

## SEBI increases shareholder might

*In its proposed changes to the listing regulations, SEBI is trying to plug for side deals and structures that entrench a set of shareholders. This will further empower shareholders and limit the ability of controlling shareholders to play between the spirit of the regulation and the letter of the law.*



*Note: This image was created with the assistance of DALL.E 2*

SEBI's February 2023 Consultation Paper on Strengthening Corporate Governance at Listed Entities by Empowering Shareholders attempts to address some of the loopholes that have been exploited by companies in the past.

There have been instances in the past, where deals impacted control over a company, but were not disclosed. While regulations require material disclosure to be made to investors, the test of materiality is a subjective one. Moreover, when deals take place

between a controlling shareholder and a third-party, the company can always claim (and sometimes rightfully so) ignorance – in which case it could not have possibly made a disclosure.

Rana Kapoor raising debt in Yes Bank’s holding company was one such structure. Since his was not a pledge in its explicit sense, no disclosure was required – under SEBI’s proposed amendments, such structure may require the company to be informed and for the company to make subsequent disclosures to its investors. Other instances of arrangements between two sets of shareholders that bind the company or put the company at risk, will also now need disclosure.

To bind a company into an arrangement between shareholders, usually the company’s Articles of Association (AoA) is modified, for which shareholder approval is sought. If the controlling shareholder has majority equity, these resolutions are more likely to get embedded into the AoA. This is against the principles of shareholder democracy. Such rights, if they continue post-IPO, is effectively akin to holding differential voting rights (DVR), without having paid a premium for them. Regulations have sunset clauses for superior voting rights – however, once embedded into the AoA, these clauses are set and will change only if the board seeks shareholder approval afresh for these changes.

In ZOMATO’s case, for example, the AoA allows Deepinder Goyal (4.42% voting rights on 31 December 2022), and Info Edge (India) Limited (14.29%), the right to nominate one board member each till they get diluted by almost 50%<sup>1</sup>. Deepinder Goyal’s board nomination rights continue as long as he is Executive Director, independent of his shareholding.

Similar is the case for PAYTM. Vijay Shekhar Sharma (9.13% stake on 18 February 2023) has board nomination rights as long as he holds 3,100,000 shares (which shall not be less than 2.5% of the issued and subscribed share capital on a fully diluted basis), or he continues to hold an executive position in One 97 Communications Limited (independent of shareholding).

In Global Health Limited, the NT group (promoters) has the right to appoint MD and Chairperson and to nominate directors (including Wholetime Director) as long as they hold 4% equity, which is a low threshold for critical nomination rights. Appointing Wholetime Directors is the prerogative of the Nomination and Remuneration

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<sup>1</sup> Alipay Singapore Holding Pte Limited also has the right to a board seat till it held 7.5% equity – Alipay has since sold down its stake and it currently below this threshold.

Committee, and not that of the controlling shareholder group. The nomination rights (to investors other than promoter) are given only to three groups of public investors: Dunearn, RJ Corp and SS group. The threshold of 4% (in case of RJ Corp) and 7% (in case of Dunearn and SS group) is low and unfair to other public shareholders who need at least 10% equity to be able to propose a resolution (and thus propose their nominee's appointment).

Such provisions allow a set of shareholders to remain entrenched in the company, and when performance deteriorates, it makes it difficult for investors to effect change.

AoAs often also embed clauses that do not require directors to retire by rotation. Hindustan Construction Company Limited (HCC), for example, has embedded within its AoA that the Chairperson will be appointed as a director not liable to retire by rotation.

Such provisions are usually created for promoters, which gives them board permanency – an issue that we raised concern about in our [August 2022 paper](#). Through its consultation paper, SEBI too is addressing this issue. Dr. Vijay Mallya's refusal to exit the board of United Spirits Limited after Diageo plc had taken control was a manifestation of the issues regarding board permanency. Despite the concerns raised with respect to financial leakages, Dr. Mallya continued to remain on the board since the company's AoA afforded him that right.

SEBI's proposal to put to shareholder vote all transactions undertaken by a set of shareholders that impact the company comes with its challenges. On the face of it, having this provision empowers shareholders but it may also limit promoters' rights as shareholders. In cases where there are non-compete clauses – either through a family arrangement, or through business structuring (typical for MNCs) – this must be put to shareholders for a vote, since it limits the company's ability to grow. On the other hand, let's argue that the promoter group wishes to pledge its entire equity to raise debt (for whatever reason) – if this is put to shareholder vote and gets defeated, it does not allow the promoter group to exercise their rights as a simple shareholder. Therefore, in some instances, mere disclosure should be advised, while others – especially those that limit the company's ability to grow – must require shareholder approval. Articulating such differences in the regulations may pose a challenge for SEBI.

By and large, SEBI's consultation paper is in the right direction – it aims to protect the interests of minority shareholders and attempts to balance the scales between entrenchment and accountability, and between the spirit of the regulation and the letter

of the law. Even so, there are nuances that the regulator will need to keep in mind before it makes amendments to the listing regulations.



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