

***RESTRICTION ON TRANSFER OF SHARES –  
CONFLICTING DECISIONS, CHALLENGE FOR  
LAWYERS***



**SINGHANIA & PARTNERS<sub>LLP</sub>**  
SOLICITORS AND ADVOCATES

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## ISSUES

- ❖ Restriction on transfer – private vis-à-vis public?
- ❖ Whether restriction on transfer of shares valid?
- ❖ Whether restrictions should be incorporated in Articles?
- ❖ Remedy available in case the restrictions enumerated in shareholders agreement are contravened?

## **STATUTORY PROVISIONS – CA 1956**

### Section 3 (iii)

Private Company means a company:-

- Minimum paid up capital of Rs. 1 lakhs
- Restricts the right to transfer its shares by Articles
- Limits the number of members to 50
- Prohibits any invitation to public to subscribe to its shares/debentures
- Prohibits any deposit

# STATUTORY PROVISIONS

## Section 3 (iv)

Public company means a company which:

- is not a private company.
- is a private company which is a subsidiary of a company other than a private company

# STATUTORY PROVISIONS

## Section 9

- The provisions of the Act shall have effect notwithstanding anything contained in the MOA, AOA or in any agreement executed or any resolution passed by the company ;
- Any provision of MOA, AOA or agreement or resolution shall to the extent repugnant to the Act be void.

# **STATUTORY PROVISIONS**

## **Section 82**

The shares or other interest in a company (both pvt. and public) shall be:-

- Movable property
- Transferable in the manner provided by the AOA.

# STATUTORY PROVISIONS

## Section 111 (Private Company)

- The company has the power to refuse to register the transfer of shares if in contravention of AOA or otherwise.
- The transferor or transferee may appeal against the refusal to register the transfer in CLB.

## **STATUTORY PROVISIONS**

### **Section 111 A (Public Company)**

- The shares or debentures and any interest therein of a company shall be freely transferrable.
- If company without sufficient cause refuses to register the transfer, the transferee may appeal to CLB against refusal to register the transfer.

# JUDICIAL PRECEDENTS

## S. P. Jain Vs Kalinga Tubes (14.01.1965) - SC

### Issue

Whether an agreement between shareholders and an outsider for issuance of shares binding on the company even if the terms of agreement has not been incorporated in AOA?

### Brief Facts

- Agreement between two shareholders and an outsider that shares would be issued to outsider (Jain) whenever the company (private) would increase its share capital.
- Agreement was acted upon by parties in few instances, as some shares were issued to Jain.

## S. P. Jain Vs Kalinga Tubes (14.01.1965) - SC

### Brief Facts

- However, company was not a party to agreement neither terms were in AOA.
- The company was later on converted into public company. Further, shares were issued but Jain was not allotted any shares.
- Jain filed a suit on the ground of oppression and mismanagement.

## S. P. Jain Vs Kalinga Tubes (14.01.1965) - SC

### SC Observations

- Company was not a party to the agreement.
- The terms of the agreement were not incorporated in AOA and therefore, the company was not bound by the agreement.
- The company acted in terms of AOA and Act and therefore, no case of oppression and mismanagement was made out.

## V. B. Rangaraj Vs V. B. Gopalkrishnan (28-11-1991) - SC

### Issue

Whether the shareholders can enter into an agreement which is inconsistent with AOA?

### Brief Facts

- The shares of a private company were held by two brothers.
- Agreement between brothers that each branch of the family would hold equal number of shares.
- If any member of the branch wished to sell its share, first option to purchase was to be given to member of that branch.

## V. B. Rangaraj Vs V. B. Gopalkrishnan (28-11-1991) - SC

### Brief Facts

- The agreement was not incorporated in AOA.
- One of the member sold the shares in contravention of agreement.

### Contention of Defendant

- Restriction was not envisaged by AOA - not binding on shareholders or a vendee of the shares
- It was unenforceable at law – not binding on the company

## V. B. Rangaraj Vs V. B. Gopalkrishnan (28-11-1991) - SC

### SC Observations

- Act makes it clear that AOA is binding on company and shareholders and transfer of shares is regulated by AOA;
- The only restriction on transfer of shares are one contained in AOA;
- Restrictions not specified in AOA is neither binding on company nor on the shareholders;
- Vendee cannot be denied registration except for grounds in AOA.

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### Issue

Whether an agreement for pre-emption can be enforced in view of the concept of free transferability of shares.

### Brief Facts

- Mafatlal was shareholder in a public limited company and transferred some of its shares in the company to Jardine Fleming;
- Jardine Fleming agreed that in case Jardine sells its shares in company, ROFR would be given to Mafatlal;

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### Brief Facts

- This agreement was not incorporated in the AOA;
- Jardine sold its shares in company without giving ROFR to Mafatlal.
- Mafatlal filed a suit for specific relief and interim injunction

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### Contention of Jardine

- Relied on Rangaraj case - Section 82 and 111A mandates that shares are freely transferrable and no restriction is sustainable except the one provided in AOA;
- Section 82 and 111A are not made subject to a contract to contrary
- AOA do not incorporate the agreement between the shareholders.

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### Contention of Mafatlal

- Rangaraj is applicable to private companies
- Free transferability of shares refers to absence of restriction imposed by third parties; cannot exclude right of shareholder to impose restriction on himself.
- Shanti Prasad case only held that agreement between shareholders for issuance of shares cannot bind company unless such agreement was incorporated in AOA.

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### Contention of Mafatlal

- Shanti Prasad is not a proposition on restriction imposed by shareholder on himself.
- If the Rangaraj case is read in a manner to have the effect of nullifying the restrictions imposed by shareholder on himself, merely because they are not contained in AOA, would have a serious fallout.
- Free transferability of shares does not convert shares into currency notes or bearer bonds.

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### GHC Observations

- The distinction between a private and a public company is that in private company provision of restriction of transfer is contained in AOA whereas AOA of public company cannot contain such restrictions.
- Therefore, ratio of Rangaraj would apply to public companies with a greater force.
- GHC cannot ignore law laid down in Rangaraj. Only a court of co-ordinate jurisdiction can consider whether Rangaraj is per incuriam.

## Mafatlal Industries Vs Gujarat Gas (24-10-1997) - GHC

### GHC Observation

- Therefore, Jardine were free to sell the shares to any party and the agreement not having been incorporated into the AOA, cannot be enforced.

## Madhusoodhanan Vs Kerala Kaumudi (01.08.2003) - SC

### Issue

Whether a suit for specific performance would lie upon contravention of pre-emptive right in family settlement (Karar).

### Brief Facts

➤ There were 9 shareholders (family members) in a private company. 5 shareholders entered into a karar (family settlement) that on the death of the Chairman (also a shareholder) her shares would be divided in ratio of 50:25:25 between the three shareholders. 50% was to be held by Madhu. The Karar was not embodied in AOA.

## Madhusoodhanan Vs Kerala Kaumudi (01.08.2003) - SC

### Brief Facts

- On the death of chairman, the 50% shares were not transferred to Madhu in terms of Karar.
- Madhu filed a suit for specific performance.

### Contention of Defendant

- The defendant relied solely on Rangaraj case to argue that this restriction on transfer of share is in contravention of AOA, therefore, unenforceable both against company and shareholders and no suit for specific relief would lie.

## Madhusoodhanan Vs Kerala Kaumudi (01.08.2003) - SC

### SC Observations

#### *Kalinga Tubes Analyzed*

- The agreement was between two shareholders and an outsider for issue of new shares in company.
- The case of issue of new shares is distinct from transfer of shares as in issue of shares it is the company which issues and allots the shares while in the transfer, company's role is only in recognizing the transferee as new shareholder.
- It is imperative that company should be a party to agreement relating to issue of shares, before such agreement can be enforced. While the company need not be a party for agreement for transfer of shares.

## Madhusoodhanan Vs Kerala Kaumudi (01.08.2003) - SC

### SC Observation

#### *Kalinga Tubes Analyzed*

- Kalinga Tubes does not in any way hold that the transfer of shares agreed to between shareholders inter se does not bind them or cannot be enforced like any other agreement.

## Madhusoodhanan Vs Kerala Kaumudi (01.08.2003) - SC

### SC Observation

#### *Rangaraj Distinguished*

- In Rangaraj case there was a blanket restriction on all the shareholders, present and future. The decision in Rangaraj is entirely distinguishable on facts.
- In the present case, agreement was between particular shareholders relating to transfer of specified shares of deceased chairman, inter se.
- It was not necessary for the company or the other shareholders to be a party of the agreement.

## Madhusoodhanan Vs Kerala Kaumudi (01.08.2003) - SC

### SC Observation

- Holders of shares in a private company may agree to sell his shares to a person of his choice.
- Such agreements are specifically enforceable under Specific Relief Act.
- Generally, Specific Relief does not lie for contract to transfer movable property unless covered by exception to Section 10.
- One such exception is if the property is not easily obtainable in market. Shares of private limited company are not easily obtainable in market . Suit for specific performance would lie.

## Pushpa Katoch Vs Manu Maharani (04.07.2005) - DHC

### Issue

Whether the right of pre-emption was breached by transferring the shares to outsiders.

### Brief Facts

- Memorandum of family agreement was entered into between 4 sisters. Any sister could only dispose of her shares in the company (public) after offering it first to the other sisters.
- However, the three sisters in contravention of family agreement sold their shares in the company without informing the fourth sister.

## Pushpa Katoch Vs Manu Maharani (04.07.2005) - DHC

### Brief Facts

- The fourth sister filed an application before CLB under Section 397/398. CLB dismissed the application.
- CLB order challenged before HC.

### DHC Observation

- There can be no fetters on the right of the shareholders of a public company to transfer his shares.
- Even if the AOA had provided for such restrictions it would have been ultra vires the Act.
- Parties should have incorporated a private company if they intended to put restrictions on transfer of shares.

## Western Maharashtra Vs Bajaj Auto (15.02.2010) - BHC

### Issue

Whether challenge to jurisdiction on ground that protocol agreement is void in the light of Section 9 and 111 A of the Act is valid.

### Brief Facts

- Protocol Agreement between Western Maharashtra and Bajaj Auto pursuant to which a public company was incorporated. Company is listed on BSE and NSE.
- Protocol agreement provided for ROFR at a price agreed between the parties or as may be decided by the Arbitrator. The term was incorporated in AOA.

## Western Maharashtra Vs Bajaj Auto (15.02.2010) - BHC

### Brief Facts

- Western offered its shares to Bajaj Auto in terms of agreement. However, the price was not mutually agreed and arbitrator was appointed.
- Western challenged jurisdiction of Arbitrator on the ground that agreement was void as it violates Section 111 A of the Act.
- The application challenging jurisdiction was dismissed by the Arbitrator.
- The award was challenged before BHC.

## Western Maharashtra Vs Bajaj Auto (15.02.2010) - BHC

### Contention of Western Maharashtra

- The AOA must yield to the principles of free transferability in Section 111 A and the pre-emptive right is inoperable.

### Contention of Bajaj Auto

- Relied on Madhusudan case to argue that restriction does not bind all shareholders, but is only between 2 shareholders in a specified contingency.
- The restriction is contained in the AOA. Section 111 A does not prohibit agreements between specific shareholders regarding specific shares especially when incorporated in AOA.

## Western Maharashtra Vs Bajaj Auto (15.02.2010) - BHC

### Contention of Bajaj Auto

- Section 111A was intended to curb the power of board of directors to obstruct transfer and not to destabilize bargains which are heart of commerce.

### BHC Observations

- By definition private company has to restrict the right to transfer its share. In case of public company shares are freely transferable.
- The free transferability of shares in a public company is founded on the principle that members of public must have freedom to purchase and every shareholder the freedom to transfer.

## Western Maharashtra Vs Bajaj Auto (15.02.2010) - BHC

### BHC Observations

- The effect of a clause of pre-emption is to impose a restrictions on the free transferability of the shares. This is impermissible.
- Section 9 has overriding effect on the AOA or any agreement.
- The Court relied on DHC ruling in Pushpa Katoch to hold that even if the AOA provided for such restrictions it would have been ultra vires the Act.

## Western Maharashtra Vs Bajaj Auto (15.02.2010) - BHC

### BHC Observation

- The argument relying on Madhusudan case that Section 111A would not interdict agreements between particular shareholders relating to the transfer of specified shares is not tenable in case of public companies as Madhusudan case was dealing with private companies.
- In essence the submission of respondent is that the provision of Section 111A should be read as being subject to a contract to the contrary. This cannot be read into a Statute.

## Messer Holding Vs Shyam Ruia (01.09.2010) - BHC

### Issue

Whether the clause of SPA which gives pre-emptive rights violates Section 111A.

### Brief Facts

- Ruia and Hoechst Group entered into a SPA for transfer of Ruia's shares in Bombay Oxygen (listed on BSE).
- SPA provided for ROFR, however, Hoechst group could transfer it to any of its subsidiary in which it had more than 51% shares.

## Messer Holding Vs Shyam Ruia (01.09.2010) - BHC

### Brief Facts

- Hoechst Group transferred its shares in Bombay Oxygen to an entity in which it had only 49% shares. The SPA was violated.
- Ruias filed a suit for specific performance and permanent and interim injunction.

### Hoechst's Contention

- Relying on Rangaraj and Western Maharashtra contented that pre-emptive right is in the teeth of Section 111A.

## Messer Holding Vs Shyam Ruia (01.09.2010) - BHC

### Ruia's Contention

- Decision in Western Maharashtra is not correct as it is based on misreading of Madhusudan Case.
- The crucial distinction made in Madhusudan case that agreement between particular shareholders relating to transfer of specified shares is not a restriction on transfer of shares, was glossed over in Western Maharashtra.
- Relation with Section 22A of SCRA. Section 111A was introduced with intention of restricting the rights of BOD to register the transfer not to restrict the right of shareholders in entering into consensual agreements.

## Messer Holding Vs Shyam Ruia (01.09.2010) - BHC

### Ruia's Contention

- A contract to pledge, sale or principle of first refusal, is in exercise of shareholders right of free transferability of shares. That right of any person would be intrinsic in his right of free transferability. If the statute made by Parliament intended to affect such right, ought to have made express provision in that regard.
- There can be no presumption that the legislature has taken away that right while making provision to restrict the right of Directors of a company to refuse transfer of members share.

## Messer Holding Vs Shyam Ruia (01.09.2010) - BHC

### BHC Observation

- Section 22 A was deleted in SCRA and at the same time Section 111 A was introduced . The scope of both the Sections are same.
- Section 111 A is to regulate the powers of BOD regarding transfer of shares and provides that BOD cannot refuse transfer unless there is sufficient cause. Section 111 A is not intended to curtail the rights of shareholders to enter into any consensual agreement for transfer of specific shares.
- If the intention was to take away the right, the legislature would have made specific provision.

## Messer Holding Vs Shyam Ruia (01.09.2010) - BHC

### BHC Observation

- The general proposition laid down in Madhusoodhnan will be applicable to public company as well, that is, the shareholders can enter into consensual agreement for transfer of specific shares which are not in conflict with AOA. This does not impede the free transferability.
- Section 9 has effect on agreements executed by the company and not the shareholders.

# APPEAL

- An Appeal has been filed against the Judgment of the Bombay High Court in the Messers Holding before the Supreme Court (SLP (C) 33429-33434 of 2010).

## CONCLUSION

- Shareholders are free to enter into consensual agreements for transfer of specific shares. This proposition would be applicable to both private as well as public companies.
- Any blanket restriction on the shareholders, present and future, on transfer of shares would be invalid in case of private companies unless incorporated in Articles. In case of Public companies the blanket restriction would be invalid even if incorporated in AOA.
- If the agreement between shareholders is for transfer of specific shares, it will be binding irrespective of the fact that the same has not been incorporated in AOA. For public companies the restriction should not be incorporated in Article as it would violate Section 9.

# CONCLUSION

## Remedy - Private Company

- In case agreement has been incorporated in AOA, the company may refuse to register any transfer in contravention of such agreement.
- In case the agreement is for transfer of specific shares and the same has not been incorporated in AOA, a suit for specific relief can be filed if the provisions of the agreement are contravened.
- Injunction can also be prayed against company to restrain company to register the transfer. Even if the transfer has been registered, a petition under Section 155 can be filed for rectification of register.

# CONCLUSION

## Remedy – Public Company

- If there is blanket restriction on shareholders, present and future, for transfer of shares, the same would be invalid even if incorporated in AOA. No remedy is available.
- If restriction is on transfer of specific shares, then a suit for specific relief would lie against contravention of the terms of agreement.
- Injunction can also be prayed for against company to register the transfer.

Thank You!



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