

# Family Settlement Agreement – Grave Need of The Hour

## BACKGROUND

Family businesses contribute more than 70% of the GDP of India. These businesses are expected to have long term vision rather than merely achieving periodical results<sup>1</sup>. India has a long tradition of prominent business families enjoying high reputation for their contributions. Most of the businesses in India are family businesses operated through listed or unlisted entities, with the owners actively involved in the business and management. Despite enjoying high reputation and founded on traditions which have stood the test of time, most business families are found to be in quagmire of disputes /family feuds. To name a few, owners of Ranbaxy, Reliance group, JK Group, Apollo Tyres, Escorts Group and Kirloskar, Wadia, Bajaj, Godrej Family, and now even Hinduja Family etc.; the list just goes on and on. Ironically, such disputes have resulted in significant reduction or destruction of family businesses and family wealth. These issues are also likely to pose future challenges for many businesses, like Reliance and Wipro. It is high time that appropriate precautionary measures are taken by these families to protect, preserve and grow the businesses. Therefore there is a crying need for these families to formulate a constitution for defining family values, succession in

business, management and governance and terms of ownership and distribution of family wealth, commonly known as Family Settlement Agreement ('FSA').

## JUDICIAL APPROACH

Family Settlement, though not defined under Indian statute is well recognised in India. Thankfully, there is enough jurisprudence on the subject which is encouraging given the approach of the Courts towards upholding the FSA, disregarding technical aspects/shortcomings and have also given wider meaning to the word "family". The Supreme Court of India, through various judgements<sup>2</sup>, including a recent ruling given on July 31, 2020<sup>3</sup>, has afforded special equity to the family settlements while considering their enforceability and has not permitted a party to renege on the agreement after having acted upon the same (known as "estoppel"). One observes from the relevant Court rulings that FSA, which is found to be bona fide, fair and equitable and entered into with a genuine object of avoiding disputes whether, present or potential, have found favour with the Indian Courts. Needless to state, these agreements have to stand the test of free consent of all parties, i.e. consent not vitiated by fraud, coercion or undue influence. Even the rulings on the aspects

<sup>1</sup> Business Today, Article dated September 9, 2019

<sup>2</sup> Kale v/s Dy Director of Consolidation 1976, H S Singhania v/s G H Singhania 2006, Sita Ram

Bhama v/s Ramvatar Bhama 2018, Thulsidhar v/s Narayanappa 2019

<sup>3</sup> R K Grewal & Ors. v/s Manjit Kaur & Ors. 2020



of registration<sup>4</sup> and taxability on the FSA<sup>5</sup> is reasonably well settled.

Critical aspects to be considered for FSA

While conceptualising FSA, following non-technical/softer aspects should be considered by the family:-

- open communication, discussing sensitive issues/ questions and demonstrating inclusive and open mindset;
- merit oriented and gender neutral approach, emphasis on business considerations rather than personal considerations;
- appreciate aspirations/concerns of different generations and strive to meet their expectations;
- being flexible and pragmatic to mould family traditions (without compromising family values);
- remunerate members, commensurate with market standards;
- foregoing control and affording requisite independence; and
- fair and equitable sharing/distribution of wealth amongst family members.

While preparing FSA, following technical/legal aspects should be considered:-

- all family members (including close relatives), competent to contract, being signatories to the FSA;
- principles of valid contract, including free consent, certainty, lawful object, objective of avoiding/settlement of

present or potential disputes, to maintain peace and harmony;

- signatures in presence of witnesses, notarisation of the FSA;
- appropriate stamping and registration, if and as necessary;
- clarity of roles and responsibilities, code of conduct, distribution of family assets/businesses;
- clear entry and exit mechanism, rules for entering into new businesses;
- provision for the maintenance of minor and other needy members of the family;
- management and governance principles, decision making bodies; and
- conflict resolution mechanism, constitution of the resolution committee having neutral third party experts/family friends.

## INCIDENTAL DOCUMENTS

FSA is usually a master agreement defining overall principles applicable to diverse businesses and assets. Therefore, FSA should be backed by necessary incidental documents for legally enforcing and implementing the provisions of FSA; for example, (i) board/shareholders' resolution, power of attorney and/or voting agreement; (ii) property conveyance document for mutation of the property in favour of intended owner, (iii) execution of shareholders'/partnership agreement, amending the constitutional documents,

<sup>4</sup> Ibid

<sup>5</sup> Ramcharan v/s Girijanandinidevi 1965 SC, CIT v/s. AL. Ramanathan 2000 Mad, CGT v/s. D. Nagrathinam 2003 Mad



depending upon nature of business vehicles involved.

## CONCLUSION

Admittedly, no one agreement is a panacea for resolution of all issues. However, one can't expect desired behaviour from all without setting ground rules. Therefore, having FSA, alongwith other incidental and even succession documents, such as Wills, Trusts, etc. (as required) will surely mitigate risks. Well defined charters have been found to be preferred mode, as demonstrated by Murugappa family and Bajaj family. As even these families have faced issues, it is equally important to periodically revisit and suitably amend the FSA to address changing business dynamics and personal needs.

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