

is that whether the arrangements being finalised are legally valid. It has also to be considered as to whether rights and obligations can be enforceable legally before the court and if not one has to find out the alternatives to the extent possible. This is where the role of a professional comes into play in the decision making process. All these aspects and roles become more vital and critical when joint venture party is foreigner. Because, to handle laws of multi-countries and to correlate each other, is a challenging task. Restriction on transfer of shares is management and business decision. The role of professional is to test such decision in terms of applicable statutory as well as case laws and to ensure its enforceability to serve the ultimate purpose of a venture.

Necessity for Restriction on Share Transfer

The basic thing that needs to be understood is: why the restriction on transfer of shares? Restrictions are very much required for strategic reasons in commercial sense. If a person alone is doing something, there will be no need to any major understanding. However, when two or more persons come together for a venture, it is necessary to have understanding about the control and rights of management and transfer of the same. Here control means mainly shares and voting powers. Restriction on share transfer is used mainly in Joint Venture Company (JV).

Practically, if anybody is holding more than 10% shares, it enjoys some rights. Prima facie it appears minority holding and it can not block any resolution but a person with 10% holding can approach Company Law Board on the ground of 'operations and mismanagement' in the company and many a time it is difficult to put the business situation before

the authority. Because of these business reasons, involved parties want some kind of restrictions on share transfer e.g. 'First right of refusal' and 'Tag along Right'.

Although parties are ambitious in the beginning, many a time one or more of them may seek to exit the venture for one of the other reason. The purpose of restriction on share transfer is to protect the party who is willing to continue the venture, as well as to have some understanding in advance to meet the contingency which may arise in between.

If any JV partner wants to exit and wants to dispose off its shares, then what about the other partner who wants to continue, and what is more important, is 'what about the new incoming partner' and whether existing operations or a project of JV company can be continued smoothly with new shareholders. The very purpose of share transfer restrictions is to meet such kind of contingencies. Purpose of share transfer restrictions is to protect interest of the parties who are continuing in the JV and overall to set a mechanism in advance to avoid any business and management deadlock. Restrictions are agreed through shareholders agreement which is further incorporated in Articles of Association of the Company (the Articles).

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In case of a private company, restrictions on share transfer can be agreed between the shareholders and further incorporated in Articles of the private company and accordingly binding to all the shareholders and the private company. Private company is most preferable vehicle for Joint Venture. In this, Articles' authors focus on restriction on transfer of shares in a public company registered under the Companies Act 1956.

Statutory Provisions and Judicial Precedents

Two important things that should be taken note of at this point are: (1) back-to-back decisions of Bombay High Court in the case *Bajaj Auto Ltd.* and *Messers Holing*, and (2) Companies Bill 2009.

For better understanding, we should have quick view about the relevant sections of the Companies Act 1956 (the "Act"). Section 3 of the Act requires and enables a private company *inter alia* for restriction on transfer of shares. Section 9 of the Act stipulates that the provisions of the Act shall have effect, notwithstanding anything to the contrary contained in the Memorandum or Articles of Association or Resolution or any Agreement.

Section 111A of the Act is more relevant for the subject matter and it is perhaps most significant unresolved controversy in Indian Corporate Laws. In 1996, The Depositories Act was enacted which omitted Section 22A of the Securities Contract Regulation Act 1956 and simultaneously added Section 111A to the Act.

In a recent decision of division bench of Bombay High Court in the case of *Messers Holding*, it was held that private arrangement between the shareholders conferring the right of first refusal means restriction on transfer of shares, is valid and not contrary

to the Section 111A. However, the decision is not conclusive for corporate world and some questions are yet to be answered. To get into the subject, it is useful to have a vivid picture and close analysis of following five decisions by Supreme Court and different High Courts.

1. *VB Rangaraj vs. VB Gopalkrishnan* (1992) 1 SCC 160, a decision by the Supreme Court.
2. *Mafatalal Industries Ltd vs. Gujarat Gas Co Ltd* (1997), a decision of Gujarat High Court.
3. *M.S.Madhusoodhanan Vs. Kerala Kaumudi Pvt. Ltd* 2003 Vol.117 Company Cases 19, a decision by the Supreme Court of India.
4. Twin judgements of Bombay High Court in the case of *WMDCL vs. Bajaj Auto Ltd*, dated February 15, 2010 and *Messers Holding Ltd vs. Shyam Madanmohan Ruia & Others*, decided on 1st September, 2010).

It is very important to identify what exactly these decisions hold and how are they relevant to each other and for a public company. It is also necessary to consider the legislative history of Section 111A of the Act and the position of transferability of share in common law.

VB Rangaraj vs. VB Gopalkrishnan (1992) 1 Scc 160

We should begin with the decision of Supreme Court in the Case of *V B Rangraj*. In this case shareholders of a private limited company were two branches of a family and it was agreed orally in 1951, i.e. in the backdrop of Independence and partition, that the proportion of the shareholding of respective branches would not change, and further agreed that for this purpose, if any member of a branch wants to sell his shares

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he/she must first offer the share to his own branch. The crux in this case is the oral agreement about restriction was not incorporate in Articles. Referring its own earlier relevant decision in *Kalinga Tubes*, the Supreme Court held that the shares are “freely transferable” and that a private agreement imposing restriction on transfer of shares which is not stipulated in Articles of association is neither binding to the Company nor to shareholders. It means such kind of agreement is void in toto. One thing very clearly established in this case is any restriction on share transfer must be incorporated in the Articles of the Company otherwise it will not have any effect and aggrieved shareholder cannot have any legal remedy against violation of such restrictive provisions of agreement or understanding.

The later part of the decision – that it does not bind the company is not new and is an accepted English Rule. However, that it does not bind the shareholders, was something strange to Indian Law.

Mafatalal Industries Ltd. vs. Gujarat Gas Co. Ltd (1997) – Gujarat High Court

The decision of Gujarat High Court in the case of *Mafatalal Industries* in 1997 is another important precedent

relating to the subject matter. This was the case relevant to a public limited company. In this case a shareholder disposed the 3.87% share holding in the open market in violation of the agreed terms. It was very interestingly and rightly argued that “free transferability” refers to absence of restriction which may be imposed by the third parties, but it cannot exclude the right of a shareholder to impose restrictions on himself in the matter of transfer of shares to another person. This argument was rejected by the then judge Mr. Shah who pointed out that ratio laid down in the case of *V B Rangara* by the apex court is having much greater force and can be applied to public company also. This decision had changed the whole scenario for public company.

M. S. Madhusoodhanan vs. Kerala Kaumudi Pvt. Ltd 2003 Vol.117 Company Cases 19

The case of *Madhusoodhanan* was decided by Supreme Court in the year of 2002. This was also in reference to a private limited company. This case arose out of a complex family dispute in Kerala and specifically out of a karar/ agreement that provided that “there would be no change in the existing share structure among the family” of the private limited company. It further provided that the shares of two members would pass to Madhusoodanan in a certain percentage on their death. The facts of the case were to some extent similar to the case of Rangaraj. However, the Court had a different view and distinguished Rangara and Kaling tubes case and held that this restriction was not on a share as a class but on specific, identified shares between specific and identified members to which the company need not be a party.

Western Maharashtra Development Corporation Limited vs. Bajaj Auto Limited – February 2010 – Bombay High Court

The twin important judgements of Bombay High court in the Case of *Bajaj Auto Ltd* decided in February 2010 and the case of *Messers Holding* decided in September 2010 need to be specially taken note of.

In the *Bajaj Auto*, in the year 1974, Western Maharashtra Development Corporation Limited and Bajaj Auto Limited entered into an agreement to incorporate a JV company named Maharashtra Scooters Limited (MSL) and accordingly the Company was incorporated under the Companies Act as a Public Company. The share of the Company are listed on the BSE and NSE. Western Maharashtra Development Corporation held 27%, Bajaj Auto held 24% and public holding is 49%. In this case there is a Protocol Agreement dated 2nd October, 1994 ("Agreement") between the two promoter shareholders restricting transfer of their respective shares which is also incorporated in the Articles of Association. As per the Agreement, if either of the parties desires to sell its shares, such party shall give the first offer to purchase the share to other party at such price as may be agreed. If within 30 days of such intention, the party agrees to purchase the shares then the selling party is bound to sell the shares. If the other party is willing to purchase the shares, however, the proposed price is not acceptable to it; the question of the price should be referred to arbitration.

Later, the Petitioner wanted to dispose of its holding and accordingly offered the shares to the Bajaj Auto at a price of ₹ 232.20 per share which was not acceptable to it. In terms of the Agreement the issue to determine price was referred to the sole arbitrator. The

arbitrator after considering the matter through arbitration award directed to sell share to Bajaj Auto at a price of ₹151.63 per share. Aggrieved, the petitioner filed an application before the Hon'ble Bombay High Court.

The Petitioner *inter alia* argued that the Agreement regulating transfer of shares was illegal and void on the ground that (a) the Agreement was a forward contract prohibited by the Securities Contract Regulation Act; and (b) The agreement contained restrictions on the transferability of the shares of MSL which were violative of the provisions of Section 111A read with Section 9 of the Companies' Act, 1956 and hence void. The Petitioner contended that in terms of Section 111A of the Companies

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Act 1956, which provides for 'free transferability of shares' in a public company, the agreement providing for restrictions on share transfer and restrictions embodied in Articles of Association was illegal and, therefore, any determination there under and arbitral award was void. Section 34 of the Arbitration and Conciliation Act 1996 provides for setting aside an arbitration award in some circumstances. It defines the parameters of recourse to a Court against an arbitral award. Section 28(1) (a) mandates that the arbitral tribunal must decide the dispute in accordance with the substantive law in India. In the case of *ONGC vs. Saw Pipes*, the Supreme Court held that if an award is in contravention of the provisions of any Act, it is subject to judicial intervention and can be set aside.

From other side in response, the counter argument of Bajaj Auto/Respondent was that the restriction imposed by the agreement was valid because it did not bind all shareholders, but only two shareholders in a specific contingency. The restriction has also been incorporated in the Articles of Association of the Company. Based on decision in the case of *Madhoosudhanam*, It was further argued that Section 111A of the Act does not prohibit restriction on transferability when agreed between specific shareholders regarding specific shares.

Single Judge of the Bombay High Court held that the principle of free transferability must be given a broad dimension in order to fulfill the object of the law. The word "transferable" is of the widest possible import and Parliament by using the expression "freely transferable", has reinforced the legislative intent of allowing transfers of shares of public companies in a free and efficient domain. The Court further held that the Agreement and provision

in Articles of Association restricting the transfer shares is violative of Section 111A read with Section 9 of the Companies Act and, therefore, it is void and accordingly the award is contrary to substantive provisions of law and is patently illegal.

Messers Holding Limited vs. Shyam Madanmohan Ruia and Others (September 2010) – Bombay High Court

The latest and most important decision of the division bench of the Bombay High Court in the case of Messers Holding decided in September 2010 has changed the way to negotiate share transfer restrictions in a public company. The decision by the single judge in Bajaj Auto case that restriction on transfer of shares in a public company is contrary to Section 111A of the Act, has been now overruled to some extent by the division bench in the case of Messers Holding by declaring that Section 111A is not a law dealing with the right of the shareholders to enter into consensual arrangement/agreement by way of pledge, preemption/sale or otherwise and accordingly such agreement

in relation to the specific shares can be enforced like any other agreement. That does not impede the free transferability of shares in a public company at all.

The facts in brief, Bombay Oxygen Ltd as defendant no. 2 company was listed on BSE. Messers Holding was the major shareholder of the Company. It entered into agreement dated 23rd June 23, 1997 where under the German company was to acquire shares and management of the company and provide some technology to the company. It was condition in the agreement that if either party want to sell its share then first offer should be made to other party except for some situations as provided in the agreement. In this case, the arguments were (a) the agreement was void because of fraud and misrepresentation (b) the agreement was void because it was in violation of SEBI rules and regulation and (c) the agreement was void as it restricted free transferability in terms of Section 111A of the Companies Act and recent decision of Bombay High Court in the case of Bajaj Auto.

For the first time the Court went into legislative history of Section 111A of the Act. It was observed that in 1986 Section 22A was introduced in Security Contract Regulation Act 1956. It provides free transferability of shares in a registered company. However, a Company can refuse transfer of shares on four specified grounds. The section was introduced in the backdrop of series of complaints regarding arbitrary power exercised by the board of directors in refusing or non-consideration of request for transfer and transmission of shares. The Court noted that suffice and observed that the intention behind introducing Section 22 A in 1986 was to regulate the right of the Board of Directors to refuse transfer of members share and it

was not to impose restriction on the right of shareholder to deal with his shares by entering into consensual arrangement with the third party to which the company need not be a party.

Section 22A was deleted by Depositories Act 1996 and at the same time Section 111A of the Companies Act came into picture. The proviso to sub-section (2) reinforces the position that Section 111 A is to regulate the powers of the Board of Directors of the company regarding transfer of shares or debentures and any interest therein of a company. The Board of Directors cannot refuse to register transfer of shares unless there is sufficient cause to do so.

The expression “freely transferable” therein is in the context of the mandate against the Board of Directors to register the transfer of specified shares of the members in the name of the transferee, unless there is sufficient cause for not doing so. The said provision cannot be construed to mean that it also intends to take away the right of the shareholder to enter into consensual arrangement/agreement with the purchaser of their specific shares.

If the legislature intended to take away that right of the shareholder, it would have made an express provision in that regard. Reliance has been rightly placed on the decision of the Apex Court in the case of *Byram Pestonji Gariwala vs. Union Bank of India (1992) 1 SCC*, which takes the view that the freedom of contract generally, the legislature does not interfere except when warranted by public policy, and the “legislative intent is expressly made manifest”. That means it is open to the shareholders to enter into consensual agreements which are not in conflict with the Articles of Association, the Act and the Rules, in relation to the specific shares held by them; and such

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It is pertinent to note that in the case of Messers Holding, the Bombay High

Court has decided the issue in context of shareholders inter se and not shareholders and a Company. The Court kept Company aside by holding that "... shareholders inter se to which company is not a party..." The effect of the decision is that an agreement between shareholders restricting transfer of shares in a public company is a valid agreement and not repugnant to Section 111A of the Act. It signifies that such restrictions in joint venture agreement will remain only as contractual between the shareholders.

agreement can be enforced like any other agreement. That does not impede the free transferability of shares at all. Further, such consensual agreements between particular shareholders relating to their shares can be enforced like any other agreements. It is not required to be embodied in the Articles of Association.'

In respect to the Section 9 of the Act, the Court noted that Clause (a) thereof, which refers to any agreement executed, is in respect of an agreement executed by the company; and not by the shareholder with third party which is a private agreement to which the company is not a party.

As aforesaid, Section 111A is not a law dealing with the right of the shareholders to enter into consensual arrangement/agreement by way of pledge, preemption/sale or otherwise. If that right is not covered by Section 111 A of the Act as has been found by us, then consensual arrangement/agreement between shareholder

and third party or shareholders inter se to which company is not a party, Section 9 of the Act will not come into play at all. Thus, the expression "freely transferable" in Section 111A does not mean that the shareholder cannot enter into consensual arrangement/agreement with the third party in relation to his specific shares. If the company wants to even prohibit that right of the shareholders, it may have to provide for an express condition in the Articles of Association or in the Act and Rules, as the case may be, on that behalf. The legal provision as obtained in the form of Section 111 A of the Companies Act does not expressly restrict or take away the right of shareholders to enter into consensual arrangement/agreement in respect of shares held by him.

Viewing the decision of Bombay High Court in the case of Messer Holding, as of now it can be concluded that agreements between particular shareholders relating to and regulating transfer of their shares in a public company can be enforced like any other agreements and it does not impede the free transferability of shares in terms of Section 111A of the Act. Further it is not required to be embodied in the Articles of Association.

Position after Messers Holding Case

It is pertinent to note that in the case of Messers Holding, the Bombay High Court has decided the issue in context of *shareholders inter se and not shareholders and a Company*. The Court kept Company aside by holding that "... *shareholders inter se to which company is not a party...*". The effect of the decision is that an agreement between shareholders restricting transfer of shares in a public company is a valid agreement and not repugnant to Section 111A of the Act. It

signifies that such restrictions in joint venture agreement will remain only as contractual between the shareholders. This implies that they can find only place in agreement but not in Articles of a public company and accordingly its binding to the shareholders and not the Company. In case of violation of such agreement, aggrieved shareholder has to resort lengthy civil jurisdiction.

After the Messers Holding's judgment, the fundamental difference between private and public company as far as share transfer restrictions are concerned remained the same. In case of private company, restrictions are contractual as well as constitutional provisions as provided in Articles and hence binding and enforceable against all the shareholders and the private company. However the same will not be case for a public company.

The decision in the case of Messers Holding provided some relief to shareholders of a public company. However, it has not resolved issues and concerns of corporates and joint venture

In the backdrop of the twin judgements of the Bombay High Court – Bajaj

Auto and Messers Holding, the Companies Bill 2009 should make clear provisions recognising the restriction on share transfer in a public company considering present requirement of business in the form of Joint Venture Company. Until the restrictions on share transfer legally finds place in the corporate laws, the possible way is to have well pre-defined arbitration mechanism in the shareholders agreement.

