

Zee Vs Invesco: Has the court contained investor stewardship?

The Bombay High Court's order indicates that large shareholders¹ cannot propose a slate of Independent Directors without the approval of the NRC. The litigation is testing regulations for their ability to accommodate shareholder action. As the litigation progresses through the appeals process, it should provide clarity on what recourse shareholders have, if they feel short changed.



Picture source: collectorbazar.com

The battle between ZEE and Invesco, as it continues through the courts, will test the regulation for its ability to handle shareholder activism. The Bombay High Court issued an injunction against Invesco, stopping it from pursuing the EGM. The judge agreed with all of ZEE's contentions regarding the infirmities in the requisition notice for the EGM.

Notable in the order is the contention that when shareholders appoint directors, these cannot be considered Independent Directors. The judgement says that under Section 149(6) of the Companies Act 2013, Independent Directors can only be those that are not Executive Directors and nominees, and who, *in the opinion of the board*, must be a person of integrity

¹ Large here is defined as investors who hold more than 10% of the equity

and must possess the relevant experience and expertise. To this extent, Independent Directors can be appointed to the board only if they are vetted by the NRC and approved by the board – and then presented to shareholders for a vote. Therefore, where shareholders seek to appoint directors to the board by requisitioning an EGM, these cannot be Independent Directors – but they can be nominees.

The Bombay High Court order has stymied shareholders. A judgement limiting shareholders from appointing Independent Directors was surprising especially since there is existing precedent in Fortis Healthcare Limited (Fortis). In 2018, [two shareholders holding over 12% equity got together and requisitioned an EGM](#) removing four directors of Fortis and appointing three Independent Directors. The EGM was held – shareholders voted to remove one director, the remaining directors resigned before the EGM, and three directors were voted in as Independent Directors. From a legal standpoint, perhaps one can argue that since the board held the EGM, there was tacit approval from Fortis' NRC and the board for the appointment of the three Independent Directors.

Leave aside the Zee-Invesco spat, there is an incongruity in the Bombay High Court's verdict. Independent Directors are tasked with the protection of the rights of all stakeholders, especially those that do not have controlling interest in the company. Therefore, to not allow those same stakeholders (investors) to be able to appoint Independent Directors seems intuitively unfair. Shareholders can engage, even protest, but are left waiting outside the board room.

With the Bombay High Court ruling, boards will find it that much easier to block shareholder action. Shareholders seeking board changes to arrest further value destruction – as was the case in Fortis – no longer appears feasible. Surely, there must be some recourse to investors between a narrow interpretation of the process at one end and an open offer at the other extreme: else investors will be compelled to *walk the Wall Street walk*.² This will be inimical to our markets.

An entrenched board can only be in the interest of the incumbent management and not of all stakeholders. In instances where promoters have been uprooted – Fortis Healthcare Limited, United Spirits Limited, CG Power and Industrial Solutions Limited – the companies have bounced back to create value. The bankruptcy code too is built on the premise of breaking the chains that hamper. Where promoters have stayed entrenched – and there are many examples – companies have been unable to break away from their old shackles.

This isn't to say that shareholders are always right (or the 'good guys') – but there is a case to be made that where boards are underperforming and value is being destroyed, there has to be a way to holding incumbent management accountable. The regulations should allow for more flexibility – rather than force investors to exit the shares.

² *Wall street walk refers to investors selling their shares and exiting the company*

There is of course the contrafactual. Would the judgement have been different if Invesco's legal counsel also argued against the infirmities cited³? What if a consortium of investors had proposed the directors, rather than two funds under the same umbrella – would they have been seen as acting in concert? Or merely exercising their fiduciary duties as enjoined in the Stewardship code?

Now that the injunction has been appealed, we hope it will bring more debate on these aspects as well.

The ZEE-Invesco battle is testing the regulations for shareholder activism, which is a necessary step for activism to take root - not as much for control, but as a way of holding managements accountable. Class action suits are another set of provisions that remain untested. The Companies Act, 2013 came into promulgation with the Ministry of Corporate Affairs stepping hard on the pedal, at a time when shareholder activism was not as prevalent. One could not then have expected all such scenarios to be built into the regulation, because the market itself had little to show for this. As the litigation between ZEE and Invesco continue up the judicial ladder, the regulatory gaps will be exposed. One can hope that the judgements create flexibility in the regulation to allow for shareholders not just to demand, but also their ability to effect change.

³ *Invesco's legal counsel focused on jurisdiction of the courts and argued that the shareholders right to hold an EGM is absolute if it met the shareholding threshold of 10% or more.*

Disclaimer

This document has been prepared by Institutional Investor Advisory Services India Limited (IiAS). The information contained herein is solely derived from publicly available data, but we do not represent that it is accurate or complete and it should not be relied on as such. IiAS shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not be taken as the basis for any voting or investment decision and/or construed as legal opinion/advice. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of the information referred to in this document (including the merits and risks involved). The discussions or views expressed may not be suitable for all investors. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. IiAS reserves the right to make modifications and alterations to this statement as may be required from time to time. However, IiAS is under no obligation to update or keep the information current. Nevertheless, IiAS would be happy to provide any information in response to specific client queries. No copyright infringement is intended in the preparation of this document. Neither IiAS nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. This report may cover listed companies (hereinafter referred to as the 'subject companies'); IiAS may hold a nominal number of shares in some of the subject companies to the extent disclosed on its website and/or these companies might have subscribed to IiAS' services or might be shareholders of IiAS. The disclosures of interest statements incorporated in this document are provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report.

Confidentiality

This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IiAS to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information provided in these reports remains, unless otherwise stated, the copyright of IiAS. All layout, design, original artwork, concepts and other Intellectual Properties, remains the property and copyright of IiAS and may not be used in any form or for any purpose whatsoever by any party without the express written permission of the copyright holders. This report may not be reproduced in any manner without the written permission of IiAS.

Analyst Certification

The research analyst(s) responsible for this report certify/ies that no part of his/her/their compensation was, is or will be, directly or indirectly related to the views expressed in this report. IiAS' internal policies and control procedures governing the dealing and trading in securities by employees are available at <https://www.iiasadvisory.com/about>.

Conflict Management

IiAS and its research analyst(s) responsible for this report may hold a nominal number of shares in some of the subject companies as on the date of this report. A list of IiAS' shareholding in companies is available at <https://www.iiasadvisory.com/about>. However, IiAS, the research analysts and their associates or relatives, do not have actual/beneficial ownership of one per cent. or more securities of the subject company, at the end of the month immediately preceding the date of publication of this report. Further, a list of shareholders of IiAS as of the date of this report is available at <https://www.iiasadvisory.com/about>.

Other Disclosures

IiAS is a SEBI registered research entity (proxy advisor registration number: INH000000024) dedicated to providing participants in the Indian market with independent opinions, research and data on corporate governance issues as well as voting recommendations on shareholder resolutions of about 800 listed Indian companies (<https://www.iiasadvisory.com/iias-coverage-list>). Our products and services include voting advisory reports, standardized services under the Indian Corporate Governance Scorecard, and databases (www.iiasadrian.com and www.iiascompayre.com). There are no significant or material orders passed against the company by any of the Regulators or Courts/Tribunals.

The attached article is a general event-based commentary.

IiAS confirms that, save as otherwise set out above or disclosed on IiAS' website,

- IiAS, the research analyst(s) responsible for this report, and their associates or relatives, do not have any financial interest in any of the subject companies.
- IiAS, the research analyst(s) responsible for this report and their associates or relatives, do not have any other material conflict of interest any of the subject companies at the time of publication of this report.
- None of the research analyst(s) responsible for this report, and their associates or relatives, have received any compensation from any of the subject companies or any third party in the past 12 months in connection with the provision of services or products (including investment banking or merchant banking or brokerage services or any other products and services), or managed or co-managed public offering of securities of the subject companies.
- The research analyst(s) responsible for this report has not served as an officer, director or employee of any of the subject companies in the past twelve months.
- Neither IiAS nor the research analyst(s) responsible for this report have been engaged in market making activity for any of the subject companies.