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Rules on small shareholders' director lack clarity

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THE Companies (Amendment) Act, 2000 has amended Section 252(1) of the Companies Act, 1956 by adding a proviso that a public company having a paid up capital of Rs 5 crore or more and 1,000 or more small shareholders may have a director elected by small shareholders.

"Small shareholders" means shareholders holding shares of nominal value of Rs 20,000 or less. This provision has been introduced to enable small shareholders, who individually hold few shares but collectively hold a large chunk, to appoint their nominee on the company's board to ensure protection of their interests. To give effect to the amendment, the department of company affairs (DCA) has recently notified Companies (Appointment of the Small Shareholders' Director) Rules, 2001. The rules provide that a company may act either *suo motu* to elect a small shareholders' director or upon receipt of a notice from small shareholders proposing the name of a person as director.

It may be recalled that the Companies (Second Amendment) Bill, 1999 included a clause which sought to amend Section 252(1) of the Act by providing that all public companies having a paid-up capital of Rs 5 crore or more and 1,000 or more small shareholders shall have at least one director elected by small shareholders. However, later on the provision was diluted to some extent as the word "shall" was substituted by the word "may" when the Act was a passed. Therefore, a sort of discretionary power was conferred upon companies i.e., whether to have a small shareholders' director or not on the board. But the rules notified by DCA seem to be contradictory to this as now companies will have no option but to set into motion the procedure for appointment of small shareholders' director once a notice is received.

Moreover, the term 'paid-up capital' has been used in Section 252(1) and in the rules and as paid-up capital includes both equity capital and preference share capital, the right given to small shareholders to elect a nominee director will be available to preference shareholders also whereas the fact is that preference shareholders are entitled to vote at general meetings only if dividend on their shares is in arrear for two years or more. In view of this, only small equity shareholders should have the right to appoint nominee director.

Another area of contradiction is between Rule 4(1) and Rule 4(2). The former requires that at least one-10th of total small shareholders should propose the name of a person to be their director whereas the latter provides that 100 small shareholders may leave a notice of their intention with the company at least 14 days before the meeting proposing the name of a small shareholder as director. Therefore, if a company has 10,000 small shareholders a notice received from 100 shareholders will be in conformity with Rule 4(2) but will not fulfill the condition laid down under Rule 4(1) as in such a case notice should have been endorsed by at least 1,000 shareholders.

Further, Rule 4(5) says that unlisted companies may appoint such director if majority of small shareholders recommend his candidature. This provision goes against Section 87 of the Act as it provides that every member shall have a right to vote on every resolution placed before the company whereas in such a case those holding shares of nominal value of over Rs 20,000 will be debarred from voting.

(The writer is an Asst. Manager with JK Industries Ltd. These are his personal views)