SHAREHOLDERS

Meaning of Shareholder

As per Section 86(1), the term “shareholder” means.

(a) A person whose name is entered in the share register as the holder for the time being of one or more shares in the company;

(b) Until a person’s name is entered in the share register, a person named as a shareholder in an application for incorporation (Form 1) of a company at the time of registration of the company;

(c) until a person’s name is entered in the share register, a person who is entitled to have that person’s name entered in the share register under a registered amalgamation proposal as a shareholder in an amalgamated company;

(d) Until a person’s name is entered in the share register, a person to whom a share has been transferred and whose name ought to be but has not been entered in the register.

As per section 86(2) the person for whose benefit shares are held in trust by a central depository is also treated as a shareholder of the company.

Therefore, Shareholders of a company are:

1. The initial shareholders of a newly formed company or amalgamated company
2. Persons whose names are entered in the Share Register
3. A person to whom a share has been transferred but has not been entered in the register yet
4. Those who hold shares through the central depository

Share Register

Every company that has issued shares has a duty to maintain a share register that records the shares issued by the company. Section 123(1) of the Companies Act 2007 provides:

(1) Every company which has issued shares shall maintain a share register that records the shares issued by the company, and which includes—

(a) the name and the latest known address of each person who is or has within the last ten years been a shareholder;

(b) the number of shares of each class held by each shareholder within the last ten years; and

(c) the date of any—

(i) issue of shares to;
(ii) repurchase or redemption of shares from; or
(iii) transfer of shares by or to, each shareholder within the last ten years, and in relation to the transfer, the name of the person to or from whom the shares were transferred.

Failure to maintain a share register is an offence under Section 123(2) of the Act.

Rectification of the Share Register

In terms of Sec.128, if there is any error in the share register, any person aggrieved, or the company, or any shareholder has a right to make an application to the court for the rectification of the share register. Then the court may order rectification of the register and payment by the company of any damages sustained by any party aggrieved.

On an application made under this section, the court may decide—

(a) any question relating to the title of any person who is a party to the application to have his name entered in or omitted from the register, whether the question arises between shareholders or alleged shareholders or between shareholders or alleged shareholders on the one hand and the company on the other hand; and

(b) any other question necessary or expedient to be decided for rectification of the register.

If the court makes an order directing the rectification of the register, the company shall within ten working days of the making of the order, deliver a copy of the order to the Registrar. Where a company fails to do so, the company shall be guilty of an offence.

MAJORITY RULE AND MINORITY PROTECTION

In the early history of company law, a company was treated similar to a Partnership. Therefore, it was felt that majority of members of the company could rule the company anyway possible. This position was affirmed in *FOSS VS HARBOTTLE (1843)* case.

Majority Rule

In ***FOSS*** **VS** ***HARBOTTLE***, the directors of a company sold their own land to the company at a price which is more than its true value. Two shareholders filed a case against the directors and requested from the court that the directors should repay the loss suffered by the company on the purchase of the land. The court dismissed the case and held that company and members are two different entities (two different persons). Therefore ***'if any wrong is done to a company the proper plaintiff is prima facie the company itself, and not its individual members'***.

As per this decision, a company is a separate a person, therefore, the directors and other officers belong to the company and they have duties towards the company. If they breach their duties or do any wrong to the company, shareholders individually cannot file any case against them. Because those directors and other officers have no duties to the shareholders, but they have duties only to the company, therefore it is the Company that must sue them. The court said further that in order to file a case on behalf of the company an **ordinary resolution** should be passed at a general meeting of members.

To pass an ordinary resolution more than 50% of votes are required. Therefore, without majority shareholders' permission (i.e. shareholders with more than 50% of votes) no cases can be filed on behalf of the company. Therefore, *Foss* Vs *Harbottle case established the majority rule*. By virtue of the majority rule, the minority shareholders are required to accept the decisions made by the majority shareholders.

MINORITY PROTECTIONS OR EXCEPTIONS TO THE RULE IN FOSS V HARBOTTLE

By permitting the majority to rule the company, many problems started to arise. For example- the Directors who had the majority votes or the directors who had the support from the majority of members, started to do many wrongs against the company or against minority shareholders. And such directors by using their voting power prevented cases being filed against them.

Therefore, the companies act has identified some exceptional circumstances to permit minority shareholders to file cases directly to the court without passing any resolutions in a meeting. These exceptional circumstances are known as exceptions to the rule in Foss v Harbottle or minority protections.

Minority protections provisions in the Companies Act

There are many provisions in the Companies Act for the minority protection, some of them are as follows

1. Oppression or Mismanagement (Section - 224 & 225)
2. Restraining Orders (Section - 233)
3. Derivative Action (Section - 234)
4. Minority Buy-Out Rights (Section - 93)

Oppression

Sec.224 provides that any shareholder who has a complaint against the company that the affairs of such company are being conducted in a manner oppressive to any shareholder or shareholders such a shareholder may make an application to court against oppression.

What Type of Conduct will amount to Oppression?

The word oppression has not been defined in the Companies Act. According to the common law, oppression occurs when the minority member proves that

1. The activities of the majority must be unfair, wrongful, harsh and burdensome
2. There are series of activities by the majority against the interest of the minority. But if the wrong done by the majority is too harsh or burdensome even a single incident is sufficient to file a case against oppression.
3. The minority member suffered by the activities of the majority members in the capacity as a member and not in any other capacity, such as a secretary or director.

Mismanagement

Section 225 provides that any shareholder or shareholders of a company may make an application to court, if he has a complaint—

(*a*) that the affairs of the company are being conducted in a manner prejudicial (harmful) to the interests of the company; or

(*b*) that a material change has taken place in the management or control of the company, and that by reason of such change it is likely that the affairs of the company may be conducted in a manner prejudicial to the interests of the company.

We can see that the word 'mismanagement' is also not defined in the act. Generally, when the company is managed in a manner prejudicial (harmful) to the interests of the company, it is said to be mismanaged.

Who may make an Application against Oppression or Mismanagement (Section -226)?

An application for oppression or mismanagement may only be made by a shareholder or shareholders, who at any time during the six months prior to the making of the application—

(*a*) constituted not less than five *per centum* of the total number of shareholders; or

(*b*) held shares which together carried not less than five *per centum* of the voting rights at a general meeting of the company.

RESTRAINING ORDERS (SECTION - 233)

If the company or a director **proposes to engage** in a conduct that would contravene the articles of the company or any provision of the companies act, the court may make an order restraining (preventing) the company or the director from engaging in that conduct. To get a restraining order the application may be made to the court by —

(a) the company; or

(b) a director or

(c) a shareholder of the company.

However, the restraining order may not be made by the court in relation to a conduct that has been completed.

DERIVATIVE ACTIONS (SECTION – 234)

Generally majority shareholders or majority directors may have the power to manage a company, and they may manage it according to their own wish. Sometimes their decisions or activities may be harmful to the interest of the company.

In such situations as per Sec.234, a Derivative action may be filed on behalf of the company by a shareholder or a director to protect the company's interest.

The principle underling the derivative action is that since a company has a duty to act in the best interest of its shareholders, a shareholder has a right to file a case on behalf of the company when the directors and management are failing to act for the benefit of the company and all of its shareholders. It would be difficult to assume that the wrongdoing directors in control of the company would bring an action in the name of the company alleging wrongdoing against themselves. Therefore, it became imperative that some means be found for a company to bring an action to protect itself.

When the wrongdoers themselves are in control of the company, an action can be brought on behalf of the company by the minority shareholders on the footing that they are the company's representatives and that they are bringing the action on behalf of the company. This is referred to as 'derivative action' because an individual member sues on behalf of the company to enforce rights 'derived' from the company. Therefore, a derivative action is brought by a shareholder on behalf of a company to redress a wrong done to the company. It is not an action available to enforce personal rights of individual shareholders, unlike actions under oppression (sec.224) and mismanagement (sec.225).

A derivative action often arises in cases of fraud, mismanagement, self-dealing and/or dishonesty which are being ignored by officers and the board of directors of a corporation.

To file a derivative action, such shareholder or the director should get the permission (leave) from the court. Because sometimes unnecessary or useless cases may be filed by such shareholders or directors.

Before granting leave, the court will consider the following,

(a) the likelihood of the success of proceedings;
(b) the costs of the proceedings in relation to the relief likely to be obtained;
(c) any action already taken by the company to obtain relief;
(d) the interests of the company in the proceedings

The purpose of the above is mainly to prevent trivial actions being instituted against the company in the guise of a derivative action.

MINORITY BUY-OUT RIGHTS (SECTION - 93)

If a company has passed a special resolution or a written resolution regarding

a) the alteration of articles which imposes or removes a restriction on the business or activities in which the company may engage

b) a major transaction or

c) amalgamation

A shareholder who voted against such special resolution or a shareholder who did not sign such a written resolution will be entitled to require the company to purchase his shares.

A minority buy-out gives the minority shareholder the right to exit from the company by getting a fair price for his shares.

Where a shareholder wishes to exercise this right, he shall give prior written notice to the company within ten days of the passing the resolution. When a company receives a notice from a shareholder requiring the company to purchase shares, the board must,

a) agree to purchase the shares;
b) arrange for some other person to agree to purchase the shares;
c) apply to court for an order exempting the company from purchasing the shares, or
d) arrange the rescinding of the special resolution that triggered the operation of the buy-out rights or deciding not to take the action concerned.

The court has the power to make order as it thinks fit, including exempting the company from purchasing shares, setting aside the resolution passed by the company, granting compensation to affected shareholders or even winding up of the company.