DIVISION OF UNITS OF A COMPANY AMONG FAMILY MEMBERS THROUGH MOU OR FAMILY ARRANGMENTS. - HOW FAR VALID AND LEGAL ?

By
Pradeep K Mittal. B com, LLB,FCS*

In this Article, an attempt has been made to explain law on the point of division of various manufacturing units of a company among various segments of the joint family under a Memorandum mof Understanding or Family Arrangments. This topic can be dealt with in relation to three types of companies:-

a) Private Limited Company;
b) Public Limited – Closely held;
c) Public Limited widely held company;

2: In a growing family, the business or enterprise is started under the embrella of a parternship firm. Later on, and as the business grow, a private limited company is incorporated for the purpose of taking over the business of the partnership firm – in other words corporatization of business.

PRIVATE LIMITED COMPANY:

3: The Company is a separate entity and is governed by the provisions of the Companies Act, 1956 (and presently by the Companies Act, 2013). The essential legal position that the shareholders of the Company are not the owners of its assets and that there cannot be an agreement between the shareholders for any group to divide the assets of the Company. The private limited company may be controlled by one segment of the family or different segments of a family and would be in the nature of quasi-partnership and in which, the outside public is not at all interested.

---

*Advocate – Past Central Council Member, the ICSI.

4: A question then arises as to whether such company can be divided into different segment of a larger family on the basis of Memorandum of Understanding or Family Arrangements has fallen for consideration before the Hon'ble Supreme Court in the case of Sangramsinh P Gaekwad Vs. Shantidevi P Gaekward MANU/SC/0052/2005 = AIR 2005 SC 809 when the court has held as follows:-

> 238. It is now well-known that principles of quasi-partnership is not foreign to the concept of Companies Act. For the purpose of grant of relief, the principles of partnership had been applied even in a public limited company. (See Loch and Anr. v. John Blackwood Ltd., 1924 AC 783, Ebrahimi v. Westbourne Galleries Ltd. and Ors., 1972 (2) All ER 492.

PUBLIC LIMITED CLOSEDLY HELD COMPANY:

5: However, the companies which are in the nature of quasi-partnership and of which the shares are held by various segments of the family and where members of general public are not at all interested, such companies can also be subject matter of division in the sense that if in a company, there are more than division/manufacturing unit, such division or unit could be subject matter of division between different members of a Joint Family. The Supreme Court in the case of Sangramsinh P Gaekwad Vs. Shantidevi P Gaekward has recognized and approved the bifurcation of Division or Unit among different division/segment of larger Joint Family Company.

PUBLIC LIMITED WIDELY HELD COMPANY;

6: An interesting question may now arise as to whether the principal of quasi-partnership could be applied to a widely held public limited company in which members of general public are also interested – in other words a widely held public limited company. In a latest judgment in the case of Sanjay Kapur &

others Vs. Vikram Kapur & others 2015 (225) Delhi Law Times, 633, the Delhi High Court made analysis of law on this point:-

FACTS OF THE CASE:

6.1: The 1999 MOU recorded the agreement that the division of the three lots should be made in such a manner that one bicycle unit falls in the share of each of the three groups such that the production facility including machinery, painting and plating plants, etc., and that of services including tool room, maintenance, electrical, generators, research and development, heat treatment, etc. of each bicycle unit is more or less equally divided. It envisaged that the market areas for sales in India and exports for each separate unit "shall be clearly identified, demarcated and equated." In case any benefit was to be given to any group/groups, it could be given in the form of net worth/assets.

7: It would be beneficial to know few other relevant judgment on this point.

8: In Reliance Natural Resource Limited Vs. Reliance Industries Ltd., IV (2010) STL 705=(2010)7 SCC 1, the Supreme Court held that an internal family arrangement and an MoU signed between family members were not legally binding on the Company. It was observed by the majority. Needless to say, all were widely held public limited company.

> "The MoU was signed as a private family arrangement or understanding between the two brothers, Mukesh and Anil Ambani, and their mother. Contents of the MoU were not made public, and even in the present proceedings, they were revealed in parts. Clearly, the MoU does not fall under the corporate domain – it was neither approved by the shareholders, not was it attached to the scheme. Therefore, technically, the MoU is not legally binding."

9: In a concurring opinion of Sudershan Reddy J., it was observed:

> "It is absolutely clear that the MoU was executed in the private domain, with the help and aid of a lawyer and then marked confidential. Further, the individuals, from all indications have only executed it in their individual capacity and it was not purported to be in exercise of their positions in RIL or any other company of the Reliance Group. It is also very clear that the MoU itself recognizes that the reorganization that the promoters sought would have to be routed through the Board…..
>
> Inasmuch as the terms and conditions of gas supply, as specified in the MoU, were not specifically informed to all the shareholders and stakeholders, including in this case the GoI (as a party to the PSC), we simply fail to see how the MoU can be read into the Scheme itself. It does not matter whether one calls MoU the guiding light or a tool for interpretation or a foundation – the sheer fact that the terms of gas supply contained in the MoU were withheld from the shareholders imples that it cannot now be imported into the Scheme."

10: InVodafone International Holdings BV Vs. Union of India, (2012) (1) SLT 547=(2012) 6SCC 613, it was held as under:

> "64. Shareholders can enter into any agreement in the best interest of the company, but the only thing is that the provisions in the SHA shall not go contrary to the Articles of Association. The essential purpose of the SHA is to make provisions for proper and effective internal management of the Company. It can visualize the best interest of the company on diverse issues and can also find different ways not only for the best interest of the shareholders, but also for the company as a whole. In S.P.Jain V. Kalinga Cables Ltd., (1965)2SCR720, this Court held that agreements between non-members and members of the Company will not bind the company, but

there is nothing unlawful in entering into agreement for transferring of shares. Of course, the manner in which such agreements are to be enforced in the case of breach is given in the general law between the company and the shareholders. A breach of SHA which does not breach the Articles of Association is valid corporate action but, as we have already indicated, the parties aggrieved can get remedies under the general law of the land for any breach of that agreement."

11: The Delhi High Court in the case of Sanjay Kapur & others Vs. Vikram Kapur & others (supra) has observed that what is relevant for the purposes of the present case is that any scheme of restructuring of the company will necessarily have to abide by the provisions of the Companies Act. The Section 390 to 396A of Chapter V of Part VI of the Companies Act, 1956 contained provisions relating to compromises, arrangements and reconstructions. The court further observed that in the Companies Act, 2013, these provisions find place in Chapter XV which is titled "Compromises, Arrangements and Amalgamations". It includes Sections 230 to 240.

12: The procedure involved in giving effect to any scheme of restructuring or arrangement requires applying to the Company Court, and under the Companies Act, 2013, to the National Company Law Tribunal. Specific directions have to be sought for the holding of meetings of different interested groups including the shareholders, the financial institutions and seek their approval to the scheme of arrangement. In other words, any decision taken consequent to an agreement arrived at in the form of an MoU between shareholders cannot be straightway given effect to unless it has received the imprimatur of the shareholders in an Extraordinary General Meeting apart from the approval of other interested parties inclulding the Creditors-both secured and unsecured.

13: These provisions require proposals for arrangements, reconstruction or amalgamations to be placed before the shareholders and creditors. The provisions mandate the

minimum percentage of such groups of interested persons to approve the scheme of compromise, arrangement, reconstruction, etc. The Regional Director/Registrar of Companies and/or the Official Liquidator, as the case may be, can object to the scheme. The Central Government can file an application that the scheme for amalgamation should be reconsidered. The Court further observed that the decision to reconstruct the Company which is a public limited company and majority of shares in which are held by the public cannot be left to be determined by a private arrangement between certain group of shareholders.

14: The court further observed that "there cannot be any estoppels against law". The restructuring of a Company has to happen mandatorily in accordance with the provisions of the Companies Act. It is not open to any of the parties to insist that irrespective of the above stated settled legal position, the MoUs or any other "family arrangements" entered into between them must be given effect to.

15: The Court was of the view that the learned Arbitrator wholly overlooked the above legal position (Learned Arbitrator was the Chief Justice of India – Retired).

16: It is not possible to anticipate what could be the outcome of proceedings, as and when initiated, under the Companies Act ny any or all of the groups pursuant to the MoU&s and the BoD resolution of 31st August, 2003. That stage is yet to be reached. The learned Arbitrator, therefore, could not have pre-empted the decision in such proceedings by putting a seal of approval on the division of lots as set out by Mr. Vikram Kapur in para 14 of his application in sofar as it involved the assets of Atlas Cycles (Haryana) Limited or for that matter any other company to which the Companies Act applies. In the proceedings under the Companies Act, 2013 it would be open to any group to contend that members of other groups are bound by the 1999 or the 2003 MoUs and cannot resile from it. Even that would not prevent the Court or the tribunal from coming to a conclusion as to whether the arrangement or restructuring agreed upon by the

members of different groups of Kapur family is in the best interests of the Company.

17: It has been viewed by the court that from any angle, these were matters entirely outside the scope and ambit of the arbitration proceedings. It was impermissible in law for the learned Arbitrator to take upon himself a task which could be done only in accordance with the Companies Act and only by the authorities entrusted with such powers. The parties to the 1999 MoU could not have conferred a jurisdiction upon the learned Arbitrator which he did not have to begin with. Therefore, a patent error was committed by the learned Arbitrator in not dealing with the application of Mr. Arun Kapur wherein he has questioned the jurisdiction of the Arbitrator to order division of the assets of the Company into baskets or lots.

18: The Supreme Court in the case of Kilpest Pvt. Ltd. and Ors. v. Shekhar Mehra MANU/SC/1673/1996 : 1996(10)SCC 696 has observed as under:-

> "11. The promoters of a company. whether or not they were hitherto partners, elect to avail of the advantages of forming a limited company. They voluntarily and knowingly bind themselves by the provisions of the Companies Act. The submission that a limited company should be treated as a quasi-partnership should, therefore, not be easily accepted. Having regard to the wide powers under Section 402, very rarely would it be necessary to wind up any company in a petition filed under Sections 397 and 398.

19: The Division Bench of the Hon'ble Bombay High Court in the case of Maharashtra Power Development Corporation Ltd Vs. Dabhol Power Co MANU/MH/0125/2004 = 2004(120) Company Cases 560 Bombay has observed as under:-

> It is true that the principles enunciated in Ebrahimi's case (supra) as noticed above have been held by the Supreme Court to be sound principles but it has been stated in

unambiguous terms that the limited company should be treated as quasi-partnership should not be easily accepted. If the apparent structure of the company is not the real structure and on lifting the veil, it is found that in reality it is the partnership, the principles of dissolution of partnership may apply but that is not the case here.

20: Consequently, the Delhi High Court has held that the directions issued by the Learned Arbitrator as regards the division of the assets and management and control of Atlas Cycles (Haryana) Ltd., is opposed to fundamental policy of Indian Law and, therefore, cannot be sustained under Section 34(2)(b) (ii) of the Arbitration & Conciliation Act, 1996.

21: To summarise, it is easily discernible that (i) private limited companies and (ii) closely held public limited companies could be subject matter of partition amongs the various segments of the Joint Family and one each unit or division could be transferred/vests in one segment of the large Joint Family. However, if a company is widely held public limited company, then there cannot be any partition, division except, of course, by way of a Scheme of Arrangement under Section 390 to 396A of the Companies Act, 1956 being sanctioned by the Company Court of High Court concerned.