Beyond The Boardroom Battle

Durgesh Singh and Abhishek Sarkar dwells on the impact of the Tata Sons and Cyrus Mistry dispute on India's corporate governance norms

Corporate governance deals with the processes, relations and mechanisms through which companies are directed and controlled. With regards to companies having a concentrated shareholding, dissonance among promoters and minority shareholders are widespread, making it imperative for sound corporate governance norms. The emphasis on corporate governance by the legislature has been evident in recent years with the introduction of the Companies Act of 2013 and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations of 2015 (SEBI Regulations). These measures have targeted the most common issue – disputes between minority shareholders and promoters. Although the strengthening and codification of corporate governance has been a welcome change, the murky Tata Sons-Cyrus Mistry affair has thrown up new questions regarding the viability of such norms.

The Tata-Mistry conflict commenced on October 24, 2016 with the removal of the chairman of the board of Tata Sons Limited, Cyrus Mistry and the appointment of Ratan Tata as an interim chairman for four months, till the appointment of a new chairman. What followed was a series of accusations from either side in the form of public statements and legal notices that culminated in a legal battle at the National Company Law Tribunal (NCLT). By an extraordinary general meeting dated February 6, 2017 Mr Mistry was removed as a director of the company with the shareholders voting in favour of his removal with the requisite majority. This high profile dispute that largely played out in the public domain has led to concerns being raised by companies and investors alike regarding the corporate governance issues raised by it. Not only the big listed entities, but also the smaller unlisted entities including start-ups who often lack exposure to appropriate governance practices, are concerned about the potential ramifications of this dispute.

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Applicability of Companies Law

It will be interesting to see how the judiciary decides on the provisions related to company law affected by this matter. While prima facie the determination of legality in replacing Mr Mistry as the chairman seemed to be a straightforward affair, the complexities in the dispute arose once the matter was presented before the NCLT. The issues deliberated in the following paragraphs are specific to this dispute, but have applicability to all companies covered by the Act.

Tata Sons, being an unlisted company, falls under the purview of the Act and escapes the series of corporate governance related regulations issued and monitored by SEBI. The shareholding pattern of Tata Sons is tightly knit, with about 66 per cent of the equity capital held by philanthropic trusts endowed by members of the Tata family (the "Tata Trusts") and Cyrus Investments Private Limited and Sterling Investments Private Limited (the "Mistry Firms") holding 18.4 per cent of the equity shareholding and 2.17 per cent of the total share capital.

Although the board of Tata Sons stripped Mr Mistry of his designation as chairman, he initially remained a non-executive director of the company. The Act lays down the functions and roles for the chairman of a company, but remains silent on the process for his removal or appointment,

which is understood to be a part of the Articles of Association of the companies. Therefore, the issue that arose in this case was whether Tata Sons acted in conformity with their Articles of Association when they decided to replace Mr Mistry as the chairman. News reports suggested that after Mr Mistry was designated as the chairman, Tata Sons had amended their Articles of Association with the aim of curtailing the chairman's powers and increasing the control and authority of the Tata Trusts. The board had thus been empowered to replace the chairman of the company.

The question that arose next was when would this dispute reach the courts. Mr Mistry had accused the directors of Tata Sons to have failed in their fiduciary duty towards the stakeholders and group companies. The legal recourse in such a scenario could have been two-fold:

A. Approaching the civil court, in which case it would have been a cumbersome process to prove the said breach and resulted in loss of substantial time and cost given the nature of this dispute; and

B. Approaching the NCLT under sections 241, 242 and 244 of the Act and present a case for oppression and mismanagement.

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The Mistry Firms took the second route and approached the NCLT.

Mismanagement and Oppression Petition

The NCLT held on March 6, 2017 that the Mistry Firms are not eligible to file a petition claiming oppression of the minority shareholders and mismanagement of the company. The reason behind this verdict was that the Mistry Firms possessed 2.17 per cent of the total share capital of Tata Sons, which amounted to 18.37 per cent of its equity shares. Section 244 of the Act states that to file a case with the NCLT for oppression and mismanagement under section 241 of the Act, the shareholder must hold at least 10 per cent of the issued share capital of the company. The issue that arose was whether section 244 had the minimum requirement of 10 per cent of the entire share capital (including

equity and preference shares) of Tata Sons or 10 per cent of only the equity share capital. The Mistry Firms do not satisfy the former qualification, while they would fall under the provision with respect to the latter. The NCLT considered the arguments presented and decided against the Mistry Firms, mentioning that the qualifications under section 244 of the Act were with regards to the total share capital and not restricted to only the equity share capital.

Section 244 of the Act also empowers the NCLT to waive certain conditions for any case under section 241 of the Act. With that provision in mind, the Mistry Firms proceeded with the petition to waive specific conditions, and contest the decision of Tata Sons to remove Mr Mistry as the chairman.

However, the NCLT by its order dated April 17, 2017 rejected the waiver petition on the grounds that the aforesaid allegations were not raised before, and due to lack of any agreement to the contrary, the Mistry Firms could not have had a legitimate expectation for any representation from their side to exist on the board of Tata Sons. It labelled the petition as a proxy petition and stated that it could have been permitted only in specific circumstances such as:

A. fraud;

B. misappropriation of corporate assets;

C. director's breaches of trust;

D. misuse of company's funds; and

E. inability to conform to the procedures set out in the articles of association.

Here, it is pertinent to note that the NCLT has been given a wide purview when passing orders related to mismanagement and oppression in a company. However, the threshold is quite high to bring such an action and its success depends entirely on the facts and circumstances of the dispute.

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Although the dispute at the NCLT level has now been adjudicated, the legal battle seems far from over as the Mistry Firms will probably take the dispute to a new battleground by presenting it in front of the National Company Law Appellate Tribunal ("NCLAT"), the high court or the civil sessions court. A decision at these courts would also not lead to the final settlement of this dispute as it can be challenged till the matter reaches the Supreme Court. Most likely, the Mistry Firms will first approach the NCLAT, which may:

A. refer the plea back to the NCLT if it finds defects in the NCLT's order; or

B. dismiss the Mistry Firms' appeal. In such a scenario, the Mistry Firms may approach the Supreme Court next; or

C. if the NCLAT allows the appeal then it will direct the NCLT to hear the main petition, that is yet to be heard by the NCLT.

Legality of shareholders' Meeting

Another dispute that arose in the past few months, was with regards to the shareholders' meeting that was held on February 6, 2017, to replace Mr Mistry as a director. The Mistry Firms had argued that the meeting would lead to oppression and mismanagement, and hence should be stayed. However, the NCLT passed orders allowing the meeting, and the NCLAT rejected the appeal by the Mistry Firms. Therefore, the meeting took place and Mr Mistry was removed as a director of Tata Sons.

Issues on Corporate Governance: Legal and Ethical

Apart from the legal drama that is still unfolding, the dispute has a larger bearing on the issue of corporate governance Tata Sons is a controlling shareholder (i.e., promoter) of multiple listed companies and therefore may indirectly affect minority shareholders and various stakeholders of the listed companies falling under the Tata group.

The dispute also highlights that there exists considerable scope for reform in the corporate governance structure of India. Although the board of Tata Sons possessed the legal right to remove its' chairman, the process of doing so may not have followed the spirit of corporate governance norms. Media reports indicated that appropriate notice may not have been served to the chairman prior to the meeting and the item for his replacement was a part of the agenda under the list of "other items". This did not leave him with much preparatory time for addressing the said meeting, although some reports have also indicated that this information was passed onto him a day before. Since Tata Sons is an unlisted company, these actions may be argued to be in consonance with the law. But, Mr Mistry's departure as chairman, and then also as a director, had an adverse effect on the listed companies under the Tata group, most of which saw a fall in their market value of shares.

Further, after ten days of Mr Mistry's removal as chairman of Tata Sons, the Indian Hotels Company Limited (a Tata group company) notified to the stock exchange a meeting that was held

among its independent directors to analyse Mr Mistry's performance as the chairman. This meeting was of significance because all the independent directors extended support and appreciation to Mr Mistry's contribution and style of leadership. The meeting, however, raises a crucial question – should independent directors act in this manner and opine against the board's decision? The Act and the SEBI Regulations mention that the board and the independent directors of a company are supposed to be proactive and provide support to the interests of the stakeholders and minority shareholders. Thus, this instance of a measure being taken by independent directors is a strong move that reinforces the strength of India's corporate governance structure and shows the extent of powers possessed by the independent directors.

Recent Initiatives by SEBI

While the dispute between Tata Sons and the Mistry Firms did not directly involve the SEBI as Tata Sons is an unlisted company, it provided an impetus to deliberate on the compliances necessary for the board of directors to improve their effectiveness and rethink the procedure followed for evaluating the board of directors by the listed companies.

In this backdrop, the SEBI came up with a guidance note on January 5, 2017 for the listed companies on several facets related to the evaluation of the board of directors, in order to increase their effectiveness and raise the bar of corporate governance. It laid down the following evaluation procedure:

A. Pre-evaluation process.

B. Evaluation process.

C. Post-evaluation process.

A joint reading of section 178(2) of the Companies Act and regulation 19 of the SEBI Regulations mandates the listed companies to undertake an evaluation of the board of directors along with their several committees. However, since the concept of board evaluation is still new in India, the listed companies have mainly strived to comply with the law laid down above only to the extent provided and neglected to take part in any sort of active evaluation that improves the effectiveness of the board of directors. The SEBI Note aims to fill up these loopholes present in the existing structure.

When the Tata-Mistry turmoil ends and both the parties move on with their business ventures, the need for stricter regulation of companies run by promoters, specifically the ones driven by business families that has been highlighted by the dispute will still remain a live issue.

Further, parallel to the NCLT proceedings, SEBI in its press release dated January 14, 2017 discussed several issues that were raised in the Tata-Mistry dispute, such as the need for corporate governance, board evaluation and disclosure to shareholders. In a separate development, Tata Sons has filed a complaint with the SEBI against Mr Mistry for violation of regulation 3(1) of the SEBI (Prohibition of Insider Trading) Regulations, 2015 by making confidential and sensitive information public by virtue of his petition presented to the NCLT. It is pertinent to note here that Mr Mistry had also alleged in his petition to the NCLT that Mr Ratan Tata had influenced important decisions regarding operations although he was not able to direct the management, and asked the group's companies for price sensitive information.

Conclusion

When the Tata-Mistry turmoil ends and both the parties move on with their business ventures, the need for stricter regulation of companies run by promoters, specifically the ones driven by business families that has been highlighted by the dispute will still remain a live issue. For such instances, the scope of corporate governance will need to go beyond the listed entities and into the domain held by the promoters. It must be appreciated that the issues that affect such promoters cannot be separated from the impact they have on listed entities. Therefore, the debate arises whether there should be a certain level of norms for corporate governance for promoters, apart from for listed entities? While a knee jerk reaction to extend the norms related to corporate governance to promoters may sound unreasonable, at least the process of decision making by promoters should be made more transparent. Further, listed entities along with their boards should be prepared to tackle issues occurring with the promoters. ■

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