ARBITRATION CLAUSES IN SHAREHOLDER AGREEMENT

Ambika Kunwar Sisodiya, Christ University (Deemed to be University), Bangalore, Karnataka

ABSTRACT

In the past two decades, arbitration has gained prominence as a swift and cost-effective means of resolving disputes, making it the preferred choice for many. The arbitration landscape in India witnessed significant changes with the enactment of the Arbitration and Conciliation Act 1996 (referred to as the Arbitration Act) and its subsequent amendment in 2015. Nevertheless, a notable area of ambiguity within the Act pertains to the concept of "arbitrability." Indian courts have grappled with distinguishing between disputes that are suitable for arbitration and those that are not. While the Arbitration Act does not explicitly classify disputes into arbitrable and non-arbitrable categories, courts have, at times, claimed jurisdiction over certain disputes, reserving them for resolution within their own precincts.

The essence of arbitration is rooted in the contractual relationship between parties, where they can either choose litigation in courts or opt for arbitration, a decision based on their own accord. Following the 2015 Amendment Act, Section 83 of the Arbitration Act places an obligatory duty on courts to refer all disputes to arbitration when an arbitration clause exists in the underlying contract between the involved parties. Section 8 of the Arbitration Act pertains to disputes that are arbitrable and can be appropriately adjudicated by a competent arbitrator. The ongoing struggle to determine the arbitrability of disputes has led to a multitude of conflicting judicial decisions and varying viewpoints. In this article, we delve into the ongoing discourse surrounding whether disputes arising from a shareholders' agreement (SHA) can be considered arbitrable and fall within the purview of the Arbitration Act.

Keywords: Arbitration, Arbitrability, Dispute, Shareholders' Agreement

INTRODUCTION

Mergers, acquisitions, and joint ventures involving multiple jurisdictions are typically executed through shareholders' agreements (SHAs), which govern the internal management and operations of the resulting or target company (referred to as the 'Company'). In addition to controlling the transfer of shares, SHAs may also stipulate management rights, the appointment of nominee directors, and the necessity of affirmative votes, among other provisions. It is customary for these SHAs to specify that the Company's Articles of Association ('AoA' or 'Articles') will be appropriately amended to align with the SHA's terms. These agreements often include arbitration clauses as well. However, in the process of incorporating these terms into the Articles, the involved parties, which may or may not include the Company itself, occasionally overlook integrating the SHA's arbitration clause into the Company's Articles. This issue appears to be relatively common in the Indian business landscape, as evident from the numerous cases discussed in this paper. The underlying reasons for this oversight are somewhat unclear but could involve perceived challenges in enforcing arbitration clauses within a Company's Articles, as well as the perceived unique status of these Articles as quasi-legal instruments distinct from standard contracts.

In this context, it is imperative to assess the applicability of the arbitration clause within a Shareholders' Agreement (SHA) for resolving disputes arising from the Company's Articles. This particular inquiry assumes significant relevance, especially during shareholder disputes, where a shareholder, acting as the claimant, could potentially sidestep arbitration by framing their grievance as an infringement of the Articles rather than the SHA. Given the frequent overlap between the provisions of the Articles and the SHA, a claimant shareholder may opt to disregard the SHA and limit their complaint or petition solely to breaches of the Articles. This situation was notably observed in a legal case before the Honorable High Court of Singapore, known as BTY v. BUA [1](referred to as 'BTY'). Consequently, the proper interpretation of the arbitration clause becomes a pivotal consideration in such cases.[2]

In order to maintain a focused discussion on the heart of the debate, this paper will make several factual assumptions. Firstly, it is assumed that the company in question is a party to the Shareholder Agreement (SHA) under consideration. The primary question we aim to address pertains to the necessity of incorporating an arbitration clause into the Articles, even when the

[1] BTY v BUA. [2018] SGHC.
[2] Article 1(5), Model Law on International Commercial Arbitration.

company is a party to the SHA. Notably, we will refrain from delving into the separate, albeit related inquiry of whether covenants among shareholders can legally bind a company that is not a party to the agreement.

When dealing with arbitration clauses where the subject company is not a direct participant in the arbitration clause but is an essential party to the arbitration process, it is generally acceptable to decline reference to arbitration. Secondly, we need to acknowledge that any clause in the SHA that contradicts the company's Articles must defer to the Articles.

Our core concern here is centred on the enforceability of supplementary and additional terms. Specifically, we are interested in those terms that are not explicitly integrated into the Articles but also do not inherently contradict them. The distinction between an additional term and one that is implicitly contradictory can be somewhat murky. Take, for example, an arbitration agreement within an SHA, which might be perceived as contradictory to a straightforward jurisdiction clause favouring a specific court in the Articles. For the purpose of this discussion, we will assume that such a scenario either does not exist or, in light of the distinct nature of arbitration clauses, does not qualify as a 'contradiction.'.

CONCEPT OF ARBITRATION UNDER SHAREHOLDERS' AGREEMENT

A paramount consideration in the context of arbitrability is the nature of the dispute itself, specifically, its suitability for arbitration. Given that the Arbitration Act does not offer explicit differentiation between disputes that can or cannot be subjected to arbitration, the judiciary plays a central role in ascertaining the arbitrability of a particular matter. The foundational guidance in this regard was initially provided by the Supreme Court in the landmark case of Booz Allen & Hamilton v. SBI Home Finance Ltd. (Booz Allen). In this seminal judgment, the Court introduced the concept of the "test of arbitrability," establishing the criteria for determining whether disputes concerning a particular subject matter can be referred to arbitration:

(i) rights in personam, referring to those claims against an individual or entity amenable to arbitration; and

(ii) rights in rem, encompassing claims against society at large, exclusively reserved for adjudication within the purview of courts and public tribunals. Nevertheless, the judicial authority has refrained from furnishing a definitive litmus test to discern

> arbitrable disputes from non-arbitrable ones. It is imperative to note that the Court emphasized the imperfections of this classification, acknowledging that rights in personam, stemming from rights in rem, may, on occasion, be subject to arbitration.

This case adopted a "rights" centred perspective, categorizing disputes as either right in rem or right in personam. It, however, issued a warning against rigidly applying this classification, thus paving the way for a more arbitration-friendly stance. Subsequently, the Supreme Court has consistently embraced a pro-arbitration stance in its rulings, broadening the boundaries of rights in rem to include matters suitable for arbitration. Regrettably, this expansion has given rise to increased uncertainty instead of providing a definitive solution for determining arbitrability in disputes.

In the legal context, we can draw parallels between the treatment of fraud allegations in arbitration cases and the arbitrability of intellectual property disputes. Notably, the Supreme Court, in the case of A. Ayyasamy v. A. Paramasivam (Ayyasamy)[3] underscored that a mere accusation of fraud unless it attains a significant level of seriousness, does not suffice to render a dispute non-arbitrable. However, the Court, regrettably, refrained from delineating specific criteria for determining the gravity of such fraud allegations. Similarly, concerning intellectual property disputes, the Bombay High Court, in Eros International Media Ltd. v. Telemax Links India (P) Ltd., affirmed that contractual disputes related to copyright infringement, constituting rights in personam, are arbitrable. Nevertheless, the status of arbitrability for intellectual property disputes remains uncertain due to the Bombay High Court's stance in Indian Performing Right Society Ltd. v. Entertainment Network (India) Ltd. and certain incidental remarks in the Ayyasamy case.

LEGAL ISSUES AND CONTRADICTIONS

In addressing the aforementioned queries pertaining to arbitration agreements, a preliminary analysis of the prevalent ambiguity in Indian corporate law concerning the validity of Shareholders' Agreements (SHAs) not integrated into a company's Articles becomes imperative. It is vital to note that this article exclusively delves into the clauses within SHAs that pertain to a company's internal governance, leaving aside the distinct inquiry into the enforceability of share-transfer restrictions external to a company's Articles. Within the Indian legal landscape, two contrasting perspectives have surfaced through judicial precedents. The

[3] *A Ayyaswamy v A Paramasivam* (2016) 10 SCC 386.

first viewpoint, often referred to as the 'incorporation view,' posits that a company's internal management and operations are comprehensively governed by its Articles, thereby necessitating the inclusion of SHA terms within these Articles to bind the company legally.

The second perspective asserts that failing to include the Shareholders' Agreement (SHA) terms in a company's Articles might limit specific legal actions and remedies under company law. However, the SHA itself remains legally binding as a standalone contract, irrespective of its inclusion in the Articles; this viewpoint is often referred to as the 'contractual view.' A significant legal precedent supporting the 'incorporation view' comes from the Honorable Delhi High Court's judgment in the case of World Phone India Pvt. Ltd. and Ors. v. WPI Group Inc.[4] USA ('World Phone'). In this instance, a joint venture agreement provided one shareholder with an affirmative vote on specific matters. The Delhi High Court, in confirming the legality of a resolution passed without the said shareholder's affirmative vote, determined that the joint venture agreement could not bind the company without being integrated into its Articles of Association.

The Delhi High Court upheld the validity of the board meeting and resolution in accordance with the Company's articles. This decision drew its foundation from the Supreme Court of India's ruling in V.B. Rangaraj v. V.B. Gopalakrishnan [5]('V.B. Rangaraj'). In the V.B. Rangaraj case, the Supreme Court clarified that a right of first refusal in a share transfer agreement is unenforceable against a company's shareholders if not incorporated within the company's Articles. The Supreme Court underscored that the Companies Act of 1956 unequivocally governs share transfers through a company's Articles. Restrictions not articulated in these Articles lack binding force on the company or its shareholders.

In the World Phone case, the Court drew inspiration from the Bombay High Court's ruling in IL&FS Trust Co. Ltd. v. Birla Perucchini Ltd[6]. ('Birla Perucchini'). In 'Birla Perucchini', it was firmly established that the principles outlined in the V.B. Rangaraj case extended beyond share transfer restrictions to encompass unrelated clauses. Expanding upon this precedent, the Court in World Phone made a crucial point. It emphasized that even when a subject company is party to a Shareholders' Agreement (SHA), the provisions governing the company's management cannot be enforced unless they are formally incorporated into the company's Articles.

[4] World Phone India Pvt. Ltd. and Ors. v. WPI Group Inc., 2013 SCC OnLine Del 1098.
[5] V.B. Rangaraj v. V.B. Gopalakrishnan., (1968) 1 All ER 1132.
[6] Il And Fs Trust Co. Ltd. vs Birla Perucchini Ltd., 2003 (3) BomCR 334.

However, the contractual perspective, as endorsed by the Supreme Court in Vodafone International Holdings B.V. v. Union of India[7]('Vodafone International'), takes a different stance. In Vodafone International, the Court notably disagreed with its earlier V.B. Rangaraj decision without a clear overruling. It argued that contractual freedom, including the shareholders' ability to define their rights and share transfer restrictions, does not contravene any laws and thus need not be incorporated into a company's Articles.

The contractual perspective gains further validation from Delhi High Court rulings, particularly exemplified by cases such as Spectrum Technologies USA Inc. v. Spectrum Power Generation[8] (commonly known as 'Spectrum Technologies') and Premier Hockey Development Pvt. Ltd. v. Indian Hockey Federation[9] (referred to as 'Premier Hockey').

In the past, a company involved in a 'Promoters' Agreement' had formally adopted it through a board resolution, and it was legally binding on the company, even though the agreement was not incorporated into its Articles of Association. This legal obligation arose because neither the Companies Act of 1956 nor the company's existing Articles prevented it from entering into such a 'Promoters' Agreement. Moreover, the 'Promoters' Agreement' explicitly required the company to amend its Articles in accordance with the terms of the agreement, which set it apart from the V.B. Rangaraj case, where no such provision existed.

Similarly, in the Premier Hockey case, the company was a party to the 'Subscription and Shareholders Agreement' along with the Shareholders' Agreement, which contained a requirement to modify the Articles to align with the Shareholders' Agreement. This obligation was sufficient to bind the company to the agreement, even without its formal inclusion in the Articles.

When attempting to reconcile these two perspectives, challenges arise. Firstly, the decision in the World Phone case, which relied heavily on V.B. Rangaraj, pertained to share-transfer restrictions and may have been influenced by different legal considerations.

Furthermore, the Two-Judge Bench's ruling in the World Phone case has sparked significant controversy, with a prominent three-judge Bench decision in the Supreme Court, namely

[7] Vodafone International Holdings B.V. v. Union of India., APPEAL NO.733 OF 2012 (arising out of S.L.P. (C) No. 26529 of 2010).
[8] *Spectrum Technologies USA Inc v Spectrum Power Generation* (2000) SCC Del 472.
[9] Premier Hockey Development Pvt. Ltd. v. Indian Hockey Federation., O.M.P. 92/2011 & O.M.P. 52/2011.

Vodafone International, expressing disagreement with it. However, it is important to note that the comments made by the Vodafone International bench on this matter are often considered obiter, and thus, they lack the power to establish a binding legal precedent. This may explain why the Vodafone International bench refrained from explicitly overturning the earlier decision in V.B. Rangaraj. Additionally, the World Phone judgment, issued subsequent to prior judgments by a more extensive and coordinating bench in the High Court, specifically Spectrum Technologies and Premier Hockey, omits any reference to these prior decisions. Consequently, it fails to offer any rationale for its departure from or distinction in the application of the law.

Lastly, complicating matters further, the Supreme Court rejected a petition seeking permission to appeal the Delhi High Court's decision in the World Phone case. The Supreme Court's order contained an ambiguous statement, noting that the Delhi High Court had previously clarified that its opinions in the judgment were solely intended for the interim application. The final dispute, as per the High Court's direction, would be resolved without being influenced by these interim proceedings. The exact intent behind the Supreme Court's observations, whether to nullify the legal stance outlined by the Delhi High Court in the World Phone case or to facilitate the ongoing litigation, remains shrouded in uncertainty.

JUDICIAL PRONOUNCEMENTS

Before the introduction of the Arbitration Act, the prevailing perspective within the legal framework was to prioritize statutory rights and remedies as outlined in the Companies Act. In a pivotal case, Surendra Kumar Dhawan v. R. Vir[10], the Delhi High Court firmly established that contractual arbitration clauses could not undermine disputes falling under the statutory jurisdiction of the National Company Law Tribunal (NCLT). This ruling hinged on the application of Section 926 of the Companies Act, 1956 (now Section 6 of the Companies Act, 2013).

In the case of O.P. Gupta v. Shiv General Finance (P) Ltd.[11], the Delhi High Court it has reaffirmed a legal stance similar to that in the case of Surendra Kumar. It emphasized that the exclusive jurisdiction of safeguarding and preserving the interests of shareholders resides

[10] Surendra Kumar Dhawan v. R. Vir,1974 SCC OnLine Del 101.
[11] O.P. Gupta v. Shiv General Finance (P) Ltd., 1975 SCC OnLine Del 147.

within the Companies Act. Consequently, any attempt to resort to arbitration in such matters would amount to a procedural formality lacking substance.

Conversely, the Gujarat High Court, as demonstrated in the case of Sadbhav Infrastructure v. Company Law Board[12], has taken a divergent view. It opines that disputes related to operations and maintenance (O&M) can be subjected to arbitration, even if the underlying claim falls under Section 241 or 242 of the Companies Act. The pivotal consideration is whether the breach stems from a contractual obligation or statutory provisions.

Since the enactment of the Arbitration Act in 1996, Indian courts have consistently adopted a pro-arbitration stance. This is primarily due to the Arbitration Act's mandate, which obliges the courts to refer disputes to arbitration. A recent case, Indus Biotech (P) Ltd. v. Kotak India Venture Fund[13], exemplifies this approach. In this case, the National Company Law Tribunal (NCLT) granted an application under Section 8 of the Arbitration Act, requesting a reference to arbitration. Simultaneously, the NCLT dismissed the company petition filed by the financial creditor. The NCLT's rationale was that arbitration, being a specialized legal framework, takes precedence over general laws (lex specialis derogat legi generali). Consequently, the courts are duty-bound to refer parties to arbitration when an arbitration clause is in place. It is evident that even the NCLT is inclined towards encouraging arbitration for the resolution of contractual disputes that are amenable to this method.

CONCLUSION

Given the aforementioned context, it is suggested that adopting a contract-focused approach concerning the extent and enforceability of arbitration clauses within Shareholders' Agreements (SHAs) is preferable to rigidly adhering to the concept of incorporating all covenants into a company's Articles. In cases where the arbitration clause within the SHA explicitly indicates an intent to resolve all disputes stemming from either the SHA or the Articles through arbitration, the absence of such a clause within the company's Articles should not obstruct a court from referring such a dispute to arbitration. This is especially relevant when the subject or target company is a party to both the SHA and the arbitration clause therein.

The insistence on the incorporation theory, which treats a company's Articles as the exclusive repository of covenants regarding its internal affairs and excludes additional covenants that do

[12] Sadbhav Infrastructure Project Ltd. v. Company Law Board, 2014 SCC OnLine Guj 9159.
[13] Indus Biotech (P) Ltd. v. Kotak India Venture Fund, 2020 SCC OnLine NCLT 1430.

not contradict the Articles, lacks sustainability and lacks a foundation in any established principles of company law.

LITERATURE REVIEW

1. **Author Name:** Anuj Berry, Ashish Bhan and Mohit Rohatgi

Title: Arbitrability of Shareholder Disputes in India: Complexities and Issues[14]

This article offers a comprehensive insight into the concept of arbitrability within the framework of Indian law, with a particular emphasis on its application in shareholder disputes and the enforceability of shareholders' agreements (SHAs). To provide a contextual foundation, it initiates by tracing the historical evolution of arbitration laws in India, underscoring the absence of explicit directives on arbitrability until the enactment of the Arbitration Act in 1996. This historical context underscores the essential role that Indian courts have played in delineating the parameters of arbitrability over the years.

A pivotal focus of this article is the renowned case of Booz Allen & Hamilton Inc v SBI Home Finance Inc, which introduced a pivotal distinction between rights in personam and rights in rem as a pivotal criterion for determining arbitrability. This dichotomy pivots on whether a dispute impacts specific individuals or the broader populace, rendering it a seminal precedent in the realm of Indian arbitration jurisprudence. However, it is essential to note that this decision does not provide a comprehensive framework for all arbitrability issues.

2. **Author:** Weitzel, P. D. (2012).

Title: Allowing Shareholders to Customize Their Protections Through Arbitration of Shareholder Disputes[15]

This paper explores a complex and contentious matter within Indian company law concerning the inclusion of arbitration clauses from shareholders' agreements (SHAs) into a company's Articles of Association (AoA). This debate centres on the necessity of incorporating arbitration clauses into a company's AoA, mainly when the company is already a party to an SHA that

[14] Anuj Berry, Ashish Bhan and Mohit Rohatgi (2023) Arbitrability of shareholder disputes in India: complexities and issues. (2023, May 26). Lexology. https://www.lexology.com/library/detail.aspx?g=ea424d79-2b74-47fe-8e52-cd6007d4a51d.

[15] Weitzel, P. D. (2012). Allowing Shareholders to Customize Their Protections Through Arbitration of Shareholder Disputes. SSRN Electronic Journal. https://doi.org/10.2139/ssrn.2011931.

contains such a clause. It underscores that for the purposes of this discussion, we assume the subject company's involvement in the SHA and concentrate exclusively on the importance of integrating the arbitration clause into the Articles in such instances. The paper deliberately avoids addressing whether covenants between shareholders can legally bind a non-party company, maintaining a specific focus. One pivotal issue that emerges is the differentiation between supplementary or additional terms and those that contradict the existing Articles. This distinction may become blurred, particularly in the context of arbitration clauses.

3. **Author:** Prakhar N S Chauhan, Prashant Singh

Title: Lessons from the US: Arbitrability of oppression and mismanagement in India[16]

This analysis challenges the basis for categorically deeming oppression and mismanagement (O&M) disputes as non-arbitrable due to public policy considerations. Although public policy is frequently cited as a rationale for exempting specific disputes from arbitration, the author critically questions whether the mere allegation of O&M inevitably precludes arbitration, potentially encroaching upon the principle of competence-competence.

[16] Chauhan, P. N. S., & Singh, P. (2021, June). Lessons from the US: Arbitrability of oppression and mismanagement in India. Journal of Strategic Contracting and Negotiation, 5(1–2), 76–98. https://doi.org/10.1177/20555636211027333.