Dr. A. Lakshmanaswami Mudaliar and Others

Vs

Life Insurance Corporation of India and Another

Civil Appeal No. 400 Of 1961

(CJI B.P. Sinha, P. B. Gajendragadkar, K. N. Wanchoo, K. C. Das Gupta, J. C. Shah JJ)

11.12.1962

JUDGMENT

SHAH, J. –

This is an appeal from the order dated December 20, 1958, of the Life Insurance Tribunal in case No. 21/XV of 1958.

The United India Life Assurance Company Ltd. - hereinafter called 'the Company' - incorporated under the Indian Companies Act, 1882, with the principal object of carrying on life insurance business in all its branches was registered as an insurer under the Life Insurance Act, VI of 1938 for carrying on life insurance business in India. On July 15, 1955, at an extraordinary General Meeting of the shareholders of the Company, the following resolution, amongst others, was passed :-

> "Resolved that a donation of Rs. 2 lakhs be sanctioned from out of the Shareholders' Dividend Account to the M.Ct.M. Chindambaram Chettyar Memorial Trust proposed to be formed with the object, inter alia, of promoting technical or business knowledge, including knowledge in insurance.
>
> Resolved further that the Directors be and are hereby authorised to pay the aforesaid sum to the Trustees of the aforesaid Trust when it is formed."

On the date of this resolution, appellants 2 & 4 were Directors of the Company, appellant 4 being the Chairman of the Board of Directors. On December 6, 1955, five settlers (including the Company) executed a deed reciting that the settlers desired to establish a charitable trust for commemorating the name of the Late M.Ct.M. Chidambaram Chettyar "befitting his services to various institutions and organisations with which he was connected, and to industry, commerce, finance, art and science in general and the great encouragement he gave to education, training, research and promotion of human relationship," and with that object the settlers had declared, transferred and delivered to the trustees a sum of Rs. 25,000/- and interest, rents, dividends, profits and other income thereof to be held upon Trust for the objects and purposes mentioned in the deed. The objects of the Trust were manifold, e.g. to establish and maintain scholarships, stipends, allowances to be awarded to Indian students for prosecuting studies, to provide chairs or lectureships, to conduct competitions to test proficiency in the art of essay writing or speaking, "to promote art, science, industrial, technical or business knowledge including knowledge in banking, insurance, commerce and industry", to establish and maintain subsidies or support charities in India engaged in improving human relations in industrial or commercial affairs, to establish and maintain or support any educational institution or libraries in India for imparting general, technical or

scientific knowledge and to give subscriptions or donations or to render financial assistance to any educational or other charitable institution in India.

Appellants 2, 3 & 4 were the trustees nominated under the deed of trust, and the first appellant was appointed a trustee under cl. 8 of the deed. In pursuance of the resolution dated July 15, 1955, of the Directors of the Company made an initial instalment of Rs. 5,000/- to the trustees and the balance of Rs. 1,95,000/- was paid on December 15, 1955. On July 1, 1956, the Life Insurance Corporation Act, 1956, was brought into force. By s. 7 of that Act on the appointed day all the assets and liabilities appertaining to the 'controlled business' of all insurers were to stand transferred to and vested in Life Insurance Corporation of India. The expression 'controlled business' meant, amongst others, in the case of any insurer specified in sub-cl. (a)(ii) of sub-cl. (b) of cl. (9) of s. 2 of the Insurance Act and carrying on life insurance business all his business if he carries on no other class of insurance business. September 1, 1956 was notified as the 'appointed day', and on that day, all the assets and liabilities of insurers including the Company stood transferred to and vested in the Life Insurance Corporation. On September 30, 1957, the Life Insurance Corporation - which will hereinafter be referred to as 'the Corporation' - called upon the appellants to refund the amount of Rs. 2 lakhs received by the trust from the Company in December, 1955, and the appellants by their letter dated December 10, 1957, having denied liability to refund the amount, the Corporation applied on March 14, 1958 to the Life Insurance Tribunal constituted under the Life Insurance Corporation Act for an order that the trustees be ordered jointly and severally to pay to the Corporation the sum of Rs. 2 lakhs with interest thereon at the rate of six per cent per annum from the date of payment to the trustees. It was alleged by the Corporation that the resolution dated July 15, 1955 as well as the payments made in pursuance thereof were ultra vires the Company and void and of no effect in law, that the Memorandum of the Company did not authorise such payment, that making of such a donation was not in the interests of the Company's business nor was it a generally recognised method of conducting the business and by the donation no direct or substantial advantage accrued to the Company. The appellants by their written statement submitted that the Directors of the Company were authorised by the Articles of Association of the Company to make donations towards any charitable or benevolent object or for any public, general or useful object, that the amount of Rs. 2 lakhs was paid out of the Shareholders Dividend Account which was distinct and separate from the general assets of the Company, and under the Articles of Association money standing to the credit of the 'Shareholders' Dividend Account being the exclusive property of the shareholders and not of the Company, was held by the Company for and on behalf of the shareholders and in trust for them; that the shareholders had absolute right of disposal over the said account and the shareholders of the Company having resolved to donate Rs. 2 lakhs to the trust out of that account in exercise of their absolute ownership and power of disposal over the said fund, the payment could not be called in question by the Company or by any body purporting to act on behalf of the Company, for if the Company had not been taken over by the Corporation, the impugned payment could not have been challenged as ultra vires, and the powers of the Corporation were not larger in scope and ambit than that of the Company. The appellants also contended that as trustees they were not personally liable to refund the amount claimed.

By order dated December 20, 1958, the Tribunal directed the appellants to pay jointly and severally Rs. 2 lakhs within fifteen days from the date of service of the order, and in default to pay interest thereon at the rate of 6 per cent per annum till the date of realisation. Against the order, this appeal with special leave is filed.

The right of the Corporation to demand payment of the amount if the resolution sanctioning payment was unauthorised, cannot be challenged in view of the express provision in s. 15 of the

Life Insurance Corporation Act. Under s. 15(1)(a) of Life Insurance Corporation Act, 1956, where an insurer whose controlled business has been transferred to and vested in the Corporation under the Act, has at any time within five years before the 19th day of January, 1956, made any payment to any person without consideration, the payment not being reasonably necessary for the purpose of the controlled business of the insurer or has been made with an unreasonable lack of prudence on the part of the insurer, regard being had in either case to the circumstances at the time, the Corporation may apply for relief to the Tribunal in respect of such transaction; and by cl. (2) the Tribunal is authorised to make such order against any of the parties to the application as it thinks just having regard to the extent to which those parties were respectively responsible for the transaction or benefited from it and all the circumstances of the case.

It is necessary in the first instance to ascertain the true effect of the resolution dated July 15, 1955, and the character of the Shareholders' Dividend account. The material clauses of the Articles of Association of the Company relating to the constitution of the Shareholders' Dividend Account are Arts. 116 and 117. Article 116 reads :

> "Interest on the paid-up capital at the rate of six per cent per annum simple for each of the years covered by the Valuation Period shall from a first charge on and be deducted from the surplus remaining; and the said amount shall become the exclusive property of the shareholders and shall be carried over to the Shareholders' Dividend Account."

Article 117 reads :

> "Of the remaining surplus the shareholders shall be entitled to a one-tenth share and the amount representing the said one-tenth share shall also thenceforth become the exclusive property of the shareholders and be carried over to the Shareholders' Dividend Account."

Article 119 provides for payment of dividend and or bonus out of the Shareholders' Dividend Account. That article states that :

> "Dividend and or bonus shall be declared and paid to the shareholders in proportion to the paid-up capital from and out of the total amount remaining in the Shareholders' Dividend Account in accordance with the provisions of the Articles."

By Article 123 it is provided that no larger dividend shall be declared than is recommended by the Directors, but the Company in a general meeting may declare a smaller dividend. By Article 124 no dividend is payable to the shareholders except out of the surplus of the Company and such dividend shall not be paid except from the amount in the Shareholders' Dividend Account.

By the resolution passed by the Company on July 15, 1955, it was resolved to donate Rs. 2 lakhs to the Trust. Undoubtedly the amount was payable out of the Shareholders' Dividend Account : but by the impugned resolution no dividend was declared. Every resolution of the Company directing payment out of the Shareholders' Dividend Account is not a resolution declaring dividend. The Directors have to recommend payment of dividend at a certain rate, and a resolution declaring dividend so recommended or at a smaller rate may alone be passed. The directors had at the same meeting recommended payment of an interim dividend (free of income tax) at Rs. 50/- per share on the paid-up capital of the Company, and it was resolved that dividend at the rate be paid out of the

Shareholders' Dividend Account in respect of all shares to such persons as were registered as holders of shares. The impugned resolution was therefore one donating an amount to the trust, and not declaring dividend payable on behalf of the shareholders to the trust.

Constitution of a separate Shareholders' Dividend Account in Life Insurance Companies was necessitated because of s. 49 of the Insurance Act, 1938, which prohibited insurers of certain classes (and the Company is an insurer of that class) from carrying on the business of life insurance, from utilizing directly or indirectly any portion of the life insurance fund or of the fund of such other class or sub-class of insurance business, as the case may be, for the purpose of declaring or paying any dividend to shareholders or any bonus to policy-holders or of making any payment in service of any debentures, except a surplus shown in the valuation balance-sheet in Form I as set forth in the Fourth Schedule submitted to the Controller as part of the abstract referred to in s. 15 as a result of an actuarial valuation of the assets and liabilities of the insurer. By sub-section (1) of s. 10, every insurer carrying on life insurance business was required to maintain a separate fund of receipts due in respect of such business a separate fund distinct from all other assets of the insurer, and deposits made by the insurer in respect of life insurance business were to be deemed parts of the assets of such fund. By sub-section (3) the life insurance fund was made absolutely the security of the life insurance policy holders, and could not be applied directly or indirectly for purposes other than those of the life insurance business. By s. 13 every such insurer was required to cause an investigation to be made in respect of all life insurance business transacted by him once in three years by an actuary into the financial condition of the business, including a valuation in respect thereto and to cause an abstract of the report of such actuary to be made in accordance with the regulations contained in Part I of the Fourth Schedule and in conformity with the requirements of Part II of that Schedule. By the Fourth Schedule in Part I various regulations for the preparation of abstracts of actuaries reports are laid down and Part II prescribes requirements applicable to an abstract in respect of life insurance business.

To maintain a reserve account for payment of dividends, Articles 116 and 117 provide that out of the surplus shown in the valuation Balance-Sheet, interest on the paid-up capital at the rate of 6 percent per annum for each of the years covered by the valuation period and of a ten per cent share of the remaining surplus shall be set apart and be carried over to the 'Shareholders' Dividend Account. The scheme of the two Articles is that the surplus is to be allocated first to the shareholders for the percentages prescribed, and then to the policy-holders, and by Art. 124 divided is made payable only out of the surplus, which is included in the Shareholders' Dividend Account. By Arts. 116 and 117 the amounts so set apart are declared to be the exclusive property of the shareholders, that however does not create in the individual shareholders and proprietary interest in the Shareholders' Dividend Account. Until dividend is declared, the shareholders have no right to participate in the fund. The expression 'exclusive property of the shareholders' only emphasizes that in the Shareholders' Dividend Account the policy-holders have no interest : it means that the fund is divisible only among shareholders, policy-holders having no right to participate therein. However unit dividend is declared, the shareholders do not become creditors of the Company for a fractional share in the Fund proportionate to the value of their holding. As observed by this Court in Bacha F. Guzdar v. Commissioner of Income-tax, Bombay [[1955] 1 S.C.R. 876.].:

> "The true position of a shareholder is that on buying shares an investor becomes entitled to participate in the profits of the company in which he holds the shares if and when the company declares, subject to the Articles of Association, that the profits or any portion thereof should be distributed by way of dividends among the shareholders. He has undoubtedly a further right to participate in the assets of the

company which would be left over after winding up but not in the assets as a whole."

The fund, therefore, belongs to the Company, and continues to so belong until its destination is determined by a resolution of the Company declaring a dividend pursuant to a recommendation of the Directors. The scheme of the Articles of Association of the Company makes this abundantly clear. The power to declare a dividend is given by Arts. 122 & 123 to the Company in general meeting, but no larger dividend can be declared than what is recommended by the Directors. The right to dividend therefore depends upon the recommendation to be made by the Directors and unless there is a recommendation made by the Directors and the general meeting declares a dividend, the shareholders acquire no right to the fund or any part thereof, out of which dividend is when declared payable.

The argument of counsel for the appellants that the meeting held on July 15, 1955, was a meeting of the shareholders, and when the shareholders resolved to donate an amount of Rs. 2 lakhs out of the Shareholders' Dividend Account they must be deemed to have resolved upon the destination of a part of the Fund to which they were entitled, has therefore no force. The meeting was a meeting of the Company specifically convened for considering various resolutions one of which was to make a donation of Rs. 2 lakhs out of the Shareholders' Dividend Account. Dividend is by the Articles undoubtedly payable out of the Shareholders' Dividend Account, but until a resolution is passed by the Company in a general meeting, no part of the Account belongs to the shareholders as dividend. It is common ground that no resolution was passed declaring that the amount of Rs. 2 lakhs be declared as dividend and paid over to the shareholders.

The contention raised by counsel for the appellants that the resolution of the Company and the acceptance thereof by the appellants as trustees of the Trust constituted a contract is, in our judgment, futile. There was within the meaning of the Indian Contract Act no consideration moving from the trustees for accepting the amount assuming that the resolution amounted to an offer. By s. 2 cl. (d) of the Indian Contract Act when at the desire of the promisor, the promisee or any other person has done or abstained for doing, or does or abstains from doing, or promises to do or obstain from doing, something, such act or abstinence or promise is called a consideration for the promise. Mere willingness to utilise the monies for the purpose of the trust cannot be regarded as consideration, for consideration to support an agreement must be valuable. In the case before us even before the trust came into existence the Directors of the Company entertained a desire to make a donation in favour of the trust to be constituted, and a resolution of the Company sanctioning the donation was passed. When the trust deed was executed the Directors paid over the amount pursuant to the resolution to the trust. By mere acceptance of the amount donated no consideration was rendered by the trust in favour of the Company. Payment by the Company of the amount resolved to be donated was therefore purely gratuitous : its acceptance made it a gift, and did not give rise to a contract.

A Company is competent to carry out its objects specified in the Memorandum of Association and cannot travel beyond the objects. The objects of the Company are set out in Cl. III. By the first sub-clause the Company is authorised to carry on life insurance business in all its branches and all kinds of indemnity and guarantee business and for that purpose to enter into and carry into effect all contracts and arrangements. By sub-cl. (ii) the Company is authorised "to invest and deal with funds and assets of the Company upon such securities or investments and in such manner as may from time to time be fixed by the Articles of Association of the Company." Sub-clause (iii) and (iv) are not material for the purposes of this appeal. By sub-clause (v) the Company is authorised to do "all such other things as are incidental or conducive to the attainment of the above objects or any of

them." The Memorandum of Association must like any other document be construed according to accepted principles applicable to the interpretation of all legal documents and no rigid canon of construction is to be applied to such a document. Like any other document, it must be read fairly and its import derived from a reasonable interpretation of the language which it employs. Egyptian Salt & Soda Company v. Port Said Salt Association [[1931] A.C. 677.]. As observed in Ashbury Railway Carriages and Iron Company v. Riche [(1875) L.R. 7 H.L. 653.].

> "The covenant, therefore, is not merely that every member will observe the conditions upon which the company is established, but that no change shall be made in those conditions; and if there is covenant that no change shall be made in the objects for which the company is established, I apprehend that that includes within it the engagement that no object shall be pursued by the company, or attempted to be attained by the company in practice, except an object which is mentioned in the memorandum of association.
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> Now, my Lords, if that is so - if that is the condition upon which the corporation is established - it is a mode of incorporation which contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively, that nothing shall be done beyond that ambit, and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified."

Power to carry out an object, undoubtedly includes power to carry out what is incidental or conducive to the attainment of that object, for such extension merely permits something to be done which is connected with the objects to be attained, as being naturally conducive thereto. By sub-clause (i) of cl. III of the objects clause of the Memorandum of Association, the Company is to carry on the life insurance business in all its branches. Clause (ii) authorises the Company to invest and deal with funds and assets of the Company upon such securities or investments and in such manner as may from time to time be fixed by the Articles of Association of the Company. This is in truth not an object clause, it is a clause authorising investment of funds. Clause (ii) does not invest the Directors with power to deal with the funds in such manner as may from time to time be fixed by the Articles of Association : power conferred thereby is power to invest and deal with funds and assets of the Company. The Directors under sub-clause (ii) of cl. III merely have the power to invest and deal with the funds and assets of the Company upon such securities or investments, and the power is to be exercised in the manner prescribed by the Articles of Association. By Article 93(t) the Directors are undoubtedly invested with authority to establish, maintain and subscribe to any institution or Society which may be for the benefit of the Company, and to "make payments towards any charitable or any benevolent object, or for any general public, general or useful object". But this is within the authority of the Directors only if the Company has the power under the Memorandum of Association to achieve the object specified, or for doing anything incidental to or naturally conducive to objects specified. If the object is not within the competence of the Company, the Directors relying upon Art. 93(t) cannot expend the funds of the Company for achieving that object. The primary object of the Company is to carry on life insurance business in all its branches, and donations of the Company's funds for the benefit of a trust for charitable purposes is not incidental to or naturally conducive to that object. There is in fact no discernible connection between the donation and the objects of the Company. Undoubtedly the Memorandum of Association has to be read together with the Articles of Association, where the terms are ambiguous or silent. As observed in Angostura Bitters & Company Ltd. v. Kerr [[1933] A.C. 550.] by the Judicial Committe of the

Privy Council :

> "that except in respect of such matters as must by statute be provided for by the memorandum, it is not to be regarded as the dominant document, but is to be read in conjunction with the articles : Harrison v. Mexican Rly. Co. ((1875) L.R. 19 Eq. 358); Anderson's case ((1877) 7 Ch. D. 75); Guinness v. Land Corporation of Ireland ((1882) 22 Ch. D. 349); In re. South Durham Brewery Co. ((1885) 31 Ch. D. 261). Their Lordships agree that in such cases the two documents must be read together at all events so far as may be necessary to explain any ambiguity appearing in the terms of the memorandum, or to supplement it upon any matter as to which it is silent."

There is however no ambiguity in the relevant terms of the Memorandum of Association. Clause III of the Memorandum deals with the objects, and powers of the Company in language which is reasonably plain. The Articles may explain the Memorandum, but cannot extend its scope. Sub-clause (v) merely authorises the Company to do all such other things 'as are incidental or conducive to the attainment of the above objects or any of them'. The clause merely sets out what is implicit in the interpretation of every Memorandum of Association : it does not set up any independent object, and confers no additional power. Acts incidental to or naturally conducive to the main object are those which have a reasonably proximate connection with the object, and some indirect or remote benefit which the Company may obtain by doing an act not otherwise within the object clause, will not be permitted by this extention. In Tomkinson v. South Eastern Railway it was held that a resolution passed by the shareholders of a Railway Company authorising the Directors to subscribe Pound 1000 out of the Company's funds towards a donation to the Imperial Institute was ultra vires, even though the establishment of the Institute would benefit the Company by causing an increase in passenger traffic over their line. Kay, J., announcing the judgment of the Court observed :

> "Now, what is proposed to be done here is this : the chairman of the railway company, at a meeting of the company, proposed this resolution : 'That the directors be authorised, either by way of donation from the company or by an appeal to the proprietors, as they may be advised' - the resolution thus proposing two alternative modes - 'to subscribe the sum of Pound 1000 to the Imperial Institute'. I pause there. The Imperial Institute has no more connection with this railway company than the present exhibition of pictures at Burlington House, or the Grosvenor Gallery, or Madame Tussaud's, or any other institution in London that can be mentioned. The only ground for the suggestion that this company has the right to apply its funds, which it has been allowed to raise for specific purposes, to this purpose is, that the Imperial Institute, if it succeeds, will very probably greatly increase the traffic of this company. If that is a good reason, then, as I pointed out during the argument, any possible kind of exhibition which, by being established in London, would probably increase the traffic of a railway company by inducing people to come up to see it would be an object to which a railway company might subscribe part of its funds. I never heard of such a rule, and, as far as I understand the law, that clearly would not be a proper application of the moneys of a railway company. I cannot distinguish this case from that at all, though, of course, I do not mean to disparage the enormous importance of the Imperial Institute. It may be established for the highest possible objects of interest to this country; but still, the only reason given to me why this railway company thinks it right to spend part of its funds in subscribing to it is this, that it will probably greatly increase the traffic of the company by inducing many people to travel up to visit this Institute. I cannot accept that as a reason for a

moment."

The trust has numerous objects one of which is undoubtedly to promote art, science, industrial, technical or business knowledge including knowledge in banking, insurance, commerce and industry. There is no obligation upon the trustees to utilise the fund or any part thereof for promoting education in insurance, and even if the trustees utilised the fund for that purpose, it was problematic whether any such persons trained in insurance business and practice were likely to take up employment with the Company. Thus the ultimate benefit which may result to the Company from the availability of personnel trained in insurance, if the trust utilises the fund for promoting education in insurance practice and business, is too indirect, to be regarded as incidental or naturally conducive to the object of the Company. We are, therefore, of the view that the resolution donating the funds of the Company was not within the objects mentioned in the Memorandum of Association and on that account it was ultra vires.

Where a Company does an act which is ultra vires, no legal relationship or effect ensues therefrom. Such an act is absolutely void and cannot be ratified even if all the shareholders agree. Re. Birkback Permanent Benefit Building Society [[1912] 2 Ch. 183.]. The payment made pursuant to the resolution was therefore unauthorised and the trustees acquired no right to the amount paid by the Directors to the trust.

The only question which remains to be considered is whether the appellants were personally liable to refund the amount paid to them. Appellants 2 and 4 were at the material time Directors of the Company and they took part in the meeting held under the Chairmanship of the fourth appellant in which the resolution, which we have held ultra vires, was passed. As office bearers of the Company who were responsible for passing the resolution ultra vires the Company, they will be personally liable to make good the amount belonging to the Company which was unlawfully disbursed in pursuance of the resolution. Again by s. 15 of the Life Insurance Corporation Act, 1956 the Life Insurance Corporation is entitled to demand that any amount paid over to any person without consideration, and not reasonably necessary for the purposes of the controlled business of the insurer be ordered to be refunded, and by sub-section (2) authority is conferred upon the Tribunal to make such order against any of the parties to the application as it thinks just having regard to the extend to which those parties were respectively responsible for the transaction or benefited from it and all the circumstances of the case. The trustees as representing the trust have benefited from the payment. The amount was, it is common ground, not disposed of before the Corporation demanded it from the appellants, and if with notice of the infirmity in the resolution, the trustees proceeded to deal with the fund to which the trust was not legitimately entitled, in our judgment, it would be open to the Tribunal to direct the trustees personally to repay the amount received by them and to which they were not lawfully entitled.

The appeal therefore fails and is dismissed with costs.

Appeal dismissed.

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