
THE INTERPLAY BETWEEN ARTICLES OF ASSOCIATION AND SHAREHOLDERS' AGREEMENTS IN CORPORATE VOTING RIGHTS: A LEGAL ANALYSIS IN THE INDIAN CONTEXT

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ABSTRACT

This research paper examines the relationship between Articles of Association (AOA) and Shareholders' Agreements (SHA) in the context of corporate voting rights in India. It analyzes the legal framework governing these documents, focusing on key sections of the Companies Act, 2013 and the Indian Contract Act, 1872. The study explores landmark cases such as *V.B. Rangaraj v. V.B. Gopalakrishnan* and *Tata Consultancy Services Ltd. v. Cyrus Investments*, which have shaped the legal landscape.

The research highlights the traditional supremacy of the AOA while acknowledging the growing importance of SHAs in modern corporate governance. It discusses the challenges in reconciling conflicting provisions and the evolving approach of Indian courts in interpreting and enforcing SHA clauses not incorporated in the AOA. Recent trends are examined, including the use of entrenchment provisions and increased transparency requirements. The paper offers recommendations for harmonizing AOAs and SHAs, emphasizing careful drafting and effective dispute resolution mechanisms.

This study contributes to the debate on balancing statutory regulations with contractual freedom in corporate governance, providing insights relevant to India and other jurisdictions facing similar issues in a globalized business environment. It concludes by suggesting areas for future research, including comparative analyses and empirical studies on the impact of AOA-SHA conflicts.

Introduction

The focus of this research paper is the relationship between Articles of Association (AOA) and Shareholder Agreements (SHA) in relation to the corporate voting rights. It seeks to understand the laws relating to these documents in India and review important judicial rulings. The paper also pays attention to the practical impacts of voting rights disputes and suggests ways of addressing them, which will be useful to practitioners of corporate governance as well as legal counsel.

Voting rights in the context of corporate governance never miss the list of attributes and privileges of the shareholders since most of these rights are related to control over the most important aspects of the company.¹ These rights are generally stated in the company's Articles of Association (AOA) and are frequently modified in Shareholders Agreements (SHA) and are mostly affecting the decisions of the board of directors in the company. However, these two corresponding documents tend to work simultaneously most of the times, and this is the case with provisions of voting rights in most instances.

The AOA, being the constitution of a company, details the fundamental aspects of how the company will be governed including the manner in which and the extent of voting rights which may be allocated and exercised. On the other hand, SHAs are contracts between the shareholders and are often used to provide for extra rights and responsibilities and control mechanisms over the corporation.² Conflict threatens when such documents offer separate or even opposing provisions on voting which raises ambiguity in management control and potential legal disputes.

The purpose of this paper is to elucidate the relationship which we see existing between the AOAs and the SHAs in terms of exercise of voting rights, understanding the situational law within India and the landmark judicial precedents. The aim of this research is to examine the practical consequences of these conflicts and, thus, suggest ways in which they can be resolved in an order to achieve a more balanced and consistent approach towards corporate governance

¹ Varottil, U. et al. (2017) Conflicts between shareholders agreements and articles of a company, IndiaCorpLaw. Available at: <https://indiacorplaw.in/2013/06/conflicts-between-shareholders.html> (Accessed: 18 October 2024).

² Ryan, C. and Reece, K. (2020) Reece Thomas & Ryan: The law and practice of shareholders' agreements fifth edition, Reece Thomas & Ryan: The Law and Practice of Shareholders' Agreements Fifth edition | LexisNexis UK.

in relation to the voting rights of shareholders.

The Interplay between AOA and SHA

There has been a paradigm shift in India's corporate governance from a model focused on the promoters to one that is increasingly centred around shareholders and their rights. Such a change is attributed to the economic liberalization policies adopted by the country in the 90's which led to increased foreign investment in the country and the subsequent necessity for stronger corporate governance mechanisms.³

As we know, prior to this development, the Companies Act, 1956 was the primary statute that governed companies and regulated all matters including provisions regarding the voting rights. However, this act did not speak much about the enforceability of shareholders' agreements, leading to confusion in respect of their implementation.⁴ The case of *V.B. Rangaraj v. V.B. Gopalakrishnan*⁵ that arose in 1992, raised this concern and clarified that the AOA takes precedence over such agreements between shareholders. India's corporate landscape saw a considerable turning point after the introduction of the Companies Act, 2013.

This new law not only brought changes to the governance structure however it also made some provisions that indirectly acknowledged the promises made by the shareholders in relations to the sections on the enforceability of the contracts. This textual development and the judicial interpretation have defined the current context within which legal provision about voting rights in India exists and the relation between the AOA and the SHA has developed.

In Indian firms, the general legal basis of voting powers of the shareholders is mostly the Companies Act 2013 which also draws certain provisions from the Indian Contract Act 1872. These legislative provisions together weave a intricate quilt of clauses which stipulate the voting powers as given in the AOA and the SHA.

The Companies Act 2013 contains provisions that act as the structural platform for the corporate governance of all companies in India and lays out in detail the various provisions

³ Chakrabarti, R. and Megginson, W.I. (2009) 'Corporate Governance in India', Global Corporate Governance, pp. 151–176. doi:10.7312/chew14854-008.

⁴ Varottil, U. (2015) 'The evolution of corporate law in Post-Colonial India: From transplant to Autochthony', SSRN Electronic Journal [Preprint]. doi:10.2139/ssrn.2557809.

⁵ *V.B. Rangaraj v. V.B. Gopalakrishnan*, (1992) 1 SCC 160

pertaining to the voting rights. According to Section 47, the fundamental voting rights of members of the company are determined and it states that every member of a company limited by shares holding equity share capital shall have a right to vote at every resolution which may be placed before the members at the general meeting or to the shareholders.⁶ As regards to changes in rights of the stockholders, section 48 determines the requirement for three quarters of the issued shares of that class or a special resolution passed at a separate meeting of the holders of the issued shares of that class.⁷ Section 58(2) deals with shareholders agreements, since it establishes that contracts or arrangements between two or more persons with respect to transfer of securities shall be treated as executory agreements.⁸ This excludes any understanding to the effect that voting arrangements provided for in SHAs do not have legal support. Section 10 provides for the effect of the AOA so that when it is registered, the company and its members are bound by the same as if each member has signed it.⁹ This section emphasizes the role played by the AOA in the management of the affairs of the company including the power to vote.

The Indian Contract Act is very instrumental in the upholding of the SHAs. Section 10 specifically states: “A contract is an agreement enforceable by law if it meets certain essentials” which is critical to the enforceability of SHAs.¹⁰ Section 23 is also important when considering the provisions within the SHAs since this article notes that the agreements are void if they go against public interest.¹¹

While the AOA is already comprehensive, it is likely to conflict with the SHAs when dealing with special voting rights, veto powers and transfer restrictions. It is possible that the SHAs may allocate extra voting powers that the AOA does not account for, to some shareholders. Other shareholders may also be afforded conditional veto powers on certain issues via the SHA that do not conform to the AOA’s voting system. Under AOA and common practice, such restrictions include share transfers which are usually contained in SHAs. Such legal provisions are the ones that the courts use to interpret the other such as AOA in relation to the voting rights issues of the SHA or any other provisions of the constitution.

⁶ The Companies Act, 2013, §47 (India).

⁷ The Companies Act, 2013, §48 (India).

⁸ The Companies Act, 2013, §58(2) (India).

⁹ The Companies Act, 2013, §10 (India).

¹⁰ The Indian Contract Act, 1872, §210.

¹¹ The Indian Contract Act, 1872, §23.

The legal framework of voting rights as it is affected by Articles of Association (AOA) and Shareholders' Agreements (SHA) is intricate and interesting in equal measure. It is clear from the provisions of Indian company law that the Articles of Association is placed above all other documents. This is regarded as the constitution of the company and governs the company and the members in relation to each other. This dominance of the AOA can be traced to its provision under the Companies Act of 2013, as well as its character as a public document available for filing at the Registrar of Companies and to all pertinent parties. On the other hand, SHA's are essentially agreements entered into by the shareholders and are private documents and not usually available for the rest of the shareholders that are not a party to the agreement. This difference is important in appreciating how the courts resolve differences regarding the two documents.

Even though AOA takes superior position over other documents, it does not mean that there does not exist legal power for SHA's. Indian Contract law gives SHA's the necessary legal framework for the enforcement of those agreements as legal contracts. And yet, to some extent, and the authors outlined the so-called prerequisites, this enforceability is dependent.

Generally acceptable are provisions in the SHA which do not contravene the AOA and the Companies Act provisions. Companies as well as each and every shareholder can be contracted by the SHA if such provisions are included in the Memorandum and Articles of Association. Even in the absence of incorporation into the AOA, such provisions may be enforced as agreements made between the contracting parties, as long as such provisions are not in contradiction to the AOA or the Companies Act.

There also existed a significant number of complaints by horizontal integration shareholders who were linked to such agreements but whose voting rights and restriction of votes or particular action not carried out or created in the articles. There is also a general rule that these modifications and restrictions cannot lend any enforceable or restrictive measures to a company unless such restrictions have been included within the articles. In this instance, if there is an SHA with respect to the shareholders which gives managerial voting rights, such rights are not included in the AOA then might not be presumed to be obligatory against the company who other shareholders who have not signed. There may be, however, contractual relational constructs presumed between the parties to the signing agreement, so they are legally bound to the contract terms. There are instances when SHAs can contain a right of first refusal for the

shareholders over a specific portion of the non-responsible parties share transfers. Suffice to say, these provisions have been the subject of judicial inquiry.

This is a general tendency to say, progress is inter se among the parties to the contract but not to the company unless such amendments are brought within the AOA. The appointment and powers of directors as addressed in SHAs may also be inconsistent with the AOA. Consistently, the courts have adjudicated that such rights ought to be recorded within the AOA in order to be enforceable against the company. It should be pointed out that there are new pieces of legislation that have enhanced the protection of the interests of owners of shares of agreements. Section 58(2) of the Companies Act 2013, provides that a contract on securities transfer between two or more persons shall be enforceable just as any contract.¹² Some legal scholars have even gone ahead to explain such a provision as an endorsement of SHAs through indirect legislation.

The doctrine of indoor management, which is also known as the rule in *Royal British Bank v Turquand*,¹³ is of significant relevance in this case. This doctrine assists third parties interacting with a company by enabling them to presume that the internal affairs and processes of the company are appropriate. With respect to voting rights conflicts, this doctrine may hinder the cross-application of postfix modalities of the SHA that are not incorporated into the AOA, especially upon third parties or non-signatory shareholders of the SHA clauses.

The legal perspective brings to the fore the interaction of different statutory provisions, contract law and the principles of the courts. However, while the AOA remains the supreme document controlling the activities of the company, SHAs have evolved into valid contracts. But, their implementation, especially relating to voting rights, has always been dependent on the contractual provision to be annexed to the AOA or be in harmony with the contents therein. This complexity factors into the need for precision in the wording and coordination of these very important documents in corporate governance scattering.

There is an emphasis on the importance of the Indian judiciary in addressing the legal aspects of conflicts involving the AOA and the SHA, primarily in terms of voting rights. The case of *V.B. Rangaraj v. V.B. Gopalakrishnan*¹⁴ is significant because it touches on the concern of the

¹² The Companies Act, 2013, §58(2) (India).

¹³ *Royal British Bank v. Turquand* (1856) 6 E&B 327

¹⁴ *V.B. Rangaraj v. V.B. Gopalakrishnan*, (1992) 1 SCC 160

relationship between Memorandum and the Articles of Association on the one hand and the Shareholder's Agreement on the other hand. The Supreme Court of India ruled that conditions regarding the transferability of Shares in a Shareholders' Agreement are void to the company and its members unless these are found in the Articles of Association. The Court noted that such agreements were subordinate to the company's Memorandum and Articles of Association and there was no scope for any free restriction. It stated that such restrictions shall only be imposed if the provision is made in the company act. The progress of the case showed that the greater the number of key provisions within the AOA the less likely will SHA be enforced since it is hard to enforce provisions filed under the company act or any similar documents. This case established the conditions of the problem and how clearly the conflicts of AOA's and SHAs, in this case, the purpose of transferring shares, are easily resolved.

In the case of *World Phone India Pvt. Ltd v. WPI Group Inc USA*,¹⁵ the Rangaraj estoppel was proceeded with a particular bitterness by the Delhi High Court, differentiating the circumstances. The AOA was delivered to the court of first instance, compared with the reason to sign shareholders agreement and said even that has substantial weight. The court maintained that the any provision in an SHA not enshrined under AOA is nonetheless a valid contractual agreement between the parties to the agreement. It was able to draw the line between the enforceability of provision of the SHA against the company while reasoning that those too were between the contracting parties of the agreement. This way of thinking allowed further latitude claiming that active provisions might concern more the parties than the company itself and therefore the company would not be bound, unless the provisions are included in the articles. This decision enabled a looser view of SHAs by accepting their validity as agreements while still giving precedence to the AOA for purposes of company management.

One should always bear in mind that although this was more in the country in issue of taxation, the *Vodafone International Holdings BV v. Union of India*¹⁶ case also had a lot to do with SHAs and corporate governance in that country. The Supreme Court accepted that such agreements as Shareholders' Agreements do possess a valid existence and weight within the confines of the corporate structure. It's apparent that the Court was aware of the vast potential usage of SHAs for the definition of duties and rights of shareholders. It observed that SHAs inter alia, managed the controlling rights that can sometimes be hidden behind the percentages in shares.

¹⁵ *World Phone India Pvt. Ltd. v. WPI Group*, 2013 SCC OnLine Del 1098

¹⁶ *Vodafone International Holdings BV v. Union of India and Anr.* (2012) 6 SCC 613

The outstanding issue here is the issue of enforcement of the provision of SHAs. The Supreme Court also implied that the sanctioning agreements inter alia provisions of SHAs did possess an obligatory enforcement between the contracting parties. It must be noted that the case did not seek out contradictions between AOA and SHAs but gave hope to the legitimacy and the primacy of SHAs within the corporate confines.

The more well-known issue in the case of *Tata Consultancy Services Ltd. v. Cyrus Investments*.¹⁷ was the fact that it concerned the removal of Cyrus Mistry as the chairman of Tata Sons which brought to the forefront matters of corporate governance and shareholder actions. While there were several issues involved in the case, it helped to understand how courts perceive the relationship between the AOA and SHAs in the context of corporate control and voting rights. In the last instance the Supreme Court of India stressed that all relevant provisions of the AOA that deal with appointment or termination of directors must be recognized as essential for governing the affairs of the company. The Court accepted the merit in specific limitation and special rights as existing in the AOA including the ability of Tata Trusts to nominate directors. This ruling went a step further in emphasizing the need that good majority of the key governance aspects most notably those that touch on the aspect of voting rights and control ought to be contained in the AOA if they are to be effective in practice.

It has also emerged over time that there is a settled view that most if not all SHAs and AOA do have certain conflicts which need to be resolved in a manner that gives honor to the AOA as the supreme document in all affairs including the conduct of voting. There appears to be an increasing acknowledgement of the fact that the agreements are indeed contractually binding, at least to the parties that have signed them. The provisions of the AOA with regard to the link between SHAs and specifically provisions which are not in conflict with the AOA, and which do not conflict with any statute have been enforced by the courts. There is a specific focus that keeping the key amendments in the AOA is important so that they are effective and lawful to the company and its entire shareholders. There has been some gradual enhancement of these powers and the courts have become more willing to exercise them in a variety of contexts such as tightly held business and corporate governance in terms of SHAs and AOA. This type of development is indicative of how the courts seek a balance between the legal regime of corporate governance and the dynamics of a business scene with respect to the key

¹⁷ *Tata Consultancy Services Ltd. v. Cyrus Investments (P) Ltd.*, (2021) 9 SCC 449

consideration of control rights and voting arrangements.

Recent Trends and Practical Implications

In India, with respect to the governance provided by the AOA and how it interacts with SHAs emphasizing on voting rights has also been consistently progressing. The corporate governance environment witnesses a growing practice in recognition of the SHAs. The Courts tend to regard AOA as fundamental, but SHAs are increasingly acknowledged in business relations¹⁸ Furthermore, companies and legal practitioners are trying to better synchronize AOA's and SHAs to avoid future discrepancies. This trend is attributed to court rulings where the judiciaries have emphasized the need to include certain key SHA provisions within AOA's.

Section 5(3) of the Companies Act, 2013 allowed for the inclusion of entrenchment provisions within the AOA.¹⁹ Hence, companies can have articles that are more difficult to amend than the other articles, which would still be incorporated in the AOA so as to safeguard the pertinent SHA provisions. For public companies, there is increasing interest to make shareholder arrangement more transparent. The Securities and Exchange Board of India (SEBI) has made compliance measures mandating the publication of significant provisions of SHAs which have bearing on control or management of companies. Companies are increasingly faced with the incorporation of other forms of dispute resolution in both the AOA's and SHAs in order to resolve conflict in more expedient and less expensive ways.

Taking into consideration the current patterns and legal positioning, a number of recommendations are made for companies, shareholders and legal practitioners.

In undertaking the SHA upon entering or altering the AOA, the parties are required to perform comprehensive analysis to avoid any discrepancies between the provisions of the AOA and the amendments proposed.²⁰ While drafting the SHAs, the existing AOA must be taken into account, and vice versa. If this is the case, making both documents congruent to each other's

¹⁸ Varottil, U. (2023) 'Shareholder Inspection Rights in India: Restricted scope and diminished effect', SSRN Electronic Journal [Preprint]. doi:10.2139/ssrn.4636946.

¹⁹ The Companies Act, 2013, §5(3) (India).

²⁰ Bajpai, G.N. (2016) The Essential Book of Corporate Governance, Google Books. Available at: https://books.google.com/books/about/The_Essential_Book_of_Corporate_Governan.html?id=cTtwDQAAQBAJ (Accessed: 18 October 2024).

language and provisions so as to avoid any confrontation in future would be feasible.²¹ Incorporating the voting control provisions of the SHA into the AOA and integrating the relevant provisions into the AOA. For some basic control issues, it may be advisable to consider entrenching provisions within the AOA and making them harder to change without major shareholder agreement. To mitigate the risk of ambiguity in interpretation, it is essential to avoid duplicative or overlapping provisions in the Articles of Association (AOA) and the Shareholders' Agreement (SHA). Both documents should be subject to routine review processes, ensuring that they remain fit for purpose in the context of the company's evolving needs and adhere to contemporary legal standards. Furthermore, it is crucial to provide shareholders with transparent explanations regarding any restrictions on their rights, their roles and responsibilities, and the governance structures of the company, particularly where specialized voting arrangements are involved. The AOA and SHA should also incorporate clearly defined alternative dispute resolution mechanisms, such as mediation or arbitration, to effectively address potential conflicts. This can help avoid delays and minimize costs commonly associated with traditional legal disputes. Companies, especially those listed on the stock exchange, must diligently ensure compliance with all regulatory requirements, including the disclosure of material provisions in the SHA. Lastly, careful consideration should be given to the company's current ownership structure and future strategic objectives during the drafting of the AOA, reducing the need for frequent amendments.

Indian corporate law is in a transition stage and the scope of the interaction between Articles of Association and Shareholders' Agreements in terms of voting rights is one of the examples of this transitional period.²² This paper has stressed the main conflict which exists between the law embedded in the AOA and the current relevance of SHAs in the model of corporate governance. The primary conclusions of this study are the following: The principle of the supremacy of the AOA, founded in some of the most important cases in this field such as the case of *V.B. Rangaraj v V.B. Gopalakrishnan*,²³ still prevails as one of the key principles in legal interpretation in this sphere. Courts acknowledge the existence of such documents called SHAs but the substantive enforcement of these SHAs is usually restricted to the signatories

²¹ Bainbridge, S.M. (2012) 'Shareholder empowerment', *Corporate Governance after the Financial Crisis*, pp. 204–260. doi:10.1093/acprof:oso/9780199772421.003.0008.

²² Kraakman, R. et al. (1970) *The Anatomy of Corporate Law: A Comparative and functional approach*, CBS Research Portal. Available at: <https://research.cbs.dk/en/publications/the-anatomy-of-corporate-law-a-comparative-and-functional-approac> (Accessed: 18 October 2024).

²³ *V.B. Rangaraj v. V.B. Gopalakrishnan*, (1992) 1 SCC 160

except some core provisions which are incorporated in the AOA. Some of the recent legal progresses for instance the Tata – Mistry case embarked on a conservative perspective from majority of the key factors determining where AOAs and SHAs fit in the more sophisticated model of corporate governance. It is also noted that there is a gradual trend for greater congruency of the AOA to the SHA, better disclosure of shareholder arrangement and resort to ADR processes. In particular, the Companies Act of 2013 invites creative structuring of voting rights, but the framing also draws lines on the practice of corporate democracy and fairness principle. As governance systems in corporations continue to get more multifaceted than ever alongside the increase in the global vision of corporations, the pressure for concise, coherent and executable biology on governance is on the other side of the full spectrum. The difficulty that arises from this situation is that companies, shareholders, and legal practitioners must board the complex environment of corporate governance while ensuring the interests of all stakeholders are secured and protected.

Conclusion

In the future, we might expect additional changes to the law or general regulatory practice through the Companies Act, or through more comprehensive SEBI rules for listed companies which aim to clarify how Company AOA and SHA interact with each other. We may also see a drift toward greater uniformity in the language used in these documents to reduce the scope of disputes. To sum up, the problem of duality of voting rights embedded into Company AOA and SHA is persistent; however, it is also clear that strong reasonable documentation together with best practices, active mode of oversight and changing perspectives will ultimately lead to better management of corporations. The outlook for future evolution of the formulation of Company AOA and SHA should be such that it will facilitate the concentration of power of shareholders in the companies in question whilst also balancing their powers. Of particular importance, this research has implications that go beyond context specific to India. The recurrent tension between statutory documents, and shareholders agreements is a theme that cuts across corporate law. The Indian experience, including a mix of common law patterns as well as innovations through statutes, has much more to the legal systems in other jurisdictions faced with these same problems.

Future research in this area could explore comparative analyses with other major economies, examining how different legal systems balance the competing interests of contractual freedom

and statutory regulation in corporate governance. Additionally, empirical studies on the practical impact of AOA-SHA conflicts on corporate decision-making and shareholder value could provide valuable insights for policymakers and practitioners alike.

As companies increasingly operate across borders and attract diverse international shareholders, the harmonization of governance practices becomes ever more crucial. The evolution of Indian law and practice in this area may well influence global trends in corporate governance, particularly in emerging markets seeking to balance rapid economic growth with robust shareholder protection.

In the end, the goal of corporate governance frameworks, whether embodied in AOAs or SHAs, should be to foster sustainable business growth while ensuring fairness and transparency for all stakeholders. As this research has shown, achieving this balance requires ongoing dialogue between legislators, judiciary, corporate entities, and shareholders, adapting to the changing needs of the business world while upholding the fundamental principles of corporate law.