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Update on
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A division bench of the Bombay High Court in the matter of Messer Holdings Ltd. v/s Shyam Madanmohan Ruia and Ors¹ has addressed the issue of what is meant by “free transferability” of shares under Section 111A of the Companies Act, 1956 (“Act”). The bench has taken a stand contrary to some of the earlier judgments on this issue, the most recent one being the judgment by the single judge of the Bombay High Court in the matter of Western Maharashtra Development Corporation Ltd. v/s Bajaj Auto Ltd (“WMDC”)².

Prior Position

The judge in WMDC (supra) held that free transferability must be given a broad dimension in order to fulfill the object of the law and any restrictions on the principle of free transferability should be by way of a legislative function. It was held that the word “transferable” is of the widest possible import and that the Parliament by using the expression “freely transferable” has reinforced the legislative intent of allowing transfers of shares of public companies in a free and efficient domain. It was thus held that free transferability of shares is the norm in the case of shares in a public company which is founded on the principle that the public/shareholders must have the freedom to purchase and every shareholder, the freedom to transfer.

¹ Appeal no. 855/ 2003, delivered on September 1, 2010

² (2010) 154 Company Cases 593 (Bom)

Taking recourse to section 9³ of the Act, the judge further held that, pre-emptive rights (whether as part of an agreement or incorporated in the Articles of Association) are impermissible under Section 111A.

Present Position

In the present matter the court examined whether a clause relating to a pre-emptive rights/ right of first purchase in a share purchase agreement executed between specific shareholders was void in light of section 111A of the Act.

In deciding this issue, the bench considered the objects and reasons for the introduction of section 111A, in light of Section 22 A of the Securities Contracts (Regulations) Act, 1956 (“SCRA”) and opined that the sweep of Section 111 A is the same as Section 22 A of the SCRA. It was observed that the intention behind introducing Section 22 A in 1986 was to regulate the powers of the Board of Directors to refuse the transfer of shares and it was not to impose a restriction on the right of shareholder to deal with his shares by entering into a consensual arrangement with a third party.

³ Section 9 of the Companies Act, 1956 stipulates that the provisions of the Act shall have effect, notwithstanding anything to the contrary contained in the Memorandum or Articles of Association.

In other words, the setting in which Section 111A is placed in part IV of the Act under heading “transfer of shares and debentures” is not a provision to curtail the rights of shareholders to enter into consensual arrangements with purchasers in respect of their specific shares and if the legislature intended to take away that right of shareholders, it would have made an express provision in that regard.

Highlights

- The bench held that when a shareholder deals with a share or enters upon a contract to pledge his shares, or binds the sale of shares to the preemptive rights of other shareholders, he does so in exercise of his right of free transferability of shares and he does that in the same manner as in the case of any other movable or immovable property in India which is also freely transferable. That right would include right to pledge, mortgage or preemption regarding his property.
- The fact that shares of public company can be subscribed and that there is no prohibition for invitation to the public to subscribe to shares does not whittle down the right of the shareholder of a public company to arrive at a consensual agreement which is

otherwise in conformity with the articles of association and provisions of the Act and Rules.

- Section 111A does not deal with the right of the shareholders to enter into consensual arrangement/agreement by way of pledge, pre-emption/sale or otherwise. If that right is not covered by Section 111A of the Act, then, section 9 (supra) of the Act will also not come into play at all.

Comment

This judgment was delivered by the division bench of the Bombay High Court. While the Supreme Court has not given a clear ratio on this particular aspect, this judgment would only have a persuasive value on other High Courts.

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