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**Corporate Analysis - Restrictions
on Transfer of Shares**

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Legal Validity of Restrictions on Transfer of Shares of Public Companies

In terms of Sections 2(68) and 2(71) of the Companies Act, 2013 (“**CA13**”), a public company is defined as a company which *inter alia*, does not restrict the right to transfer its shares. These provisions of the CA13 have already been notified and have come into force in supersession of the corresponding provisions of the Companies Act, 1956.

Further, as stipulated under Section 58(2) of the CA13, the shares of a public company are freely transferrable. However, the proviso to Section 58(2) further states that “any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract”.

The aforesaid provisions of the CA13 appear to be an attempt to codify the principles laid down in a recent judgment of the Bombay High Court in the case of *Messer Holdings Limited vs. Shyam Madanmohan Ruia and Ors.*, [2010]104SCL293 (Bom), noted below:

“...an agreement by a particular shareholder or between two shareholders relating only to their own shares (by way of pledge, sale or for preemption) is a consensual arrangement entered into by them, in exercise of their right of free transferability and it consequently imposes no restriction on transferability...The concept of free transferability of shares of a public company is not affected in any manner if the shareholder expresses his willingness to sell the shares held by him to another party with right of first purchase (preemption) at the prevailing market price at the relevant time. So long as the member agrees to pay such prevailing market price and abides by other stipulations in the Act, Rules and Articles of Association there can be no violation. For the sake of free transferability both the seller and purchaser must agree to the terms of sale.... The fact that shares of public company can be subscribed and there is no prohibition for invitation to the public to subscribe to shares, unlike

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in the case of private company, does not whittle down the right of the shareholder of a public company to arrive at consensual agreement which is otherwise in conformity with the extant regulations and the governing laws... 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 agreement can be enforced like any other agreement. That does not impede the free transferability of shares at all..."

Interestingly, the nature of a shareholders' agreement was considered by a 2 (two) Judges Bench of the Supreme Court of India in the case of *V.B. Rangaraj v. V.B. Gopalakrishnan and Ors.*, (1992)1SCC160. In that case, an agreement was entered into between shareholders of a private company wherein a restriction was imposed on a living member of the company to transfer his shares only to a member of his own branch of the family. Such restrictions were, however, not envisaged or provided for within the articles of association of the company. The Apex Court took the view that provisions of the shareholders agreement imposing restrictions even when consistent with company legislation, are to be authorized only when they are incorporated in the articles of association.

This view was however not subscribed to by the Apex Court in a recent matter of *Vodafone International Holdings B.V. vs. Union of India and Anr.*, (2012)6SCC613, wherein the Court has taken a view that freedom of contract can be restricted by law only in cases where it is for some good of the community. The Companies Act, 1956, or the other legislations do not explicitly or impliedly forbid shareholders of a company to enter into agreements as to how they should exercise voting rights attached to their shares.

Legal Analysis

In light of the revised definitions under CA13 and the recent judgments, the legal position with respect to validity of restrictions on transfer of shares of a public company can be summarized as under:

- An agreement between shareholders restricting the transfer of shares in a public company does not violate the legal mandate of free transferability of shares of a public company;
- Restrictions on transfer of shares as aforesaid, must not be in violation of the articles of association of the public company or the governing law (i.e. the CA13);
- Such agreement restricting transfer of shares, can be enforced as a contract amongst and against the shareholders who are party thereto;
- However, such contractual restrictions on transfer of shares of a public company are not enforceable against the company, in case the company is not a party to the agreement containing such restrictions.

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