TATA-MISTRY CASE - HOW IT INVOKED DIFFERENT SECTIONS OF THE COMPANIES ACT, 2013: ISSUES AND SOLUTIONS

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ABSTRACT

The Supreme Court recently clarified its position on the collision of the representational and fiduciary duties of a nominee director in the case of Tata Sons v Cyrus Mistry.[1] The court while setting aside the NCLAT order provided clarity on the duty of nominee directors towards their nominators. The court examined the affirmative voting rights given to nominee directors during certain board resolutions.

There were several other issues in front of the court including the independence of independent directors and allegations of oppression and mismanagement by Tatas.

The decision of the Supreme Court brought down the curtains in the Cyrus Mistry case but left open a plethora of ramifications which has pushed India into an unfamiliar corporate governance landscape.

This paper would analyse the fiduciary duty of the nominee directors in a company and their roles and responsibilities vis-à-vis their nominators. It seeks to delve into how the Tata-Mistry case has upheld the **shareholder primacy model** of corporate governance, instead of commitment to the company and all its stakeholders.[2]

[1] Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd., 2021 SCC OnLine SC 272 .
[2] Cydney Poser, So Long To Shareholder Primacy (22 August, 2019). Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu/2019/08/22/so-long-to-shareholder-primacy/>

Introduction

The Supreme Court recently clarified its position on the collision of the representational and fiduciary duties of a nominee director in the case of Tata Sons v Cyrus Mistry.[3] The court while setting aside the NCLAT order provided clarity on the duty of nominee directors towards their nominators. The court examined the affirmative voting rights given to nominee directors during certain board resolutions.

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Over here, would first begin by understanding the concept of nominee directors and the jurisprudence in India before the Tata Mistry decision. Then we would delve into the facts of the Cyrus Mistry case and the decisions given by the NCLT, the NCLAT and the honourable Supreme Court with regard to the fiduciary duties of nominee directors. At the end of we would be analysing the decision of the Supreme Court and its future ramifications on Indian corporate governance.

Who are nominee directors and what are their duties?

The concept of nominee directors is a global norm in countries across the world. The Companies Act, 2013 has recognised the role of a nominee director in Section 149 (7). A nominee director is appointed when the shareholders have a massive stake in the company and want their interests to be protected. A nominee director essentially represents the interest of the

[3] Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd., 2021 SCC OnLine SC 272 .
[4] Cydney Poser, So Long To Shareholder Primacy (22 August, 2019). Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu/2019/08/22/so-long-to-shareholder-primacy/>

shareholders in the company while also practicing his duties as a director towards the company. These duties of a nominee director towards the company he is nominated to are his fiduciary duties.

Fiduciary, which comes from the Latin word fiduciaries means "one on whom trust is reposed". The concept of fiduciary duties of a director has existed from centuries. In the Companies Act, Section 166 enshrines the fiduciary duties of a director. The section as quotes states-

"A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment."[5]

A fiduciary duty of a director enables him to safeguard the interests of all their shareholders and investors of a company. This duty makes the directors act in good faith for the company so that investors/ minority shareholders have their interests protected and a fair exit option is available to them.[6] It was first recognised by the Apex Court in the *Nandala Zaver* judgement.[7]

Fiduciary duties are a common law principle. In the landmark case of *Cook v Deeks*[8] the court ruled that those who assume complete control of a company's business are not at liberty to sacrifice its interests for their own advantage. Similarly, in *Aviling v Perion*[9] the court noted that information received by a director should not be used for their own favour. Several other Indian and foreign cases are analysed later to prove how the ratio of Cyrus Mistry has and nullified the fiduciary duties of nominee directors. Before that, let us understand what happened in the Cyrus Mistry case

The Tata-Mistry Saga

The Tata-Mistry saga starts with the failure of the revolutionary Nano car, the brainchild for Ratan Tata and a consistently loss-making advent. The case is about Tata Sons, a private limited

[5] Section 166 Companies Act, 2013
[6] Arjun Anand and Arushi Gupta. The Viewpoint: Nominee Director - The tug of war between duty to company and nominator. (5 August 2021) Bar and Bench. <https://www.barandbench.com/view-point/nominee-director-the-tug-if-war-between-duty-to-company-and-nominator>
[7] Nanalal Zaver v. Bombay Life Assurance Company Limited, AIR 1950 SC 172.
[8] Cook v Deeks 1 AC 554,, UKPC 10
[9] Aveling Barford Ltd v Perion Ltd [1989] BCLC 626

company which It led to a clash between the majority shareholders (the Tata Group) and the minority shareholders (the Shapoorji Paloonji group).

The Cyrus Mistry case raised several points of law and corporate governance regulations which are being currently reviewed in the Supreme Court. Some noteworthy points were discussed regarding oppression and mismanagement due to the 'legacy issues' Tatas had with their company. Along with those questions were allegations of Tata Sons investment in certain companies like Corus, Mr. Tatas compensation, transactions with Siva Group and Mehli Mistry and even high costs for PR campaigns run by the company.

However, the main point of contention was removing Cyrus Mistry as the Executive Chairman of Tata Sons in the 2016 due to a loss of confidence from shareholders and following a resignation as board of director. The Mistry group (Shapoori Pallonji group) were the single largest shareholder in Tata Trusts. Mistry filed a case under Sections 241, 242 and 244 of the Companies Act alleging oppression and mismanagement from the Tata Group. Ratan Tata later replaced Mistry as an incumbent Chairman.

Nusli Wadia, who acted as one of the independent directors of the Tata groups supported Mistry in his claims against the Tatas. He also corroborated his differences with the Tata group on the production of Nano car and how it is a loss-making advent. The Tata Group in retaliation to Wadia's allegations called for an extra ordinary general meeting to remove Wadia as an independent director.[10]

What ensued after this a five year long legal battle showcasing a bitter boardroom saga which shook the corporate governance space in India. The NCLAT noted it is "not just the reputation of the Tata group but the reputation of the country is at stake."

Under Article 104-B of the AoA of Tata Sons, the two Tata trusts had a joint right to nominate one-third of the directors to the Board as long as the two trusts owned 40% of the paid-up share capital in the company. The directors who were appointed under Article 104-B were also granted affirmative voting rights in the board.

[10] Aparna Chaturvedi Tata Vs Mistry: Why Mistry's Oppression Case Failed In The Supreme Court BloombergQuint. (28 March, 2021). <https://www.bloombergquint.com/law-and-policy/tata-vs-mistry-why-mistrys-oppression-case-failed-in-the-supreme-court>

The Issue

A major contention over the rights of directors were the Affirmative Voting Rights (AVR's) granted to the directors of Tata Sons who were nominated by Tata Trusts. The charter documents of Tata Sons, more specifically the Articles of Association (AoA) have bequeathed the right to Tata Trusts (who hold 66% shareholding in Tata Sons) that as long they hold 40% of the share capital in Tata Sons, they can nominate one-third of the directors. These nominee directors are bestowed with affirmative voting rights on certain specific matters under Article 121 of the AoA.[11]

The affirmative voting rights were problematic due to three major reasons

1) No general body meeting quorum could be conducted without the presence of the representatives of Tata Trusts as they held a major chunk of the share capital

2) The majority decisions of the board required the affirmative votes of the nominee directors according to Article 121 of the AoA. This bestowed the nominee directors with a pre-eminent power

3) The nominee directors had the power to transfer shares of any shareholder (especially Cyrus Mistry's) without notice through a special resolution. They could again do this through their affirmative voting rights.[12]

The principal argument by Mistry in this case was that the affirmative voting rights were violating the principal duty bestowed on the directors. The directors in this case were acting on the best interests of the shareholders which nominated them (Tata Trusts). By acting in the best interests of the shareholders, the directors were infringing their duty to act in the best interest of the company which is bestowed on them in Section 166 of the Companies Act.

The NCLT decision[13]

The argument before the NCLT was that the Board of Tata Sons committed several acts and

[11] Shivani Saxena. Mistry Firms Argue For Removal Of Tata Trusts' Affirmative Voting Rights. [online] BloombergQuint. Available at: <https://www.bloombergquint.com/law-and-policy/mistry-firms-argue-for-removal-of-tata-sons-affirmative-voting-rights

[12] Nishith Desai Associates. Supreme Court says Tata to India Inc's Biggest Corporate Mystery. (August, 2021) <https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/The_Tata_Mistry_Saga.pdf>

[13] Cyrus Investments Pvt. Ltd. v. Tata Sons Ltd., 2018 SCC OnLine NCLT 24460

misused their affirmative voting rights causing severe loss to Tata Sons. The court held that Tata Trusts did not opt for having majority of their directors on board, it was only 1/3rd which in itself is not oppressive. [14]This point of the court again echoes in the Supreme Court which gave credit to Tata Trusts for not indulging in 'board packing'. The NCLT found no merit in the argument that Articles 104 B and 121 were oppressive against the petitioners. Furthermore, the purpose of the voting rights was to enable effective decision making and was in fact approved by Mistry in 2014.[15]

The NCLAT decision[16]

The Counsel from SP group argued that granting affirmative voting rights to majority shareholders was not a norm and it should be instead granted to minority shareholders. During the arguments it was also suggested by the Tatas that they buy out the stake of the SP group. The Counsel for SP group argued that if the stake of minority shareholders is not protected by affirmative voting rights the Tatas might exercise this option[17]

The NCLAT in its decision held that according to the AoA, no major decision could have been taken without the approval of nominee directors. These directors never used their affirmative voting rights to reverse the decisions taken by Mistry during his tenure if they believed it was leading to mismanagement. [18]

Even though the courts do not have jurisdiction to hold Articles agreed to by a shareholder of a company as arbitrary if they were in accordance with law, however if they were oppressive to any member of the company the NCLAT could determine whether they would justify winding up the company.[19]

It was clear that the Nominee Directors had a pre-eminent power over the board of Tata Sons. The NCLAT went on to say that the affirmative voting rights available to the nominee directors were "offensive and prejudicial". It also held there was "continuing oppression" against the SP group and other minority shareholders.[20]

[14] Supra Note 11, 102
[15] Supra Note 11, 230
[16] Cyrus Investments (P) Ltd. v. Tata Sons Ltd., 2019 SCC OnLine NCLAT 858 .
[17] Supra Note 14, 130
[18] Supra Note 14, 141
[19] Supra Note 14, 119
[20] Supra Note 14, 26

Therefore, the court held Article 121 of the AoA as oppressive as it led to the majority decision resting on the shoulders of the affirmative votes of nominee directors. The court also ordered for Mistry to be reinstated as director of several tata companies he was expunged from earlier.[21]

The Supreme Court decision[22]

Out of the 15 appeals filed before the Supreme Court against the NCLAT order, one was by Mistry's group. The Supreme Court set aside the NCLAT order and observed in its 282 page judgement that there was no instance of oppression and mismanagement in the Mistry case. Rather, the court was disappointed at Mistry leaked confidential documents alleging wrongdoing in several Tata companies. In this regard the court noted- "A person who tries to set his own house on fire for not getting what he perceives as legitimately due to him, does not deserve to continue as part of any decision-making body."[23]

In its judgement pronounced on March 26, 2001, the court answered several of the SP groups contentions.

The SP group argued for-

1) Proportionate representation[24]

The SP group believed that it was their statutory right to also get affirmative voting rights in the board matters and be proportionately represented. It relied on S. 163 of Companies Act to further its claim.[25]

The court said that while there was a statutory right under 163 for a proportionate claim, this right is not available for the Board of the company. [26]Further, the right under 163 is anyway

[21] Supra Note 14, N.B.
[22] Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd., 2021 SCC OnLine SC 272 .
[23] Supra Note 20, 115
[24] Supra Note 20, 232
[25] "Section 163 - Option to Adopt Principle of Proportional Representation for Appointment of Directors.
Notwithstanding anything contained in this Act, the articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a company in accordance with the principle of proportional representation, whether by the single transferable vote or by a system of cumulative voting or otherwise and such appointments may be made once in every three years and casual vacancies of such directors shall be filled as provided in sub-section (4) of section 161."
[26] Supra Note 20, 243

not available to a minority shareholder but vests with "small shareholder"[27], Mistry's SP group cannot be called a small shareholder.[28]

The court caught on with SP groups petition and rightly pointed out that this was not a matter of principles for them. The court stated, "If affirmative voting rights are bad in principle, we do not know how they may become good, if conferred on S.P. Group also."[29]

The court also noted that the Tatas had provided the SP group with more than a proportionate representation when they elected Mistry as the Chairman on the board even though he was just a minority shareholder.[30]

2) Fiduciary duties

The most important point raised by the court was of fiduciary duties of the nominee directors. The court pointed out that there needs to be a balance between two companies

(1) fiduciary duties of a director under Section 166 of the Act towards the company they are nominated into

(2) the duty towards their nominating company[31]

In the courts opinion another separate category of independent directors already exists in the corporate governance landscape and the existence of it would be futile if we expect every director to only act in the best interest of the company. It noted that the corporate world has moved from a "familial regime to a contractual and managerial regime of social accountability and responsibility". The court therefore gave a narrow interpretation of the obligation of fiduciary duty on nominee directors. [32]

Analysis

The decision of the Supreme Court is one of the most landmark decisions on the role of

[27] A small shareholder would have 0.04% of the shareholding, Mistrys group has 18.37%
[28] Supra Note 20,, 237
[29] Supra Note 20, 204
[30] Supra Note 20, 242
[31] Supra Note 20, 218
[32] Megha Mittal and Ajay Kumar. Role of Nominee Directors : Balance is the Key. (April 2, 2021) Vinodkothari.com. Available at: <https://vinodkothari.com/2021/04/role-of-nominee-directors-balance-is-the key/#:~:text=A%20nominee%20director%20oversees%20the,An%20Information%20Bridge>

nominee directors. It made several observations which are contrary to the conventional letter of law.

The Company's Act is a fairly new provision, and the current judgement requires a critical analysis to understand the potential loopholes missed by the Court and what it could mean for the future of corporate governance in India-

1. **The Driving Seat Parallel-**

In its judgement the court stated-

"Trusts which own 66% of the paid-up capital of Tata Sons will be entitled to pack the Board with their own men as Directors.". The court further stated that "majority shareholders "can always seek to be in the driving seat by reserving affirmative voting rights".[33]

The use of this phrase implies that majority shareholders appoint directors on the basis of who would give preference to their interests and steer the company's decision in that direction, rather than their acumen and competence.

The apex court in its ruling drew a parallel between 'affirmative voting rights for nominee directors' with the 'voting process in shareholder meetings'. In the latter, the majority shareholders influence the decision through their voting rights.[34] In practical sense, the majority shareholders (the Tata group) can influence the voting outcome. The court said if the Tata's wanted they could have indulged in 'board-packing'. [35]

Equating affirmative voting rights with shareholder meeting would mean that the court approves shareholders to influence the decisions of the company. Under law the Board of the company is vested with the power to regard the company as a separate legal personality. So if shareholders influence the companies decisions with their vested interests it would hamper all stakeholders of the company.

2. **Dual Agency Problem**

It is said "in a casino, the house always wins". The same can be said about the influence of

[33] Supra Note 20, 223
[34] Supra Note 20, 198
[35] Supra Note 20, 219

majority shareholders in a company. There is a conundrum of **dual agency problem** with nominee directors. Nominee directors are supposed to act in the best interests of their nominators as well as the company. However, sometimes these interests may differ and the Nominee Directors face crossroads of either voting in favour of their nominator or in the favour of best interests of the company.

The Supreme Court in the analysis of the Mistry case clarifies the conundrum of the responsibilities of a nominee director. Before the Supreme Court's decision, the common law principle was that directors owe their duties to the company and not to shareholders. The only exception to this rule was such as in the case of *Stein v Blake*[36].

In the case of *Stein v Blake*, Millet LJ noted that there are special circumstances in which a fiduciary duty is owed by a director to a shareholder personally and breach of it may cause loss to him. This case was further cited in the landmark case of *Peskin v Anderson*.[37] The Indian judiciary also affirmed this in *Sangram Singh v Shantadevi*[38].

In the case of *Bennetts v Board of Fire Commissioners*[39], it was held that

"In particular, a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the board exists. He is most certainly not a mere channel of communication or listening post on behalf of the group which elected him."

Even Lord Denning in the case of *Boulting v Assoc of Techni*[40]. held that while a nominee directors can represent the shareholders' interests "as long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful. "

In the case of *Dale and Carrington Invt. Private Limited v Prathapan*,[41] the Court held that "irrespective of whether directors are described as trustees, agents or representatives, they have

[36] Stein v Blake [1995] UKHL 11
[37] Peskin v Anderson [2000] EWCA Civ 326
[38] Sangramsinh P. Gaekwad v Shantadevi P. Gaekwad, (2005) 11 SCC 314, at para. 42.
[39] Bennetts v Board of Fire Commissioners of New South Wales (1995) 7 BOND L R
[40] Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606
[41] Daleant Carrington Investment Pvt. Ltd. v P.K. Prathapan 2004 CompCas 161 SC.

a duty to act for the benefit of the company and must not derelict their duty towards the shareholders and investors in the company." The court further held that the directors should act in good faith while exercising due diligence. This principle was later affirmed in *Vasudevan v Uoi*[42].

Legal scholars like Professor Umakanth have taken the example of Sangram Singh to state that even if under S. 166 (2) directors though, must be liable to the interests of shareholders, their duty is nonetheless owed to the company[43].

In Palmers Company Law, it is noted that the duty of independent judgement "applies equally to nominee directors, who cannot blindly follow the judgment of those who appointed them, although they may rely on their advice provided, they make the judgment their own".[44]

Another way to look at Nominee Directors could be through Section 6 of the Companies Act. The section provides that "provisions of the Act will have effect notwithstanding anything to the contrary contained in any agreement entered into by the company. We can use this section to state that affirmative voting rights conferred by shareholding agreements can be exercised in lieu of the nominators interest but should not deter the nominated director from their fiduciary duties.[45]

3. Existence of Independent Directors

The Companies Act was the first to codify the fiduciary duties of directors. It is important to note that there are no statutory differences between duties of different directors in Section 166 of the Companies Act. It is provided in sub-section (2) and (3) that all directors must act in good faith of the Company and exercise duties with reasonable care. This section is also akin to Section 173 and 174 of the English Companies Act.[46].

[42] G. Vasudevan v. Union of India and Ors.(WP No.32763 of 2019

[43] Umakanth Varottil, Supreme Court on Directors' Duties in the Tata/Mistry Case: A Critique - IndiaCorpLaw. (March. 29, 2021). https://indiacorplaw.in/2021/03/supreme-court-on-directors-duties-in-the-tata-mistry-case-a-critique.html

[44] Palmer's Treatise on Company Law, Vol. II, at Para 8.2704

[45]Bharat Vasani, Varun Kannan and Rajashri Seal (March 20, 2022) Dilemma of a Nominee Director on the JV Company's Board – Is there a conflict in his fiduciary duties? https://corporate.cyrilamarchandblogs.com/2022/03/dilemma-of-a-nominee-director-on-the-jv-companys-board-is-there-a-conflict-in-his-fiduciary-duties/

[46] S.173 and 174 of the English Companies Act, 2006

The Supreme Court in this case went ahead to create a distinction the standards of due diligence and good faith to be exercised. The court stating that nominee directors can prioritise their representational duties over their fiduciary duties because independent directors exist, lowers the bar for nominee directors. It also doesn't comply with the legislative intent of the codified Section. [47]

This tacit view of the court is anyway an antithesis to the "check and balance mechanism" for independent directors. It showcases the viewpoint that only independent directors need to exercise due diligence and put the needs of the company first and lowers the bar for nominee directors. In the Kumar Birla report also, it was recognised that "*6.8 Independence of the board is critical to ensuring that the board fulfils its oversight role objectively and holds the management accountable to the shareholders*.[48]"

Rather, when you look at the concept of bestowing affirmative voting rights on majority shareholders, it is in flagrant contravention of Section 166.

This goes to show that nominee directors should still act in the best interests of the company and that independent directors should only be there to present an independent viewpoint to the board decisions.

4. Nature of Company

The Supreme Court constantly emphasised on how Tata Sons is a private limited company which holds investment and works for public interest. The court used this as a justification to deter several provisions from the Companies Act to apply in this case.[49]
It is pertinent to note here that the Companies Act in Section 166 provides no distinction in the type of company to which it can be applied to. This reasoning of the court suggests that the type of business should have an effect of the liability or duties of directors. The court has created an undue extension.

Such distinctions are not supported statutorily and might create problems as other companies may want to distinguish themselves as investment holding companies just to reduce the burden

[47] Supra Note 20, 208
[48] Securities and Exchange Board of India, Report of the Kumar Mangalam Birla Commiittee on Corporate Governance, 2000.
[49] Supra Note 20, 215

of fiduciary duties on their directors. [50]

Conclusion

The decision of the Supreme Court in this case has muddied the waters in several facets of corporate governance. As emphasised earlier, it has shifted from the conventional global norm and reduced the standard of liability on nominee directors. Another area the court can delve into is the communication channels between the nominee directors and their nominators. Sensitive information may also travel between them, and this would invite sanction by SEBI which would out the company in troubled waters.[51]

This 'catch-22' situation also creates issues for nominee directors, and it is important to protect them from legal liability, and thereby can be considered like creating a formalised structure in the shareholders agreement which defines the obligations of the nominee directors vis-à-vis their nominators and their company. The nominating director may also enter into an officer's liability insurance with the company or an indemnification agreement.[52]

As the size of business houses keeps growing in India, this judgment will have a significant impact on agency problem 2 disputes in the corporate sector. The Indian corporate governance scenario is such that it is important to understand how Agency Problem 2 would continuously crop up courtesy the concentrated shareholding pattern. In this situation protecting the interests of minority shareholders should be a priority of the judiciary. It would have been helpful if the courts would have paid attention to Mistry's proposal of granting proportional affirmative voting rights, these rights would have protected the interest of the minority SP group

[50] Another contention which was raised by the SP group was that the Tatas wanted to run the group as a family business. It argued that there was a shift from corporate democracy to corporate governance in the board of Tata Trusts. The Supreme court rejected both these contentions. The court pointed out if the Tatas in fact wanted to run the company as a family business "Mr. Ratan Tata need not have stepped down as the chairman". Answering the second point related to corporate democracy, the court pointed out that Mistry, an outsider himself was appointed as the Chairman by the Committee who were nominated by the two trusts.

[51] John Emanoilidis, Aaron S. Emes, Andrew Gray, Mile T. Kurta, James C. Tory and Sophia Tolias, Information Flows Between Nominee Directors and Their Appointing Shareholders, https://www.torys.com/Our%20Latest%20Thinking/Publications//2018/07/information-flows-between-nominee-directors-and-their-appointing-shareholders/

[52] Archana Khosla Burman, Viewpoint: Protecting Investor Nominee Directors from potential liabilities under the Indian laws (19 March, 2021) https://www.barandbench.com/view-point/the-viewpoint-protecting-investor-nominee-directors-from-potential-liabilities-under-the-indian-laws

Recently a revision petition filed by Mistry has been accepted by the Supreme Court, so for now we can look forward to how the court reinterprets this ‘catch-22 situation’.