake in the company and is one of the largest non-promoter shareholders in the company. Unify Capital was seeking steps to check the wide margins that exist between the stock prices and market caps of Alembic as compared to the company's main underlying asset Alembic Pharma which has a market value of Rs. 10000 crores Unify capital was seeking to appoint its Vice-president as the small shareholder director in the company ostensibly for sub-serving the interest of the minority shareholders..

As per filings made by the company with the Stock Exchanges, the Company's Board had rejected the proposal received from Unify Capital on the ground that it had noticed 'very close nexus' between Unify Capital , some of the shareholders and their Nominee.The Company added that 914 shareholders who had proposed the candidature of the Nominee were clients of Unify Capital. Further, the Company added that out of the 914 shareholders 320 had become shareholders only in the last five days prior to the date of the requisition primarily with the intention of supporting the application. The Company has also justified its action of turning down the proposal alleging that there was 'conflict of interest' and 'misuse' of the provisions of the Act. It is not yet known whether the small shareholders are contemplating to move the Courts against the decision of the Board and it would be interesting to follow the developments in the matter, given the fact that the issue has stoked an enormous debate on whether the

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decision of the company's Board tantamount to scuttling shareholder democracy and throttling the rights of the minority shareholders. Questions are also being raised , in legal circles, as to whether the Board was at all empowered to reject the proposal and if so, whether the action was legally justified given the fact the requisition moved by the minority apparently was satisfying the basic ingredients laid down in Section 151,Rest assured, the embers of the fire that has been ignited by the issue will take quite a while to die down , considering that it has touched a sensitive nerve-the rights of the minority shareholders.

Section 151 analyzed

Against the above backdrop, it would be appropriate for us to go into the nitty-gritty of the law. Section 151 in the Act, inter alia, provides that a listed company ,may(Emphasis supplied)have one director elected by such small shareholders in the manner and on such terms and conditions as may be prescribed. It is pertinent to note that the reference in the Explanation to the above Section is to the nominal value of the shares held and not either to its market value or the price at which the member has acquired the share, as on date.

The Explanation also provides that a 'small shareholder' would be one who holds shares of nominal value of not more than twenty thousand rupees or such sum as may be prescribed. As of now, the threshold remains at Rupees twenty thousand only.

The modalities for appointment of a small shareholders' director are set out in Rule 7 of the Companies (Appointment and Qualifications of Directors) Rules 2014. The above Rule is summarized as under:

• Only a listed company is under obligation to appoint such a director upon receipt of a notice from not less than one thousand small shareholders or one-tenth of the total number of such shareholders whichever is lower.

• Proviso under Rule 7(1)stipulates that listed companies can suo moto on its own volition opt to have such a director without waiting for a request from the small shareholders. It is pertinent to note that whereas the Section provides that the trigger for the appointment of such a director would be the receipt of a request from the small shareholders, Rule 7 allows such an appointment also at the behest of the company. This portion of Rule 7 therefore travels beyond the scope of the Act and being inconsistent with the Act, it is liable to be struck down as being legally unsustainable.

• The notice for appointment of the director should be left with the company at least fourteen days before the meeting duly signed by the required number of members as above. The notice should also state the name, address and folio number of the person whose candidature is being proposed. The Rule also clarifies that the candidate need not be a shareholder in which case there would be no need to state his folio number.

• The Notice should also contain the Director Identification Number (DIN) of the candidate, his consent for the appointment along with a confirmation to the effect that he is not disqualified from being appointed as a director.

• The director so appointed shall be considered as an Independent director under Section 149 and he will have to therefore provide a declaration as to his independence as called upon by Section 149(7).

Critique

It is intriguing to note that under the law, a small shareholder director would be considered as an Independent director despite the fact that he represents a constituency of small stakeholders whose interests he seeks to safeguard. Clearly the office would give rise to a conflict of interest and what makes the legal position paradoxical is the fact that a Nominee Director appointed normally by financial Institutions is not to be considered as an Independent director. This is clearly a contradiction in the law. What is sauce for the Goose should be sauce for the Gander as well!!

• The appointment shall be made subject to Section 152 of the Act in that Section 152(2)provides that the appointment of every director shall be at a General Meeting save as otherwise expressly provided under the Act.

• The person so appointed shall not be liable to retire by rotation and he shall have a term of office for three years from the date of his appointment.

• The incumbent shall not be a small shareholders director in more than two companies simultaneously and it is also necessary to ensure that in case of appointment in the second company, the second company should not be in the same business as the first company or it should not be in conflict with the business of the first company.

• The director shall vacate office in case he incurs any disqualification under Section 164 , fails to maintain his independence as contemplated under Section 149(7) or where he has to vacate office due to intervention of Section 167.

• Upon completion of his period of office in the company, the director shall not be associated directly or indirectly in any capacity with the company for the next three years..

Differences between Section 151 of the Act and Section 252 of the 1956 Act

The subtle differences between the Act and the predecessor Act are noted below:

• Whereas Section 151 applies to listed companies only, Section 252 applied to those companies which had a threshold capital of Rupees five crores or more having a shareholder population of one thousand or more.

• As the concept of an 'Independent director' was non-existent under the 1956 Act ,the present Act gives him the status of an independent director.

• The length of appointment of the small shareholder director under both the Acts is similar.

Is Section 151 a directory provision

The use of the expression 'may' in Section 151 gives rise to a debate as to whether Section 151 is a directory provision or a mandatory provision. It is a settled legal principle that there is no general rule which can be laid down on whether a particular provision is mandatory or directory .It is always the duty of the Courts to try to get at the real intention of the legislature by carefully construing the whole scope of the Statute.(L. Hazari Mal Kathiala v ITO AIR 1961 SC 200) .

Where the Statute uses the word 'shall' prima facie, it is mandatory but the court may ascertain the real intention of the legislature by looking into the whole scope of the statute. For ascertaining the real intention, the Court may resort to considering the nature and design of the statute, the consequences that would

follow while construing a provision one way or the other, the fact that the non-compliance with the provisions will be is or not visited by some penalty and above all, whether the object of the legislation will be defeated or furthered. (State of U.P v Babu Ram Upadhya AIR 1961 SC 751).

It is also a settled principle that a provision which is procedural should not ordinarily be considered as mandatory .(CIT v Hardeodas Agarwala Trust 198 ITR 511 Cal) .

The principles carved out above can be applied in good measure in deciding the question whether Section 151 is directory or not.

It is pertinent to note that the Section enjoins upon the Board to initiate action for appointing a director once the notice to this effect is received and the said notice satisfies the ingredients laid down under Rule 7 ibid..It does not appear as if the Board can apply discretion in the matter of deciding whether the requisition for appointing a small director should be taken to the general meeting for approval as long as the procedure set out in Rule 7 ibid have been followed religiously by the applicants Newspaper reports emanating on the Alembic issue do not suggest that the rejection of the shareholders' plea is on technical grounds or for non-adherence to procedure laid down in the Rules.. Having said that , the question that arises is whether the reasons put forward by the company to scuttle the endeavors of the shareholders are within the ambit of law.

The objective of Section 151 is to provide an opportunity to the minority shareholders to have representation on the Board so that their constituency can be safeguarded. Viewed against this perspective, Section 151 cannot be said to be directory notwithstanding the usage of the expression 'may' in the operative portion of the Section.

The decision of the Alembic Board does not appear to be justifiable , given that it cuts across the edifice of shareholder democracy.

Whether the person proposed for appointment has to be a shareholder

There is nothing in the Section or in the rules which suggest that the person whose candidature is proposed, has to be a shareholder - a small shareholder at that. In the Alembic case, the person whose candidature had been proposed was not a shareholder of the company. This did not , as stated above, disentitle him for the appointment as long as he satisfied the criteria set out in Rule 7 for the appointment.

Are only small shareholders' entitled to vote on the appointment of the small shareholder director

It is pertinent to address this issue considering the fact that Section 151 speaks about the director 'being elected by such small shareholders'..Rule 7(1) also lends fortification to the above view by stipulating that the director shall be elected by the small shareholders.

To our mind, the above view is incorrect. Section 152(2) of the Act contemplates that ,subject to the exceptions carved out under Section 160 every director shall be appointed by the company in general meeting.

The appointment of a small shareholders' director has to take place through the process of a postal ballot as stated in Rule 22(16) of the Companies (Management and Administration) Rules, 2014.The above Rule corresponds to Section 110 of the Act which lays down the requirement of seeking approval of members through postal ballot which now includes the e-voting process in respect of specific items of business laid down in Rule 22 as above.

The Rules relating to voting by postal ballot do not contemplate segregation of shareholders into the categories of small shareholders and non-small shareholders and the facility of such voting is available uniformly to all shareholders entitled to vote at the general meeting.

In view of the above, it is submitted that suitable changes need to be made to Section 151 and Rule 7(1) of the Companies (Appointment and Qualifications of Directors)Rules 2014 to clarify that every shareholder shall have the right to vote on a resolution moved under Section 151.

Conclusion

We have endeavoured in our exposition to bring to the fore, thread bare the law on the subject , its nuances and have also analysed the implications of the action taken by the Alembic Board.. We firmly believe that the Alembic Board's refusal to entertain the plea of the minority shareholders is not in keeping with the spirit of the law and does not appear to be legally tenable. The Board's decision should be considered with consternation by the Regulators and the law makers alike as otherwise it would literally sound the death knell as regards the enforceability of Section 151 in the Act. Corporate law is built on the bed rock of shareholder democracy and any attempt to throttle legitimate rights should be treated with contempt.

Ramaswami Kalidas
on 08 August 2017

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