
PRE-EMPTIVE RIGHTS FROM COMPANY LAW AND FAMILY LAW PERSPECTIVE: A DETAILED OVERVIEW

Drishti Banerjee, Amity Law School, Amity University, Kolkata

ABSTRACT

The rights of pre-emption have twofold significance in law. The concept is prevalent in both Company Law and Family Law, bestowing somewhat a similar preferential right upon the beneficiary by offering him or her the first option to acquire a certain property. The Sociological theories on property rights propose the concept of property to be a social institution which ensures that wider societal interests are upheld. The Natural Law theory on the other hand proposes that the right over a certain property is derived from capturing it first, i.e., the first occupier becomes the owner. The jurisprudence of pre-emptive rights can be argued to have been derived from these ideas. This article examines the current legal position pertaining to pre-emptive rights in light of landmark judgments. The Companies Act, 2013 and the latest SEBI Guidelines are also discussed. Further, this study sheds insight on the legal and constitutional validity of the act of offering shares to the existing shareholders first and offering an immovable property for sale first to the neighbours. The article concludes with the argument that while customary pre-emptive rights in Family Law stand against the lofty ideal of enforcement of the constitutional goal of a Uniform Civil Code, the right shall continue to exist in Company Law.

Introduction

The Latin term “emptum” means “buy or purchase”. The legal connotation of the word “pre-emption”, therefore, is “the first option to purchase”.¹ Pre-emptive rights are given to shareholders under Company Law and to the owner of the neighbourhood property under personal laws in India. This right is present in the Company Law of the United Kingdom,² the United States,³ and even in other parts of Asia.⁴ As topic of dispute and legal conundrum, the concept of pre-emptive rights can be discussed in detail.

Company Law

The right of the shareholder to acquire more shares of the company’s stock before they are offered to other investors is referred to as pre-emptive right, right issue, or subscription privilege.⁵ It is a right and not an obligation, that is to say that the shareholder may choose not to exercise it. Therefore, it is also known as the right of first refusal.⁶ The Apex Court in the landmark judgment of **Nanalal Zaver v. Bombay Life Assurance Co. Ltd., 1950**⁷ held that the company is entitled to offer shares to the existing investors first before anyone else. It was reiterated in **Sahara India Real Estate Corporation v. SEBI, 2013**.⁸

Pre-emptive rights are also known as “anti-dilution” rights because the existing shareholders are given the option to retain their proportionate part in the company’s ownership and their voting rights are not diluted. For instance, an investor with 5% equity interest in the company gets the pre-emptive right to purchase as many shares necessary to protect that 5% equity at stake. However, whether or not he exercises that right depends upon him.⁹ The Hon’ble

¹Gurpreet Kaur Dutta, *Law of Pre-emption*, FINOLOGY BLOG, (10th July, 2023, 1:41 P.M.), <https://blog.finology.in/Legal-news/law-of-preemption#:~:text=What%20is%20Pre%2Demption%3F,This%20is%20called%20pre%2Demption>.

² *Preemptive Rights*, BANK OF ENGLAND QUARTERLY BULLETIN, 545-549, (1987).

³ Legal Information Institute, https://www.law.cornell.edu/wex/preemptive_right#:~:text=A%20preemptive%20right%20is%20a,dilution%20in%20value%20or%20control, (last visited 12th July, 2023, 2:30P.M.).

⁴ CFA INSTITUTE, https://www.law.cornell.edu/wex/preemptive_right#:~:text=A%20preemptive%20right%20is%20a,dilution%20in%20value%20or%20control, (last visited July 11th, 2023, 2:30P.M.).

⁵ Kiran Mallik, *An Overview of Pre-emptive Rights of Shareholders*, ENTERSLICE, (10th July, 2023, 1:50 P.M.), <https://enterslice.com/learning/an-overview-of-preemptive-rights-of-shareholders/>.

⁶Carla Tardi, *Preemptive Rights: Some Shareholders Get First Dibs on New Stock*, INVESTOPEDIA, (10th July, 2023, 2:00P.M.), <https://www.investopedia.com/terms/p/preemptiveright.asp>.

⁷ Nanalal Zaver v. Bombay Life Assurance Co. Ltd, AIR 1950 SC 172.

⁸ Sahara India Real Estate Corporation v. SEBI, AIR 2013.

⁹ *Id.* at 6.

Supreme Court has held that only one pre-emptive offer can be made to the existing shareholders even when the shares are unaccepted and that the primary motive behind granting such a right is to ensure that the control of a member is not taken away.¹⁰

Pre-emptive rights are seen as advantageous because raising capital becomes easier from the existing investors. It becomes cost-effective, time-effective, and bestows a sense of security upon the existing shareholders.¹¹ Not offering pre-emptive shares would be unfair for the existing shareholders because outsiders would be flexible to enter the company ousting voting rights of existing members who had paid a higher price to buy the shares.¹²

The Companies Act, 2013

The Board of Directors has the power to issue securities by means of resolutions passed in the Board meetings according to **s.179(3)** of the Companies Act, 2013.¹³

The provision for pre-emption of shares is given under **s.62** of the Companies Act, 2013.¹⁴ According to **s. 81** the erstwhile Act of 1956, a company could disregard this right if it allotted shares within two years of its formation,¹⁵ but this provision has been done away with in the 2013 Act. Simply put, the provision with regards to right issue in the Companies Act, 2013 iterates—

- When a company having share capital proposes to increase its subscribed capital by issue of further shares, such shares shall be offered to members holding equity shares in proportion to paid-up shares. It shall be subject to the following conditions—
 - a. **Notice of offer-** The notice to the shareholders must contain details of the number of shares offered.
 - b. **Time Period-** The limiting time period shall not be less than 15 days and shall not exceed 30 days from the date of offer. If not accepted within this stipulated time

¹⁰ Sangramsinh P. Gaekwad v. Shantadevi P. Gaekwad, (2005) 11 SCC 314.

¹¹ *Id.* at 2.

¹² Sushil Kumar Antal, *Pre-emptive rights of Existing Shareholders for further issue of shares*, TAXGURU, (10th July, 2023, 2:00P.M.), <https://taxguru.in/company-law/pre-emptive-rights-existing-shareholders-issue-shares.html>.

¹³ Companies Act, § 179(3), No. 18, Acts of Parliament, 2013 (India).

¹⁴ Companies Act, § 62, No. 18, Acts of Parliament, 2013 (India).

¹⁵ Companies Act, § 81, No. 1, Acts of Parliament, 1956 (India).

period, the offer shall be deemed to have been declined.

- c. **Right to renounce-** The member may renounce the shares offered to him in favour of any other person. This is, however, subject to the Articles of the Company. The impugned notice shall contain a clause stating this right.
- d. **Procedure for disposal if offer is declined-** If the impugned offer is not accepted, the Board of Directors should thereafter dispose off the shares in a manner that is not disadvantageous to the company.
- The notice may be given through registered post, speed post, or through electronic mode to the existing shareholders at least three days prior to the opening of the issue.
- If the subscribed capital is increased by converting loans or debentures into shares, these provisions shall not be applicable.
- If the government directs conversion of debentures or loans into shares of the company and no appeal has been preferred, the memorandum of the company is to be amended accordingly.

Contracts of Pre-emption have been made permissible by SEBI

The Companies Act, 2013 must be read with the SEBI Act, and the guidelines and regulations thereof. The procedure for rights issue or rights of pre-emption have been enumerated in the recent SEBI guidelines.¹⁶ By Notification vide October 3rd, 2013,¹⁷ SEBI has included contracts of pre-emption within the scope of permissible contracts under the **Securities Contract (Regulation) Act, 1956**.¹⁸ Contracts of Pre-Emption including the right of first refusal, or tag-along or drag along rights contained in shareholders agreements or articles of association of companies or other body corporate are permissible.¹⁹

¹⁶ SEBI, https://www.sebi.gov.in/sebi_data/meetingfiles/nov-2019/1574750221977_1.pdf, (last visited July 12th, 2023).

¹⁷ INDIA JURIS, <https://www.indiajuris.com/newsletter/15oct2013-online.html>, (last visited July 12th, 2023).

¹⁸ Abhinav Harlalka , Deepak Jodhani , Simone Reis, Nishchal Joshipura, *India: SEBI Permits Options And Preemptive Rights Arrangements*, MONDAQ, (July 12th, 2023 2:00 P.M.), <https://www.mondaq.com/india/shareholders/270684/sebi-permits-options-and-preemptive-rights-arrangements>.

¹⁹ *Id.*, at 11.

Do Pre-emptive Rights violate s. 241?

Section 241 of the Companies Act, 2013 provides the right to apply to the Tribunal for relief in cases of oppression. The complaints include those regarding affairs that are conducted in a manner prejudicial to public interest, interest of the company, or oppressive to one or more of the investors.

It is often argued that giving preference to existing shareholders through rights issue so that they may retain their majority voting rights could be oppressive to the minority shareholders. This may connote abuse of authority, and oppression over the minority shareholders.²⁰ This in the long run may affect the interests of the company. Generally, Courts refrain from interfering in the internal matters of the company.²¹

In the case of **Shanti Prasad Jain v. Kalinga Tubes Ltd.**,²² it was alleged that the majority shareholders, in order to retain their hold over the company. The Hon'ble Supreme Court rejected the contention and went on to hold that issuing of shares by the majority shareholders to their friends or outsiders would not amount to an act of oppression.²³

PERSONAL LAWS

Under personal laws, the right of pre-emption acts as a bar against the free sale of property. Justice **DY Chandrachud**, as His Lordship then was, described it as “a preferential right to acquire property by substituting the original vendee.”²⁴ In the judgment of **Shyam Sunder & Ors. v. Ram Kumar & Anr, 2001**,²⁵ the Apex Court had held the law of pre-emption to be a maligned law. Recently in **Punyadeo Sharma v. Kamla Devi**,²⁶ the Apex Court reiterated its position and abated all pre-emption proceedings pending before any authority. Nevertheless, the law on pre-emption rights is a centuries-old one, and has been variably interpreted by the judiciary. Statutorily, it had been adopted through various State Legislations, most of which

²⁰ P. S. Sangal, *Abuse Of Authority By A Majority Of Shareholders In A Company*, 6, JOURNAL OF THE INDIAN LAW INSTITUTE, 380-409 (1964).

²¹ MacDougall v. Gardiner, (1875) 1 Ch. 13.

²² S. P. Jain vs Kalinga Tubes Ltd., 1965 AIR 1535, 1965 SCR (2) 720.

²³ K.R. Dixit, *Minority Oppression: Corporate Control*, 9, JOURNAL OF THE INDIAN LAW INSTITUTE, 223-236 (1967).

²⁴ Suresh Chand v. Suresh Cander (D) Thr LRs and Ors., 2020.

²⁵ Shyam Sunder & Ors. v. Ram Kumar & Anr, 2001.

²⁶ Punyadeo Sharma v. Kamla Devi, 2022.

stand amended or repealed.

Doctrine of Shuffa

The doctrine of Shuffa is a right to stop strangers in one's neighbourhood. The main objective is to prevent the displeasure that would arise by the interference of an outsider. It finds its origin during the sixth century in Arab when jointly owned and undivided properties were often disposed of without the consent of the partners or co-owners of the property. According to Hedaya, the term "Shuffa" means "the conjunction of property". Other communities absorbed this custom of pre-emptive rights over immovable property from Islam.²⁷ It is majorly followed in North India and is not prevalent in South India.²⁸

The Doctrine of Shuffa gives an advantageous right to the neighbour of purchasing the adjoining property from its owner. It is a right granted by the personal laws of the Muslim Community in India and can be claimed even against a Hindu or a non-Muslim individual. It becomes functional only during sale, i.e., sale is a condition precedent to its enforceability and not existence.²⁹ After the sale, the purchaser is obligated to surrender the property to a neighbour or partner seeking to enforce that right. The neighbour therefore acquires the property from the first purchaser as if he were taking it directly from the original vendor. The original vendor makes the sale to the first purchaser subject to the condition that any person having the right of pre-emption may take it from him.³⁰

There have been contradictions regarding the nature of the right of pre-emption. The Hon'ble Calcutta High Court in the landmark judgment of **Koodrutoollah v. Mohinee Mohan Shaha**³¹ the majority view held that the right of pre-emption is a personal right and does not attach to the land. An opposing view was expressed in **Inayatullah vs Gobind Dayal**³² by the Allahabad High Court. Finally, the Apex Court in **Shri Audh Behari Singh vs Gajadhar Jaipuria**³³ clarified that the right of pre-emption, if derived from the custom of a place, becomes the lex

²⁷ A. Abedin, *The Islamic Doctrine of Shuffa*, THE STATESMAN, (July 12th, 2023, 2:05 P.M.), <https://www.thestatesman.com/features/the-islamic-doctrine-of-shuffa-1487802653.html>.

²⁸ Barasat Eye Hospital & Ors. v. Kaustabh Mondal, 2019.

²⁹ Shri Audh Behari Singh vs Gajadhar Jaipuria, AIR 1954 SC 417.

³⁰ Ishant, *Inception of Shufaa*, LEGAL READINGS, (July 12th, 2:19P.M.) <https://legalreadings.com/inception-of-shufaa-pre-emption/>.

³¹ Koodrutoollah v. Mohinee Mohan Shaha, 1869.

³² Inayatullah vs Gobind Dayal, (1885) ILR 7 All 775.

³³ Shri Audh Behari Singh vs Gajadhar Jaipuria, AIR 1954 SC 417

loci, affecting all lands situated therein. It applies irrespective of the personal laws. The burden lies on the vendor and the benefit lies on the pre-emptor.³⁴

The Apex Court further reiterated in **Bishan Singh v. Khazan Singh**³⁵ that the right to pre-emption is a right to offer sale. Justice Subbarao observed that the right is twofold: right to offer the thing about to be sold, and the secondary remedial right following the thing about to be sold (right of substitution).

Shuffa has two essential formalities: **talabi Mowasibat** and **talab-i-ishhad**. The right may be claimed by three classes of persons, classified based on preference—

- a. **Shafi-i-sharik:** A co-sharer in the property.
- b. **Shafi-i-khalit:** A participator in immunities and appendages (e.g.- right to discharge water, right of passage, etc.)
- c. **Shafi-i-jar:** An owner of adjoining immovable property.

Therefore, the right to pre-emption on the ground of vicinage is the weakest. The Court even held in **Rukmani Devi v. Prabhu Narayan**³⁶ that the right to pre-emption is a weak right. If the pre-emptor waives off his right, no substitution in the sale deed shall be allowed. It may be offered for only the first time (**Raghunath v. Radha Mohan**).³⁷

In **Sheo Kumar Dubey vs Smt. Sudama Devi and Anr.**,³⁸ the appellant claimed to be entitled to enforce her rights of pre-emption against a contiguous property under customary laws. The suit property was conveyed to the appellant through a registered instrument. The defendant contested non-compliance with the essential pre-requisites of ‘talabs’ to a claim of pre-emption. The High Court observed otherwise. Upholding the constitutional validity of the law that has existed in the society for over a century ensuring social harmony and peaceful coexistence among neighbours, the Court ruled in favour of the appellant.

³⁴ Sheo Kumar Dubey vs Smt. Sudama Devi, AIR 1962 Pat 125.

³⁵ Bishan Singh v. Khazan Singh, AIR 1958 SC 838.

³⁶ Rukmani Devi v. Prabhu Narayan, RLW 2007 (4) Raj 2882.

³⁷ Raghunath(D) By Lrs. vs Radha Mohan (D), 2020.

³⁸ Sheo Kumar Dubey vs Smt. Sudama Devi And Anr., AIR 1962 Pat 125.

Conflict with constitutional rights

If the 44th Constitutional Amendment were not effected and the right to property as a fundamental right were still in place, the right to pre-emption would be unconstitutional in light of Article 13³⁹ read with Article 19(1)(f)⁴⁰ of the Constitution of India. The Apex Court dealt with this issue in **Smt. Vijayalakshmi vs B. Himanthalraja Chetty & Anr.**⁴¹ However, since the right to property no longer remains a fundamental right, there is no direct conflict with the Constitution per se. One may however always argue the violation of Article 15⁴² of the Constitution, viz., discrimination based on the place of birth. However, the Apex Court has already confirmed the unlawfulness of the Doctrine for being “anarchic”, as discussed above (**Punyadeo Sharma v. Kamla Devi**).⁴³

Conclusion

In light of the broad constitutional goals of a Uniform Civil Code, invalidating the Doctrine of Pre-Emption under personal laws that led to different legislations across States, was a welcome change. As regards Company Law, pre-emptive rights have many cons, like limited power of ownership, limited negotiations, restrictions on new investors, and uncertainty over exercise of the right by existing owners. Nevertheless, as held by the Apex Court, the benefits outweigh the deficiencies and it can be well expected that this Doctrine would remain to be operational in Company Law.

³⁹ INDIA CONST. art 13.

⁴⁰ INDIA CONST. art 19(1)(f).

⁴¹ Smt. Vijayalakshmi vs B. Himanthalraja Chetty & Anr., JT 1996 (4), 747 1996 SCALE (4)300.

⁴² INDIA CONST. art 15.

⁴³ *Id.* at 20.