REVISITING SHAREHOLDER RATIFICATION IN INDIAN CORPORATE GOVERNANCE: BALANCING POWER AND ACCOUNTABILITY

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ABSTRACT

Shareholder ratification is a contentious corporate governance concept intended to endorse the actions of directors post-facto which have been unauthorized. The principle of ratification in India stands at a delicate crossroad where democratic governance and dilution of responsibility meet. Unlike the common-law nations that have established guidelines regarding this concept, the Companies Act, 2013 of India does not provide a set framework on when the violation of the director's duties could be ratified. In this regard, the judgment of Securities Appellate Tribunal in Terrascope Ventures Ltd. v. SEBI poses serious threats in allowing the majority shareholders to endorse the breach of fiduciary duties at the cost of the minority shareholders. Thus, this research paper explores the scope and boundaries of the ratification of breaches within Indian law while comparing it to the UK and Australian case law. Specifically, this paper critically discusses how the agency-based approach to ratification should address the four contemporary challenges of corporate governance, such as separate legal personality, Business Judgment Rule, the inclusiveness of other stakeholders (Section 166(2)), and voting rights as property.

Keywords: Shareholder Ratification, Corporate Governance, Companies Act 2013, Fiduciary Duty, Terrascope Ventures, Minority Protection, Stakeholder Primacy.

INTRODUCTION

The concept of shareholder ratification is pivotal in corporate governance, particularly in jurisdictions like India where regulatory frameworks emphasize transparency and accountability. Shareholder ratification refers to the process by which shareholders approve or adopt actions taken by directors that were unauthorized at the time they were made. However, this mechanism is considered to be contentious in the sense that it blurs the line of activism of the shareholders and dilution of the accountability of the directors. While ratification provides companies with a pathway to rectify unauthorized actions *post facto*, it also raises significant concerns about its impact on corporate governance, especially when it may be used to excuse breaches of fiduciary duties and regulatory non-compliance.

The landmark case of *Terrascope Ventures Limited v. Securities and Exchange Board of India*,[1] which shall be elaborated upon later in the following section, highlights significant gaps in India's corporate governance framework concerning shareholders' ratification. While ratification empowers shareholders with certain rights, it also risks diluting directors' accountability, especially given that unlike other common law jurisdictions that have developed clear legal standards for such cases, the Companies Act, 2013 lacks provisions for ratifying directors' breaches of duty. This legislative gap in India could be exploited by directors seeking shareholder approval to evade consequences for violating their duty of care, undermining regulatory mechanisms aimed at ensuring transparency and fairness.[2]

Courts have traditionally viewed the relationship between shareholders and directors through the lens of agency theory, which positions shareholders as principals and directors as their agents.[3] However, the evolution of corporate governance has increasingly shifted this view, and thus complicating the role of ratification in corporate law. The absence of a clear agency relationship raises questions about the legality and fairness of shareholder ratification, particularly when it benefits majority shareholders at the expense of minority rights. Such practices could turn corporate democracy into a tool for shareholder activism, where directors are reduced to instruments of the majority, further eroding corporate governance standards.

As shareholder ratification becomes increasingly prevalent, its implications for corporate governance, accountability, and minority shareholder rights must be carefully examined. Key

[1] *Terrascope Ventures Ltd. v. SEBI, 2022 SCC OnLine SAT 179.*
[2] Harshit Joshi, *Ratification of Breach of Duty by Shareholders*, CBCL, 2022.
[3] Pearly Coh, Directors' Fiduciary Duties: Unthreading the Joints of Shareholder Ratification, (2005). 5 J. CORP. L. STUD.

sections of this paper will delve into the legal principles of ratification, the extent of its applicability, challenges like conflicts of interest, minority shareholder oppression, and shifts from shareholder primacy to stakeholder inclusivity. Further, the implications for corporate democracy, accountability, and transparency are critically assessed, culminating in recommendations for judicial scrutiny, regulatory safeguards, and enhanced shareholder awareness to ensure equitable governance.

Understanding the Legal Framework and Principles of Ratification

I. Concept of Ratification

The word "ratification" does not have direct definition under the Companies Act, 2013. Section 188[4] gives the authority to the shareholders of ratification of the breach of duty by the director in specific context. According to Section 188, if a director or employee enters into a contract or arrangement with a related party without getting prior approval from the board or shareholders through a resolution at a general meeting, the shareholders can still ratify the contract afterward.

Securities Appellate Tribunal (Mumbai) in the landmark case of *Terrascope Ventures Limited v. Securities and Exchange Board of India*[5] referenced the judgment of *National Institute of Technology v. Pannalal Choudhury, 2015*[6]. Court explained that the term ratification means "the making valid of an act already done". This can be understood in the context of a legal maxim "*ratihabitio mandato aequiparatur*" which basically means, a later ratification of an action is considered the same as having had permission to do it in the first place. In the case, SEBI imposed a penalty for the company's failure to disclose variations between projected and actual fund utilization. However, the Securities Appellate Tribunal overturned the ruling of SEBI, and held that a post-facto ratification of any breach committed by the director did absolve their personal liability to the company.

There are certain conditions to this 'ratification'- like, such ratification cannot be made if the members ratifying are the directors themselves and*, the ratification is to be done only after the members are well versed with the true facts of the breach*[7] and *surrounding circumstances*[8] and without any undue influence over the ratifying shareholders.[9] If shareholders are not informed wilfully then such ratification is invalid.[10]

The meaning of ratification stands under similar restriction in the UK jurisdiction. The expression "ratification" was succinctly defined by the English Court in one old case, *Hartman*

[4] *The Companies Act, 2013, §188.*
[5] *Terrascope Ventures Ltd. v. SEBI, 2022 SCC OnLine SAT 179.*
[6] *National Institute of Technology v. Pannalal Choudhury 2015 SCC Online SC 581*
[7] *Farrant v. Blanchford* (1863) 1 De G.J. & Sm. 107.
[8] *Smt. Premila Devi & Others v. Peoples Bank of Northern India Ltd*., (1939) 41 BOMLR 147; *T. R. Pratt (Bombay) Ltd. v. E.D. Sassoon And Co. Ltd. And Anr*., AIR 1936 Bom 62.
[9] *Overton v. Bannister* (1844) 3 Hare 503.
[10] *C. D. S. Financial Services v. B. P. L. Communications Limited*, 2004 121 CompCas 374 Bom.

v. Hornsby[11] as “approval by act, word, or conduct, of that which was attempted (of accomplishment), but which was improperly or unauthorisedly performed in the first instance."

Recent judgments illuminate the scope and limits of ratification. In *BTI 2014 LLC v. Sequana SA & Ors* (2022),[12] the UK Supreme Court ruled that shareholders cannot ratify breaches leading to insolvency, a principle mirrored in section 180(4)(a) of the UK Companies Act 2006. Further, the decision in *Re Mobigo Ltd (In Liquidation)* [2022][13] examined whether directors could invoke the Duomatic principle to counter a claim by a company’s liquidator for pre-liquidation conduct. The Duomatic principle, originating from *Re Duomatic Ltd* [1969][14], asserts that informal assent by all shareholders can equate to formal approval, thereby validating an act even if procedural requirements were not met. However, in *Re Mobigo Ltd*, the English High Court noted that this principle does not apply when a company is insolvent, as creditors' interests take precedence over shareholders’. With unresolved questions about the company’s solvency and whether the shareholder genuinely considered ratification, the court denied summary judgment for the directors.

The evolving jurisprudence highlights a cautious approach in defining the meaning of ratification, ensuring it neither undermines accountability nor facilitates the evasion of liability, thereby preserving the integrity of corporate governance frameworks.

II. Breach of duty and the question of extent of ratification

Directors of a company generally have duties of two kinds like, duty of care and fiduciary duties. In *Official Liquidator, Supreme Bank Ltd. v. P.A Tendolkar (1973)*,[15] the Supreme Court held that directors meet their duty of care if they act within their powers, exercise reasonable skill, and act in good faith for the company’s benefit. While, fiduciary duties require directors to act in the company’s best interests and avoid conflicts of interest. In *Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad (2005)*,[16] the Supreme Court emphasized that directors owe a fiduciary duty to the company and must prioritize its welfare over personal or individual shareholder interests.

[11] *Hartman v. Hornsby 44 SW 242 at p. 244 (1897).*
[12] BTI 2014 LLC v. Sequana SA & Ors [2022] UKSC 25.
[13] *Re Mobigo Ltd (In Liquidation) [2022] EWHC 1349 (Ch).*
[14] *Re Duomatic Ltd [1969] 2 Ch. 365.*
[15] *Official Liquidator, Supreme Bank Ltd. v. P.A Tendolkar 1973 SCC 1 602.*
[16] *Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad 2005 AIR SC 809.*

The fact that shareholders can ratify breach of duty by a director is because the interests of the shareholders are considered equivalent to the interests of the company itself. Essentially, shareholders, acting collectively, represent the company in matters pertaining to decisions regarding the duties of directors.

A director's action that exceeds their authority under the Articles of Association may be considered intra vires which means that such act falls within the scope of the company's objects and framework but outside the scope of directors' powers. This however can be ratified later through a special resolution at a general meeting. On the other hand, actions that does not align and exceed the object as defined in the MoA are considered ultra vires,[17] meaning they fall outside the scope of the company within which it was supposed to work and thus void.

An ultra vires action cannot be ratified, meaning that even if every shareholder agrees, the action remains void and unenforceable.[18] This is the primary threshold. Even after meeting this threshold, not all breaches can be ratified. For instance, breaches involving fraud or other wrongful conduct by directors are non-ratifiable. There exists no strict law that defines the extent of ratification, but, the evolving jurisprudence through different case laws shed enough light upon this question.

In *Rabindra Chamria And Others v. Registrar Of Companies, West Bengal And Others (1991)*,[19] the Supreme Court established that acts performed with mala fides or in breach of duty cannot be shielded through shareholder ratification. This ruling underscores that ratification is not a blanket tool to validate fundamentally unethical actions, safeguarding corporate governance from misuse by directors. This aligns with the earlier judgment in *V.N. Bhajekar v. K.M. Shinkar (1933)*[20], where the Bombay High Court clarified that acts entirely beyond a company's powers (ultra vires) cannot be ratified, while those exceeding a director's authority may be approved by shareholders. This refinement adds nuance, linking ratification to the company's legal powers.

In *C. Ranganathan v. President/Secretary Of School Committee (1997)*,[21] the Madras High Court reinforced these limits, holding that acts void ab initio due to a lack of authority cannot

[17] *Ashbury Railway Carriage & Iron Co. v. Riche* (1875) LR 7 HL 653.
[18] *Gower & Davies'* Principles of Modern Company Law, (Paul L. Davies, 10th edn., 2018), 571).
[19] 1992 AIR SC 398.
[20] *V.N. Bhajekar v. K.M. Shinkar 1934 AIR BOM 243.*
[21] *C. Ranganathan v. President/Secretary Of School Committee 1997 SCC Online MAD 273.*

be ratified under any circumstances. This case complements earlier rulings by confirming that intrinsic invalidity cannot be remedied retrospectively.

Cour of Appeal in *Kinsela v Russell Kinsela Pty Ltd [1986],* ruled that shareholders have the ability to approve or ratify a director's breach of duty when it only affects their own interests. However, when creditors' interests are at stake, shareholders lose that power. The court pointed out that once a company is close to insolvency, the creditors' interests become more important than the shareholders', since the company's assets are considered to belong to the creditors. As a result, shareholders can't be seen as representing the company in these cases and thus, can't ratify the breach.[22]

Thus, case laws have played a crucial role in clarifying the boundaries or extent of ratification, illustrating how different scenarios interact and how the principle is applied to uphold accountability and ethical conduct.

[22] *Nicholson v Permakraft* (NZ) Ltd [1985] 1 NZLR 242.

IMPLICATIONS: THE IMPACT OF SHAREHOLDER RATIFICATION ON DIRECTORS' LIABILITY

Corporate democracy requires that the interests and concerns of all the shareholders – minority and majority are protected. While majority shareholders make their way through in company decisions, the minority shareholders' interests should be protected. Ratification can also be unfair or unjust on grounds like it might favour one group of shareholders and leave the rest but also that the action or the transaction that is ratified is not in accordance with the interest of the company. Hence, the doctrine of shareholder's ratification raises genuine questions about whether it serves as a mechanism to prevent or facilitate the evasion of directors' liability.

The implications of this doctrine demand that the effect or the use of this should be regulated or restricted. Such a position was found in *Solomon TRV v. Armstrong* where the Court of Chancery of Delaware found out that "*the true effect of ratification as merely conferring a cleansing effect on transaction but does not extinguish the claim for a breach of duty*."[23]

The judiciary should check if any action or dissatisfaction is shown by the minority shareholders contesting the legality or effectiveness of ratification. "*It is only by subjecting the ratification to judicial scrutiny that the process through which the ratification is attained would be known. A ratification which is fraudulently procured by the majority even with the exclusion of the 'connected persons' should not receive judicial approval.*"[24]

On one hand, ratification can be seen as a safeguard against frivolous litigation and a means to protect directors acting in good faith.[25] It allows shareholders to forgive honest mistakes or approve actions taken in the company's best interests, even if they technically constitute a breach of duty. [26]

Ratification may facilitate the evasion of directors' liability, potentially undermining the fundamental principles of corporate governance.[27] Powerful directors might use their influence to secure ratification, effectively escaping accountability for their actions.[28] This could lead to a situation where directors are protected from the implications of their breaches, potentially

[23] *Id.*
[24] Re Halt Garage (1964) Ltd [1982] 3 All ER 1016 at 1037.
[25] Smith v. Croft (No 2) [1988] Ch 114.
[26] Gower and Davies' Principles of Modern Company Law (10th ed, 2016) p. 479.
[27] Kershaw, D. "The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle" (2015) Journal of Business Law 274.
[28] Reisberg, A. "Shareholders' Remedies: In Search of Consistency of Principle in English Law" (2005) 16(5) European Business Law Review 1065.

encouraging reckless or self-serving behaviour. The effectiveness of ratification in preventing or facilitating evasion of liability largely depends on the specific circumstances and the legal framework in place.

Limitations can be imposed on what can be ratified, particularly for serious breaches or those involving fraud or personal benefit.[29] For instance, in the UK, under *Section 239 of the Companies Act, 2006* shareholders can only ratify conduct amounting to negligence, default, breach of duty or trust in relation to the company under some special circumstances that the decision of the company to ratify such conduct must be made by resolution of the members of the company and the director or any connected member will not be eligible members.[30] Similarly, in Australia, *Section 239 of Corporations Act 2001* restricts ratification of serious breaches. In Delaware, courts have consistently laid down guidelines related to shareholders ratification, as established in cases like *Fliegler v. Lawrence* and *Lewis v. Vogelstein*. These restrictions aim to strike a balance between shareholder autonomy and the need for director accountability.

The balancing act between prevention and facilitation of directors' liability through ratification depends heavily on jurisdictional safeguards. While ratification can shield directors from minor breaches, robust legal frameworks across jurisdictions prevent its misuse for serious misconduct. This creates a nuanced system where ratification serves both as a protection mechanism for good-faith actions and a regulated tool that cannot be exploited to escape significant liability.

[29] Hannigan, B. Company Law (5th ed, 2018) Oxford University Press, p. 253.
[30] Companies Act, 2006, s 239 (UK).

CHALLENGES: RATIFICATION IN MODERN CORPORATE GOVERNANCE

Shareholder's ratification allows the shareholder to acquiesce or approve any irregularities out of directors' decisions since their "*unanimous voice was an authority superior to the deed itself.*"[31]

However, in relation to a company, this application of this principle is hindered, mostly on the grounds of weakened position of the justification of this principle in the current era and the implications. Modern corporate governance presents four interconnected challenges that question this principle's effectiveness:

I. Separate legal personality of a company

Company has its separate legal personality distinct from all the other entities involved.[32] Hence, it is said that there are three entities involved and not two – the board, the shareholders and the company separately. [33] Hence, the company is a separate identity and the directors act for the company alone[34] unless the action involves owing duties directly to the shareholders. But the company can't act on its own, it elects representatives and those representatives are the shareholders of the company. [35] The rationale is based on the ground that if we allow shareholders to take part in the process of decision-making, it will deprive the board of directors of its power of decision making given by the Articles of Association.[36] However, the process of ratification is not deprivation of powers of the board but a process of combined release or exoneration of directors from their liability and the affirmation of the fraudulent or wrong doings of the directors hence, there is no direct threat to the powers of the board.

But there are some policy implications of this as well. The company can be questioned about the appropriateness or legality of shareholders to represent the company. Because of the peculiar position of the shareholders, it is almost impossible for them to remain absolutely independent or impassive on deciding whether or not to ratify the wrong done. This is because shareholders have invested money in the company and hence the decision to ratify has direct economic impact on them. There can be conflict of interests for them. For example: there might

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[31] L. S. Sealy, "The Director as Trustee" [1967] C.L.J. 83.
[32] *Salomon v. Salomon & Co. Ltd.* [1897] A.C. 22.
[33] Winkworth v. Baron Developments [1986] 1 W.L.R. 1512 and see D. Prentice, "Creditors' Interests and Directors' Duties" 10 O.J.L.S. 265.
[34] *Percival v. Wright [1902]* 2 Ch. 421.
[35] *Regal (Hastings) Ltd v. Gulliver* [1967] 2 A.C. 134n, 150.
[36] *Id.*

be situations where the board of directors authorised some act or entered into a transaction which is outside the memorandum of articles but it is beneficial to the company and the shareholders are paid full dividend out of the capital of the economy.

The UK Supreme Court in *Prest v. Petrodel Resources Ltd*. reinforced this tripartite relationship, emphasizing that shareholder's interests don't automatically align with company interest. This creates tension when ratification decisions potentially benefit shareholders but harm the company.

II. Business Judgement Rule

Business Judgement Rule states that while making business decisions, it is presumed that "*the Directors of a company act in good faith, on an informed basis and in the honest belief that the action is in the best interest of the company.*"[37]

The limitations of this principle were elaborated in the case of *Cede v. Technicolor* where the court held that that the court will not interfere if the director's conduct was "*just, fair and reasonable, according to a reasonable businessman, taking a commercial decision beneficial to the company."* This was also held by the court in the case of *Miheer M. Mafatlal v. Mafatlal Industries.*

It has been well recognized by the Indian courts that the decision-making process of the directors is complex hence, various factors need to be taken in consideration.[38] This has been further substantiated by a circular issued by the Ministry of Corporate Affairs which provides that penal or civil proceedings should not be instituted against independent directors without a cause. [39] This rule directly impacts ratification by creating a presumption of directors' good faith, which shareholders must overcome.

III. Primacy of Stakeholders

"There has been a shift away from the assumption of principle-agent relationship between shareholder and director which has been a result of business judgement."[40] Fiduciary duty is also owed to creditors, employees, customers and third parties relatives of the company. There

[37] A. Ramaiya, Guide to the Companies Act (18th edn, LexisNexis, 2015) at p. 4007
[38] Tata Consultancy Services Ltd. v. Cyrus Investments Pvt. Ltd. and Ors., (2021) 9 SCC 449.
[39] Ministry of Corporate Affairs, Clarification on Prosecutions filed or internal adjudication proceedings initiated against Independent Directors, non-promoters and non- KMP, Mar. 02, 2020, https://www.mca.gov.in/Ministry/pdf/Circular_03032020.pdf.
[40] Maliki Mukherjee, "Incorporating Shareholder Ratification in the Companies Act, 2013: Relevance for Corporate Group" Journal on Corporate Affairs and Governance.

is a "*nexus of contracts*" between the company and other participants who are the stakeholders.[41]

Realising the growing significance of stakeholders primacy, there has been a shift from shareholders primacy to stakeholders primacy in India with the introduction of Section 166(2) in 2013. Hence, a director working within the framework of Companies Act, 2013 particularly Section 166(2) has a duty to act in good faith for the interests of the company and all the stakeholders.[42]

IV. Notion of 'vote' as a 'piece of property'

The notion that shareholders hold their votes as a piece of property was highlighted in the case of *North-West Transportation v. Beatty.* The privy council held that, "*every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject matter opposed to, or different from, the general or particular interests of the company*."

Hence, the shareholders of the company generally don't owe obligations to one another. On this basis of the principle, a shareholder can ratify a wrong which they committed in another capacity, such as a breach of duty as a director.

These challenges are interconnected through their common theme: the evolution from a shareholder-centric to a stakeholder-inclusive model of corporate governance. The separate legal personality ensures independence from pure shareholder interests; the business judgment rule protects director autonomy; stakeholder primacy broadens the scope of responsibilities; and the reconceptualization of voting rights reflects growing recognition of corporate social responsibility. Together, these challenges necessitate a modernized approach to shareholder ratification that balances traditional shareholder rights with broader stakeholder interests.

[41] Frank H Easterbrook & Daniel R Fischel, The Economic Structure Of Corporate Law (1991).
[42] Mihir Naniwadekar and Umakanth Varottil, 'The Stakeholder Approach towards Directors' Duties under Indian Company Law: A Comparative Analysis', in Mahendra Pal Singh (Ed.), The Indian Yearbook of Comparative Law 2016 (Oxford Academic 2019).

CONCLUSION

In India, there has been a notable move away from viewing shareholders and directors as having a principal-agent relationship. Since this relationship doesn't exist, combined with the lack of direct contractual ties, shareholders are essentially seen as outsiders when ratifying any improper actions taken by directors.

On one side, this setup enables shareholders to hold directors accountable for their decisions, encouraging corporate democracy and improving oversight. However, without proper safeguards, shareholder ratification could be exploited to shield directors from liability, weakening the core principles of accountability and transparency that are essential for good governance.

The Companies Act, 2013 does not provide a clear definition of this doctrine, and judicial precedents remain underdeveloped. However, the Act does include well-defined provisions regarding directors' fiduciary duties and the significance of the Memorandum and Articles of Association. Therefore, introducing a provision for shareholder ratification is essential.

Safeguards must be implemented to protect minority shareholders from oppressive practices, and transparency must be prioritized in the ratification process. Additionally, shareholder engagement and awareness need to be enhanced to ensure that ratification decisions are informed and in the best interest of the company.