# NAVIGATING SHAREHOLDER DISPUTES IN INDIA: UNVEILING CAUSES, ARBITRABILITY, AND EFFECTIVE RESOLUTION STRATEGIES

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**ABSTRACT**:

Shareholder disputes have become an increasingly common occurrence in India's corporate landscape. As the country's economy continues to grow and attract investments, the complexities surrounding ownership and control in corporations have amplified, leading to conflicts among shareholders. These disputes not only disrupt business operations but also have far-reaching consequences and multi-faceted impact on businesses. They disrupt operations, tarnish the company's reputation, drain financial resources, divert management attention, and potentially lead to a decline in stock prices. In this article, we delve into the nature of shareholder disputes in India, examining their causes like disagreements between majority and minority shareholders concerning governance practices, and strategic direction, divergent interests among shareholders, differing objectives, risk appetites, differed opinion on decisions such as investments, expansion plans, or dividend policies, violations, or breaches of shareholder agreements. This article further aims to explore the legal stance pertaining to the arbitrability of shareholder disputes which remains a complex and evolving area of law in India. The paper throws light on various judicial pronouncements including recent judgments that have reaffirmed the pro-arbitration stance of the Indian legal system, reinforcing the principle of party autonomy in choosing arbitration as a means of resolving disputes arising from allegations of fraud and misrepresentation, providing clarity to stakeholders and guiding their choice of dispute resolution mechanisms. The article further explores effective strategies for resolving such disputes. Emphasizing the importance of strong corporate governance practices, measures such as independent directorship, transparent financial reporting, regular communication with shareholders, and well-drafted shareholders' agreements are discussed as key components of a comprehensive resolution strategy. These strategies not only help minimize conflicts among shareholders but also contribute to the long-term success of the business. By proactively implementing these measures, companies can foster a positive shareholder environment, mitigate disputes, and promote sustainable growth.

## Introduction

Shareholder disputes refer to conflicts or disagreements that arise between shareholders of a company. These disputes typically revolve around issues related to ownership, control, management, decision-making, and the rights and interests of shareholders. Shareholder disputes can occur in various forms and can involve different parties within a company, such as majority shareholders, minority shareholders, board members, or company management.

## Causes of Shareholder disputes

Shareholder disputes can arise from a variety of factors and circumstances within a company. These disputes can significantly impact the stability, growth, and overall functioning of the organization. Some of the key causes of shareholder disputes are:

**I. Mismanagement and Oppression:** Shareholders may raise concerns when they perceive mismanagement, abuse of power, or oppressive behaviour by the majority shareholders or the company's management. This can manifest in various forms, such as nepotism, diversion of company funds, or decision-making without due consultation.

Both the Companies Act, 1956 and 2013 do not define ‘oppression’ as well as “mismanagement”. Oppression refers to conduct that violates the reasonable expectations of shareholders, causing prejudice or injustice. It typically involves the abuse of majority power to suppress the rights of minority shareholders, depriving them of their legitimate interests and benefits. Any act of oppression is contextual and relative to the facts and circumstances of each case. What may constitute as oppression in one case may not amount to oppression in other cases. Accordingly, depending on the facts and circumstances of a particular case, there can even be an oppression of the majority by the minority. [i]Mismanagement refers to the improper or inefficient management of a company, leading to losses, lack of transparency, and disregard for shareholders' interests. The Companies Act, 2013, contains provisions to address oppression and mismanagement, primarily under Sections 241 to 246. These provisions empower shareholders to approach the National Company Law Tribunal (“NCLT”) seeking redress for acts of oppression and mismanagement within a company.

In the case of *S.P. Jain v. Kalinga Tubes Ltd.*[ii], the Supreme Court of India defined the scope of oppression and mismanagement under Section 397 and 398 of the Companies Act, 1956 (predecessor to the Companies Act, 2013). The court held that oppression includes conduct that goes against the principles of fair dealing and prejudicially affects the interests of

shareholders and mismanagement refers to conduct that departs from normal standards of business operations and leads to the unfair treatment of shareholders. In *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*[iii], the Supreme Court clarified that oppression need not involve illegal or unlawful acts, but can also arise from acts of mismanagement that cause prejudice to the rights and interests of minority shareholders.

In recent years, there have been significant developments in cases involving oppression and mismanagement in India including the case of Cyrus Mistry vs. Tata Sons[iv]. The case revolved around the removal of Cyrus Mistry as the Chairman of Tata Sons in October 2016. Mistry, who had held the position since 2012, was abruptly ousted by the board of directors, leading to the legal dispute. Cyrus Mistry alleged acts of oppression and mismanagement within Tata Sons, claiming that he was wrongfully removed and that certain decisions taken by the board were detrimental to minority shareholders' interests. He accused the Tata group of corporate governance lapses and questioned the conduct of several board members. The court observed that there were lapses in the decision-making process and expressed concerns regarding the lack of effective communication between the board and Cyrus Mistry and further examined the composition of the Tata Sons board and acknowledged the rights of minority shareholders and the need to protect their interests. It emphasized the importance of fair treatment, equal opportunities, and respect for shareholder rights. The case brought attention to the importance of transparency, accountability, and the protection of minority shareholders' rights.

**II. Divergent Interests:** Shareholders are individuals or entities who hold ownership in a company and have invested capital with the expectation of financial returns. They may have differing objectives and priorities, which can lead to conflicts and disagreements within the company. Some shareholders may be more risk-averse and prefer conservative financial strategies, while others may be willing to take on higher levels of risk in pursuit of higher returns. Conflicts can arise when determining the appropriate risk levels for the company's operations, investments, or financial policies. Further, they may have different objectives when investing in a company. Some shareholders may prioritize short-term profits and dividend payments, while others may focus on long-term growth and capital appreciation. These varying objectives can lead to conflicts when making strategic decisions that impact the allocation of resources, investment choices, or business expansion plans.

**III. Breach of Shareholder Agreements:** Shareholders agreement (“SHA”) play a vital role in shaping the relationships and protecting the rights of shareholders in Indian companies.

These agreements are voluntary contracts entered into by shareholders to establish their respective rights, obligations, and mechanisms for dispute resolution. Shareholders agreements encompass a wide range of provisions tailored to the specific needs and concerns of shareholders. Some essential provisions commonly found in shareholders agreements in include provisions pertaining to ownership and voting rights defining the percentage of shares held by each party, outlining voting rights, including special voting rights for specific decisions or reserved matters, provisions regulating the transfer of shares, including pre-emptive rights, restrictions on share transfers, and procedures for approving or rejecting transfer requests, provisions for composition of the board of directors, appointment and removal of directors, decision-making processes within the board dividend policies, capital contributions, and financing arrangements, ensuring clarity and fairness in financial matters. Some SHAs frequently include mechanisms for resolving disputes, such as arbitration or mediation, providing a structured and efficient framework for conflict resolution. Disputes can arise due to a breach of agreements, including shareholders' agreements, articles of association, or voting rights. Violation of these agreements can fuel discontent among shareholders, prompting them to take legal action.

**IV. Transfer of Shares:** Shareholders may find themselves at odds when it comes to the transfer of shares, especially if there are restrictions on share transfers or if minority shareholders feel unfairly treated during the process. Conflicts regarding the transfer of shares can arise due to restrictions, perceived unfair treatment, or dilution concerns. Companies often impose restrictions on the transfer of shares to maintain control, protect the interests of existing shareholders, or comply with regulatory requirements. These restrictions may include pre-emption rights, approval requirements, lock-in periods, or limitations on transferring shares to external parties. While such restrictions can serve legitimate purposes, they can also create conflicts among shareholders.

Conflicts can arise when minority shareholders perceive that the restrictions disproportionately favour majority shareholders or the controlling group. Minority shareholders may feel that their ability to freely transfer shares is limited, reducing their liquidity and investment flexibility. This can lead to disputes, as minority shareholders seek to protect their rights and maximize their options for realizing the value of their shares. Shareholders may also experience conflicts during the transfer of shares if they feel unfairly treated or disadvantaged compared to other shareholders. For example, in cases where there are differential pricing or preferential terms for certain share transfers, minority shareholders may perceive such arrangements as dilutive

or prejudicial to their interests. This can result in conflicts and disputes regarding the fairness and equality of treatment during share transfers. Transparency and fairness are crucial in mitigating conflicts related to share transfers. Companies should adopt clear and well-defined policies and procedures regarding share transfers, ensuring that they are communicated effectively to all shareholders. This includes providing information on any restrictions, pre-emption rights, or approval processes involved. Transparency in the pricing and valuation of shares is also important. Shareholders should have access to accurate and up-to-date information on the valuation methods used and the factors considered in determining the transfer price. This helps ensure that shareholders perceive the process as fair and equitable.

**Arbitrability of Shareholder disputes**

The arbitrability of shareholder disputes in India remains a nuanced and evolving area of law. Arbitration has gained traction as an effective alternative dispute resolution mechanism in India. However, when it comes to shareholder disputes, questions regarding the arbitrability of such matters have emerged. Shareholder disputes often involve complex corporate and legal issues, raising concerns about whether they can be appropriately resolved through arbitration. The arbitrability of shareholder disputes in India is governed by the Arbitration and Conciliation Act, 1996 ("the 1996 Act"), as amended in 2015. Section 2(1)(a) of the 1966 Act defines arbitrable disputes as those that can be resolved through arbitration. However, certain categories of disputes are considered non-arbitrable, including those that involve rights or obligations arising out of criminal offenses, matrimonial disputes, or matters affecting public interest. The arbitrability of shareholder disputes in India has been the subject of significant judicial scrutiny. The Supreme Court of India, in various landmark judgments, has clarified the scope and limits of arbitrability.

The Supreme Court in the case of *Booz Allen and Hamilton Inc. v. SBI Home Finance Ltd*[v]. held that disputes that involve rights in rem (rights against the world at large) are generally non-arbitrable. However, disputes arising from rights in personam (rights against specific individuals or entities) are arbitrable.

In the case of *A. Ayyasamy v. A. Paramasivam*[vi], the Supreme Court of India provided clarification on the arbitrability of disputes involving allegations of fraud. The court's ruling shed light on the circumstances under which such disputes could be subject to arbitration. The case involved a dispute between two parties, A. Ayyasamy and A. Paramasivam, who had entered into a partnership agreement. Ayyasamy alleged that Paramasivam had committed

fraud, misrepresentation, and misappropriation of funds. Paramasivam, in turn, argued that the dispute was subject to arbitration based on an arbitration clause in the partnership agreement. The Supreme Court first addressed the issue of whether disputes involving allegations of fraud were arbitrable. The court recognized that allegations of fraud could be categorized into two types: (1) those that relate to the internal affairs of a company and impact the rights and interests of shareholders, and (2) those that involve serious allegations of fraud requiring detailed investigation. Regarding the first category, the court held that disputes involving allegations of fraud that pertain to the internal affairs of a company and affect the rights and interests of shareholders are arbitrable. The rationale behind this ruling is that such disputes primarily concern private rights and can be resolved through arbitration, which is a recognized mode of dispute resolution in India. However, the court distinguished the second category of disputes involving serious allegations of fraud that require detailed investigation. It held that disputes of this nature may not be suitable for arbitration. The court recognized that cases involving complex fraud allegations often require extensive evidence gathering, examination of witnesses, and detailed analysis, which are better suited for adjudication by courts. The court emphasized that in cases where fraud is of such a nature that it would require an elaborate examination of evidence and factual determinations, it would be more appropriate for the dispute to be adjudicated by the regular courts rather than through arbitration.

This judgment strikes a balance between the principle of party autonomy in choosing arbitration as a means of dispute resolution and the need for a robust judicial process in cases involving serious fraud allegations. It clarifies that disputes involving allegations of fraud that impact the internal affairs of a company and shareholders' rights can be resolved through arbitration. However, when the allegations of fraud are complex and require extensive investigation, courts are better equipped to handle such cases. Further, this ruling has significant implications for commercial disputes involving fraud allegations in India. It provides clarity to parties involved in such disputes, allowing them to assess whether arbitration is a viable option based on the nature and complexity of the fraud allegations.

Recently, the Supreme court in the case of *Vijay Karia v. Prysmian Cavi E Sistemi*[vii] further clarified the arbitrability of disputes arising out of allegations of fraud and misrepresentation, reiterating the pro-arbitration stance of the Indian legal system on the arbitrability of disputes arising out of fraud and misrepresentation. It reinforces the importance of examining the nature and complexity of fraud allegations to determine the appropriate forum for dispute resolution.

In this case, the dispute arose between Vijay Karia and Prysmian Cavi E Sistemi SRL, where Karia alleged fraud and misrepresentation on the part of Prysmian. Prysmian contended that the dispute was subject to arbitration based on the arbitration clause in their agreement. The Supreme Court reiterated the principle of party autonomy and the pro-arbitration stance of the Indian legal system. It emphasized that disputes arising out of allegations of fraud and misrepresentation can be subjected to arbitration unless they involve serious and substantial allegations of fraud that necessitate a detailed examination of facts. The court clarified that if the allegations of fraud are of a simple nature and do not require complex factual determination, they can be decided through arbitration. However, in cases where the allegations of fraud are complex and would require extensive investigation and examination of evidence, the court is more suitable for adjudication. The judgment provides further guidance on the arbitrability of disputes involving fraud and misrepresentation. It recognizes the general arbitrability of such disputes, allowing parties to choose arbitration as a means of resolving their disputes. However, it also acknowledges that certain cases involving serious and substantial fraud allegations may require the involvement of the court due to the complexity of the factual determination involved.

**Effective Resolution Strategies**

Resolving shareholder disputes requires a strategic and multi-faceted approach. Some effective resolution strategies include strengthening corporate governance practices that can contribute to minimizing conflicts among shareholders, implementing independent directorship, transparency in financial reporting, and regular communication with shareholders, and a well-drafted shareholders' agreements which can serve as preventive measures, outlining the rights and obligations of each shareholder, dispute resolution mechanisms, and exit strategies. By proactively implementing these strategies, companies can foster a positive shareholder environment and minimize conflicts, ensuring the long-term success of the business.

**Conclusion**

Shareholder disputes in India are a complex issue that can significantly impact the functioning and stability of companies. Understanding the causes of these disputes and implementing effective resolution strategies is crucial for maintaining a healthy shareholder environment. By promoting transparency, open communication, and adherence to strong corporate governance practices, companies can mitigate the risk of conflicts among shareholders. Further, with the pro-arbitration stance of the Indian legal system on the arbitrability of shareholder disputes, the

endeavour must be to encourage shareholders to engage in open and constructive dialogue can help identify common ground and potential solutions.

[i] Prakhar N S Chauhan, Prashant Singh, "Lessons from the US: Arbitrability of oppression and mismanagement in India", 5 JSCAN 76-98 (2021)

[ii] S.P. Jain v. Kalinga Tubes Ltd. AIR 1965 SC 1535

[iii] Miheer H. Mafatlal v. Mafatlal Industries Ltd. AIR 1997 SC 506

[iv] Cyrus Investments Pvt Ltd v. Tata Sons Ltd and Ors. Company Appeal (AT) No. 254 of 2018

[v] Booz-Allen & Hamilton Inc v. SBI Home Finance Ltd & Others. Civil Appeal No.5440 of 2002

[vi] A. Ayyasamy v. A. Paramasivam (2016) 10 SCC 386

[vii] Vijay Karia v. Prysmian Cavi E Sistemi (2020) SCC 177