



IMPACT OF WADIA CASE ON GOOD CORPORATE GOVERNANCE IN CORPORATE SECTOR

By *Khadija Fatma*
From Faculty of Law, AMU, Aligarh

ABSTRACT

The research paper investigates the recent case of the corporate governance in Wadia Group. It covers the consequences of non-disclosure, hiding material information and its impacts on the corporate governance and share prices. The paper analyses the impact of Wadia case on the good governance in corporate sector. The study demonstrates disclosure requirements to SEBI from time to time is a pre-requisite for good corporate governance.

INTRODUCTION

To benefit one ownself is the prime concern when an individual carries on business. In the course of business though he might have professional terms and relationship with several others but the duty towards such individuals is only to the extent of his specific contracts that he may have signed with them. The duty of the business manager changes in the higher forms of business organizations, such as in case of a partnership firm the partners owe duty towards each other. And if a master hires an agent and takes his services he owes duty towards his agent and is also liable for his acts done during the course of his employment.

The association of several individuals working for common purpose, and being the

most evolved form of business organisation is called Corporation. *Berle and Means* have classified this form of business organisation as different from other businesses as “there is separation of control from ownership.”

In the Corporation, Company Directors are the controllers or managers of the business while at the same time Stockholders are the virtual owners. The Company directors are the fiduciaries that carry the business solely for the interest of the corporation’s stockholders. The position has been laid down in a number of authoritative decisions. In *Ferguson v Wilson*¹, Turner and Cairns, L.J., pointed out that “the directors are agents of the Company. The Company cannot itself act in its own person, for it has no person; it can only act through Directors and the case is, as regards the directors merely the ordinary case of principal and agent, for whenever an agent is liable the directors would be liable.”

In some sense and to some extent, the directors are no doubt in the position of trustees. In *York and North Midland Ry. Co. v Hudson*², Roulmilly, M.R. observed: “Directors are persons selected to manage the affairs of the company for the benefit of the shareholders. It is an office of trust, which if they undertake, it is their duty to perform fully and entirely.”

Although company directors are not strictly speaking trustees, they are in a closely analogous position because of the fiduciary duties which they owe to the company: **Bairstow v Queens Moat**

¹ *Ferguson v Wilson* (1866) 2 LR 77(Ch)

² *York and North Midland Ry. Co. v Hudson* (1845) 22 LJ 529(Ch)



Houses plc³, in particular they are treated as trustees as respects the assets of the company which come into their hands or under their control; Per Nourse LJ in re Duckwari plc⁴. Similarly a person entrusted with another person's money for a specific purpose has fiduciary duties to the other person in respect of the use to which those moneys are put.”

A significant role is in all case i.e., whether assuming position of director is of agent or trustee is played by Directors in a Company in ensuring that there is good corporate governance. This paper aims to consider the impact of Wadia group case on the good governance in corporate sector and also how does non-disclosure of material facts impact the market price of the share?

RESEARCH METHODOLOGY

The research methodology chosen is case study method. Taken to be as a single unit the case of Wadia Group identify the causal relationship between non-compliance of corporate governance rules and the resultant impact on the market price of the share. The contribution of this paper enriches both the understanding of prominent role of disclosure requirements and the cause-effect relationship of Wadia Case on good governance in corporate sector. Ultimately, the case study helps the firms and industry to abide by the corporate governance rules in order to have good governance in corporate sector.

CORPORATE GOVERNANCE

Corporate governance involves a set of relationships between a company's

management, its board, its shareholders and other stakeholders, laying down the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined⁵.

The Cadbury Report has provided the meaning of corporate governance as 'system by which companies are directed and controlled', in circumstances where the corporates are required to adopt the corporate governance practices with utmost precision and pursue the principle of abide by or explain as a result of which the relationship between the managers and the shareholders is improved. Companies are directed and controlled by the structures and processes which is called Corporate Governance. To help companies to operate more competently, ameliorate access to capital, mitigate risk, and safeguard against mishandling is some of the key elements which are the result of Good Corporate Governance. Corporate governance provides the tools to respond to stakeholders concerns by making companies more accountable and transparent to investors and thus contributes

to development. The uplift in economic growth, providing of employment opportunities and encouragement to new investment is the result of increased access to capital. Corporate governance is directed more toward promoting corporate fairness which as a result ensures sufficient disclosures and efficacious decision making to attain corporate objectives, transparency in business transaction, constitutional and

³ Bairstow v. Queens Moat Houses plc (2001) 2 BCLC

⁴ 501,5484. Re Duckwari plc. (No. 2) (1999) Ch 253.262

⁵ (OECD 2015)



legal compliances, protection of shareholders' interests, commitment of values and ethical conduct of business. The purpose of corporate governance is to facilitate efficacious, entrepreneurial and prudent management that can deliver the long-term success of the company. Corporate governance is also a set of relationship between company management.

ONTOLOGICAL DIMENSION

The Board of Directors is typically central to Corporate governance which is most often viewed as both the structure and the relationships which determine corporate direction and performance. Its relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors. The corporate governance framework also depends on the legal, regulatory, institutional and ethical environment of the community. It provides clear guidance on how authority is exercised within the group.

Reason to existence

Corporate governance being of uppermost importance to a company is almost as important as its primary business plan. On being executed effectively, it can prevent corporate scandals, fraud and other civil and criminal liability of the Company, magnify a company's image in the public eye as a self policing company being responsible and worthy of shareholder and debt holder capital. It dictates the shared philosophy, practices and culture of an organization and its employees. A corporation without a system of corporate governance is often regarded as a body without a soul or conscience. Corporate governance keeps a

company honest and out of trouble. If this shared philosophy breaks down, then corners will be cut, products will be defective and management will grow complacent and corrupt. The end result is a fall that will occur when gravity - in the form of audited financial reports, criminal investigations and federal probes - finally catches up, bankrupting the company overnight. Dishonest and unethical dealings can cause shareholders to flee out of fear, distrust and disgust.

Good corporate governance

Corporate governance is a term that encompasses much many things and the bottom line for good corporate governance is the dual aim of pursuing profits and at the same time doing so in accountable and lucid manner. Good corporate governance means that the processes of disclosure

and transparency are followed so as to provide regulators and shareholders as well as the general public with precise and accurate information about the financial, operational and other aspects of the company. Four pillars of Good corporate governance are accountability, independence, fairness and transparency.

Challenges of good corporate governance

The main problem with corporate governance is that it doesn't stand alone; regard being had to the fact that it has to work in conjunction with a company's expedition and values statement to give directors and stakeholders a clear guide about how they should behave. Friction and discord among board members or senior executives, failure by board of director to understand the risks their firm is taking, boards allowing the transactions that



benefits few at the expenses of many, weak internal control system, internal or external audit failure, short term thinking, unnecessarily tall organization structures, political intrusion at board level in making decisions are some of the challenges of good corporate governance.⁶ Listing some of the major challenges faced in the good corporate governance:-

1. ***Conflict of Interests***- It occurs within the framework of corporate governance when an officer or other controlling members of corporation has other financial interests that directly conflict with the objectives of the corporation. Basically the conflicts of interest deteriorate the trust of shareholders and the public while making corporation vulnerable to litigation.
2. ***Ineffective leadership of chairman***
3. ***Poor Composition of Board***
4. ***Ill defined roles and responsibilities***, if not might led to conflict between executive management and board.
5. ***Inappropriate size of board i.e.,*** neither should be too large which ultimately going to affect cost, cost might increase nor too small.
6. ***Low level of integrity of management***
7. ***Ineffective Communication***⁷

CASE STUDY

Ness Wadia, son of industrialist Nusli Wadia an heir to the 283-year-old Wadia Group and the co- owner of the Kings XI Punjab Cricket Team is presently serving on the Boards of eleven companies including Britannia, a giant food company having a market share of over 30%, Bombay Dyeing and Bombay Burmah Trading Corporation Ltd.

At New Chitose Airport in the Northern Japanese Island of Hokkaido The Customs officials arrested Ness Wadia for keeping 25 grams of Cannabis resin in his trouser pocket in early March 2019. His two-year imprisonment which was awarded by The Sapporo district court in Japan has been suspended for five years. As per regulation 30 of SEBI (LODR), 2015 the respective companies have not provided the information about the arrest of Director of the Company to the SEBI. This act of non-disclosure on the part of the company forced SEBI to take action. There was an evident fall in the company's stocks, the moment the news of the arrest of the company's director came to the knowledge of stakeholders via social media, newspapers and television. It was required to report their earnings and other business performance measures by all publicly traded companies. In case of Britannia Industries in spite of good Q4 report of the fiscal year the market share price fell below the usual prices i.e., from Rs. 2,974 on 30 April, 2019, the stock saw consistent decline in the week the news surfaced on media platforms at Rs. 2,650 on 7 May, 2019. Stock dropped by 10.69% in a week. The primary factors that affect the share price of any company are several usual economic conditions such as inflation, deflation, introduction of new policies by the government, liquidity etc. However, gradually non-economic factors such as the political stability, society's requirements and sentiments of investors have become equally significant. In the present study moral conduct of the director of the company affected the market share price even though as per the legal provisions he could not be disqualified as the director

⁶

<https://www.researchgate.net/publication/341510585>

A Glance to Corporate Governance Concept and Practices



since the sentence was not confirmed and suspended for another five years. The question is can moral turpitude be considered as a reason for resignation or removal of director from a company? To answer this question reference can be made to the two most relevant provisions under the Company Act, 2013 one section 164 and the other section 167. Under the Act moral turpitude is specifically defined. Therefore, under the Act a person acting as director will continue to discharge his duties as director of the company if a situation does not fit into the criteria given and this is where the role of Corporate Governance becomes relevant. Due to non-disclosure of 'material information' the sentiments of the investors were affected even though everything is within legal framework.

CORPORATE GOVERNANCE ISSUE

To ensure the basic corporate governance norms is fulfilled is the responsibility of the Company's Board. It is required that the Board asks itself whether any of its acts or omissions is in the interest of the company or not. Every action of the Board must be in compliance with the Doctrine's basic rules as per the proper purpose doctrine that helps to determine the duties of directors. In the present case it was not. The non-compliance with the SEBI disclosure requirements was another important corporate governance issue in the present case. It is required that a company has to report any fraud, default by promoter or arrest of key managerial persons or promoters as it is a material event according to SEBI's listing obligations and disclosure requirements (LODR). The arrest of promoter here was a material event and that was to be disclosed to the stock exchanges. Britannia did not do that.

Provisions under the SEBI (LODR), 2015 regulations --

There are several provisions that specifically require the board of directors to fulfil certain statutory duties, viz., regulation 4(f)(i)(2) requires the board of directors and senior management to conduct themselves in such a way that operational transparency is maintained for the benefit of stakeholders. Another clause of the same regulation (f)(iii)(1) states that the board of directors shall be accountable to the listed entity and the shareholders.

Regulation 30 states that the listed company is required to make disclosures of any event or information, which is material information. The regulation also defines the criteria to determine the materiality of the event or information by stating that all events and information that are likely to result in discontinuity or alteration of event or information already available publicly; or the omission of such an event or information is likely to result in significant market reaction if the said omission came to light at a later date. Schedule III, Part A (6), states that any default or arrest of promoter would also constitute material event or information that is required to be disclosed.

CONCLUSION AND SUGGESTION

On the non-disclosure of the information most of the cases are related to the financial fraud or lead to insider trading. As it deals with moral grounds this case has been discussed: It is a case based on hiding or not disclosing information relating to the arrest of the key managerial personnel. As against the general perception the case highlighted that corporate governance is not just about financial governance of the corporation.



This case is an insight to the understanding of the impact of moral turpitude where the sentence of imprisonment has been postponed and this information led to decline in market price of the shares, thus the instant case is an interesting study as it is different from previous cases being of Corporate governance that has been related to insider trading or financial scams.

Referring to *Black's Law Dictionary*⁷ the term '*moral turpitude*' can be understood as '*conduct that is contrary to justice, honesty, or morality*'. Explaining the same: "*Moral turpitude* is more often a departure from ordinary standards of honest, good morals, justice or ethics which is shamefully wicked and shocking to the moral sense of the community." More broadly defined as an act of baseness, vileness or depravity in the private and social duties which one person owes to another or to society in general, contrary to what is accepted and customary rule of duty and right between people. Thus it cannot be left at the discretion of the courts especially when the case is of corporate governance issues to determine as to what constitute immoral behaviour on the part of key managerial personnel or on the part of Company directors. Regard being had to provision contained under **Section 164 of the Companies Act, 2013**, which, inter alia, provides that a director whose conviction has been recorded by a criminal court for an offence involving moral turpitude and in respect of which imprisonment imposed is not less than six months.

In the instant case the sentence was suspended and the conviction postponed. Therefore, no move could be taken against the director under section 164 of the Companies Act, 2013. However, the discussion on the disclosure requirements and the facts of the case which clearly indicate a downfall in the market share price of the concerned company helps in concluding that the non-disclosure of the fact of arrest of the director of the company was a material information that was required to be shared with the respective stock exchanges where the company's shares were listed and also to the capital market regulator- SEBI. It was a violation of regulation 30 of the SEBI (LODR) Regulations, 2015.⁸

8 key effective corporate governance practices, suggestion⁹;

- 1.) Governance Frameworks
- 2.) Governance Documentation.
- 3.) Policies in line with law and applicable regulations
- 4.) Documenting processes and procedures
- 5.) Effective board reporting
- 6.) Agenda and minutes
- 7.) Director training and board evaluations
- 8.) Subsidiary governance policies

BIBLIOGRAPHY

L. COMPANY LAW, 2013 [as amended by Companies (Amendment) Act, 2015] by Dr. N.V. Paranjape.

⁷ Black's Law Dictionary, Eighth Edition, by Bryan A. Garner,

⁸

https://www.researchgate.net/publication/341625778_WADIA_CASE_CLJ

⁹ <https://www.pwc.ie/services/human-resource-services/insights/the-eight-key-effective-corporate-governance-practices.html>



-
- 2 Corporate Governance Concept & Dimensions (2003), by S. Aggarwal
 - 3 https://www.researchgate.net/publication/341510585_A_Glance_to_Corporate_Governance_Concept_and_Practices
 - 4 https://www.researchgate.net/publication/341625778_WADIA_CASE_CLJ
 - 5 <https://jmuirandassociates.com/corporate-governance-issues/6>.<https://www.pwc.ie/services/human-resource-services/insights/the-eight-key-effective-corporate-governance-practices.html>

