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Expert Expressions
Corporate Governance Demystified

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TRUSTS AND TRUST

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In this, the 60th edition of this newsletter, we had looked forward to doing something different. Then, came the judgement of the Supreme Court of India (SC or the Apex Court) in a number of appeals, referred to for our purposes, as the Tata-Mistry dispute. There can be no better peg on which to hang a Corporate Governance conversation.

The 282 page judgement, dealing with 8 civil appeals, pronounced by a 3 judge bench of the Apex Court, has finally determined a number of issues arising out of the dispute. Even without finding fault with the judgement, it is useful to remind ourselves of the observation of Justice Robert Jackson of the US Supreme Court several decades ago - "We are not final because we are infallible, but we are infallible only because we are final".

The first judicial determination of the issues was made by the National Company Law Tribunal, Mumbai (NCLT), which saw no merit in any of the contentions advanced by the Mistry Group. In doing so, the author of the order of the Tribunal indicated that he had made references to Google to acquaint himself with the history of the Tata Group. As a result thereof, or otherwise, the order, in parts, reads like a panegyric. To the layman, it is not clear whether reliance should be placed, in a judicial proceeding, on contents of Google, since neither Google nor anyone, on its behalf, has taken the oath to speak the truth in the judicial forum.

The judgement of the SC is, for students of the evolution of Company Law, a very useful treatise. That however should not divert our conversation from issues of Corporate Governance.

Normally, the import of significant sentences in judgements is lost to the common man on account of the complexity of the issues, compounded by the complex articulation of the findings. A few years ago, there were some comments in the media on the number of words in a single sentence in some of the SC judgements. Mercifully, "for easy appreciation", the Apex Court has captured in a tabular statement the findings of the NCLT in respect of each of the allegations advanced by the Mistry Group, and whether National Company Law Appellate Tribunal (NCLAT) specifically dealt with such allegations. It is clear from the tabular statement in para 16.7, that the NCLAT did not specifically address the issues that were determined by the NCLT. The NCLAT being an Appellate Tribunal, is a final Court of facts. Therefore, any issue dealt with by the NCLT finds finality on fact, in the absence of any determination to the contrary by the NCLAT. It would be idle to speculate what might have happened had the NCLAT, instead of addressing only 3 reliefs sought by the appellants before it, recorded its findings on the facts determined by the NCLT. The following sentence (in para 16.8) from the judgement of the SC makes matters abundantly clear – "Considering the nature of the jurisdiction conferred upon NCLAT, it is clear that the findings of the NCLT, not specifically modified or set aside by NCLAT should be taken to have reached finality, unless the parties aggrieved by such non-interference by NCLAT have approached this Court, raising this as an issue." Based on this position, the SC has stated that "We have no hesitation in holding that the allegations relating to .... reached finality".

One major governance issue addressed by the SC relates to the removal of Mr. Cyrus P. Mistry (CPM) from the post of Executive Chairman of Tata Sons by a resolution of the Board dated 24.10.2016. In his communication, subsequent to his removal, CPM had alleged that the company's affairs had been conducted in an oppressive and prejudicial manner. Addressing this allegation, the SC has observed – "If CPM and the members of the Nomination and Remuneration Committee as well as the entire Board were on the same page till 29.6.2016 that the company was doing well under the stewardship of CPM, then there can be no allegation that the company's affairs were conducted in a manner oppressive or prejudicial to the interest of anyone, namely the company or the minority, at least until 29.6.2016." The SC goes on

to observe that – "if the company's affairs have been conducted in a manner oppressive or prejudicial, even before 29.6.2016, the other members of the Board and CPM could not have formed themselves into a mutual admiration society to laud CPM's performance and CPM acknowledging that the company was doing well when he was in the driver's seat." While one cannot quarrel with this assessment, there is a related question that needs to be addressed. If everyone concerned believed that the company was doing well until 29.6.2016, and this was validated by the evaluation of CPM, what suddenly happened in 4 months to lead to a conclusion that he should be removed from the Executive Chairmanship. This is an issue that does not seem to find adequate elaboration in the judgement of the SC.

While looking at the legislative history of oppression, mismanagement and prejudice/unfair prejudice, the SC in para 15.1 has stated that "colonial vintage continues to haunt us (fortunately or unfortunately), both in legislative drafting and in judicial decision making even till date." This is a welcome observation and should hopefully lead to improved legislative drafting.

In para 16.23, the SC has referred to CPM as "the very same person… identified as the successor to the empire". Most Executive Chairmen would be delighted if they could see themselves "as a successor to the empire", instead of merely chairing the Board at its meetings, in addition to discharging some executive functions. In the same para is the observation which, in the context of judicial pronouncements, should raise eyebrows. Correctly holding that failed business decisions and the removal of a person from directorship can never be projected as acts oppressive or prejudicial to the interests of the minorities, the judgement goes on to state – "In fact it may be concede today by Tata Sons that one important decision that the Board took on 16.03.2012 certainly turned out to be a wrong decision of a life time." 16.03.2012 was the date on which CPM was appointed as Executive Deputy Chairman of the Board.

Responding to the allegation that the removal of CPM was a premeditated act, the SC in para 16.32 states that – "The induction of new members on 8.8.2016 into the Board and the Board securing a legal opinion prior to the Board meeting, cannot make the act a pre-meditated one. There is a thin line of demarcation between a well-conceived plan and a premeditated one and the line can many times be blurred."

The NCLAT'S direction to have CPM reinstated has been described as "to set things right in the State of Denmark (of which CPM himself was the Premier for 4 years)." The SC goes on to add "But interestingly, NCLAT understood what the complainant companies and CPM actually wanted, though they attempted to camouflage their intentions with legal niceties." This is in the context of the contentions that reinstatement as Executive Chairman was not sought.

It is admitted that the Board of Directors is the authority to appoint a Chairman, and also the authority to remove him. However, the process underlying the removal requires to be gone into in any discussion on Corporate Governance. From available facts, it would appear that in the Board meeting on 24.10.2016, with no specific agenda item on the proposed removal of the Chairman, the matter was brought up under "Any other item". The requirement is that "Any other item" is taken up with the approval of the Chairman. During the meeting, CPM was asked to step aside, and the resolution taken up for his removal. 2 Directors did not seem to support the proposal, for reasons that are not clear. It would be idle to speculate on whether they were unhappy with the process, or with the proposal of removal not being justified by the incumbent's performance. This was also a meeting in which 2 Directors, including an Independent Director (ID), stepped out of the boardroom, admittedly to seek instructions from Mr. Ratan N. Tata (RNT). The course of events points to a well-conceived plan, given expression to in a somewhat arbitrary fashion.

Para 16.33 reproduces Article 118 of the Articles of Association of Tata Sons (AoA) which provides for the constitution of a Selection Committee to recommend the appointment of a person as the Chairman of the Board of Directors, and adds that "the Board may appoint the person so recommended as the Chairman of the Board of Directors, subject to Article 121 which requires the affirmative vote of all Directors appointed pursuant to Article 104B." The next paragraph in the same Article reads – "The same process shall be followed for the removal of the incumbent Chairman". Responding to the contention that the same process was not followed for CPM's removal, the SC held that the latter sentence "actually goes along with the last limb of the portion immediately preceding this line", that is "subject to Article 121 which requires the affirmative vote of all Directors appointed pursuant to Article 104B." It is not clear why the sentence in question, which by itself is another paragraph, should not apply to the whole of the preceding paragraph.

On the allegation that no advance notice of his removal was given to CPM, and no agenda item was placed in advance in terms of Article 121B, the SC observes that Article 121B deals with a situation where a Director wants to bring up any matter or resolution before the Board. The SC states "It has no relevance to the agenda that the Board wants to take up." This portion of the judgement seeks to differentiate between a Director bringing up a matter before the Board, and the Board taking up a matter. Ordinarily, Boards "take up" matters when either the management or any individual Director, with the permission of the Chairman, brings up a matter before the Board. The mechanics of a Board collectively taking up a matter, without any proposal by either a Director or management, is somewhat difficult to comprehend.

One issue that the SC has addressed is in regard to the role of Nominee Directors. The SC has ruled that "In fact it is a paradox to claim that by virtue of Sub-sections (2) and (3) of Section 166, every Director of a Company is duty bound to act in good faith in order to promote the objects of the company for the benefits of its members and in the best interests of all the stakeholders as well as environment and a duty to exercise independent judgment, and yet mandate the appointment of independent Directors under Section 149(4). If all Directors are required under Section 166(3) to exercise independent Judgment, we do not know why there is a separate provision in Section 149(4) for every listed Public Company to have at least 1/3rd of the total number of Directors as independent Directors." The SC has held that the duty of a Director under Section 166(2) of the Companies Act, 2013 should be balanced with the duties of a Director nominated by an institution, including a public charitable trust. The SC goes on to add that "If philosophical rhetoric is

kept aside for a moment, it will be clear that success and profit making are at the core of business enterprises. Therefore, the best interest of the majority shareholders need not necessarily be in conflict with the interest of the minority or best interest of the members of the company as a whole, unless there is siphoning of(f) or diversion." The SC emphasizes its position by stating that "It is good to wish that the creation gets liberated from the creator, so long as the creator does not have any control or ability to manipulate." The findings of the SC on this matter, even though it applies to the Nominees of a public charitable institution, cast a cloud on the role of Nominee Directors. Corporate Governance theory would have us believe that every Director, including a Nominee Director, acts, or is required to act, in the best interests of the company on whose Board he/she serves.

There is one curious finding which deserves mention. Responding to the allegations of CPM that RNT was vetting the minutes of the meetings of the Board *post facto*, the SC observed that CPM himself had sought, while accepting the office of Executive Chairmanship, the continued guidance of RNT. "When the Board, of which CPM was a Chairman, nominated RNT as Chairman Emeritus and recorded their desire to look forward to his support and guidance, it is not open to the complainant companies to call RNT a shadow Director." A person (CPM) thus appointed as Chairman should not "engage in shadow-boxing through the companies controlled by him, he cannot accuse the very same person who chose him as successor to be a shadow director. Someone who gained entry through the very same door..." There is a matter of detail that needs to be brought out. CPM was identified as a successor following a year-long search by a Committee of eminent persons, including outside experts. He was appointed Executive Chairman by the Board, and not by any individual, however exalted that person might be. The appointment was not a matter of nomination of a successor, but one of appointment by a Board, through a formal process. Also "continued guidance" should not amount to vetting minutes *post facto*, provided this is true.

The SC has rightly rejected the contention that minority shareholders should have a right for Board seats. At the same time however, it has chosen to dwell on the applicability of Section 155(1) of the Companies Act, 2013, and the definition therein of "small shareholders". Small shareholders are different from minority shareholders, the latter having no prescribed statutory ceiling on their shareholding. It is relevant to point out that not a single listed entity has resorted to Section 155(1) of the Companies Act, 2013 to get a representative of small shareholders on its Board.

Having ruled on all matters germane to the question of the removal of CPM, and the correctness of the conversion of Tata Sons into a private company, the SC has rightly observed that it cannot adjudicate on the fair compensation, in regard to the valuation of the shares of the SP Group. Given that the relationship between the two contending parties is not amicable, to say the least, it is unlikely that there would be an agreed position on how the valuation should be determined. It would have been in the fitness of things, if the SC had pointed to the manner in which this is to be done, by suggesting or advising the constitution of an appropriate independent Committee.

Their Lordships have spoken. What next? Only the Lord above knows.

SEBI had invited comments on some proposals relating to IDs. For our response, please see our 2-part article published in Business Standard. For the articles, click here.

Also, our comprehensive Survey on various aspects of Corporate Governance was released in early March, 2021. For the full report, click here.

Do let us know of any specific issues you would like to see addressed in subsequent issues.