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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provided dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

# **UNCHARTERED TERRITORY: THE ENFORCEABILITY OF SHAREHOLDERS' AGREEMENT WHEN THE ARTICLES OF ASSOCIATION ARE SILENT**

AUTHORED BY - AU CHANDANA SAJJA

## **I. INTRODUCTION**

The enforceability of shareholders' agreements (SHAs) in India has been a topic of significant debate, particularly when these agreements conflict with or are silent in the Articles of Association (AoA) of a company. While Indian jurisprudence has largely settled the issue in cases where SHAs are in direct conflict with the AoA, ambiguity arises when SHAs contain provisions that are silent in the AoA. The Supreme Court's decision in *V.B. Rangaraj v. V.B. Gopalakrishnan*,<sup>1</sup> established a key precedent, holding that the terms of a shareholders' agreement must not be inconsistent with the AoA to be enforceable. This judgment set a clear rule that SHAs conflicting with the AoA are unenforceable unless incorporated into the company's constitution through the AoA. This principle was extended in the case of *World Phone India Pvt. Ltd. v. WPI Group Inc.*,<sup>2</sup> where the court ruled that even SHAs with provisions silent in the AoA would not be enforceable unless those provisions were formally included in the AoA. This created a more rigid framework for the enforceability of SHAs, requiring that key terms be integrated into the AoA for them to be enforceable. However, the Supreme Court's view in *Vodafone International Holdings B.V. v. Union of India*,<sup>3</sup> introduced a reasoned perspective on the purpose of Shareholders' Agreements (SHAs). While the court did not directly overrule *Rangaraj*, it expressed a differing opinion through *obiter dicta*. The court observed that SHAs, even if not reflected in the AoA, could potentially be enforced if they serve the interests of the company and are not in direct conflict with the AoA. Although this was not the binding ratio decidendi of the case, it indicated a diversion from the strict rule laid down in *Rangaraj* and *World Phone*, offering a more flexible interpretation.

The approach taken in *Rangaraj*, and *World Phone*, has been criticized for limiting the flexibility of shareholders to contract freely, particularly in areas such as the protection of

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<sup>1</sup> *V.B. Rangaraj v. V.B. Gopalakrishnan*, (1992) 1 SCC 160.

<sup>2</sup> *World Phone India Pvt. Ltd. v. WPI Group Inc.*, (2013) 114 CLA 333.

<sup>3</sup> *Vodafone International Holdings B.V. v. Union of India*, (2012) 6 SCC 613.



minority shareholders or the transfer of shares. Additionally, the requirement to amend the AoA to incorporate private agreements undermines the purpose of an SHA as a private document by forcing its terms into a public record like the AoA. The enforceability of shareholders' agreements (SHAs) in India, especially when silent in the Articles of Association (AoA), remains legally ambiguous. This paper argues that a more flexible approach is needed to ensure contractual freedom while balancing corporate governance principles.

## **II. PRIVATE NATURE OF SHAREHOLDERS' AGREEMENTS**

The enforceability of shareholders' agreements (SHAs) that are not repugnant to the Companies Act, but are also not incorporated into a company's Articles of Association (AoA) was addressed by the court in *World Phone India Pvt. Ltd. v. WPI Group Inc.*. The court held that, under Section 9 of the Companies Act, 1956,<sup>4</sup> agreements, MoA or AoA, that are contrary to the Act are unenforceable. However, the court also applied Section 9 to emphasize that simply being consistent with the Act does not make an SHA enforceable if its terms are not incorporated in the AoA. Relying on the precedent set in *V.B. Rangaraj v. V.B. Gopalakrishnan*, the court in *World Phone*,<sup>5</sup> held the need for SHA provisions to be incorporated into the AoA through formal amendment, particularly if the AoA is silent on the matter. This reasoning, which mandates the incorporation of SHA provisions into the AoA when the AoA does not include them, raises concerns about the balance between the private nature of SHAs and the public nature of corporate constitutional documents like the AoA and Memorandum of Association (MoA). The requirement for an SHA's provisions to be amended into the AoA, a public document, undermines the SHA's purpose as a private contract between shareholders.

This creates tension between contractual freedom and the formalities of corporate governance, particularly when the AoA does not directly conflict with the SHA but is simply silent on its provisions. This Contractual freedom between the shareholders to a SHA was emphasized in the *Vodafone* case,<sup>6</sup> where the court reasoned that a Shareholders' Agreement (SHA) is a private contract between some or all shareholders, providing rights and obligations beyond those established by company law. Unlike the Articles of Association (AoA), a public document binding on all shareholders, the SHA only binds its parties and offers greater flexibility. While

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<sup>4</sup> The Companies Act, 1956, § 9, No. 1, Acts of Parliament, 1956 (India).

<sup>5</sup> *World*, *supra* note 2.

<sup>6</sup> *Vodafone*, *supra* note 3, at para 261.



SHAs can include provisions on dispute resolution and future capital contributions, if the SHA conflicts with the AoA, the AoA will prevail, limiting the enforceability of conflicting SHA terms. This highlights the tension between the private nature of SHAs and the public governance framework of the AoA. Thus, the current law laid by V. B Rangaraj and World Phone cases would undermine the flexibility of entering into a SHA by undermining its purpose.

### **III. LEGAL LACUNA AND AMBIGUITY**

In *Amrit Kaur Puri vs. Kapurthala Flour, Oil and General Mills Co. P. Ltd.*,<sup>7</sup> the Punjab and Haryana High Court allowed shareholders to set a higher quorum than what was prescribed by the 1956 Act as the Act was silent showcasing that Act's silence on the matter did not oppose such a positive modification.<sup>8</sup> If such reasoning was applied by the Court in the World Phone case in regard to the interpretation of section 9, the enforceability of SHAs would have been upheld in case silence in the AoA as a positive modification. The possibility of positive and negative interpretation of a provision rendering contradictory rulings makes the law on this subject ambiguous leaving a possible lacuna.

A potential lacuna exists in the Court's reasoning and interpretation of Section 9 of the Companies Act,<sup>9</sup> 1956, which corresponds to Section 6 of the Companies Act, 2013.<sup>10</sup> This issue arises because applying the same interpretation upheld by the Court in the *World Phone* case regarding Section 10 of the Companies Act, 2013, would effectively uphold the enforceability of Shareholders' Agreements (SHAs) against silent Articles of Association (AoA). Section 6(b) of the Companies Act, 2013,<sup>11</sup> clearly states that any provision in the Memorandum of Association (MoA) or AoA that is repugnant to the Act shall be rendered void. While, Section 10 of the Companies Act, 2013,<sup>12</sup> provides for the effect of MoA and AoA thereby requiring observance of all provisions of the MoA and AoA by the company and its members. However, the provision explicitly does not provide for in case of an agreement between the shareholders that the AoA is silent upon. If we apply the interpretation set forth in

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<sup>7</sup> *Amrit Kaur Puri v. Kapurthala Flour, Oil and General Mills Co. P. Ltd.*, [1984] 56 CompCas 194 (P&H).

<sup>8</sup> Prateek Gupta, *Shareholder's Agreement and Articles of Association: A Power Struggle*, 4 INT'L J.L. MGMT. & HUMAN. 1239, 1244 (2021).

<sup>9</sup> The Companies Act, 1956, § 9, No. 1, Acts of Parliament, 1956 (India).

<sup>10</sup> The Companies Act, 2013, § 6, No. 18, Acts of Parliament, 2013 (India).

<sup>11</sup> The Companies Act, 2013, § 6 (b), No. 18, Acts of Parliament, 2013 (India).

<sup>12</sup> The Companies Act, 2013, § 10, No. 18, Acts of Parliament, 2013 (India).

the *World Phone* case, it can be inferred that agreements with clauses that remain silent in the AoA, provided they do not contradict the MoA or AoA, would be enforceable. This interpretation implies that SHAs not in conflict with the AoA could still hold validity, even when the AoA is silent on certain matters. However, the Companies Act, 2013 does not provide specific guidance on the enforceability of SHAs for private companies, while Section 58(2),<sup>13</sup> does address this for public companies. Consequently, an interpretation of Section 10 that favors the enforceability of SHAs would contradict the judgement established in the *World Phone* case. Such an inconsistency highlights the ambiguity of the law in this regard, as the same reasoning leads to conflicting outcomes.

In a contrasting decision, the Delhi High Court in *Premier Hockey Development Private Limited v. Indian Hockey Federation*,<sup>14</sup> upheld the enforceability of an SHA, despite the AoA being silent. The court explicitly rejected the reasoning from the *V Rangaraj* case, which had informed the *World Phone* judgement. This divergence adds to the substantial ambiguity surrounding the position of SHAs, especially regarding their enforceability when the AoA is silent. In light of these complexities, there is an urgent need for the Supreme Court to establish a definitive legal standard governing the enforceability of SHAs, particularly to reinforce the private nature of these agreements. By clarifying the interplay between SHAs and AoA, the Supreme Court can provide necessary guidance to navigate the ambiguities that currently pervade corporate law in this context.

#### **IV. INSIGHTS FROM ENGLISH LAW**

To address the ambiguity surrounding the enforceability of Shareholders' Agreements (SHAs) in the context of silent Articles of Association (AoA), it is prudent to draw upon established principles from English law, particularly as articulated in the case of *Russell v. Northern Bank Development Corporation Ltd.*<sup>15</sup> This landmark case underscores that a contract allowing shareholders to exercise their voting rights in a particular manner is enforceable. It establishes that the right to vote, inherently linked to share ownership, is a property right that shareholders are entitled to exercise in their own interests. Thus, agreements among shareholders to coordinate their voting strategies are lawful and recognized as fundamental to effective

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<sup>13</sup> The Companies Act, 2013, § 58(2), No. 18, Acts of Parliament, 2013 (India).

<sup>14</sup> *Premier Hockey Development Private Limited v. Indian Hockey Federation*, OMP 92/2011 & OMP 52/2011.

<sup>15</sup> *Russell v. Northern Bank Development Corporation Ltd.*, [1992] 1 WLR 588.

corporate governance.<sup>16</sup> In its decision, the House of Lords made an important distinction between agreements that unlawfully restrict a company's statutory powers and those that merely guide shareholders on how to exercise their voting rights. The latter type of agreement is considered valid and enforceable, provided it does not impose unreasonable restrictions on future shareholders. Moreover, the House recognized the doctrine of severance, which permits the enforcement of lawful portions of an agreement even if certain aspects are deemed illegal.<sup>17</sup> This framework not only enhances clarity and consistency in the enforcement of SHAs but also safeguards the rights of minority shareholders while respecting the statutory powers of the company.

The Supreme Court's ruling in the *Vodafone* case reinforces the idea that SHAs, when not in conflict with the AoA, can be viewed as binding contractual obligations. This recognition of contract law is essential for maintaining the enforceability of SHAs while ensuring compliance with the Companies Act. Incorporating such legal interpretations in the Indian context would help uphold the integrity of the Companies Act, 2013, while ensuring the enforceability of SHAs. By clearly laying down the permissible scope of SHAs, Indian courts can minimize potential conflicts with the AoA, thereby preserving the private nature of these agreements. This approach provides for flexibility necessary for effective corporate governance without compromising the foundational principles of corporate law. In doing so, the judiciary can not only clarify existing ambiguities but also reinforce the legal status of SHAs, ensuring a more stable environment for shareholders. This stability would enable shareholders to collaborate effectively and protect their interests within the corporate framework, ultimately contributing to a healthier corporate governance landscape in India.

## **V. CONCLUSION**

In conclusion, the enforceability of shareholders' agreements (SHAs) in India, particularly in cases where the Articles of Association (AoA) are silent, presents a complex legal ambiguity that necessitates balancing of interests. The very purpose of SHAs as private contracts among shareholders must not be undermined; these agreements serve to protect minority interests, facilitate the smooth operation of companies, and provide a framework for resolving internal disputes. However, the AoA, as a public document, should maintain its dominance, particularly

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<sup>16</sup> L. S. Sealy, *Shareholders' Agreement – An Endorsement and Warning from the House of Lords*, 51 THE CAMBRIDGE LAW JOURNAL 437 (1992).

<sup>17</sup> *Id.* at 478.



when provisions of the SHA are repugnant to its terms. The prevailing legal principles established in cases such as *V.B. Rangaraj* and *World Phone* have inadvertently created rigidity, which restricts shareholders' contractual freedoms and undermines the very purpose of SHAs. The Supreme Court's approach in the *Vodafone* case shows the potential for a more flexible interpretation, recognizing the purpose of SHAs while still ensuring they are not repugnant to the AoA. This balance is crucial, as it allows for the enforceability of private agreements that enhance corporate governance without encroaching upon the statutory framework established by the Companies Act.

To address the ongoing ambiguities surrounding the enforceability of SHAs in instances where the AoA is silent, it would be prudent for Indian jurisprudence to incorporate principles derived from English law, particularly those articulated in the case of *Russell v. Northern Bank Development Corporation Ltd.* Such principles emphasize the enforceability of shareholder agreements that guide voting rights without imposing unreasonable restrictions on future shareholders. By adopting this approach, Indian courts can delineate permissible boundaries for SHAs, ensuring they remain enforceable and respected while also adhering to the established tenets of corporate governance. A cohesive legal framework is essential for navigating the intersection of SHAs and AoA, promoting both the flexibility needed for effective corporate management and the integrity of statutory obligations. By doing so, the Supreme Court can establish a clearer, more equitable landscape for shareholders in private companies, fostering collaboration and protecting their interests within the corporate framework.

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