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The Constitutionality of Disenfranchising Majority Shareholders: A Multidimensional Analysis under purview of Corporate Law

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ABSTRACT

Corporate governance is dependent on majority shareholders having significant influence over key decisions. Disenfranchisement, or the deprivation of these shareholders' voting rights, raises significant legal and ethical concerns that call for in-depth analysis. The complex issue of majority shareholder disenfranchisement is examined in the paper within the framework of corporate law and constitutional issues. The first section of this paper discusses corporate law, particularly the privileges accorded to majority shareholders, their duties as fiduciaries, and the protection of minority shareholders' interests. The author(s) have analysed the arguments for and against such tactics by way of looking at the historical instances and case studies that show corporate disenfranchisement. With reference to fundamental rights under the Constitution of India, like the right to property and the right to vote, in regard to corporate governance systems, this paper explores the interactions between corporate law and the constitutional law of India. Notably, the judicial precedents' critical influence on the development of the legal environment has been considered while examining the legal consequences and issues surrounding disenfranchisement that have been presented before courts. This paper also evaluates the corporate governance norms and legislative frameworks put in place to address disenfranchisement issues, with an emphasis on how they manage the hazardous balance between majority shareholder control and maintaining shareholder rights. Also addressed is the effect of shareholder activism and dissent in opposing disenfranchised policies. The paper examines disenfranchisement from a comparative examination of national perspectives, taking into account the many legal and cultural influences that shape national perceptions of majority shareholders' rights.

Keywords: *Companies Act, Corporate Governance, Disenfranchisement, Majority Shareholder, SEBI*

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I. Introduction

The set of laws, customs, and procedures known as corporate governance governs and controls businesses. The shareholders, who have stock ownership stakes in the business, are at the centre of this structure. Because of their huge ownership shares, majority shareholders have a tremendous impact on corporate decision-making. Their privileges and rights are protected by corporate law, giving them the opportunity to influence the strategic course and daily operations of the business.

By possessing a sizable number of a company's shares, majority shareholders have a considerable impact on the corporate landscape. They frequently have the power to choose directors, authorize significant business transactions, and change the company's articles of incorporation. Majority shareholders are able to control the company's activities in a way that advances their interests and objectives due to concentration of power. Their impact is most noticeable in closely held businesses where few shareholders frequently possess a big chunk of the company's stock. In these situations, majority owners may successfully control the business without being constrained by the opinions of all shareholders. Despite the benefits they receive, having majority owners also raises questions regarding the possibility of power abuse. They could operate in a way that is harmful to the firm as a whole by prioritizing their own interests over the interests of minority owners and other stakeholders. This concentration of power could make it more difficult for businesses to make decisions that are transparent, accountable, and equitable.

Disenfranchisement is the act of depriving someone of their civic rights, including the ability to vote. Disenfranchisement of majority shareholders, as used in the context of corporate governance, refers to the restriction or loss of some of their voting rights. There are several ways to do this, such as altering the voting procedures, creating several classes of shares with various voting privileges, or demanding supermajority votes for specific topics. The impact of disenfranchisement on corporate governance is extensive and complex. On one hand, these regulations could be implemented to promote organizational resilience and long-term stability. By limiting the immediate voting power of majority shareholders, companies may be shielded against short-term, profit-driven decision-making that might endanger the company's long-term viability. On the other hand, disenfranchisement policies can also be regarded as a strategy to support present management or controlling owners, allowing them to maintain their positions of authority and influence without enough oversight from other shareholders. Due to the possibility that checks and balances would n'ot be present in the company's decision-making

processes, this might raise concerns about corporate governance practices. Disenfranchisement could also scare off potential investors since it might be seen as a violation of shareholders' rights and a symptom of poor company governance. In addition to harming the company's overall worth and image in the market, this might limit its access to funding. Disenfranchisement can also lead to legal and constitutional issues. It can be contested on the grounds that it violates company law-protected shareholder rights or constitutional values like the right to own property and to vote.

II. Corporate law and majority shareholders

A majority shareholder is a person or entity that has a substantial portion of the company's shares, giving them a controlling interest and the authority to influence corporate decision-making. While different countries may have different definitions of what defines a majority shareholder, it is generally accepted that these stockholders control a percentage of shares more than 50% of the total number of outstanding shares. Majority shareholders often have special advantages and authority within the firm due to their significant ownership interest. Majority shareholders have a number of important rights, including the following –

- *Voting Rights* - Majority shareholders have a significant impact on corporate decision-making, which includes selecting the board of directors and approving crucial company actions. They have the ability to affect the outcomes of significant choices like mergers, purchases, and shareholder resolutions.
- *Board Representation* - When shareholders own a majority of the company's shares, they typically have the authority to nominate and elect board members, giving them direct control over the company's management and strategic direction.
- *Dividend Entitlement* - The company has a right to provide dividends to majority shareholders in accordance with their ownership stake. Their part of the dispersed earnings increases with the number of shares they own.
- *Information Access* - Majority shareholders often have the right to delve into the important corporate information, financial statements, and other vital data that can aid them in making educated decisions and successfully exercising their voting rights.
- *Inspection Rights* - In certain countries, majority shareholders may be entitled to see the books, records, and corporate documents of the Company, subject to statutory limitations and for reasonable purposes.

- *Control over Corporate Policies* - Majority shareholders that own a controlling stake in the company have the authority to shape corporate policies that have a significant impact on the operations, governance, and long-term goals of the company.

Minority shareholders have a critical role in a company's management overall. They are stockholders who have less stock in the corporation than the major shareholders. Even if minority shareholders may not have the same level of influence or control over the company's decision-making processes, protecting their rights and interests is essential to creating a fair and equitable corporate environment. To protect them from potential abuse by majority owners, corporate laws and regulations have been established. The following factors are what determine the procedures and policies that are followed to safeguard the interests of minority shareholders[3]–

- *Directors' Fiduciary Duties* - The board of directors must act in the best interests of all shareholders, including minority shareholders, in accordance with the law. In order to fulfil this obligation, directors must act in the corporation's best interests overall and consider the interests of all shareholders, not just the majority. Directors must refrain from favouring majority shareholders over minority shareholders and avoid any conflicts of interest.
- *Equal Treatment* - In corporate law, the concept of equity for all shareholders is widely emphasized. This implies that when it comes to having access to information, dividends, or other shareholder advantages, minority shareholders should not face undue bias or discrimination. Legal action may be taken in response to any corporate or majority shareholder acts that disproportionately affect the rights of minority shareholders.
- *Transparency and Disclosure* - The quick and frequent disclosure of material information is necessary to preserve the interests of all shareholders, especially minority shareholders. Minority shareholders may make educated judgments about their investments and determine if their interests are appropriately represented by the company's management with the help of transparent reporting.
- *Oppression Redress* - When minority shareholders feel their rights have been violated or unfairly disadvantaged by the conduct of the majority shareholders or the company's management, several countries have established oppression remedies that provide them the opportunity to seek compensation. Injunctions, monetary damages awards, and court-ordered business reorganization are a few examples of these remedies.

[3] 'Freezing Out Minority Shareholders' (1955) 41 Va L Rev 77.

- *Voting Rights of Shareholders* - While majority shareholders frequently have more influence over decisions due to their bigger shareholdings, some actions may necessitate special resolutions that have a higher approval requirement. This helps to stop the majority from acting alone and making crucial choices that can harm the interests of minority shareholders.
- *Proxy Voting* - By using proxy voting, minority shareholders who are unable to attend shareholder meetings in person can nevertheless take part in crucial decisions. Minority shareholders can voice their opinions and safeguard their interests by designating proxies to vote on their behalf.

III. Disenfranchisement of majority shareholders

The 'Right to Property' has remained a constitutional right in India, in accordance with Article 300-A of the Constitution of India, even after the 44th Amendment to our Constitution abolished it as a fundamental right.

In business law, the term 'Property' refers to the voting rights attached to a share. The right to vote is a power of Property, according to the well-known English ruling in *Pender v. Lushington*, and is linked to a shareholder's ownership interest in the business.[4] This common law precept is clearly acknowledged in Section 47(1) of the Companies Act of 2013 (Act), which is equivalent to Section 87 of the Companies Act of 1956. Notably, Section 47(1) was changed by the Companies (Amendment) Act of 2017 to allow for the restriction of a related party's voting rights for a major RPT under Section 188.

Under the Companies Act of 2013, the right to vote is likely the most important advantage that an equity shareholder may enjoy. The Securities and Exchange Board of India (SEBI), through Regulation 23(4) of the LODR Regulations, has recently changed the regulatory framework for listed companies. As a result, provisions relating to shareholders' approval by a 'majority of minority' vote have been introduced for elements like related party transactions (RPTs) and schemes of arrangement. Therefore, the voting rights of an equity shareholder must be considered. Regulation 23(4) of the LODR Regulations, which states that no connected party, regardless of whether it is a party to the transaction, shall vote in favour of the resolution for any substantial RPT, uses the wording 'majority of minority'. This suggests that the minority shareholders of the listed company will be required to support the sale with a "majority" of their

[4] *Pender v. Lushington,* (1877) 6 Ch D 70.

votes, but the majority shareholders of the listed firm will never be permitted to vote to approve the sale.

When giving shares to the promoter/promoter group, integrating the listed firm with a promoter/promoter group business, etc., listed businesses employ similar arrangements. Additionally, SEBI recently released a consultation paper that pushed for the introduction of 'majority of minority' approval for two different types of agreements: (a) business transfer agreements **(BTAs)** reached outside the scheme route, and (b) those that affect a listed entity's management or control, regardless of whether the listed entity is a party. The Securities Contracts (Regulation) Act of 1956 **(SCRA)** and the SEBI Act of 1992 **(SEBI Act)**, which would have contained the concept of 'majority of minority' approval, are instances of delegated legislation, not the LODR Regulations and the Scheme Circular.

(A) "Authority of Law" under Article 300-A of the Indian Constitution

While a "delegated legislation" may be considered a "law" under Article 300-A, this property deprivation can only be carried out by a delegated legislation if the parent statute has granted it with an enabling authority. In other words, a parent statute must be the source of authority, and delegated legislation cannot have the authority to rob someone of their property.

This verdict was reached in *Alka Synthetics Ltd. v. SEBI* by the Gujarat High Court's learned Single Judge.[5] He pondered whether Article 300-A was breached by SEBI's activities, such as keeping money received by stock exchanges in custody or forfeiting it, or whether Section 11-B of the SEBI Act, which grants SEBI jurisdiction, permits such acts. The Learned Single Judge determined that subordinate legislation may be included in the definition of 'law' under Article 300-A provided the parent laws (under which the subordinate legislation was enacted) clearly permit such a deprivation of property.

Delegated legislation that imposes a 'majority or minority' shareholder approval requirement must expressly permit such a loss of voting rights in order to pass the Article 300-A test. This is based on the well-known definition of "law" found in Article 300-A.

(B) Is there a "Source of Power" for SEBI?

The MCA and SEBI's respective areas of authority and jurisdiction are clearly defined in Section 24 of the Act. Even for listed corporations, Chapter IV of the Act which deals with "voting rights" clearly falls outside the purview of the MCA. This is evident in Section 47. As a result, the Act gives SEBI no authority to pass laws pertaining to voting rights.

[5] *Alka Synthetics Ltd. v. SEBI,* 1997 SCC OnLine Guj 258.

When combined with Section 31 of the SCRA, Sections 11(2), 11A, and 30 of the SEBI Act apply to the LODR Regulations. Both the SEBI Act and the SCRA do not contain any provisions that would authorize SEBI to restrict or limit the voting rights of a majority shareholder, in contrast to Section 47 of the Act (which permits imposition of voting limitations for RPTs under Section 188). Notably, Section 47 only states that the rights of equity owners may be impacted by voting restrictions implemented under Section 188. Through SEBI laws, it does not enable restrictions on voting rights.

While it is true that any terms used but not defined in the SCRA and the LODR Regulations must have the meanings ascribed to them by the Act, it should be emphasized that this is only true for 'terms' and 'expressions. In the absence of expressly permitted provisions in the SEBI Act and the SCRA, it might not be feasible to determine the source of power by directly borrowing provisions from those statutes.

Furthermore, it is widely accepted that only the Board is subject to fiduciary obligations, so when a shareholder votes at a public meeting, he or she is free to do as they choose and prioritize protecting their own investment in the company. There is no authority for SEBI to limit the use of this privilege in the SEBI Act or SCRA.[6]

(C) Manifest Arbitrariness and Proportionality

Even if there is no conflict of interest associated with the transaction, the "majority of minority" arrangement now leaves the majority shareholders helpless. Additionally, starting on April 1, 2023, the 10% Shareholding Test will consider any person or entity that owns 10% or more of the equity shares of a listed company to be a related party. Even financial or institutional investors, regardless of whether they had a direct or indirect conflict of interest with the transaction, would not be permitted to vote in favour of a large RPT under the 10% Shareholding Test.

1. *Test of Manifest Arbitrariness under Article 14 of the Indian Constitution*

Genuine equality, not only nominal equality, is required under Article 14 of the equality law. It was determined that if it could be shown that delegated law was prepared capriciously, without a clear guiding principle, or without employing good judgment or reasoning, it might be shown to be plainly arbitrary.[7] In *Shayara Bano v. Union of India*, it was ruled that any legislative action that was taken capriciously, irrationally, or without a strong enough guiding basis qualifies as obvious arbitrariness. This decision reaffirmed the manifest arbitrariness test in the

[6] *Re: Imperial Chemical Industries,* (1937) AC 707.
[7] *Sharma Transport v. Govt. of Andhra Pradesh*, (2002) 2 SCC 188.

context of plenary legislation.[8] It might be claimed that the voting restrictions lack any suitable deciding considerations and have the fault of obvious arbitrariness under Article 14 because SEBI's structure allows disenfranchisement even when there is no real or prospective conflict of interest.

2. *Proportionality*

A constitutional court must evaluate whether the questioned policy passes the following four-part test as part of the 'proportionality test' under Articles 14, 19, and 21, as the SC stated in its rulings in *K.S. Puttuswamy*[9] -

(A) The restriction of a right must have a justifiable objective.

(B) There must be a practical way to achieve this goal (at an adequate level or with a logical link).

(C) There is no less restrictive option that is similarly effective (necessity stage).

(D) At the time of balancing, the measure must not materially disadvantage the right-holder.

Perhaps SEBI should have restricted voting rights solely in cases when a shareholder's interests are at odds with those of the proposed contract, arrangement, or transaction. This would have been a less demanding but no less successful strategy. The fundamental rights of the majority shareholders under Articles 14 and 19(1)(g) are unquestionably adversely impacted by a blanket prohibition that fails to establish a balance between these rights and the regulatory purpose of safeguarding the minority.

A financial or institutional investor's right to vote on a significant RPT would be suspended if they meet the 10% Shareholding Test, defeating the purpose of empowering the minority. As a result, it seems like the "majority of minority" concept could fail the proportionality test.

(D) Corporate Democracy

The Supreme Court recognized the fundamental rule of "corporate democracy" (governance by majority), which has been practiced for more than 300 years in England and more than 100 years in India, in its well-known ruling in *LIC v. Escorts*.[10] In this case, it was decided that a minority of shareholders could not, while they were in the driver's seat, adopt a strategy of engaging in litigation to which the majority was opposed.

[8] *Shayara Bano v. Union of India*, (2017) 9 SCC 1.
[9] *K.S. Puttaswamy (Aadhar-5J) v. Union of India,* (2019) 1 SCC 1.
[10] *LIC v. Escorts,* (1986) 1 SCC 264.

Corporate democracy acknowledges that the majority shareholder, who by virtue of his ownership controls the company's activities, should have the last word in matters of governance and management. Given India's evolving investment climate, it is possible to continue to increase the statutory safeguards offered to minority shareholders, but this must be done at the expense of subverting the corporate democracy ideal. Sections 27, 448, 100, 108, 151, 160, 169, 230, 236, and 241-244 of the Act already offer a comprehensive framework for safeguarding the rights of minority owners.

(E) Potential Defences

In order to demonstrate where the power comes from in the event that a constitutional challenge is made, SEBI may rely on Section 11(1) of the SEBI Act. According to this provision, SEBI has the responsibility to safeguard the interests of investors in securities and to support the growth and regulation of the securities market by taking whatever steps it deems appropriate, subject to the restrictions of the SEBI Act.

The market regulator may contend that Section 11(1) is a "catch-all" clause that gives it a lot of flexibility to create regulations to protect the interests of minority shareholders. The rule's goal, according to SEBI, was to provide minority shareholders with a meaningful say on key transactions and corporate activities that might have an impact on governance, given that over 75% of Indian listed businesses are promoter-controlled.

The SEBI Act is a social welfare act that should be interpreted in a way that advances its goals and does not obstruct its implementation; as a result, in light of the Supreme Court's ruling, it may also be relied upon.[11] In the case of *Prakash Gupta v. SEBI*, the Supreme Court ruled that the SEBI Act should be construed 'rather than one which thwarts its considered course of action' and advance SEBI's statutory responsibilities. It was also noted that SEBI's opinions needed to be given more weight because it is an expert regulating organization for the securities market.[12]

IV. Ethical perspectives

(A) Exploration of Ethical Theories and Frameworks

Particularly in situations as complicated as majority shareholder disenfranchisement, ethical theories and frameworks offer useful tools for evaluating the moral implications of acts in the complex world of corporate law.

[11] *SEBI v. Ajay Agarwal*, (2010) 3 SCC 765.
[12] *Prakash Gupta v. SEBI,* 2021 SCC OnLine SC 485.

1. *Utilitarianism*

An ethical theory known as utilitarianism emphasizes consequences and judges the morality of choices based on the results and total pleasure or well-being they create. Several elements are relevant when considering majority shareholder disenfranchisement from a utilitarian perspective. Utilitarians might contend that the benefits for minority shareholders and other stakeholders may outweigh the personal losses suffered by majority shareholders if disenfranchising them results in improved corporate transparency, fewer conflicts of interest, and better decision-making. In utilitarian analysis, the satisfaction of various stakeholders would be compared. It would evaluate whether the increase in the well-being of minority shareholders, employees, and other stakeholders adequately offsets any harm to the well-being of the majority shareholders.

2. *Rights-Based Ethics*

Rights-based ethical theories place a strong emphasis on the intrinsic worth and rights of every person. Majority shareholders have made significant financial commitments to their shares, according to proponents of the property rights position, giving them the right to input into company decisions. Disenfranchising them can be construed as an infringement on their property rights and self-determination on their assets. The ethical examination would look at whether reducing the power of majority shareholders interferes with their capacity to make independent investment decisions and if the distribution of power that results is equitable to all stakeholders.

3. *Justice and Fairness*

The allocation of responsibilities and advantages within society is a topic covered in justice-oriented ethical frameworks. The question of whether the concentration of power in the hands of a few numbers of majority shareholders unfairly affects other stakeholders, such as minority shareholders and employees, may come up while assessing the disenfranchisement of majority shareholders from the perspective of justice. The research may examine if disenfranchisement guards against the exploitation of stakeholders by restricting excessive influence and decision-making that prioritizes the interests of the majority above those of minority shareholders and other stakeholders.

(B) Analysis of Ethical Implications of Diluting Majority Shareholders' Powers

Diminishing the authority of majority owners in favour of minority shareholders, employees, and other stakeholders creates a complicated ethical environment that calls for a careful analysis

of its ramifications. In addition to assessing the possible advantages of increased inclusion, this study also takes into account any potential downsides and moral trade-offs –

- *Equity and Fairness* - The question of whether dilution fosters justice and fairness among many stakeholders is one of the main ethical problems. Dilution raises concerns about the validity of diminishing the influence of individuals who have made major investments in the firm, even while it may empower minority shareholders and give other stakeholders a voice. Here, the ethical question is whether pursuing equity justifies limiting the rights of majority shareholders.
- *Representation and Participation* - The fact that dilution increases involvement in decision-making is a crucial ethical justification. This is important in situations where the majority of shareholders' interests do not align with those of society or long-term considerations. However, evaluating the effectiveness of such engagement and determining whether it accurately represents the many viewpoints of stakeholders are among the ethical issues.
- *Balancing Stakeholder Interests* – One aspect of ethics is balancing the interests of many stakeholders. Although dilution could improve the representation of workers, local communities, and other stakeholders, it might unintentionally create conflicts between the interests of various groups. Finding solutions to these tensions and making sure that the pursuit of one group's interests does not result in the exclusion of others are both parts of ethical analysis.
- *Incentives for Responsible Governance* - The development of incentives that promote ethical and responsible business action is emphasized by ethical viewpoints. Dilution could encourage businesses to weigh a wider range of interests and take ethical issues into account when making decisions. But ethical analysis also considers whether power transfer only results in more responsible governance or if it actually results in better decisions.

V. CONCLUSION

In the event that the constitutionality of the 'majority of minority' approval requirement is called into question, there are compelling arguments on both sides of the issue. Even when strictly viewed through the prism of Article 300-A, which demands a specific enabling provision for 'deprivation of property', the general guidelines under Section 11 of the SEBI Act may not seem to be an adequate legal basis for restricting a majority shareholder's voting rights. Because neither the SEBI Act nor the SCRA has a provision that is comparable to Section 47 of the Companies Act, courts may decide that SEBI lacks the authority to restrict the voting rights of

majority shareholders under the Act, the SEBI Act, or the SCRA. In any case, this outcome would be against Articles 14 and 19(1)(g) of the Constitution.

Whatever the outcome of any potential constitutional challenge, it is necessary to remember that giving a tiny minority of shareholders the power to reject important decisions that might affect stakeholder interests is frequently counterproductive and undermines corporate democracy. Even if there is not a conflict of interest, this still holds true. Regulators must understand that protecting minority owners cannot mean completely stripping away the rights of the majority shareholders. The need for such clauses must be widely discussed among all interested parties since denying majority shareholders the opportunity to vote goes against fundamental corporate law principles and raises constitutional validity concerns.

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