

Living with shareholder agreements

The boardroom battle at United Spirits raises questions over related party transactions, legal sanctity of a shareholder agreement, rights of minority shareholders and corporate governance practices

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Between 2010 and 2013, United Spirits entered into several agreements with group companies to give out loans, largely to finance its ailing aviation venture, Kingfisher Airlines. These transactions were prior to British liquor major Diageo picking up a controlling stake in United Spirits in July 2013. The new company law, Companies Act of 2013, came into effect from April 1, 2014.

A tighter corporate governance regime, with empowered minority shareholder rights, in a way, tripped the Diageo-Vijay Mallya marriage. Legal experts point out had the new company law provisions been in force in the period when the contracts were entered into, and subsequently cleared by the respective boards of United Spirits Limited and United Breweries Holding Limited, there would have been greater scrutiny of these transactions from minority shareholders.

"Indian companies paid little or no regard to related-party transactions and there was little scrutiny of such transactions that were detrimental to the interests of minority shareholders," says Shriram Subramanian, founder and managing director, InGovern Research Services. Legal experts say the previous version of Securities and Exchange Board of India (Sebi)'s listing agreement under Clause 49 did not have elaborate provisions for related party transactions. The new Companies Act and the revised listing agreement brought related party transactions into focus with minority shareholders needing to approve related party transactions.

MINORITY POWER

The special resolutions that were defeated at the USL EGM

Nature of agreement	Related party	Votes against* (%)
Loan	UBHL	44.12
Property sale	UBHL	27.12
Services	Kingfisher Finvest	77.17
Advertising Force India	Watson Ltd	58.78
Sponsorship	United Racing & Bloodstock Breeders	58.25
Sponsorship	United Mohun Bagan Football Team	32.69
Aircraft services	UB Air Pvt Ltd	77.53
Properties call	PE Data Centre Resources	75.52
Contribution	Vittal Mallya Scientific Research foundation	47.48

POSTAL BALLOT RESOLUTION

licence for manufacture & distribution, sharing of advertising cost	Diageo BV, Diageo N-America, Diageo Scotland	29.80
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Still requirements under related party transaction provisions fall short of global best practice in this regard. Globally, the best practice is related party transactions are voted for by a majority of minority shareholders, with all related parties getting no votes. However, according to an amendment to the Act requires only the specific related party with whom the transaction was taking place getting no votes, while other connected parties to the related party get to vote. According to Sebi notification in April 2014, companies were supposed to get shareholders' approval for existing material related party contracts or arrangements that are likely

* 75% votes from non-promoter shareholders is required
Source: USL filing with BSE

to continue beyond March 2015. In November last year, in an extraordinary general body meeting (EGM), United Spirits shareholders - armed by provisions of Sebi's new listing agreement and the new company law - questioned the related-party transactions between United Spirits and the entities owned by Mallya. Subsequently, United Spirits said, in a filing to the stock exchanges, nine of the 12 resolutions had not been approved by members with the requisite majority. It also informed the exchanges that the licensing proposal for manufacture and distribution of Diageo's products in India, on which it had sought approval through a postal ballot, had also failed to sail through.

Many proxy advisory firms have also raised questions over Diageo's role in letting these related party transactions pass the muster under its corporate governance code in the first place. Though the United Spirits board has recently asked Mallya to step down as chairman of the board, pending enquiry over allegations of fund diversion, the liquor baron has resisted the move, citing provisions in a shareholder agreement between him and Diageo.

When contacted, a spokesperson for Mallya said, "As stated earlier, Mallya will discuss bilaterally with Diageo and not in the public domain."

A United Spirits spokesperson did not respond to the email seeking comments.

This has raised questions over legal sanctity of such shareholder agreements between two or more shareholders, and whether provisions under agreements could override rights of minority shareholders and existing corporate governance norms.

"A shareholders' agreement is like any other agreement or contract under Indian Contract Act, which lays down the contractual rights and obligations of the parties to the agreement, provided the terms and conditions are enforceable in law," says Lalit Kumar, partner in law firm J Sagar Associates.

Only the signatories are party to the contract, points out Vaibhav Kakkar, partner, Luthra & Luthra Law Office. However, for shareholders' agreement to be enforceable against the company and other shareholders, including those who are in minority, the provisions of the agreement have to be incorporated in the Articles of Association of the company, say legal experts.

Though there is no mention of shareholder agreement under the Act, it does recognise transfer restrictions - like lock-in provisions in shares, right of first refusal, and right of first offer - between two or more shareholders of a public company.

Legal experts say even if a shareholder agreement becomes binding on minority shareholders, they continue to retain their rights under the Act. Minority shareholders have the right to file a case of oppression and mismanagement against the promoters before the company law board, or file a class action suit as and when the provisions of come into force.

In the event of a conflict between the shareholder agreement and the Article of Association, the provisions of the shareholder agreement cannot go contrary to the Article of Association. "When it comes to governance or board structures the Article of Association is a self-containing document," says Kakkar of Luthra & Luthra.

Legal experts point out that corporate governance standards provided under the Act cannot be overridden by a shareholder agreement. "The terms of the shareholder agreement cannot go beyond the provisions of law," says Kumar of JSA.

However, there are judgments, which have upheld that if provisions of the shareholder agreement are more stringent than the ones set out under the Act, the same will bind the company, says M S Ananth of Nishith Desai Associates. "In essence, the stricter of the compliance requirements prevails," says Ananth.