INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 2 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

ROLE OF ARBITRATION IN SHAREHOLDER DISPUTES

AUTHOR - DIKSHA RAO, STUDENT AT CHRIST (DEEMED TO BE UNIVERSITY), PUNE, LAVASA, CAMPUS

BEST CITATION - DIKSHA RAO, ROLE OF ARBITRATION IN SHAREHOLDER DISPUTES, *INDIAN JOURNAL OF LEGAL REVIEW (IJLR)*, 4 (2) OF 2024, PG. 315-321, APIS – 3920 – 0001 & ISSN - 2583-2344.

ABSTRACT

The concept of arbitrability in India, particularly concerning shareholder disputes, has garnered significant attention and debate since the enactment of the Arbitration and Conciliation Act 1996. Understanding arbitrability's definition is crucial as it delineates the scope of disputes amenable to arbitration versus those falling within the exclusive jurisdiction of state courts. While Indian courts have established criteria for determining arbitrability, the issue remains complex and varies across jurisdictions. This article examines the divergent perspectives on arbitrability, particularly focusing on shareholder disputes, which have become increasingly common amidst India's economic growth. The enforcement and interpretation of shareholder agreements (SHA) vis-à-vis a company's articles of association (AOA) have led to contrasting judicial interpretations, further complicating the landscape. Recent Supreme Court rulings, notably in Booz Allen & Hamilton Inc v SBI Home Finance Inc and Vidya Drolia v. Durga Trading Corporation, have attempted to provide clarity on arbitrability criteria, emphasizing distinctions between rights in personam and rights in rem. However, challenges persist, especially regarding the enforceability of arbitration provisions solely within SHAs. Additionally, shareholder disputes intersect with statutory remedies under the Companies Act 2013, particularly in cases of oppression and mismanagement, which are exclusively adjudicated by specialized tribunals. Despite judicial efforts to address arbitrability, the intricate nature of shareholder disputes necessitates a nuanced, fact-based approach, balancing the parties' contractual autonomy with statutory safeguards. Thus, while arbitration offers a potential avenue for dispute resolution, the unique circumstances of each case demand careful consideration to ensure equitable outcomes.

Keywords - Arbitrability, Arbitration and Conciliation Act 1996, Shareholder Disputes, Legal Framework, Arbitration Agreement, Supreme Court of India, Companies Act 2013, Oppression and Mismanagement.

Introduction

The concept of arbitrability in India has brought up several crucial issues ever since the Arbitration and Conciliation Act 1996 (the 1996 Act) was passed. It might be important to first comprehend this concept's definition given how important it is. Arbitrability refers to whether a disagreement can be resolved through arbitration or if state courts should have the sole authority to handle it. Under no circumstances, including arbitration agreements, may a dispute that is not amenable to arbitration be submitted to arbitration. Indian courts have frequently examined the issue of whether or not disputes can be arbitrated and have established useful criteria for doing so. An important concern in this effort has been the arbitrability of shareholder disputes.[411] The various high courts in India have taken quite different stances on these issues; these have ranged from a more pro-arbitration stance that supports the authority of an arbitral tribunal to make decisions on them to a more conservative

[411] Chilumuri, Gambhir. "*Invocation of Arbitration Clauses in Shareholder Agreements for Disputes under Articles of Association.*" NUJS Law Review, vol. 13, no. 4, 2020, pp. 54-72. https://nujslawreview.org/wp-content/uploads/2020/12/13-4-Chilumuri-Gambhir-Invocation-of-Arbitration-Clauses-in-Shareholder-Agreements-for-disputes-under-Articles-of-Association.pdf. (last visited May 5, 2024)

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 2 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

stance that extols the sanctity of the statutory bodies to decide such disputes. To contextualize the debate over the arbitrability of shareholder disputes in India, this article tracks these differing points of view. [412]

1. **Understanding the notion of arbitrability within the legal framework of India.**

Early in the nineteenth century, there was no specific legislation about arbitration; instead, the law was governed by the provisions included in schedules found in civil procedural statutes that were dedicated solely to arbitration. However, neither the Code of Civil Procedure 1859 nor its successor, the Code of Civil Procedure 1882, addressed the fundamental question of what kinds of conflicts can be sent to arbitration. Similarly, this important aspect was left unspoken in the Arbitration Statute 1899, the first unified statute that codified the subject matter of arbitration in India. The Arbitration Act of 1940, which was likewise vague on the subject of arbitrability, replaced this version.

The United Nations Commission on International Trade Law Model Law on International Commercial Arbitration serves as a major source of inspiration for the 1996 Act, which codifies India's current arbitration process. The Model Law on International Commercial Arbitration thoroughly covers all incidental aspects of arbitration to globally standardize the law on arbitration. It's interesting to note that it expressly leaves the issue of arbitrability up to state-national legislation. Nevertheless, despite this flexibility, the 1996 Act neither explicitly addresses arbitrability nor offers definitive clarification about the kinds of conflicts that can be submitted to arbitration.

The 1996 Act's Section 2(3), which states that "this Part (Arbitration) shall not affect any other law for the time being in force by which certain disputes may not be submitted to arbitration," makes a hazy reference to the idea of arbitrability. Therefore, under the 1996 Act, unless there is an express or implicit restriction on the arbitral tribunal's jurisdiction, all civil and business disputes are often amenable to arbitration.

In the seminal decision of Booz Allen & Hamilton Inc v SBI Home Finance Inc, the Supreme Court of India endeavoured to define the parameters of arbitrability in light of the ambiguity surrounding the 1996 Act's arbitrability. The Supreme Court observed in this decision that, in contrast to courts, which are open forums established by the laws of a certain nation, arbitration tribunals are private forums for dispute resolution selected voluntarily by the parties. An arbitral tribunal is contractually empowered to resolve disputes and bind the parties to its ruling where there is a valid arbitration agreement. The Supreme Court distinguished between the determination of rights in personam—that is, interests protected exclusively against particular people—and rights in rem, or rights that can be used against the entire world, based on this view.[413] The Supreme Court ruled that all conflicts about rights in personam are arbitrable in general, whereas all disputes about rights in rem must be decided by courts or specially appointed tribunals.

The exclusion of rights in rem, according to the Supreme Court, further emphasizes arbitration's fundamental character as a private dispute resolution process that is exclusively binding on the parties to the arbitration agreement.

The Supreme Court ruled that these types of disputes are not arbitrable since the outcome of these processes determines the parties' standing not only against one another but also against the entire world. This ruling justified the exclusion of certain conflicts from arbitration.

[412] [Ayush Patria], "*Navigating Corporate Turbulence: A Deep Dive into ADR as a Conflict Resolution Strategy*," Abott (January 10, 2024), https://abott.in/2024/01/10/navigating-corporate-turbulence-a-deep-dive-into-adr-as-a-conflict-resolution-strategy/. (last visited May 5, 2024)

[413] Joseph Lee, *Intra-Corporate Dispute Arbitration and Minority Shareholder Protection: A Corporate Governance Perspective*, SSRN ELECTRONIC JOURNAL (2015), https://www.ssrn.com/abstract=2736981 (last visited May 5, 2024)

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 2 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

In the wake of the **Booz Allen & Hamilton Inc. v. SBI Home Finance Inc**[414]. case, Indian courts have attempted to ascertain the nature of a disagreement to make an arbitrability determination (that is, the issue must be of a kind that makes it suitable for referral to arbitration). When deciding regarding arbitrability, the courts have also taken into account the issue of whether the arbitral tribunal is qualified to provide the kind of remedy that the parties have requested. As a result, a crucial factor in establishing arbitrability has frequently been the type of relief that the parties have requested. For instance, absent express consent from the parties, arbitrations held in India are not entitled to equitable remedies. Because of this, courts are reluctant to restrict parties' rights and send disputes to arbitration based only on the arbitration agreement when the subject matter of the dispute is before equitable forums like the National Company Law Tribunal (NCLT). In these situations, the courts would rather hear the case themselves to maintain their broad, equitable jurisdiction and to provide full justice.

In the more recent case of **Vidya Drolia v. Durga Trading Corporation**[415], the Supreme Court thoroughly examined the idea of arbitrability.

The Supreme Court established four-point criteria to identify whether a disagreement qualifies as non-arbitrable:

The cause of action relates to inalienable public and sovereign functions of the state; it affects third-party rights and has the potential to create an erga omnes effect; it relates to rights in rem, which do not include subordinate rights in personam arising out of the rights in rem; and it is expressly or necessary impliedly non-arbitrable under mandatory statutory enactments.

The Supreme Court did, however, issue a warning, stating that while helpful, this approach does not offer precise standards for whether a disagreement can be arbitrated. Despite this, it continues to be a useful tool for figuring out whether different types of disputes—including those resulting from the increasingly complicated ties between a company's shareholders—can be arbitrated.

2. Disputes between shareholder

Due to India's recent economic growth, formerly uncharted trade routes have opened up, creating significant wealth generation and fresh waves of opportunity. Parties engaging in a commercial connection frequently form intricate agreements defining the parameters of their relationship or investment because of the riches at stake. These intricate interactions may be the reason why disagreements among a company's shareholders are becoming more typical. [416]These disagreements frequently centre on the management of a business's operations. However not every disagreement results in claims that can be pursued in court, and legal action can only be taken when the shareholder's rights have been infringed.

Contraventions of the shareholders' agreement (SHA), which is an agreement between the shareholders of a company that governs the relationship between the shareholders as well as between the shareholders and the company and aims to protect the interests of the shareholders, are a common form of legally actionable dispute. SHAs frequently set forth clauses about the following: prohibitions on share transfers to avoid improper equity dilution; board representation; reserved matters and veto rights; information rights to guarantee correct information dissemination; exit clauses; tag-along rights; and dispute resolution clauses.

On the other hand, there is disagreement over the legal enforceability of the clauses contained in SHAs. The main cause of this controversy is

[414] Booz-Allen & Hamilton Inc vs Sbi Home Finance Ltd. & Ors on 15 April, 2011 (indiankanoon.org) (last visited May 5, 2024)

[415] Vidya Drolia vs Durga Trading Corporation on 14 December, 2020 (indiankanoon.org) (last visited May 5, 2024)

[416] Michael Q. Eagan, *Reasonable Compensation and the Close Corporation: McCandless, the Automatic Dividend Rule, and the Dual Level Test*, 26 STANFORD LAW REVIEW 441 (1974), https://www.jstor.org/stable/1227795?origin=crossref (last visited May 5, 2024)

INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]
VOLUME 4 AND ISSUE 2 OF 2024
APIS – 3920 - 0001 *(and)* ISSN - 2583-2344
Published by
Institute of Legal Education
https://iledu.in

the lack of clarity surrounding the enforceability of SHA provisions that aren't included in the company's articles of association (AOA). [417]

3. Implementation of SHA Rules Not Listed in the AOA

The Indian courts have given this puzzle a lot of attention lately, leading to differing views throughout high courts over the nature of the relationship between an AOA and SHA. The uncertainty of this relationship has led to the development of two different approaches. The conservative perspective maintains that the AOA provides comprehensive regulation of a company's internal management and affairs.[418] Therefore, unless they are expressly included in the SHA, a firm cannot be bound by the conditions of an external document like a SHA. The opposing liberal viewpoint holds that the SHA is a legally binding agreement that establishes a binding contract between the parties. Nevertheless, a party may not be able to pursue certain company law remedies if the provisions of a SHA are not included in the AOA.

The Delhi High Court's ruling in **World Phone India Pvt Ltd and Ors v WPI Group Inc USA (World Phone)**[419] demonstrated the conservative approach by ruling that a company cannot be bound by the terms of a joint venture agreement until it incorporates them into its AOA. Upon reaching this decision, the Delhi High Court cited rulings rendered by the Supreme Court in the cases of:

- **IL&FS Trust Co Ltd v Birla Perucchini Ltd**[420], where the Bombay High Court held that the ratio in Rangaraj would also apply to clauses unrelated to share transfer restrictions; and
- **V B Rangaraj v. V B Gopalakrishnan (Rangaraj)**, [421]where the Supreme Court held that the right of first refusal in a share transfer agreement was not enforceable due to its lack of incorporation in the company's AOA.

Based on these directives, the Delhi High Court concluded that, even if a business is a party to the SHA, this does not automatically obligate the business to abide by the SHA's terms unless such terms are included in the business's AOA.

But in the later decision of Vodafone International Holdings **B.V v Union of India (Vodafone)**[422], the Supreme Court questioned this inflexible approach of giving the AOA primacy, disagreeing with the Rangaraj ruling without overtly overturning it. According to the ruling of the Supreme Court, a SHA is essentially a private agreement signed by some or all of the company's shareholders to enact meaningful rules for the internal management of the business. The freedom of contract also extends to shareholders' ability to define their rights and obligations beyond those outlined in the Companies Act of 2013. Unlike the public AOA, a company's SHA is a private document that gives the parties more flexibility in defining the conditions of their partnership. For this reason, a company's AOA cannot prevent provisions from being enforced if they are found in a SHA. Subsequent rulings by the Delhi High Court have echoed this liberal viewpoint by affirming the legality of SHA clauses that are not included in the AOA.

Any attempt to reconcile these ostensibly confining judgements frequently encounters some challenges. First off, the ruling in World Phone was mostly predicated on the Rangaraj ruling from the Supreme Court. However, the Rangaraj ruling dealt with the enforceability of certain affirmative voting rights that were only included in the joint venture agreement, and it could have been made based on particular factors that did not apply to World Phone. The Rangaraj ruling was rendered in the context of share transfer restrictions. These particular factors might have contributed to the Supreme

[417] Microsoft Word - Document1 (ecgi.global) (last visited May 5, 2024)
[418] Sharad Bansal & Divyanshu Agrawal, *Are anti-arbitration injunctions a malaise? An analysis in the context of Indian law*, ARBITRATION INTERNATIONAL aiv018 (2015), https://academic.oup.com/arbitration/article-lookup/doi/10.1093/arbint/aiv018 (last visited May 5, 2024)
[419] World Phone India Pvt. Ltd. & Ors. vs Wpi Group Inc., Usa on 15 March, 2013 (indiankanoon.org) (last visited May 5, 2024)
[420] Il And Fs Trust Co. Ltd. vs Birla Perucchini Ltd. on 10 October, 2002 (indiankanoon.org) (last visited May 5, 2024)
[421] V.B. Rangaraj vs V.B. Gopalakrishnan And Others on 28 November, 1991 (indiankanoon.org) (last visited May 5, 2024)
[422] Vodafone International Holdings B.V vs Union Of India & Anr on 20 January, 2012 (indiankanoon.org) (last visited May 5, 2024)

Court's decision in Vodafone to not overrule Rangaraj outright.[423] Second, the Delhi High Court did not refer to the larger-bench Delhi High Court rulings that followed the Vodafone ruling, even though the World Phone ruling was rendered after these rulings were announced. Ultimately, the Supreme Court denied a petition asking for permission to appeal the World Phone ruling, noting that the Delhi High Court had made it clear that any opinion it expressed in the case would only be used to determine the interim application and that the NCLT would make its own decisions without regard to the Delhi High Court's observations.

4. Enforcement of Arbitration Provisions Existing Only in the SHA

The necessity for prompt and effective resolution of conflicts is evident in all situations, but it is particularly critical in shareholder disputes since they frequently include substantial financial claims. As a result, arbitration clauses are frequently included in company SHAs in case of future problems. Nonetheless, the discussion about the connection between a company's SHAs and AOA has inevitably led to concerns about the enforceability of arbitration clauses contained only in SHAs. In particular, several court rulings have addressed the issue of whether an arbitration agreement may be enforced inside a SHA even when it is not included in the company's AOA.[424]

In **Umesh Kumar Baveja v. IL&FS Transportation Network**[425], the Delhi High Court adopted a conservative stance, noting that the parties' relationship is governed by the AOA of the company. Since the AOA lacked an arbitration clause, the arbitration clause in the SHA could not be enforced. The Delhi High Court based this decision on the rulings in the cases of Rangaraj-, IL&FS Trust Co Ltd v. Birla Perucchini Ltd, and World Phone.

5. Oppression And Mismanagement Under The Companies Act 2013

In addition to the customized protection clauses that the shareholders may include in the SHAs, the statutory remedies contained in the Companies Act 2013 provide a strong layer of protection to the interests of minority shareholders. According to the Companies Act of 2013, for instance, all company members must get notice of an annual general meeting in advance, and some resolutions must be approved by special measures that require the support of 75% of the members present and voting to pass[426]. In addition, limitations on related-party transactions and requirements for the independence of the auditors and board of directors enforce corporate governance norms.[427]

In addition to the aforementioned, Indian courts and tribunals have the authority to examine majority shareholder decisions if they are deemed to be oppressive to minority shareholders' interests. A 1951 amendment to the Companies Act 1913 brought in the first provisions about oppression and mismanagement (O&M) in India. These clauses were derived from the Cohen Committee's advice, which was then included in the UK Companies Act 1948. The Companies Act of 2013 does not define the term "oppression," but it has been understood to refer to a sequence of occurrences showing that a company's operations were being managed in a way that was detrimental to the interests of the minority shareholder.

Similar to this, provisions about mismanagement—a term that is exclusive to India—have been construed to include significant alterations in a company's management that lead to the conduct of that company's affairs in a way that is detrimental to

[423] Adjudicating Global Business in and with India: International Commercial and ... - Google Books (last visited May 5, 2024)
[424] Eva Riccomagno, *A short history of algebraic statistics*, 69 METRIKA 397–418 (2009), http://link.springer.com/10.1007/s00184-008-0222-3 (last visited May 5, 2024)
[425] Umesh Kumar Baveja & Ors. vs Il&Fs Transportation Network Ltd. & ... on 30 September, 2013 (indiankanoon.org) (last visited May 5, 2024)
[426] Section 114 in The Companies Act, 2013 (indiankanoon.org) (last visited May 5, 2024)
[427] Section 139 in The Companies Act, 2013 (indiankanoon.org) (last visited May 5, 2024)

the company or some or all of its shareholders. The NCLT, a statutory body with the authority to handle O&M cases, may hear a claim of O&M. A challenge to an NCLT order may be filed with the National Company Law Appellate Tribunal (NCLAT) and ultimately the Supreme Court. Furthermore, about any matter falling under the scope of the NCLT or the NCLAT, the Companies Act of 2013 prohibits civil courts from having jurisdiction over it. Consequently, the only courts with the authority to decide cases involving O&M are the NCLT and the NCLAT.

Conclusion

There is a growing amount of intricate intra-company disputes in legal venues, which may be a natural consequence of the more complex connections among shareholders. These disagreements frequently centre on complex and unique legal issues that call for cautious decision-making. One such frequently asked topic in Indian courts is whether these disagreements can be submitted to arbitration following the parties' arbitration agreement. Nevertheless, notwithstanding the Supreme Court of India's efforts to reevaluate the arbitrability of these kinds of disputes, the unique circumstances of every case make it impractical to consistently use predetermined standards in their assessment.

In situations like this, the courts have resorted to using a fact-based methodology to address the arbitrability of shareholder disputes. The arbitration agreement's enforceability, the type of remedy sought in the dispute, and its character have all been considered by the courts in making this conclusion. To make sure that a reference to arbitration does not deprive the parties of their statutory safeguards, the courts have also given careful regard to the provisions of the Companies Act 2013 during this procedure. For these reasons, in India, issues about O&M are not subject to arbitration.

REFERENCE

a) Chilumuri, Gambhir. "*Invocation of Arbitration Clauses in Shareholder Agreements for Disputes under Articles of Association.*" NUJS Law Review, vol. 13, no. 4, 2020, pp. 54-72. https://nujslawreview.org/wp-content/uploads/2020/12/13-4-Chilumuri-Gambhir-Invocation-of-Arbitration-Clauses-in-Shareholder-Agreements-for-disputes-under-Articles-of-Association.pdf. (last visited May 5, 2024)

b) [Ayush Patria], "*Navigating Corporate Turbulence: A Deep Dive into ADR as a Conflict Resolution Strategy*," Abott (January 10, 2024), https://abott.in/2024/01/10/navigating-corporate-turbulence-a-deep-dive-into-adr-as-a-conflict-resolution-strategy/. (last visited May 5, 2024)

c) Joseph Lee, *Intra-Corporate Dispute Arbitration and Minority Shareholder Protection: A Corporate Governance Perspective*, SSRN ELECTRONIC JOURNAL (2015), https://www.ssrn.com/abstract=2736981 (last visited May 5, 2024)

d) Booz-Allen & Hamilton Inc vs Sbi Home Finance Ltd. & Ors on 15 April, 2011 (indiankanoon.org) (last visited May 5, 2024)

e) Vidya Drolia vs Durga Trading Corporation on 14 December, 2020 (indiankanoon.org) (last visited May 5, 2024)

f) Michael Q. Eagan, *Reasonable Compensation and the Close Corporation: McCandless, the Automatic Dividend Rule, and the Dual Level Test*, 26 STANFORD LAW REVIEW 441 (1974), https://www.jstor.org/stable/1227795?origin=crossref (last visited May 5, 2024)

g) Microsoft Word - Document1 (ecgi.global) (last visited May 5, 2024)

h) Sharad Bansal & Divyanshu Agrawal, *Are anti-arbitration injunctions a malaise? An analysis in the context of Indian law*, ARBITRATION INTERNATIONAL aiv018 (2015), https://academic.oup.com/arbitration/article-lookup/doi/10.1093/arbint/aiv018 (last visited May 5, 2024)

i) World Phone India Pvt. Ltd. & Ors. vs Wpi Group Inc., Usa on 15 March, 2013 (indiankanoon.org) (last visited May 5, 2024)

j) Il And Fs Trust Co. Ltd. vs Birla Perucchini Ltd. on 10 October, 2002 (indiankanoon.org) (last visited May 5, 2024)

k) V.B. Rangaraj vs V.B. Gopalakrishnan And Others on 28 November, 1991 (indiankanoon.org) (last visited May 5, 2024)

l) Vodafone International Holdings B.V vs Union Of India & Anr on 20 January, 2012 (indiankanoon.org) (last visited May 5, 2024)

m) Adjudicating Global Business in and with India: International Commercial and ... - Google Books (last visited May 5, 2024)

n) Eva Riccomagno, *A short history of algebraic statistics*, 69 METRIKA 397–418 (2009), http://link.springer.com/10.1007/s00184-008-0222-3 (last visited May 5, 2024)

o) Umesh Kumar Baveja & Ors. vs Il&Fs Transportation Network Ltd. & ... on 30 September, 2013 (indiankanoon.org) (last visited May 5, 2024)

p) Section 114 in The Companies Act, 2013 (indiankanoon.org) (last visited May 5, 2024)

q) Section 139 in The Companies Act, 2013 (indiankanoon.org) (last visited May 5, 2024)