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IS RESTRICTION ON TRANSFER OF SHARES VALID UNDER COMPANIES ACT, 2013?

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Sometimes investor(s) investing in a company, in India, prefer restrictions on transfer of shares by the promoters / shareholders under the shareholders' agreement / consensual arrangement with an intent to protect their interest or for any other reason. Therefore, it is imperative to understand the legality of such restrictions on transfer of shares in India under Companies Act, 2013 ("CA 2013"). We have analyzed the relevant provisions of CA 2013 regarding transfer of shares, as applicable to a public as well as private company below.

Public Company

Section 58 (2) of CA 2013 provides that the securities or other interest of any member in a public company shall be '**freely transferable**' (emphasis supplied). Further, **proviso to Section 58 (2) of CA 2013** provides that any contract or arrangement between two or more persons in respect to transfer of securities shall be enforceable as a '**contract**'. The aforesaid provisions of Section 58 (2) of CA 2013 are similar to the provisions of Section 111A (2) of the erstwhile Companies Act, 1956, **except the aforesaid proviso to Section 58 (2) of CA 2013**.

In the erstwhile Companies Act, 1956, there were some debatable issues with respect to the expression '**freely transferable**'. However, in the matter of Messer Holdings Limited vs. Shyam Madanmohan Ruia & Others [2010 159CompCas29(Bom)], the Hon'ble Bombay High Court held that any contract or arrangement between two or more persons with respect to transfer of securities can be enforced like any other contract and does not impede the free transferability of shares at all. Therefore, the aforesaid **proviso to Section 58(2) of the CA 2013** has been incorporated in line with the aforesaid judgment of the Bombay High Court.

In view of the above, any restriction on transfer of shares under the shareholders agreement / consensual arrangement as executed amongst the shareholders shall be valid and binding as a '**contract**' inter-se the shareholders. If any public company is also being made party to such shareholders agreement / consensual arrangement, then such contract will also be enforceable against the public company like any other contract. In case of breach of such contract by any party, the aggrieved party may avail such legal remedies as available in case of '**breach of contract**' including the specific performance of such contract under the Specific Relief Act, 1963.

It is also important to analyze the expression '**freely transferable**', which has not been defined under CA 2013. The expression '**freely transferable**' is a mandate against the board of directors to register the transfer of the specified shares and such expression should be given wider interpretation. Any consensual arrangement / contract providing restriction on transfer of shares or providing pre-emptive rights pertaining to transfer of shares should not be construed as violation of the expression '**freely transferable**'. Had that not been the intention of the legislature, the proviso to Section 58(2) of the CA 2013 would not have been specifically inserted and appropriate restriction would have been placed in CA 2013 in relation to transfer of shares in terms of consensual arrangement. However, such expression does not in any way restrict the power of the board of directors of a public company to refuse the registration of transfer of such shares on '**sufficient cause**'.

The board of directors, upon '**sufficient cause**' being seen, may refuse to register the transfer of shares. The words '**sufficient cause**' in Section 58(4) takes within its ambit not only those contingencies contemplated under sub-section (3) but also circumstances and reasons other than which might require the company to refuse to register the transfer of shares. Thus, there can be various reasons, though it is not possible to enumerate all of them and may depend on the facts of each case, which would constitute '**sufficient cause**' for a company to refuse the registration of transfer of shares.

Private Company

In terms of the provisions of CA 2013, a private company is required to restrict the transfer of its shares through its articles of association ("**AoA**") [Section 2(68) of CA 2013]. Hence, any restriction on transfer of shares as agreed under the shareholders agreement / consensual arrangement and duly incorporated in its AoA shall be valid and binding on such a private company and may be enforced against the shareholders of a private company. However, if a private company refuses to register the transfer of any securities or interest of a member, whether in pursuance of any power of the company under its AoA or otherwise, it is required to intimate the transferor and transferee within the stipulated time period [Section 58 of CA 2013].

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.