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Mandatory Shareholder Arbitration: Moving the Debate to India

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Class action suits were introduced in India by the 2013 Companies Act, with the hope that costs of litigation might reduce in comparison to individual cases. However, not a single class action case has been filed in the past five years. This suggests that litigation is currently not serving the interests of shareholders. Given arbitration's various advantages as a dispute resolution mechanism, mandatory shareholder arbitration may be a good alternative for Indian investors.

While the Indian state has been actively encouraging arbitration over the past few years, domestic securities law has been growing stricter as a result of multiple large scale scandals. These conflicting trends raise questions about the legality of mandatory arbitration clauses in shareholder agreements. This post explores both the law of securities and of arbitration on the matter in order to ascertain the viability of mandatory shareholder arbitration in India.

India's Arbitration Law – The Arbitration and Conciliation Act 1996, as amended in 2019, lays out India's arbitration law, inspired largely by the UNCITRAL Model Law. Section 7 simply provides that an arbitration agreement is any agreement by "*the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not*". The conditions provided for such an agreement, such that it has to be in writing, are unlikely to impose any restrictions. Section 8 provides that a judicial authority before which a dispute, that is the subject of an arbitration agreement, is brought, must refer the parties to an arbitration. Disputes related to corporate law in India are dealt with by a parallel structure of tribunals, established in 2013 by the Companies Act. While these National Company Law Tribunals are quasi-judicial authorities, they are entitled to refer parties to arbitration under this section (see – *Richa Kar v. Actoserba Active Wholesale Pvt. Ltd*).

When the word 'mandatory' is used, the first concern that may arise is that such a set up might violate the necessity of consent for arbitration. Indeed, the Indian Supreme Court has held that no reference can be made to arbitration unless all the parties explicitly consent (see – *Afcons Infrastructure ltd v. Cherian Varkey Construction Company Pvt.*). However, this requirement is not necessarily undermined by mandatory shareholder arbitration. Whenever the proposal is brought up, the existing shareholders will have to vote on it. Only those who accept the idea of arbitrating future disputes will vote positively. Shareholders who do not agree may let go of their shares or agree to be bound by the agreement nonetheless. Since the provision introduced by the agreement will be a part of the company's public documents, all prospective shareholders are legally required to be aware of it. Based on this knowledge, they can make an informed decision about buying the

company's shares and will only agree if they consent to having any conflicts arbitrated. Consequently, Indian arbitration law does not serve as a hinderance to mandatory arbitration for shareholders.

With respect to ***Indian Corporate Law*** – There are two conceivable laws that may potentially come into conflict with and impact the viability of mandatory shareholder arbitration in India: the Companies Act 2013, and Securities and Exchange Board of India Act 1992 ("SEBI Act").

Companies Act – An agreement for mandatory shareholder arbitration can be entered into either in the Articles of Association of a company, or a separate private agreement between the shareholders. Section 6 of the Companies Act states that the provisions of the Act would override any provisions of the articles of association that contradict it. The Companies Act also provides for a National Company Law Tribunal ("NCLT") for the redressal of any grievances of shareholders. The question then is whether an arbitration proceeding can take place or whether the jurisdiction of the NCLT would override such a proceeding.

The Supreme Court of India has defined a standard rule as to whether or not a matter can be referred to an arbitral tribunal, in the *Booz-Allen* case. The test is essentially to see whether or not the actions relate to actions *in rem* or *in personam*. Actions *in rem* are to be adjudicated upon by courts, and those *in personam* may be referred to arbitration. The Bombay High Court has held that arbitration cannot be referred to even when the remedy asked for is *in rem.* However, the decision has been criticised and the *Booz-Allen* test continues to be the binding law on the matter. Therefore, it stands to reason that only cases such as winding up or certain cases of oppression and mismanagement cannot be referred to arbitration. In consonance with the broadening acceptability of arbitration, this position has been altered by some courts who say that even in cases of oppression and mismanagement, if the tribunal or court finds the petition to be mala fide, vexatious, or submitted with the intent of avoiding the arbitration clause, the dispute will be duly referred to arbitration.

Additionally, rights *in personam* that are derived from rights *in rem* are arbitrable. It must be noted at this point however, that under section 8 of the Arbitration Act, a cause of action cannot be split up to be adjudicated upon.

SEBI Act – A bare reading of the SEBI Act makes it clear that the SEBI performs public functions – it deals with matters of securities that have a larger impact on public and economic development. It ensures investor confidence, which is beneficial for economic progress. The SEBI Act creates and governs special rights. The Bombay High Court has held that if there is a legislation governing special rights and obligations, and the adjudication is reserved exclusively for a specific authority (SEBI in this case), it is contrary to public policy to allow for arbitration.

Given this, there seems to be a bar on arbitration in securities disputes. However, the SEBI itself has promulgated certain norms promoting arbitration in disputes of this nature. It has published a circular laying down procedures and guidelines for arbitration in redressing investor grievance. Further, SEBI bye-laws also provide for arbitration to resolve disputes arising out of trading between members. The bye-laws of the National Stock Exchange also contain similar provisions. It is to be noted that the disputes made explicitly arbitrable by the securities laws and rules in India are rights *in personam*. It seems clear, therefore, that both the company law in India and the securities law in India arrive at the same conclusion – that so long as the rights affected are *in personem*, they shall be referred to arbitration whenever an agreement requires this.

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