

Significance of Shareholders' Agreement & its Enforceability in India: A Critical Study

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ABSTRACT

Apart from the constitutional documents of the company namely the Articles of Association (A.O.A.) and the Memorandum of Association (M.O.A.); the Shareholders' Agreement (S.H.A.) is another document that plays a vital role in establishing the relationship among the shareholders themselves and also between the shareholders and the company. S.H.A. is a reassertion of 'contractualism' in corporate law. However, even after being a valid contract, the terms of S.H.A. can only apply on the company if they are in consonance with the terms of A.O.A. This paper will focus on understanding the intricacies attached with Shareholders' Agreement and why does entering into such an agreement has become a usual business practice even when there is no proper legislation or guideline governing the same. It will also focus on the impact of 2018 amendment in Specific Relief Act 1963 on the enforceability of S.H.A. upon companies. This paper has tried to discuss the important judicial pronouncements relating to the Shareholders' Agreement in India and how the concept has developed over the period of time in our country.

Keywords: Memorandum of Association, Articles of Association, Shareholders' Agreement, Specific Relief, Enforceability.

I. Introduction

Since the 4th century BC *i.e.*, during arthashastra, the term 'industry's sector' has been regularly addressed. However, over time developments have been made to suit the market dynamics. the recent being the advent of Corporation that has many advantages, distinct from other forms of business.¹

The sole motive behind establishing any corporation is to do business and earn profit out of that business. However, setting up a corporate entity is arduous as it requires investment in monetary terms and human resources. To start a business, one needs land, appropriate machinery, funds, raw materials to process into finished products, and many other commodities.

However, apart from all of these prerequisites, human resources in the form of promoters, investors, directors, and shareholders, often referred to as Key Managerial Personnel (hereinafter mentioned as K.M.P.), are considered highly crucial for the smooth functioning of any business institution.

Even though the company is a distinct legal entity, the company members manage all of its operations and represent the company in the market.

¹ Dr. Trilok Pratap Singh, "Company Law: A Bibliometric Approach to Understand the Conceptual Breadth, Depth, and Development Of 29 Years of Research and Theory, from 1991-2019" *PalArch's Journal of Archaeology of Egypt/Egyptology*, 17 (6) (2020), available at: <https://www.archives.palarch.nl/index.php/jae/article/download/1942/1920> (Last Visited on April 22, 2022).

Now, if everything goes well, the company can expect the right outcome to generate revenue, which will enhance the company's capital market valuation. As a result, stockholders will see a higher return on their investment.

When we talk about corporations, there is no doubt that Corporations are a mix of contractual laws and laws relating to the regulation of the companies, thus opening broader scope for a researcher to research. It can be argued that the origin of a corporation lies equally in the contract between the parties and the statute governing the company. It might be observed that the legislature initially provided the corporate veil. Still, the contract law has aided in filling the gaps in that veil regarding the relations between the various stakeholders.²

As the companies have complete freedom to fashion their constitutional documents, which are the Memorandum of Association (hereinafter mentioned as M.O.A.) and the Articles of Association (hereinafter mentioned as A.O.A.), based on the input provided by the shareholders and other K.M.P.s of the company, this gives scope to 'private ordering' into the rules governing the company.³ However, A.O.A. is not the only method that the company's shareholders can use to introduce the rules for its governance. An alternative approach is an agreement known as the Shareholders Agreement (hereinafter mentioned as S.H.A.), which is concluded between the shareholders themselves or between the shareholder and the company.⁴

S.H.A. defines the arrangement among the shareholders *per se* or among the shareholder/s and the company itself. This agreement contains various provisions which outline the rights and obligations of the shareholders⁵ and includes provisions regarding the company's operations.⁶

Therefore, S.H.A. might be considered a reassertion of 'contractualism' in corporate law. Shareholders have consistently expressed the desire for a more inclusive role in the company's functioning. This need has been increasingly ingrained in today's business environment, and contractualism in the form of S.H.A. has become one of the important ways to satisfy it.⁷

This document is distinct from the company's constitutional documents, which include the 'M.O.A.' Companies worldwide have widely used A.O.A. S.H.A. Evidence of this fact is that almost all the joint venture companies, besides having the constitutional documents, *i.e.*, M.O.A. and A.O.A., also have entered into S.H.A.'s to run the joint venture.⁸

Also, the Specific Relief Act 1963 (hereinafter mentioned as S.R.A.) was recently amended in 2018. Section 10 of the amended act has made it mandatory for the courts to enforce the contractual terms to remedy specific performance.

Therefore, with the growing popularity of S.H.A. and the recent Section 10 of S.R.A., two crucial questions have come up that are debatable. The questions are as follows:

1. What are the legal consequences when A.O.A. and S.H.A. are not in conformity?
2. What is the impact of Section 10 of the Specific Relief Act, 1963, as amended by the 2018 amendment act on S.H.A.?

The paper will focus on answering the following questions and, where possible, giving suggestions.

²Michael J. Duffy, "S.H.A.s And Shareholders' Remedies Contract Versus Statute?" 20 *Bond Law Review* 29 (2008), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3192206 (Last Visited on September 9, 2021).

³Paul L. Davis and Sarah Worthington, *Gower's Principles of Modern Company Law* 70, (Sweet & Maxwell, 10th South Asian edn.).

⁴*Ibid.*

⁵Shareholder's Agreement, available at: <https://cleartax.in/s/shareholders-agreement-format-download> (Last Modified June 22, 2021).

⁶What is a Shareholders' Agreement, available at: <https://corporatefinanceinstitute.com/resources/knowledge/finance/shareholders-agreement/> (Last Visited on September 9, 2021).

⁷Raghavendra Kishore Singh, "Shareholders' Agreements", in Sairam Bhat, *Law of Business Contracts In India* (Sage Publication 2009).

⁸*Ibid.*

To understand S.H.A., it is essential to look into its origin and significance in the Indian Corporate Structure. However, the concept of S.H.A. is still developing in India, but many countries worldwide have tried to formalize it through statutory laws or appropriate guidelines. Many lawsuits have already been filed in India regarding the applicability of S.H.A. in various High Courts and the Supreme Court.

Nevertheless, before we get into it, it is essential to understand why S.H.A. should be paid attention to and why it matters to businesses. Therefore, the next part will deal with this particular aspect.

Moreover, taking care of all the stakeholders by creating forward-looking policies by management, keeping in mind the company's interest facilitate the phenomenon of corporate social responsibility.⁹

II. Shareholders' Agreement and its Significance

S.H.A. is a contract that defines the scope and extent of the relationship between the shareholders and the corporation.¹⁰ It is a contract that structures the relationship among the company's shareholders and provides the foundation for how the company's owners interact with each other and with the company's directors. It also mentions the rights, privileges, and restrictions imposed upon the shareholders.¹¹

The shareholders have certain inherent rights with the shares they own. However, an S.H.A. provides other rights to the parties to the agreement, which are over and above their inherent rights.¹² S.H.A. specifies the rights and duties of shareholders when those prescribed by law and various regulations are considered incomplete or inappropriate.¹³

Three pillars determine the efficacy of an S.H.A. The first is the use of S.H.A. in governing the transfer of shares among the company members to make the distribution of power more stable.¹⁴ The second is using S.H.A. to position the different groups of shareholders within the company properly.¹⁵ Furthermore, the third is to resolve specific issues when the corporate governance structure fails to represent the interest of the shareholders.¹⁶

One of the most important purposes for drafting an S.H.A. is that when parties enter into a business, there is usually a lot of trust and goodwill among the shareholders with the primary aim to earn a profit and the business's growth. However, one area that often gets neglected is related to the disputes that can arise in the future among the various stakeholders and resolve such conflicts.

Moreover, during the inception, many promises were made, and discussions were done regarding the company's scope of operation and the relationship between the shareholders, some of which may be oral and some in writing. Thus, a well-

⁹ Dr Aruna Dhamija, Dr Somesh Dhamija, Mr Amit Kumar, "Corporate Social Responsibility: The Force to Reckon Corporate Progression" 131 *Pacific Business Review International* 9(11) 2017, available at: http://www.pbr.co.in/2017/2017_month/May/16.pdf (last visited on February 25, 2022).

¹⁰ Ricardo Molano Leon, "S.H.A.s in Close Corporations and Their Enforcement" n. 117 *Vniversitas* 219-252 (2008), available at: http://www.scielo.org.co/scielo.php?script=sci_arttext&pid=S0041-90602008000300009 (last visited on September 9, 2021).

¹¹ L. S. Sealy, "S.H.A.- An Endorsement and a Warning from the House of Lords", 51 *Cambridge Law Journal* 437-439 (1992), available at: <http://www.jstor.org/stable/4507715> (Last Visited on September 10, 2021)

¹² The Corporation Law Committee of the Association of the Bar of the City of New York, "The Enforceability and Effectiveness of Typical S.H.A. Provisions", 65 *The Business Lawyer* 1153-1203 (2010), available at: <http://www.jstor.org/stable/25758511> (last visited on September 10, 2021).

¹³ Gilles Chemla, Michel Habib, *et.al.* (eds.), "An Analysis of SHAs", *ZORA* (2007), available at: https://www.zora.uzh.ch/id/eprint/63184/1/Chemla_An_Analysis_of_Shareholder_Agreements.pdf (last visited on September 10, 2021).

¹⁴ André Leonardo Pruner da Silva, Jefferson Lana, *et.al.* (eds.), "Agreeing and Impacting: The Effect of the S.H.A. on Firms' Market Value", *SCIELO* (2018), available at: http://www.scielo.br/scielo.php?script=sci_arttext&pid=S1808-23862018000100088 (last visited on September 10, 2021).

¹⁵ *Ibid.*

¹⁶ Georgi Kalchev, "Corporate Governance and Shareholder Litigation", available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1309555&download=yes (last visited on July 24, 2021).

drafted S.H.A. can bridge all these gaps as it can set out in writing the verbal commitments and mechanism for dispute resolution, thus reducing the chances of future altercations.¹⁷

Most importantly, Unlike M.O.A. and A.O.A., The S.H.A. is not in the strict sense a 'constitutional document' and is not liable to alteration in the same way as the M.O.A. and A.O.A.¹⁸The director and the company are duty-bound to act according to the AOA, and the director should act in good faith for the benefit of all the members.¹⁹

An S.H.A. can be divided into three types categorically. These are as follows:

- First, an agreement that is entered between the company and the members and acts as a supplement to the A.O.A.;
- Second, an agreement where the parties are all the shareholders only and not the company;
- Thirdly, an agreement between some shareholders of a specific class.²⁰

S.H.A. is a document that contains provisions that determine some of the core arrangements on which the functioning of the company and the shareholders depend. Such core arrangements are as follows:²¹

- Ensuring that the rights of the shareholders and their obligations are set out;
- Ensuring that the sale of shares of the company is appropriately regulated;
- Ensuring that adequate measures are present for minority shareholder's protection;
- Setting out how the company should run a business;²²
- Providing an adequate mechanism for dispute resolution through arbitration by incorporating such clauses in the agreement.

Taking into account the core arrangements discussed above, a well-drafted S.H.A., in general, shall be drafted to achieve the objectives mentioned below:

- It should set out the basic rules and regulations governing the transfer of shares and the relation of the various stakeholders with the company per se.
- It should be forward-looking and thus, provide reasonable solutions for issues that might occur in the future of the corporation till the time agreement is alive. *For example*, if there is a need for further Capital Infusion, Buy-Back of Shares, dispute resolution between different shareholders, etc., an S.H.A. should contain clauses dealing with the same.
- It should be flexible in dealing with any unforeseen event such as a situation where the shareholder desires to terminate the relationship with the company; an S.H.A. should be flexible enough to quickly and efficiently accommodate this demand.
- It should contain provisions for dispute resolution so that the corporation's resources are utilized to increase its efficiency and not resolve the disputes among the shareholders.²³

On the analysis of the abovementioned objectives, it is evident that the aspects covered in S.H.A. are similar to what is covered in the company's rule book, *i.e.*, A.O.A., which ultimately contains the internal governing elements of the

¹⁷*Ibid.*

¹⁸*Supra* note 17.

¹⁹Hina Kausar, "Personal Liability of Director of a Company in Insolvency & Investor Frauds Cases", 1431 Turkish Journal of Computer and Mathematics Education 12(5) 2021, available at: <https://www.turcomat.org/index.php/turkbilmat/article/view/2120/1843> (last visited on 12 April, 2022)

²⁰John Farrar and Brenda Hannigan, *Farrar's Company Law* 136 (Butterworths, 4th edn. 2000).

²¹Philip Newman, *What is an S.H.A.*, Informdirect, available at: <https://www.informdirect.co.uk/shares/what-is-a-shareholders-agreement/> (last modified on September 26, 2021).

²²*Supra* note 11.

²³Brian Graves, *Shareholder Agreements*, available at: https://www.mccarthy.ca/pubs/Insight_paper_Ver_two.pdf (last visited on September 5, 2021)

corporation.²⁴ The importance of S.H.A. can be determined by the fact that the shareholders of the company are one of the essential stakeholders in the corporate structure, holding some fundamental rights such as the appointment and removal of directors, approving or disapproving the decisions made in the Annual General Meeting or Extra-Ordinary General Meeting, etc.

Therefore, the S.H.A. helps the Shareholders assert their rights more specifically and protect them when the A.O.A. is silent. Moreover, the company's Articles are subject to certain limitations, and the S.H.A. provides a valuable supplement. Some of these limitations are as follows:²⁵

- A.O.A. is a post-incorporation document, whereas an S.H.A. may deal with events before incorporation as well;
- A.O.A. contains provisions for protecting minority shareholders, *e.g.*, conferring rights to block a special resolution. At the same time, an S.H.A. can supplement it by vesting the power to *veto* any alteration of A.O.A. without creating any particular class of shareholders.
- A.O.A. being a constitutional document of the company involves various procedural limitations. Whereas an S.H.A. being a contract does not hold any such requirement.
- The members' rights can be altered by altering A.O.A. even when all the stakeholders do not agree. Whereas such requests can be protected if they are a part of S.H.A.
- Companies can be apprehensive about including sensitive information in A.O.A. as it is a public document. Whereas shareholders being a member, should have access to

such data to prevent any future altercation. The S.H.A. plays an essential role in such situations.²⁶

II.I Advantages of S.H.A. to various stakeholders

S.H.A. is not about trust or acrimony. They are about communication and shared understanding. They are about building a solid relationship between the company's various stakeholders *inter-se* and the company itself. They are about making an agreement today that avoids messy and expensive litigations in the future. The S.H.A. helps bridge the gap between the shareholder and the company itself, thus leading to better communication and equal power distribution to manage the company most efficiently. At last, the S.H.A. helps maintain the company's good governance because the corporate governance at its basic level is all about how good corporations operate.²⁷

S.H.A. is not an ambiguous document, but the issues it addresses are significant for the better and efficient functioning of the corporate entity concerned.²⁸ The S.H.A., as discussed earlier, acts as a bridge between the corporation and its various stakeholders. Therefore, the S.H.A. provides certain advantages to these stakeholders who are as follows:

II.II Benefits to the Minority Shareholders

Drafting an S.H.A. could be more advantageous to the minority shareholders than any other stakeholder. It is often felt that while drafting the A.O.A. of a company, the minority shareholders are left out. So, their interest can be well taken care of when one drafts an S.H.A. Some of the advantages that can be drawn in favor of the minority shareholders are as follows:

²⁴The Article of Association, *available at:* <https://www.lawteacher.net/free-law-essays/business-law/the-Articles-of-association-business-law-essay.php> (last modified on July 18, 2019).

²⁵*Supra* note 6.

²⁶G.S.C. Solicitor, A Shareholders' Agreement- what's in it and how to negotiate?, *available at:* <https://www.lexology.com/library/detail.aspx?g=01564284-2c08-4f60-a7c0-cdef8bc61c73> (last modified on April 19, 2017).

²⁷Phil Thompson, Shareholders' Agreement: A Checklist For Discussion Purposes, *available at:* <https://www.yumpu.com/en/document/read/52228807/shareholder-agreements-a-checklist-for-discussion-purposes> (last visited on September 5, 2021).

²⁸*Supra* note 23.

- A shareholder has access to much information about the company, which is generally unavailable to the public. However, most of it remains unutilized due to a lack of awareness. But when an S.H.A. is drafted, all the rights and information they are entitled to can be categorically put into it.
- Though, Section 151 of the Companies Act 2013 has provision for the appointment of the minority shareholder's director in public listed company. However, if S.H.A. also contains such a clause, it gives the minority shareholders a contractual right to nominate and appoint a director to the company's board.
- Free Transferability is a significant advantage attached to a publicly listed company's shares. However, specific qualifications like the right of *Pre-emption*, where a shareholder can be prohibited from selling its shares to a third party without first approaching the company members can be added while drafting an S.H.A.²⁹ Thus, helping the shareholders in securing such a right.³⁰
- With the help of S.H.A., the minority shareholders can use the *Tag-Along* right, which entails that if the majority shareholder is selling its shares, then the minority shareholders can also tag its shares and get them sold. Such protection is necessary as minority shareholders often find it challenging to find a suitable buyer for their shares.³¹

II.III Advantages to the majority shareholders

Unlike the A.O.A., S.H.A. is a flexible document that can be drafted to meet the parties' specific objectives. Therefore, keeping this in view, certain extra advantages can be given to the majority shareholders provided that the same is not against the provisions of any statute and does not hamper the company's interest.

- The flexible nature of the S.H.A. helps the majority shareholders tailor it in a manner which according to them is best suited for the overall growth and achieving the company's desired objectives.
- Similar to Tag Along Protection given to the Minority shareholders, the option of *Drag Along* is available to majority shareholders. Whenever large shareholders or groups of shareholders plan to sell the venture itself, then in such case, they, along with themselves, can 'Drag' the other shareholders to sell off their holding.³² This clause comes into use when the purchaser is interested in buying the entire 100% stake in the company. Such an arrangement is very beneficial as the majority does not have to invest time in negotiating with the minority, thus avoiding unnecessary utilization of the company's resources.³³
- Majority shareholders can add specific clauses as default provisions like the confidentiality clause, which prevents the shareholders from disclosing any sensitive information about the company while the parties are in business and after their relationship has ended.³⁴

II.IV Advantages to the Investors

Investor protection is one of the paramount considerations of any business. It is the investors that infuse capital into the company and help it in keeping afloat. Moreover, transparency and ease of doing business are two of the most critical factors that can attract investment in the company.³⁵ S.H.A. becomes more important as such investments happen mostly

²⁹Greg Henry, Tag along, drag along and similar clauses in a Shareholders Agreement, , *available at*: <https://www.turtons.com/blog/tag-along-drag-along-and-other-exit-provisions-in-a-shareholders-agreement> (last visited on September 5, 2021).

³⁰Shareholders' Agreement, *available at*: <https://www.companylawclub.co.uk/shareholders-agreements> (last visited on September 6, 2021)

³¹Alan O'Driscoll, Advantages and Disadvantages of putting a SHA in place, *available at*: http://www.accountingnet.ie/law_regulation/Advantages_and_Disadvantages_of_putting_a_shareholders_agreement_in_place.php (last modified on November 28, 2011).

³²*Supra* note 26.

³³*Supra* note 28.

³⁴Caroline Grey, The Importance of a S.H.A., *available at*: <https://tinsdills.co.uk/the-importance-of-a-shareholders-agreement/> (last visited on September 7, 2021).

³⁵Whittock Consulting, Benefits of a Shareholder's Agreement, *available at*: <https://whittockconsulting.co.uk/benefits-of-a-shareholder-agreement/> (last visited on September 7, 2021).

via the purchase of shares. Therefore, including specific clauses in S.H.A. can help investors discern how the company will be managed. These clauses can relate to:

- *Easy entry and exit* is a main concern of the investors. It is always possible that the investor is not planning to stay in the company forever and should be given the option to exit. Therefore, while drafting S.H.A., a suitable exit mechanism can be put in place so the investor can realize its investment and exit.
- There might be instances where certain actions by the company impact its functioning and the investment being made in the venture. Therefore, an investor can seek to add specific clauses in the S.H.A. to veto such decisions that have an adverse impact on the value of their investment.

Though many advantages are attached to the S.H.A., such an arrangement also has an inherent disadvantage. Free transferability of shares is an established principle of the Companies Act 2013. Private sector companies can also transfer their shares but with certain restrictions. With the transfer of shares from one party to another, the S.H.A. also has to be renewed because it is a private arrangement between the contracting parties. Such renewal of S.H.A. might lead to specific changes or modifications in the contractual terms between the parties, thus making it different from the previous S.H.A.

If the abovementioned situation happens, then such an effect will snowball as the rights and liabilities of other members vis-à-vis the company or other members will change. In short, changes in one S.H.A. might lead to interlinked changes in other S.H.A.s.

Therefore, if modification leads to contradictions between two different S.H.A.s at a different level or even at the same level and the A.O.A. of the company is not amended in accordance, it will further escalate the problem.

At last, it can be said that S.H.A. in India is still in its developing stage. The jurisprudence behind S.H.A. has developed with the help of various case laws and is also based on customary business practices. However, the situation is different in other countries. To understand S.H.A. from a legal perspective, it is essential to know the laws relating to the same in other countries. Therefore, the next part will deal with this aspect only.

III. Law Applicable to Shareholders' Agreement

In the Indian context, S.H.A. is used quite repeatedly by companies. There is no explicit statutory act that controls the S.H.A., and there is also no definite case law that governs it. The creation of S.H.A. is not bound to any legislative framework. It is guided in part by the Contract Act and other legal concepts. The terms of the S.H.A. are usually made in conformity with the A.O.A. of a company, or the articles are updated after the shareholders agree to seek redress under the Company Act 2013.³⁶

The question of whether such agreements are enforceable under Indian law has been a difficult one to answer. Though such contracts have acquired considerable popularity in India, courts have not had enough opportunity to discuss the enforceability and legality of the S.H.A. and its related clauses. However, when courts have come across any such issue, the decisions on such agreements have more tilted towards establishing parity among various parties rather than answering the enforceability of the S.H.A. Nevertheless, maintaining a balance between the parties entering into such agreements has also been a complicated issue.³⁷

Due to the lack of specific legislation on S.H.A., Indian courts had taken up the matter when it needed to be resolved. One significant Supreme Court decision (*V.B. Rangaraj v. V.B. Gopalakrishnan, A.I.R. 1992 SC 453*) is widely mentioned in this context. The majority of other choices that have been pronounced are by the various High Courts. However, the applicability of High Court rulings is limited due to the jurisdictional conflict with the other High Courts, resulting in limited precedential validity.³⁸

³⁶UmakanthVarottil, "Shareholders Agreement: Clauses and Enforceability" *IndiCorpLaw* (2010), available at: <https://indiacorplaw.in/2010/12/shareholders-agreements-clauses-and.html> (last visited on September 9, 2021)

³⁷*Ibid.*

³⁸*Ibid.*

In this context, where elements of the S.H.A. go beyond the purview of company legislation, Indian courts have traditionally not preferred absolute contract flexibility. Courts have either refused to acknowledge such features in shareholder agreements or have only executed such sections that are adopted or aligned with the articles of association.³⁹

IV. Enforceability of Shareholders' Agreement

The enforceability of S.H.A. has been a debatable issue in India. Despite having Companies Act 2013, which covers almost all the aspects relating to the company's governance. We still lack the rules and regulations to govern the S.H.A. It is the judiciary that has time and again tried to give a definite answer regarding the enforceability of S.H.A.

Therefore, in light of the various case laws, this part will try to find the answers to the questions discussed in the introduction.

Q. 1 What are the legal consequences when A.O.A. and S.H.A. are not in conformity?

The significant difference that comes between an A.O.A. and the S.H.A. is the nature of both these documents. S.H.A., unlike A.O.A., is not a constitutional document. Section 10 of the Companies Act 2013 makes the M.O.A. and A.O.A. of the company binding on the company and the members *inter-se*.⁴⁰ A.O.A. includes various clauses regarding the rights of directors and their duties, board proceedings, transfer of shares, and other operational terms. There might be a possibility that the terms are not drafted in detail.⁴¹ But due to the very nature of the document, they will supersede S.H.A. whenever there is a conflict.⁴² It can be said that the enforceability of the S.H.A. is derived from the A.O.A. itself.

Many case laws before the Supreme Court and the High court which are dating back to 1965⁴³ have discussed the enforceability of S.H.A. To know about the validity of S.H.A. and the parties' liability, it is pertinent to discuss the relevant case laws relating to the issue.

In the famous case of *S. P. Jain v Kalinga Tubes Ltd.*⁴⁴ which dealt with the 'Oppression and Mismanagement,' enforceability of S.H.A. was also discussed. The brief facts were that a private company by the name Kalinga Tubes had two shareholders who entered into an oral agreement (S.H.A.) with a third party who was given an equal number of shares as to the existing shareholders, thereby vesting him with *similar powers and say* in the finance and management of the company.

The agreement was entered in the private capacity of the shareholders, and no changes were made in A.O.A.

Later on, the company got converted into a public company, and in a general meeting, the third shareholder was outvoted by the other two shareholders. After that, an application was filed by the concerned shareholders alleging oppression as the act of outvoting in the general meeting was against the oral agreement between the shareholders.

It was *held* that an agreement between the members and non-members where the company is not the party would not bind the company. There is no fault in entering into a separate agreement to transfer shares, but a breach of such contract without breaching the A.O.A. is a valid corporate action. However, the aggrieved can get a remedy for the violation in the general law of the land.

³⁹*Ibid.*

⁴⁰Articles of Association vs. Shareholders' Agreements- Which one prevails?, *available at*: <https://indiancaselaws.wordpress.com/2014/12/05/case-list-articles-of-association-vs-shareholders-agreements-which-one-prevails/> (last visited on September 9, 2021)

⁴¹Taarakesh Sunku, Shareholders' Agreement, *available at*: <https://taxguru.in/company-law/shareholders-agreement-and-its-importance.html> (last modified on October 14, 2017)

⁴²*S. P. Jain v. Kalinga Tubes Ltd.*, A.I.R. 1965 SC 1535.

⁴³*Ibid.*

⁴⁴*Ibid.*

In *VB Rangarajv. VB Gopalakrishnan*⁴⁵, an agreement was entered between the shareholders of the private company wherein restrictions were imposed on a living member of a company to transfer its shares only to a member of the family in its particular branch. Such restrictions were, however, not mentioned in the A.O.A. of the company.

The court *held* that if the S.H.A. contains provisions that imposed certain restrictions on the shareholders even if they were consistent with the Companies Act, they could only be authorized if they were also incorporated in the A.O.A. of the company.

However, later on, the Supreme Court in *Vodafone International Holdings B.V. v. U.O.I.*⁴⁶ questioned the view expressed in *Rangarajan's case*. The court under *para 262* of its judgment reiterated what was opined in *Rangarajan's case* but at last, used the words "*a view we do not subscribe to*".

The case further created confusion rather than clearing the air regarding the enforceability of S.H.A. However, a comprehensive reading of the judgment shows that the court is inclined towards giving enforceability to the SHA only when it is not contrary to the company's Articles, even when shareholders enter into a contract for the best interest of the company.⁴⁷

Another Supreme Court decision worth mentioning is the *MS Madhusoodhanan v. Kerala Kaumudi Pvt Ltd.*⁴⁸ In the center of the dispute were four brothers, an agreement executed between them and their mother. The agreement stated that after the mother's death, the shares would be divided among the four brothers in which the appellant was entitled to 50% of the total shares, including the shares owned by another brother. The remaining two were entitled to a 25% share each. After the mother's death, the appellant went for the specific performance of the agreement.

Based on *Rangaraj's case*, the respondent argued that the agreement was not a part of the A.O.A. thus, unenforceable. The court, however, rejected the argument and opined that the restriction imposed in the present case was on identified members. It was not a blanket ban on all the present and future transfers of shares by the shareholders. Therefore, the court enforced the agreement even though the A.O.A. did not talk about the same.

Supreme Court in the case of *Claude-Lila Parulekar V. Sakal Papers (P) Ltd. & Ors.*⁴⁹ opined that A.O.A. constitutes a contract between shareholders and the company, apart from the agreement between the shareholders *inter se*. Moreover, it is an extended version of S.H.A.

Similar issues have also come up in various High Courts, like in *the Venire Industries Ltd. case.*⁵⁰, *World Phone India Pvt. Ltd. case*⁵¹. In *I.L. & F.S. Trust Co. Ltd case*⁵² the Bombay High court, following *Rangarajan's case*, stated that the ordinary principles of contract law could bind a company that is a party to the agreement. However, the same is not the case in company law, as the provisions that put constraints on the management of the company's affairs are not binding unless A.O.A. incorporates them.

The House of Lords in *Russell v Northern Bank Development Corporation Ltd.*⁵³ also reiterated that provision in the S.H.A. to which the company is a party is not enforceable against the company if it curtails the exercise of the statutory powers of the company.

However, a Delhi High Court's Judgment of 2011 had made the S.H.A. applicable even when the A.O.A. was silent on the issue. In *Premier Hockey Development Private Limited vs. Indian Hockey Federation.*⁵⁴ ESPN and the Indian

⁴⁵(1992) 1 SCC 160

⁴⁶(2012) 6 SCC 613

⁴⁷*Id.* at para 264

⁴⁸(2003) 117 Comp. Cas 19 (S.C.).

⁴⁹(2005) 11 S.C.C. 73

⁵⁰*Rolta India Ltd. & Anr v. Venire Industries Ltd. & Ors.*, [2000] 100 Com Case 19 (Bom).

⁵¹*World Phone India Pvt. Ltd & Ors. v. WPI group Inc, USA*, [2013] 178 Comp Cas 173 (Del).

⁵²*IL & FS Trust Co. Ltd. v. Birla Perucchini Ltd.*, [2004] 212 Com Case 335

⁵³*Russell v. Northern Bank Development Corporation Ltd.*, [1992] 3 All ER 161.

⁵⁴*Premier Hockey Development Private Limited v. Indian Hockey Federation*, O.M.P. 92/2011 & O.M.P. 52/2011.

Hockey Federation signed a memorandum of understanding. A new organization called Premier Hockey Development Private Limited was founded to manage and conduct hockey leagues and tournaments. After the agreement, the Indian Hockey Federation tried to put on a hockey league with another partner *i.e.*, Nimbus Sports. ESPN claimed that this action violated their S.H.A. Therefore, Premier Hockey Development Private Limited filed a petition against the Indian Hockey Federation. The respondents contended that since no amendment was made in the A.O.A. after the said agreement, S.H.A. was unenforceable.

The H.C. ruled that S.H.A. did not violate any of the terms of the A.O.A. Hence clauses mentioned in the S.H.A. would be binding on the parties because they did not contradict the Companies Act 1956, or any rules made thereunder and such a lawsuit could be brought against Indian Hockey Federation. Also, the court put forward two different perspectives, *where the company is not a signatory to the S.H.A.*; that does not stop the shareholders from executing their agreement on shareholding transfers, and *the company is a party to the S.H.A. in connection with the allotment of new shares*; the S.H.A. can be enforced against it.

Despite numerous cases, legal consequences in case of contradiction between AOA and SHA are still ambiguous. However, it may be worth mentioning that the proviso to Section 58 (2) of the Companies Act 2013 has tried to address the ambiguity about the enforcement of terms relating to the transfer of securities incorporated in the S.H.A. of a public company. The proviso states, "*Any contract or arrangement between two or more individuals concerning the transfer of securities is enforceable as a contract,*" according to Section 58(2). Therefore, the proviso makes the company contractually liable.

As a result, if the A.O.A. is silent on the subject, a contract between shareholders and the company concerning the transfer of securities is binding on the company. However, if the Section is read along with various Supreme Court rulings, it is clear that the SHA has to always function within the ambit of the AOA. Anything ultra-vires would become unenforceable. But ambiguity remains in private companies, necessitating a review of the same by the courts.

Q. 2 What is the impact of Section 10 of the Specific Relief Act, 1963 on S.H.A. as amended by the 2018 amendment act?

One of the most important aspects attached to civil rights is the expectations of the parties created with the contracts and the fulfillment of those expectations.⁵⁵ The same expectation, however, is not always met since the parties break the contract and do not abide by it. The Specific Relief Act 1963 is a legislation that assists parties in enforcing their rights under civil law, namely the Indian Contract Act of 1872.

The purpose of enacting S.R.A. was to provide the specific performance of the contracts entered between the parties. Still, the discretionary power given to the courts had created numerous roadblocks over time. Specific Performance of Contract, due to its equitable roots is more of a discretionary remedy than an equitable one.⁵⁶

Edward Fry, one of the most renowned authors on Specific Relief in his exemplary work, prophesied:

"It may be suggested that a perfect system of jurisprudence ought to enforce the actual performance of contracts of every kind and class, except only when there are circumstances which render such enforcement unnecessary or inadvisable, and that it ought to be assumed that every contract is specifically enforceable until the contrary be shown. But so broad a proposition has never, it is believed, been asserted by any of the judges of the court of chancery, or their successors in the high court of justice, though, if the prophecy were the function of a law writer, it might be suggested that they will more and more approximate to such a rule".⁵⁷

⁵⁵Avatar Singh, *Contract Act and Specific Relief* 843 (E.B.C., 12th ed.)

⁵⁶Report of The Expert Committee on Specific Relief Act 1963, "Chapter IV: Discretion of Court in the grant of Specific Performance and Injunction" (2016).

⁵⁷William Donaldson Rawlins and Edward Fry, *A Treatise on the Specific Performance of Contracts* 21 (Nabu Press, 5th ed. 1911).

This prophecy came true when the government of India's emphasis on the ease of doing business under the 'Make in India' initiative led to the establishment of an expert committee to review and suggest amendments in the S.R.A.⁵⁸

This led to a complete overhaul of the law relating to Specific Performance in India. The amendment brought a paradigm shift in the approach of courts, *i.e.*, from damages being the rule and the specific performance being the exception to specific performance being the rule and damages being the exception.⁵⁹

One such Section that went complete overhaul was Section 10 of S.R.A. If the unamended section 10 of the S.R.A. is read, the Section stated that "*Specific Performance of contract may, in the discretion of the court be enforced when the court is of the opinion that damage caused by the non-performance of the contract cannot be ascertained*". Now, the language of the Section has changed, and it read, "*The Court shall enforce the Specific Performance of a contract...*"⁶⁰. Similarly, the amendment has also happened in Section 11 of S.R.A., thus making the enforcement of contract mandatory by the court.

The amendment has done away with the requirement to ascertain damage as the benchmark for providing the specific performance. Upon analysis of Section 10 and the S.H.A., there might be a point of clash if both are compared together. As already established that S.H.A. is a contract under the Indian Contract Act 1872 having all the qualifications of a valid *i.e.*, promisor, promise, consideration, valid purpose, and enforceable by law. Moreover, there is no doubt in saying that the specific performance of any contract can be sought under Section 10 of S.R.A.

Previously, if parties went for the enforcement of S.H.A., the same could only be enforced if the A.O.A. had provision for the same as stated by the Supreme Court in various judgments. But after the amendment, specific performance of a contract has become a rule under section 10 of the S.R.A. subject to sections 11 & 14 of the same act, and S.H.A. does not fall under any of the restrictions mentioned. Therefore, the parties to the S.H.A. can now seek remedy under S.R.A. for specific performance because they are bound to perform the contract. If the remedy is provided in the form of specific performance, even if the A.O.A. does not authorize it, it will go against the principle established by the Supreme Court.

Since no case has come up before the court after the 2018 amendment, it is difficult to say how the court will decide in the future regarding the enforceability of S.H.A.

V. Conclusion

In the current scenario, our country is looking increasingly toward the corporates to provide stability and the capital to grow as an economy. A sustainable business model is a necessity in today's world for the corporates, and therefore, for the long-term survival of any business focus should be on sustainability model practices.⁶¹

This era is the era of the corporate, where corporate transactions have increased manifold. Therefore, we need documents like the S.H.A. to protect the interest of one of the most important stakeholders of a company, *i.e.*, its shareholders and maintain a system of checks and balances.

⁵⁸Recommendations for amendment to Specific Relief Act, available at: <https://agamalaw.in/2016/07/04/recommendations-for-amendments-to-specific-relief-act/> (last visited on September 12, 2021).

⁵⁹Gunjan Chhabra, Restoring the Faith in Contracts Performed in India: Specific Relief Amendment 2018, available at: <https://www.linkedin.com/pulse/restoring-faith-contracts-performed-india-specific-relief-chhabra/> (last visited on September 12, 2021).

⁶⁰*Ibid.*

⁶¹Dr. Sunita Pachar, Dr. Shaifali Garg, "Corporate Sustainability Development Business Model: A Study on Indian Perspective" 5875 International Journal of Advanced Science and Technology 29(3) (2020), available at: https://www.researchgate.net/profile/Sunita-Pachar/publication/340770220_Corporate_Sustainability_Development_Business_Model_A_Study_on_Indian_Perspective/links/5e9c815c299bf13079aa2389/Corporate-Sustainability-Development-Business-Model-A-Study-on-Indian-Perspective.pdf (last visited on March 22, 2022)

On a careful analysis of the issues surrounding the S.H.A., it is quite evident that, unlike other countries, we still struggle to give certainty to this concept. Indeed, we cannot allow such ambiguity surrounding the validity of the S.H.A. on the one hand, and the increasing practice of corporations entering into such agreements on the other. As discussed earlier, it will not always be the case where all such factors (A.O.A., Companies Act 2013, etc.) would align together to enforce the S.H.A.

Moreover, by analyzing the abovementioned judicial pronouncement, there is no denying that the Indian judiciary has been proactive in finding a middle path so that neither the value of the A.O.A. nor the value of S.H.A. is diminished. Still, somehow, the result seems to be a bit different. The Supreme Court has categorically mentioned in the *S. P. Gupta case*.⁶² and *Rangarajan's case*⁶³, not enforcing S.H.A. is a valid corporate action, but the aggrieved party can seek remedy in general law. However, what remedy can be sought is still a question of debate.

If the parties seek remedy under breach of contract, then there is no mechanism for the aggrieved to decide the quantum of punishment that should be imposed on the contracting parties. An S.H.A. can be executed even by a single shareholder; therefore, companies would be better equipped to overpower the aggrieved if there is a breach. As a result, the aggrieved might stay remediless or not get adequate compensation.

There have been instances where High Court has enforced S.H.A. and also bypassed, though, not superseded A.O.A. But the law of the land is laid down by the Supreme Court, which gives the A.O.A. supremacy. Most importantly, since judges have their way of analyzing the facts, there is no denying that decisions have varied over.

Also, while reading the S.H.A. along with the Indian Contract Act, 1872, it is evident that there is a 'proposal,' 'acceptance,' and *consensus-ad-idem* between the parties concerned. Thus, it is a valid contract, and with the latest amendment under S.R.A., the aggrieved party can go to the court to seek specific performance, which was earlier not the case.

Therefore, after analyzing the issue and answering the question posed at the beginning of the article. Certain suggestions can be drawn, which are as follows:

1. Due diligence should be done by the parties while entering into S.H.A., ensuring its conformity with A.O.A.
2. Suppose there is a breach of S.H.A. even though A.O.A. permits such breach. In that case, the penalty should be settled via the company itself when drafting S.H.A. or via the adjudicating authority.
3. After the 2018 amendment in the Specific Relief Act 1963, efforts should be made to harmoniously construe the provision of A.O.A. read with Section 10 of S.R.A.
4. The Supreme Court should *Suo-moto* take cognizance and draft a proper set of rules or guidelines to govern such agreements.

At last, till such time comes, the companies shall exercise the utmost caution while drafting the S.H.A. and ensure that whatever clause is included in the S.H.A., the same should be included in the A.O.A. as well by way of an amendment.

⁶²Supranote 39.

⁶³Supra note 42.