Narayandas Shreeram Somani

Vs

The Sangli Bank Ltd. (With Connected Appeal)

Civil Appeal Nos. 801 and 802 of 1962

(A. K. Sariar, J. R. Mudholkar, R. S. Bachawat JJ)

15.04.1965

JUDGMENT

BACHAWAT, J. –

The Bank of Poona Ltd., (hereinafter referred to as the Company) now amalgamated with the Sangli Bank, Ltd. was incorporated in 1945. The Company was promoted by N. G. Parulekar and Murlidhar Chaturbhuj Loya. The authorised capital to the Company was Rupees fifty lakhs divided into 50,000 ordinary shares of Rs. 100/- each. By the end of April, 1946, the Company was able to find subscribers for 4,860 shares only. In view of s. 277(I) of the Indian Companies Act, 1913, the Company was unable to carry on business unless the subscribed capital was not less than half the authorised capital. In order to comply with the requirements of s. 227(I), the directors of the Company decided that they or their nominees would subscribe for a large number of shares. Narayandas Shriram Somani was one of the directors of the Company. Ramnath Shriram Somani is his brother. They carried on business in the name of Ramkisan Ramratan Somani, Jivanbai is the mother of Narayandas and Ramnath Goverjabai is the wife of Narayandas, and Kamalabai is the wife of Ramnath. Narayandas decided to subscribe for 2000 shares in the names of the three ladies. At a meeting held on May 25, 1946, the board of directors of the Company allotted 500 shares to Goverjabai, 500 shares to Kamalabai and 1000 shares to Jivanbai against three separate applications for shares signed by them. The applications were accompanied by three separate hundis dated May 25, 1946 for Rs. 25,000, Rs. 12,500 and Rs. 12,500 drawn by Narayandas in favour of the Company. The meeting of May 25, 1946 was attended by three directors, Murlidhar Loya, D.R. Nayak and Narayandas. At that meeting, the directors also sanctioned a loan of Rs. 60,000 to Ramnath. On May 28, 1946, Ramnath obtained from the Company the loan of Rs. 60,000 against his promissory note, and a separate loan account No. 1/18 was opened in his name in the books of the Company. The three hundis were honoured on May 29, 1946. The directors of the Company at a meeting held on June 8, 1946 resolved to give an overdraft of Rs. 40,000 to Ramnath. A separate overdraft account L.A./C. No. 71 in the name of Ramnath was opened in the books of the Company, and Ramnath obtained the sanctioned overdraft by a cheque dated June 27, 1946 for Rs. 15,000/- and another cheque dated June 29, 1946 for Rs. 25,000. The balance of the application and allotment moneys amounting to Rs. 12,500, Rs. 12,500 and Rs. 25,000 in respect of the shares of Goverjabai, Kamalabai and Jivanbai were paid to the Company on June 22, June 28 and June 29 respectively. There is reason to believe that the subscription of the 2000 shares was financed by the advances to Ramnath.

On December 28, 1948, Ramnath was indebted to the Company in his loan account for Rs. 65,743-6-6 and in his overdraft account for Rs. 41,909-10-0. On that date, both accounts were closed, and a new loan account No. 9 with a debit of Rs. 1,09,500/- was opened in the name of Ramnath, who

executed a promissory note. The Reserve Bank of India was pressing the Company to take steps in respect of the advances to Ramnath. In these circumstances, Ramnath repaid to the Company Rs. 18,500/- on December 29, 1950 and Rs. 1,500/- on January 2, 1951. At the same time, on January 6, 1951, the Company gave a new loan of Rs. 20,000/- to Ramkisan Ramratan Somani and Ramnath, and the borrowers executed a joint and several promissory note in favour of the Company for the sum of Rs. 20,000/-. In respect of this loan, a separate loan account was opened in the books of the Company. In his loan account No. 9, Ramnath repaid. Rs. 1,00,000/- on December 27, 1951 and Rs. 4,198-8-0 on December 29, 1951, and as a result of the last payment, the account was closed. The above sum of Rs. 1,00,000/- was paid on behalf of Ramnath by Narayandas, who on the same date obtained a loan of Rs. 1,00,000/- from the Company. On the same date, Narayandas executed a promissory note for the sum of Rs. 1,00,000/-, a letter of pledge and trust receipt in respect of cloth, saris etc., valued at Rs. 1,50,000/-, and a separate loan account No. 6/184 in his name was opened in the books of the Company.

In spite of demands, the Company was unable to realise its dues in respect of the outstanding loans. On March 18, 1954, the Company instituted Special Suit No. 39 of 1954 in the Court of the Civil Judge, Senior Division of Poona, against Ramkisan Ramratan Somani and Ramnath for the recovery of Rs. 22,964-13-0 due from them in respect of their loan account and the promissory note dated January 6, 1951. The suit was dismissed by the trial Court on April 23, 1955, but in First Appeal No. 819 of 1955 preferred by the Company, the High Court decreed the suit. Civil Appeal No. 801 of 1962 arises out of this claim. On April 24, 1954, the Company instituted Special Suit No. 78 of 1954 in the Court of the Civil Judge, Senior Division, Poona against Narayandas for the recovery of Rs. 1,09,099-14-4 due from him in respect of the loan account No. 6/184 and the promissory note dated December 27, 1951. On April 23, 1955, the trial Court dismissed the suit, but in First Appeal No. 820 of 1955 preferred by the Company, the High Court decreed the suit. Civil Appeal No. 802 of 1962 arises out of this claim.

On behalf of the appellants, Mr. Purushottam Tricamdas contended that the allotment of the 2000 shares and the several loans in the names of Ramnath and Narayandas were not genuine transactions, and that the parties did not intend that the allottees would be the holders of the shares or that Narayandas and Ramnath would be liable to repay the loans. It is to be noticed that the plea that the allotment of the 2000 shares was not intended to be operative, was not sufficiently raised in the pleadings. Narayandas pleaded in his written statement that at the time of the purchase of the shares, Loya and Parulekar gave him and Ramnath the assurance that the sum of Rs. 1,00,000/- required for the purchase of the shares would be paid by the Company on interest at 4 1/2 per cent per annum and Loya and Parulekar would not demand and recover the amount but they would sell the shares and credit the amount of the sale proceeds towards the principal and interest in the loan account and would not allow Narayandas and Ramnath to suffer loss with regard thereto. Narayandas swore that it was agreed between him. Parulekar and Loya that he should normally take the 2000 shares which would be finally sold to others and he would be out of liability and he and Ramnath would not repay the loans nor take any benefit thereunder. He also suggested that he or Ramnath did not repay any moneys out of their own pocket, and all repayments in the accounts were made out of the moneys received by him from the Company. At the trial, the Company did not examine either Loya or Parulekar. It may be that Loya and Parulekar gave some understanding to Narayandas with regard to the disposal of the shares, and in view of this understanding, they subsequently executed in favour of Narayandas two letters dated December 27, 1951, whereby Parulekar agreed to buy from him 500 shares and Loya agreed to buy from him 800 shares. But these assurances, if any, were given to Narayandas by Parulekar and Loya in their individual capacity and not as directors of the Company. There is no record of any assurance given on behalf

of the Company to Narayandas in the minutes of the board meetings. Narayandas and his nominees, Goverjabai, Kamalabai and Jivanbai, dealt with the shares on the footing that they were the owners of the shares. Some of the shares were transferred to third parties under transfer deeds executed by Jivanbai, and the sale proceeds were credited to the loan account of Narayandas. Jivanbai received from the Company all the 1000 shares allotted to her and executed a receipt dated February 25, 1953. Narayandas obtained from Loya and Parulekar written undertakings dated December 27, 1951 for the purchase of 800 and 500 shares respectively. By letter dated June 28, 1954, Narayandas called upon Parulekar to fulfil his undertaking for the purchase of 500 shares. All these circumstances prove that the allotment of the 2000 shares was intended to be operative and the allottees were intended to be the holders of the shares. Ramnath out of his own funds paid several sums of money towards discharge of his indebtedness in the loan accounts. He paid Rs. 750-4-0 in the overdraft account towards interest on December 12, 1946 and Rs. 1,484-7-0 in the loan account No. 1/18 on April 21, 1947, and we are not satisfied that these sums were paid out of commission earned by Narayandas from the Company. Similarly, on December 29, 1951, he paid Rs. 4,198-8-0 in the loan account No. 9 and on January 4, 1954, Rs. 100/- was paid by Ramkisan Ramratan and Ramnath in their loan account. The loan accounts were secured by promissory notes. Moreover, the loan account of Narayandas was secured by a trust receipt and a letter of pledge. Even on March 3, 1953, Narayandas executed a letter in favour of the Company declaring that he held as security a stock of sarees valued at Rs. 1,50,000/-. In respect of other loan transactions, the Company charged the appellants interest at the rate of 6 per cent and those loans were repaid quickly. But the loan transactions insult were intended to be of a more permanent nature, and in order to accommodate Narayandas and Ramnath, the Company agreed to charge interest at 4 1/2 per cent. We are satisfied that the allotment of the 2000 shares was intended to be operative and the allottees became the owners of the shares. We are also satisfied that the loans to Ramnath and Narayandas were intended to be operative, and the Company did not give any assurance to them that they would not be called upon to repay the loans.

The next contention of Mr. Purushottam Tricamdas arises in this way. Article 126 of the articles of association of the Company provides that the directors may determine the quorum necessary for the transaction of business, and unless and until otherwise determined, three directors shall be the quorum. The directors did not make any other determination with regard to quorum, and at all material times, a quorum of three was required for a directors' meeting. The board meeting of May 25, 1946 was attended by three directors only, namely, M. C. Loya. D. R. Nayak and Narayandas. At this meeting, the directors resolved to allot 2000 shares to the nominees of Narayandas. Narayandas was clearly interested in the allotment of the shares. Section 91B(1) of the Indian Companies Act, 1913 provided that "No director shall, as a director, vote on any contract or arrangement in which he is either directly or indirectly concerned or interested nor shall his presence count for the purpose of forming a quorum at the time of any such vote; and if he does so vote, his vote shall not be counted". The Poona Bank Ltd. was a public company, and s. 91B(1) applied to its directors. Narayandas therefore, ought not to have voted at the meeting of May 25, 1946. If his vote is excluded, there was no quorum for the meeting. Mr. Purushottam Tricamdas therefore, contended that the allotment of 2000 shares to the nominees of Narayandas at this meeting was invalid and no title passed to the allottees in respect of the shares, and in the circumstances, there was a total failure of the consideration paid for the shares, and as the consideration was paid out of the loans, the appellants are not liable to repay the same.

Now, a director of a company stands in a fiduciary position towards the company and is bound to protect its interests. For long, it has been an established rule of equity that he must not place himself in a position in which his personal interest conflicts with his duty, and unless authorised by the

company's articles, he must not vote as a director on any contract or arrangement in which he is directly or indirectly interested. Standard articles give effect to this rule of equity. See Plamer's Company Precedents, 17th Edn., Part I, p. 553. If he votes in such a case, his vote would not be counted, and his presence would not count towards the quorum, that is to say, the minimum number fixed for the transaction of business by a board meeting, for a quorum must be a disinterested quorum, and must be comprised of directors who are entitled to vote on the particular matter before the meeting. See In re. Yuill v. Greymouth Point Elizabeth Railway and Coal Company, Limited [[1904] 1 Ch. 32]. If an interested director votes and without his vote being counted there is no quorum, the meeting is irregular, and the contract sanctioned at the meeting is voidable by the company against the director and any other contracting party who has notice of the irregularity, see Transvaal Lands Company v. New Belgium (Transvaal) Land and Development Company [[1914] 2 Ch. 488]; but the company may waive the irregularity and affirm the transaction. The matter is put succinctly by Gore-Browne in Handbook on Joint Stock Companies, 41st Edn., p. 363 thus :

> "According to the well-established rule that an agent cannot act on behalf of his principal in a matter in which the agent has a conflicting interest or duty, directors are precluded from taking part in any resolution under which they take a benefit or which adopts a contract that concerns them unless the Articles authorises their doing so. It must be here noted that if interested directors take part in any transaction there is an irregularity which renders the transaction avoidable by the company as against the directors and any persons who have knowledge of the facts".

Section 91B embodied the existing rule of equity in the form of a statutory provision. In Pratt (Bombay) Ltd. v. M.T. Ltd. and Sassoon & Co. Ltd. v. Pratt (Bombay) Ltd. [I.L.R. [1938] Bom. 421], Sir George Rankin observed that the section is a concise statement of the general rule of equity explained in the Transvaal Lands Company's case [[1914] 2 Ch. 488], and he pointed out that the impugned transactions on which the interested directors had voted, were voidable by the official liquidator of the company. The voting by the interested director, of itself, does not invalidate the contract. The effect of s. 91B is that the vote of the interested director must be excluded, and if as a result of such exclusion there is no quorum, the resolution sanctioning the contract is irregular and the contract is liable to be avoided by the company against the directors and other contracting party having notice of the irregularity. Section 91B is meant for the protection of the company, and the company may, if it chooses, waive the irregularity and affirm the contract.

We think that the allotment of the 2000 shares to the nominees of Narayandas in the meeting of the directors of the company held on May 25, 1946 was not void. In view of the fact that Narayandas was not entitled to vote on the allotment and after exclusion of his vote there was no quorum, the allotment was irregular, and the Company was entitled to avoid the allotment. Instead of avoiding the allotment, the Company has chosen to affirm it. The allotment is, therefore, valid and binding on the allottees.

Moreover, Narayandas cannot be heard to say that there was no valid allotment of the shares. For the purpose of satisfying the requirement of s. 277(I) it was necessary to allot the shares, and he allowed the Company to commence business on the footing that the shares had been subscribed. He was a director of the Company and a party to the resolution alloting the shares. He dealt with the shares on the footing that the allottees were the holders of the shares with a clear knowledge of the circumstances on which he might have founded his present objection. He cannot now be heard to say that he was interested in the allotment and could not vote. Like the director in York-Tramways Company v. Willows [[1882] 8 Q.B.D. 685], he is now stopped from contending that the allotment

is invalid. For all these reasons, we hold that the allotment is valid, and there is no failure of consideration.

In the plaint in Suit No. 78 of 1954, the Company pleaded that on December 27, 1951 Narayandas took from it on loan a sum of Rs. 1,00,000/- and executed an on-demand promissory note for the amount. Mr. Purushottam Tricamdas contended that, as a matter of fact, no cash amount was paid and no loan was advanced by the Company to Narayandas on December 27, 1951, and consequently, the suit as framed is not maintainable. Now, at the relevant time, Ramnath was indebted to the Company for Rs. 1,04,198/- in respect of loan account No. 9. On December 27, 1951, at the request of Narayandas, the Company credited Ramnath with Rs. 1,00,000/- in his loan account and debited Narayandas with Rs. 1,00,000/- in a new loan account opened in his name. On the same date, Narayandas acknowledged in writing the receipt of Rs. 1,00,000/- and executed a promissory note for the amount in favour of the Company. Ramnath took full advantage of the credit of Rs. 1,00,000/- and on payment of the balance of Rs. 4,198-8-0 closed his loan account No. 9. Though no actual money passed, the two entries in the books of account amounted to payment of Rs. 1,00,000/- by the Company to Narayandas by way of a loan and repaymant of the same amount by Narayandas to the Company towards discharge of the indebtedness of Ramnath in the latter's loan account with the Company. The result was as if the Company had paid a sum of Rs. 1,00,000/- in cash to Narayandas and then Narayandas had returned the amount to the Company with instructions to credit it to Ramnath. To support a plea of payment, it is not necessary to show that cash passed. Illustration (a) to s. 50 of the Indian Contract Act, 1872 shows that payment may be made made by means of transfer entries in books of account. The Company has sufficiently established a payment of Rs. 1,00,000/- by it to Narayandas by way of loan on December 27, 1951.

Mr. Purushottam Tricamdas contended that the loan to Narayandas and Ramnath were financial assistance by the Company for the purpose of or in connection with the purchase of its shares by Narayandas or his nominees, and the loans being in contravention of s. 54A(2) of the Indian Companies Act, 1913 were illegal and could not be recovered. Mr. K. N. Bhabha contended (1) that the appellants ought not to be allowed to take this new point in this appeal; (2) the lending of the money was a part of the ordinary business of a banking company and the loans to Ramnath and Narayandas were made by the Company in the course of its business; and (3) having regard to the decision in Re V.G.M. Holdings, Ltd. [[1942] 1 All E.R. 234], the word "purchase" in s. 54A(2) did not include the acquisition of shares by subscription or allotment, and in this case, the loans were given in connection with the acquisition by Narayandas or his nominees of shares by subscription or allotment and not in connection with acquisition of shares by purchase, and consequently, s. 54A(2) had no application. Now, it appears that in paragraph 15 of his written statement Narayandas pleaded that the advance of loan to him in connection with the purchase of shares was illegal, but no issue was raised on the question whether the loans were financial assistance in connection with the purchase of the shares and were in contravention of s. 54A(2). There is passing reference to this contention in paragraph 15 of the judgment of the trial Court, but there is no reference to it in the judgment of the High Court. We find also that this contention finds no place in the statement of the case filed on behalf of the appellants. Mr. Purushottam Tricamdas relied on ground No. 12 of the appellants statement of case, but, we think that this ground is wholly insufficient to raise this contention. In these circumstances, we think that it is not open to the appellants to urge this contention, and we indicated this to Mr. Purushottam Tricamdas in the course of the argument.

In the Courts below, the appellants contended that Kamalabai was a minor, and, therefore, the allotment of 1000 shares to her was invalid. This contention is no longer pressed, and does not survive.

No other contentions were advanced before us.

In the result, the appeals are dismissed with costs, one hearing fee.

Appeals dismissed.

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