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Position of Minority Shareholders in Shareholder's Agreement under Indian Legal Framework

PARTHEESWARAN PARAMESWARAN¹ AND ATHMA RUBAVATHI M.²

ABSTRACT

A Share-holder is one of the most important documents in a company, defining the rights, responsibilities, and powers among the shareholders, which serves as a contribution to stability and conflict resolution. The shareholders are diverse, with the minority shareholder often not being able to influence decision-making, and the SHA will govern matters of share transfer, voting, and dividend policies that often favours a majority shareholder. Since SHAs are not specifically governed in the Indian legal framework, even the general provisions of Sections 6 and 58 of the Companies Act go a long way in governing validity and shareholder rights. The research paper will address the role of minority shareholders in SHAs and their legal protection and compare this approach of India with other common law jurisdictions, such as the USA, looking at judicial trends and real-life implications.

Keywords: SHA, minority shareholder.

I. INTRODUCTION

“When you have strong protections for the interests of minority shareholders, then more people are willing to invest money in the stock market. As a result, what you get is a larger stock market with more turnovers and higher capitalization or more dynamism.”³

Shareholder agreement is the one of the primary document in a company which anticipates the chaos and pre-determines the solutions to the future problems. The shareholders are the main entity in a company according to the shareholder's primary theory, so they are the investor who invest their money for the expansion of the company and the shareholder aren't homogenous there are many kinds of shareholders, mainly the minority shareholders are at the stake because of lack of upper hand position in the decision making.

The shareholder agreement is essential for a company because first it deals about the power

¹ Author is an Assistant Professor at SRM School of Law, India.

² Author is an Assistant Professor at SRM School of Law, India.

³ Capital Ideas Online, <https://capitalideasonline.com/wordpress/good-read/the-value-of-protecting-minority-shareholders-in-the-market/> [Accessed 16 July 2021].

distribution between the various shareholder and define their position in the company, moreover it also deals with how the shares can be transfer and their commitments are decided. So this SHA is an important document that sets the rules to govern the internal affairs of the company after AOA. This is the ideal mechanism of the company but when drafting a SHA it differs from the actual participation of all the shareholders because shareholder agreement is nothing but a compromising of right and liabilities of shareholders against the criteria laid by the legislation like pre-emptive rights and etc and it is like standard form of contract where the party in lower hand don't have much power to express in this contract. The majority shareholders always make a contract with the way of paying the dividends, voting power and mechanism to buy and sell the shares, so we can understand that it deals with the majority of important work nature which governs the company.

The Indian legal framework is silent on the shareholder agreement but there are some provisions like sec 6⁴ of the act which deals about the validity of the agreement with respect to the provision of the companies act and as well as the sec 58⁵ deals about the compromise between the shareholders . So if this is the current scenario of the legal position then what is the position of the minority shareholders in the shareholder agreement. This study revolves around the participation of minority shareholders in SHA and what are the rights available to them and also whether India is par with other common wealth countries like USA, so it is easy to navigate the current position of Indian laws and the researcher also tries to find the real world and judicial trend on the subject matter.

(A) Shareholder agreement:

Shareholder agreement is a contractual compromise between all the shareholders of the company and these agreements usually deals with the individual rights and special rights and shareholders duty, it also impose certain limits over the companies Act. These shareholder its purely contractual it covers most of the important area of governance like a) management and company ownership rights 2) transfers of shares and its restriction 3) appointing directors 4) veto power 5) protection of minority shareholders.⁶

The shareholder assignment sets out the rights and duties of the shareholders and mechanism related to the governance and the ownership of the company. The aim of the shareholder

⁴ Act to override memorandum, articles, etc.

⁵ Refusal of registration and appeal against refusal.

⁶ Lawyered. 2020. Are the Rights of the Minority Shareholders Protected? By Abhishek Dutta. [ONLINE] Available at: <https://www.lawyered.in/legal-disrupt/articles/are-rights-minority-shareholders-protected-abhishek-dutta/>. [Accessed 16 July 2021].

agreement is to protect the interests of the shareholders

(B) Importance of Shareholder agreement for minority shareholders:

Most of the decision in the company is decided but the majority shareholders like they call for the meeting and the director will be representing them in the meeting and the decisions will be passed and it becomes the norm so the minority shareholders don't have proper representation in passing any resolutions or the veto, so to overcome that shareholder agreement are the only way to protect their rights sometimes it is used in other way around also where the majority shareholders tries to eliminate all the rights that is been available to the minority shareholders. So the shareholder agreement has a power to overshadow the certain conditions of law and helps the company to work more efficiently.

(C) Research Questions:

1. Is there any legal provision in India present to protect the interest of minority shareholder in India?
2. Does Indian legal foundation in protecting the minority shareholder interest in SHA on par with other common law country like American?
3. What is the current scenario or judicial trends with respect to minority shareholder contribution in shareholder agreement?

(D) Data and methods:

The current research is proposed to be a doctrinal study based on primary and secondary sources. The primary sources include company law act 2013 and also other company's regulation and contract act 1972 and the secondary sources may include articles, books, journals etc that will help in the progression of the current research. The study will mostly be descriptive and as well as analytical. In the descriptive part, the study will focus on detailed explanations of the existing laws that ensure protection of minority shareholders. The analytical part will contain a critical analysis of the application of the mentioned regulation and its influence on the governance mechanism.

(E) Limitations of the Study:

The primary limitation of this study is, it is an analytical and descriptive study the outlook of the person will differ from that of a researcher and the materials used for the study are the articles written by different authors so the standpoint of the maybe relative. one of the important problem is that since this research was carried out during pandemic period so the materials used is so limited, so this research is done with limited best materials that has been found online and

the time constraint was also an limitation for this study.

II. MINORITY SHAREHOLDER PARTICIPATION

Minority shareholders are the ones who doesn't have sufficient voting rights and they hold below 50% of the shares⁷ they are known as the minority shareholders in a company, these minority share holders are subjected to the domination by the majority shareholder and also the majority shareholders pass the most of the resolution without the approval of the minority share holders so the minority shareholders face corporate discrimination. In order to stop this there are being many precautions by legislators and also from the regular practice the shareholders also form a shareholder agreement to anticipate the problem that might arise in future.⁸

This shareholder agreement is more helpful to solve the issues and it will be binding on all the shareholders irrespective of shares they own, this shareholder agreement is both helpful and destructive to this issue⁹. This can be used to voice out the needs of the shareholder and also in some case it can suppress the minority shareholder also.

The shareholders are of two types majorly that is 1) standard general type shareholder agreement and 2) unanimous shareholder¹⁰. In the former part in the standard SHA is type where there it lays different types of rights and duties laid to the different types of shareholders so in this type not all the shareholders own equal rights and duties, it varies according to the position they are in or according to the explicit provision in the agreement. Whereas in the unanimous shareholder agreement where from the word it is been evident that there is been in declared in a uniform and single mindedly, this type of shareholder agreement is drafted and it's been unanimously accepted by all the shareholders in the company and it also binds the future shareholders of the company also¹¹. In this type of shareholders agreement the shareholders irrespective of their class or the position everyone will have same amount of rights and liabilities.

(A) Minority rights in the shareholder agreement:

There are many clauses in the shareholder agreement which are there to protect to the welfare

⁷ KPPBLAW. 2018. Minority Shareholder Rights and Why They Matter. [ONLINE] Available at: <https://www.kppblaw.com/protect-minority-shareholder-rights/>. [Accessed 16 July 2021].

⁸ CFI. 2018. What is a Shareholder Agreement?. [ONLINE] Available at: <https://corporatefinanceinstitute.com/resources/knowledge/finance/shareholder-agreement/>. [Accessed 18 July 2021].

⁹ OldMutual company. 2019. 5 Devastating shareholders agreement mistakes that could harm your business. [ONLINE] Available at: <https://www.oldmutual.co.za/articles/5-devastating-shareholders-agreement-mistakes-that-could-harm-your-business/>. [Accessed 18 July 2021].

¹⁰ DuncanCraig LLP. 2016. Shareholder Agreements 101: Unanimous vs Standard Agreements. [ONLINE] Available at: <https://dcllp.com/blog/2016/08/03/shareholder-agreements-101-unanimous-vs-standard-agreements/>. [Accessed 18 July 2021].

¹¹ Graves B, (2005) Shareholder Agreements, Insight Information Co Article

of the minority shareholder like there is tag along where when a majority of shareholders sell their shares the minority shareholders have right to participate in the transaction on the pro rata basis. In the unanimous SHA it can work on both ways it helps and as well as pull down the space of minority shareholders as well. Like with the help of unanimous SHA the seats of the directors can be reserved for the directors, so which gives an assurance to minority shareholders to invest. It is also seen in many company's shareholder agreement like Divi's Laboratories¹².

There are few clauses in Shareholder's agreement which protects the interest of Minority shareholder like:

1. Anti- dilution clause:

Which ensures the present shareholders ownership don't get diluted if there is further issue of share.

2. Drag & Tag along:

In this where the drag along clause makes majority shareholder to take minority shareholder shares during the time of sale and it is vice versa in Tag along.

3. Capital Expenditure Approval:

Capital expenditures are of large amount, so the minority shareholders require that they approve any disbursement of capital to protect the investment which is done by the minority shareholders.

4. Appointment of Director:

Where it gives minority share holder to appoint a director to represent

5. Pre-Emptive Rights:

The shareholders that when there is issue of capital the shareholders have first right to subscribe for that share. So these are the few clauses in the shareholder agreement which protects the interest of the minority shareholder agreements.

(B) Protection of minority shareholders in real world

There many provisions in the companies act 2013 like sec 235¹³, 244¹⁴ but it is deals with the accruing shares and the mismanagement, there is no provisions regarding the shareholder

¹² Business-standard. 2019. Five years on, Sec 151 on small-shareholder directors makes little headway. [ONLINE] Available at: https://www.business-standard.com/article/companies/five-years-on-sec-151-on-small-shareholder-directors-makes-little-headway-119062900156_1.html. [Accessed 18 July 2021].

¹³ Power to acquire shares of shareholders dissenting from scheme or contract approved by majority

¹⁴ Right to apply under 241(Application to Tribunal for relief in cases of oppression, etc)

agreement. The minority protection can be seen in not only the shareholder agreement but other documents like private placement memorandum and etc because the shareholder's agreement are usually confidential. Where when there is an issue according to the SEBI regulations there are instances where it helped to secure the interest of the minority shareholders and as well as the it helped to give more power to majority shareholders.

In the year 2020 the Bajaj finance ltd¹⁵ issued PPM for raising the capital that it has given all the details in crystal clear manner like how the shares of the shares will be divided and the rights of the party etc. It also lays that the issue followed the pari passu principle¹⁶ where there is no hierarchy of the person who invest and everyone will be treated alike and the rights to re-issue the debenture that is being issued, so there is no bar on the resale in the secondary market and this applies to all types of market. It also gives assurance that if in case there is any conflict arises in the future then the content provided in this document shall prevail over the other. It gives strong base for minority shareholders protection.

In the year 2019 Axis bank issued PPM¹⁷, where it speaks about the dilution of the shareholding pattern¹⁸ it is the negotiating line between shareholders and the bank because it says that bank is the ultimate decider to dilute the ownership of the shareholders in the company and it solely depends on the resolution passed by the majority shareholders, so there is a high chance of violation of minority rights and in the same way the preemptive rights is also being compromised that according to the decision of the board the act to further issue will be decided and the shareholders won't get a right to buy the new shares. So these are epitome of the shareholder oppression where the minority shareholders have to agree to the majority shareholders and their decision so it is the violation of the justice. The unanimous shareholders work in both the ways.

This shows that in real world the participation of minority shareholders is still a question whether there is sufficient protection given to minority shareholders in the SHA, even though there are hues and cries about the participation of shareholders but in reality it is very minimal. So it is important to know where the other countries law standstill and how they protect and helps the minority shareholders to participate in SHA and protect their rights. This helps us to navigate the fathom of law in the shareholder agreement so to reform the laws of India, which in returns

¹⁵ BAJAJ FINANCE LIMITED(2020) private placement offer cum application letter cum information memorandum

¹⁶ All unsecured creditors in the process of insolvency, the factors like management, liquidation and bankruptcy must be shared equally on any present assets of the company from the sale of any of those assets, which is in proportion to the debts due to each creditor

¹⁷ Axis Bank Ltd (2019) Preliminary Placement Document

¹⁸ Axis bank 2019 pg 90

helps the economy.

III. COMPARATIVE STUDY BETWEEN INDIAN AND US LEGAL FRAMEWORK IN THE FIELD OF SHAREHOLDER AGREEMENT

The comparative analysis is important to understand the position of the particular country's law. Doing a comparative study with the developed nation's legal framework like USA, which will help us to do self evaluation with our Indian law because in global level the economics and business trades are increasing. The corporate industry are colossally growing and USA it is the most, so if we know the factor of it growing especially in shareholder agreement which gives out the flexibility and promote economical activity. India and USA legal framework is totally different because in India where there is only one law which is applies to all part of the nation but it isn't the same in US because it is true federal country where the corporate falls under the state list.

The shareholder agreement is of two classifications 1) the shareholder agreement deals with transfers of shares and 2) shareholder agreement deals with the internal governance.¹⁹ In the former case it falls under the ambit of federal law and latter falls under the scope of state law but India don't have so it is one of the primary differences between the country's legal frameworks.

In US law the corporate laws on the federal state where the state passed a uniform act which applies to the whole US nation and the state follow this as a model legislation and its name is Model Business Corporation act which applies to all the corporate companies. This code exclusively deals with the relation between shareholders, the shareholder and the company as well as the limitation laid on the rights of the shareholder. It explicitly deals in 7.32(a) (1) – (8) of the MBCA code²⁰. It specifies that limitation lay on the shareholders it shouldn't be in contrary to the public policy so the minority rights. Where it's been considered as the corporate custom and this same principle is been agreed in California code²¹ in Sec 300 where it states that in a closed corporation it doesn't have to follow all the corporate norms regarding the annual meeting or other factors that's been laid in the corporate domain, so the minority shareholders get a chance to represent in spite of various corporate names that is been laid on them.

¹⁹ Testing the Validity of a Type of Shareholders' Agreements in India. 2018. Indiacorplaw. [ONLINE] Available at: <https://indiacorplaw.in/2018/05/testing-validity-type-shareholders-agreements-india.html>. [Accessed 18 July 2021].

²⁰ Chapter 7- Shareholder agreement, Model Business Corporation Act 2002

²¹ Section 300 of the California Corporations Code

Recently there is statutory board Public Company Accounting Oversight Board which was created by the Sarbanes- Oxley act²². This was established to regulate and protect the interest of investors. So this regulatory body oversees the function of the corporate and curbs unreasonable violation of corporate norms. Apart from these indirect provisions mentioned in the Code of Virginia where it explicitly talks about the shareholder agreement § 13.1-671.1- Shareholder agreements of Virginia stock corporation act²³ it gives the plethora of explanation to degree of limitation that can be laid on the shareholders so this provision is likely to be exhaustive section. So this proves that in US the laws are much more clear and definite and also the state laws can changes the legal framework with respect to federal law. In *Ritchie v. Rupe*²⁴ which was a landmark judgment passed on 2014 where it lays the foundation of minority shareholder rights, Where it explains about, the fathom of minority shareholder's rights which can be protected.

In India there are no explicit provisions in Indian law that explicitly deals with the shareholder agreement but the trace can be found in Section 58 (2)²⁵ but apart from it the laws are unclear. This shows that the US laws are better in protecting the rights of the shareholders and there are even judicial precedents in America to protect the minority shareholders.

IV. CURRENT POSITION OF MINORITY SHAREHOLDERS ACTIVITY IN SHAREHOLDER AGREEMENT

This part deals with the participation of minority shareholders in the functioning of the company. Where the company is a closed corporation so we won't know the degree of participation in the governance of the company, so we try to find the fathom by going through the Indian case laws so we would understand how much protection is given and the real dynamics inside the closed corporate.

When it comes to company act 2013 there are many sections which deals with the variation of shareholder right, it is dealt under sec 48 of the act²⁶ where it says that when there is a variation of rights in MOA or AOA it should be done with approval of three fourth shareholders vote and it also gives a condition that if more than 10% of the issued shares don't approve of it then they

²² The Sarbanes Oxley Privilege For Public Company Accounting Oversight Board Materials: Its Implications For SEC Enforcement Proceedings. 2015. Harvard Business law review. [ONLINE] Available at: <https://www.hblr.org/2015/06/the-sarbanes-oxley-privilege-for-public-company-accounting-oversight-board-materials-its-implications-for-sec-enforcement-proceedings/>. [Accessed 18 July 2021].

²³ Code of Virginia- Art 8- Shareholder

²⁴ *RITCHIE v. RUPE*, 339 S.W.3d 275

²⁵ Sec 58(2) Without prejudice to sub-section (1), the securities or other interest of any member in a public company shall be freely transferable

²⁶ Sec 48. Variations of shareholders' rights

can reach out to the tribunal. So by this it ensures that there is enough participations of minority shareholders.

Minority shareholders not necessarily always have to be the lower power hand, sometimes when a company be in a verge of insolving there will be acquiring of shares by another company to save the company, so this investing company do get more benefit through process of shareholder agreement and possesses a high degree of quorum rights as mentioned in *Rhodia S.A. v. SEBI* case.²⁷ Which this case where is shown that when it comes to minority it doesn't always have to be in lower hand, the investor shareholders who invest to save the company from insolving is also a minority shareholders but they have enormous power.

There are many judicial precedents which gives an idea about minority shares and participation in voting. The acquirer company stepped into the shoes of the seller company and misused the shares of the seller company.

The sec 5 of the companies deal with the article of association and it will prevail over the SHA and its proved in the case of *V.B. Rangaraj v V.B. Gopalakrishnan*²⁸ where in this case it is quite old which happened in 1992 where it has been held that transferring of shares contrary to the article of association is void, so it shows that even the shareholder agreement can compromise with the existing shareholders but it will be subjected to the article of association. So the article of association will protect the interest of the minority shareholders.

In the case of *Rakesh agarwal vs SEBI*²⁹ where it has laid down that the shareholders agreement should be clear, it shouldn't give vague terms like minority or majority decision. It should explain the percentage also, if not that will be misused by the decision of the company. This helps the minority shareholders to know the threshold of the company. It makes sure that when drafting a clause in the shareholders agreement it should be clear and precise.

In the case *Alpha TC Holdings Pvt Lt*³⁰ where this case it classifies the powers or the rights that are guaranteed to the minority protection so in this case where the judiciary has explained what falls under investor protection rights and minority protection rights. So the investor protection rights that has been guaranteed in the shareholder agreement is different from the minority rights, so the judiciary makes a clear difference between these two rights so the former won't seek protection under minority rights.

²⁷ [2001] 34 SCL 597 (SAT)

²⁸ AIR 1992 SC 453

²⁹ (2004) 49 SCL 351 (SAT)

³⁰ CCI Order in the matter of Alpha TC Holdings Pte Limited and Tata Capital Growth Fund I, Combination Registration No. C-2014/07/192, 9 September 2014.

V. CONCLUSION

The minority shareholders is always a problematic are when it comes to a corporate system, the shareholders agreements are the instruments which confer the privileges to the minority shareholders and sometimes it can snatch away the rights of the same. The involvement of the minority shareholders do varies depending on the company but there sufficient provisions in the law which guarantees protection to minority shareholders in participating in the shareholder agreement. Though there is a lack of solid legislation for shareholders which is one of the drawbacks for the Indian scenario so it's high time the government should consider and act accordingly.

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