excellence enablers CORPORATE GOVERNANCE SPECIALISTS
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Expert Expressions
Corporate Governance Demystified

November, 2021

THE COMPANY ONE KEEPS

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In corporate battles that seem to be emerging with frightening frequency, the focus is almost always on individuals and institutions. Isn't it time to shift attention to issues that give rise to disputes that are disruptive and value-destroying?

When a media conglomerate and a satellite services producer are involved in serious standoffs with significant shareholders, it would be unreasonable to expect that entertainment, on a continuing basis, with twists and turns that befit a serial, would not be on offer.

The issues are many and varied. Broadly classified, they relate to interpretation of provisions in statutes and regulations, and issues that raise questions on the structural arrangements to ensure Corporate Governance. For the large part, what follows is an attempt to focus on Corporate Governance issues, without entirely ignoring the legal and regulatory pillars on which the structures have been erected.

Shorn off all less relevant details, the Zee-Invesco saga is a dispute between a Promoter group with 3.99% shareholding in the Company (Zee), and an investor group with 17.88% shareholding (Invesco). With 21.87% of the shareholding in the hands of the protagonists, there is near-deafening silence on the part of the remaining 78.13% of the shareholders, including major institutions, such as the big daddy of the Indian insurance industry.

Form and substance are also competing for primacy. The learned single Judge of the Bombay High Court, while granting Zee's request for an injunction, has opined that "This is a case where the form must follow the substance." He goes on to add that "If the substance is illegal, the form is illegal. The substance of the proposed resolution will dictate its form."

More important for our purpose is the implication that the dispute and the pronouncement have for shareholders' rights. The proximate trigger for this dispute is a move by an institutional shareholder group, with 17.88% of the shareholding, to have an Extraordinary General Meeting (EGM) called, and to replace the existing Managing Director (MD), as also to bring in 6 new Independent Directors (IDs). While the right of a shareholder to requisition a General Meeting, if the Board fails to do so, is detailed in Section 100 of the Companies Act, 2013 (the Act), it does not follow that any requisition seeking to bring up resolutions, that are inconsistent with law and regulations, should be cleared by the Board of Directors. With the Bombay High Court having underscored the importance of resolutions being compliant with law and regulations, it is not proposed to address them in detail. Suffice it to say that the prerequisites contemplated by law and regulations have been rightly held to be non-negotiable conditions precedent for bringing up resolutions before the general body of shareholders.

Motivations of either party also need not detain us. Focussing on the basics of Corporate Governance, it is useful to start by reiterating that the Board of Directors of any company has an important role in decision-making, and that it is only the shareholders, expressing themselves by way of a majority vote at a General Meeting, that can override the decisions or the proposals of the Board of Directors. To enable the Board of Directors to discharge its onerous responsibilities, there are mandatory committees that the Act has provided for. To begin with, we must turn our attention to the Nomination and Remuneration Committee (NRC). Subsequent to the resignation of 2 of its members (both of whom were non-independent), the Committee presently has 3 members, all of whom are IDs. Therefore, there can be no quarrel, either with the arithmetic, or the content, of the NRC. It is for the NRC to initiate appropriate action, when it comes to identifying a pool of potential new IDs, or prematurely discontinuing with the services of an existing Director, whether independent or non-independent. This is not a matter that one set of shareholders can unilaterally dictate to the Board or to the company. With the Board, as presently constituted, meeting legal requirements, even after the resignation of 2 Directors, and the business of the company being carried on, there cannot be any justification for one set of shareholders, seeking to bring on board 6 IDs of their choice. In the words of the Bombay High Court, the "nomination of identified individuals speaks — and not well — of their 'independence'. It is impossible not to see these as 'nominees' of the requisitionists." Therefore, even assuming for argument's sake, that the performance of the Board, and its constituent Directors, has been suboptimal, the solution does not lie in bringing in 6 other IDs, and foisting them on the Board. Adding 6 members to the present complement of 7, including the MD, would violate the maximum size of 12 Directors envisaged by the Articles of Association. It would be inappropriate to proceed on the assumption that the MD would be voted out, and therefore, there would be space available within the overall ceiling, to bring in 6 more Directors. What this also does not address is the requirement that there should be one MD or a Whole-time Director (WTD) on the Board of the company. In the absence of a WTD or MD, 12 IDs would not by themselves amount to a properly constituted Board.

In all the discussions, debates and discourses on the ongoing saga, one important character does not seem to have found any mention. The reference here is to the Stakeholders Relationship Committee (SRC), which is tasked by law and regulations to resolve the grievances of holders of securities. The Invesco Group, with its 17.88% shareholding, is a stakeholder, with one or more grievances, related to the manner in which the company is run. It is therefore not clear why they did not choose to bring up their issues before the SRC.

Media reports refer, sometimes tangentially, to the Corporate Governance concerns that the shareholder group claims to have with the manner in which the company is being run. It would have been reasonable to expect that, as responsible shareholders, they would have been more forthcoming in regard to the specific concerns that they have in the area of Corporate Governance. What must necessarily raise eyebrows is the fact that in the deal that they sought to negotiate between Reliance and Zee, the position of the MD was reportedly expected to remain with the present incumbent. Serious Corporate Governance concerns, if any, should have ruled out such a possibility, while trying to put through a deal.

Disclosure and transparency are the *sine qua non* of a healthy Corporate Governance environment. While one might not fault either of the parties for non-disclosure at a time when there were ongoing negotiations, with no guarantee of a positive outcome, it certainly does not behove responsible shareholders to deal only with the MD, and not to approach the Chairperson of the Board, and through him the Board, if the intended merger was meant to improve the business prospects of the company, and address issues of governance. At the same time, it is not known whether the MD chose to keep the Board apprised as soon as such information was necessary to be shared with the Board. The question also arises whether the shareholders concerned had Unpublished Price Sensitive Information (UPSI).

The Board also seems to have chosen, perhaps on advice, to take a backseat, and to allow the standoff between the shareholder and the Promoter MD to play out in public. The only act that has been attributed to the Board of Directors is the decision to not hold an EGM because of the substantive infirmities attached to the requisition, and the resolutions sought to be brought up before the EGM. A more positive and proactive role by the Board would perhaps have set some doubts at rest, even if it would not have addressed the underlying issues. The IDs, on their part, should have sought a Board meeting to discuss all matters, and to determine such remedial action as was warranted.

What does responsible shareholding, especially institutional shareholding, entail? The least that can be expected is for the dissatisfied shareholders to approach the Chairperson of the Board, with a detailed communication, setting out all the concerns which impinge on Corporate Governance, as also the manner in which the company is being run by the management. Depending on the response, if any, of the Chairperson, and assuming, for argument's sake, that it does not satisfactorily address the

concerns that have been articulated, a formal requisition under Section 100 of the Act should be sent to the company to call an EGM to remove all the Directors, including the MD, and as an interim measure, to request the National Company Law Tribunal (NCLT) to appoint a 5-member Board, until such time as new Directors are elected by the shareholders. This approach would be on the same lines as the action taken in the Satyam case, where the earlier Directors were removed, and the Company Law Board (CLB) appointed a few Directors to look after the affairs of the company.

At the heart of this dispute is the question of the extent and scope of the rights of the shareholders. The Bombay High Court has eloquently stated that "Sometimes, it happens that a company must be saved from its own shareholders, however well-intentioned. If a shareholder resolution is bound to cause a corporate enterprise to run aground on the always treacherous shoals of statutory compliance, there is no conceivable or logical reason to allow such a resolution even to be considered. Shareholder primacy or dominion does not extend to permitting shareholder-driven illegality." In the context of the present dispute, and the questions of validity attached to the requisition, and to the resolutions, there is reason to applaud this observation of the Court. However, this should not be generally construed as negating the concept of shareholder primacy in a corporate entity. The structure of Corporate Governance envisages a Board of Directors acting on behalf of the shareholders and the other stakeholders. The observation of the High Court should not be interpreted in a manner that circumscribes the legitimate expectations of shareholders.

The sooner this serial saga comes to an end, the better it would be for the practice of Corporate Governance. There would be clarity on the existence, and the limitation, if any, of shareholders' rights. The appropriateness of the action of a few shareholders, with a significant shareholding, keeping everyone else in the dark, would also be called into question. Those that ask questions, must also be prepared to answer questions, when asked, as also to voluntarily share information that is relevant to the public, even if no questions are asked. Responsible shareholding by institutional investors contains within it, the duty to act in a manner consistent with the interest of all stakeholders. If the discomfort persists, notwithstanding their efforts, institutional shareholders should consider voting with their feet. Their obligation, to their investors, demands that they do not continue in a company, with the operations and governance of which they have serious reservations.

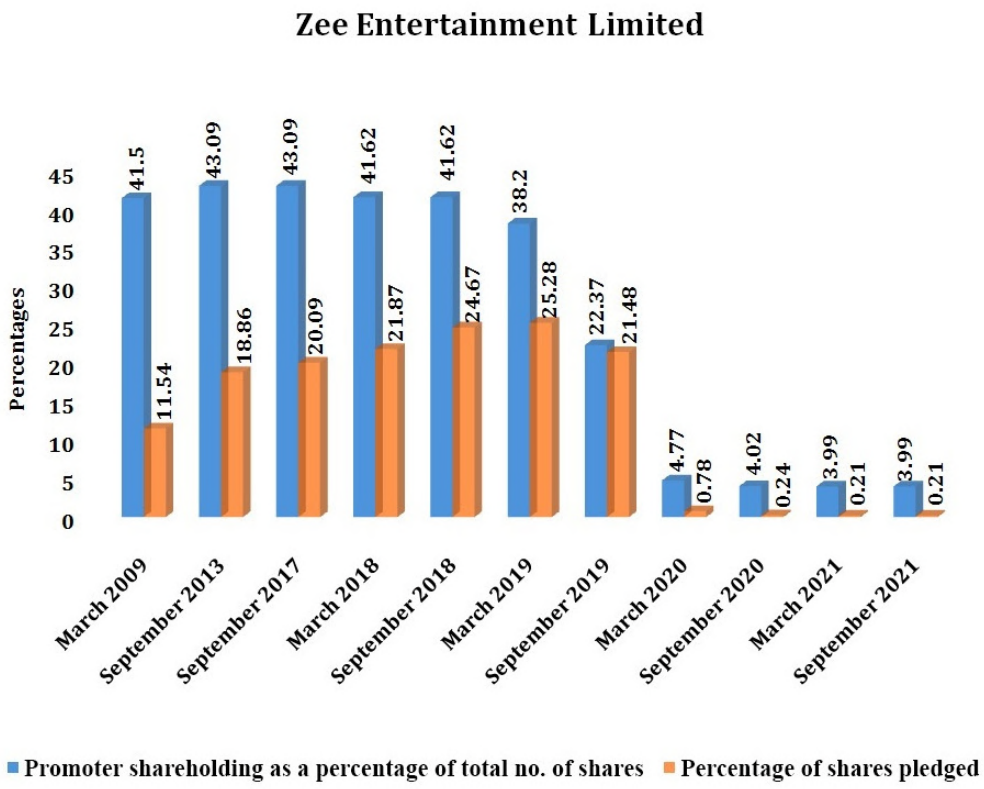
What is more worrisome is that in this ongoing saga, many major shareholders have chosen to maintain studied silence. While retail shareholders might not have the resources, or perhaps, even the inclination to get involved, institutional shareholders must step up to the plate, and act in the best interests of the company. Not to do so, or not to be seen as doing so, will run counter to the requirements of stewardship that resides in shareholdings with significant size.

The story of the sibling is no less exciting. Dish TV, the satellite distribution company in the Zee family, faced several setbacks, resulting in 25.63% of its shareholding being pledged with Yes Bank. This is where the story takes an interesting turn. The request of the majority shareholder to have 2 of its nominees on the Board, did not find favour. The expectation that related matters, such as the suggested removal of Directors and appointment of new Directors would be addressed in the Annual General Meeting (AGM) in September, 2021, was also belied, since the AGM was postponed. The Bank's subsequent request for an EGM also did not go through, in view of the objections raised by Dish TV's Board. Resultantly, the largest shareholder has no representation on the Board, and no clear idea on how to protect its interest. While legal proceedings in Tribunals and Courts might offer some solution, it cannot be ignored that the relationship between the Bank and Dish TV would remain suboptimal. The question that then arises is whether banks and financial institutions that get into a position of being the largest shareholder on the basis of invocation of pledges, should remain invested in what is essentially a non-banking activity. Would the preferable option not be to find a buyer, and to exit from the shareholding of an entity with which the bank is not at peace?

There are also some grey areas, both substantive and procedural, that would need to be addressed. These would constitute the major takeaways from a standoff that does not have any obvious winners. When these stories wind their way to their end, logical or otherwise, they must throw up enough lessons for all sets of stakeholders. Merely dismissing the protagonists as not bringing value to the Corporate Governance conversations would not help. Long years ago, a wise man said: "A man is known by the company he keeps." Is it time now to say that investors are known by the kind of companies they seek to keep?

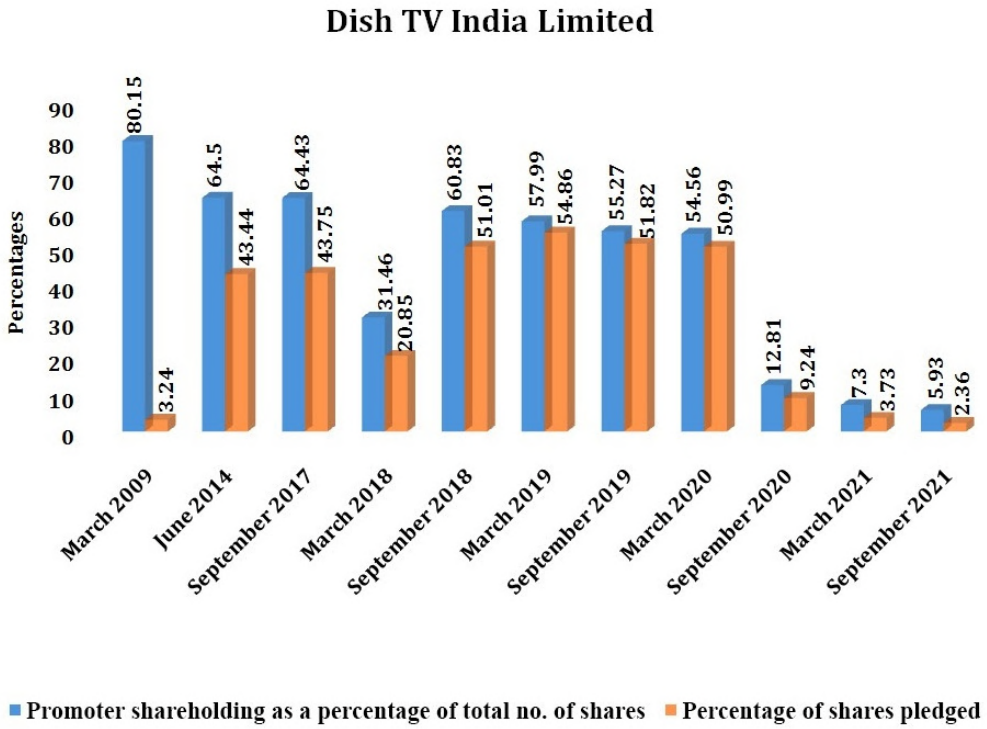
THE STORY SO FAR...

Promoter Shares Held and Shares Pledged



As on September, 2019, 96% of shares held by the promoters had been pledged.

Source: BSE filings of respective quarters.



As on March, 2019, 94.6% of shares held by the promoters had been pledged.

Source: BSE filings of respective quarters.

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

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