Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2023 – ISSN 2582-7820
Editor-in-Chief – Prof. (Dr.) Rishikesh Dave; Publisher – Ayush Pandey

Shares with Superior Voting Rights from the Perspective of Promoters

Sandhya Narayanan[a]

[a]OP Jindal Global University, Sonipat, India

Received 18 January 2023; *Accepted* 03 February 2023; *Published* 06 February 2023

---

*Shares with differential voting rights ("**DVR shares**") are internationally known as dual-class shares and have disproportionate rights to their economic ownership. M/S Opgs Power Gujarat Pvt Ltd v State of Punjab and Ors*[1] *confirmed that the Indian courts see merits in the contention that Section 2(46) and Section 86 of the Companies Act, 1956 permit the issuance of classes of shares with differential voting rights. These shares can be of two types: superior voting rights shares with more than one vote per share ("**SR shares**"), and fractional voting rights shares with less than one vote per share ("**FR shares**").*[2] *The focus of this article is on SR shares. It is vital to note that there have been fewer willing takers for SR shares since SEBI modified the Listing Regulations in 2009, which indicated that listed companies are not permitted to issue SR shares.*[3] *Section 43(a)(ii) of the Companies Act, 2013 ("**Companies Act**") states that the equity share capital of a company may have differential rights as to dividends and voting.*[4] *Notably, in 2019, the Securities and Exchange Board of India ("**SEBI**") approved a framework for listing companies with DVR shares, particularly SR shares. This was viewed as a welcome move towards enabling the issuance*

---

[1] *M/S Opgs Power Gujarat Pvt Ltd v State of Punjab & Ors* CWP No 12908/2016
[2] Bhavya Solanki, 'Mandatory Sunset Provisions in Shares with Superior Voting Rights' (*Indiacorplaw*, 2021) <https://indiacorplaw.in/2021/07/mandatory-sunset-provisions-in-shares-with-superior-voting-rights.html> accessed October 2021
[3] Akila Agrawal, 'Shares with Differential Voting Rights – SEBI's Sequel Trumps the Original' (*CAM Blog*, 2021) <https://corporate.cyrilamarchandblogs.com/2019/05/shares-with-differential-voting-rights-sebi/> accessed October 2021
[4] Companies Act 2013, s 43(a)(ii)

*and listing of DVR shares.[5] According to the Companies Act[6], if a company meets the standards outlined in Rule 4 of the SEBI (Share Capital and Debentures) Rules, 2014 ("**Rules**")[7], it may issue equity shares with different dividends, voting, or other rights. The issuance of DVR shares is not a new notion in India; it has existed since 2000, and certain publicly traded companies, notably Tata Motors, have issued DVR shares. The importance and benefits of SR shares can be appropriately understood from the perspective of promoters. Therefore, this article discusses the critical considerations of SR shares from a promoter's perspective.*

Keywords: *dvr shares, sebi rules, superior voting rights, fractional voting rights, companies act.*

INTRODUCTION OF SR SHARES: THE RATIONALE

DVR shares have traditionally been used by promoters to retain control of a company while seeking financing for its growth.[8] India has experienced a substantial increase in entrepreneurial activity in the recent decade, notably in the technology sector. One of the significant challenges encountered by promoters is raising financing for development without relinquishing control.[9] New-age technology-based enterprises prefer to raise equity capital over debt capital, resulting in the dilution of promoters' shareholding and thereby their influence over decision-making in the company. The success and growth of such companies depend primarily on promoters' innovative potential and their ability to explore *avante-garde*, disruptive ideas.[10] Hence, it becomes imperative to allow promoters to retain their decision-making powers.

SEBI's attempt to address this critical issue by improving access to the Indian capital markets through an improved and regulated DVR regime is timely, and it involves issuing SR shares to promoters. SEBI adopted the SR share framework in light of the debate over listing Indian companies with DVR shares and the need to loosen existing norms to allow technology-based businesses to access domestic capital markets while maintaining promoter control. This is

---

[5] Sharad Moudgal & Ors, "Framework for Issuance of Differential Voting Rights Shares" (*Khaitan & Co,* 5 July 2019) <https://www.khaitanco.com/thought-leadership/framework-for-issuance-of-differential-voting-rights-shares> accessed October 2021

[6] Companies Act 2013

[7] SEBI (Share Capital and Debentures) Rules 2014, rule 4

[8] Agrawal (n 3)

[9] *Ibid*

[10] Yiming Sun, 'A Hybrid Approach to Sunsetting Dual-Class Shares' [2021] SSRN Electronic Journal

similar to stock exchange structures in the United States, Hong Kong, and other internationally recognised stock exchanges.[11]

GLOBAL PERSPECTIVES OF SR SHARES

While considering the benefits of SR shares to promoters in India, it may be relevant to first consider the perspectives taken towards such shares worldwide. For instance, companies with DVR shares can be listed on the Hong Kong Stock Exchange and the Singapore Stock Exchange. However, only ordinary equity shares with one vote per share are permitted to be listed and offered to the public on both countries' stock exchanges. Other classes of DVR shares, on the other hand, are not eligible for a public offering and must be kept unlisted and untradeable by shareholders.[12] This is similar to the structure seen in India, where SR shares are *only* available to promoters of the company with restrictions on transferability. In contrast, ordinary shares and FR shares can be held by ordinary shareholders and are freely transferable.

LEGAL FRAMEWORK & SEBI'S CONSULTATION PAPER

The legal framework that governs the issuance of SR shares is primarily based on SEBI's 2019 consultation paper ("**Consultation Paper**")[13] in addition to the Companies Act and the Rules. Companies with DVR shares will be subject to the Rules, which provide that DVR shares cannot account for more than 26% of total paid-up equity share capital.[14] Furthermore, the current equity shares cannot be converted into DVR shares and vice versa. This implies that a company has to issue fresh DVR shares after meeting the requirements of the SR share framework if they wish to issue SR shares to promoters. According to the Consultation Paper, a promoter's voting rights (an aggregate of ordinary, SR, and FR shares) cannot exceed 75% of the overall voting rights.[15]

[11] Moudgal (n 5)
[12] *Ibid*
[13] SEBI, 'Framework for Issuance of Differential Voting Rights (DVR) Shares' (*SEBI,* August 2019) <https://www.sebi.gov.in/sebi_data/meetingfiles/aug-2019/1565346231044_1.pdf> accessed October 2021
[14] Companies (Share Capital and Debentures) Rules 2014
[15] SEBI (n 13)

Additionally, the Consultation Paper provides that SR shares have voting rights in the ratio of a minimum of 2:1 to a maximum of 10:1 compared to ordinary shares.[16] Companies can only issue one class of SR shares with the same face value as ordinary shares. SR shareholders, except for voting rights, are to be treated equally to ordinary shareholders in all circumstances.[17] The Consultation Paper also requires that the Issuer Company must be a technology-based company (for instance, intensive use of technology, including biotechnology and data analytics to provide services, products, or business platforms that create substantial value addition) and that a special resolution should have authorised the issue of SR shares at a general meeting of the shareholders.[18] These conditions are a part of the legal framework that governs SR shares ("**SR share framework**").

KEY CONSIDERATIONS

A key consideration is that the intent or the rationale behind the issuance of SR shares is rather evident. SR shares can *only* be offered to promoters of a company that occupies an executive role.[19] This implies that they are required to be actively involved in the functioning and growth of the company to hold SR shares of that company. Promoters are instrumental in the success of the companies; SEBI recognises the need for a structure to enable promoters to retain decision-making powers and rights vis-a□-vis other shareholders through the issuance of SR shares to promoters of the company.[20] Therefore, the SR share framework in India allows promoters to lose shareholding while attracting more investors without losing proportionate voting power. Mark Zuckerberg, for example, has 58% voting share power and only a 22% equity investment.[21] Shareholders are willing to invest predominantly because they trust Zuckerberg's decision-

[16] *Ibid*
[17] *Ibid*
[18] Moudgal (n 5)
[19] SEBI (n 13)
[20] *Ibid*
[21] Solanki (n 2)

making skills and vision for Facebook. Other well-known technology-based companies such as Pinterest, Zoom, and TripAdvisor have opted for dual-class structures[22] for the same reason.

Another critical consideration is that SR shares are illiquid and cannot be exchanged even if they are listed. This means that following an IPO, they will be perpetually locked in. Transfers of SR shares between promoters are also not permitted.[23] This further highlights the intention of SEBI when introducing the current SR share framework. They have made it evident that the intent behind the issuance of SR shares is solely to enable promoters, who are invested in the company, to retain decision-making power. This is further emphasised by their requirement for promoters to have an executive position in the company.

POTENTIAL FOR A MORE ROBUST FRAMEWORK

While the current framework aims to encourage entrepreneurial efforts with the issuance of SR shares, a few amendments to the existing SR share framework have the potential to provide a conducive environment to India's rising, new-age technology-based companies.

Distributable Profits Requirement: The Companies Act and the Rules allow a public company to issue SR shares if it has distributed profits for the previous three years, among other requirements. Technology-based companies are a critical enabler for India's growing economy. To allow promoters to hold SR shares, and thereby maintain the control they require over the company to fulfill the visions of the company, it is pertinent to relax the Companies Act requirement. For technology-based companies looking to issue SR shares, the requirement to show distributable profits for the previous three years can be a significant hindrance. These companies tend to prioritise revenue growth, asset acquisition and advancement, customer acquisition, and outreach in their early years instead of overall profitability.[24] As a result, they are unlikely to meet this requirement laid down by the Companies Act and Rules. This article

---

[22] Council of Institutional Investors, 'Dual Class Companies List' (*Council of Institutional Investors*, September 2019) <https://www.cii.org/files/FINAL%20format%20Dual%20Class%20List%209-27-19.pdf > accessed October 2021
[23] Agrawal (n 3)
[24] *Ibid*

proposes relaxing the requirement of three years of distributable profits, allowing more companies to issue SR shares.

Sunset Clauses: Another amendment or solution can be seen in the sunset clause of SR shares. There are two types of sunset provisions: (1)time-based and (2)event-based. According to the SR share framework approved by SEBI, SR shares will automatically convert to ordinary shares after five years from the listing date, subject to a one-time extension of another five years through a resolution in which SR shareholders will not be allowed to vote. The disadvantage of this type of sunset clause is that it proposes a one-size-fits-all approach, i.e., a five-year required sunset clause.[25] While the structure must collapse at the appropriate time (i.e., when it loses value), it is difficult to pinpoint that time significantly when each firm's structure, goals, and objectives vary. As a result, the obligatory 5-year timeframe fails to recognise a company's unique characteristics, which may alter the time it takes to self-actualize, thereby rendering the time-based sunset required by the SR share framework ineffective.

Event-based sunset clauses may be more beneficial to companies and their promoters because they detect occurrences that cause the structure to lose its value and, as a result, unification. The death of promoters with SR shares, the resignation of SR shareholders from an executive position, or the sale of SR shares after the lock-in period but before sunset are all possible events that could trigger an event-based sunset clause. These events would allow the structure to be unified even before the five years if necessary. This is because, after a promoter has stepped down as an executive or is no longer in a position where their influence over decision-making is required, there is no need to safeguard their decision-making authority.[26] Hence, a possible solution to the issue that the mandatory 5-year sunset period poses could be to do away with time-based sunset clauses and require an event-based sunset instead.

The flexibility of SR shares: Another solution or amendment that could be introduced into the DVR framework is more flexibility in SR shares. The SR share framework prohibits the *inter se* transfer of SR shares among the Issuer Company's promoters or founders until SR shares are

[25] Solanki (n 2)
[26] *Ibid*

converted into ordinary shares after the sunset.[27] SEBI may offer SR shares more flexibility, such as permitting *inter se* promoter transfers if there is a significant change in the executive role being performed, allowing shareholders to choose the duration of the sunset, and so on. Moreover, it is essential to highlight that the SEBI ICDR Regulations already provide flexibility by allowing the transfer of locked-in securities among Issuer Company promoters.[28] Such initiatives for SR shares are likely to boost the instrument's appeal and viability amongst promoters. These changes to the SR share framework could support India's entrepreneurial activities and create a more favourable atmosphere for new-age businesses to thrive and grow.

CONCLUSION

It is excellent that India is starting to look favourably at SR shares. As discussed, SR shares are very beneficial to promoters looking to attract investors without relinquishing proportionate control or decision-making power over the company. The need of the hour for India's growth follows a path of an upsurge of technology-based companies. In the Indian context, where corporate governance norms are generally complacent, SEBI's efforts to reconcile promoter concerns with prudent corporate governance measures, such as making SR shares non-transferable, allowing for coat-tail provisions, and establishing a sunset period, are applauded and necessary.[29] Some specific steps or amendments could make for a truly effective and conducive environment for technology-based entrepreneurial efforts in India. Whether it is an alteration to the Companies Act and the Rules that relaxes the requirement of a track record of distributable profits, more flexible SR shares, or a change to the mandatory sunset provision, all of these changes could make SR shares a more appealing and viable option for promoters looking to keep control of their company while expanding.[30] This article has determined the rationale behind introducing SR shares in India, SEBI's framework in tandem with the Companies Act, and the Rules while considering how this framework has the potential to be more robust.

[27] Moudgal (n 5)
[28] *Ibid*
[29] Agrawal (n 3)
[30] *Ibid*