TATA SPONGE CASE: 'MINORITY OPPRESSES MAJORITY'!

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Executive Summary

Defeat of three Related party transactions ('RPT') by shareholders in recently concluded AGM of Tata Sponge Iron Ltd (hereinafter referred to as 'TSIL') is an eye opener and requires regulator to have a relook at laws. Such outcome raises following questions which needs to be addressed. (Click here to read SES Report on the TSIL AGM)

- Did the law intent to create a monster out of minority protection? Certainly not.
- Are shareholders going to benefit by defeat of resolutions which was core to business? One cannot say
- Does the outcome reveal wish of majority public shareholders? while results indicate but the conclusion is doubtful.

SES is of the view defeat of resolution is unintended consequence. In that case what is the way out to avoid such outcomes and really achieve intended objective of regulations?

Answer is – to relook at current regulations and make necessary amends to avoid such outcomes.

SES suggest following for consideration.

- Change in provision of law: Some minimum voting on outstanding public shares may be made mandatory, else a miniscule minority will rule majority.
- Encouraging participation by retail investors so that voting outcome cannot be strategized by few shareholders.
- Mandating all Institutional Investors to vote, while MFs and Insurance companies are mandated, banks, FIIs, corporates & HNI are not. The suggestion is difficult to implement; however, it can be mandated for Banks and FIIs by respective regulators.
- Till such time voting percentage improves, such risks would remain. Therefore, laws on RPTs have a chance to occasionally turn into a bane more by default, rather than by intent of law makers.

Shareholders vote is like any election in democracy, indifferent voters always pay price for their indifference. Has the regulator given power/ rights to minority, for which shareholders lack maturity or preparedness? A question which will have multiple answers.

Related Party Regulations a bane or boon?

Related party transactions (RPTs) have been occupying CenterStage of corporate governance arena for last couple of years initially due to problems associated with RPTs and later due to the legislative reform in this regard viz., Companies Act, 2013 (the Act) and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR). The attention it got was justified looking at total lack of transparency associated with RPTs coupled with lack of any clear cut legal provisions regarding such transactions, which resulted in many RPTs, which were of abusive nature, hurting interest of minority shareholders. Clearly, there was need for review of laws and that too need for introducing tough laws which could be enforceable. Suddenly, from almost a non-existent regime on RPTs, minority shareholders were overnight made extremely powerful by introducing legal provisions which took away rights of controlling shareholders in influencing RPTs approval process. Like many governance practitioners, SES too welcomed the new law.

Current Legal Framework:

<table>
<tr><th rowspan="2">Legislative Reforms</th><th colspan="2">Shareholders' approval (Nature of Transaction)</th><th rowspan="2">Voting Rights, when approval required</th><th rowspan="3"><u>DISCUSSION</u>
▪ The Act exempts approval for transactions which are in 'ordinary course & at Arm's length', however, no such respite available under the SEBI LODR.
▪ The legal framework differentiates between volume of turnover as well.
▪ The Act prohibits voting of interested party only, while SEBI LODR prohibits all related parties from voting, irrespective of, whether the shareholder is a party to transaction or not.</th></tr>
<tr><th>Arm's Length & Ordinary Course (both)</th><th>Not on Arm's length, or in ordinary course</th></tr>
<tr><td>Section 188 of Companies Act, 2013</td><td>Not Required</td><td>Required</td><td>Only interested Party shall abstain from voting</td></tr>
<tr><td>Regulation 23 of SEBI LODR</td><td colspan="2">Required only if >10% of Turnover</td><td>All Related parties shall abstain from voting</td></tr>
</table>

Impact of legislations:

It would be very difficult to asses the overall impact of the most revolutionary piece of legislation on RPTs, as no data will be available as to how many RPTs and of what nature & value have been avoided, which because of law were not culminated for fear of disapproval. Further, no data would also be available on how many RPTs were initiated by interested parties but were blocked by Audit Committee and the Board. Therefore, impact analysis can be done only based on proposals put forth for approval of shareholders as the same is available on public domain.

Once again, there is a handicap as no comprehensive data is available on the shareholders voting on all RPTs proposed. However, SES has data on the sample companies, which covers more than 90% market cap of all listed companies in India. The data comprise of the shareholders resolutions relating to the past 3 years, which is tabulated as below. A word of caution, this data may not be a representative sample and at the most it may be biased data in the sense as it is only SES data.

Year	RPT	Passed	Defeated	% Passed	SES recommendation			More than 10% Against by Institutional Investors
					FOR	AGAIINST	% Against	
2014-15	123	117	6	95.12%	81	42	34.15%	21
2015-16	124	112	2	90.32%	70	54	43.55%	25
2016-17	126	123	3	97.62%	72	54	42.86%	26

The above Table throws the following observations:

- Investors have been approving RPT resolutions as more than 90% resolutions proposed were approved since 2014-15, after law became effective. Although analysts like SES, had recommended AGAINST in close to 40% resolutions. Indicating investors were not following SES' recommendations blindly but taking a considered decision.
- Only about 20% resolutions received more than 10% against vote from Institutional Investors.
- Shareholders are still indifferent to RPTs as most of resolutions relating to RPTs have passed and very few have faced negative voting.
- Small shareholders have hardly voted on these resolutions.
- Advisors like SES though have recommended in few cases to vote against, still the resolutions have sailed comfortably, either because perception of shareholders is different from perception of advisors like SES or they still feel that they cannot bring any change.
  A few resolutions have faced defeat as well.

Qualitative benefit of law

- Companies have been or rather forced to bring in resolutions for approval of RPTs to shareholders.
- Resolutions have been detailed giving requisite information.

Need for re-look at RPT norms?

While, the existing legal framework under the Companies Act and the SEBI Listing Regulation may appear to be an excellent piece of legislation and was much needed to curb the menace of abusive RPTs. However, defeat of three RPTs of Tata Sponge Iron Ltd (TSIL) in recently concluded AGM of the Company, has perturbed SES and has forced to analyse the pros and cons of the existing legal framework in this regard.

SES also believes that any power that is bestowed upon any individual/ class of people must be used responsibly and judiciously, and the shareholders of the Company whether minority or majority are no exception to this. Although, SES has throughout been battling in favour of minority shareholders' rights, however, after noticing the voting results of the recently concluded AGM of TSIL, SES is obligated to analyse the flip side of the RPT legislation, given abysmal participation of investors in voting process.

SES has always maintained the following principles when it comes to RPTs:

- All RPTs are not detrimental to the minority interests;

- RPT if entered judiciously may help both the parties to transaction reap synergy benefits;
- Certain RPT that transfer undue benefit to one party at the cost of other, need to be curbed;
- Majority shareholders must not use their rights to oppress or abuse minority shareholders;

The present case involving TSIL has exposed the flip side of current legislation. And since SES battles for fairness, a sense of fear has gripped SES of the negative unintended consequence of current legislation. One may note that SES has no financial interest either in the transactions, nor in the Company nor any of its holding or subsidiary or associate companies except holding 1 share each in the BSE 500 companies (including Tata Companies) to get timely information.

To appreciate SES's fear, a look at poll results is must.

Background

TSIL had proposed for shareholders consideration, three Related Party Transaction (RPTs) Resolutions in recently concluded AGM and released voting results on 20th July 2018.

The Company has faced defeat on all the three resolutions for approval of RPTs

Shareholding pattern and Voting result is summarised below: (weblink)

Shareholding Pattern as on Cut-off date				Voting Pattern						
Category	No. of shareholders*	Number of Shares	%	Total Votes Cast	% Participation	Favour	Against	% Against Votes cast	Against % of category	Against Total capital
Promoter	1	83,93,554	54.50	Not Eligible to vote						
Public institutions	61	15,60,838	9.30	8,64,810	55.41%	2,84,276	5,80,534	67.13%	37.19%	
Public Non Institutions	35,516	54,45,608	36.20	5,917	0.11%	5,112	805	13.60%	0.01%	
Public Total	35,577	70,06,446	45.50	8,70,727	12.43%	2,89,388	5,81,339	66.76%	8.30%	
Grand Total	35,578	1,54,00,000	100.00							3.77%

**As on 30th June 2018*

Data in the of table can be de-coded as under:

S. No.	Facts of the Voting	SES Observation / Comments
1	Promoters holding 54.50% shares were ineligible to vote	*SES supports such restriction on Promoters*
2	Of 45.50% public shareholders only 12.43% voted. Those who voted accounted for 5.65 % of total issued capital	*SES feels that low participation has risk of unintended consequences, as any interested party can take advantage.*
3	Of these 12.43% who voted,12.34% were Public institutional and only 0.09% were Public Non-Institutional i.e. retail shareholders	*Retail participation has remained negligible, SEBI must do something about it.*
4	Public institutional shareholders were holding only 9.30% of total capital, of this only 55.41% voted. In this category- 67% voted against resolution.	*Only about half of Public Institutions cast their votes*
5	Public non-institutional who have almost 36.20% equity, voted miniscule .04% of total shareholding or 0.11% of category shareholding.	*Negligible voting in Public-Others category*
6	While 67% of votes cast in Public Institutional category were against the resolution, the same amounted to only 37.19% of outstanding shares held by institutions. Difference is because only 55% institutional shareholders voted.	-
7	Because of almost no voting by Public retail holding 36% of total capital and 77.72% of eligible voting power and	*Retails investors need to be educated and made aware regarding the importance of their votes.*

	just 55% voting by Institutional holders who held about 22% of eligible votes, and only 12.43% eligible votes polled, the resolution got defeated with only 8.30% eligible votes being polled against resolution.	
8	Effectively, shareholders with just 3.77% of total equity capital defeated the resolution, whereas it can be said that 54.50% (promoter shareholders) were in support of resolution and another 41.73% were indifferent, who did not vote.	*Indicating shareholders holding 3.77% were able to bulldoze wish of 96.23%, because law was created for their protection.*

Other way to look at is, given retail does not vote, law has acknowledged that 9.30% equity holders (institutional) are master of the rest 90.70%

SES firmly believes that the law never intended to target genuine transactions that were aimed at reaping synergy benefits especially given the fact that the transactions were at arm's length in ordinary course of business.

Effectively, in this case, shareholders holding just 3.77% of voting power have become empowered to destabilize a running profitable business? Can SES blame the law or law maker? Certainly not. The law makers make the law with all good intent, unfortunately they cannot capture all eventualities, designs, manipulation or accidental happenings. It appears to be one such case. One cannot say for sure whether it is by design or by accident.

Approval for RPT by TSIL was not sought for the first time, similar resolution was proposed in FY 2016-17 also and the same was duly approved by the shareholders. A quick peep into the shareholding pattern of the Company during the period between both the AGMs indicates that HSBC Global Investment fund, which owned about 4.56% equity, holding 7.03 lac equity shares as on 30th June, 2017 doesn't appear as major Public shareholder in June 2018, anymore. This indicates that they must have sold at least 3.57% equity during time elapsing between both the AGMs.

Is it a coincidence that 3.77% of total capital has voted against or are we reading too much?

In any case, this clearly points out, that knowing very well that retail participation is abysmally low and most of the institutional investors do not participate unless mandated, an adversary by studying publicly available data can strategize to defeat RPTs causing huge loss to the Company and in turn to its various stakeholders at large for whose protection the law was created to begin with.

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