Makarand Joshi,
Company Secretary

CORPORATE LAWS

Case Law Update

1. Companies Act

Riverdale Infrastructures Pvt Ltd (Appellant) vs. Kirloskar Ebara Pumps Ltd (Respondent No. 1/ R1/KEPL) Ebara Corporation (Respondent No. 2/R2/Ebara) Kirloskar Brothers Ltd. (Respondent No. 3 /R3/KBL) – NCLT Mumbai Bench – Order dated 26.05.2020

Facts of the case

- EBARA and KBL entered into Joint Venture Agreement (JVA) pursuant to which KEPL(Public Limited Company) was incorporated as Joint Venture (JV) company.
- There were total 68 shareholders in KEPL. Amongst which EBARA and KBL holds 45% shares each.
- Clause 6.01 of JVA states that the parties hereto covenant and agree that, notwithstanding anything to the contrary contained in the MoA or the AoA of the Company, they shall **not sell**, …. any of the shares of the Company respectively held by them … **unless prior written consent is obtained from the other party**. In case either party offers to sell… any such shares with the consent of the other party, such other party shall have the **right of first refusal of such offer.**"
- Further Clause 11.02 of JVA states that in the event of refusal, if no reply is communicated within 3 months to the party…party offering the same may, subject to such approvals or consents as may be required by mandatory provisions of law or ordinance of the Republic of India, sell the shares so offered to any third party within 3 months thereafter.
- **Article 51(b) of AOA of KEPL also provides for the same.**
- **EBARA had offered** to sell the shares for ₹ 50 lakhs and KBL was requested to convey acceptance or otherwise of the offer.
- KBL replied that it is willing to purchase shares at mutually agreed price and the terms and conditions of EBARA's exit were still being discussed.
- The **offer given by KBL** and terms suggested therein was found **unacceptable by EBARA.**
- Therefore EBARA entered into share sale and purchase agreement (**SSPA**) **with the**

appellant for sale of its entire shareholding in KEPL

- Appellant **requested KEPL to give effect of transfer of shares** but KEPL has **not given effect** of transfer of shares as **KBL had not granted prior written consent** for the said transfer pursuant to clause of AOA.
- The appellant wrote to KEPL inter alia stating that there cannot be an absolute embargo on the transferability of shares, particularly **in the case of a public limited company**.
- The Appellant wrote to KEPL, stating that **the refusal to register** the transfer of shares is **unsustainable and mala fide**. The Appellant called upon KEPL to disregard KBL's objections and register the transfer of shares.
- KEPL is a public limited company and in terms of **section 58** of the Act, shares of a public limited company are **freely transferable**. Even if it is assumed that section 58(2) of the Act permits such a restriction, **it can only apply to the parties to the JVA and not to others**.
- Appellant **filed petition under section 58(4)** of Companies Act, 2013 seeking following reliefs:
  - To strike down clause 6.01 of the Joint Venture Agreement dated 27.01.1988 and Article 51(b) of the Articles of Association (AOA) of the KEPL to the extent that they are ultra vires section 58 of the Act
  - To direct KEPL to register the transfer of shares in favour of appeallant and to further direct compliance with such order within 10 days; and
  - To award costs;

Arguments

The sole issue requiring determination in the said case is as follows:

Whether the refusal by KEPL to give effect to the registration of shares acquired by the Appellant from EBARA is permissible within the framework of law, given that KEPL is public company, and public companies by definition, cannot restrict transfer of shares as is permissible in a private company?

Arguments on behalf of Appeallant:

After referring to Sec. 58, Sec. 2(68) and Sec. 2(71) i.e. definition of Private Company and public company. Learned council on behalf of appellant argued that:

- If a public company could indeed restrict transferability of shares by virtue of proviso to Sec. 58(2), then it would in effect **render nugatory the basic difference between a private and public company**. A purposive reading of the scheme and provisions of the Act was necessary.
- Further Submitted that, **Article 51(b) of AOA of KEPL** comprised of **2 "inextricably interwoven facets** – (1) **Consent** of a non-existing shareholder for a proposed exit by another shareholder, and (2) a **pre-emptive right to acquire** the shares proposed to be sold by the exiting shareholder. Therefore, **the right of first refusal (ROFR)** and the **right to approve an exit are two sides** of the **same coin**. If this **two facets are not interlinked**, then tribunal can rule out that a public company may place an unconditional restriction on the right of shareholder to transfer of its shares which would have **effect of converting KEPL into Private Limited Company**.
- Article 51(b) of the AOA is that the right of either shareholder to consent (or to reject

consent, as the case may be) is a right in aid of first refusal, intrinsically embedded in the very same provisions.

- Learned council urged that if the **two views** are possible, the view that is **in consonance with the vires of the scheme of the legislation** is the view to **be adopted.**
- Continuing further with his argument, submitted that a **contract which erodes the very substratum of the character of a public company cannot become enforceable** by reason of the proviso to Sec. 58(2). Therefore insisted that only logical, reasonable and harmonious construction of the proviso to sec. 58(2) would be that in an agreement which does not amount to a blanket restriction on transfer of shares shall be recognized as a valid contract
- Further submitted that the cause shown by KEPL for refusal of transfer is not sufficient cause. Once the offer is made and rejected, the offer or would have a right to sell the shares to a third party
- Further argued that KBL has been consistently **attempting to hold EBARA hostage** to clause 6.01 and 11.02 of the JVA as well as Article 51(b) of the AOA
- KBL constantly evaded responding to the offer of EBARA and non-reply constitutes deemed refusal. Further KEPL is acting under influence and control of KBL even after requisite clarifications were provided to it.

Arguments on behalf of KEPL

- **KEPL is bound by the terms of JVA and AOA.** KEPL cannot be expected to go beyond the terms of JVA and AOA
- The restrictions embodied in Article 51(b) of the **AoA** and clause 6.01 of the **JVA are both valid and enforceable**.
- Even in the case of a public company, any contract or arrangement between two or more persons in respect of transfer of shares is enforceable and constitutes a valid contract. **A mere restriction in a contract as between two or more shareholders in respect of transfer of shares cannot in any manner change the character of a company** from public to private.
- Referred ***Bajaj Auto Limited vs. Western Maharashtra Development Corporation Limited,18***[1] that contractual restrictions contained in an agreement between shareholders of a public company are valid and enforceable.
- With regard to the contentions of the Appellant that certain clauses in the JVA and the AoA are bad in law, submitted that Tribunal, **while exercising summary jurisdiction under section 58 of the Act, cannot go into disputed questions of facts or adjudicated upon the remedy for the Appellant lies before a civil court**. On this ground, the present appeal is not maintainable.

Arguments on behalf of EBARA

- Learned council argued that **EBARA had offered to sell** its entire shareholding to

1. 2015(4) Bom CR 299:2015 SCC Online Bom 2111, decided on 08.05.2015

KBL. However **KBL choose to abuse the terms of AOA** to compel EBARA to accept unilateral, onerous and unacceptable terms.

- The onerous condition proposed by **KBL was not acceptable to EBARA. KBL found a way to refuse to buy the shares, thereby refusing the offer made by EBARA *sub-silentio*.**
- Therefore **EBARA was left with no option** but to sell its shares to a third party on conditions similar to those offered to KBL.
- Further submitted that on a plain reading of clause 6.01 of the JVA, requirement of prior consent is in aid of the right of first refusal in the same clause, whose last sentence provides that "the other party shall have the right of first refusal of such offer."
- Harmonious reading of the clauses will clarify that the **intendment between the parties was only RoFR (Right of First Offer) and not anything more.**
- If, in the present case, "prior written consent" is considered as a condition precedent in addition to RoFR, then it would amount to an absolute prohibition, which is impermissible in law. **What constitutes a restriction cannot transmogrify into a prohibition**. Such a contract would become illegal and therefore unenforceable even under the proviso to section 58(2).
- **Once EBARA's offer is rejected by KBL, no additional consent from KBL would be required.**

Arguments on behalf of KBL

- **Proviso to Sec. 58(2)** referred was meant to be **an exception not the rule** laid down. Further explained the function/ purpose of proviso with the help of Supreme Court's Judgments[2].
- Further expounding on the **definition of the term 'contract'** under section 2(h) of the Indian Contract Act, 1872, which defines that a contract as an agreement enforceable by law and after referring section 10 of the Indian Contract Act, 1872 which explains what agreements are contracts. Submitted that **JVA executed between EBARA and KBL is a valid contract and therefore enforceable as one.**
- Further pointed out that **Article 51(b) binds only two out of the 68 shareholders** of KEPL and thus, this would not be violative or contrary to **section 58(2)** of the Act. Further took aid of Judgment of the Hon'ble Bombay High Court in ***Bajaj Auto Limited vs. Western Maharashtra Development Corporation Limited,18*** which deals squarely with aspect of restriction on transferability of shares
- Also pointed out that the **JVA was entered into on 27.01.1988**. EBARA and KBL have been JV partners since then. **EBARA has acknowledged and acted upon the JVA.**
- Also **referred one clause of SSPA** entered into between EBARA and appellant which indicates that **Appellant and EBARA were both aware of the existence, execution, validity and enforceability of the JVA**. Inter se they have **also agreed to abide by all the**

2. in *S Sundaram Pillai & others vs. R Pattabiraman/& others (1985) 1 SCC 591* and in *Ali M.K. vs. State of Kerala (2003) 11 SCC 632.*

terms of JVA without exception. Having acted upon, acknowledged and acquiesced in terms contained in the JVA. **Therefore it is not open to the Appellant or EBARA now to challenge or dispute any terms of JVA.**

- Further alleges that whole purpose of the present Appeal is an **attempt to resile from the non-compete obligation cast upon EBARA under the JVA,** in respect of which Suit No. 56/2018 is pending before the learned District Court, Pune.
- Further stated that it is not the case of the Appellant that the **JVA is not a valid contract** that may fall foul of section 14 to 19 of the Indian Contract Act, 1872. In any case, even if the **Appellant wanted to challenge to the terms of the JVA, such a challenge would lie only before a civil court.** The question of unreasonableness in withholding consent cannot be gone into in the present Appeal.

Held

- **First**, the principle of law embodied in the **proviso to section 2(68)** is, in our view **not in conflict with the definitions of a public company** in section 2(71).
- While the principle in general is that the shares of a public company are freely transferable, there is **nothing in law that stops two or more shareholders from entering into a covenant containing clauses for pre-emption,** such as right of first refusal embodied in clause 11.02 of the JVA under consideration in the present Appeal.
- **Secondly**, if we do go along with line of reasoning of Ld. Council of appellant, then what we would in effect be doing is to **take upon ourselves the role of a civil court in deciding whether the contract itself contains clauses that are too onerous or incapable of performance.** We feel that we are not empowered by legislation to do so.
- **Thirdly**, if there is any **problem with the way the contract has been worded**, even if such problem comes to the fore later on, **then there are effective remedies under the Indian Contract Act, 1872**, for novation, rescission or alteration of the contract under sections 26 and 27 of the Specific Relief Act, 1963. The fact pointed out by learned council of KBL that **no such suit has been instituted so far in any civil court,** means that EBARA itself did not think that the contract was unfair and required alteration or rescission in any manner.
- Further **JVA binds only two of the shareholders**. The AoA incorporates the provisions of the JVA. While the fact remains that what **two independent shareholders contract amongst themselves is a matter concerning those two shareholders alone, KEPL is bound to be run in accordance with the AoA.**
- EBARA simply shifted its own responsibility under the JVA to the Appellant *vide* SSPA requiring the Appellant to sign and deliver to KBL a letter agreeing to comply with and be bound by the terms of the JVA. Therefore, we must come to the conclusion that even now, **neither EBARA nor the Appellant find the terms of the JVA to be onerous or contrary to the law.**
- The **proviso to section 58(2) enables a company to exist anywhere in the continuum subject to agreement between the parties.** To read it otherwise, as Ld. Council of appellant would like us

to do, would be to render the proviso to section 58(2) a nullity. It **is not for this Tribunal to go into the vires of the legislation itself,** that is something that only the constitutional courts can go into.

- For all the above reasons, Company Appeal No. 221/58(4)/MB/2017, therefore, **fails and is, accordingly, dismissed.** No order as to costs.

2. SEBI

Ruling of Adjudicating Officer – SEBI
Name of the Case: In respect of Shreejesh Harindranath and Sandeep AC in the matter of Spicejet Ltd. ("Spicejet")

Facts of the case

- Spicejet on January 22, 2016 at 03.27 p.m. announced financial results for the quarter ended December 2015 wherein company reported net profit of ₹ 238.39 crores as compared to profit of ₹ 23.77 crores for previous quarter September 2015 and net loss of ₹ 275.02 crores for same quarter previous year i.e. December 2014. This increase in net profit was around 902.90% as compared to net profit for the previous quarter ended September 2015.
- The above Information relating to financial results was a Price Sensitive Information (PSI). It came into existence on January 6, 2016, when the Finance and Accounts Department started receiving provisional details from respective user departments. It was disclosed to stock exchange on January 22, 2016 at 03.27 p.m. Therefore, the period from January 6 to 22, 2016 is considered as the period of UPSI (*"UPSI period"*).
- Upon examination of trading details by SEBI it was observed that Shreejesh Harindranath ("Noticee 1"), General Manager (GM), Financial Planning Analysis and Treasury, Spicejet Ltd. had traded in the scrip of Spicejet during UPSI period. Noticee 1 bought 3100 shares during January 6, 2016 to January 14, 2016. Noticee 1 had not obtained pre-clearance for the trade executed by him on January 25, 2016 the value of which was above ₹ 5,00,000.
- Noticee 1 was a designated person and had carried out contra trades during November 1, 2015 to April 30, 2016 and earned a profit of ₹ 1.76 lakh.
- Noticee 1 being a designated person bought 3100 shares while in possession of UPSI and sold 13550 shares of Spicejet during post announcement period i.e. January 25, 2016 to February 8, 2016 the cumulative value of such trades was in excess of ₹ 10,00,000.
- Sandeep AC ("Noticee 2") being real brother of Noticee 1 was a connected person as defined under Regulation 2(1)(d)(ii)(a) of SEBI (Prohibition of Insider Trading) Regulations, 2015 ["SEBI (PIT)"] and is considered to be an 'insider' in accordance with Regulation 2(1)(g) of SEBI (PIT).
- On further investigation SEBI observed that Noticee 2 had bought 800 shares of Spicejet on January 22, 2016 i.e. just before announcement of UPSI and sold the same shares on January 25, 2016 i.e. post announcement of financial results. SEBI alleged that Noticee 2 by procuring UPSI from his brother i.e. Noticee 1 had traded in the scrip of Spicejet and his selling of shares post announcement also corroborates the same fact.

Charges levied:

Noticee 1: Violation of Regulation 3(1), 4(1), 7(2)(a) of SEBI (PIT) read with Section 12A(e) of SEBI Act, 1992, Clause 10 of Minimum Standard of Code of Conduct in Schedule B read with Regulation 9(1) of SEBI (PIT), Clause 6 of Minimum Standard of Code of Conduct of Schedule B read with Regulation 9(1) of SEBI (PIT).

Noticee 2 has violated the provisions of Regulation 3(2) and 4(1) of SEBI (PIT) and provisions of Section 12A(d) and 12A(e) of SEBI Act, 1992.

Arguments made by Appellant/Noticees

Arguments by Noticee 1

1) Noticee 1 submitted that not taking pre-clearance and entering into contra trade was out of sheer ignorance and without malafide intention.

2) ***Disgorgement done for contra trade:*** It was alleged that Noticee 1 had not taken pre-clearance for the transaction done on January 25, 2016 as it crossed the threshold limit of ₹ 5,00,000 for obtaining the pre-clearance. In this regard Noticee 1 submitted that he was not keeping tab on the value of the purchases and sales and hence he did not seek pre-clearance. He further submitted that this was purely by oversight and was not with any *mala fide* intention. The moment it was detected by Company Secretary that these trades were in violation of the model code of conduct, he repaid the profits made by him to the company which in turn was forwarded to SEBI Investor Protection and Education Fund (IPEF).

Reply by Noticee 2

1) ***No evidence of leak of UPSI***: Noticee 2 submitted that allegations against him are based on preponderance of probability. He further submitted that he being the real brother of Noticee 1 it is presumed that his purchase of 800 shares on January 22, 2016 before announcement of UPSI to stock exchanges was on the basis of UPSI received from his brother. There is no iota of evidence for this. It is all based on surmise. No direct or circumstantial evidence such as call records or funding arrangement has been shown and the probability is merely an allegation.

Arguments made by SEBI

Reply to Noticee 1

1) ***Disgorgement done for contra trade***: The Noticee 1 stated that he has remitted an amount of ₹ 1.76 lakhs being the profit earned by him to SEBI Investor Education and Protection Fund. SEBI stated that the fact Noticee 1 is required to abide by code of conduct prescribed for prevention of insider trading cannot be ignored. SEBI further stated that any deviation from the established regulatory practices cannot be considered leniently. Therefore, submissions made by Noticee 1 are not taken into consideration and it is concluded that Noticee 1 by executing contra trades had violated the provisions of Clause 10 of minimum standard of code of conduct prescribed under Schedule B read with Regulation 9(1) of SEBI (PIT).

Reply to Noticee 2

1) ***No evidence of leak of UPSI***: SEBI stated that given the gravity of charge in the absence of any direct evidence, circumstantial evidence cannot be ignored. Upon analysing the trading date of the Noticee 1 and 2 it is observed that the Noticee 2 had bought the shares on the same days when the Noticee 1 had bought. The details of trades carried out by the Noticees 1 & 2 are as follows:

Date	*No. of shares bought by Noticee 1*	*No. Of shares bought by Noticee 2*
16-12-2015	550	400
23-12-2015	1150	600
29-12-2015	1550	1200
01-01-2016	1000	1400
04-01-2016	550	250

Noticee 2 had bought shares on same dates when Noticee 1 had bought. Therefore, it can be reasonably construed that there was an implied communication/advice between Noticee 1 and Noticee 2.

The reliance placed by the Noticee 2 on the news report dated November 25, 2015 for buying 800 shares on the date of publication of financial results is a farfetched argument, as in normal course of investment, any positive news about the Company's performance, if relied upon, would trigger an investment decision within reasonable period of time unlike 2 months in this case. The circumstantial evidence and trading pattern indicates that the Noticee 1 had consistently displayed exchange of aid and advice to Noticee 2. From the same, it can be concluded that there is reasonable certainty that the basis of buy transaction of 800 shares by Noticee 2 was pursuant to communication of UPSI by Noticee 1. Further, the investment in shares by a person who is not a regular trader, would hold the investment for a long term rather than selling the shares on the next trading day as observed in the instant case.

From the facts of the case and circumstantial evidence, the preponderance of probability indicates that the Noticee 2 was in receipt of the unpublished price sensitive information regarding the financial performance of the Company from his brother i.e., Noticee 1 and on the basis of this Noticee 2 bought shares, before the information became public. It is imperative that anyone in possession of or having access to unpublished price sensitive information should be considered an "insider" regardless of how one came in possession of or had access to such information.

Held

Noticee 1 is penalized ₹ 20 lakhs for engaged in Insider Trading and leak of UPSI and charged with ₹ 2 lakh and 1 lakh for violation of SEBI PIT (entering into contra trade and not taking pre-clearance) and non-submission of disclosures under Reg 7(2)(a) of SEBI PIT. Noticee 2 penalized Rs 10 lakh for trading on the basis of leaked UPSI and ₹ 2 lakh for procuring UPSI from Noticee 1 which is violation of SEBI PIT read with relevant provisions of SEBI Act, 1992.

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