

SHAREHOLDERS RIGHTS: BEYOND YET UNDER THE PURVIEW OF LAW



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In most of private investment transactions, whether the party is an investor or an investee, after structuring the deal, the primary focus is mainly on completion of mandatory compliances as per the Companies Act, 2013 (“Act”) and other relevant laws (as applicable). While a huge amount of time might be consumed in negotiations of definitive agreements, the same can be more fruitful when the parties’ specific concerns in the transaction are considered[1].

The Act broadly covers the rights and responsibilities of stakeholders, which are further developed and modified as per the specific arrangement and requirement of Parties while still being under the purview of law. A few of such examples are:

PARTICULARS OF CLAUSE IN THE AGREEMENT	PROVISION AS PER LAW	POTENTIAL MODIFICATIONS AS A PART OF AGREEMENT
<p>Sections under Act 149, 152, 173, 174</p> <p>Management and Board of Directors</p>	<p>The Act provides for minimum and maximum number of directors for companies, along with provisions for appointment and removal of directors and conduct of board meetings and proceedings.</p>	<p>The definitive agreement outlines in detail the rights of specific shareholders for appointing directors or observer rights on the board and quorum.</p>
<p>Sections under 62 (1) (a)</p> <p>Pre-Emptive Rights</p>	<p>This is a right to subscribe to new shares being issued in the company to the existing shareholders in preference to third parties. The right is to be exercised in proportion to the existing shareholding in the company.</p>	<p>Under definitive agreement, the clause can be elaborated on the pre-emption process, including timing and the mechanism for exercising these rights.</p>

[1] The article reflects the general work of the authors and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.

PARTICULARS OF CLAUSE IN THE AGREEMENT	PROVISION AS PER LAW	POTENTIAL MODIFICATIONS AS A PART OF AGREEMENT
<p>Sections under Act 96,97,98</p> <p>Shareholders Meetings</p>	<p>The Act provides for the conduct of Meeting of Shareholders including Annual General Meetings, their timing, agenda etc</p>	<p>The definitive agreement may further develop the specific requirements for notice periods, additional reporting obligations etc.</p>
<p>Sections under Act 134, 118, 119, 120</p> <p>Information Rights</p>	<p>The Act provides for obtaining and inspecting the books of accounts and other information for the company for shareholders.</p>	<p>The clause in definitive agreement may be drafted to provide require more frequent reporting or additional financial disclosures.</p>
<p>Sections under Act 47</p> <p>Voting Rights</p>	<p>The Act provides for right of equity shareholders to vote and pass resolutions in the meetings.</p>	<p>The Parties can identify affirmative voting right for specific reserved matters for identified shareholders.</p>

While most of the shareholders rights are identified as per the provisions of Act, there are certain special rights or obligations which can be created as a part of definitive agreements.

Rights And Obligations Which Are Typically Not Covered Under The Act But Can Be Created Under the Agreement:

Anti-Dilution Provisions

Anti-Dilution Clause protects the shareholders from dilution of their ownership percentage in case of fresh issue of shares in future. This is generally proposed to protect the strategic investors having exit rights as a part of their investment arrangement.

Earn-Out Clause

This clause is incorporated for additional performance-based payments basis future turnover or profit or valuation of the company. It is generally provided for promoters by investors to allow the promoters to earn additional consideration at the same time providing assurance to investors regarding future value of their investment.

Drag-Along Right

Drag-Along Right allows majority shareholder to force remaining shareholders to sell their shares to a third party along with the shares of majority shareholder. This right is seldom enforced by the concerned party. It is generally incorporated in transactions where the majority shareholder takes a decision of selling entire shareholding to a third party either a) for a higher value where investor is interested in the entire acquisition or b) as a last resort of exit in case of loss-making entity.

Tag-Along Rights

Tag-Along Right allows mainly minority shareholders to tag along in a sale of shares transactions where one shareholder is offering its shares to a third party. This right is not only specific to minority shareholders and very commonly incorporated for other shareholders as well. The clause needs to be clearly drafted in order to provide clarity to shareholders with respect to the extent of their shareholding to which the right can be exercised.

Right of First Refusal (ROFR)

In case a shareholder is willing to sell his/her shares to a third party, the ROFR Clause provides the remaining shareholders with the right of purchasing the shares before they are offered for sale to a third party. This protects the existing shareholders from an unacquainted third-party having shareholding in the company at the same time giving an exit to the selling shareholder.

Lock-In On Shares

In investment transactions the Lock-In on transfer of shares is incorporated for a specific period of time for both Investor and Investee. This ensures that both investor and promoters are invested in the company for a longer period.

Post-Sale Payback Right

This clause is to provide price protection to selling shareholder in a share purchase transaction. If the purchaser further sells the shares to a third party at a higher price within a specified period, the purchaser has the obligation to make additional payment to the original seller for the amount of profit made in the transaction.

Conclusion

While the Act governs various statutory rights and obligations affecting the shareholders and company, the Act is non-exhaustive and various special rights and obligations can be identified for parties in the definitive agreements specific to the transaction and requirement of the parties.

These rights can also be enforced in the court of law as far as they are within the purview of law, are clearly drafted and does not conflict with the charter documents, especially the Articles Of Association of the company.

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