

VARIATION OF SHAREHOLDER'S RIGHTS

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ABSTRACT

The research paper is a doctrinal research revolving around the rights of shareholders, and the variation in each of their rights. Shareholders are the backbone of a company without these entities the firm cannot function and based on the shares they purchase their rights are decided and the part they will play in the company. The paper will be dealing with the answers of certain questions as to who is a shareholder and its classification. Also, the Sections of Companies Law 2013, which deals with variations in Shareholders rights and the procedure which is to be followed while dealing with such Sections of the law and the facets of the company.

The paper will be divided into 4 chapters which will cover the ambit of the topic as a whole and provide a thorough understanding of the concept.

Keywords- Companies Act 2013, Section 48(2), Variation of Rights, Procedure of variation.



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RESEARCH QUESTIONS

The Research Paper will be dealing with questions such as-

- ✓ Who are Shareholders and what are the rights available to them?
- ✓ What are the variations in rights of the Shareholders?
- ✓ What are the procedures that need to be followed in varying one's rights?

METHODOLOGY

The Research shall be a doctrinal one based on-

- Books
- Journal & Research Paper
- Online Reports



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CHAPTER ONE

INTRODUCTION

The Share capital of the company is classified into two different classes of shares namely, ordinary shares and preference shares. The classification is generally based on the special rights which are particular to a class of shares. The rights of shareholders which are attached to one class of shares are quite different to the rights of the shareholders which are attached to different class of shares. A shareholder who was given the right to purchase the shares of the company on a pre-emptive basis was held to constitute a special class distinguishing him from other shareholders who did not have any such right and consequently his right was not permitted to be taken away without his consent. The point of information that arises here is; who is a shareholder? A shareholder or stockholder is an individual or institution that legally owns one or more shares of a public or private company. Like any other entity of the company shareholders have certain rights and they differ from the type of shares they own in a company. Basing on that premise the shareholders are categorised into two categories namely common shareholders and the preferred shareholders.

When one owns the corporation's common stock they come to know as common shareholders. They are quite common in the corporate world and have the right to vote on matters concerning the corporation or company and hence they have right to file a class action law suit against the corporation. Whereas preferred shareholders are quite rare and the voting rights are absent and have no say in the management of the company. These two categories of shareholders are also known as-

1. Equity shareholders
2. Preference shareholders
3. Debenture shareholders

If a company has raised funds by means of equity or preference shares the shareholders come to know as equity shareholders and preference shareholders respectively, and if a company has raised money by means of loans then the shareholders come to know as debenture holders. On this basis they each have different rights in the management of the company or corporation. The rights of shareholders are determined by the Companies Act, Memorandum of Association, Article of Association of the company and the terms and conditions of issue of shares. The rights attached to a class of shares are known as class rights.

CHAPTER TWO

RIGHTS OF SHAREHOLDERS

In each company there is a pecking order of rights i.e. they all have a hierarchical structure of rights for the securities that the company issues. The best point to look at the priority of each of these classes of securities is at the time of bankruptcy. The rights of each shareholders differ and so their liabilities.

RIGHTS OF COMMON SHAREHOLDERS

1. Director's Appointment- Stockholders plays a vital role in the appointment of the directors in the company. As an ordinary resolution is required to be passed by the shareholders for the appointment. They can also appoint various types of directors such as-

- **Additional Director-** Such directors will hold office until the next general body meeting.
- **Alternate Director-** Persons appointed as alternate director can act as one for a period of three months
- **Nominee Director-** They are individuals nominated by the shareholders who have some interest in the company. The interest can be in form of some financial aid.
- Director appointed in case of a casual vacancy in the office of any director appointed in a general meeting in a public company.

Apart from this they can also challenge any resolution passed for the appointment of a director in the general body meeting.

2. Law suit against directors- Stockholders can bring legal action against the directors of the company by the provisions laid down in the Companies Act 2013 such as-

- Any act which are done by the directors in any way which is prejudicial against the affairs of the corporation.
- Any act done outside the periphery of law or against the constitution.
- When the assets are being transferred at any undervalued price.

- They can sue directors even if there is a diversion of funds and if any act is done in any mala fide order.
3. **Auditor's Appointment-** Under the Companies Act of 2013, shareholders have the authority to appoint the auditors of the company. As per the Act the first auditor is to be appointed by the board of directors. The term is generally of five years and can be ratified further by passing a resolution in the annual general body meeting.
 4. **Voting Rights-** One of the major rights of an individual in any organisation is one's right to give his vote. The privilege of this has been given to the common shareholders. His voting rights include electing directors, having a say in fundamental changes affecting the company for example liquidation, mergers etc. Voting in a company always takes place at the annual meeting of the company and if for some reason the shareholders are not able to attend, they can do so by means of polling, electronic means, postal ballot or by means of mail. He also has the right to appoint proxy though it is not allowed to be included in the quorum of the meeting in case of voting. Though it can be allowed by following the procedure mentioned in the act.
 5. **Part owners-** At the time of liquidation of the company bondholders and preferred shareholders are paid first. Although when business is thriving, common shareholders own a piece of company that has value and they also have certain claim on a portion of the assets of the company. The assets generate profits and the profits are again reinvested in the additional assets of the company. With this process the shareholders see a great return as the value of each of their shares increases as stock prices rise.
 6. **Ownership Transfer-** With this privilege the shareholders are allowed to transfer their ownership rights i.e., they can trade their stock on an exchange. It is the liquidity that is provided by the stocks, the degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price is one of the key factors that differentiate stocks from an investment such as real estate. If an investor owns the property, it can take months to convert that investment into cash. Because stocks are so liquid, an investor can move their money into other places almost instantaneously.
 7. **Right to call for general meetings-** They have the authority to call for the general meeting and can also approach the Company Law Board for the conduction of general body meeting if not done as per the statutory requirements.
 8. **Dividends-** Common shareholders are entitled to dividend along with a claim on assets and investors also receive a claim to any of the profits of the company paid in form of dividend. With respect to profit the management of the company has two

options only i.e., either it can be reinvested back or can be paid out in the form of dividend. Though investors do not have any say as to what percentage of profit should be paid out but whenever the dividends are declared they have the right to receive the share.

- 9. Right to inspect financial books and records-** Shareholders have the authority to inspect basic documents of the company such as their bylaws and minutes of board meetings.

RIGHTS OF PREFERRED SHAREHOLDERS

These shares are the securities which represent the ownership in one's company and have priority claim over common shares of the assets and earnings of the company. The basic difference between common and preferred shareholders is that the right to vote is absent in case of preferred shareholders. They receive the fixed amount or percentage of dividends and are paid before common shareholders.

There are certain advantages of preferred shares to both the issuers as well as holders such as-

- It allows the issuers to avoid or to defer the dilution of control since they have limited rights and holders of preferred shares are not allowed to vote.
- The issuers of such shares are not forced to pay dividend to the shareholders, i.e. if the corporation does not have funds to pay the dividends, they may just defer it.
- The management is flexible enough to set up any terms for such shares.

CHAPTER THREE

VARIATION IN SHAREHOLDER'S RIGHTS

*“Where a Share capital of a company.....provision of this section shall apply to such variation”*². As per the provisions of section 48 of the Act, the variation of rights of a particular class of shareholders could be affected either by passing a special resolution or by consent though it is not necessary that the consent given should be further approved by any special resolution. As when there are equity shares in a company the rights attached to the preference shares, namely the rate of dividend payable on such shares or the period of redemption could also be varied via passing a special resolution at a meeting of the holders of the preference shares. The special resolution in respect of section 48 in a listed company shall be passed by postal ballot. The variation can be made, provided there is provision in the articles or memorandum or in the absence of any such specific provision the variation should not to be prohibited by the terms and conditions of the issue of shares. So, if the corporation has issued more than one series of preference shares each holder having different rights each of such issue will belong to a class and action shall be taken for each class separately.

As the shares of the company are divided into different classes it becomes necessary sometimes to amend the rights attached to these classes of shares. The memorandum of association or the article of association might authorise the variation of rights attached to these shares. Sometimes there might come a situation where the article of association or memorandums of association of companies are silent with respect to variation of rights. Under such circumstances the company has no authority to vary the shareholders rights without undergoing any formality. These rights could be varied only if the consent in writing of the holders constituting not less than 3/4th of the issued shares of the concerned class of shares has been taken, or only if the sanction through a special resolution passed at a separate meeting of the holders of the issued shares of that class has been taken prior to the variation of the rights and if such variation is prohibited by the terms of the class of shares then in such scenarios the variation won't be possible.³

² The Companies Act, 2013, Section 48 (1), The gazette of India, pt. II sec. 1 (August 30, 2013).

³ Divya Rai, Variation of shareholders rights (Dec. 4, 2020, 12:15 PM) <https://www.taxdose.com/variation-of-shareholders-rights/>.

If the variation curtails rights of any class of shareholders in such cases the consent or sanction of those particular classes of shareholders will be mandatory. If the variation pertains to adding or enhancing any such rights to any of the classes of shareholders then also the compliance with the provision of Section 48 would be required.

In the landmark judgement of *In re Hindustan General Electrical Corporation* it was held that, *“a variation which affects only the enjoyment of a right without modifying the rights itself does not fall within the purview of Section 106 of the Companies Act 1956..”*⁴ Again in the judgement of *In re Ramuria Cotton Mills Ltd.* it was held that-*“Once the variation is affected in strict consonance with the provisions of the act, it is complete and no further step is necessary to adopt it..”*⁵

In order to make any changes in the rights of shareholders there is a proper procedure which has to be followed by the management of the company in order to maintain transparency in the management and the goodwill of the company.



⁴In re Hindustan General Electrical Corporation AIR 190 Cul. 672.

⁵ In re Ramuria Cotton Mills Ltd. 53 C.W.N II.

CHAPTER FOUR

PROCEDURE FOR VARIATION OF SHAREHOLDERS RIGHTS

If proposed to change certain rights of particular class the procedure which is to be followed are-

- There should be provision in the memorandum or articles of the company entitling it to vary such class rights or at any rate there should be nothing in the terms of issue of the shares of that class prohibiting such a variation. This was held in the judgement of Sitarama Reddy v. Bellary Spg & Wvg Co.⁶
- If neither the memorandum and articles nor the terms of issue permit variation of rights then the first step would be to alter the article or memorandum.
- The holders of the 3/4th of the issued shares of that class must have given their consent in writing or a special resolution sanctioning the variation must have been passed at a separate meeting of the shareholders of that class.
- The holders of at least 10% of the shares of that class who did not consent to or vote in favour of the resolution may apply to the tribunal and then variation shall not take effect unless and until it is confirmed by the tribunal.
- An application should be made within 21 days of the date of consent or resolution. Such application has to be made within 21 days after the date on which the consent was given or resolution was passed.

It can be made on behalf of the shareholders entitled to make the application by such one or more of their numbers as they may appoint in writing for the purpose. The decision of the tribunal is to have binding effect upon shareholders of the class. The company has to file a copy of the order with the registrar within 30 days of the date of the order.⁷

Any default on part of the Company in complying with the provisions of the section of the Companies Act is punishable with fine by an amount not less than 25,000 INR extending up

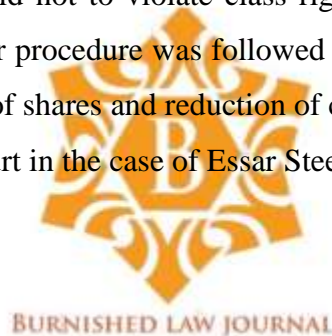
⁶ (1984) 56 Comp Cas 281 (Ker).

⁷ AVTAR SINGH, COMPANY LAW 244-245 (17th ed. 2018).

to 25,00,000 INR. Every officer in default is punishable with imprisonment for a term extending up to 6 months or fine not less than 25,000 but extending up to 5,00,000.⁸

The tribunal shall grant a hearing to the applicant and any other persons who apply to it to be heard and appeared to be interested in the application. If the tribunal having regard to all the circumstances of the case is satisfied that the variation would unfairly prejudice the shareholders of that class, it would be disallowed. But if the scheme appears to be reasonable and fair it would be confirmed. The decision of the Court is final. The Company shall within 30 days send a copy of the Courts order to the registrar.

There are also certain exceptions in variation i.e., such amendments do not amount to variation of class rights such as new issue of preference shares ranking pari passu with the existing shares does not amount to variation so as to require the consent of preference shareholders. This was held in *White Bristol Aeroplane Co. Ltd.*⁹ The Conversion of loans of an ex-director into shares was held not to violate class rights though voting powers of the shareholders were affected. Proper procedure was followed and the scheme was also of bona fide character. Also, cancellation of shares and reduction of capital do not amount to variation of class rights as stated by the Court in the case of *Essar Steel Ltd.*¹⁰



⁸ The Companies Act, 2013, Section 48 (2), The gazette of India, pt. II sec. 1 (August 30, 2013).

⁹ (1953) 2 WLR 144.

¹⁰ (2005) 59 SCL 457 (Guj).

CONCLUSION

The Shareholders or stockholders enjoys certain rights in the corporation but at times their rights vary and it becomes necessary to amend the rights attached to one or more classes of shares. This requires valid procedure which is to be followed and must be in accordance with the MOA or AOA of the company. The main strength of the provision is that it depends upon the MOA and AOA of the Company which defines an interlinking provision of agreements based on share capital. This can easily adapt to various circumstances this could easily be demonstrated as the statute has its own provisions and has its own part to play the Company has documents like Memorandum of Association or Article of Association which provides the independence one needs to have. In

