



# Enforceability of Contractual Restrictions and Share Transferability in Public Companies

The Issue as to *whether two or more shareholders of a company can in a valid manner restrict the transferability of their shares by entering into private contracts* has hitherto remained in a state of uncertainty in India. Such contractual clauses confer pre-emption rights on parties as and when a shareholders intends to sell his shareholding in a company held by him, the said party is required to offer such shares to the other party, i.e. the party holding the pre-emption rights. The pre-emption rights are popularly known as “Right of First Refusal” (ROFR) clauses which have no statutory recognition and are generally contractual in nature.

Any issue with relation to enforceability of ROFR clause, has to be commenced by looking back at the Supreme court decision in *V.B. Rangaraj v. V.B. Gopalakrishnan and others.*, wherein the court taking in mind common law decisions held that shares are freely transferable and a private agreement that imposes restrictions not stipulated in the articles of association is nether binding on the company nor on the shareholders.

The division bench of the High Court of Bombay by its judgment dated 8-05-2015 has clarified the position of law relating to the enforceability of the ROFR Clauses. The present Article seeks to analyze the relevant statutory provisions in relation to the subject. The analysis is based on the judicial pronouncements in *Western Maharashtra Development Corpn. Ltd. Vs. Bajaj Auto Limited*

## Analysis of Western Maharashtra Development Corpn. Ltd. Vs. Bajaj Auto Limited

The Parties had entered into a protocol agreement and Clause 7 of the Protocol Agreement stated: “If either party desires to part with or transfer its shareholding or any part thereof in the equity share capital of Maharashtra Scooters Ltd., such party shall give first option to the other party for the purchase of such shares at such rates as may be agreed to between the parties or decided upon by arbitration.” (i.e. ROFR)

In direct contrast is Section 22-A (2) of SCRA which states that, “Subject to the provisions of this section, securities of companies shall be freely transferable” Section 111 A (2) of the Companies Act, 1956 states that, “Subject to the provisions of this section, the shares or debentures and any interest therein of a company shall be freely transferable.

By virtue of a protocol agreement entered into on October 2, 1974, Bajaj and Western Maharashtra Development Corpn. Ltd (WMDCL) incorporated Maharashtra Scooters Limited (“MSL”), a public listed company and a wholly owned undertaking of the State of Maharashtra. Bajaj and WMDCL respectively held 24% and 27% shares in MSL respectively, while the remaining 49% of the equity shareholding was held by the public. Clause 7 of the Protocol Agreement provided for a right of pre-emption to Bajaj and WMDCL.

In 2003, WMDCL considered selling and transferring its 27% shareholding in Maharashtra Scooters Limited (MSL), to Bajaj at a price of INR 232.20 per share. Bajaj confirmed its interest in buying WMDCL's shareholding in MSL, but did not find the price offered per share as acceptable and therefore, requested a meeting by High Level Committee to reach a settlement. After failure of several communications between the Parties to come to consensus as regards rate at which the shares of WMDCL would be sold, a joint reference was made to the Arbitrator on December 29, 2003. The Arbitrator passed an award wherein it was held that the equity shares of WMDCL in MCL are to be sold at a price of INR 151.63 per share to Bajaj ("Award"). WMDCL challenged the Award of the Arbitrator under Section 34 of the Arbitration and Conciliation Act, 1996 before the Bombay High Court.

The Single Judge of the Bombay High Court negated all the contentions made by WMDCL except the one challenging the legality of Clause 7 of the said Protocol Agreement. The Single Judge of the Bombay High Court upheld WMDCL's contention regarding Clause 7 being invalid and held this to be the sole ground to set aside the Award. The order of the Single Judge of the Bombay High Court was challenged before the division bench of the Bombay High Court by Bajaj and one of the main contentions by Bajaj was:

*"In today's globalized world, joint ventures are common and clauses similar to Clause 7 are necessary to ensure that a joint promoter of a public company do not sell his shareholding to a competitor who then would turn and would get control of his rival".*

Hence, clause 7 of the Protocol Agreement should be held to be valid and not impinge upon the principle of free transferability of shares as contemplated under Section 111 A of the Act. However, the court firmly establishes the fact that a public company in India cannot provide for restrictions on the transferability of its shares.

The Supreme Court in the Vodafone International Holdings case, once again held that ROFR clauses have no statutory recognition and are generally contractual in nature thus not subscribing to the view expressed in VB. Rangarajan case.

However, had the court reconsidered the decision keeping in mind the decision in V.B. Rangaraj case, it would have been a welcome step for companies as the supreme court will have to expressly consider whether the ROFR clauses can be enforced only when it is incorporated in the articles of the company.

## Conclusion

With the current market scenario, where joint ventures are on the rise, there is a dire need for clarity with regard to the ROFR clause in order to protect the promoter of such ventures.

It is thus, important that the Supreme Court sets a binding precedent on the issue after weighing all the issues and jurisprudence with regard to the same.

The Companies Act, 2013 recognizing these anomalies & confusions & diverse practices has inserted a new proviso in Section 58 "Contracts or arrangements between two or more persons in respect of securities shall be enforceable as a contract" which inter alia recognises the Share Holders agreement & Private Contracts between the shareholders and gives it legal force, this again only merely codifies and clarifies the existing legal position regarding pre-emption agreements, hence what was implicit in Section 111A of the 1956 Act has now been made explicit in Section 58 of the Companies Act, 2013.

With The SLP (Special Leave Petition) in Messer Holdings pending adjudication before the Supreme Court, it is hoped that the court will clarify & consider the ROFR Clause in agreements which is common in today's globalized world.

