

# Concept of 'Entrenchment' in the Companies Act 2013

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In this article, the author has made an attempt to explain concept of 'entrenchment' along with its practical application and suitability to companies in present scenario.

## Meaning of 'entrenchment'

1. The term entrenchment has not been defined in the Companies Act, 2013. The dictionary meaning is as follows:

- (1) to apply additional legal safeguards;
- (2) to place (someone or something) in a very strong position that cannot easily be changed;
- (3) basic law or constitution is a provision which makes certain amendments either more difficult or impossible

Therefore, 'entrenchment' means an addition of provision which makes certain amendments either more difficult or cumbersome by way of procedure, checks and safeguards.

## Entrenchment provisions in the Companies Act, 1956

2. The Companies Act, 1956 did not have an explicit provision on entrenchment, but the concept of additional legal safeguards, checks and controls was recognised only through judicial decisions. In one of the landmark judgments in V B Rangaraj v. V B Gopalakrishnan [1999] 6 CLA 211 (SC) the Supreme Court laid down the law that private agreement between shareholders would not bind the company unless the articles of association ('AoA') of the company provide for such restrictions. Therefore, it was necessary to include the shareholders agreement ('SHA')/memorandum of understanding ('MoU') in AoA for ensuring the enforceability of SHA/MoU. If for some reason the SHA/MoU was not imbibed in the AoA, then such SHA/MoU was not binding on company/its shareholders.

## Entrenchment provisions in the Companies Act, 2013

3. Sub-sections (3) to (5) of section 5 contain provisions related to entrenchment and the same are summarised as follows :

- AoA may contain provisions for entrenchment for giving an effect that the specified provisions of AoA may be altered only if conditions or procedures as are more restrictive, are met or complied with.
- Entrenchment provisions shall only be made either at the time of incorporation of a company, or at the time of amending AoA.
- Amendment of the AoA of private company (relating to 'entrenchment') can be effected only if the same is agreed to by all the members of the company.
- Amendment of the AoA of public company (relating to 'entrenchment'), can be effected only upon passing of a special resolution.
- Where the AoA contain provisions for 'entrenchment' (whether made on formation or by AoA amendment), the company is under an obligation to give notice to the Registrar of Companies (RoC).

## Practical application of 'entrenchment' provisions

4. Considering the above definition and provisions of Companies Act, 2013 ('the Act') relating to 'entrenchment', we can attempt to understand its practical application in the current corporate scenario. It is necessary to note that 'entrenchment' relates to placing some strict provisions / restrictions in the AoA. Therefore, it is of utmost importance to ensure that 'entrenchment' provisions are in compliance with provisions of the Act and memorandum of association. A few practical examples for understanding the same are discussed below :

Sl No.	Provisions in the Act	Proposed entrenchment provisions	Validity of the proposed entrenchment provisions
1	General meeting may be called by giving not less than clear <b>21 days' notice</b>	General meeting may be called by giving not less than clear <b>14 days' notice</b>	Proposed entrenchment provision is not valid, as the same conflicts and overrides the provisions of the Act
2	General meeting may be called by giving not less than clear <b>21 days' notice</b>	General meeting may be called by giving not less than clear <b>24 days' notice</b>	Entrenchment provision is valid since the same is in valid since the same is in line with the provisions of the Act.

3	Auditor appointed under section 139 may be removed from his office before the expiry of his term only by a <b>special resolution</b> of the company, after obtaining the Central Government's previous approval....	Auditor appointed under section 139 may be removed from his office before the expiry of his term only by <b>an ordinary resolution</b> of the company, after obtaining the Central Government's previous approval....	Proposed entrenchment provision is not valid, as the same conflicts and overrides the provisions of the Act
4	Detailed auditor's disqualifications are provided of the Act	Any provision in AoA which <b>curtails the disqualification of auditor.</b>	Proposed Entrenchment provision is not valid, as the same is in conflict and overrides the provisions of the Act.

## Which companies will prefer entrenchment provisions in their AoA

5. In my view, following companies will prefer to include entrenchment provisions in the AoA:

- Closely-held companies which intend to restrict transfer of shares and maintain the status of "Closely-held".
- Family-owned companies which intend to ensure that the control and management is kept with the same family.
- Companies – in which there is strategic investment by private equity firm/ angel investor – which intend to have more control over the management and control (shareholding, investments, borrowings, authority, etc.) over the company;
- Joint Venture ('JV') company which may include restrictive provisions on the other JV party (e.g. shareholding, investments, borrowings, authority, etc.) or may include provisions which may require unanimous approval of both JV partners (e.g. increase in capital, allotment of shares, convening of general meeting, etc.).

## Conclusion

6. The provisions relating to entrenchment may seem burdensome at first, but it is important for each professional to know and understand the compliance provisions of the Act. Therefore, it is of utmost importance to ensure compliance with the Act at the time of drafting MoU, SHA, JV agreement, etc., such as including the entrenchment provisions in the AoA and giving notice to Registrar of Companies. Only this will make such entrenchment provisions enforceable.

### FOOTNOTES

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