

NATIONAL COMPANY LAW APPELLATE TRIBUNAL, NEW DELHI

Company Appeal (AT) No. 32 of 2019

[Arising out of Order dated 27th November, 2018 passed by the National Company Law Tribunal, New Delhi Bench in CP-159(ND)2017]

IN THE MATTER OF:

1. Ajay M. Patel,

511, Dilnawaz Apartment,
Lalubhai Park Road, Andheri (West),
Mumbai – 400 058.

2. Bhavik Ajay Patel,

511, Dilnawaz Apartment,
Lalubhai Park Road, Andheri (West),
Mumbai – 400 058.

3. Apoorva Patel,

Jalshree, Flat No.501, 5th Floor,
Jalshree Presidency Society,
N S Road, 7, JVPD Scheme,
Vile Parle (West),
Mumbai – 400 049.

4. Sonal Apoorva Patel,

Jalshree, Flat No.501, 5th Floor,
Jalshree Presidency Society,
N S Road, 7, JVPD Scheme,
Vile Parle (West),
Mumbai – 400 049.

...Appellants

Vs

1. Aarohi Polymers Pvt. Ltd.,

With its registered office at
1/1291-93, Naiwala, Karol Bagh,
New Delhi – 110 005.

2. Mahesh Madanlal Shah,

Director of Respondent No. 1
204, Purnima Apartment,
Near Anand Balwadi,
Amarkunj Extention,
Vadodara – 390 023. Gujarat.

3. Dinesh Khandelwal Kumar,

Director of Respondent No. 1
85, 28, Tehsil Pachpahad,
District Jhalawar,
Bhawani Mandi – 326 502,
Rajasthan.

4. Hara Estates & Capital Pvt. Ltd.,

602, Janki Centre,
Off Veerai Desai Raod,
Andheri (West)
Mumbai – 400 053.

5. Finhelp Investments & Consultants Pvt. Ltd.,

with its registered office at
1, Mistri Nagar, Pandurang
Naik Marg, Shivaji Park,
Mumbai – 400 016.

6. Mr. Jyotindra S. Patel,

31, Anand Nagar Society,
Productivity Road,
Baroda – 390 007.

**7. Multidimensional Holdings & Consultants
Pvt. Ltd.**

8/A, Shree Nagar Society,
Akota Road, Baroda – 390 020.
Gujarat.

8. Mr. Sanjay S. Patel,

31, Anand Nagar Society,
Productivity Road,
Baroda – 390 007.

9. Rajesh Chandubhai Patel,

4, Prabhu Park Society No. 2,
Near Anand Balwadi,
Amarkunj Extention,
Baroda – 390 023.

10. Shilpa Rajesh Patel,

4, Prabhu Park Society No. 2,
Near Anand Balwadi,
Amarkunj Extention,
Baroda – 390 023.

11. Nita S. Patel,

31, Anand Nagar Society,
Productivity Road,
Baroda – 390 007

12. Meeta Ajay Patel,

511, Dilnawaz Apartment,
Lalubhai Park Road, Andheri (West),
Mumbai – 400 058.

....Respondents

Present:

For Appellants: Mr. Raju Ramachandran, Sr. Advocate with
Mr. Rishad A. Showdhury, Ms. Madhurika Ray and
Mr. Ishwar Mohanty, Advocates.

For Respondents: Dr. U. K. Chaudhary, Sr. Advocate with Mr. Dhruv
Gupta, Mr. Sanjeet Ranjan and Mr. Nakul Gandhi,
Advocate for R-1 to 3.

Mr. Darpan Wadhwa, Sr. Advocate for R-7 and R-8.

Mr. Manu Agarwal, Advocate for R-5, 6, 9, 10 & 11.

J U D G M E N T

BANSI LAL BHAT, J.

Appellants claiming to be shareholders holding an equity of 21.99% in Respondent No. 1 Company styled as 'M/s Aarohi Polymers Pvt. Ltd.' are aggrieved of impugned order dated 27th November, 2018 passed by National Company Law Tribunal, New Delhi Bench (hereinafter referred to as "Tribunal") in CP-159(ND)2017 by virtue whereof Appellant's petition under Section 241-242 of the Companies Act, 2013 (hereinafter referred to as "the Act") alleging oppression and mismanagement at the hands of Respondents No. 2 and 3 being in-charge of the affairs of business operations of Respondent No. 1 as Directors came to be dismissed primarily on the ground that neither did the transfer of shares inter-se the members require prior approval of the Board of Directors nor option of purchase to all existing members prior to effecting of such transfer was required. The impugned order is assailed on the ground that the preemptive right of having notice of proposed transfer of shares incorporated in Article 7 of the 'Articles of Association' (hereinafter referred to as 'AOA') vested in the Shareholders is not diluted by the provision engrafted in Article 8 of 'AOA' which operates in a different field and comes into operation only after exercise or non-exercise of the preemptive right by the shareholders. The impugned order is also assailed on the ground that the preemptive right vested in the existing shareholders does not only serve the purpose of regulating the entry of

outsiders in the Company as held by the Tribunal but is also designed to protect the balance of power in closely held/ family run Companies.

2. For better understanding of the controversy inter-se the parties a brief reference to the factual matrix is inevitable. The authorized, issued and paid up capital of Respondent No. 1 Company is Rs.1,00,000 divided into 10,000 shares of Rs.10 each. Number of respective shares with percentage is given in the impugned order. Appellants alleged before the Tribunal that though Respondent No. 1 Company comprised of a closely held group of members, Respondents No. 2 and 3 being at the helm of affairs as Directors managing the affairs of the Company ignored the Appellants and did not keep them informed of the developments in regard to affairs of the Company. It was alleged that the financial statements and statutory records were withheld and notices of meetings were not effected on the Appellants. Communications from Appellants in this regard were attended to partially and no intimation of AGM was given to the Appellants for annual year 2014-15. Subsequently, in the AGM scheduled for 19.09.2015 decision to transfer the shares of Respondent No. 7 'M/s Multidimensional Holdings and Consultants Pvt. Ltd.' to Respondent No. 5 and 6 viz. 'Finhelp Investment and Consultants (Mumbai) Pvt. Ltd.' and 'Mr. Jyotindra Shantilal Patel' was ratified. According to Appellants, this was done in utter disregard of the Article 7 of AOA, which provides for sale of shares by a member only after notifying the proposed sale to the Board of Directors which must offer to the other shareholders such shares at a fair value and

only upon such offer being not accepted the member proposing the transfer of shares would be entitled to sell and transfer the shares to any person other than the Shareholders. The Appellants contended before the Tribunal that denial of opportunity to exercise their preemptive right of purchase of shares violated Article 7 of AOA and ratification of the sale on 19.09.2015 was a mere subterfuge as the transfer of shares had already been approved by the Board of Directors on 20.12.2014. The stand taken by the Respondents before the Tribunal was that the transfer of shares in question was governed by Article 8(1) of the AOA and not by Article 7 as it was a transfer inter-se the members.

3. Admittedly, Respondent No. 1 is a private company. Section 2(68) of the Act defines a private company as a company having a prescribed minimum paid up share capital which, by its Articles restricts the right to transfer its shares and limits the number of its members to 200 except in case of one person company. The private company, by its Articles prohibits any invitation to the public to subscribe for any securities of the company which includes shares and debentures. It is well settled by now that the 'Articles of Association' of a private company are in the nature of a contract between such company and its members/ shareholders and also inter-se the members/shareholders. It is not in dispute that in the case in hand 'Articles of Association' of Respondent No. 1 restrict the right to transfer its shares and the controversy dealt with by the Tribunal in terms of the impugned order assailed before this Appellate Tribunal pertains to the true

import, scope and interpretation of the relevant Articles dealing with restriction on transfer of shareholding. The relevant of the 'Articles of Association' are reproduced hereunder:-

“Article 7. *Any member desiring to sell any of his shares must notify in writing to the Board of Directors of the number share, the fair value and the name of the proposed transferee and the Board of Directors must offer to the other shareholders, the shares offered at the fair value and if the offer is accepted, the shares shall be transferred to the acceptor and if the shares or any of them are not so accepted within one month from the date of notice to the Board, the member proposing transfer shall, at any time within three month afterwards, be at liberty, subject of Articles 8 & 9 thereof, to sell and transfer the shares to any person at the same or at higher price.*

In case of any dispute, regarding the fair value of the share it shall be decided and fixed by the company's Auditors whose decision shall be final.”

Article 8. 1. *No transfer of shares shall be made or registered without the previous sanction of the Directors,*

except when the transfer is made by any member of the Company to another member or to a member's spouse or child or children or his/her heirs and the Directors may decline to give such sanction without assigning any reason, subject to Section 111 of the Act.”

4. According to learned counsel for Appellants, the right to preemption couched in broad and unambiguous terms within the ambit of Article 7 is not limited to transfers to non-members/ outsiders but it applies to all transfers irrespective of the status of transferee. It is contended that the Tribunal erred in holding that the only objective of such Article was to regulate the entry of outsiders into the company. It is further contended that the transfer of shares must be strictly in accordance with the Articles and any transfer effected without allowing the preemptive clause to operate would be violative of the 'Articles of Association' and would be construed as an act of oppression.

5. Per contra, it is argued on behalf of Respondents that in case shares are proposed to be sold to a person outside the existing nucleus, the transfer is required to be made in terms of Article 7 but in case the shares are proposed to be sold to a person within the existing nucleus of the company, the transfers can be made under Article 8 without the sanction of the Board of Directors. It is further submitted that the exception in Article 8(i) exempts sale of shares inter-se members from previous sanction of

Board of Directors and no offer is required to be made to the Board for its previous sanction in terms of provisions of Article 7.

6. We have perused the record and given our anxious consideration to the arguments advanced at the Bar. It appears that identical Articles 7 and 8 fell for consideration of the Hon'ble Karnataka High Court in the Case of **“Mukundlal Manchanda Vs. Prakash Roadlines Ltd., reported in 1991 SCCOnlineKar 131”** . Learned Single Judge interpreted the Articles as under:-

“4.x....x....x....The object of Article 7 is to preserve the shareholding to the members of the family and to the existing shareholders. Suppose, a shareholder wants to sell 3 or 4 shares to another shareholder and all other shareholders offer to purchase the same at the market price, how to effect the transfer by selling the share to other shareholders is not forthcoming in Article 7. The shares cannot be divided in proportion to the shareholding of different shareholders who are willing to purchase the same. Further, what is the purpose of preventing one shareholder from purchasing the share of another is also not clear. The purposes behind Article 7 is clear when it is compared with Article 8. Article 8 states that shares shall not be transferred without the previous sanction of the

Directors except when transfer is made by one member to another or to a member's wife or child etc. In other words, Article 8 does not bar the transfer of the share by one shareholder to another shareholder or to the relatives stated therein for which purpose sanction of the Directors is not necessary. Previous sanction of the Directors is not at all necessary for transfer of the shares by one shareholder to another falling within the enumerated clause in Article 8. Transfer includes sale. In fact, Article 7 also uses the word 'sell' of 'transfer'. Article 8 should have an independent operation and Article 7 also should have an independent operation. Both Articles can have full play provided their para-makers are understood. The sale or transfer of one shareholder to another shareholder or to the relatives mentioned in Article 8, is excluded from the operation of Article 7. Both Articles can act independently of each other. Further, nowhere Article 8 say, it is subject to the provision of Article 7. Therefore, it is clear that the transfer of shares in favour of the existing shareholders does not require to be effected after following the procedure stated in Article 7."

7. The decision rendered by the Hon'ble Single Judge was upheld by a Division Bench of the Hon'ble Karnataka High Court in appeal titled

“Mukundlal Manchanda Vs. Prakash Roadlines Ltd. & Ors., reported in (1996) 87 Compas 102 (kar)”, relevant whereof is reproduced hereinbelow:-

“28.x....x....x....The scheme and the object behind articles 7 and 8 appear to be to prevent an outsider from purchasing the shares of the respondent-company by way of sale or otherwise and in that direction the provisions of articles 7 and 8 envisage that before the third party, i.e., a non-member can be allowed to purchase shares of the company, the option to purchase the said shares must first be given to the existing members. It is only when the existing members decline to purchase shares offered for sale, that an outsiders should be allowed to purchase the same. To this scheme however, article 8 provides an exception, i.e., in case the transfer is intended to be made in favour of an existing member or a member’s wife, children or legal heir, the previous sanction of the directors is not required. In other words, if the sale takes place within the existing family of members of company or their legal heirs or children or spouses, there is no requirement of previous sanction from the board of directors. This exception to us appears to be logical for the entire object behind articles 7 and 8 being to prevent an outsider

purchasing the shares without the existing members exercising their rights, is achieved by making such an exception. It is significant in this connection to mention that article 7 refers only to parties other than existing shareholder. Similarly, the term “transfer” appearing in article 8 appears to us to be a term wide enough to include a transfer by way of sale also. In other words, article 8 would apply even to a situation where the transfer is being made by way of a sale by one member of the company in favour of another member, his spouse or children. In any such situation, the right of pre-emption as envisaged by article 7 would not be applicable for the sale is being made either to an existing member or his legal heir or children.”

8. From the aforesaid interpretation of identical Articles 7 and 8, it is abundantly clear that these provisions are intended to block an outsider from purchasing the shares of a private company through the mode of sale or transfer by any other mode and for achieving this objective these Articles envisage that a stranger/ third party may be allowed to purchase the shares of the company only after the existing shareholders have been given the option to purchase the shares intended to be sold and the existing shareholders/ members have declined to purchase the shares offered for sale. This is the general principle. However, an exception is carved out under Article 8 by providing that previous sanction from Board of Directors

would not be required if the sale of shares is made in favour of an existing member/ members, their spouses, children or legal heirs. Article 8 thus dispenses with the issuance of notice for allowing the members to exercise their right of pre-emption/ prior purchase in respect of the shares offered for sale to the existing members, their spouses, children or legal heirs as the transfer of share by any mode including the sale would not induct any third party/ stranger in the nucleus of members/ shareholders. It can be stated without any amount of ambiguity that the settled position of law divests the members/ shareholders of a private company of right of pre-emption/ prior purchase of shares transferred/ sold by a member to an existing member/members, their spouses, children or legal heirs. Admittedly, this case falls within the aforesaid exception. Further, that the alteration of balance of power as a sequel to the transfer of shareholding by a member in favour of an existing member would be a concept alien to the true scope and ambit of these Articles. This is apart from the fact that on facts the Tribunal has not found any material alteration on the aspect of balance of power and such finding is not shown to be erroneous, much less perverse.

9. For the foregoing reasons, we find that the impugned order does not suffer from any legal infirmity or factual frailty. The interpretation placed on the language of Article 7 and 8 of the 'Articles of Association' of Respondent No. 1 Company by the Tribunal is perfectly in consonance with the settled position of law. Since, the Appellant fails to succeed on the primary issue raised in this appeal, we refrain from making any comment on the conduct

of the Appellant in a similar transfer of shareholding in past where the Appellant himself is stated to have been a beneficiary. There being no merit in the instant appeal, it is accordingly dismissed.

[Justice Bansi Lal Bhat]
Member (Judicial)

[Balvinder Singh]
Member (Technical)

NEW DELHI

3rd July, 2019

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