

### Voting Rights (Sec 47)

#### 1. Meaning of Voting right

The term ‘voting right’ is defined in Section 2(93) of Act, as “Voting right” means the right of a member of a company to vote in any meeting of the company or by means of postal ballot.

As per dictionary “voting rights” means “delegable right of a common stock (ordinary share) holder to take part in a firm’s decision making process, by voting on matters of policy and to choose members of the board of directors”.

Since voting rights are either contractual or statutory rights, the Companies Act, 1956, envisaged the possibility of such voting rights being curtailed by contract viz., the Articles of Association. In order to prevent such contractual contraction, the Companies Act contains Section 9, which confers overriding effect to the provisions of the Act, upon the Memorandum and Articles of Association of a Company. [B. Ramachandra Adityan vs Tamil Nadu Mercantile Bank v. Tamil Nadu Mercantile Bank Shareholders Welfare Association, Application No.2954 of 2008 in C.S.No.481 of 2008, decided on 26th November, 2011]

#### 2. Voting rights if the amount paid by the member but not called up

As per the section 50(2) of the Act, member of the company limited by shares shall not be entitled to any voting rights in respect of the amount paid by him until that amount has been called up even though the company accepted the amount from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up.

Therefore, the calling up of the money from the company is condition precedent to get the entitlement of voting right by the members of the company. This ensures that no voting rights which are above the rights of others shareholders will accrue to any shareholder. It conforms to the fundamental tenets of shareholder democracy.

#### 3. Issue of shares without voting rights

Opening paras of the Section 47 starts with “subject to the provisions of section 43 and sub-section (2) of section 50”. Section 43 deals with the provisions of differential voting rights. As per the provisions of section 43 of the Act, a Company

may issue equity shares with voting rights or with differential rights as to dividend, voting or otherwise.

A company may issue equity shares which carry rights only with respect to dividend and do not carry any voting rights.

#### 4. Superior Voting Rights

Superior voting right means any right that gives the shareholder more than one vote per share.

The term “differential voting rights” emanates from its usage in Section 86(a)(ii) of the Companies Act, 1956. The validity of such shares has also been subjected to judicial determination. In *Anand Pershad Jaiswal v. Jagatjit Industries Limited*, MANU/CL/ 0002/2009, the Company Law Board (CLB) upheld the validity of issue of shares with differential voting rights as being valid under Section 86 of the Companies Act as well as the Companies (Issue of Share Capital and Differential Voting Rights) Rules, 2001. Unfortunately, the CLB did not have the opportunity to devolve into the details of the issues raised in that matter because it was settled through a consent order.

An unlisted public company can issue shares with superior voting rights subject to the provisions of Rule 4 of the Companies (Share Capital and Debenture) Rules, 2014. However, section 47 and related rules are not applicable to a private company and hence a private company may issue shares with differential rights as to voting, dividend or otherwise without complying the provisions mentioned in section 47 subject to the condition that such a provision is contained in the memorandum or articles of the company. [MCA Notification dated 5th June 2015]

#### 5. Superior Voting Rights in case of listed companies

SEBI vide press release No. 192/2009 dated 18<sup>th</sup> June 2009 prohibited the issue of shares with “superior voting rights” by listed companies, in order to “avoid the possible misuse by the persons in control to the detriment of public shareholders”. Further regulation 41(3) of LODR specifies that the listed entity shall not issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares that are already listed.

It is possible for listed companies to issue shares with differential voting rights which provide voting rights below the normal “one-share-one-vote” rule. However, conferring voting rights greater than normal is prohibited.

#### 6. General Voting rights to Preference shareholder

As per the provisions of sub-section (2) of section 47, the preference shareholder is entitled to vote on such resolutions directly affecting the rights attached to the preference shares placed before company. Rights of the preference shareholders are specified under section 43. The preference shareholder gets a right to vote on following matters directly affecting his rights:

- (a) change in rate of dividend of preference shares;

- (b) change in the period of redemption of preference share capital;
- (c) compromise or arrangement or amalgamation of company,
- (d) change in the nature of the shares convertible to non-convertible, cumulative to non-cumulative

Further they are also entitled to vote on other resolutions such as (i) winding-up of the company, (ii) repayment or reduction of equity or preference share capital of the company. However his voting rights shall be in proportion to paid-up preference capital of the company. The proportionate voting rights between equity share capital and preference share capital shall be same proportion of paid-up capital of respective capital in the total paid-up capital of the Company.

## **7. Special voting rights- due to non-payment of dividend to preference shareholders**

As per the second proviso to sub-section 2 of section 47, where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company. This proviso specifies as “class of preference share” which may be cumulative preference share or any other class. In case the company does not pay the dividend for a period of 2 years or more to such class of preference shares, such class of preference shares shall have a right to vote on all the resolutions placed before the company till such time all pending dividends are paid, for such preference shares, if declaration of dividend by the company year on year is a contractual obligation either under terms of issue of such shares or under a provision in the memorandum or articles.

## **8. Effect of Agreement amongst shareholders**

The seminal question faced by the Courts in this era of modern commercial practices is enforceability of agreements entered into by the shareholders amongst themselves regarding exercise of voting rights in a particular / specified manner. These could be pooling agreements, memorandum of understanding or even joint venture agreements.

Bombay High Court has extended the principle laid down by the Supreme Court in the case *V. B. Rangaraj v V. B. Gopalakrishnan And Others* [AIR 1992 SC 453 ] for transfer of shares to all other management matters and ruled as follows: ‘The principle laid down by the Supreme Court in *V. B. Rangaraj’s* case (supra) is, therefore, not confined to a situation involving only a transfer of shares’ [IL And FS Trust Co. Ltd. v Birla Perucchini Ltd. 2004 121 CompCas 335 Bom]. Hence, all such Agreements will not have a binding force unless and until they are incorporated in the Articles of Association. ‘A pooling agreement, in that case, could not be used to supersede the statutory rights given to the board of directors to manage the company, the underlying reason being that the shareholders cannot achieve by a pooling agreement that which is prohibited to them if they are voting individually’ [Rotta India Ltd. v. Venire Industries Ltd. [2000] 100 Comp. Cas. 19, 24 SCL 13 cited with approval in *IL And FS Trust Co. Ltd. v Birla*

Perucchini Ltd. 2004 121 CompCas 335 Bom]. Delhi High Court concurred with both the cases above while refusing to give effect to a provision for affirmative vote in a Joint Venture Agreement which was not incorporated in the Articles of Association. [World Phone India (p) Ltd v. WPI Group Inc (2013) Comp Cas 173 (Del)]

While deciding upon the enforceability of a Memorandum of Understanding against the Company, the Company Law Board held 'Normally, private agreements, unless they are made part of the articles, are not binding on the Company. Any dispute regarding private agreements for investment in shares has to be agitated in a Civil Court. While in the normal course, the Company should be a party or the articles should reflect such a private agreement to bind the company, yet if the Company has taken benefit or has acted in terms of any such private agreement, then the Company is bound by the terms of the agreement, at least in relation to the terms that the Company has acted upon or derived certain benefits. However, even if they do not form part of the articles, if the Company has acted in terms of such agreements, as in the present case, they are binding on the Company in so far as the terms which have been acted upon by the Company. [Harshadbhai B Patel v. Bhagirath Construction Co. (P.) Ltd. [2013] 117 CLA 52 (CLB)]. Hence, even though there can be no restrictions on inherent voting rights of the members which could amount to their alteration, the terms of exercise of voting rights can be regulated by such agreements.

At the same time, in Act, proviso to section 58(2) lays down that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. Hence, now the above judgements are required to be evaluated in the context of this new statutory provisions.

## 9. Effect of exemption to private companies

- The exemption has facilitated the private companies to issue non-voting right shares. The exemption has also benefitted the private companies who wish to raise funds by structuring their capital without dilution of control.
- The exemption has provided major relief to the private equity funds which structure instruments on priority basis on dividend, liquidation and entitlement to vote. These funds stress on instruments with rights which are flexible.
- The exemption will help in structuring returns and liquidation preference to foreign investors. While dividends on compulsorily convertible preference shares issued to foreign investors entitle them to receive dividends at a certain rate, there shall be no such limitation if structured by way of equity shares with differential rights.