NATURE OF THE RIGHTS OF SHAREHOLDERS

K. B. Rohatgi*

During the last fifty years or so there has been a gradual divorce of ownership from the control in the large business enterprises mainly because there are numerous geographically scattered shareholders. The Cohen Committee has given the gist of the nature and extent of control of a shareholder over large business enterprise in the following words, "The illusory nature of the control theoratically exereised by shareholders over directors has been accentuated by the dispersion of capital among an increasing number of small shareholders who pay little attention to their investment so long as satisfactory dividends are forthcoming, who lack sufficient time, money and experience to make full use of their rights as occasion arises and who are, in many cases, too numerous and too widely dispersed to be able to organise themselves"[1]

A company is a legal entity quite distinct from the members constituting it.[2] This, however, does not imply that the members have neither rights nor duties. Shareholders have three classes of rights against the company under their share-contract and by virtue of their status as owner of shares. These are :

(1) Rights as to control and management, which include :

- (*a*) right to vote in person or by proxy;
- (b) voting right for election of directors, auditors, inspectors and incidental right to participate in annual and extra-ordinary general meetings;
- (*c*) voting right for amending the Memorandum and Articles of Association;

(2) Proprietory rights, which include :

- (*a*) right to dividend;
- (*b*) right to participate in the distribution of assets on liquidation;

* Professor of Law, and Dean, Faculty of Law, University of Delhi.

1. Cohen Committee Report on Reform of English Law, 9 (1965).
2. *Solomon* v. *Solomon & Co.*, (1897) A.C. 22.

(*c*) pre-emptive rights;

(3) Remedial and auxiliary rights, which include :

(*a*) right to information and inspection of corporate books;
(*b*) right to maintain representative or derivative suits.

In this paper an attempt is made to discuss a few important rights of the shareholders.

Right to Vote by Proxy

The usual method of voting at a meeting of the shareholders is by show of hands, in which case each member has one vote. A member of the company is entitled to attend and vote at a meeting of the company or at a meeting of any class of members of the company or is entitled to appoint another person (whether a member or not) as his proxy to attend and vote at the meeting. In India, a proxy has no right to speak at a meeting of the company. He can demand or join in demanding a poll. In England, on the other hand, section 136 specifically provides that a proxy appointed to attend and vote shall have the same right to speak at the meeting as the member. A proxy is appointed to safeguard the interest of the shareholder. Shareholders are scattered over large geographical area, while meetings of the company are invariably held in the city or town where it has its registered office. A proxy cannot be very effective unless he is given a right to speak at the meetings. Most of the States in the U.S.A. permit a proxy to speak at the meetings. The Uniform Companies Act 1961 of Australia which has been adopted by the States of New South Wales, Victoria and Queensland provides that a proxy appointed to attend and vote shall have the same right to speak at the meeting as the members.[4] Of course, the writer is conscious of the fact that this may give rise to a class of professional hecklers and black-mailers who may use this facility not for the benefit of the shareholders whom they represent but for their selfish ends.

In India, an instrument appointing a proxy is valid for the meeting for which it is given. In the State of New York a proxy remains valid for eleven months. It is revocable at will at any time[5] unless it is an irrevocable proxy under the statute. A proxy is irrevocable, if so entitled and so stated, when it is held by any of the following or a nominee of any of the following :

(*a*) A pledgee under a valid pledge.
(*b*) A person who has agreed to purchase stock under an executory contract of sale.

3. Companies Act 1956, Section 178.
4. The Uniform Companies Act 1961, section 141(2).
5. New York State Corporation Law, Section 47(a),

(*c*) A creditor or creditors of the corporation, other than a banking corporation who extend or continue credit to the corporation in consideration of the proxy.

(*d*) A person who has contracted to perform services as on officer of the corporation, other than a banking corporation, if such proxy is required by the contract of employment.

The proxy becomes revocable after the pledge is redeemed, the executory contract of sale is performed, the debt of the corporation is paid or the employment has terminated. In the State of Delaware, a proxy unless coupled with an interest is a revocable at any time. No proxy can be voted on after three years from its date unless it provides for a longer period.[6]

It is suggested that a provision providing for the duration of the proxy be inserted in the Companies Act 1956.

Right to Information and Inspection of Books

Shareholders have a statutory right to inspect and demand copies of certain registers, books and documents etc., kept by the company, for example, register of members, register of mortgages and charges, minutes of general meetings, register of directors' shareholdings, proxies, register of contracts, firms and companies in which directors are interested. The books of account and minutes of directors meetings are not open for inspection to the members. Most of the States in the U.S.A. permit inspection of even account books and directors' minutes book by the shareholders who may also have the assistance of their attorneys and make reasonable extracts from them. However, certain restrictions regarding the time, place, conditions of inspection such as minimum shareholding or holding for a minimum period have been placed on the right of inspection. The writer is not unaware of the possibility of misusing the information so obtained for the ulterior purpose of learning business secrets or finding out technical defects so as to blackmail and harass the management. Nevertheless, a provision in the Companies Act, in India, providing for inspection of corporate books of account will have a salutary effect on company management and will, to a great extent, reduce financial irregularities in companies. The right of shareholders to receive the annual profit and loss accounts and the balance sheet leave much to be desired as they convey little information regarding the real financial position of the company. Although, the (English) Companies Act 1967 provide for disclosure of certain material information in Directors' Reports as well as in annual accounts (which we have not yet borrowed from English Law), right to inspect corporate books of account will certainly be a radical step in the right direction.

6. *Hard* v. *Mokan* 54 F: Supp. 659; D.C. Delawara 1944.

Right to Maintain Representative or Derivative Suits

The affairs of a company are conducted in accordance with the wishes of the majority shareholders. Like any democratic set up, the majority has its way, though due provision must be made for the minority to have its say. This principle, followed in many cases, is often described as the rule in *Foss* v. *Harbottle*.[7] In *Macdougall* v. *Gardiner*,[8] single shareholder complained of an irregularity in voting. The Court dismissed the suit on the ground that an action should have been brought in the name of the company, and it was for the majority to complain against the action of the chairman. In this case Melish L.J. observed as follows :

> "in my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."[9]

Shareholder's suit may be classified into three kinds :

(*a*) Shareholder's suit to enforce a personal right arising out of contract.
(*b*) Shareholder's representative suit on behalf of himself and other shareholders.
(*c*) Shareholder's derivative suit on behalf of the company when the company has failed to bring an action directly.

Individual shareholder's suit involves the enforcement of a cause of action belonging to him, on the basis of his membership contract *e.g.*, suit to enforce inspection of books and records of the company, transfer of shares, right to vote, etc.

Sections 397 and 398 recognise the right of a shareholder or shareholders to bring a representative suit in cases of oppression or mismanagement. The following members of a company have the right to apply to the court under section 397 or 398.

(1) in the case of a company having a share capital, not less than hundred members or not less than one-tenth of the total number of its members, whichever is less, or any number of members

7. (1843) 2 Hare 461.
8. (1875) 1 Ch. D. 13.
9. *Ibid.* at 25

holding not less than one-tenth of the issued share capital of the company.

(2) in the case of company not having a share capital not less than one-fifth of the total number of its members.

The Central Government may authorise any member or members of the company to apply to the court notwithstanding that the requirement of point (1) and (2) are not fulfilled.

Derivative suits or secondary suits are also referred to as suits 'in the right of a company'. The general rule is that in order to redress a wrong to the company or to receive money due to the company, the action should *prima facie* be brought by the company and that it is not a matter for individual shareholders. The only exception to this rule is when the persons against whom relief is sought control the majority of shares and will not allow an action to be brought in the name of the company. The plaintiff shareholder is not acting as a representative of the other shareholders but as a representative of the company.[10] The company is the true plaintiff, although neither the Board of directors nor the general meeting will authorise a suit by the company. The next best thing is to make the company a party defendant in the suit. The suit, if decreed in favour of the plaintiff/shareholder, shall ensure for the benefit of the company and the general body of the shareholders. Some advance countries like the U.S.A. have framed elaborate rules of procedure for enforcing a shareholder's derivative action. We have provisions in the Act for instituting a representative suit but not a derivative suit. It is suggested that the provisions in the nature of a derivative action, if incorporated in the Act, would given an important statutory remedy to shareholders of companies all over the country. Although such suit may amount to a nuisance, they do have the beneficial effect of keeping directors and officers alert. In the United States many a corporate irregularities have been removed, even without court assistance, simply because such a potent weapon is available to stockholders.

10. *East Pant Du Lead Mining Co.* v. *Meryweather*, (1864) 2 H, & M. 254,